



***The Auditor General:  
Ally of the People  
and Parliament***

***Report  
296  
Joint  
Committee  
of Public  
Accounts***

***Reform of the  
Australian  
Audit Office***





THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA  
JOINT COMMITTEE OF PUBLIC ACCOUNTS

**REPORT 296**

**THE AUDITOR-GENERAL: ALLY  
OF THE PEOPLE AND PARLIAMENT  
REFORM OF THE AUSTRALIAN  
AUDIT OFFICE**

Australian Government Publishing Service  
CANBERRA

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ISBN 0 644 09538 5



Printed in Australia by Watson Ferguson and Co., Brisbane

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Mrs L Brennan

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## DUTIES OF THE COMMITTEE

Section 8.(1) of the Public Accounts Committee Act 1951 reads as follows:

Subject to sub-section (2), the duties of the Committee are:

- (a) to examine the accounts of the receipts and expenditure of the Commonwealth including the financial statements transmitted to the Auditor-General under sub-section (4) of section 50 of the Audit Act 1901;
- (aa) to examine the financial affairs of authorities of the Commonwealth to which this Act applies and of inter-governmental bodies to which this Act applies;
- (ab) to examine all reports of the Auditor-General (including reports of the results of efficiency audits) copies of which have been laid before the Houses of the Parliament;
- (b) to report to both House of the Parliament, with such comment as it thinks fit, any items or matters in those accounts, statements and reports, or any circumstances connected with them, to which the Committee is of the opinion that the attention of the Parliament should be directed;
- (c) to report to both Houses of the Parliament any alteration which the Committee thinks desirable in the form of the public accounts or in the method of keeping them, or in the mode of receipt, control, issue or payment of public moneys; and
- (d) to inquire into any question in connexion with the public accounts which is referred to it by either House of the Parliament, and to report to that House upon that question,

and include such other duties as are assigned to the Committee by Joint Standing Orders approved by both Houses of the Parliament.

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## PREFACE

This report presents the results of the Committee's inquiry into the Australian Audit Office, AAO.

The inquiry was the first comprehensive governmental or parliamentary inquiry into the Australian Audit Office since establishment of the Office at Federation in 1901. In the 88 years since then, Government and Parliament have changed dramatically, and the purpose and conduct of audits have also been transformed. The Committee examined the role of the AAO and the Auditor-General in the light of those changes.

The Auditor-General and the AAO are fundamental to maintenance of accountability of government officials and instrumentalities to Parliament and through Parliament to the people. The inquiry was given wide terms of reference in order to be able to address several aspects of accountability. Specifically, the inquiry asked whether the Australian Audit Office had kept pace with developments in public sector audit elsewhere in Australia and overseas, and whether current arrangements guaranteed the independence and resources necessary for the Australian Audit Office to fulfil its role as determined by the Audit Act 1901.

In 1979 the Audit Act was amended to permit the Auditor-General to undertake efficiency audits. Subsequently, not only was the Auditor-General requested to form an opinion on auditees' financial statements and accounts and records, but he was expected to inform Government and Parliament of how efficiently resources were applied. Efficiency audits are important in protection of the Parliament's interests.

Efficiency audits have made important contributions in the last ten years. Nevertheless, their contribution has been small because the Audit Office has had few resources to allocate to them. A consequence is that, according to the Audit Office's records, large programs with income or expenditure greater than \$10m can be expected to be subject to an efficiency audit only once every 40 years. This scenario is not consistent with a maximum effort to improve the public sector's efficiency.

The current emphasis on risk management within the public sector is a further factor increasing the Audit Office's responsibilities. The great majority of the Audit Office's resources are allocated for statutory financial and compliance auditing required by the Audit Act. Since there can be no diminution of attention to financial and compliance auditing, the only way to utilise efficiency audits as major instruments of public sector reform is to provide more resources for the Audit Office.

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A number of changes, particularly in recent years, have tended to weaken public accountability. These changes include granting of certain kinds of instrumentalities the right to appoint their own auditors. Ministers have also been permitted to appoint the auditors of other kinds of instrumentalities, but within arrangements which complicate the division of responsibilities between the Auditor-General and an instrumentality's other auditor. The combined effect of these changes is to reduce the flow of financial information on government companies to ministers and to Parliament. In turn, this leads to a lessening in Parliament's ability to make sound laws, and a weakening of the accountability of Executive Government to Parliament.

Another weakness highlighted during the inquiry was that the Department of Finance was the principal advisor to Executive Government on the resources that should be allocated to the Australian Audit Office. This was so even though the Department of Finance was the Audit Office's most important auditee. The AAO appears to have been constrained in its efficiency audits of the Department of Finance because of this arrangement. The Audit Office had never conducted an efficiency audit of any aspect of that Department's operations, despite the centrality of the latter to the efficiency and effectiveness of the Commonwealth sector. Nor had efficiency audits ever been conducted of the Department of Prime Minister and Cabinet, the Treasury or Reserve Bank.

Many experienced Audit Office staff have been attracted to the private sector largely because of higher salaries. The latter have made it difficult for the Audit Office to recruit experienced staff, especially in specialist areas such as the application of computers to audits. Of note was that the Commonwealth Government spent more on Audit Office salaries in 1978-79 than in 1987-88. Salary differentials between certain categories of public and private sector auditors are now so substantial that maintenance of a strong audit capacity is at risk. The report discusses this problem and recommends establishment of the Australian Audit Office as a statutory authority, and granting to the Auditor-General the authority to determine the conditions of staff employment.

The Committee believes that the major inadequacies identified in this report are best overcome, and the Australian Audit Office strengthened, by promoting a closer relationship between the Auditor-General and Parliament. Specifically, the report recommends that the Auditor-General become an officer of the Parliament, and that an Audit Committee of Parliament be established to become Parliament's principal source of advice on the Audit Office's resources. These proposals are consistent with the direction of change for audit which has already occurred in the British Parliament. The effect of these changes would be to reduce Executive Government's influence over audit of public accounts. For these and other reasons, the Audit Act 1901 should be repealed and replaced by a new act more in keeping with modern government and audit.

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The inquiry was announced before the current Auditor-General was appointed. Therefore, the problems identified here existed before he commenced his duties in Australia in June 1988.

The Committee has welcomed the interest shown in the inquiry by Parliamentarians, government officials and organisations, State Auditors-General, the Canadian Auditor-General who was invited to appear before the inquiry, professional associations and others who appeared as witnesses. In particular, the Committee found the co-operation of the Australian Audit Office and the Department of Finance most valuable.

The Committee expresses its deep appreciation to Dr Paul Nicoll of the Department of Employment, Education and Training who was the secretary and researcher for the work of the subcommittee and who prepared a draft report for consideration by the subcommittee. The Committee would like to thank the Department and the Public Service Commission for permitting Dr Nicoll's secondment to the inquiry through the Executive Development Scheme. The Committee extends its best wishes to Dr Nicoll in his future career and thanks him for his contribution to the work of the Parliament. Support was provided by Mrs Laraine Brennan.

The Committee has produced comprehensive recommendations on the vast array of issues raised in the course of the inquiry. It is the unanimous view of the diverse members of the Committee that the report is a significant step forward in the process of reform of parliamentary democracy.

For this reason the Committee urges that the report be read widely by parliamentarians, professional associations, academics, public servants and by the public. The Committee commends the report to the Government for implementation at the earliest opportunity.

For and on behalf of the Committee

R E Tickner, MP  
Chairman

M J Talberg  
Secretary  
Joint Committee of Public Accounts  
Parliament House  
CANBERRA  
9 March 1989

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## SUMMARY

The inquiry examined the role and condition of the Australian Audit Office, AAO. Since the AAO was an 'arm' of the Auditor-General, the role of that officer was also examined.

The report argues that a strong Australian Audit Office is essential for maintenance of the accountability of Federal Government organisations and officials to Parliament. The statutory relationship between the Auditor-General and Parliament, which has not changed since Federation, needs major revision to reflect, first, the evolution of government in the 88 years since Federation, and second, evolution in the role of audit. The intention is to add meaning to Parliament's status as the Auditor-General's client. Therefore, fundamental to reform of the Audit Office is establishment of a better foundation for relations between the Audit Office and Parliament.

From that basis, the report addresses the question of what should be the limits of the Auditor-General's responsibilities, or for which Federal Government organisations should he be the external auditor.

Analysis of whether the Audit Office had sufficient resources for financial and compliance audits was inconclusive. Notwithstanding, doubt remained over the adequacy of those resources. On the other hand, resources for efficiency audits were so inadequate that, according to Audit Office records, it would take 40 years to conduct an efficiency audit of all government programs with income or expenditure greater than \$10m annually. Because of legislative and financial constraints, the Auditor-General could devote only about 10 per cent of resources to efficiency audits, while the percentage of resources devoted to similar tasks in Great Britain and Canada was approximately 50 per cent, with an even higher proportion in the United States. No reasons were given during the inquiry for why the AAO should continue to lag so far behind other national audit offices in its contribution to public sector efficiency and effectiveness. Accordingly, additional funds were recommended by the Committee.

The Audit Office's internal organisation was out of step with modern accounting practice. Large private sector accounting firms, on average, had a partner: staff ratio of approximately 1:12. The equivalent ratio in the Audit Office was approximately 1:24. The reasons for this situation were largely outside the Auditor-General's control. Salaries of senior staff were less than half those of their private sector peers. This was at a time when demand in the economy for persons with accountancy

skills was very strong. The result was that the Audit Office had major problems in recruiting staff. In the Committee's view, the overall effect of these factors tended to diminish the AAO's effectiveness and efficiency in public sector audit.

Current audit legislation was outdated. Separation of the financial management and audit provisions of the Audit Act 1901 was necessary.

For these and for other reasons, audit provisions of the Audit Act should be repealed and replaced by separate audit and financial management legislation.

## Recommendations

The categories of recommendations listed below are not necessarily discrete. The Committee's analysis in the text should be referred to when considering these recommendations. Page numbers are indicated. Recommendations are numbered here but not in the text.

### Legislation

1. The Audit Act 1901 be repealed, and replaced by two new laws, a Financial Administration Act and an Audit Act. (Page 240)

2. A Parliamentary committee be established to advise the Auditor-General on Parliament's audit priorities and to consider the Australian Audit Office's finances in detail. The Committee will report to Parliament. It will be titled the Audit Committee of Parliament, and have the following membership of nine persons:

- . President of the Senate or Speaker of the House of Representatives, alternating each year;
- . Minister for Finance;
- . Public Accounts Committee Chairperson;
- . the Chairperson of a House of Representatives committee which uses AAO reports;
- . the Chairperson of a Senate committee which uses AAO reports or which reports on changes in public administration;
- . three members of the Opposition;
- . a Parliamentarian who is a member of a minority party which is not part of the Government or Opposition. If no such person is in Parliament, then a member of the Opposition.

The Speaker and President will alternate as Chairperson on an annual basis. (Page 72)

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3. Future audit legislation state unequivocally that the Auditor-General is an officer of the Parliament in order to emphasise the Auditor-General's relationship with Parliament. (Page 76)

4. The Government appoint an advisory panel comprising the Chairperson of the Audit Committee of Parliament and the Minister for Finance, and one person nominated by the Leader of the Opposition. Further, nominations to fill future vacancies of the post of Auditor-General be made by the Prime Minister after consultation with the advisory panel. The Governor-General will make the appointment. (Page 77)

5. Auditors-General be appointed by the Governor-General in Council and shall not be removed except by the Governor-General in Council, on an address from both Houses of the Parliament in the same session, praying for such removal on the ground of proved misbehaviour or incapacity. (Page 81)

6. Future appointments to the post of Auditor-General be for ten years or until the incumbent reaches the age of sixty-five years, whichever is sooner. (Page 79)

7. Legislation be introduced to establish the Australian Audit Office as a statutory authority, and to permit the Auditor-General to determine the terms and conditions of employment of Australian Audit Office staff. (Page 84)

8. The Audit Act 1901 be rewritten to clarify the role of the Auditor-General and his Office. (Page 236)

9. The Australian Audit Office be renamed the Australian National Audit Office. (Page 237)

10. Section 70BA of the Audit Act 1901 be amended to permit the Auditor-General to delegate to qualified staff the authority to sign audit reports on Government companies. (Page 85)

11. New Commonwealth audit legislation maintain the Auditor-General's authority to:

- . undertake large and small performance audits;
- . access Commonwealth departments and other agencies;

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- . report the results of performance audits.  
(Page 140)

12. Audit legislation state that the Auditor-General must report whether satisfactory procedures have been established to measure and report on the effectiveness of programs. (Page 157)

#### Resources

13. In keeping with the user pays principle, in future Parliament pay all audit fees. The practice of auditees being charged audit fees should cease. (Page 66)

14. In future, the Australian Audit Office calculate the average costs of all audits, and that calculations should be based on the formula used to estimate audit fees. (Page 49)

15. The Australian Audit Office's appropriations be included in the Appropriation (Parliamentary Departments) Bill. (Page 71)

16. The funding of efficiency audits be based on the following four principles, which would be the basis of a funding formula to be adopted by the Audit Committee of Parliament:

- . a legislative requirement for efficiency audits;
- . separate determination of the budget for regularity and performance, specifically efficiency, audits;
- . linkage of funds for efficiency audits with growth in government income and outlays, and with change in the structure of government programs; and
- . the Australian Audit Office's performance in regard to efficiency audits. (Page 227)

17. The Australian Audit Office adopt the following cycle of audits for all programs with expenditure or revenue greater than \$10m:

- . a 20 year cycle for government companies;

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- . a 10 year cycle for statutory authorities;
- . a 5 year cycle for departmental commercial undertakings;
- . a 5 year cycle for departmental outriders; and
- . a 3 year cycle for departments. (Page 231)

18. There be major recruitment of senior staff from either within or outside the public sector. (Page 211)

#### Mandate

19. The Auditor-General should be reinstated as the external auditor of Statutory Marketing Authorities, considering their strategic importance in the Australian economy. (Page 92)

20. Where the services of a private audit firm are considered necessary by a Statutory Marketing Authority and the Auditor-General agrees, then the Auditor-General should appoint a private audit firm as contract auditor under section 11 of the Audit Act 1901. (Page 92)

21. The Auditor-General be reinstated as the external auditor of Government Business Enterprises. (Page 107)

22. Amendments be made to legislation governing AUSSAT, QANTAS and Australian National Railways Commission, and to the Audit Act 1901 to restore the Auditor-General as their external auditor. (Page 107)

23. The Audit Act 1901 be amended to require the Auditor-General to be appointed the external auditor of all Government companies. Private sector audit firms and partnerships which are the external auditors of government companies would continue until their appointments expire whereupon the Auditor-General would become the company's external auditor. The Auditor-General, after consultation with the appropriate minister, may decide to contract a private sector auditor to undertake the audit on the Auditor-General's behalf. (Page 108)

24. The subsidiaries of all statutory authorities government owned companies and Government Business Enterprises should be audited by the Auditor-General. (Page 109)

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25. The Auditor-General should not develop other specialties permitting the Audit Office to operate as a consultant in fields such as:

- . human resource management,
- . financial management,
- . taxation,
- . investment advice, or
- . computer systems,

except where areas are developed as a result of evolution of the audit task. (Page 117)

#### Performance Audits

26. The Auditor-General continue to have responsibility for efficiency audits. (Page 131)

27. The general principle that efficiency audits be conducted by multi-disciplinary teams be accepted. Further, in conducting efficiency audits, the Auditor-General ensure that a sufficient level of experience and expertise relevant to the audit subject is available to the efficiency audit team. (Page 153)

28. The Auditor-General give priority to development of the capacity to criticise constructively auditees' evaluation plans without commenting on the merits or otherwise of government policies and recruit staff with the skills necessary to analyse evaluation plans and practices. (Page 157)

29. The Auditor-General initiate each year a number of efficiency audits spanning more than one program or agency. This focus could coincide with experimentation in audit reports, for example, through release of discussion papers on audit topics. (Page 159)

30. The Auditor-General and the Secretary of the Department of Finance consult on topics for efficiency audits. Further, the Auditor-General also consult with Parliamentary committees on topics for efficiency audits. (Page 160)

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31. The Auditor-General be required to provide a final efficiency audit report within six months of initiation of selected efficiency audits. Further, that this requirement be introduced on an experimental basis for a two year period to determine the effects on resources, selection of topics, and accountability to Parliament. (Page 146)

32. The Auditor-General trial for two years the conduct of efficiency audits of commercially oriented government organisations with restricted reporting as provided for under section 48F of the Audit Act 1901. Further, restricted reports be provided to the Minister responsible for the auditee organisation and to the Public Accounts Committee. (Page 177)

33. For selected efficiency audits, the Auditor-General consult with the departmental secretary or chief executive officer of the instrumentality to be audited to permit temporary appointment of an auditee staff member or members to the efficiency audit team. (Page 146)

34. The Auditor-General publish in his annual report details of all or any instances of a minister refusing the Auditor-General's request to conduct an efficiency audit of government instrumentalities where such permission is required. (Page 169)

35. Section 48C of the Audit Act 1901 be amended to permit the Auditor-General to conduct an efficiency audit of an eligible incorporated company without a minister's permission. Further, the definition of eligible incorporated company be amended to give effect to the Committee's concerns that the current definition excludes a company which is incorporated as an initiative of the Commonwealth and which receives the majority of its funding from the Commonwealth but which for policy reasons has a board of directors on which Commonwealth representatives are in a minority. (Page 170)

36. A detailed review of efficiency audit guidelines for Government Business Enterprises be undertaken, as recommended in the Committee's Report on the Australian Wool Corporation's property operations (Report 282). Further, this review should be undertaken by the Auditor-General and include new guidelines for Statutory Authorities, Statutory Marketing Authorities and government companies, involving representatives of those organisations and the Department of Finance. (Page 183)

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37. In accordance with the recommendation of the House of Representatives Standing Committee on Transport, Communications and Infrastructure, where an auditee accepts the proposals for change made by the Auditor-General in an efficiency audit report, the auditee provide the relevant Parliamentary committee with a timetable for implementation at the commencement of the Parliamentary inquiry. (Page 189)

38. The Auditor-General devote significant resources to follow-up of performance audits, and adopt a systematic approach to follow-up of performance audit findings. (Page 198)

39. Follow-up procedures for performance audits be linked to follow-up procedures for regularity audits in the Audit Office. (Page 198)

40. In accordance with the recommendation by the former House of Representatives Standing Committee on Expenditure in 1986, the Australian Audit Office advise the Parliament of deficiencies in the consideration and implementation of efficiency audit recommendations. (Page 199)

#### Department of Finance

41. The Secretary of the Department of Finance ensure that Supply Divisions upgrade their effective oversight and analysis of ministers' quarterly reports. (Page 196)

42. The Department of Finance should provide to the Public Accounts Committee on a quarterly basis copies of ministers' responses received by the Minister for Finance and make those responses publicly available. (Page 196)

43. In specific cases where there are policy reasons why the reports cannot be made publicly available, then they be supplied to the Public Accounts Committee on a confidential basis. (Page 196)

44. The Department of Finance develop a stronger interest in the adequacy of internal audit in Budget-funded agencies through, for example, sponsorship of inservice education including seminars. (Page 207)

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#### Audit of Section 96 Grants to State and Territory Governments

45. The Commonwealth Government provide additional resources to State Auditors-General where, as a result of inter-governmental agreements, they have responsibility for providing to the Commonwealth Government audit certificates on section 96 grants. These additional resources should originate from the section 96 grant and should be determined by negotiations between the granting Commonwealth agency and the State Auditor-General. (Page 125)

46. The Department of Finance and the Commonwealth Auditor-General co-operate to ensure that Commonwealth agencies give more attention to audit requirements at the program design stage. (Page 125)

47. Draft legislation on specific purpose section 96 grants be provided to the Department of Finance and the Commonwealth Auditor-General for scrutiny. (Page 125-6)

48. The granting Commonwealth agency consider whether, in the case of Commonwealth grants to State government agencies, a State Auditor-General audit certificate on the financial statement of the State recipient agency would suffice. (Page 126)

49. The Commonwealth Auditor-General explore with State Auditors-General the advantages of joint audits. (Page 126)

50. Where a State or Territory Auditor-General is required to provide an audit certificate to a Federal agency, there be a requirement in the related Federal-State agreement to provide the audit certificate by a specified date or within a specified period. (Page 126)

51. Commonwealth grants be made to State government Treasuries rather than directly to State government agencies to provide State governments with a better indication of their agencies' sources of funding and a firmer basis for intergovernmental co-operation. (Page 126)

52. The Commonwealth and State Auditors-General improve the flow of information about problems in audit of section 96 grants to provide early warning of problems. (Page 126)

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#### Reports/Reporting

53. A requirement necessitating the inclusion of information on reports of the Auditor-General or of Parliamentary committees relevant to the agency similar to that for departmental annual reports be introduced into guidelines for preparation of annual reports by statutory authorities. (Page 191)

54. The Auditor-General list project audits in his annual report to Parliament. (Page 138)

55. Consistent with ministerial responsibility, audits mentioned in the Auditor-General's biannual reports be grouped and discussed by portfolio. (Page 164)

56. The main results of efficiency audits be included in the Auditor-General's biannual reports on audits completed in the previous six months. (Page 163)

57. The Auditor-General publish in his annual report the costs of each audit including the costs of audits reported separately, such as efficiency audits and any special audits. (Page 66)

58. Auditees record audit costs in the notes to their financial statements. (Page 66)

59. The Auditor-General brief Ministers and the Prime Minister regularly on significant audit findings. (Page 199)

#### Contract Audits

60. The Auditor-General develop and publish a range of criteria on which to base any decision to employ auditors on contract. (Page 114)

61. Engagement letters to private sector auditors include the following requirements:

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- . statements clarifying the nature of the review that the contracted auditor is expected to undertake - whether limited to the expression of an opinion on financial statements or whether concerned with authorisation of transactions, fraud, illegal transactions, adequacy of procedures to safeguard assets, or other;
- . statements indicating that the Auditor-General's agents will be required to conduct audits in accordance with standards devised by the Auditor-General. Audit standards were published by the Australian Audit Office in August 1987;
- . statements clarifying the matters on which an auditor is expected to report - whether irregularities, internal control weaknesses or fraud, and with what frequency;
- . statements clarifying to whom such reports should be directed - whether to ministers, management, and/or the boards of statutory authorities or companies or to audit committees of boards;
- . statements indicating that the contracted auditor will recommend to the Auditor-General the audit opinion to be expressed and submit to the Auditor-General a signed management letter on the audit results. Completed working papers including a recommended audit report will also be required; and
- . a statement indicating that the Auditor-General or his or her delegate will sign the audit report. (Page 115)

62. A condition of the award of a contract by the Auditor-General to a private audit firm be that the latter offers no other services to the auditee during the life of the audit contract. (Page 117)

63. The Auditor-General monitor the quality of contracted audits. (Page 119)

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## Private Sector

64. The Auditor-General discuss with the Australian Society of Accountants, the Institute of Chartered Accountants, and with accounting firms, the possibility of their augmenting the salary of staff who are recruited from the private sector for temporary appointment to Senior Executive Service positions in the Australian Audit Office. (Page 85)

65. The Auditor-General sponsor education and information programs in public sector audit with professional accounting bodies, audit firms, and tertiary education institutions. (Page 119)

66. The Auditor-General appoint a consultative or advisory committee with representatives from the private sector, universities and auditees. The committee would advise him on developments in private sector audit. It would assist in identifying emerging problems or issues, and would be a source of strategic advice including contracting of audits (section 11 of the Audit Act 1901). Further, the committee's terms of reference be drafted to avoid any impression that it would reduce the Auditor-General's independence and status. (Page 210)

67. The Auditor-General appoint a separate consultative or advisory committee on audit practices and standards. This committee would provide technical advice to the Australian Audit Office and ensure that the Audit Office's practices and standards were formed with knowledge of private sector practices without necessarily adopting those. This group may be a subcommittee of the major consultative or advisory group. (Page 211)

68. An interchange scheme be initiated wherein Australian Audit Office staff would work in private sector audit firms. (Page 211)

69. Membership of both of the major professional accounting bodies, the Institute of Chartered Accountants and the Australian Society of Accountants, be adequately represented amongst the Australian Audit Office's senior and other staff. (Page 213)

70. The Australian Audit Office commence negotiations immediately with the Institute of Chartered Accountants to permit young accountants who wished to become Institute members to have their professional training in the Audit Office. (Page 213)

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#### Independent Auditor of the Australian Audit Office

71. Applicants for the position of Independent Auditor of the Australian Audit Office be selected from individuals who do not have current audit contracts with the Commonwealth Government, and further from a firm which does not have current contracts with the Australian Audit Office. (Page 216)

72. Future recommendations for appointment to the position of Independent Auditor be the responsibility of the Audit Committee of Parliament. The Governor-General would continue to have the power to appoint the Independent Auditor but on the advice of the Prime Minister who, in turn, would be advised by the Audit Committee of Parliament. (Page 217)

73. Appointment of Independent Auditor of the Australian Audit Office be for a minimum term of three years and a maximum term of five years. (Page 217)

74. The outgoing Independent Auditor make available to the incoming Independent Auditor relevant letters, working papers and other documentation to facilitate the change-over of auditors. (Page 217)

75. The Independent Auditor of the Australian Audit Office analyse the way in which the Australian Audit Office conducts its audits to determine if costs can be reduced to generate efficiency gains. (Page 50)

#### Other

76. The Australian Audit Office undertake an efficiency audit of internal audit in the Commonwealth sector. The efficiency audit should include a comprehensive survey of internal audit. (Page 206)

77. The Government and the Australian Audit Office adopt the former Senate Standing Committee on Finance and Government Operations' organisational classification. (Page 26)

78. The Australian Audit Office plan for a new building either within the Parliamentary Triangle or on State Circle adjacent to the new Parliament House, and that the building be called Audit House. (Page 246)

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## **PART A**

### **BACKGROUND**



## Chapter 1

### INTRODUCTION

1.1 This inquiry was initiated because of a general concern by the Joint Parliamentary Committee of Public Accounts, JPCPA, with public sector auditing. A backdrop to the inquiry was constant Parliamentary attention to accountability and efficiency, as shown by the many revisions to the Audit Act 1901 in recent years. JPCPA concern was accelerated by the release in late 1987 of the Auditor-General's 1986-87 annual report on the Australian Audit Office<sup>1</sup> and by publication of the results of an efficiency audit of the Australian Audit Office conducted by the Independent Auditor<sup>2 3</sup>.

1.2 The terms of reference for this inquiry were to investigate:

- . whether the Australian Audit Office had kept pace with developments in regard to the public audit function in the States and Territories and in comparable countries; and
- . whether current arrangements guaranteed the independence and resources necessary for the Australian Audit Office to fulfil its role as determined by the Audit Act 1901.

1.3 The inquiry commenced with no preconceived ideas about the Australian Audit Office. However, a critical belief was that Australia needed an efficient, effective and accountable Commonwealth sector, and the Australian Audit Office had a role in achieving this. In other words, the Public Accounts Committee,

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1. The Auditor-General, Annual Report of the Australian Audit Office 1986-87, AGPS, Canberra, 1987.
  2. E. Cameron, Report of the Independent Auditor on an Efficiency Audit of the Auditor-General's Office under the Audit Act 1901, AGPS, Canberra, 1987.
  3. The role of the Independent Auditor of the Australian Audit Office is described in Chapter 14.

PAC, believed that a strong Australian Audit Office was essential for good government. This perspective created two objectives for the inquiry:

- . to revitalise the AAO and redefine its role; and,
- . to increase debate about public sector auditing through removing its mystique.

1.4 Consequently, preparation of this report has been a vital task for the PAC, and goes to the very essence of public accountability.

1.5 The Auditor-General's Office was established in 1901 under provisions of the Audit Act 1901. Its name was changed to the Australian Audit Office in 1984. The AAO under either name had been reviewed twice previously in Royal Commissions established for other purposes.

1.6 The Royal Commission on Navy and Defence Administration and the Economies Commission were formed during the First World War<sup>4</sup>. Rapid expansion of government expenditure to meet defence obligations had led to problems in government agencies applying resources efficiently. The Royal Commissions were established partly to address those problems, and amongst their tasks they commented on some work of the Auditor-General's Office.

1.7 The Royal Commission on Australian Government Administration, RCAGA, which was formulated to inquire into and report upon the administrative organisation and services of the Australian Government, recommended changes to the Audit Act 1901<sup>5</sup>. Addition of efficiency audits to the Auditor-General's other responsibilities was the major change recommended. RCAGA did not review the Auditor-General's Office.

1.8 In other words, the last time the Audit Office was subject to any specific governmental or Parliamentary review was about 70 years ago, and then only for part of the Audit Office's role. This meant that the current PAC inquiry was the first Governmental or Parliamentary inquiry into the entire operations of the Australian Audit Office since its inception at Federation.

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4. Royal Commission on Navy and Defence Administration, Second Progress Report, Government Printer for the State of Victoria, Melbourne, 14 February 1918. Economies Commission Report, Government Printer for the State of Victoria, Melbourne, 1 July 1920.
  5. Royal Commission on Australian Government Administration, Report, AGPS, Canberra, 1976.



1.9 The Office of the Auditor-General of Canada was subject to a far-reaching review in 1975<sup>6</sup>. In the United Kingdom, the National Audit Office was reinvigorated after a major Parliamentary investigation<sup>7</sup>. New audit legislation, which was introduced into the New Zealand Parliament at the end of 1988, will have a dramatic effect on the work of that country's Auditor-General<sup>8</sup>.

## Conduct of the Inquiry

1.10 The inquiry was announced in April 1988. Forty-seven submissions were received from:

- . individuals;
- . professional associations;
- . trade unions;
- . private companies;
- . Mr David Block, consultant to the Prime Minister and Cabinet;
- . Mr Kenneth Dye, the Canadian Auditor-General;
- . State and Territory Auditors-General;
- . Commonwealth Government organisations;
- . the former and present Independent Auditor of the Australian Audit Office;
- . the Acting Australian Auditor-General; and
- . the Australian Auditor-General.

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6. Report of the Independent Review Committee on the Office of the Auditor-General of Canada, Information Canada, Ottawa, March 1975.
  7. Refer to the following series of reports: Chancellor of the Exchequer, The Role of the Comptroller and Auditor-General, Her Majesty's Stationary Office, London, March 1980. First Special Report from the Committee of Public Accounts, Session 1980-81, The Role of the Comptroller and Auditor-General, Volume 1 - Report, Her Majesty's Stationary Office, London, February 1981. Chancellor of the Exchequer, The Role of the Comptroller and Auditor-General, Her Majesty's Stationary Office, London, July 1981.
  8. Finance and Expenditure Committee, Report of the Finance and Expenditure Committee on the Inquiry into Officers of Parliament, New Zealand Parliament, Wellington, New Zealand, 1989.

1.11 In addition, information was gathered from many national audit offices in other countries, including:

- . Canada;
- . Federal Republic of Germany;
- . Great Britain;
- . New Zealand;
- . Republic of Ireland; and
- . United States.

1.12 Ten public hearings were conducted in Canberra between June and December 1988. Appendix 1 lists submissions to the inquiry. The Committee met with a wide range of individuals and groups. Appendix 2 notes the dates of hearings and the identities of the 57 witnesses.

1.13 Despite all aspects of the Audit Office being subject to review, the inquiry focused on selected issues considered vital for the Audit Office's evolution. Selectivity was also necessary to make the review practical and the report timely.

1.14 The first term of reference required international comparisons. Consequently, the Committee or its staff met with:

- . the Canadian Auditor-General;
- . the New Zealand Deputy Auditor-General; and
- . the Chairman of the British Public Accounts Commission.

1.15 Emphasis in the international comparisons was on countries with parliamentary political systems. However, reference was made to developments in other political systems where appropriate.

1.16 It became apparent immediately that the role of the Auditor-General must be discussed prior to discussion of the Australian Audit Office. This was because only the Auditor-General had the authority to appoint persons to his Office, (Audit Act 1901, section 11). Consequently, this report is as much an analysis of the role of the Auditor-General as it is of the Audit Office.

1.17 Two kinds of audits are referred to in this study, as follows<sup>9</sup>:

- . regularity auditing which referred to audits that embraced all aspects of compliance with laws and regulations and of financial accountability; and
- . performance auditing which covered audits concerned with evaluation of the economy, efficiency and effectiveness of public sector management. Performance audits are also known as efficiency, project, or value for money audits.

## Discoveries

1.18 A number of discoveries were made during the inquiry. First, as just suggested, the Australian Audit Office had not been reviewed even in part for many generations, and it had never been reviewed in its totality. Second, there was a complacency in political and administrative circles about the Audit Office's condition. Third, Commonwealth audit legislation needed a major overhaul.

1.19 When attention was focused on the Audit Office itself, further patterns appeared. The Audit Office:

- . had developed enormous expertise in public sector audit. Since the AAO had 88 years of experience, this should not have been surprising. However, it is stated here to place beyond doubt the Committee's views on this matter;
- . had a reputation for integrity. This reputation, which had been sustained for a very long time, was a most valuable asset for maintaining community confidence in government. Much of this report proposes ways to maintain and strengthen the integrity of the position of the Auditor-General and the Office;
- . was a powerful deterrent on illegal behaviour by public officials. Existence of the Auditor-General and his or her Office was not sufficient to stop

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9. The definitions were derived by the International Organisation of Supreme Audit Institutions, INTOSAI. J Monaghan, In My Opinion: The Auditor-General's Approach to Performance Auditing, An Address by the Auditor-General of Australia, Mr J V Monaghan, to the Royal Australian Institute of Public Administration (ACT Division), 29 July 1987.



illegal acts and wasteful decisions by public servants. However, those aberrations would be more frequent if there were no Auditor-General. Maintenance of this deterrent role was important;

- . was respected by Parliamentarians from all parties because of the bipartisan way in which it carried out its tasks. Decisions and advice given by the Auditor-General and his staff were seen as being relatively unaffected by political considerations. Strengthening the capacity of the Auditor-General and his officers to remain politically neutral has been a major consideration of this report; and
- . was a means by which the public sector was kept accountable to Parliament.

1.20 These strengths or attributes were challenged by criticisms of the AAO. During the inquiry it was alleged that the AAO:

- . asked the wrong questions. It was concerned with the pennies and not with the pounds. This view was of the AAO's alleged adherence to scrutiny of line item budgeting at the expense of the larger questions of efficiency and effectiveness of resource usage;
- . it was intrusive. Excessive emphasis on performance auditing involved access to management decisions on non-financial matters;
- . it was ill-informed. Auditors did not have the technical training to assess decisions in areas as diverse as meteorology, the construction of large buildings or military administration;
- . it was out of date. Auditors did not have sufficient knowledge of the private sector milieu in which many government enterprises functioned. Furthermore, public sector auditing lagged developments in the private sector; and
- . the AAO was unstable. High levels of staff turnover in the AAO often meant that different auditors were assigned annually to the same audit. This was inefficient since new auditors then had to familiarise themselves with the account each year.



1.21 During the course of the inquiry, the Committee explored these criticisms in details.

## **Need for an Auditor-General and a National Audit Agency**

1.22 One of the advantages of having the Auditor-General between auditees and Parliament is that Parliament can rely on the Auditor-General to identify or to filter the most important audit issues. On the basis of his advice, Parliament may pursue or ignore an issue. The Auditor-General's presence does not stop Parliament from disagreeing with his opinion, but usually his assessment of the importance of audit issues is a starting point for Parliamentary consideration. This function justifies the position of Auditor-General and the maintenance of his or her Office.

1.23 In the unlikely event that Parliament were to abolish the Australian Audit Office and allocate audit tasks to private audit firms, very large numbers of individual reports would go to Parliament, which would have the task of identifying the most important issues. Such an arrangement would not exist for very long before another 'filter' with the same functions was put in place to assist Parliament in sorting through audit issues.

## **Accountability and Efficiency**

1.24 Much of this report discusses the Audit Office's role in maintaining the accountability of federal officials and the public sector to Parliament. Accountability to Parliament means that federal officials are answerable to Parliament for their actions and decisions. In other words, maintenance of accountability maintains Parliamentary authority over the public sector.

1.25 Accountability cannot be measured like the amount of water in a glass. However, there can be varying degrees of accountability. The report notes this and makes a distinction between necessary and sufficient accountability. Also noted was disagreement in various circles over what was sufficient accountability of federal officials to Parliament. It was found that the adequacy of provisions for maintaining accountability varied with different kinds of Commonwealth organisations.

1.26 One set of problems which the inquiry encountered was the relationship between accountability and efficiency in the public sector. An efficient public sector was one which used the

least possible resources to achieve the desired effect. One set of views was that there was a trade-off between efficiency and accountability: that is, the push for greater accountability was a barrier to development of a more efficient public sector. In other words, accountability and efficiency coexisted, but an increase in one led to or was associated with a decrease in the other.

1.27 The Committee could see no necessary conflict between accountability and efficiency. It acknowledged, however, that political decisions, first, could determine the efficiency with which a government organisation applied its resources, and second, could define the goals and criteria by which the organisation's effectiveness could be assessed. Objections to the right of Parliament to influence the efficiency and effectiveness of bodies which it created were misguided. Australian Governments of all persuasions have made such decisions and will continue to do so. The reality is that political considerations in all countries affect the operation of organisations established by statute. Of course, though, there are varying degrees of political control in existence.

1.28 Many believers of an inverse relationship between accountability and efficiency were looking for ways to reduce government controls. Without necessarily sharing their beliefs, the Committee has argued that controls which reduce the efficiency of government organisations for no good reason should be revised. The Committee noted the Government's announcements in the 1988 May Economic Statement reducing controls on government business enterprises in the Transport and Communications Portfolio.

1.29 Some argue that the most accountable government organisations (presumably Departments of State) have low levels of efficiency, and that the least accountable organisations (for instance, government companies) are the most efficient. No empirical evidence was presented to the Committee to support such claims. However,, there is some evidence to suggest that if government business enterprises operate in a truly competitive environment, some greater efficiencies are obtained.

1.30 Reduction in government controls has no effect on the obligation of officials in those organisations to be answerable to Parliament for their decisions. If anything, a justifiable reduction in executive government's control over the daily operation of those government business enterprises strengthened the need for their accountability to Parliament in order that the latter could be guaranteed that those enterprises were achieving their objectives, whether those were set by the enterprises themselves or by Parliament.

1.31 The Auditor-General has a vital role to play in this debate because he has the authority to ask how efficiently are



government agencies applying their resources. He also has the means to answer that question and to inform Parliament directly. This inquiry has upheld his right to ask that question, and has sought to strengthen his capacity to form an opinion on this matter.

## New Interest in Accountability in Government

1.32 This report was written while State government reports with auditing and accountability implications were published. These reports included:

- . New South Wales Commission of Audit, Focus on Reform: Report on the State's Finances<sup>10</sup>;
- . The Report to the Premier by the Commission on Accountability established by the Western Australian Government<sup>11</sup>; and
- . Report of the Inquiry into the Victorian Economic Development Corporation<sup>12</sup>.

1.33 Release of these reports pointed to a sharpened awareness of the need to maintain and strengthen the accountability of officials and governmental organisations.

## Acceptable Audits

1.34 Auditees considered a good audit one which found nothing wrong. Auditors were satisfied if their findings justified their effort. Parliament was pleased if the audit showed that laws were complied with and/or resources used efficiently. Existence of three stakeholders in each audit guaranteed the likelihood of disagreement on the characteristics of a quality audit. Surprisingly, then, stakeholders often agreed on what were quality audits. Nevertheless, acceptance of the reality of conflict over audits was essential to understanding the functions of the Auditor-General and his Office. Such acceptance also helped the Committee make sense of the various views put to it on the work of the Audit Office.

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10. New South Wales Commission of Audit, Focus on Reform: Report on the State's Finances, Government Printer, New South Wales, Sydney, 1988.
  11. Commission on Accountability, Report to the Premier the Honourable P McC Dowding LL.B. MLA., Commission on Accountability, Perth, 1989.
  12. Ryan, F., Report of Inquiry, Victorian Economic Development Corporation, Melbourne, 1989.

1.35 It was important to affirm that Parliament, not auditees, was the Auditor-General's client. Some government officials and organisations did not appreciate this. A related issue was whether the Auditor-General could serve Parliament and assist auditees at the same time. The affirmative answer to this question also pointed to how the views of various stakeholders on what was a good audit could be brought closer together without necessarily being the same.

## Structure of the Report

1.36 The report is in five parts. Part A, Background, contains this introduction and a brief history of the Australian Audit Office. A history was necessary to provide a broader perspective on changes advocated in this report. Of note was the paucity of academic studies of public sector auditing. More studies are necessary of how the function of audit in government has changed. Other chapters provide basic facts such as information on the number of audits the AAO conducts annually and the costs of audits. A critical question raised was whether resources for public sector audit are adequate.

1.37 Part B, Major Changes, examines different methods of funding national audit offices and highlights the impact on their independence. A closer relationship between Parliament and the Auditor-General is advocated, with Parliament taking a greater interest in the Audit Office's estimates. Appointment of the Auditor-General and Audit Office staff is examined. This part of the report asks which government organisations the Auditor-General should audit, or what are and should be the limits of the Auditor-General's responsibilities. Accountability provisions of the Audit Act and the Companies Act and Code are compared. The contracting of audits by the Auditor-General to private sector auditors is also discussed. The final major issue raised is audit of the \$11 billion in Commonwealth specific purpose grants to State and Territory governments.

1.38 Part C is a review of performance audits. Efficiency audits are the most well-known form of performance audits. Project audits are less visible although as many resources are devoted to them as to efficiency audits.

1.39 Part D, Selected Issues, focuses on acceptance and implementation of audit findings, internal audit, private sector and professional relations, and responsibilities of the Independent Auditor of the Australian Audit Office.

1.40 Part E, The Future, proposes a new funding arrangement and a funding increase for the Audit Office, and advocates the need for a new audit act.



## Chapter 2

### A BRIEF HISTORY OF THE AUSTRALIAN AUDIT OFFICE

#### Origins

2.1 In 1901, the year of Federation, the Audit Act established a legislative basis for the financial management of Commonwealth moneys and a legislative basis for the audit of related accounts<sup>1</sup>. The Act was the fourth to be passed by the first Federal Parliament, indicating its high importance.

2.2 In his Second Reading Speech on the Audit Bill, Sir George Turner, the Treasurer, stated that<sup>2</sup>:

It was wise and necessary that a uniform system with regard to the receipt and payment of moneys, and the audit of the public accounts, should be established throughout the Commonwealth.

2.3 He argued that it was necessary:

that we should provide the best checks we can get in regard to all dealings with public moneys, and especially in regard to disbursements, in order to prevent frauds and defabrications.

2.4 The Act provided a legal foundation for appointment of an Auditor-General, who was given power to appoint inspectors for the purpose of having the books of the various departments kept in good order. He was also given the authority to create his own Office. The inspectors were officers of the Audit Department and were attached to the larger departments such as the Post Office

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1. Audit Act 1901.

2. Commonwealth of Australia, Parliamentary Debates, Session 1901-2 (First Session of the First Parliament, Vol.1) Senate and House of Representatives, Government Printer for the State of Victoria, Melbourne, 1901, pp.1247.

and Customs, to make an audit of the accounts daily. Part II of the Act which gave him this authority still applies as the foundation of the Australian Audit Office.

2.5 The first Auditor-General, a former State Auditor-General, was appointed in December 1901, and 16 staff were recruited to his Office in the next few months. Of note in the Auditor-General's first annual report was his acknowledgement of the staffing assistance provided by the Treasury. The Treasury's role on this matter has been taken over in recent times by the Department of Finance.

2.6 The Act became effective from the beginning of 1902, but, to give the Auditor-General time to establish his Office, all Commonwealth accounts from Federation until June 1902 were examined by State Auditors-General<sup>3</sup>. The Office was responsible for audit of all Commonwealth departments and instrumentalities. The Departments were:

External Affairs  
Attorney-General  
Home Affairs  
Treasury  
Trade and Customs  
Defence  
Postmaster-General

2.7 The Audit Act was amended in 1906 to relieve the Auditor-General of the necessity of auditing accounts at short intervals where the audit cost was disproportionate to the amount involved.

2.8 In 1911, the Auditor-General's Office was included under the Prime Minister's Portfolio for administrative and budgetary purposes. This arrangement continued for 75 years until the 1985-86 financial year. Since then, appropriations for the Australian Audit Office, AAO, have been included within the Finance Portfolio.

2.9 The Commonwealth Public Accounts Committee was formed in 1913. This followed a general election in which one issue was the financial methods of the retiring Government which had been trenchantly criticised by the Opposition. Formation of this Committee was an important step in the development of means to make government more accountable to Parliament.

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3. B. Cathro, History of the Australian Auditor-General's Office, 1901-1980, CCAE, Canberra, 1980.

## Early Views on Resources and Independence

2.10 The Royal Commission on Navy and Defence Administration in 1918 accused the Auditor-General of failing<sup>4</sup>:

... in his duty to the public in not strenuously representing to Parliament that his inability to secure a sufficient staff of suitable officers precluded him from conducting an effective and up-to-date audit. The fact that he was content with a more formal compliance with his statutory duties shows that he did not realise the extent of his responsibility. We consider that if he had reflected on the results that might be expected to accrue from the belated condition of his audit, he would have realised the necessity for a more vigorous policy, and more insistent demand for his right to be provided with adequate assistance...

2.11 The Auditor-General replied to the Royal Commission in strong terms<sup>5</sup>.

With respect to the opinion of the Commission that the Auditor-General failed in his duty to the public in not "strenuously representing" to Parliament his inability to secure a sufficient staff raises the question as to how far the Auditor-General should go in making such representations. That depends upon circumstances, and requires the exercise of fact and discretion. In the case under review, it involved reference to the action of the Cabinet, the Prime Minister's office, the Right Honourable the Treasurer, and the Public Service Commissioner, considerations of the insistent demand for economy, and of Government policy. There was no open and absolute refusal to supply the Auditor-General with the assistance he required. There was certainly delay, and that delay continues, owing... (partly) to the restrictions which Government policy has imposed in connection with conditions of employment.

2.12 The ensuing debate led to a request from the Prime Minister to the Auditor-General soliciting his views on the

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4. Royal Commission on Navy and Defence Administration, op.cit.
  5. Special Report of the Auditor-General on Amendments of the Audit Act and Position and Status of the Auditor-General, the Parliament of the Commonwealth of Australia, 1917-18-19, Government Printer for the State of Victoria, Melbourne, 1919.



status or independence of the Auditor-General. Relevant to the current JPCPA inquiry<sup>6</sup> is that the Auditor-General was also requested to furnish information as to the position in the States and in Great Britain<sup>7</sup>.

2.13 The Secretary to the Treasury was also invited to give his views on the independence of the Auditor-General. He wrote that<sup>8</sup>:

Carried to its logical conclusion, the contention of the Royal Commission and the Auditor-General requires that the Auditor-General shall himself decide how much shall he spend on Audit, and the Minister would be compelled to place upon the Estimates just what the Auditor-General indicated. That would be a subversion of Ministerial responsibility, and would be antagonistic to representative government.

2.14 The Secretary to the Treasury went further to affirm that:

The Commission and the Auditor-General seem to have overlooked the fact that Ministers (especially the Treasurer) are closely concerned in the maintenance of a effective audit and are not likely to interfere unnecessarily in arrangements of staff.

The Auditor-General has been placed by the Audit Act in a very strong position, and his right to report at any time direct to Parliament is a sufficient safeguard against undue interference. Greater power seems neither necessary nor desirable.

2.15 The question of the Auditor-General's independence was also raised by the 1918 Royal Commission<sup>9</sup>:

We consider that those sections of the Audit Act which attempt to detail the Auditor-General's

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6. The first term of reference for the current inquiry is to investigate whether the Australian Audit Office has kept pace with developments in regard to the public audit function in the States and Territories and in comparable countries.
  7. M Shepherd to Auditor-General, Special Report, op. cit., 6 June 1918.
  8. J Collins to the Secretary, Prime Minister's Department, Special Report, op. cit., 30 December 1918.
  9. Special Report, op. cit.



duties should be eliminated. The Act should require the Auditor-General to conduct an audit of all the financial operations of the Commonwealth Government, but the procedure and scope of the audit should be left to his discretion.

2.16 There was some debate about whether the Auditor-General should be the permanent head of a separate Department outside the operations of the Commonwealth Public Service Act. The Commonwealth Public Service Commission argued against this proposal, while the Auditor-General supported it.

2.17 The Auditor-General's administration of his Office was also criticised to some extent by the Economies Commission established towards the end of the First World War. The Auditor-General and other senior staff responded in strong terms to these criticisms<sup>10</sup>.

2.18 A consequence of this attention was that the Audit Act was amended in 1920 to permit the Auditor-General further discretion in the extent of his audits. Further change was that from 1922 the Auditor-General was given the authority of a permanent head of a department under the Commonwealth Public Service Act. Previously this authority was exercised over the Auditor-General's Office by the Secretary of the Department of the Prime Minister.

2.19 In 1923, increased responsibilities were given to chief Commonwealth auditors in the States. At that time, cash books for receipts and expenditures were still subjected to a 100 per cent check. Discretion was extended over the amount of detailed checking of transactions resulting in a decrease in the amount of this work.

2.20 The first Auditor-General died in office in 1926 after 25 years in the role. A successor was appointed<sup>11</sup>.

## Evolution of Responsibilities

2.21 During the Second World War (1939-1945), the responsibilities of the Auditor-General and his Office increased with the very rapid growth in Commonwealth expenditure and with the proliferation of new Commonwealth organisations to support the war effort. It was increasingly difficult for the

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10. Economies Commission, op. cit., Remarks by the Auditor-General and Certain Officers of his Staff on the Commission's First Progress Report, in So Far As the Audit Office is Concerned.

11. Appendix 3 lists Australia's Auditors-General.

Auditor-General to maintain staff since these were recruited into the armed forces. Thus, discretionary reduction of audit checks and examinations became more acceptable<sup>12</sup>.

2.22 In 1948 after the War ended, the Office was reorganised and the establishment increased. In the same year, further discretion was granted to the Auditor-General with the passage of an amendment to the Act. Section 45B stated that:

The Auditor-General may, at his discretion, dispense with all or any part of the detailed audit of any accounts.

2.23 The relationship between Parliament and the Auditor-General was more clearly defined with passage of the Public Accounts Committee Act<sup>13</sup>. Section 8 (1) of the Act requires the Committee -

(a) to examine the accounts of the receipts and expenditure of the Commonwealth including the financial statements transmitted to the Auditor-General under sub-section (4) of Section 50 of the Audit Act 1901;

...

(ab) to examine all reports of the Auditor-General...

2.24 In the same year, there was heated disagreement between the Speaker of the House as to the Auditor-General's right to audit accounts of the Parliament itself. The issue was the limit of the Auditor-General's mandate. This critical issue was resolved in the Auditor-General's favour when the Prime Minister tabled a statement in Parliament in 1952 which indicated that the Audit Act applied to the audit of the Parliament's accounts.

2.25 Commonwealth revenue and expenditures increased considerably after the Second World War, with a corresponding rapid increase in the number of financial transactions. It was no longer possible to check every financial transaction because of their great number. A new approach to auditing was developed, wherein the purpose of the audit was to ensure compliance with procedures determined by the Treasury in its administration of the Audit Act.

2.26 Technological innovation in financial administration

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12. It is likely that responsibility for financial management was devolved to line managers during the war because of war-time exigencies.

13. Public Accounts Committee Act 1951.



led to the establishment in 1963 of an Audit Office division for audit functions related to electronic data processing. Audit planning became more formalised. The Office was reorganised at the end of the decade with different divisions responsible for the audits of particular departments and other government organisations. In addition, more authority was decentralised to regional offices in the States.

2.27 Audit workload continued to increase leading to a large 44 person increase in establishments in 1975.

2.28 Amendments to the Audit Act of great significance were passed in 1979. Until then, audit and reporting requirements were only contained in specific acts relating to auditees<sup>14</sup>. Previously, the Auditor-General was not legally empowered or required to report on those audits to the Parliament in his annual report although in reality he did so. Surprisingly then, it was not until 1979 that amendments were passed to the Audit Act authorising the Auditor-General to report on financial statements. In other words, legislation lagged audit practice.

2.29 The amendments extended the Auditor-General's mandate to include efficiency audits of Government departments. In the then Auditor-General's opinion, this was the most significant innovation in the Office's responsibilities since Federation. Initially a separate efficiency audit division was formed within the Audit Office<sup>15</sup>. However, this division was disbanded within a few years and responsibilities for efficiency audits distributed across those divisions with responsibility for the audit of particular groups of government organisations. Decentralisation of efficiency audits was consistent with the prevailing philosophy of integrating performance and financial audits as comprehensive audits.

2.30 In 1984, the name of the Auditor-General's Office was changed to the Australian Audit Office.

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14. T. Jambrich, The Changing Emphasis in Public Sector Audit Reporting from the Australian Audit Office Perspective, Conference of the Accountability Interest Group of the Accounting Association of Australia and New Zealand, 1988.

15. P Hamburger, Efficiency Auditing by the Australian Audit Office: Reform and Reaction Under Three Auditors-General, John F. Kennedy School of Government, Harvard University, Cambridge, MA, 1987.





## Chapter 3

### RESPONSIBILITIES AND RESOURCES

3.1 This Chapter presents statistical data on the Australian Audit Office's, AAO's, responsibilities and resources. It argues that public sector audit is conducted in a more complex environment than in the 1960s and 1970s and notes some important changes that have taken place in audit, asks whether current resources are adequate for the conduct of public sector audit, and finally describes how successive Auditors-General have exercised their responsibilities with limited resources.

#### How Many Audits Does the Australian Audit Office Conduct?

3.2 Table 3.1 demonstrates the enormity of the task confronting the Auditor-General. In 1988 he was responsible for the audit of:

- . 323 organisations which had an estimated 505 100 staff;
- . 42 programs with budgets greater than \$1b;
- . 10 programs with budgets between \$501m and \$1b;
- . an additional 774 programs; and
- . 960 data processing installations.

3.3 These organisations had<sup>1</sup>:

- . an expenditure of \$112.4b; and
- . revenue of \$117.7b;

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1. In this Chapter, all dollar amounts are in 1987-88 values unless otherwise indicated, and 'b' means 1000m.

**TABLE 3.1**

**Size of Audit Task: 30 June 1987 and 30 June 1988<sup>1</sup>**

Organisations/ Programs/DP Installations	1987	1988
No. of Organisations	298	323 <sup>2</sup>
Total Expenditure \$b	104.5	112.4
Total Revenue \$b	106.6	117.7
Total Assets \$b	104.9	115.1
Total Liabilities \$b <sup>3</sup>	76.5	79.1
Staff Numbers (est)	501.4	505.1
No of Programs		
- Over \$1000m	40	42
- \$501-\$1000m	11	10
- \$100-\$500m	59	69
- \$10-\$100m	231	229
- Up to \$10m	467	476
Total Programs	808	826
No of DP Installations <sup>4</sup>	701	960

1. The Auditor-General, Annual Report of the Australian Audit Office 1987-88, AGPS, Canberra, 1988.
2. Tables 3.3 and 3.6 indicate that there are 343 auditees. Twenty of these are not separate organisations but superannuation funds of larger organisations or external activities.
3. The value of assets and liabilities for departments and other branches of the Australian Public Service are not available.
4. Refers to the number of DP hardware systems within the Commonwealth and may include networked minicomputers. It does not refer to stand alone microsystems or computer systems applications.

TABLE 3.2  
Audits of Commonwealth Government Organisations, 1987-88<sup>1</sup>

Type of Commonwealth Government Organisation	Number of Audits <sup>2</sup>				Project Audits <sup>4</sup>	Efficiency Audits	Total
	Accounts and Records	Financial Statements	0 <sup>3</sup>	1			
Departments and Outriders			0 <sup>3</sup>	1	n.a <sup>5</sup>	6	7
Departmental Commercial Undertakings	10	19			n.a	0	29
Statutory Authorities	108	104			n.a	2	214
Companies	52	68			n.a	0	120
Total	170	192			181	8	551

- 
1. The Auditor-General, Annual Report 1987-88, op. cit.
  2. Refer to the number of audit reports issued. These reports may combine the results of one or more audit tasks.
  3. The term accounts and records derives from the standard provisions for audit of statutory authorities, e.g. Section 63G of the Audit Act. The term is not used in respect of the audits of departments and their outriders which rely on broader provisions of the Audit Act.
  4. It was not possible to separate project audits which were part of regularity audits, from project audits which were part of performance audits.
  5. Data for project audits were not available by type of Commonwealth Government organisation.



3.4 Table 3.2 shows that in 1987-88, the Audit Office completed 551 audits, including at least:

- . 7 audits of departments and their outriders<sup>2</sup>;
- . 29 audits of departmental commercial undertakings;
- . 214 audits of statutory authorities; and
- . 120 audits of government companies.

3.5 Of the 551 audits:

- . 170 were audits of accounts and records;
- . 192 were audits of financial statements;
- . 181 were project audits; and
- . 8 were efficiency audits.

3.6 Longitudinal data were not available to determine whether the AAO conducted more audits in 1987-88 than, for example, five or ten years previously.

3.7 Table 3.3 shows that from 1978 to 1988:

- . the number of departments and their outriders rose from 93 to 104, while their percentage of all government auditees fell from 47.9 per cent to 30.3 per cent. Notwithstanding, only one audit was conducted of these in 1988 as in 1978. This was the audit of the financial statements prepared by the Minister for Finance; and
- . the number of other government organisations, (departmental business undertakings, statutory authorities and government companies) more than doubled from 101 to 239, while their percentage share of all government organisations subject to audit rose from 52.1 per cent to nearly 70 per cent.

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2. Outriders included organisations such as the Australian Development Assistance Bureau, Australian Taxation Office, Bureau of Meteorology, Export Grants Development Board, Defence Science and Technology Organisation, the Schools Commission and the Australian Audit Office itself.

TABLE 3.3

AAO Auditees by Auditee Type, 1978-79, 1988-89<sup>1</sup>

Auditee Type	1978-79		1988-89	
	No.	%	No.	%
Departments	31	16.0	23 <sup>2</sup>	6.7
Departmental Outriders	51	26.3	62	18.1
Miscellaneous	11	5.6	19	5.5
Sub-Total	93	47.9	104	30.3
Departmental Undertakings	4	2.1	19	5.5
Statutory Authorities	78	40.2	108	31.5
Companies	19	9.8	112	32.7
Sub-Total	101	52.1	239	69.7
Total	194	100.0	343	100.0

- 
1. C Monaghan to Secretary, JPCPA, 11 August 1988.
  2. Includes Parliamentary departments.

3.8 Table 3.1 also records the strong growth in AAO responsibilities from 1987 to 1988. In 1987, the AAO was responsible for the audit of 298 organisations compared with 323 in 1988; 808 programs compared with 826 in 1988; and 701 computer installations compared with 960 one year later.

3.9 Of note is that although the AAO's classification of government bodies has in general, been used in this report, the PAC believes that the classification devised by the former Senate Standing Committee on Finance and Government Operations is clearer. Discussions of matters of interest to this inquiry have sometimes been confused because of use of more than one classification system. It is important that terminology used to describe government agencies should be standardised to avoid this problem.

3.10 The Committee recommends that:

- . The Government and the Australian Audit Office adopt the former Senate Standing Committee on Finance and Government Operations' organisational classification<sup>3</sup>.

## **What Is the Value of Financial Transactions Audited by the Auditor-General?**

3.11 The size of the audit task can be indicated by the value of Commonwealth financial transactions subject to audit<sup>4</sup>. Table 3.4 shows that in the ten years from 1978-79 to 1988-89, the value of Commonwealth financial transactions in respect of both the general government sector and public trading enterprises expressed in 1987-88 dollars, varied as follows:

- . total Commonwealth expenditure increased from \$71.2b to \$96.8b;
- . total Commonwealth revenue increased from \$63.7b to \$98.9b; and

- 
3. Refer to Senate Standing Committee on Finance and Government Operations, List of Commonwealth Bodies, AGPS, Canberra, 1987; Non Statutory Bodies, AGPS, Canberra, 1986.
  4. Another indicator may be the number of payroll and non-payroll transactions processed in the Department of Finance's Ledgers System and audited. The Department of Finance's 1987-88 annual report described the Finance Ledger System: Department of Finance 1987-88 Annual Report, AGPS, Canberra, 1988.



TABLE 3.4

Commonwealth Sector Receipts and Expenditure and Commonwealth Expenditure on External Audit  
1978-79 to 1988-89<sup>1</sup>

Year	Total C'wealth. Expend. \$b.	Total C'wealth Revenue \$b.	Total C'wealth Expend. and Revenue <sup>2</sup> \$b.	Per Cent Variation	C'wealth AAO Staff Costs \$m.	Total C'wealth Expend on AAO \$m.	Per Cent Variation <sup>3</sup>
78-79	71.2	63.7	134.9	100.0	20.8	22.9	100.0
79-80	71.4	66.8	138.2	102.4	20.7	23.1	100.0
80-81	74.1	71.6	145.7	108.0	22.2	24.8	108.3
81-82	79.6	76.4	155.9	115.6	24.0	26.5	115.7
82-83	84.3	75.3	159.6	118.3	21.5	24.1	105.2
83-84	90.7	77.4	168.0	124.6	21.3	24.7	107.9
84-85	97.5	87.1	184.5	136.8	21.4	24.8	108.3
85-86	99.1	89.7	188.8	140.0	21.8	26.1	114.0
86-87	98.0	92.6	190.5	141.2	21.6	25.8	112.7
87-88	96.3	97.3	193.6	143.5	21.0	24.7	107.8
88-89 (est)	96.8	98.9	195.6	145.0	20.6	32.3	141.0

1. Australian Audit Office, Submission by the Australian Audit Office to the Inquiry Reform of the Australian Audit Office, AAO, Canberra, May 1988, p. 355. D Hill to Secretary, JPCPA, 9 September 1988: Department of Finance, Explanatory Notes 1988-89 Finance Portfolio, Budget Related Paper No. 8.7, Department of Finance, Canberra, 1988.

2. Columns may not total because of rounding.

3. Constant dollars were calculated using the CPI. A better deflator was the Implicit Price Deflator used in Government Final Expenditure Deflator, Australian National Accounts, National Income and Expenditure, (ABS. 5206.0). The Implicit Price Deflator was used to express Commonwealth Budget Outlays, which were a component of the above financial transactions, in constant dollars. Those figures, which are not reported here, showed similar trends to those displayed above.

- . total expenditure and revenue increased from \$134.9b to \$195.6b which was a 45 per cent increase.

3.12 These are conservative estimates of the dollar value audited by the Auditor-General because of the exclusion from the Table of:

- . public financial enterprises such as the Reserve Bank, Commonwealth Bank and some primary industry marketing boards;
- . the value of assets and liabilities for all statutory authorities and companies; and
- . the value of the assets of Commonwealth departments and outriders.

3.13 These exclusions also make it very difficult to give a consolidated picture of the Auditor-General's responsibilities<sup>5</sup>. Appendix 4 provides more detailed information.

3.14 Table 3.4 included Commonwealth payments to State and local government. Audit of some of these grants, such as general revenue and capital grants, currently requires few resources and there are grounds for giving them less attention in measurement of the Audit Office's mandate<sup>6</sup>. On the other hand, Commonwealth specific purpose grants to other levels of government require more detailed auditing and should be included in measurement of Audit Office workload. Net Commonwealth payments of all kinds to other levels of government constitute an important but declining proportion of total Commonwealth Budget outlays<sup>7</sup>. Such payments accounted for slightly more than 30 per cent of total Commonwealth Budget outlays in 1987-88. Overall, the ratio of payments to other levels of government to total Commonwealth Budget outlays has declined steadily since the mid-seventies. Therefore, if these were excluded the value of combined Commonwealth expenditures and revenue would be less than in Table 3.4, but there would be an even greater rate of increase in the combined residual total of revenue and expenditure.

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5. These also are the reasons for the differences between the amounts in Tables 3.1 and 3.4. Other possible reasons for the differences included differences in the timing of AAO and ABS data collections, and transfer payments from one part of a portfolio to another, such as from a department to a departmental commercial undertaking.

6. Audit of section 96 grants will be discussed in Chapter 9.

7. Commonwealth Financial Relations with Other Levels of Government 1987-88, Budget Paper No 4, AGPS, Canberra, 1988, p.11.

TABLE 3.5

Estimates of the Value of Assets and Liabilities of Statutory Authorities and Companies, 1985-86 - 1987-88.<sup>1</sup>

Commonwealth Body and Year	Assets \$b	Liabilities \$b	Total <sup>2</sup> \$b
Statutory Authorities			
85-86	80.2	58.6	138.8
86-87	99.1	72.4	171.5
87-88	109.4	74.6	184.0
Companies			
85-86	4.1	3.4	7.5
86-87	4.4	3.7	8.1
87-88	4.6	3.8	8.4

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1. D Hill, op. cit., 9 September 1988.

2. No account was taken of the fact that some accounts were based on cash accounting and others on accrual accounting. Therefore, these estimates were not necessarily in 1987-88 dollars.



3.15 Table 3.5 provides an indication of the value of assets and liabilities of all statutory authorities and companies. 1978-79 data were unavailable so data from a more recent period were reported. Table 3.5 shows that from 1985-86 to 1987-88:

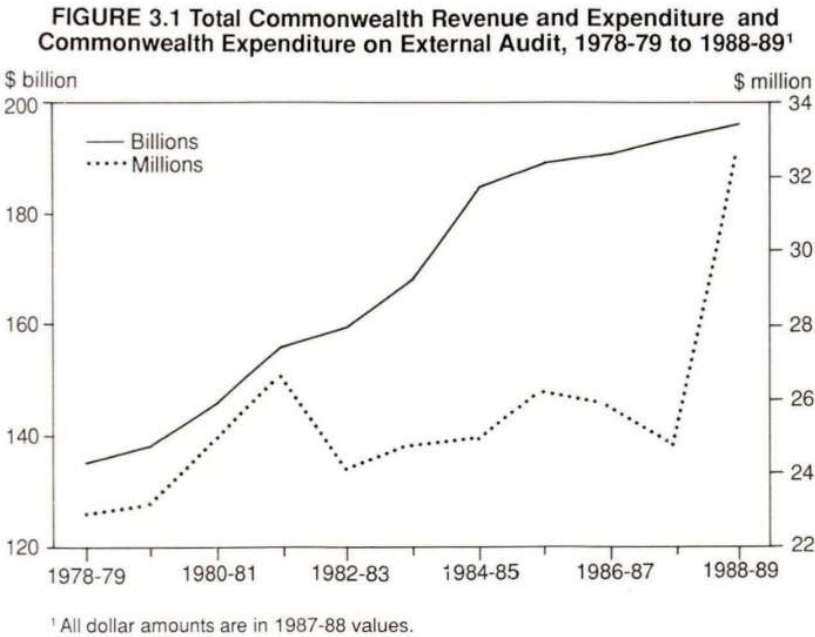
- . the value of the assets and liabilities of statutory authorities increased from \$139b to \$184b; and
- . the value of the assets and liabilities of government companies increased from \$7.5b to \$8.4b.

### **Have Resources Available to the Australian Audit Office Kept Pace with Growth in Commonwealth Financial Transactions?**

3.16 Since 1977-78 the numbers and kinds of government activities have grown rapidly. For instance, the number of statutory authorities and companies subject to AAO audit has increased from under 100 to more than 200, (Table 3.3). Allied with this is rapid growth in the number of financial transactions undertaken by officials.

3.17 Figure 3.1 displays Table 3.4 graphically. Figure 3.1 shows that, in constant dollar terms, Commonwealth allocations to the Audit Office rose from \$22.9m in 1978-79 to \$24.7m in 1987-88. This was an 8 per cent increase for a period in which the value of Commonwealth financial transactions rose by 40 per cent. Commonwealth outlays on the Audit Office increased to \$32.3m in 1988-89. This was a 41 per cent increase from 1978-79 to 1988-89 when the value of Commonwealth financial transactions rose by 45 per cent. Most of the increased expenditure on the AAO from 1987-88 to 1988-89 was because of the AAO's purchase of a computer. Of some significance was that the Commonwealth spent more on AAO salaries in 1978-79 than in 1988-89 (\$20.8m vs \$20.6m).

3.18 Figure 3.1 in no way purports to define a relationship between the size of any single account and the resources that should be allocated to the audit. Resources allocated to each individual audit are a matter for the Auditor-General's judgement.



3.19 The data show that in 1978-79:

- . the cost to the Commonwealth of every \$1000 subject to audit was 16.5 cents; and
- . \$1 expenditure on external audit provided coverage of \$5890 in Commonwealth funds.

3.20 In 1987-88:

- . the cost to the Commonwealth of every \$1000 subject to audit was 16 cents; and
- . \$1 expenditure on external audit provided coverage of \$6055 in Commonwealth funds.

3.21 Actual costs were lower because of exclusion from these calculations of assets and liabilities.

3.22 It is clear that the value of Commonwealth outlays on audit relative to the size of the audit task has remained approximately constant.

3.23 Table 3.6 provides information on the number of Government departments, statutory authorities, government business enterprises and other Government organisations subject to AAO audit, and also provides information on AAO staffing levels. The patterns were as follows:

- . from 1977-78 to 1987-88, the number of government bodies subject to audit increased from 196 to 343;
- . in 1977-78, 3 AAO staff, or 2.3 professional staff, were available for the audit of each of these organisations; and
- . in 1987-88, 1.7 AAO staff, or 1.3 professional staff, were available for each organisation.

3.24 All other factors being equal, this pointed to a possible 43 per cent rise in staff productivity over ten years to maintain the same degree of audit coverage.



**TABLE 3.6**

Organisations and Financial Activities Subject to Audit by the Australian Audit Office and AAO Staff Numbers, 1977-78, 1986-87 and 1987-88<sup>1</sup>

Year	Organisations & Activities Under AAO Audit Mandate	AAO Audit Staff	Per Cent of Total Staff <sup>2</sup>	Other AAO Staff	Total AAO Staff
77-78	196	457	78.3	127	584
86-87	318	497	80.6	120	617
87-88	343	458	77.5	133	591

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1. Auditor-General, Report of the Auditor-General, Accompanied by the Statement of Receipts and Expenditure Presented by the Minister for Finance for the Year Ended 30 June 1978, AGPS, Canberra, 1987, pp. 297. Auditor-General, Annual Report of the Australian Audit Office 1986-87, AGPS, Canberra 1987.
  2. AAO Submission, op. cit., p.362.

## **How Has the Financial, Political and Administrative Environment for Audit Changed Since the 1960s and 1970s?**

3.25 Over the last ten years the financial environment for audits has changed, as follows:

- . financial markets were deregulated and the Australian dollar floated. These initiatives required changes in the operation of particular kinds of government enterprises such as trading authorities;
- . the speed of technological change in management of financial and other resources has accelerated so that demands on auditors are even greater;
- . greater numbers of public sector bodies were required to operate on a commercial basis with allied change in their financial controls;
- . stricter accounting and reporting requirements were introduced in the public sector, with Department of Finance, DOF, advocacy of Australian Accounting Standards;
- . a greater number and complexity of accounting standards were issued by professional bodies;
- . government companies formed many more subsidiaries. Parent companies decide whether subsidiaries will be audited by the Auditor-General. Some have chosen other auditors;
- . the machinery of government was changed with greater devolution of authority to departmental secretaries. Departmental secretaries now are responsible for devising and implementing financial control systems, so that where previously there was the same DOF system in place in every department and related agency, now there is a variety of financial systems; and
- . new legislative requirements were introduced.

3.26 Clearly, compared with the 1960s and 1970s, public sector audits are conducted in a more complex environment. The

diversity of modern financial arrangements and the wealth of regulatory material places increasing demands on the government auditor in keeping abreast of the requirements of his or her profession.

3.27 Government financial management and the efficiency of Government resource allocation may have improved as a result of the changes listed above. Regrettably, however, improvements in the efficiency of government operations have been accompanied by marked increases in the amount of fraud and white collar crime. Official concern with the severity of fraud in government is very high as indicated by, for example:

- . the Royal Australian Institute of Public Administration's Conference in May 1988 on 'Ethics, Fraud and the Public Service';
- . the Australian Institute of Criminology Conference in July 1988 on 'Fraud in Government';
- . the report of the Special Minister of State, Review of Systems for Dealing with Fraud on the Commonwealth<sup>8</sup>; and
- . the Attorney-General's Fraud Control Committee.

3.28 Ten years ago fraud in government was far less of an issue. Nowadays, however, the fear and prevalence of fraud in the public sector increases the need both for more effective systems of internal financial control and for external audit of government moneys.

#### Change in Audit Technology

3.29 It has never been possible for the Auditor-General to verify every Commonwealth financial transaction. Limitations on resources meant that even at Federation when the Commonwealth Government was small and new, the most common approach to auditing required a sampling of financial transactions. Notwithstanding, some Commonwealth accounts in some portfolios may have been subjected to audit of every receipt and expenditure.

3.30 The external audit function has continued to evolve, particularly in the last decade. This is evident, for instance, in the development of a more systematic approach to estimation of audit risk.

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8. Special Minister of State, Review of Systems for Dealing with Fraud on the Commonwealth, AGPS, Canberra, 1987.



3.31 The increasing volume of financial transactions in the Commonwealth sector resulted in the Auditor-General's adoption in the 1970s of a systems-based approach to audit. This meant that external audit became a detailed review of the systems and procedures in major transaction areas, such as revenue, expenditure and payroll. As well, tests of auditees' procedures were performed. Adoption of a systems-based approach led to a reduction in the nature and extent of the traditional audit procedure's focus on individual transactions<sup>9</sup>.

3.32 Application of a systems approach to auditing meant that, other things being equal, audit resources could now be used more effectively. Lately there has been movement away from the systems approach towards a more substantive approach.

#### Use of Computers and Growth of Financial Data

3.33 Rapid increase in the volume and value of Commonwealth revenue and expenditure has resulted in increasingly heavy reliance by Government organisations on computer storage and manipulation of financial and other data. When auditees' financial systems became computerised, records of transactions ceased to be readily available for direct visual inspection by auditors. Consequently, auditors learned to use computers in their work.

3.34 One dimension of this innovation was that many auditors acquired data processing skills. Another aspect was that audit methodology changed to reflect this new way of storing and accessing financial and related data. For example, the AAO copies auditees' data files and transfers and analyses the files on an AAO mainframe or personal computer. These procedures enable the field auditor to test the auditees' data bases without reliance on reports provided by auditees.

#### Increased Responsibilities

3.35 Responsibilities of the Audit Office increased in 1979 with the addition of efficiency audits to its mandate. Efficiency audits involve independent evaluation of the efficiency and effectiveness of administrative actions and decisions taken by management in achieving program objectives within the policy guidelines and legislative framework provided by government<sup>10</sup>. This new task required the Audit Office to consider non-financial data in appraising the efficiency of administrative units.

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9. Cameron, op. cit., p. 17.

10. The Auditor-General, 1986-87 Annual Report, op. cit., p.27.

## How Adequate Are Resources for Public Sector Audit?

3.36 There are immense difficulties in answering this question. One approach is to observe whether the Auditor-General had sufficient resources for each of the thousands of audits completed, say, for example, since 1978-79. Each of those audits concluded with an audit opinion. If Auditors-General prepared these knowing that they had insufficient resources to offer an opinion, then they would have acted unprofessionally and irresponsibly. From this case by case or incrementalist perspective, sufficient resources were always available. The perspective used here was to look at changes in the Auditor-General's mandate and resources over a long period.

3.37 The Auditor-General's 1986-87 annual report to Parliament was very candid on the question of resources. The Auditor-General stated that<sup>11</sup>:

The combined impact of the need to restore adequate audit coverage of departments, the growth of workload and of complexity in the audit of authorities and enterprises, and the attempt to mount a creditable level of performance auditing activity is that the AAO ... is under-resourced.

3.38 Concern over the adequacy of resources was expressed in the AAO submission to this inquiry. The submission stated<sup>12</sup>:

... major changes to the audit mandate ... support the view that the AAO is operating in an environment of a growing workload, due not only to an increase in the number of auditees, but to an increasing complexity of audit work. This, coupled with ongoing resource constraints, indicates that the AAO is not well placed to provide a comprehensive service to Parliament.

3.39 The above changes in growth of government activity, machinery of government, the environment for financial decision-making, audit technology and audit responsibilities have had a profound impact on the Government's external auditor.

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11. Ibid.

12. AAO Submission, May 1988, op. cit., p. 61.

TABLE 3.7

Changes in Audit Fees for the 100 Largest Companies Listed on  
Australian Stock Exchanges, 1982-86<sup>1 2</sup>

Year	Audit Fees Per \$1000 of Assets (\$)
1982	0.97
1983	0.93
1984	0.90
1985	0.77
1986	0.65

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1. Craswell A., et al., Who Audits Australia? The University of Sydney, Accounting Research Centre, Sydney, October 1987.
  2. It is important to note that these costs are not necessarily compatible with the costs of AAO audits quoted earlier.



3.40 On the one hand, changes in audit technology have increased audit productivity. However, this has been compensated for by greater expectations of external audit which now operates in a more varied and complex economic and political environment than in the nineteen seventies.

3.41 An assessment is necessary of whether these two factors, increased audit productivity and increased audit workload, in terms of the number and difficulty of audits, negate each other or whether one factor has been more pervasive. Table 3.6 showed that 3 Audit Office staff were available for the audit of each account in 1977-78, and 1.7 staff were available for the same purpose in 1987-88. Therefore, if the same audit coverage were provided in 1987-88 as in 1977-78, there would have been a 43 per cent increase in staff productivity<sup>13</sup>. Such a massive productivity increase was not reflected in Government expenditure on Audit Office salaries since less was spent on salaries in 1987-88 than ten years previously. Notwithstanding, there was evidence to support the conclusion that audit staff were significantly more productive than ten years ago, but the increase would not have been 43 per cent. In comparison, all industry per person productivity growth as measured by the ABS from 1977-78 to 1985-86 increased by 14.2 per cent<sup>14</sup>.

3.42 The 43 per cent figure for the Audit Office would have been theoretically a maximum increase. However, some account must be taken of increases in audit workload responsibilities and in the complexity of the audit task. When these additional responsibilities were considered, the 43 per cent increase in staff productivity necessary to maintain, in the late nineteen eighties, the same degree of audit coverage as in the late nineteen seventies was difficult to achieve if it were achieved at all.

3.43 Table 3.7 reveals that between 1982 and 1986, audit fees paid by the 100 largest companies listed on Australian stock exchanges fell from \$0.97 to \$0.65 per \$1000 of assets. Comparable data on the value of Commonwealth assets were not available. Therefore no attempt should be made to compare audit costs for the Commonwealth and for Australia's largest companies because of differences in the measures and data bases. This should be a caution on interpretation of the audit data presented in this Chapter.

3.44 In the case of the Commonwealth's accounts the Committee believes that increases in the audit mandate were

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13. This is based on a number of assumptions, such as that the ratio of large to small accounts was constant over the decade.

14. ABS, Australian National Accounts: Gross Product by Industry, Australia, 5211.0, ABS, Canberra, 1988, Table 1.

greater than any increases in staff productivity. If so, then the Commonwealth had more reason to believe in 1977-78 that its accounts were adequately audited than it did in 1987-88.

3.45 A spectre of under-auditing appears at a time when taxpayers are demanding more efficient government, and when fraud in the public sector has accelerated rapidly.

### **How Has the Australian Audit Office Responded to Changes in Its Workload and Responsibilities?**

3.46 The AAO has been required by the growth in numbers of statutory authorities and companies combined with legislative requirements to devote more of its resources to the audit of those organisations. Fifty-six per cent of AAO resources were devoted to financial statement audits of authorities and companies in 1984-85, compared with approximately 67 per cent in 1987-88. There was a corresponding decrease in the amount of audit work in government departments with approximately 9 per cent of AAO resources allocated to financial or regularity audits in government departments in 1987-88<sup>15</sup>.

3.47 This is a remarkably low level of resources for the audit of departments, remembering the enormous sums which they are charged with administering. The 9 per cent level of resources may be the nadir since the Government has responded to a PAC recommendation in its guidelines for annual reports<sup>16</sup> and accepted the need, first, for departments to prepare financial statements, and second, to have those financial statements audited<sup>17</sup>.

3.48 The AAO has increased resources for financial or regularity audits at the expense of performance audits. Between 1986-87 and 1987-88, resources for regularity audits increased from 72 per cent to 83 per cent, while resources for performance audits fell from 28 to 17 per cent (Table 3.8). When making sense of these figures, it must be remembered that the 1976 report of the Royal Commission on Australian Government Administration recommended that the Auditor-General's jurisdiction be expanded to include efficiency audits<sup>18</sup>. 1979 amendments to the Audit Act gave the Auditor-General the authority to conduct efficiency audits, which were an important new kind of performance audit<sup>19</sup>.

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15. AAO Submission, op cit., p.73.

16. Joint Committee of Public Accounts, Guidelines for Annual Reports, Report 262, AGPS, Canberra, 1986.

17. Audit Act 1901, section 50.

18. RCAGA. op.cit., p.375.

19. Audit Act 1901, Division 3, section 48A-48H.

**TABLE 3.8**

**Percentage Allocation of AAO Resources<sup>1</sup>**

Type of Audit	<u>Percentage of Resources</u>	
	1986-87	1987-88
Regularity audits		
. Financial statements	59	66
. Government accounting	8	10
. Other	5	7
. Subtotal	72	83
Performance audits		
. Efficiency	7	6
. Project	21	11
. Subtotal	28	17
<b>Total</b>	<b>100</b>	<b>100</b>

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 1. AAO Submission, op. cit., pp.62-63: The Auditor-General, Annual Report 1987-88, op.cit., p. 21.



In the debate on the Audit Amendment Bill, Government and Opposition concurred that introduction of efficiency audits to the Auditor-General's responsibilities was a highly significant innovation in Commonwealth administration<sup>20</sup>. Neither the potential nor actual importance of efficiency audits is reflected in the resources the Audit Office has allocated to this task in recent years.

3.49 Efficiency audits are conducted at the Auditor-General's discretion. Faced with increases in the amount of mandated financial and regularity audits, Auditors-General have had no choice but to withdraw resources from performance audits in order to conduct mandated audits. Reduction in the attention given to efficiency audits was a matter of serious concern to the previous Auditor-General, who said in his 1986-87 Annual Report that<sup>21</sup>:

The future of the AAO's performance auditing function is clouded by the question mark that hangs over the adequacy of its resource provision.

3.50 This is highlighted by how, given that the AAO has identified more than 121 programs each having a value in excess of \$100m, and a further 229 programs with an annual value between \$10m. and \$100m, it would take more than 40 years to subject even one part of each of these programs to a full efficiency audit<sup>22</sup>.

3.51 This 40 year cycle of efficiency audits ignores any need for efficiency audits of the 476 program with expenditure of less than \$10m. Consequently, efficiency audits have a far more limited role in improving the Commonwealth sector's economy, efficiency and effectiveness than originally conceived.

3.52 When all of these factors are considered, the adequacy of the Commonwealth's expenditure on financial or regularity audits causes concern, while the inadequacy of resources for efficiency audits is beyond doubt.

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20. House of Representatives, Hansard, 12 September 1978, p. 824, 25 October 1978, p. 2295, 14 November 1978, p. 2740.

21. The Auditor-General, Annual Report 1986-87, op. cit., p. 11.

22. C Monaghan to Secretary, JPCPA, 13 December 1988.

## Chapter 4

### AUDIT COSTS

4.1 This Chapter presents factual information on audit costs, including information on audit fees. The data are presented to develop greater awareness of how the AAO uses its resources and the origins of its resources.

4.2 Audits are paid for in two ways:

- . by the Commonwealth Government through its annual appropriation to the AAO in the Budget. Virtually all Audit Office resources come from its annual appropriation; and
- . by those auditees required by the Minister for Finance to pay audit fees. An amount equivalent to one third of the appropriation is paid by auditees through the AAO into the Consolidated Revenue Fund as audit fees.

### Audit Costs

4.3 Table 4.1 records the resources allocated to different kinds of audits by the AAO in 1987-88. These data should be considered alongside Table 3.2 which shows the number of different types of audits of different kinds of government organisations. Table 4.1 shows that in 1987-88:

- . \$10.9m was allocated to financial statement audits and the audits of accounts and records;
- . \$3.0m was allocated to project audits; and
- . \$1.0m was allocated to efficiency audits.

4.4 These figures excludes travel, accommodation and computer costs and many central administration costs<sup>1</sup>.

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1. Additional information is in Auditor-General, Annual Report 1987-88, op. cit., p.89.

TABLE 4.1  
Resources Allocated by the AAO to the Audit of Commonwealth Government Organisations 1987-88<sup>1 2</sup>

Type of Commonwealth Government Organisation	Accounts and Records <sup>3</sup> \$	Financial Statements <sup>3</sup> \$	Project Audits \$	Efficiency Audits \$	Total \$
Departments and Outriders	2,260,055		2,482,882	767,666	5,510,603
Departmental Commercial Undertakings	1,007,285		15,485	0	1,022,770
Statutory Authorities	6,377,041		515,186	240,926	7,133,153
Companies	1,226,350		50,116	0	1,276,466
Total	10,870,731		3,063,669	1,008,592	14,942,992

1. The Auditor-General, Annual Report 1987-88, op.cit.
2. Resources allocated to various types of audits by organisation type excludes corporate management costs such as travel, accommodation and information technology.
3. Data were not available to show expenditure on these different kinds of audits or audit reports.



4.5 Other patterns evident in Table 4.1 were as follows. In terms of kinds of audits:

- . most resources were devoted to regularity audits of statutory authorities (\$6.4m); and
- . the least resources were for project audits of departmental commercial undertakings (\$15,585).

4.6 Data were not available to determine what proportions of project audit expenditure were for regularity or performance audits. Setting project audits to one side:

- . expenditure on regularity audits was ten times as much as on performance audits (\$10.0m vs \$1.0m).

4.7 When type of Commonwealth Government organisation was considered:

- . \$7.1m was spent on audits of statutory authorities;
- . \$5.5m was spent on audits of departments and outriders;
- . \$1.3m was allocated to audits of government companies; and
- . \$1.0m, the smallest expenditure, was on the audit of departmental commercial undertakings;

4.8 Table 4.2 shows the average costs of different kinds of audits by type of government organisation. The Table indicates that:

- . the average cost of regularity audits was \$30 030;
- . the average cost of project audits was \$16 926; and
- . the average cost of efficiency audits was \$126 074.

4.9 Clearly, efficiency audits were the most expensive audits. The Table also shows that:

- . regularity audits of departments and outriders had the highest average cost of \$2.3m. This was

**TABLE 4.2**  
**Average Costs of AAO Audits of Commonwealth Government Organisations in 1987-88**

Type of Commonwealth Government Organisation	Accounts and Records <sup>1</sup> \$	Financial Statements <sup>1</sup> \$	Project Audits <sup>2</sup> \$	Efficiency Audits \$
Departments and Outriders	2 260 055		-	127 944
Departmental Commercial Undertakings	34 734		-	0
Statutory Authorities	30 080		-	120 463
Companies	10 220		-	0
Total	30 030		16 926	126 074

1. Data were not available to show expenditure on these different kinds of audits or audit reports.
2. Information on the number of project audits of different kinds of Commonwealth organisations was not available to permit calculations of average costs of project audits.

because this audit was of financial statements prepared by the Minister for Finance, which included the financial statements of all departments;

- . regularity audits of companies were the least costly of all kinds of audits at \$10 220 each; and
- . there was little variation in the average cost of efficiency audits of departments and statutory authorities, (\$127 944 vs \$120 463).

4.10 The Audit Office took a considerable amount of time to produce these average costs because the Office's records are in terms of hours spent on each audit rather than actual expenditure. These average costs excluded oncosts such as staff leave, furlough, travel and office expenditure. Consequently, the figures reported here are not an accurate reflection of actual costs. This matter will be discussed further later in this Chapter.

## Who Pays Audit Fees?

4.11 Section 63Q of the Act gives the Minister for Finance the authority to identify bodies which should pay fees to the Auditor-General. These bodies are substantially self-funding and are identified in Appendix 5.

4.12 Fees are charged only for regularity audits. Fees for efficiency audits were eliminated in 1987 on the advice of a 1983 Interdepartmental Committee on efficiency audits. It was argued by the Committee that it was inappropriate for fees to be charged since such audits were not performed at the request of the body audited nor were those bodies able to determine the scope of audits<sup>2</sup>.

4.13 Table 4.3 shows that:

- . Approximately one third of the Audit Office's auditees, (97 of 315) paid fees in 1987<sup>3</sup>. The Auditor-General does not charge fees for two-thirds of his work;
- . fees compromised \$8.3m or approximately one third of the \$25.0m total outlays in 1987-88; and

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2. The Parliament of the Commonwealth of Australia, Senate, Statute Law (Miscellaneous Provisions) Bill 1987. Explanatory Memorandum (circulated by authority of the Attorney-General, the Hon Lionel Bowen, MP), 1987.

3. C Monaghan to Secretary, JPCPA, 11 August 1988.



TABLE 4.3

AAO Fees and Total AAO Expenditure, Selected Years.<sup>1 2</sup>

Year	AAO Fees (\$'m.)	AAO Expenditure (\$'m.)	Percentage %
67-68	1.6	14.3	11.5
72-73	1.6	20.5	7.7
77-78	5.6	23.1	24.3
78-79	4.6	22.9	20.3
79-80	5.0	23.1	21.7
80-81	5.8	24.8	23.3
81-82	7.4	26.5	27.7
82-83	7.6	24.1	31.6
83-84	5.8	24.7	23.5
84-85	9.3	24.8	37.6
85-86	7.8	26.1	29.9
86-87	7.9	25.8	30.6
87-88 <sup>3</sup>	8.3	25.0	33.2

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1. AAO Submission, op. cit., p. 355.

2. All dollars are expressed in average 1987-88 values.

3. Estimates only.

- . fees as a proportion of expenditure are approximately three times as much as twenty years ago. There has been some variation in the proportion of fees to expenditure in the last ten years.

## How Much are Audit Fees?

4.14 In 1986-87:

- . fees for 30 auditees were between \$1 and \$10 000;
- . fees for 38 auditees were between \$10 001 and \$20 000;
- . fees for 15 auditees were between \$50 001 and \$100 000; and
- . fees for 14 auditees were greater than \$100 001, including fees for one organisation which were greater than \$1m or nearly 20 per cent of total fee revenue.

4.15 The Auditor-General determines the scale of audit fees in a manner approved by the Minister for Finance (section 63Q). This formula includes the direct cost of salaries for actual time spent on the audit of a particular client; an overhead loading to cover leave, furlough, travel and subsistence costs, office overheads and other indirect costs; and a loading for training and other non-productive items. Average fees are much higher than average costs because of inclusion of these items in the calculation of average fees. The average audit fee in 1987-88 for the audit of companies was \$20 398 compared with the average cost of \$10 220 (Table 4.2). Clearly, average costs do not reflect actual costs.

4.16 The Committee recommends that:

- . In future, the Australian Audit Office calculate the average costs of all audits, and that calculations should be based on the formula used to estimate audit fees.

4.17 Total costs of each audit are determined by the Auditor-General. Neither the client (the Parliament) nor auditees have any direct influence over fees charged for audits. As

mentioned earlier, the Auditor-General does not retain any income from fees. Rather, the latter are paid by auditees to the AAO, which deposits them in the Consolidated Revenue Fund. This notional fee income is considered when the Department of Finance advises the Government on the AAO's annual appropriation.

4.18 Information on the base or hourly rate of fees charged by the larger private accounting firms and partnerships is difficult to obtain. However, the March 1988 Chartac survey gave an indication<sup>4</sup>. Table 4.4 compares data from the Chartac survey with data from the AAO, and reveals that the latter's hourly rate for the services of different levels of personnel was less than the hourly rate for small to medium city firms. A caveat is that there would be much variation in fees charged by private firms. Regrettably, no data were available to compare AAO staff charge rates with those of the largest accounting firms. Bigger differences in fees set by the Audit office and the largest accounting firms would have been observable. On average the AAO charged approximately \$60 per hour for audits while it is believed that a typical large accounting firm would charge approximately \$85-90 per hour for audits.

4.19 Few data were available to compare the total costs of audits executed by the 'Big 8' and the AAO. Evidence available to the Committee pointed towards the AAO charging substantially less for major audits than private audit firms. However, (at time of writing) the only example of where the AAO had submitted a tender in competition with large private audit firms suggested that AAO's total charges were similar to those of the private sector.

4.20 No comparative evidence was available on the relative efficiency of audits conducted by the Audit Office and large private firms. Nor was substantive comparative information available on any differences in the focus, scope, methodology and duration of audits. These are further matters for research. In other words, further analysis is necessary of the way in which the Audit Office conducts its audits to determine if costs can be reduced to generate efficiency gains.

4.21 The Committee recommends that:

- . The Independent Auditor of the Australian Audit Office analyse the way in which the Australian Audit Office conducts its audits to determine if costs can be reduced to generate efficiency gains (see Chapter 16).

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4. Chartac Accounting Report, March 1988, No. 126.



**TABLE 4.4**

**Comparison of AAO Hourly Fee Rate with the Hourly Fee Rate for  
Small and Medium City-Based Accounting Firms<sup>1 2</sup>**

<u>AAO</u>		<u>Big 8</u>	
Classification	Hourly Fee Rate	Classification	Hourly Fee Rate
First Assistant Secretary <sup>3</sup>	-		
SES Level 2	93	Partner/Principal	140
SES Level 1	85		
AS08/CS04	72	Manager <sup>4</sup>	109
AS07/CS03	63	Supervisor <sup>5</sup>	75
AS06/CS02	58	Senior <sup>6</sup>	70

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1. C Monaghan to Secretary, JPCPA, 24 June 1988.
  2. Data were not available to permit comparison of fees charges by the audit divisions of large accounting firms with AAO fees.
  3. There are no charge rates for AAO First Assistant Secretaries.
  4. Manager: Qualified with at least seven years experience. Responsible for control, scheduling and review of jobs; controls client servicing including internal office work flow; advises on budgeting and billing, develops and allocates staff.
  5. Supervisor: Qualified with about five years experience. Controls specific consignments directly, reporting to a manager or partner; reviews work of subordinates, controls time budgets, liaises with client, trains and develops junior staff.
  6. Senior: Qualified with three years experience. Controls individual jobs reporting to a supervisor or manager; controls staff on the job; develops junior staff; some client liaison.

## Fee Problems

4.22 Some auditees complained about the Auditor-General's fees on the following grounds. They argued that they had no control over:

- . the base rate of audit fees which was determined by the Auditor-General; and
- . the total audit fee which was set by the Auditor-General.

4.23 Objections of many auditees to audit fees became obvious shortly after passage of the 1979 amendments<sup>5</sup>. For instance, in 1981 and 1982 the Auditor-General identified the tendency of auditees to take the view that payment of a fee entitled them to influence the scope of proposed audits, the manpower to be employed and overall costs<sup>6</sup>.

4.24 While the Committee has heard the views of some auditees that on occasion the Auditor-General's fees may have been unnecessarily high, (implying inefficiency), the major objections of many auditees to the Auditor-General's total fees are based, first, on a lack of knowledge of who determines the base rate chargeable for audits, and second, on the mistaken idea that they - the auditees - are his clients. Government organisations sometimes prefer private sector audit firms because of the other services these can make available to clients.

4.25 The Committee believes that there is no acceptable alternative to the external auditor's determination of the audit's focus or scope. The latter is a function of the auditor's judgement on the work he believes necessary to be able to attest to the truth and fairness of financial statements. Certainly the focus should not be determined by the auditee.

4.26 Hours charged to an audit can reflect the condition of the auditees' accounts, records and financial statements. Audit fees will be higher if these are not in good condition.

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5. C Monaghan to Secretary, JPCPA, 24 June 1988.

6. Auditor-General, Report of the Auditor-General upon the Financial Statements Prepared by the Minister for Finance for the Year ended 30 June 1981, AGPS, Canberra, 1981: Auditor-General, Report of the Auditor-General upon the Financial Statements Prepared by the Minister for Finance for the Year ended 30 June 1982, AGPS, Canberra 1982.

4.27 The Auditor-General is obliged to conduct his work efficiently and should not seek to do unnecessary audits. However, the fact that he has so many auditees and so few resources reduces the likelihood of unnecessarily lengthy and costly audits, although these can occur.

4.28 The AAO's legislation permits it to monopolise certain audit markets. Yet there are constraints on its audit charges, including:

- . the Minister for Finance's approval of the manner in which the AAO determines its hourly rate of fees;
- . the legislative right of many important auditees, such as statutory marketing authorities in the Primary Industries and Energy Portfolio and government business enterprises in the Transport and Communications Portfolio to advise on appointment of an external auditor who may not be the Auditor-General;
- . the necessity of not stimulating other auditees to approach the Government to permit them to select their own external auditor in preference to the Auditor-General;
- . the prohibition on the Audit Office retaining fees or making a profit from fees, (section 63Q of the Audit Act).

4.29 The last point is a major departure from private sector practices, since fees charged by private audit firms are received by the latter. In other words, the Audit Office does not benefit directly from fees. (ii) and (iii) above refer to the constraint of fear of loss of auditees. This fear when combined with DOF control of the manner in which the basic rate is set is a powerful set of constraints on total fees charged in the AAO's monopoly areas.

4.30 The AAO is not permitted to make a profit from its fees. Notwithstanding, the implications of the AAO being permitted to make a profit from fees are worth exploring. Any notional profit from fees could be used to subsidise costs in the non-fee area. In other words, any inadequacy in the level of Parliamentary appropriations could be alleviated by extra revenue from statutory authorities involved in commercial activities. In theory two kinds of potential cross-subsidies are conceivable:



- . subsidisation of regularity audits of departments and their outliers by fee-paying audits of statutory authorities involved in commercial activities and by audits of incorporated companies; and
- . subsidisation of performance audits, for which no fees are charged, by 'user-pays' regularity audits.

4.31 Neither option is available to the Audit Office.

4.32 It is very important for information about public sector audit fees to be in the public domain, just as information on audit fees for private sector companies is available from the annual reports of companies listed on Australian stock exchanges. The Government agrees with this approach since the DOF's guidelines to Commonwealth undertakings require disclosure of external audit fees<sup>7</sup>.

4.33 It is equally important for information on the costs of audits for which fees are not charged to be published. It will be remembered that fees are not charged for two-thirds of the Audit Office's work. At present, the costs of efficiency audits are included in the Auditor-General's annual report to Parliament. There are very few data publicly available on the costs of other audits which comprise the bulk of the Auditor-General's work. This situation must change because, with rapid growth in the number of AAO audits due to the requirement to audit the financial statements of government departments and associated agencies from the 1988-89 financial year, there will be greater awareness from interested parties of audit costs and the efficient use of audit resources.

4.34 Audit costs and the user pays principle are explored further in Chapter 5.

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7. Department of Finance, Guidelines for the Form and Standard of Financial Statements of Commonwealth Undertakings, DOF, Canberra, July 1987.

## **PART B**

### **MAJOR CHANGES**





## Chapter 5

### INDEPENDENCE AND ACCOUNTABILITY

5.1 It is meaningful to discuss the independence of the Australian Audit Office in terms of the independence of the Auditor-General. The independence of the Auditor-General arises from the legislative basis in Part II of the Audit Act 1901 for the creation of the position.

5.2 The status and importance of the role is suggested by the method of appointment, which is made by the Governor-General on the advice of the Prime Minister, (section 3). The Auditor-General cannot be a member of the Executive Council of the Commonwealth or any State or a member of any House of Parliament. The appointment is until the incumbent reaches the age of sixty-five years. He can be removed from office in two ways, as follows, (section 7)<sup>1</sup>:

- . simultaneous requests from both Houses of Parliament; and
- . suspension by the Governor-General for incompetence or misbehaviour on the advice of the appropriate minister.

5.3 The Auditor-General has the authority to appoint staff to inspect, examine and audit any accounts, records or stores required by the Audit Act 1901, (section 11). This provision enables the Auditor-General to create an Office for the exercise of his duties. It is his responsibility to draw to the attention of the appropriate minister such matters arising from the exercise of his powers which he deems sufficiently important. Where the matter involves an efficiency audit, he must also draw the matter to the attention of the Prime Minister and the minister administering the department where the audit is conducted, (section 12).

5.4 His powers are extensive, in that he may request persons to appear before him and to produce all accounts and records necessary for an audit, (section 13). Also, he may search

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1. References in the text to sections refer to sections of the Audit Act 1901.

and take extracts from any records in the custody of a Minister or in any public office. He or his staff is entitled to have access to all accounts and records of receipt or expenditure of public moneys, (section 14).

5.5 The Auditor-General determines the nature and scope of audit activity appropriate for the exercise of his responsibilities. In other words, he determines audit standards, methodologies, and the extent of audit coverage necessary to form an opinion.

5.6 The Auditor-General has the authority of a secretary of a government department under the Public Service Act in relation to staff appointments. Also, as in government departments, the Department of Industrial Relations and the Public Service Commission exercise statutory functions in personnel management in the AAO, including setting of terms and conditions of employment and salaries.

5.7 Another important similarity with government departments is that the AAO's annual resource estimates are scrutinised and negotiated with the Department of Finance. The AAO's estimates are included with those of the Minister for Finance's portfolio. For administrative purposes other than budgetary arrangements the AAO is attached to the Prime Minister's portfolio. The Prime Minister's department is responsible for administering sections 3-9A of the Audit Act relating to the Auditor-General's appointment.

5.8 The Auditor-General reports to Parliament on his audit of the receipt and expenditure of public moneys by the executive arm of government. He audits government moneys according to legislation and regulations determined by Parliament which is his client. Government departments and other bodies which he audits, and which are called auditees, are not his clients.

5.9 In order that the Auditor-General's audits and reports be accepted as valid, it is essential that the Auditor-General should not be subject nor be suspected of being subject to pressure from the executive or legislative arms of government to report in one way or another. In other words, his independence is fundamental to the objectivity of his judgements and acceptance of the latter. Without statutory independence there could be doubts over whether he impartially exercised his functions.

## International Views on Independence

5.10 Concerning the independence of the national audit office, the International Organisation of Supreme Audit Institutions, INTOSAI, argued that<sup>2</sup>:

- . complete independence is neither possible nor desirable, but an adequate degree of independence from the legislature and executive is essential for conduct of the audit and to the latter's credibility;
- . independence from political influence is essential for impartial audits. The national audit office should not be responsive to particular political interests;
- . the national audit office must be free to set its own audit priorities and methodologies;
- . the legislature can set minimum reporting requirements, but the national audit office should have much discretion on the content and timing of reports;
- . the national audit office assists the executive by drawing attention to deficiencies in administration and recommending improvements; and
- . maintenance of the auditor's independence does not preclude the executive from requesting particular audits.

5.11 The United Nations stated the following in regard to independence of the national audit office<sup>3</sup>:

- . independence is the most crucially important auditing standard;
- . audit objectivity is not possible without independence;
- . government is an interested party in auditing. Therefore, there are incentives for biases in presentation of information;

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2. INTOSAI Auditing Standards, 3 June 1987.

3. United Nations, Audit Standards in the Public Sector. An Analysis of Comparative Experience, United Nations, New York, 1987.



- . independence of the auditor is maintained by recourse to auditing standards and to a code of professional ethics; and
- . ultimately, the auditor's independence depends on the environment for accountability.

## Local Views: 1901

5.12 Concern over the question of resources necessary for the Auditor-General to properly exercise his statutory independence has been an enduring theme since Federation. Initially in 1901, 16 staff were appointed to the Auditor-General's Office. However, these were insufficient to cover his audit mandate as the Auditor-General wrote in 1902 in his first annual report to Parliament<sup>4</sup>:

Every effort has been made to prevent the ordinary routine work of the office from falling into arrears, the whole of the staff at various times working overtime, a portion until very late hours; but the pressure is too great for the present strength to overcome, and to my great concern, I find that the provisions of the Audit Act cannot be strictly complied with, .... and the important duty of local inspection cannot be performed as fully as is deserved.

I am grateful to the Right Honourable the Treasurer for the assistance he has always given to me when it was applied for, four of the clerks already referred to having been added to the staff in September last, .... and several temporary assistants have now been engaged for some time to help to bring the work up to date; but the office was not fully equipped for the duties it had to perform, and a further addition to the staff has been found necessary. No proper allowance is at present made for emergencies, such as absences through illness or for leave granted for recreation.

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4. Auditor-General, Report of the Auditor-General for the Commonwealth upon the Treasurer's Statement of Receipts and Expenditure During the Year Ended 30th June 1902. The First Annual Report of the Auditor-General under the Audit Act 1901, Government Printer for the State of Victoria, Melbourne, 1902, p.128.

5.13 Of note in the Auditor-General's first annual report was his acknowledgement of the staffing assistance provided by the Treasury. Provision of advice to Government on staffing matters is now the responsibility of the Department of Finance (DOF).

## 1987 and 1988

5.14 The Auditor-General's 1986-87 Annual Report commented on the relationship between resources for the Auditor-General's Office and the latter's independence<sup>5</sup>. He stated that there was no recent experience of Ministerial interference in the Auditor-General's exercise of his audit mandate. This laid to rest any unease about political interference in audits. However, there were other restrictions on his independence since:

there persists a sensitive question of whether indirect influence can be exerted on the independence of the audit function through pressure on resources.

5.15 The International Organisation of Supreme Audit Institutions Auditing Standards were quoted approvingly, as follows:

...effective promotion of public accountability requires that the Supreme Audit Institution, SAI, be provided with sufficient resources to enable it to discharge its responsibilities in a reasonable manner.

Any imposition of resource or other restrictions by the executive which would constrain the SAI's exercise of its mandate would be an appropriate matter for report by the SAI to the legislative.

5.16 He then described negotiations between his Office and the Department of Finance concerning the Audit Office's annual appropriation. Outcomes of these negotiations were described as reasonable. He was most critical, however, of the tenor of those negotiations wherein, were the AAO to seek additional resources, the Department stated that it would use its powers to initiate a 'comprehensive review' covering the impact on the AAO's workloads of various projected administrative changes. The Auditor-General described such an eventuality as a challenge to his statutory responsibility to determine the manner in which the audit function was exercised.

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5. The Auditor-General, Annual Report 1986-87, op. cit., Chapter 1.

5.17 The Auditor-General's concerns were sufficiently serious for the Public Accounts Committee to address them in this inquiry. The underlying question is whether resource reductions compromise the Auditor-General's independence.

## Independence Reconsidered

5.18 The Auditor-General's independence is exercised in a number of ways through decisions on:

- . which audits will be conducted;
- . the types of audits to be conducted; and
- . how many audits are necessary.

5.19 Common views of threats to the Auditor-General's independence deal with restrictions on which organisations, activities or programs he believes should be audited. It needs to be stated clearly that, according to the AAO, there are no instances in living memory where a minister has interfered with audits<sup>6</sup>. Generally speaking, resource restrictions have no impact on this kind of decision. Nevertheless, resource restrictions can determine the types of audits initiated. We have seen how the Audit Act requires the Auditor-General to conduct regularity (including financial) audits while performance audits are at his discretion.

5.20 Statements quoted earlier from the Auditor-General expressed his frustration at not being able to conduct more performance audits and his consternation at the future of performance audits. Decisions on overall resources compelled him to reallocate resources from discretionary performance audits to mandated regularity audits.

5.21 The final domain of the Auditor-General's role considered here is his judgement on the number of audits necessary for him to fulfil his charter. Statistics quoted earlier highlighted the reduction in the Audit Office' resources relative to the size and nature of the task. Those statistics demonstrated that there was reason to be concerned about the level of audit coverage in the Commonwealth sector. Clearly, in this domain, resource shortages diminish the Auditor-General's capacity to conduct the number and extent of audits he thinks fit.

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6. AAO Submission, op. cit.



## Models of Resource Allocation

5.22 The amount of resources for public sector audit is partly a function of the mechanisms adopted to determine resources. With this in mind, three models of resource allocation to national audit offices in three different countries are examined<sup>7</sup>. These are as follows:

- . the audit office determines its own resources, Canada, or the audit office charges fees;
- . the executive determines the audit office's resources, Australia;
- . Parliament determines the audit office's resources, United Kingdom.

### Audit Office Determines Its Resources

5.23 There are two ways in which this can occur, as follows:

- . by a national audit office recommending its own resource level to Parliament; and
- . by a national audit office setting and charging fees.

### A National Audit Office Recommends Its Own Resources

5.24 The Office of the Auditor-General of Canada develops its own expenditure estimates and proposes its own annual budget. The executive arm of government has no role in assessing the proposed budget. The equivalent of the Australian Department of Finance develops the financial legislation, which is tabled in Parliament by the Minister for Finance<sup>8</sup>. Parliament votes on the latter with an oversight contribution to the debate by the Public Accounts Committee<sup>9</sup>.

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7. Appointment of auditors in the private sector is described in Appendix 6.

8. Minutes of Evidence, Joint Committee of Public Accounts, Reform of the Australian Audit Office, 26 October 1988, pp. 1651, 1164, 1683.

9. Office of the Auditor-General of Canada, 1988-89 Estimates, Part III, Expenditure Plan, Minister of Supply and Services, Ottawa, 1988.

5.25 This model is attractive because of the pure independence of the Auditor-General on resources issues. However, this is also the model's weaknesses since, for practical purposes, Parliament, plays little role in the setting of resource levels.

#### A National Audit Office Sets and Charges Fees

5.26 A national audit office which set and charged its own fees would determine its own resources. Neither in Canada, Great Britain, New Zealand nor in the United States did the national audit office exist only on income from fees. A common pattern was for total resources to come from a combination of government appropriations and fees. This combination also occurs in several Australian States.

5.27 Fee-charging focus attention on audit costs. Fee-charging in a competitive environment may result in more efficient utilisation of audit resources and perhaps encourage innovation in audit techniques. Therefore, there are sound reasons for audit fees to be used as a discipline on the auditor.

5.28 The disadvantage is that when fees are charged in the Commonwealth sector in Australia, the client does not pay fees but the auditee does. Thus, for example, the CSIRO pays fees and not the Parliament. This practice of the auditee rather than the client paying fees has promoted confusion amongst auditees since their payment of the AAO is consistent with the auditee being the client. No matter that an auditee knows that, technically speaking, this is incorrect. The lack of congruence between the principle of the auditor working for Parliament yet being paid by the auditee continues to promote the misguided expectation that the auditor is working for the auditee. Also, as evidence given to the Committee testified, the practice promoted tension between the Commonwealth auditor and the auditee<sup>10</sup>.

5.29 Commercially-oriented government organisations which pay audit fees to the Auditor-General are anxious to reduce audit costs as much as possible. Hence, it is almost inevitable that they compare their audit fees with those of their competitors and, if the latter's audit fees are less than theirs, seek to have the Auditor-General removed as their external auditor. Their competitors have some influence over audit fees while they do not. Also, it is very common for commercially-oriented government organisations to note that their competitors' auditors, which are usually the largest audit firms, provide non-audit services. The AAO has not provided these in the past. Therefore, it can appear to these government organisations that they are not receiving value for money from the AAO.

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10. C Monaghan to Secretary, JPCPA, 24 June 1988.



5.30 There is already a gap in expectations between many auditees and the AAO because of the Government's expectation that certain kinds of statutory authorities and government companies should be more responsive to the market place, while simultaneously these organisations are expected by the Government to follow the financial management code determined by the Audit Act. These organisations are pressured by both market forces and the Government's auditor. These forces need not push in the same direction.

5.31 One way out of this bind would be for the auditee to pay the AAO for the attest function and for Parliament to pay the AAO for the accountability function. This approach has been adopted in New Zealand. The Committee does not favour this approach for Australia because, even if the costs of the Auditor-General exercising his accountability function were readily identifiable (and there are many practical problems in such identification) for the auditee to continue to pay any audit fee still maintains the confusion over who is the Auditor-General's client.

5.32 Where the Auditor-General charges fees and auditees are not permitted to select their external auditor, fees are a weak incentive to efficient resource allocation by the Auditor-General. Where the Auditor-General charges fees to those auditees which can choose their external auditor, the Auditor-General may be inhibited in his work for fear of losing prestigious auditees. Other kinds of mechanisms are available to maintain pressure on the Auditor-General to use resources efficiently.

5.33 The fundamental problem is whether maintenance of a centralised approach to determination of the AAO's resources on an annual basis is compatible with the AAO charging fees for its services. After careful consideration of this matter, the Committee has determined that they are not compatible. Parliament wishes to maintain control of public sector expenditure which it does through the appropriations acts. Once it determines an appropriation for the AAO, Parliament, in some respects, has set a limit on how much auditing it wants. Clearly, bargaining has always occurred and will continue to take place between the Auditor-General and Government and Parliament on this matter. Movement to a system wherein the Auditor-General funded all audits through fees would mean that the Auditor-General had greater authority to determine how much auditing was necessary, and Parliament would have less control over this area of expenditure. There is no sign that Parliament is willing to give him increased authority on this matter. What is envisaged is that negotiations over how many resources were necessary would have a different basis than at present, (see later).



5.34 The Committee recommends that:

- . In keeping with the user pays principle, in future Parliament in future pay all audit fees. The practice of auditees being charged audit fees should cease.
- . The Auditor-General publish in his annual report the costs of each audit including the costs of audits reported separately, such as efficiency audits and any special audits<sup>11</sup>.
- . Auditees record audit costs in the notes to their financial statements.

Executive Determines Audit Office Resources

5.35 In Australia the Department of Finance advises the Minister for Finance on the AAO's proposed budget. A feature of this approach is its consistency whereby the Department applies to the Audit Office the same approaches to resource questions it uses with other Budget-dependent agencies. No special treatment or privileges are offered to the Audit Office nor is it specially disadvantaged. The Department of Finance submission argued that it should remain the Executive's principal advisor on the AAO's resources, but that it should recognise the special position of the Auditor-General<sup>12</sup>.

5.36 It is worth recounting the recent history of resource allocation to the AAO. The 1979 amendments to the Audit Act gave the AAO responsibility for efficiency audits, which was a substantial increase in the AAO's responsibilities. In December 1983 the Government accepted that efficiency audits should remain with the Audit Office and not be moved to another agency. Prior to that, the adequacy of resources for efficiency audits had been a matter of disagreement between the Auditor-General and the executive, namely with the Department of Finance. In the early part of the decade, another matter on which the Auditor-General disagreed with an executive arm of government, which this time was the Public Service Board, was in regard to classifications of SES positions. Those classifications were beneath those of other central agencies, such as the Department of Prime Minister and

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11. An Earlier PAC report made a similar recommendation. JPCPA, Review of Efficiency Audit - Administration of Capital Grants to Non-Government Schools, 288th Report, AGPS, Canberra, 1987.
  12. Department of Finance Submission, June 1988.

Cabinet, Public Service Board and the Department of Finance<sup>13</sup>.

5.37 This lag in staff classifications hindered recruitment and exchange of senior staff. In the Auditor-General's opinion, these decisions of executive government restricted execution of the audit task affecting both the number of audits, particularly efficiency audits, and audit quality. Difficulties associated with control of his Office by the executive led the Auditor-General to pose the question<sup>14</sup>:

It is timely to question whether the independence of the Auditor-General and the Australian Audit Office from the executive arm of government is not more apparent than real.

5.38 The Australian Audit Office's annual appropriation was determined as part of the appropriations for the Department of Prime Minister and Cabinet. It was suggested by the Auditor-General that the AAO should be segregated from other elements of the Prime Minister's portfolio in the budgetary process and in the presentation of Appropriation Bills and Budget documents<sup>15</sup>. The idea was to avoid a trade-off between the Auditor-General's Office and executive government areas of the Prime Minister's portfolio. Consequently, for the 1986-87 year onwards, the AAO's annual estimates were included in the Minister for Finance's portfolio.

5.39 The Auditor-General's high hopes for the effects on his resources of this change of location were not realised. In fact, disagreement between the Department of Finance and the Audit Office on resources issues was so intense the Auditor-General wrote about it in very strong terms in his 1986-87 annual report. As mentioned earlier, the debate spilled over into the political arena with public statements by the Prime Minister, Minister for Finance, and Leader of the Opposition.

5.40 The level of intensity in the debate fell during 1987-88 partly because the Audit Office was without a permanent chief for many months with a new Auditor-General appointed only at the end of the financial year. Clearly, though, problems in determination of audit resources which existed when the Audit Office's appropriations were settled under the Prime Minister's Portfolio were not resolved by movement to the Minister for Finance's Portfolio.

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13. Auditor-General, Report of the Auditor-General upon the Financial Statements prepared by the Minister for Finance for the Year ended 30 June 1984, section 5, AGPS, Canberra, 1984.

14. Ibid.

15. The Auditor-General, Annual Report of the Australian Audit Office, 1984-85, AGPS, Canberra, 1985.



5.41 Conflict between the Department of Finance, DOF, and Budget-dependent agencies is a normal part of the Budget process. Therefore, there was no reason to be surprised that the DOF and the AAO disagreed over an extended period. What, then, was the difference between the DOF disagreeing with the AAO over the latter's resources and the DOF disagreeing with other agencies over their resources?

5.42 The difference was because the AAO is the only Commonwealth agency to submit the DOF's own internal processes to scrutiny. The Human Rights Commission, the Commonwealth Ombudsman, and the Merit Protection Review Agency are examples of other instrumentalities which have the discretion to examine the DOF's administration of certain matters such as discrimination in recruitment. However, the Auditor-General is the only person with the authority to examine the efficiency and effectiveness of the DOF's management of its own organisational objectives. As mentioned previously, in Chapter 4, audit of the financial statements of the Minister for Finance's financial statements, prepared by the DOF, is the largest single audit for which the AAO is responsible.

5.43 The contradiction in these arrangements is that the Audit Office's most important auditee advises Government on how many resources the Audit Office receives. The nature of this relationship must have a bearing on audits of the DOF. Of note is that Auditors-General tend to make mild statements in their reports on financial statements prepared by the Minister for Finance. Also of note is that no Auditor-General has ever subjected any part of the Department of Finance to an efficiency audit.

5.44 The Committee shares a concern expressed by others that the focus of the Audit Office's efficiency audits has not always been central to improving the economy of Government operations nor Government's efficiency and effectiveness: for example, central departments, such as the Department of Prime Minister and Cabinet, Treasury, and the Department of Finance have never had efficiency audits. In particular, the Committee is very critical of the fact that no part of the operation of the Department of Finance has ever been subjected to an efficiency audit, despite the centrality of the DOF to the Government's operations and the potentially very large savings to Government and improved public sector effectiveness which could accrue from systematic study of the DOF's operations - particularly in the Budget context.

5.45 However, the Committee also acknowledges that there would be an unacceptable strain on the Audit Office if it subjected the organisation which recommends its budget to intensive and prolonged scrutiny. For this reason, it is wrong in principle for the Department of Finance to continue to have the final powers of advice on the Australian Audit Office's forward estimates.



final powers of advice on the Australian Audit Office's forward estimates.

5.46 It is noteworthy that the Public Accounts Committee in the United Kingdom reached a parallel conclusion when it stated that<sup>16</sup>:

however independent of Government (the) Exchequer and Audit Department may consider its audit functions to be the Department cannot be truly independent of the executive if its number and gradings are controlled by the Civil Service Department.

It is constitutionally anomalous for control over the budget and staffing of (the) Exchequer and Audit Department to rest with the executive. The best that can be said for the present administrative arrangements is that they work. But there might well be dangers for parliamentary accountability in the present very close relationship between (the) Exchequer and Audit Department and, more particularly, the Comptroller and Auditor-General and the executive.

#### Parliament Determines Audit Office Resources

5.47 The final model of resource determination for a national audit office gives Parliament this responsibility directly. The advantages of this arrangement are twofold, as follows:

- . to avoid the conflict in the previous model whereby the Government sets the Audit Office's resource levels based on the advice of the Audit Office's most important auditee; and
- . to strengthen the Auditor-General's accountability to Parliament.

5.48 Despite the Commonwealth Parliament being the Auditor-General's client, historically, the Parliament has taken little interest in the Audit Office itself. This is evident in a number of ways.

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16. House of Commons, First Special Report from the Committee of Public Accounts, Session 1980-81, The Role of the Comptroller and Auditor-General, Volume 1, Report, HMSO, London, 4 February 1981, p. li, liv.

5.49 First, it was only in November 1985 that an Auditor-General presented the first separate annual report to Parliament. This may come as a surprise since the post of Auditor-General has been a statutory office since 1901. During the intervening years, Auditors-General commented on aspects of their administration of their statutory functions in a few pages of attachments to their reports on the Minister for Finance's financial statements. Amendments to the Audit Act requiring the Auditor-General to submit an annual report to Parliament were passed as recently as 1987 (sections 11A, 48G).

5.50 Second, the Auditor-General is appointed by the Governor-General on the advice of the Prime Minister. Parliament has no role in his appointment.

5.51 Third, the PAC never met with the first Independent Auditor of the AAO in the eight years of that person's appointment. Consequently, the PAC itself did not utilise that person's knowledge and take a lead in pursuing questions associated with the condition of public sector auditing, (see Chapter 15).

5.52 Development of the role of the Auditor-General and his Office outlined in this report is likely to lead to greater Parliamentary interest in public sector audit. The Committee wishes to promote this interest further by recommending that Parliament examine the Audit Office's estimates separately in addition to the usual scrutiny by a Senate Estimates Committee. Presently a Senate Estimates Committee reviews the Audit Office's estimates alongside those of the Department of Finance. This arrangement does not give sufficient time for the Audit Office's estimates to be examined in detail, since they are overshadowed by estimates of the larger departments and other agencies which are also considered by the same Senate Committee<sup>17</sup>. The latter considered estimates of three major portfolios, and the many organisations within each portfolio. Notwithstanding, it is still appropriate for the Audit Office's estimates to be examined by a Senate Estimates Committee. However, Audit Office estimates should be considered with those of Parliament and not in conjunction with those of the Department of Finance.

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17. 1988-89 AAO estimates were considered by Senate Estimates Committee C, which also considered estimates of:

- . Department of Finance;
- . Department of Employment, Education and Training;
- . Department of the Treasury
- . Australian Bureau of Statistics;
- . Industries Assistance Commission;
- . Australian Taxation Office;
- . Insurance and Superannuation Commission;
- . Many smaller Government agencies.

Australian Senate Estimates Committee C, Report to the Senate, November 1987.



5.53 The Committee recommends that:

- . The Australian Audit Office's appropriations be included in the Appropriation (Parliamentary Departments) Bill<sup>18</sup>.

5.54 The Public Accounts Committee recommends establishment of a separate parliamentary committee to consider and recommend on the Audit Office's annual appropriation. This committee, which would meet from time to time, would have the major responsibility for advising Parliament on variations in the Audit Office's budget within variations in estimates of Parliamentary departments. It would function by considering the Auditor-General's proposed annual level of activity, and would have the authority to recommend to the Auditor-General issues or matters for audit. Other Parliamentary committees would also maintain the right to suggest topics for audit by the Auditor-General. This would be an advisory framework for the Auditor-General's decisions on priorities. As now, the holder of that office would not be obliged to accept recommendations of Parliamentary committees. Thus, there would be no change to independent exercise of his judgement, but he would have more frequent advice from Parliament on matters it thought important for improving the efficiency and effectiveness of Government administration. Maintenance of his independence in this new system of resource determination would be fundamental to maintaining the office-holder's freedom from political interference.

5.55 The direction of this change parallels developments in the British Parliament which has a similar committee called the Public Accounts Commission. In other words, formation of an audit committee of Parliament has a precedent and is consistent with the Westminster Parliamentary system.

5.56 The membership of the committee established to advise Parliament on the Audit Office's annual appropriation would have the crucial role of avoiding appearing to determine the Auditor-General's priorities. Therefore, the committee must have members from Government and Opposition and from both Houses of Parliament. In order that the committee be informed of the Government's expenditure priorities for the entire public sector, the Minister for Finance should be a committee member. Committee membership should be drawn from but not necessarily confined to the other principal Parliamentary committees which utilise the Auditor-General's reports. The Committee should appoint its own Chairperson. It would be better if the Chairperson were not the Minister for Finance because the latter's very heavy workload would prohibit him from devoting the necessary time to the task.

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18. A relevant report on this Bill and related matters is: The Parliament of the Commonwealth of Australia, Parliament's Appropriations and Staffing Report of the Senate Select Committee, Parliamentary Paper No 151/1981, AGPS, Canberra, 1981.



5.57 The Committee recommends that:

- . A Parliamentary committee be established to advise the Auditor-General on Parliament's audit priorities and to consider the Australian Audit Office's finances in detail. The Committee will report to Parliament. It will be titled the Audit Committee of Parliament, and will have the following membership of nine persons:
  - . President of the Senate or Speaker of the House of Representatives, alternating each year;
  - . Minister for Finance;
  - . Public Accounts Committee Chairperson;
  - . the Chairperson of a House of Representatives committee which uses AAO reports;
  - . the Chairperson of a Senate committee which uses AAO reports or which reports on changes in public administration;
  - . three members of the Opposition;
  - . a Parliamentarian who is a member of a minority party which is not part of the Government or Opposition. If no such person is in Parliament, then a member of the Opposition.

The Speaker and President will alternate as Chairperson on an annual basis.

5.58 These recommendations follow similar principles to those outlined in the National Audit Act 1983 in the United Kingdom.

5.59 The above recommendations would mean that the Government always had a majority of members on the Audit Committee of Parliament. Since the Minister for Finance would be a member, AAO resource bids would be subject to the same level of analysis and evaluation as for other departments. The AAO's estimates would be included in the Appropriation (Parliamentary Departments) Bills, and considered by a Senate Estimates Committee in the usual way. This would be the second level of Parliamentary scrutiny referred to earlier.

5.60 The departure from current practice would be that the executive would not have sole responsibility for advising on the AAO's appropriations. Responsibility would be shared with the legislature, or with Parliament as a whole. An objection is that these proposals do not sit easily with the convention that only the executive puts expenditure proposals to Parliament. This principle would not be infringed since the AAO's estimates would be included in Appropriations Bills as they are now. However, the process by which forward estimates would be arrived at would be very different and consistent with the principle that the entire Parliament has a special interest in maintenance of an independent and able Audit Office.





## Chapter 6

### APPOINTMENT OF THE AUDITOR-GENERAL AND OF AUSTRALIAN AUDIT OFFICE STAFF

#### Appointment of the Auditor-General: An Officer of Parliament

6.1 Currently, the executive:

- . appoints the Auditor-General;
- . determines the Auditor-General's resources;
- . determines his staff numbers and staff classifications; and
- . is responsible for administering financial management provisions of the Audit Act 1901 through the Minister for Finance.

6.2 The Auditor-General reports to Parliament. His status as an officer of the executive or of the Parliament is ambiguous. Executive government has contributed to the equivocal nature of his position. For example, the May 1988 Economic Statement's discussion of 'Reform of Commonwealth Business Enterprises' in the Transport and Communications Portfolio indicated that<sup>1</sup>:

...the current large number of Government controls over day-to-day operations will be virtually all removed or substantially relaxed...

...the requirement to use the Commonwealth Auditor-General will be removed, except in the case of Telecom and Australia Post in reflection of their large non-commercial activities.

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1. Economic Statement May 1988, Statement delivered on 25 May 1988 by the Honourable P J Keating, MP, Treasurer of the Commonwealth of Australia.

6.3 Identification of the Auditor-General as a Government control promoted the appearance of the Auditor-General as a member of the executive. More correctly, the Auditor-General is not another Government control such as arrangements (also listed in the May Economic Statement) to co-ordinate industrial relations matters, or the requirement for government business enterprises, GBEs, to rely on the Commonwealth Superannuation Scheme. The position of Auditor-General was established to maintain the accountability of the administration to Parliament. As Government has loosened its executive controls, the need for accountability remains and should be strengthened.

6.4 The executive is accountable to Parliament for stewardship of its resources. The Audit Act affirms that the Auditor-General is the executive's external auditor who has the statutory responsibility of reporting to Parliament on his audits. Thus, there is a 'natural' tension in the Audit Office's relationship with the executive because the Auditor-General must be both independent from and responsive to the executive.

6.5 British audit legislation sought to reduce the ambiguity in the Auditor-General's role vis-a-vis the executive by stating that<sup>2</sup>:

The Comptroller and Auditor-General shall by virtue of his office be an officer of the House of Commons.

6.6 The Committee agrees with the report on the role of the Auditor-General written by the British PAC which affirmed that<sup>3</sup>:

The (Auditor-General) audits the Appropriation Accounts 'on behalf of the House of Commons'. He is the external auditor of Government, acting on behalf of the taxpayer, through Parliament, and it is on his investigations that Parliament has to rely for assurances about the accuracy and regularity of Government accounts.

6.7 The Committee recommends that:

Future audit legislation state unequivocally that the Auditor-General is an officer of the Parliament in order to emphasise the Auditor-General's relationship with Parliament.

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2. National Audit Act 1983, section 1(2).

3. House of Commons, op. cit., 1981.

## Method of Appointment

6.8 Section 3 of the Audit Act 1901 states that:

The Governor-General may appoint some person to be Auditor-General for the Commonwealth.

6.9 No mention is made of who makes recommendations to the Governor-General. In practice, the Prime Minister advises the Governor-General after a recommendation by the Minister for Finance.

6.10 In other words, the recommendation is based on advice from the executive. Parliament has no role. This is consistent with the Auditor-General being answerable to Parliament through the executive.

6.11 The Committee believes that Parliament should play a stronger role in public sector audit.

6.12 The Committee recommends that:

- . The Government appoint an advisory panel comprising the Chairperson of the Audit Committee of Parliament and the Minister for Finance, and one person nominated by the Leader of the Opposition. Further, nominations to fill future vacancies of the post of Auditor-General be made by the Prime Minister after consultation with the advisory panel. The Governor-General will make the appointment.

6.13 These recommendations would raise Parliament's stake in the appointment, and ensure a continuity of Parliamentary interest in the incumbent's performance.

## Qualifications

6.14 Section 3 of the Audit Act 1901 states that:

The Governor-General may appoint some person to be Auditor-General for the Commonwealth.

6.15 The Act does not specify what skills or qualifications



an Auditor-General must have. The Committee carefully considered whether legislation should require the Auditor-General to be a qualified accountant. Arguments in favour of this requirement include:

- . the reasonableness of the expectation that the nation's chief auditor should be appropriately qualified; and
- . enhancement of the AAO's image as a centre of auditing excellence.

6.16 Arguments against the requirement were that:

- . incumbents have not always been qualified accountants yet they performed the role appropriately;
- . greater emphasis on efficiency audits means that skills other than accounting have become crucial to public sector audit; and
- . there are other ways to raise the Audit Office's image as a centre of excellence.

6.17 While accepting that accountancy qualifications are of great importance, the Committee believes that there are circumstances where the other qualifications of an outstanding candidate may hold greater sway.

## Duration of Appointment

6.18 Section 5A of the Audit Act 1901 states that:

The Auditor-General shall cease to hold office upon attaining the age of sixty-five years.

6.19 In other words, Auditors-General are appointed for the duration of their working life. The reason is that this guarantee of permanent employment protects the integrity of the office-holder's judgement. This legislative provision appears to have worked well. However, it is timely to consider whether it is as appropriate as at Federation, and whether there are other ways of protecting the Auditor-General's independence.

6.20 An argument against appointment for the duration of a person's life is that such a provision discriminates against appointment of a younger man or woman. A person appointed, say, at the age of 40 years could remain Auditor-General for a quarter of a century. Any group of selectors is faced with a daunting task to

select wisely so far ahead. Of note is that the two previous Auditors-General each served for only few years before retirement. An Auditor-General can resign whenever he or she so desires.

6.21 Since there are no calls to abandon lifetime appointment of High Court justices, why then should lifetime appointment of an Auditor-General be questioned? The reply is that there is only one Auditor-General while there are many justices, including several justices of the High Court. There is less room for error when there is only one office-holder.

6.22 Term appointments have become common for non-judicial positions. For example, the Commonwealth Ombudsman and the Director of Public Prosecutions are appointed for maximum periods of seven years. An appointment for an extended period rather than for life would permit the introduction of new ideas to the Audit Office via the Auditor-General. Benefits to the Audit Office from some turnover in the position of Auditor-General have been evident from appointments in recent years, including from the current appointment, to the post. The problem is to decide on the duration of the appointment necessary to protect the position while simultaneously legitimising some turnover of office-holders. The Auditor-General of Canada is appointed for ten years. This term seemed to balance the above concerns.

6.23 The Committee recommends that:

- . Future appointments to the post of Auditor-General be for ten years or until the incumbent reaches the age of sixty-five years, whichever is sooner.

## Salary

6.24 Section 4 of the Audit Act 1901 affirms that:

The Auditor-General shall be paid such remuneration as is determined by the Remuneration Tribunal.

6.25 The Committee does not see any reason to change this provision<sup>4</sup>.

6.26 \$104 000 was allocated in 1988-89 for the

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4. It was interesting to note that the Auditor-General complained in 1918 that his salary had not increased since his appointment in 1901, although the salaries of all other high-ranking Government officials had increased substantially. Special Report, op. cit., p.5.



Auditor-General's salary and allowances<sup>5</sup>. In comparison, partners in medium and large city accounting firms in March 1988 could expect to earn \$180 000 per annum<sup>6</sup> with senior partners earning much more than this in salaries and benefits. The Australian Government cannot expect to attract top private sector persons to the position of Auditor-General when income differences are so great. Government must be cognizant of this fact in evidence before the Remuneration Tribunal. A factor which cannot be ignored is the prestige or public recognition associated with appointment to such a high office. The taxpayer will gain if the Audit Office's status improves and the quality of its work is even higher than now. However, these benefits have costs. To avoid confronting the difference between the Auditor-General's income and the income of senior partners of large accounting firms is to avoid confronting the problem of how to improve the quality of public sector audit.

6.27 This is not to suggest that the only or the best approach to improving public sector audit is to double the Auditor-General's salary. There are two streams of senior audit positions in this country, one in the private sector and the other in the public sector, with little movement of experienced auditors between. One Committee objective is to foster movement of senior staff between the two sectors in order that both may gain. It is with this in mind that the incomes issue was raised.

6.28 The Committee searched for other public sector positions to use as benchmarks for the Auditor-General's salary. There are no exact parallels. The Committee noted that, in Canada, the Auditor-General's salary is the same as for a justice of the Supreme Court. This linkage acknowledged the importance and status of the position of Auditor-General.

## Retirement Provisions

6.29 If future Auditors-General are to be appointed for a fixed term rather than for the duration of the incumbent's working life, then maintenance of the integrity of the audit opinion will require more attention to retirement provisions for the post. An extreme case would be where there were no retirement provisions, for example, no superannuation. This omission would be a deterrent to many people otherwise interested in the job. Alternatively, if executive government paid retirement benefits according to whether it agreed with the Auditor-General's reports, then the position would be compromised.

6.30 It is doubtful whether current superannuation provisions

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5. Explanatory Notes 1988-89, Finance Portfolio, Explanation of Actual Outlays 1987-88 and Estimated Outlays 1988-89, Budget Related Paper No. 8.7, Commonwealth Government Printer, Canberra 1988, p.104.
  6. Chartac Accounting Report, March 1988.



are attractive to partners of private sector audit firms. This inadequacy limits the size of the pool of persons from which an Auditor-General can be appointed.

6.31 Retirement provisions, or superannuation and other entitlements accruing on conclusion of an appointment, should be at the same level as for other statutory office holders.

## Termination of Appointment

6.32 Section 7 of the Audit Act 1901 affirms that:

The Auditor-General shall hold his office during good behaviour and shall not be removed therefrom unless an address praying for such removal shall be presented to the Governor-General by the Senate and the House of Representatives respectively in the same session of Parliament.

The Governor-General may at any time suspend the Auditor-General from his office for physical or mental incapacity, incompetence or misbehaviour: and when and so often as the same shall happen the Minister shall lay before both Houses of the Parliament a full statement of the grounds of such suspension...

6.33 In amending the Audit Act, the Committee suggests that the power to suspend the Auditor-General should be in the hands of Parliament rather than with the Executive. Section 72 of the Constitution, which outlines arrangements for the appointment of High Court Justices, provides appropriate guarantees for the security of the position of Auditor-General<sup>7</sup>. Wording of section 7 of the Audit Act appears to be based on section 72 of the Constitution but with more power to Executive Government as indicated previously.

6.34 The Committee recommends that:

- . Auditors-General be appointed by the Governor-General in Council and shall not be removed except by the Governor-General in Council, on an address from both Houses of the Parliament in the same session, praying for such removal on the ground of proved misbehaviour or incapacity.

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7. The Australian Constitution, as altered to 1 January 1988, together with an explanatory note about the Constitution, Constitutional Commission, AGPS, Canberra, 1988, Section 72.

## **Appointment of Audit Office Staff**

6.35 The Department of Finance has influence over the Audit Office because of its recommendatory powers over the latter's running costs. DOF determines the number of SES positions the Audit Office may have and their classifications in accord with Government guidelines. However, the Auditor-General can reclassify his SES staff upwards provided there are savings in expenditures on SES salaries or with the number of SES positions. The Auditor-General can also vary downwards the classifications of his SES staff. Finance and the Audit Office determine a staffing profile for the Audit Office, although Finance does not instruct Audit on how many staff it can employ. Rather, the Department's control over the salaries vote is the control mechanism.

6.36 These procedures and mechanisms are also applied by the Department of Finance to executive departments. In combination, they result in great Departmental influence over what resources are available and how resources can be deployed.

6.37 Audit Office staff are employed according to the terms and conditions of employment set out in the Public Service Act.

6.38 The above executive government controls over the Auditor-General's staff are inconsistent with the role of the Auditor-General being independent from the executive. Also, the arrangements add to the confusion over to whom is the Auditor-General responsible, executive government or to Parliament.

6.39 This inconsistency has been acknowledged in Canada and Great Britain, where Auditors-General have the authority to recruit and dismiss staff and to determine their classifications. New audit legislation introduced into the New Zealand Parliament will also give the New Zealand Auditor-General the freedom to employ those persons best able to assist the Auditor-General to perform his responsibilities.

6.40 The effects of these controls have been to perpetuate gross inequities in incomes between AAO staff and their private sector peers. For example, the AAO officer responsible for audit of the Commonwealth Bank earns approximately one third or one quarter the income of partners in accounting firms which audit large private sector banks. In 1987-88, of 85 persons recruited to the AAO, only 3 were recruited from the private sector. Clearly, the AAO has lost its attractiveness to audit staff.

6.41 A further effect has been to severely constrain the



AAO's ability to respond adequately to increased responsibilities. This is evident in how the AAO has three Division Heads, or First Assistant Secretaries, responsible for the conduct of audits. This is the same number of Division Heads with field management responsibilities as the AAO had a decade previously when its workload was markedly less.

6.42 Current staffing controls on the Australian Audit Office prohibit the Auditor-General from major re-organisation of the Office. For example, there are strictures on his power to form audit teams similar to those used by large audit firms. Audit firms have a partner to other audit staff ratio of approximately 1:11 or 1:12<sup>8</sup>. If SES staff are equated with the level of partner in private firms, the ratio of SES to other audit staff is approximately 1:24. This latter ratio cannot be changed to any great extent under current arrangements.

6.43 If the current number of non-SES staff were maintained, the AAO would require an additional 16 SES to have the same partner to staff ratio as in large accounting firms. This would cost an additional \$4.3m<sup>9</sup>. Alternatively, if the AAO's 1987-88 budget were maintained and the objective were to obtain a ratio of 1 SES to 11.4 other staff (the same average as in large accounting firms), then there would be 46 SES and 524 other staff, or 570 staff in total, compared with actual 1987-88 staffing of 24 SES and 595 other officers, or a total staff of 619<sup>10</sup>.

6.44 A particular concern is that the Audit Office has lost many audit staff who had specialised in the application of computers to audit. They were recruited by private audit firms at far higher salaries. Their loss has affected the Audit Office's responsiveness and ability to utilise computers in the audit task.

6.45 Government controls have also limited the Auditor-General's ability to develop a team of specialists in the various accounting disciplines, and to recruit taxation specialists and actuaries. Skills which these persons have are necessary to permit the Audit Office to respond to changes in the nature of its work.

6.46 In other words, certain approaches to raising AAO productivity cannot be explored due to a combination of the Public Service Act and Government policy administered by the Department of Finance. There is a pressing need for the Auditor-General:

- . to re-organise the AAO to reflect better his charter;

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8. Chartac Accounting Report, October 1988.

9. C Monaghan to Secretary, JPCPA, 11 January 1989.

10. C Monaghan to Secretary, JPCPA, 6 February 1989.



- . to give greater attention to recruitment of talented young auditors;
- . to be able to offer financial incentives to current able staff to stop the AAO's human resources continuing to haemorrhage; and
- . to offer higher salaries to attract senior private sector auditors.

6.47      **The Committee recommends that:**

- . Legislation be introduced to establish the Australian Audit Office as a statutory authority, and to permit the Auditor-General to determine the terms and conditions of employment of Australian Audit Office staff<sup>11</sup>.

6.48      Implementation of this recommendation would mean that the Department of Industrial Relations would adopt a monitoring role of Audit Office employment conditions, as it does with other statutory authorities which have their own establishment legislation such as the Commonwealth Bank, Qantas and OTC. More importantly, it would end the anomaly whereby the AAO is an outrider of the Department of Finance.

## **Senior Appointments from The Private Sector**

6.49      The Audit Office could diversify its skill base by recruiting on contract more persons from the private sector to positions of leadership. However, there are serious disincentives for potential private sector applicants.

6.50      The longer the duration of a term appointment, the more income a private sector appointee would forsake. Also, the more difficult it would be for the appointee to establish himself or herself in private practice after the term of appointment ends.

6.51      No matter how much discretion the Auditor-General may be given over staff salaries, he or she will never be able to match private sector salaries. Therefore, other means must be found to attract quality private sector staff to leadership positions.

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11. This recommendation is a re-expression of the recommendation of the Royal Commission on Navy and Defence Administration which in 1918 urged that the Auditor-General's staff should be placed outside the operations of the Commonwealth Public Service Act. Royal Commission on Navy and Defence Administration, op. cit., p.10.

6.52 The Committee recommends that:

- . The Auditor-General discuss with the Australian Society of Accountants, the Institute of Chartered Accountants, and with accounting firms, the possibility of their augmenting the salary of staff who are recruited from the private sector for temporary appointment to Senior Executive Service positions in the Australian Audit Office.

6.53 The Committee is conscious that acceptance of this recommendation would do nothing to reduce the injustice associated with senior auditors in the public and private sectors undertaking identical work at vastly different incomes.

## Delegation

6.54 Of importance to the Auditor-General's authority to organise his Office most appropriately to meet his responsibilities is his power to delegate.

6.55 Section 70BA gives the Auditor-General the authority to delegate to others the signing of audit reports on his behalf. Since the early 1980s, the Auditor-General has used this section of the Act to authorise Division Heads to sign audit reports. From early in 1988, the Acting Auditor-General delegated his authority to sign audit reports to other SES staff and to Regional Managers in the ACT, New South Wales and Victoria, where there are large numbers of auditees.

6.56 The Auditor-General is appointed under the various Companies Codes to be the auditor of Government companies. The Code requires that the audit report be signed by a registered company auditor, and it specifies that the Auditor-General is the only registered company auditor in the AAO. Consequently, the Auditor-General must sign personally all audit reports on Government companies.

6.57 The Committee recommends that:

- . Section 70BA of the Audit Act 1901 be amended to permit the Auditor-General to delegate to qualified staff the authority to sign audit reports on Government companies.





## Chapter 7

### STATUTORY MARKETING AUTHORITIES

7.1 Statutory Marketing Authorities, SMAs, occupy a significant place in the economy since export sales of rural products contribute over one-third of total export income, with 80 per cent of rural exports derived from industries in which SMAs operate. In 1986 there were ten Statutory Marketing Authorities within the Commonwealth Primary Industry Portfolio. These were established at the request of industries to perform functions on their behalf and they are funded by the industries concerned either through statutory levies or from sales of produce. They are not Budget funded. In its January 1986 White Paper on Statutory Marketing Authorities, the Government stated that it intended the authorities to continue to operate commercially and to continue to be self-financing<sup>1</sup>.

7.2 Subsequently, legislation for SMAs was amended to give each authority the option of appointing a private audit firm as its external auditor.

### New Audit Reporting Requirements

7.3 When the Auditor-General was an external auditor of an SMA, he was required by the Audit Act to prepare<sup>2</sup>:

- . a report on the authority's financial statements. Both the financial statements and the associated report were tabled by the responsible minister; and
- . a report to the minister on audits, examinations and inspections. If the contents of this report were considered by the Auditor-General to be important, a summary may have been included in a later Auditor-General report to Parliament.

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1. Department of Primary Industry, Reform of Commonwealth Primary Industry Statutory Marketing Authorities. A Government Policy Statement, AGPS, Canberra, January 1986.

2. C Monaghan to Secretary, JPCPA, 10 August 1988.

7.4 1987 amendments to the Audit Act and to enabling legislation for SMAs changed these arrangements. Now, when an SMA appoints a private audit firm, reporting arrangements will be as follows:

- . the audit firm will report on the SMA's financial statements to the minister, who will table in Parliament the financial statements and the associated audit report;
- . the audit firm must report to the SMA's minister at least once a year on its accounts and records audits (section 63G). No audit report on accounts and records will be provided to Parliament;
- . the Auditor-General can provide a separate report to the SMA's minister and to Parliament on the SMA's financial statements;
- . the Auditor-General may choose to audit an SMA's accounts and records and report to the minister and Parliament (section 63MC); and
- . The Auditor-General may report to the SMA's minister and to Parliament on whether the private auditor has complied with AAO audit standards.

### **Australian Wheat Board**

7.5 To date, the Australian Wheat Board, AWB, is the only SMA to take advantage of the new provision in its legislation through appointment in December 1987 of a private audit firm instead of the AAO as its external auditor.

7.6 The Committee invited the Australian Wheat Board to appear before it to discuss its reasons for switching from the Australian Audit Office to a private audit firm. AWB representatives gave four reasons for preferring a private audit firm, as follows<sup>3</sup>;

- . lower cost;
- . commercial orientation, including more interaction with the private sector;

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3. Minutes of Evidence, Joint Committee of Public Accounts, Reform of the Australian Audit Office, Thursday 21 July 1988, p.1050-1085.

- . wide client base and type of interaction between management and commercial auditors; and
- . access to modern computerised accounting technology to assist in closing the accounts.

7.7 On closer examination, estimated cost savings were marginal, if any. The AAO has a very wide client base, while AWB representatives indicated that the client relationship and the relationships between AWB and AAO staffs was very good. Certainly private audit firms have more interaction with the private sector. The private audit firm selected had access to computer software which could assist the AWB in closing its accounts. Strictly speaking, however, the latter was not an audit function.

7.8 There were other factors which the Committee considered on this matter. Over several years, the AAO had criticised the form, content and timeliness of the AWB's financial reporting. Also, the AAO had qualified its audit of the AWB for eight consecutive years. These inadequacies had attracted the attention of the former Senate Standing Committee on Finance and Government Operations, (Third and Sixth Reports). Following sustained pressure from the AAO in fulfilment of its statutory obligations, the AWB produced for the year ended 30 September 1985 timely financial statements which complied with the Minister for Finance's guidelines. That year for the first time in eight years, the AAO issued an unqualified audit report on the AWB<sup>4</sup>.

7.9 Both the AWB and the Minister for Primary Industry appreciated the AAO's assistance as was shown by unsolicited written documentation from the AWB's Chairman and from the Minister in 1987.

7.10 When all of the above was considered, it was clear that the AAO over many years had played a key role in ensuring that the AWB's financial management was of an appropriate standard and that Parliament was fully informed of the state of play. This was acknowledged by both the Chairman of the Wheat Board and by the Minister. Therefore, the Committee noted with surprise that the AWB had changed its auditor.

7.11 One consideration is that the Committee's discussions were held only seven months after the appointment of the new auditor, and the potential benefits of the change of auditor will not become obvious until a minimum of one year's financial statement has been audited.

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4. J Monaghan to R Tickner, 1 December 1987.



7.12 Considering all of these factors, the Committee did not believe that the AWB had sufficient reasons to move to a private audit firm. This is not a commentary on the firm which assumed the AAO's previous responsibilities, since that firm is held in high regard professionally.

7.13 The 1987 amendments required the Committee's agreement to the appointment of a commercial auditor for any of the SMAs. PAC approval was given for the appointment of a private audit firm as the AWB's external auditor, (see below).

### **Restoration of the Auditor-General as External Auditor**

7.14 Changes in reporting requirements may appear to strengthen an SMA's accountability because of overlapping or reinforcing provisions in the SMA's legislation and in the Audit Act concerning the private audit firm and the Audit Office.

7.15 Notwithstanding, there are many inadequacies with the new arrangements:

- . no improvement in SMA's accountability to their industries through appointment of private audit firms. There was no suggestion at the introduction in 1987 of amendments to SMA legislation that inclusion of private audit firms' reports would improve SMA's accountability to their industries. Yet the new legislation appears to have given the mistaken impression that these were linked. Of note is that nine of the ten SMAs within the Primary Industry and Energy Portfolio have improved their relationship with industry through implementation of the 1987 amendments while maintaining the Auditor-General as the external auditor;
- . unnecessary duplication since SMAs which opt for private audit firms will have two auditors, the private audit firm and the AAO. The AAO's role will continue for the duration of the private audit firm's appointment;
- . high audit costs as a direct result of the potential for duplication of audit effort;
- . dependency of the Auditor-General on private audit firms. The new two auditor arrangements make the

Auditor-General very dependent on private audit firms when the former is advising Parliament on an SMA's accounts, records and financial statements. This need not be a hindrance if private audit firms were responsible to the Auditor-General as well as to the SMA and its industry. However, this is not the case since private audit firms are required to submit reports to the relevant minister with only the copies to be given to the Auditor-General (section 63MD);

- . lateness of the Auditor-General's reports. The Auditor-General will not be in a position to decide whether he will provide a separate report until some time after he has received the private auditor's report. If he so decides, then there would be two audit reports on financial statements, probably separated by some months.

This change in the timing of access to financial statements will result in other AAO work assuming higher priority. Consequently, the AAO's role in auditing SMAs will weaken;

- . superficial nature of Parliament's involvement in the appointment of private audit firms. The PAC must approve the latter's appointment. However, the PAC's role is perfunctory and merely confers the appearance of private audit firms being accountable to Parliament without that appearance having substance; and
- . weakening of the accountability of SMAs to Parliament. Private audit firms do not have to report to Parliament, only to the minister. This contrasts with previous arrangements whereby the Auditor-General was required to report to Parliament. It is not clear who gains from removal of this requirement.

7.16 It is evident that 1987 amendments to the enabling legislation of statutory marketing authorities has created a situation whereby, if private audit firms are appointed as SMAs' auditors, then:

- . the benefits to SMAs are doubtful;
- . private audit firms will not like the double audit arrangements;
- . the Auditor-General is in a weaker position from which to exercise his responsibilities; and

- . Parliament's ability to call SMAs to account is diminished.

7.17 The Committee recommends that:

- . The Auditor-General should be reinstated as the external auditor of Statutory Marketing Authorities, considering their strategic importance in the Australian economy.

7.18 The Australian Wheat Board's contract with its private audit firm should continue until the contract expires.

7.19 A mechanism would be necessary to permit SMAs to request the Auditor-General to appoint a private audit firm on contract to the Auditor-General. Since change of auditor would imply a criticism of the Auditor-General, it would be appropriate for an SMA's request to be made through its minister. The latter would have the authority to support or to deny the request. Final authority to accede to such a request would rest with the Auditor-General.

7.20 The Committee recommends that:

- . Where the services of a private audit firm are considered necessary by a Statutory Marketing Authority and the Auditor-General agrees, then the Auditor-General appoint a private audit firm as contract auditor under section 11 of the Audit Act 1901.

7.21 The above recommendations would:

- . remove ambiguities concerning the identity of SMAs' external auditors by restoring the Auditor-General to his previous role;
- . place new emphasis on those provisions of the legislation which permit the Auditor-General to hire auditors on contract; and
- . permit SMAs to be audited by private audit firms where SMAs believed there were advantages.

7.22 Acceptance of such a recommendation would not require amendment to the Audit Act, but amendments would be necessary to SMA legislation.



## Chapter 8

### THE AUDIT ACT AND THE COMPANIES ACT AND CODES

8.1 Commercially oriented government instrumentalities generally take the form of statutory authorities or companies<sup>1</sup>. In the case of the former they are created and operate under the provisions of a specific Act of Parliament which sets out their functions and powers and defines their audit requirements. They are required to keep accounts in accordance with commercial practice. This can be ensured, first, through the organisation's enabling legislation which can indicate that Part XI Division 2 of the Audit Act applies, or, second, the enabling legislation itself can contain similar provisions to the Audit Act.

8.2 In the case of companies, these are created under the provisions of the Companies legislation<sup>2</sup>. Their functions and powers are contained in their Memorandum and Articles of Association. The Companies Code sets out requirements for the appointment of auditors, and the form and content of audit reports to shareholders.

8.3 Companies may be directly owned by the Government, in which case the shares are held by the Commonwealth with the minister as the representative of the shareholder for voting purposes. Directors may hold shares in trust for the Government. Qantas Airways Limited and Australian Airlines Limited are examples of this type of arrangement.

8.4 However, the majority of public sector companies are indirectly owned by the Government as they are wholly owned subsidiaries of statutory authorities or other government owned

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1. Professor R. Walker of the University of New South Wales and Mr G. Williams of the AAO provided valuable assistance in interpretation of the Companies Act and Codes and the Audit Act.
  2. Companies legislation comprises the Companies Act 1981 for the A.C.T., and the Companies Code enacted in all States and the N.T.

companies. In these cases the shares are held by the parent body and directors may hold shares in trust for the parent body<sup>3</sup>.

8.5 Where a government owned company is not audited by the Auditor-General, the auditing arrangements and subsequent reporting are limited to those contained in the Companies legislation and common law. Where the Auditor-General is the auditor there is a dual appointment under both the Companies legislation and section 63P of the Audit Act. Section 63P provides the legal authority for the Auditor-General to carry out audits under the Companies Code and contains provisions which require the Auditor-General to report the results of the audit to the responsible Minister.

## The Audit Act

8.6 The Audit Act sets out the following audit responsibilities of the Auditor-General. Section 63G of Part XI describes the Auditor-General's responsibilities in regard to audits of accounts and records as follows:

- (1) The Auditor-General shall inspect and audit the accounts and records of financial transactions of the authority and records relating to assets of, or in the custody of, the authority, and shall forthwith draw the attention of the appropriate Minister to any irregularity disclosed by the inspection and audit that is, in the opinion of the Auditor-General, of sufficient importance to justify his so doing.
- (2) The Auditor-General may, at his discretion, dispense with all or any part of the detailed inspection and audit of any accounts or records referred to in sub-section (1).
- (3) The Auditor-General shall, at least once in each year, report to the appropriate Minister the results of the inspection and audit carried out under sub-section (1).

8.7 The Act does not require the Auditor-General to report on internal controls, although any deficiency identified and judged by him or her to be sufficiently important must be reported under section 63G. The Auditor-General's auditing standards require an audit of internal controls<sup>4</sup>.

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3. There are no known instances of Commonwealth departments creating separate companies, although this has happened in at least one State.

4. Commonwealth of Australia, *Gazette*, 'Notice by Auditor-General Setting Auditing Standards,' Friday 7 August 1987.

8.8 Section 63H describes the Auditor-General's responsibilities in respect of the audit of financial statements as:

- (2) Before submitting financial statements to the appropriate Minister....., the authority shall submit them to the Auditor-General, who shall report to the appropriate Minister -
  - (a) whether, in his opinion, the statements are based on proper accounts and records;
  - (b) whether the statements are in agreement with the accounts and records and, in his opinion, show fairly the financial transactions and the state of the affairs of the authority;
  - (c) whether, in his opinion, the receipt, expenditure and investment of moneys, and the acquisition and disposal of assets, by the authority during the year have been in accordance with the enactment establishing the authority; and
  - (d) as to such other matters arising out of the statements as the Auditor-General considers should be reported to the appropriate Minister.
- (3) The appropriate Minister shall cause copies of the report and financial statements together with a copy of the report of the Auditor-General to be laid before each House of the Parliament within 15 sitting days of that House after their receipt by the appropriate Minister.

8.9 Section 63R further defines the Auditor-General's responsibilities as follows:

- (1) The Auditor-General shall report on all cases in which, in the opinion of the Auditor-General, the receipt, expenditure or investment of money, or the acquisition or disposal of assets, by a statutory body was not in accordance with the enactment by or under which the body was established.

8.10 Section 63P states that:



- (1) The functions of the Auditor-General.... extend to the carrying out, at the discretion of the Auditor-General -
  - (aa) of the audit of all or any of the financial statements of a body:
    - (i) where a Minister requests the Auditor-General to carry out the audit and arranges with the body for the financial statements, and any necessary accounts and records, to be made available for the purpose;...
  - (a) of an inspection and audit...of the accounts and records of a body...;
- (2) The Auditor-General may, at the request of a Minister, make an arrangement with a body for the carrying out by the Auditor-General of the audit of financial statements of the body or the inspection and audit of the accounts and records of the body...
- (2A) ...the Auditor-General shall report to the Minister on the audit or inspection and audit, as the case may be.

## Companies Code

8.11 Subsection 285 (1) of the Companies legislation states that the auditor must report to the company's members. Subsection 285(2) does not require the auditor to report to directors, only to give them a copy of his or her report in time for it to be included in an annual report to be furnished to members so that an annual general meeting can be called within the prescribed time frame. Subsection 285 (3) affirms that the auditor must report:

- (a) whether the accounts and, if the company is a holding company for which group accounts are required, the group accounts are in his opinion properly drawn up-
  - (i) so as to give a true and fair view of the matters...to be dealt with in the accounts and, if there are group accounts, in the group accounts;
  - (ii) in accordance with the provisions of this Code; and

(iii) in accordance with applicable approved accounting standards.

8.12 Subsection 285(4) states that:

It is the duty of an auditor of a company to form an opinion (on)...

(b) whether proper accounting records and other records, including registers, have been kept by the company as required by this Code.

8.13 Auditors are not required to report to members on the adequacy of internal controls or whether transactions have been properly authorised in terms of procedures laid down by management, or whether they have detected fraud.

8.14 Australian auditing standards direct an auditor<sup>5</sup>:

- . to gain an understanding of the accounting system and related internal controls, and
- . to study and evaluate the operation of those internal controls upon which he wishes to rely in determining the nature, timing and extent of other audit procedures.

8.15 This auditing standard views the examination of internal controls as a step in the process of expressing an opinion on financial statements, rather than as a component of an audit.

## Comparison

8.16 Comparison of the requirements of the Audit Act and the Companies legislation revealed the following patterns:

- . Both require the auditor to report on the organisation's financial statements. The Companies legislation auditor is required to give a 'true and fair view', while the Audit Act auditor must indicate 'whether the statements are in agreement

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5. Auditing Standards, I, ASA and ICA, Sydney, March 1987.

with the accounts and records... and show fairly ...' The significance of the difference between these requirements is not clear. In practice, there appears to be little difference.

- . Both have the effect of requiring audit reports on the financial statements of Commonwealth owned instrumentalities to be provided to the auditee's minister. The Audit Act requires a report to the minister and for an annual report, which contains the audit report, to be provided to Parliament. The Companies Code requires a report to a company's members. As described earlier, the Commonwealth Government customarily holds all shares in government companies with the minister as the representative of government for voting purposes. Company directors may each hold one share in trust for the Government. However, in the case of subsidiary companies the minister is not normally a member.
- . Neither compels reporting on the adequacy of internal controls, although it is common practice to do so. However, the audience for these reports is different. The Auditor-General is far more likely to report publicly about weaknesses in internal controls than is usual in the private sector where they are rare. As mentioned, these reports are to the minister and, if sufficiently important, to Parliament. It is more common for company auditors to report privately to management rather than to company members about internal control weaknesses.
- . The Audit Act requires the auditor to report whether proper accounts and records have been kept and to report to the minister and to Parliament. The Companies legislation also requires the auditor to determine whether proper accounting records have been kept. However, it is rare to find reference to inadequate records in company audit reports, perhaps because auditors interpret the provision as relating only to deficiencies that subsequently have not been rectified.
- . For statutory authorities, the Audit Act requires the auditor to report whether the authority has complied with the provisions of the enabling legislation. The Companies Code has no equivalent requirement. In other words, there are no statutory requirements for company auditors to publicly report on whether management has breached enabling legislation or any other law. The



Australian accounting profession has not devised guidelines about auditors' responsibilities to report on illegalities.

- . Companies legislation requires all companies except exempt proprietary companies to file their annual reports, which include financial statements and the auditor's report on those statements, with State Corporate Affairs Commissions as delegates of the National Companies and Securities Commission. In other words, the audit report on financial statements is a public document.
- . Subsection 5(1) of the Companies legislation defines 'Exempt proprietary company' as a proprietary company -
  - (a) no share in which is ...deemed to be owned by a public company, and
  - (b) no member of which is a public company.

A Commonwealth-owned company could be incorporated as a proprietary company in terms of section 34 of the Companies legislation, and hence fit the test of an 'exempt proprietary company.' If the latter has been in operation for at least one year, it is offered a choice between appointment of an auditor or a public filing of its key financial data such as total assets and liabilities, and operating and after-tax profit. The option is between filing of the financial statement without the audit report, or filing the audit report (and only if this is qualified) without the financial statement. Declaration of a Commonwealth instrumentality as an exempt proprietary company risks removing the requirement on these organisations to report publicly on their financial statements and other matters mentioned in section 285.

## Implications

8.17 The implications for accountability to Parliament of the audit of a government instrumentality being conducted under the Companies Code rather than the Audit Act are as follows:

- (a) no requirement of the minister to table in Parliament the instrumentality's annual financial statements and the audit report on the financial statements;

- (b) if government enterprises are incorporated as exempt proprietary companies there may not be any public disclosure of financial information;
- (c) elimination of any vehicle for the auditor to report to Parliament except where the Auditor-General has dual appointment;
- (d) Parliament will no longer receive reports on waste, misappropriation, lax management or inefficiency within government enterprises as a matter of course. Even ministers may not receive such information;
- (e) Parliament will be less likely to receive reports on whether Commonwealth bodies have broken their own legislation or other laws;
- (f) the Auditor-General bids for a financial statement audit of a government company knowing that he must formally report on the accounts and records audit as well. This extra reporting requirement is not borne by his private sector competitors. Therefore, the Auditor-General bids knowing that his private sector competitors have an instant commercial advantage; and
- (g) government companies which can recommend on selection of their own auditor are unlikely to appoint the Auditor-General if he tendered. The reason is that the Auditor-General is bound by section 63P to report to the minister and to Parliament on a company's financial statements and accounts and records. As pointed out earlier, no similar requirement exists in the Companies Code. In other words, even if the Auditor-General's tender were the lowest for an audit contract with a government company, it would be unlikely that he would be awarded the contract. In this situation, both efficiency and accountability to Parliament are compromised.

8.18 Reduction in the information available to ministers and Parliament from private auditors because of the non-applicability of the dual appointment under the Companies legislation and the Audit Act is significant. The reduction is tempered by the increase in the amount of information which may be provided by instrumentalities to ministers on achievement of their financial targets as outlined in the May 1988 Economic Statement. One viewpoint is that provision of information to ministers on the rate of return on government investment in a government instrumentality makes redundant audit reports to ministers on



accounts and records, (see Chapter 11). Nevertheless, it can be asked whether there is any difference between information provided by auditors and by directors of government companies. Alternatively, does the source of financial information affect the accountability of government instrumentalities?

8.19 In the Committee's view, auditors independent of an instrumentality's management and board of directors are an aid to shareholders whether they support and add to the financial statements provided by management or whether they question these. To severely reduce this source and type of reporting may have no impact on an instrumentality's efficiency, yet it reduces its accountability to Parliament and to the community. It would seem to the Committee that the best way to safeguard both efficiency and accountability is for the Audit Act to continue to apply to government instrumentalities incorporated under the Companies legislation.

## Legality of Behaviour of Government Organisations

8.20 Reduction of government controls on the operation of commercially-oriented Commonwealth bodies and emphasis on bottom line performance will mean that they will become more like their private sector competitors in their operations. In particular, those agencies involved in international trade, whether through equipment purchase, service provision, product sales, or through other avenues, will be under intense pressure to maximise profitability through increasing productivity and reducing costs. This push for a more efficient public sector is desirable. However, there are some consequences which Parliament cannot ignore<sup>6</sup>.

8.21 One consequence is adoption of tax-driven financial strategies by government agencies. The boundary between legitimate tax minimisation and tax-driven financial strategies is not always

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6. The Commonwealth Attorney-General's Companies and Securities Consultative Group on the Corporations Legislation believes that certain kinds of Commonwealth Government organisations can break the law. For this reason, it recommended removal of the 'shield of the crown' for government instrumentalities, at least in respect of takeovers and market offences. Submission No. 21 to the Joint Select Committee on Corporations Legislation, Commonwealth Attorney-General's Companies and Securities Consultative Group, 5 January 1989: Gill, P., "Crown Immunity in Business Law Queried", Australian Financial Review, Thursday, 26 January 1989, p.1.



clear<sup>7</sup>. It is the responsibility of government agencies to stay within the law and the responsibility of ministers to ensure that agencies within their portfolios which are required to pay tax do so. However, a concern with organisational profitability in tight markets will place enormous pressure on those organisations to examine their financing and tax liabilities with great care to see how the latter can be reduced. An undesirable consequence of greater public sector efficiency would be where government agencies were not fulfilling their taxation liabilities.

8.22 This aspect was selected to highlight how the process by which a government agency or corporation with commercial tasks pursued its goals may be as important as achievement of those objectives. The distance of ministers from the daily operation of many statutory authorities and government business enterprises makes it very difficult for them to know about such matters in detail. Therefore, there is a need for Parliament and the public to be reassured of the probity and proprietary nature of the corporate behaviour of these organisations. The external auditor has a role to play in this matter in both his performance and regularity audits, without him being seen as an agent of the Commissioner of Taxation<sup>8</sup>.

8.23 The argument put forward by some government agencies that they should be exempt from the Audit Act is mistaken since it places such little weight on the legitimate concerns of the agencies' owners, who are taxpayers. The latter will be satisfied first if government agencies operate legally and are seen to operate legally. They will be even more at ease if those agencies operate efficiently. Agencies' annual reports to Parliament and consistent profitability are no guarantee of the exemplary corporate behaviour which Parliament has a right to expect. The Auditor-General has an important role in upholding the interests of Parliament and taxpayers in these matters. For that reason, the Committee does not agree with the boards and chief executive officers of some government agencies that the latter should be

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7. 'Don't take us on, is tax chief's warning,' Australian Financial Review, Tuesday, September 20, 1988, p.4: Boucher, T., 'Taxation Law and Administration - Beyond 1988,' ACT Bicentennial Accounting Congress, Canberra, 18 November 1988.

8. The Auditor-General's May 1983 report to Parliament drew the latter's attention to how Qantas had transferred shares from a Sydney share register to a share register in Darwin so as to attract lower stamp duty costs upon the subsequent sale of those shares: Auditor-General, Report of the Auditor-General upon audits, examinations and inspections under the Audit and other Acts, Parliamentary Paper No 2/1983, AGPS, Canberra, May 1983. Qantas is an example of a Government company which has been able to cut costs through tax effective arrangements such as leverage leasing and debt defeasance: Minutes of Evidence, Joint Committee of Public Accounts, Reform of the Australian Audit Office, 10 October 1988, p. 1402; 'You Own the Airline, Japanese Own the Jumbo' Sydney Morning Herald, 14 July 1988, p.1.

exempt from the Parliamentary scrutiny which the Auditor-General facilitates.

## **Government Business Enterprises in Transport and Communications**

8.24 In October 1987 the Minister for Finance released a White Paper on Commonwealth Statutory Authorities and Government Business Enterprises<sup>9</sup>. The Minister indicated that guidelines in that Paper were a major step in the Commonwealth's overhaul of public sector administration, implementing performance oriented management practices based on devolution of responsibility with appropriate accountability for results. According to the White Paper, the reforms indicated the Government's commitment to achieving the highest levels of operational and financial efficiency in Commonwealth business enterprises. Of relevance to this inquiry was the Guidelines' pronouncement on the accountability and auditing of statutory authorities and government business enterprises, GBEs.

8.25 Relevant accountability provisions included the following:

- . each authority was accountable to Parliament through its minister;
- . the authority's annual report was the main means for reporting to the minister and to Parliament. In fact, the annual report was the 'centre-piece of its accountability'; and
- . an authority's activities would normally be monitored by the minister to ensure satisfactory observance of the requirements of the existing charter, the adequacy of that charter, and the general quality of performance, including assurances that the conduct of business by an authority conformed to appropriate public standards of propriety and probity.

8.26 Changes were foreshadowed in Part XI of the Audit Act 1901, which provides standardised provisions for the financial management of incorporated bodies, by proposing amendments to provisions dealing with estimates, contracts and borrowings.

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9. Policy Guidelines for Commonwealth Statutory Authorities and Government Business Enterprises, A Policy Information Paper issued by the Minister for Finance, Senator the Hon Peter Walsh, October 1987, AGPS, Canberra, 1987.



8.27 No change was indicated or foreshadowed in auditing arrangements. In other words, the White Paper did not express any criticisms of the Auditor-General.

8.28 The Treasurer's Economic Statement of May 1988 included a section titled 'Reform of Commonwealth Business Enterprises', which extended the Policy Guidelines in the above White Paper<sup>10</sup>. The Economic Statement argued that the thrust of the Guidelines in the 1987 White Paper was that the Commonwealth as owner/shareholder would focus on the results achieved by each GBE rather than on the processes involved in managerial decision-making. The concentration was on GBEs in the Transport and Communications portfolio.

8.29 The eight organisations discussed in the White Paper have a strategic role in Australian transport and communications with assets of more than \$20b. At June 1987 the Commonwealth's investment in them was estimated at \$9.4b or \$1 900 for each Australian household. Their strategic importance could be gauged by how, according to the Treasurer's statement, they influenced the nation's overall cost structures.

8.30 Under a 'Removal of Controls' section, the May Economic Statement indicated that:

The current large number of Government controls over day-to-day operations will be virtually all removed or substantially relaxed.

8.31 In addition:

The requirement to use the Commonwealth Auditor-General will be removed, except in the case of Telecom and Australia Post, in reflection of their large non-commercial activities.

8.32 In future, six major transport and communications GBEs will be able to select their own auditor. These organisations are:

- . AUSSAT
- . Australian Airlines
- . Australian National Line, ANL
- . Australian National Railways Commission, AN
- . Overseas Telecommunications Commission, OTC
- . QANTAS.

8.33 The Government has passed legislation to establish

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10. Economic Statement May 1988, op. cit., p. 151.



these organisations as public companies. These companies can now seek appointment of an auditor under the Companies Code.

### The Inquiry

8.34 The inquiry received submissions from three of the six GBEs referred to above. These were:

- . AUSSAT
- . QANTAS
- . Australian National Railways Commission (AN).

8.35 They differed widely on the question of whether the Auditor-General would remain their auditor.

8.36 AUSSAT stated that it was<sup>11</sup>:

...completely satisfied with the performance by the Auditor-General of the duties required in the audit of a company.

8.37 AUSSAT was silent on whether it saw advantages in having a private sector firm as external auditor, and gave no explicit indication of whether it wanted to change auditors. However, the above extract from the response to the Committee's terms of reference indicated satisfaction with the Auditor-General.

8.38 QANTAS indicated that<sup>12</sup>:

Companies operating in a competitive environment will seek suppliers of services, including auditors, on the basis of services provided and cost.

8.39 That is, QANTAS appeared to believe that it should have the discretion to choose between the Auditor-General and private sector audit firms.

8.40 AN complimented the Audit Office's conduct of regularity

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11. AUSSAT Submission to the Inquiry Reform of the Australian Audit Office, 27 July 1988.

12. Qantas Submission to the Inquiry Reform of the Australian Audit Office, 23 August 1988.

audits, but was sceptical about the need for performance audits<sup>13</sup>. The latter were criticised for being costly with AN having no discretion over the audit's scope and costs. A stronger criticism was that performance audits were not usually carried out by private sector organisations. AN claimed that it operated in a competitive environment, and therefore performance audits placed it in an unfair commercial situation since its competitors did not have to bear similar costs. A retort was that neither did those competitors receive the benefits of those audits.

8.41 AN considered that its Act clearly defined its role as a business undertaking and provided for appropriate mechanisms for performance auditing which were more effective than the Audit Office's performance auditing approach. Accordingly, performance auditing was not considered necessary for those agencies such as AN which had modern legislation providing for a high degree of public accountability.

8.42 The Committee found that this was the clearest expression of auditee belief that the introduction of program budgeting had obviated the need for performance auditing of GBEs.

8.43 The Committee noted that the 1988 May Economic Statement provided no justification for the decision to permit six nationally important GBEs in the Transport and Communications Portfolio to select their own auditor. The lack of justification was surprising given the implications of the move. Amendments to the appropriate legislation have been introduced to implement Government policy on this matter.

8.44 Of relevance is the view of the Australian Society of Accountants. In evidence given to the Committee, the Society argued that<sup>14</sup>:

The Society favours the ultimate responsibility for the audit of Government bodies being vested in the Auditor-General with the Auditor-General being empowered to delegate the performance of the audit task to private accounting firms. Such an approach has been working successfully in the Victorian public sector for several years.

8.45 The Committee believes that there is a severe loss in accountability apparently brought about by government auditees choosing their own auditors who will work under the Companies

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13. Australian National Railways Commission Submission to the Inquiry Reform of the Australian Audit Office, 18 August 1988.

14. Australian Society of Accountants Submission to the Inquiry Reform of the Australian Audit Office, 3 June 1988.

Code rather than the Audit Act, especially in the absence of substantive criticism of the AAO's financial and regulatory audits.

8.46 The Committee recommends that:

- . Amendments be made to legislation governing AUSSAT, QANTAS and Australian National Railways Commission, and to the Audit Act 1901 to restore the Auditor-General as their external auditor.

8.47 However, as with SMAs, GBEs should have the right to request the Auditor-General through their ministers to appoint a private audit firm on contract to the Auditor-General. Ministers may agree or disagree with any such request from a GBE to approach the Auditor-General on their behalf.

8.48 The Committee recommends that:

- . The Auditor-General be reinstated as the external auditor of Government Business Enterprises.

## Government Companies and Subsidiaries

8.49 It is not clear what the taxpayer gains from removal of the Auditor-General as external auditor of Government companies and replacement by a private sector auditor who will audit under the Companies Code. A counter argument is that in those cases where the minister appoints a private audit firm as a Government company's external auditor, then the minister is acting on Parliament's behalf. The private sector audit firm will report to the minister and to Parliament via the audit opinion published in the auditee's annual report. In these situations, it can just as readily be said that the executive arm of government is appointing its own auditor.

8.50 Government permission to certain of its companies to select their own auditors suggests that the Government believes that there are efficiency gains without loss in the accountability of these companies to Parliament. This view also points to an unstated Government belief that the Australian Audit Office lags behind the best private practice in the audit of commercial organisations. Recommendations here seek to improve the Audit Office's image and capacity in this regard. The Committee is working towards a better balance of audit efficiency and Parliamentary accountability of all Commonwealth organisations. It is not convinced by the argument that there is no loss in accountability when Government companies are audited by private sector audit firms or partnerships under the Companies Code.



8.51 The Committee recommends that:

- . The Audit Act 1901 be amended to require the Auditor-General to be appointed the external auditor of all Government companies. Private sector audit firms and partnerships which are the external auditors of Government companies would continue until their appointments expire, whereupon the Auditor-General would become the company's external auditor. The Auditor-General, after consultation with the appropriate minister, may decide to contract a private sector auditor to undertake the audit on the Auditor-General's behalf.

8.52 As at the 30 June 1988, the Auditor-General was external auditor of 110 of the 133 identifiable companies in which the Commonwealth had a controlling interest<sup>15</sup>. Some of these companies were subsidiaries. The total number of companies audited by the Auditor-General increased from 69 in 1986 to 133 in 1988<sup>16</sup>.

8.53 Commonwealth authorities or companies which have a controlling interest in subsidiary companies appoint the latter's external auditors. In 1985-86, there were 16 subsidiaries of Commonwealth authorities which were incorporated in Australia and to which the Auditor-General had not been appointed auditor under either the Companies Act or the Audit Act. There were nine subsidiaries of Commonwealth statutory corporations which were incorporated outside Australia and for which the Auditor-General was not appointed auditor. The numbers of directly created Government companies and subsidiary companies of Commonwealth organisations not audited by the Auditor-General have risen in the last few years.

8.54 The consequences of subsidiaries having auditors other than the auditor of the parent company are that the overall situation of a GBE cannot be known with certainty until the reports of all its auditors are available. Even then there can be difficulties in coming to terms with a GBE's accountability.

8.55 A previous Auditor-General gave an example of problems in this area in a 1987 address<sup>17</sup>. A particular enterprise incurs

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15. The 133 total excluded 5 Aboriginal Development Commission companies: Auditor-General, Annual Report, 1987-88 op.cit., Appendix 5.

16. C Monaghan to Secretary, JPCPA, 11 August 1988.

17. J Monaghan, Public Enterprises - Are They Publicly Accountable? An Address to the Government Accountants Committee, New South Wales Division, Australian Society of Accountants, Twilight Seminar, Sydney, 26 March 1987.

costs on behalf of subsidiary companies. In accordance with what has been a fairly common business practice for 'related party transactions' (acknowledged as reasonable by the audit profession) substantial costs incurred by the authority are not passed on to the subsidiary. A result is that there is a substantial window-dressing effect on the subsidiary's financial results, and the arrangement may have been influenced by tax planning considerations. Such window-dressing may be a factor in selling the subsidiary.

8.56 The problem is to determine whether the parent company, statutory authority or GBE acted with commercial acumen or acted inappropriately towards its subsidiary. Coming to grips with the accountability consequences, including limitations on Parliament's capacity to understand the overall financial situation of the Government parent body, is difficult in itself. Certainly the situation becomes more complex when there are different auditors.

8.57 The Senate Standing Committee on Finance and Government Operations recommended in 1982 that all subsidiaries of statutory authorities be subject to audit by the Auditor-General<sup>18</sup>. The Public Accounts Committee agrees with this recommendation with an extension to include subsidiaries of Government companies and GBEs.

8.58 The Committee recommends that:

- . The subsidiaries of all statutory authorities, government owned companies and Government Business Enterprises be subject to audit by the Auditor-General.

8.59 Notwithstanding these recommendations, the Committee is not opposed to the Auditor-General employing private auditors and audit firms on contract to broaden current approaches to audit.

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18. Fifth Report of the Senate Standing Committee on Finance and Government Operations, Statutory Authorities of the Commonwealth, AGPS, Canberra, 1982.





## Chapter 9

### AUDITS ON CONTRACT

9.1 Chapters 7 and 8 stated that the Auditor-General should be maintained or restored as the external auditor of all statutory authorities, statutory marketing authorities, government business enterprises and government companies, and that the Auditor-General should continue to have the authority to recruit private sector auditors as individuals or as partners in firms to audit on his behalf on a contract basis. This chapter explores further the issue of audits being conducted on contract to the Auditor-General. Chapter 9 recommends specific guidelines and considerations relevant to the appointment of a contract auditor should the Auditor-General decide to make such an appointment.

9.2 The decision should be based on the following factors:

- . the need for an independent audit of the highest standard;
- . available resources; and
- . necessity of strengthening the AAO's capacity and professional standing.

9.3 The AAO must strengthen its capacity to undertake regularity and performance audits. This strengthening would not be achieved if all audits were contracted and AAO staff merely read reports provided to them by private sector audit firms. Under those circumstances, professional skills would deteriorate and the Audit Office would become little more than a post box. Previous chapters have argued the case for reinforcing the Audit Office's independence. Independence would have little meaning unless Audit had the expertise and resources to continue to undertake audits of all kinds of government organisations.

9.4 Consequently, private sector audit firms should not monopolise audits of any single category of government organisation, such as government companies, nor should they be permitted to monopolise any single kind of audit, such as financial audits, leaving performance audits to the AAO.

9.5 If audits of government companies and other large commercially oriented government organisations were always allocated by the Auditor-General to large audit firms, then the Audit Office would have enormous difficulty in attracting quality staff. Further, the Audit Office would never be able to offer the breadth of professional experience necessary for accreditation of chartered accountants, (see Chapter 13). Therefore, there are boundaries on what proportion of the Audit Office's work should be contracted out. Of note was the Scottish Audit Office's strategy for maintaining a strong technical capacity. The Scottish Audit Office alternates with private sector auditors as the external auditor of certain government agencies.

9.6 Progress within the AAO on its restructuring and progress on acknowledgement that auditees have interests and needs which can be met by Audit staff without undermining the Auditor-General's responsibilities to Parliament, are additional factors to be taken into account in consideration of what proportion and which Audit Office work should be contracted.

9.7 There are two specific instances where it is appropriate for the Auditor-General to employ agents:

- . where there is a conflict of interest inherent in the Auditor-General conducting the audit. A current example is of how the Auditor-General has employed an agent to audit the Department of Aboriginal Affairs. The Auditor-General was formerly Secretary of that Department, and there may well have been a conflict of interest if he undertook the audit and was examining programs which he had established or managed; and
- . where a Commonwealth instrumentality operates in another country which requires a local auditor, such as in Hong Kong.

## Legislative Basis

9.8 Section 11(i) of the Audit Act provides that:

The Auditor-General may...

- (a) appoint a person to inspect, examine and audit any accounts, records or stores which are required by this Act, or by any other Act, to be inspected, examined or audited by the Auditor-General, and to report the results... to the Auditor-General...



and a person so appointed has by virtue of his appointment, power to inspect any accounts, records or stores that are required to be so inspected, examined or audited by the Auditor-General or to inspect the accounts, records or stores specified in the instrument.

9.9 This section gives the Auditor-General the authority to appoint persons to conduct audits on his behalf on a contract basis. Advice from the Attorney-General's Department indicated that these provisions permitted the Auditor-General to appoint members of partnerships to work on his behalf. However, he may not appoint an accounting firm or partnership because at law these are not legal entities. He could, however, in the instrument of appointment after inserting the full names of the partners, add 'trading as ...' and then insert the firm's name<sup>1</sup>. Consequently, the Auditor-General has the legal authority to appoint persons as his agents. Notwithstanding, clarification and simplification of the legislation would be beneficial. Canadian legislation is an example of what may be followed. Section 15(2) of the Auditor-General Act states that:

... the Auditor-General may, within the total dollar limitations established for his office..., contract for professional services.

## Selection of Auditors

9.10 In evidence before the Committee, Mr Ken Dye, the Canadian Auditor-General described how in Canada there had been problems in the appointment of auditors of crown corporations<sup>2</sup>. Mr Dye said that:

Crown corporations do not appoint their auditors. It is done by government in cabinet, and so (for example) the chairman of the post office does not have much choice; he does not know who his next auditors will be. It will be at the whim of cabinet. They usually leave them in for five years, but sometimes they change, and they tend to change on change of government. ....I have strongly held views that accounting firms ought not to contribute to political parties on the basis of expected reward.

...there is a correlation between the strength of the gift and the appointment of audits.

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1. D. Shand to Secretary, JPCPA, 23 September 1988.
  2. Minutes of Evidence, Joint Committee of Public Accounts, Reform of the Australian Audit Office, 26 October 1988, p.1629.



9.11 The Canadian Auditor-General noted that this problem had gone away because of changes in the way accounting firms participated politically. It should be stressed that there is no evidence that these problems exist in Australia. The Committee wishes to create a framework for avoiding any such problems in Australia in the future.

9.12 Accounting firms are increasingly being made to tender for audit work<sup>3</sup>. Yet there is unease within the accounting profession that audit tendering may harm audit quality<sup>4, 5</sup>. Such concerns have become major problems for the accountancy profession in the United States.

9.13 Because the Auditor-General will select auditors to act as his agent, he may consider calling for tenders.

9.14 In order to ensure that the best auditor is selected, due weight must be given to the estimated cost of an audit. Selection of an auditor must not be based solely on price considerations.

9.15 The Committee recommends that:

The Auditor-General develop and publish a range of criteria on which to base any decision to employ auditors on contract.

## Responsibilities

9.16 Problems experienced by the Victorian Economic Development Corporation, VEDC, have focused attention on difficulties which can be encountered when private sector auditors are contracted for audits of government instrumentalities. VEDC signed a contract with the accounting firm Arthur Young to act as the Corporation's auditors. Mr Fergus Ryan, the person appointed by the Victorian Government to inquiry into certain matters concerning the VEDC, found that there were a number of difficulties in regard to audit. These were<sup>6</sup>:

- . the boundary between the Victorian Auditor-General's and Arthur Young's audit responsibilities;

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3. B. Simmons, 'The Case for Audit Tenders,' Business Review Weekly, 4 November 1988, p.117.

4. M. Peers, 'Auditors in uproar over fee discounts,' Australian Financial Review, Wednesday, 17 August 1988, pp. 1-2.

5. T. Thomas, 'No Merger, But Links to be Stronger,' Business Review Weekly, 16 December 1988, p.89.

6. Ryan, F., op. cit., p. 54.

- . lack of specification in VEDC's contract with Arthur Young on the latter's responsibilities, and specifically whether the latter included responsibility for review of all major risk areas of VEDC's activities; and
- . lack of specification in VEDC's contract with Arthur Young on an appropriate frequency of reporting.

9.17 Any increase in the proportion of audits contracted out by the Auditor-General must occur within guidelines which avoid a repetition of these problems in the Commonwealth sector. Guidelines can be contained in the Auditor-General's engagement letters to auditors<sup>7</sup>.

9.18 The Committee recommends that:

- . Engagement letters to private sector auditors include the following requirements:
  - . statements clarifying the nature of the review that the contracted auditor is expected to undertake - whether limited to the expression of an opinion on financial statements or whether concerned with authorisation of transactions, fraud, illegal transactions, adequacy of procedures to safeguard assets, or other;
  - . statements indicating that the Auditor-General's agents will be required to conduct audits in accordance with standards devised by the Auditor-General. Audit standards were published by the Australian Audit Office in August 1987<sup>8</sup>;
  - . statements clarifying the matters on which an auditor is expected to report - whether irregularities, internal control weaknesses or fraud, and with what frequency;
  - . statements clarifying to whom such reports should be directed - whether to ministers, management, and/or the boards of statutory authorities or companies or to audit committees of boards;

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7. R. Walker to Secretary, JPCPA, 20 February 1989.

8. Commonwealth of Australia, Gazette, 'Notice by Auditor-General Setting Auditing Standards', 7 August 1987.

- . statements indicating that the contracted auditor will recommend to the Auditor-General the audit opinion to be expressed and submit to the Auditor-General a signed management letter on the audit results. Completed working papers including a recommended audit report will also be required; and
- . a statement indicating that the Auditor-General or his or her delegate will sign the audit report.

## Consultancies and Conflicts of Interest

9.19 All major accounting firms provide consultancies on taxation, management practices, and computer systems. Some auditees prefer private sector audit firms as external auditors because of ready access and because of a possibly lower marginal cost of these other services. This was expressed by one Government agency wanting to appoint a private audit firm as follows:

As an audit client, the (Government agency) would have access to regular seminars conducted by the audit firm covering current issues, including indirect taxation and export and research grants. The availability of these seminars would considerably assist staff in their professional development.

9.20 If these benefits accrued to individual staff members the organisation as a whole would gain. The Auditor-General does not offer consultancies in any of these areas. Nor is such consultancy advice readily available from other parts of the Commonwealth sector<sup>9</sup>. So from the perspective of many auditees it is logical to appoint a private audit firm as external auditor.

9.21 Where one part of an audit agency provided a consultancy to a client, for example, on the design of a financial management system, and later another part of the audit agency audited that same system, then the audit agency would be indirectly auditing itself. In those circumstances, the auditor would have a conflict

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9. In future, the DOF's Financial Management and Improvement Branch may offer such advice. Of note, however, is the reluctance of many Budget-dependent agencies to turn to the DOF for advice when they must negotiate with the latter over Budget bids. The Development Consultants group within the Public Service Commission has a limited capacity to organise consultancies on some topics.



of interest and the opinion on the financial statement may be constrained. Audit firms responded to this scenario by pointing out that they constructed a 'Chinese wall' between audit and the consultancy sections of the firm<sup>10</sup>, which meant that those two sections of the accountancy firm did not exchange information about the client likely to reduce the integrity of advice any part of the firm may provide to clients. They argued that this reduced the risk of compromise of the audit opinion.

9.22 A relevant fact is that the importance to accounting firms of income from activities other than auditing has increased in recent years. For instance, for the auditors of the 100 largest listed companies on Australian stock exchanges, the proportion of total fees derived from auditing declined from an average of 79 per cent in 1982 to an average of 72 per cent in 1986<sup>11</sup>. Over the same period, the greatest increase in income was in other fees which increased by 105 per cent compared with a 42 per cent increase in fees from auditing. Companies are free to purchase these services from accounting firms other than their auditors.

9.23 The Committee believes that maximum protection of the audit opinion is necessary where Government agencies are concerned.

9.24 The Committee recommends that:

- . A condition of the award of a contract by the Auditor-General to a private audit firm be that the latter offers no other services to the auditee during the life of the audit contract.

9.25 This is standard practice in at least one other state, Victoria. This in no way would prevent the auditee from purchasing separately from another firm any of the range of consultancies available<sup>12</sup>.

9.26 The Committee recommends that:

- . The Auditor-General should not develop other specialities permitting the Audit Office to

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10. Minutes of Evidence, Joint Committee of Public Accounts, Reform of the Australian Audit Office, 1 July 1988, p. 850.

11. Craswell, op. cit.

12. Two recent court judgments have fundamentally altered the accepted relationship between independent experts and their corporate clients in the private sector. The Phosphate Co-operative Company of Australia Ltd v Shears and Anon. (No. 3) (1988) 14 ACLR 323; (1988) 6 ACLC 1046. ANZ Nominees Pty Ltd v Wormald International Ltd (1988) 13 ACLR 698; (1988) 6 ACLC 780. Stephen Bartholomeusz, 'Independent expert reports must now be just that', The Age, Friday 28 October 1988, p. 19.

operate as a consultant in fields such as:

- . human resource management,
- . financial management,
- . taxation,
- . investment advice, or
- . computer systems,

except where these areas are developed as a result of evolution of the audit task.

9.27 Were the Auditor-General to develop a consultancy arm, resources would be directed from his primary responsibility to audit. Use of computers in financial systems is one area where the AAO has considerable expertise and where the Office has and should continue to provide assistance to auditees. It is an instance of where the Office developed expertise as an ancillary to audit. Consultancies provided as part of the audit function are acceptable but those provided otherwise are not. Judgement must be exercised on the boundary between the two.

9.28 Government agencies are free, in general, to obtain such services from where they choose, which could be within or outside the public sector. It is important that commercially oriented government organisations have the capacity to purchase the best advice on which to make commercial decisions, and they should seek such advice.

9.29 Adoption of the above recommendations will not lead to any reduction in the capacity of these organisations to obtain advice, whether the source of that advice be inside or outside the public sector. However, adoption would give greater weight to the accountability of these organisations than to any efficiency gains arising from the external auditor also providing paid advice on other matters, such as financial management or taxation.

## **Audit Standards**

9.30 U.S. federal agencies contract directly with non-federal auditors, who are mostly certified public accountants, CPAs, to audit many of the \$120 b. a year the Federal Government spends on domestic assistance programs.

9.31 A recent General Accounting Office, GAO, study in the United States surveyed the quality of audits undertaken by CPAs on contract to the Federal Government. It concluded that many



governmental audits did not comply with professional standards<sup>13</sup>. Specifically, the GAO reported that:

- . CPAs did not satisfactorily comply with standards on 34 per cent of the governmental audits they performed, making audit reports less useful in ensuring that federal funds were used for authorised purposes;
- . more than half of the unsatisfactory audits had severe standards violations;
- . CPAs' two problems in performing governmental audits were insufficient audit work, first, in testing compliance with governmental laws and regulations, and second, in evaluating internal accounting controls, including controls over federal expenditures; and
- . smaller CPA firms had greater difficulties than larger CPA firms in satisfactorily complying with standards.

9.32 No evidence was presented to the Committee to indicate that there were problems in the conduct of audits contracted out by State Auditors-General in Australia. However, this may have been more a reflection of the paucity of analysis of public sector audit than it was of the absence of a problem. Audits contracted out by Commonwealth Auditors-General were so few in number and so select that few problems were encountered there. It is unclear what would happen, however, if there were sudden growth in the numbers of contracted audits at federal level in Australia.

9.33 The Committee recommends that:

- . The Auditor-General monitor the quality of contracted audits.
- . The Auditor-General sponsor education and information programs in public sector audit with professional accounting bodies, audit firms and tertiary education institutions.

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13. United States General Accounting Office, Report to the Chairman, Legislation and National Security Subcommittee, Committee on Government Operations, House of Representatives, CPA Audit Quality: Many Governmental Audits Do Not Comply With Professional Standards, USGAO, March 1986.





## Chapter 10

### AUDIT OF SPECIFIC PURPOSE GRANTS TO STATE AND TERRITORY GOVERNMENTS

10.1 Commonwealth Governments of all persuasions make specific purpose grants to the States under section 96 of the Constitution. In regard to audit, the Auditor-General has no effective jurisdiction after the Commonwealth has made a grant to State governments. Commonly, what occurs is that the Commonwealth Government department or agency, as part of its program design, inserts a clause in an agreement with State government agencies requiring the State Auditor-General to audit the use of Commonwealth finance by that State government agency, or by local government or community organisations within the State.

10.2 Approximately \$11b. in Commonwealth payments to the States were made as specific purpose grants to the States and Territories in 1988-89. Information provided to this inquiry by the Department of Finance suggested that audit certificates were required by Commonwealth departments from State and Territory Auditors-General for approximately \$2b. in specific purpose payments. A Department of Finance list of specific purpose programs for which such State or Territory audit certificates were required is in Table 10.1. At time of writing, no information was available from the Department of Finance on audit arrangements for the remaining \$9b. in Commonwealth funds.

10.3 The Chairman of the Commonwealth Grants Commission, Mr Justice Else-Mitchell, has pointed to the major problems of accountability associated with tied grants or specific purpose payments which require a State as the recipient of a grant to comply with conditions prescribed by the Commonwealth on expenditure of the funds granted<sup>1</sup>. This was particularly the case with payments which were not channelled through a State's consolidated revenue fund or some similar budget account.

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1. Else-Mitchell, R., Robson, K., Achieving Financial Accountability in a Federal System, Occasional Paper No. 43, Centre for Research on Federal Financial Relations, The Australian National University, Canberra, 1987.

**TABLE 10.1**

**Section 96 Grants For Which Audit Certificates Are Required From State or Territory Auditors-General<sup>1</sup>**

1. Australian Bicentennial Road Development Trust Fund, Department of Transport and Communication.
2. Australian Land Transport (Financial Assistance) Act 1985, Department of Transport and Communication.
3. Bovine Brucellosis and Tuberculosis Eradication Campaign, Department of Primary Industries and Energy.
4. Coal Freight Rate Efficiency Scheme (Payments to NSW).
5. Community Employment Program, Department of Employment, Education and Training.
6. Federal Water Resources Assistance Program, Department of Primary Industries and Energy.
7. Interstate Road Transport Act 1985, Department of Transport and Communication.
8. Joint Commonwealth - State Rehabilitation Centre, Northern Territory, Department of Social Security.
9. Natural Disaster Relief Arrangements, Department of Finance.
10. Local Government (Financial Assistance) Act 1986, Department of Immigration, Local Government and Ethnic Affairs.
11. Petroleum Products Freight Subsidy Scheme, Department of Primary Industries and Energy.
12. Railway Agreement (WA) Act 1961, Department of Transport and Communication.
13. Rural Adjustment Scheme, Department of Primary Industries and Energy.
14. Sugar Industry Assistance, Department of Primary Industries and Energy.
15. Torres Strait Fisheries Program, Department of Primary Industries and Energy.

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1. D. Shand to Secretary, JPCPA, 13 December 1988, Attachment J.



10.4 State Auditors-General drew the Committee's attention to the unexpected increase in workload imposed on them through these programs, and identified several other problems. These problems, which highlighted the confused accountability provisions surrounding section 96 grants, are listed below<sup>2</sup>:

- . duplication of audit by Commonwealth and State Auditors-General;
- . State Auditors-General uncertainty over whether their audit certificates should be provided to the Commonwealth Government department funding the program or to the Commonwealth Auditor-General;
- . State Auditors-General being requested to provide audit certificates outside their normal area of competence or jurisdiction. For instance, the Victorian Auditor-General made the point that he was asked to provide certificates on the effectiveness of grants for rural financing including whether or not particular properties were commercially viable<sup>3</sup>. State Auditors-General were also at various times expected by the Commonwealth to audit the accounts of community organisations and lobby and interest groups, which is a task that they would not normally undertake; and
- . Commonwealth requests for much more detailed information from State Auditors-General than the latter were accustomed to provide. An example was given by the South Australian Auditor-General who stated that, for a Commonwealth language program for children in a disadvantaged area, the Commonwealth required certification that its grant was spent by teachers in the classroom providing instruction to the particular disadvantaged students eligible for special assistance. Under normal circumstances, the State Auditor-General's responsibilities would have required him to certify only that the education authority received

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2. The United States is another federal political system which has encountered similar problems of the Federal Government needing to know whether its transfer payments to other levels of government were applied as intended by Federal law. The Single Audit Act 1984 was passed by Congress for this purpose. Single Audit Act 1984, Public Law 98-502, October 19 1984, United States Code, Congressional and Administrative News, Vol.2, West Publishing Co, Minnesota, 1984. W Broadus, J Comtois, 'The Single Audit Act: A Needed Reform', Journal of Accounting, April 1985, p.62.
  3. Minutes of Evidence, Joint Committee of Public Accounts, Reform of the Australian Audit Office, Thursday 2 June 1988, p. 503.

and applied the Commonwealth grant<sup>4</sup>. Another instance was of how the New South Wales Auditor-General was expected to provide the Commonwealth Government with certificates for the salaries of Vice-Chancellors<sup>5</sup>;

- . lack of uniformity in Federal audit requirements;
- . the pressure exerted on State accounting systems by requests from Commonwealth departments for more detailed information than they could provide<sup>6</sup>;
- . interruptions to the planned schedule of work of State audit departments though unexpected and unforeseeable Commonwealth demands for audit certificates; and
- . inadequate attempts by Commonwealth agencies to communicate the objectives of programs they funded through the States. Thus, State Auditors-General were often not sufficiently informed about the programs and expenditures they were auditing<sup>7</sup>.

10.5 A combination of these factors has led in the past to some audit certificates from State Auditors-General arriving in Canberra as much as 3 or 4 years late. These programs have included the Wage Pause Program and the Federal Water Resources Assistance Program.

10.6 The Chairman of the Commonwealth Grants Commission has drawn attention to the existence of conditions on many specific purpose grants to the States which were not reported to Parliament in a manner which would enable the accountability of expenditure to be examined at a public level. His review of the administration of these grants led him to conclude that<sup>8</sup>:

The various methods....by which the Commonwealth imposes conditions on section 96 grants do nothing to assist the process of accountability...

10.7 A possible reason for continuation of these problems is the overall lack of emphasis on auditing of Federal departments, agencies and programs. This situation should alter from 1988-89 with the requirement that departments prepare financial statements for audit.

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4. Minutes of Evidence, op. cit., 2 June 1988, p. 510.

5. Minutes of Evidence, Joint Committee of Public Accounts, Reform of the Australian Audit Office, Thursday 21 July 1988, p. 1093.

6. Minutes of Evidence, op. cit., 2 June 1988, p. 502.

7. Ibid., p. 501.

8. Else-Mitchell, R., Commonwealth Payments to the States, Biennial Conference of Public Accounts Committees, Adelaide, July 1985.



10.8 The Department of Finance's awareness of these problems was shown by re-issue of a Finance Direction regarding audit certificates in respect of bodies audited by State Auditors-General. The directive to Commonwealth agencies stated that<sup>9</sup>:

Grants made to bodies which are audited by a State Auditor-General should not be made on the condition that an audit certificate be provided by the State Auditor-General unless special reasons exist and unless the Department of Finance is first consulted as to whether it is appropriate to request such a certificate.

10.9 While the Committee supports the Department of Finance on this matter, it is suspected that additional action is necessary to reduce problems in this area.

10.10 Better tripartite co-operation at Federal level is essential. Draft legislation on specific purpose section 96 grants should be provided to the Department of Finance and the Commonwealth Auditor-General for scrutiny. Particular attention should be given during legislative drafting to the fact that State Auditors-General are not subject to general control or direction by Federal governments.

10.11 The Committee recommends that:

- . The Commonwealth Government provide additional resources to State Auditors-General where, as a result of inter-governmental agreements, they have responsibility for providing to the Commonwealth Government audit certificates on section 96 grants. These additional resources should originate from the section 96 grant and should be determined by negotiations between the granting Commonwealth agency and the State Auditor-General.
- . The Department of Finance and the Commonwealth Auditor-General co-operate to ensure that Commonwealth agencies give more attention to audit requirements at the program design stage.
- . Draft legislation on specific purpose section 96 grants be provided to the Department of

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9. Department of Finance, Finance Directions, 13/17, Department of Finance, Canberra, 1988.



Finance and the Commonwealth Auditor-General for scrutiny.

- . The granting Commonwealth agency consider whether, in the case of Commonwealth grants to State government agencies, a State Auditor-General audit certificate on the financial statement of the State recipient agency would suffice.
- . The Commonwealth Auditor-General explore with State Auditors-General the advantages of joint audits<sup>10</sup>.
- . Where a State or Territory Auditor-General is required to provide an audit certificate to a Federal agency, there be a requirement in the related Federal - State agreement to provide the audit certificate by a specified date or within a specified period.
- . Commonwealth grants be made to State government Treasuries rather than directly to State government agencies to provide State governments with a better indication of their agencies' sources of funding and a firmer basis for intergovernmental co-operation.
- . The Commonwealth and State Auditors-General improve the flow of information about problems in audit of section 96 grants to provide early warning of problems.

10.12 The reality is that audits of section 96 grants to the States are impossible without the co-operation of State Auditors-General. For too long it appears that some Commonwealth agencies have taken the co-operation of State Auditors-General for granted. Also, it is very clear that not all Commonwealth agencies have appreciated the limits to the Commonwealth Auditor-General's powers once grants were made. Much can be done within the Commonwealth sphere of influence to reduce these problems and improve accountability. However, it also appears that State government agencies in receipt of Commonwealth funds have not always been conscious of the implications for their Auditors-General of agreements they sign. This is a matter to which the Committee would like to draw attention but which is beyond its jurisdiction in terms of recommendations.

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10. An example of joint Commonwealth - State audits is the audit of the Albury-Wodonga Development Corporation. Minutes of Evidence, op. cit., 2 June 1988, p. 500.

## **PART C**

### **PERFORMANCE AUDITS**





## Chapter 11

### PERFORMANCE AUDITS

#### Origins In The Commonwealth Sector

11.1 Performance audits comprise project and efficiency audits. The Auditor-General has had the authority to undertake project audits since earliest times. Section 54 of the Audit Act defines project audits and gives him that authority as follows:

The Auditor-General may in a report under section 11A or 51, or in any special report which he may at any time think fit to make, recommend any plans and suggestions for the better collection and payment of the public moneys and any improvement in the mode of keeping the public accounts, and generally report upon all matters relating to the public accounts, public moneys and stores, and such plans and suggestions shall be considered and dealt with by the Minister.

11.2 Section 2(4) defines efficiency audits as:

(a) an examination of the functions performed by, and the operations carried on by, the body or person for the purpose of forming an opinion concerning the extent to which those operations are being carried on in an economical and efficient manner; and

(b) an examination of the procedures that are followed by the body or person for reviewing operations carried on by the body or person, and an evaluation of the adequacy of those procedures to enable the body or person to assess the extent to which those operations are being carried on in an economical and efficient manner.

11.3 The Royal Commission on Australian Government Administration, RCAGA, recommended in 1976 that efficiency audits

should be conducted within the Commonwealth sector<sup>1</sup>. Efficiency audits were introduced by the Royal Commission in the following words<sup>2</sup>:

If ... departmental managers are to be given a clearer responsibility for their managerial functions and greater freedom and discretion to perform, then it will be the more important that the quality of their performance should be subject to critical review. The Commission proposes, therefore, that there should be a regular program of efficiency audits in which departmental performance will be assessed. These assessments should be so designed that they would bring before ministers, Cabinet and Parliament both the assessment itself and the data on which it is based. Such a presentation would, at least to some extent, make the assessment open to public examination and comment. It would also clearly establish the primacy of political responsibility for administrative efficiency, including not merely that of the minister and Cabinet but also that of Parliament.

11.4 The Royal Commission's justification for efficiency audits is as valid in 1989 as it was in 1976<sup>3</sup>. First, therefore, the Committee wishes to state its belief in the importance of efficiency audits in maintaining a responsive and effective Commonwealth sector. The Committee has also recognised that there are other avenues, such as program budgeting and evaluation, to improve public service efficiency not adopted ten years ago when efficiency audits were introduced.

11.5 It was argued by the Royal Commission that an authority independent of departments and of Treasury and the Public Service Board was needed for this task. The Department of Finance now has responsibility for the Treasury's previous duty of oversight of departments' forward estimates, and the Public Service Board no longer exists. The Royal Commission decided that the Auditor-General should be given responsibility for efficiency audits and the Government accepted this recommendation. The Royal Commission's recommendations led to the 1979 amendments to the Audit Act which gave the Auditor-General responsibility for their conduct<sup>4</sup>.

11.6 The Auditor-General should continue to have responsibility for efficiency audits. His independence gives him great advantage over other agencies and avoids conflicts of

1. RCAGA, op. cit., Ch.3.

2. Ibid., p. 46.

3. J Glynn, The Department of Performance Auditing in Australia, ANU, Canberra, 16 September 1987.

4. Audit Act 1901, Part VI, Division 2.

interest which may exist were an agency of the executive arm of government to be given this role. Further, his statutory independence bestows his reports with credibility. Second, the Auditor-General has unique powers of access to the records of Commonwealth bodies which are stronger than the powers of any other office holder. These access powers will become more important as the Auditor-General starts to report on performance indicators. A third reason is that organisational efficiency can be assessed in terms of the efficiency of financial management. The Auditor-General is responsible for financial audits, which are a foundation for reviews of administrative efficiency. This is not to suggest that efficiency audits should only deal with financial issues.

11.7 The Committee recommends that:

- . The Auditor-General continue to have responsibility for efficiency audits.

11.8 Efficiency audits were first reviewed in 1983<sup>5</sup>. On that occasion, an Interdepartmental Committee found that the introduction of efficiency units had been of value. In particular:

- . efficiency audits provided a valuable addition to the means of scrutiny of the administration available to Parliament;
- . they had identified administrative efficiencies and inefficiencies;
- . their presence acted to re-emphasise the importance of efficient and sound administrative practices in the minds of departmental managers; and
- . they were a catalyst in promoting streamlined and improved management practices in audited departments.

11.9 The Interdepartmental Committee concluded that efficiency audits should be retained but that the benefits would be greater and shortcomings reduced if the following changes were introduced:

- . they were focused on a well-defined administrative function;

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5. Report of the Inter-Departmental Committee Established To Review The Process of Efficiency Audits, Department of Prime Minister and Cabinet, Department of Finance, Public Service Board, 1983.



- . they were undertaken quickly so that timely and relevant reports were presented with clearly specified recommendations;
- . they were concerned only with program efficiency and did not encroach on policy considerations; and
- . they were followed-up quickly, not only externally by Parliamentary review processes but also by relevant departments.

11.10 The current Public Accounts Committee agrees with those recommendations. However, it was evident to this Committee that further evolution of efficiency audits was desirable. At least three other Parliamentary Committees concluded similarly. For example, the former House of Representatives Expenditure Committee conducted hearings on the efficiency audit process, although a report was not completed because of the dissolution of Parliament. The Expenditure Committee and the current House of Representatives Standing Committee on Finance and Public Administration have reviewed all efficiency audits of the Australian Taxation Office<sup>6</sup>. Of note is that the Senate Standing Committee on Finance and Government Operations has reviewed the entire efficiency scrutiny process<sup>7</sup> (about which more will be said later). However, this PAC report is the first public review of efficiency audits since they were introduced in the 1970s.

11.11 Only a minority of the 52 efficiency audits completed since their introduction in 1979 have been criticised by Parliamentary committees. However, those that have been criticised have been discussed in strong terms. Examples of efficiency audits which have been criticised by Parliamentary committees include:

- . Australia Post - An Audit Discontinued, September 1986<sup>8</sup>;

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6. A Taxing Problem. Review of Five Auditor-General's Efficiency Audit Reports into the Australian Taxation Office, Report from the House of Representatives Standing Committee on Expenditure, AGPS, Canberra, 1986.  
A Taxing Review. Review of Six Efficiency Audits of the Australian Taxation Office, Report of the House of Representatives Standing Committee on Finance and Public Administration, AGPS, Canberra, 1988.
  - A Tale of Three Cities. A Review of an Efficiency Audit of the Australian Taxation Office: Taxpayers in Unincorporated Businesses, Report of the House of Representatives Standing Committee on Finance and Public Administration, the Parliament of the Commonwealth of Australia, Canberra, 1988.
  7. Senate Standing Committee on Finance and Government Operations, Review of the Efficiency Scrutiny Program, (forthcoming).
  8. Joint Parliamentary Committee of Public Accounts, Australia Post - An Audit Discontinued, Report 250, AGPS, Canberra, 1986.

- . Review of Efficiency Audit - Australian Wool Corporation Property Operations, October 1987<sup>9</sup>.
- . Management of the Main Battle Tank. Who was Outgunned? May 1984<sup>10</sup>; and
- . An Efficient Organisation, Or An Efficient Audit? Review of the Auditor-General's efficiency audit report into construction project management practised by the Department of Housing and Construction, February 1987<sup>11</sup>.

11.12 Overall, however, there is no doubt that Parliamentary committees eagerly await the arrival of efficiency audit reports.

11.13 With these Parliamentary perspectives in mind, discussion will proceed as follows. Attention will be given to:

- . major achievements of efficiency audits;
- . the distinction between efficiency and project audits;
- . the need for new legislation;
- . reducing the costs of efficiency audits;
- . efficiency audits and the Efficiency Scrutiny Unit process;
- . the skills required for performance audits;
- . audits of program evaluation plans;
- . selection of topics;
- . relationships with auditees; and
- . reporting to Parliament.

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9. Joint Parliamentary Committee of Public Accounts, Review of Efficiency Audit - Australian Wool Corporation Property Operations, Report 282, AGPS, Canberra, 1987.
  10. Management of the Main Battle Tank. Who Was Outgunned? Report from the House of Representatives Standing Committee on Expenditure, AGPS, Canberra, 1984.
  11. An Efficient Organisation, Or An Efficient Audit? Review of the Auditor-General's efficiency audit report into construction project management practised by the Department of Housing and Construction, Report from the House of Representatives Standing Committee on Expenditure, AGPS, Canberra, 1987.

11.14 Performance audits of statutory authorities, government business enterprises and companies will be discussed in the next Chapter.

### **Major Achievements of Efficiency Audits**

11.15 Efficiency audits have recommended major improvements and reforms in Commonwealth management and administration in the following areas:

- . the Australian Tax Office;
- . Commonwealth administration of nursing home programs;
- . Australia's bilateral overseas aid program;
- . collection of excise duties;
- . administration of the offsets policy;
- . the Australian Wool Corporation's property operations;
- . management of the Defence, Science and Technology Organisation;
- . administration of capital grants to non-government schools; and
- . the Department of Defence's principles and procedures for the storage and handling of explosives.

11.16 Efficiency audits have also suggested significant cost savings in many areas including:

- . collection of sales tax by the Australian Taxation Office;
- . administration of Widows Pensions and Supporting Parents Benefits;
- . control over manpower and property by the Overseas Telecommunications Commission;
- . processing and assessment of income tax returns;
- . management of the Australian Army's principal equipment assets;



- . the Community Employment Program; and
- . administration of public hospitals in the ACT.

11.17 Efficiency audits have also prescribed increased government outlays in order to overcome administrative deficiencies. For example:

- . purchase of new computers by the Australian Taxation Office;
- . repair and maintenance of Commonwealth assets;
- . the Department of Resources and Energy collection of offshore petroleum royalties and excise; and
- . storage and handling of explosives by the Royal Australian Air Force.

11.18 More detailed information is in Appendix 8.

11.19 One is struck by the range of issues addressed in efficiency audits.

## Efficiency And Project Audits

11.20 Efficiency and project audits are part of a broader category called performance audits, which are defined by the International Organisation of Supreme Audit Institutions, INTOSAI, as follows<sup>12</sup>.

Performance audit: an audit of the economy, efficiency and effectiveness with which the audited entity uses its resources in carrying out its responsibilities.

11.21 Table 11.1 provides data on which kinds of government organisations have had efficiency audits. Appendix 7 lists efficiency audits completed by 31 December 1988.

11.22 Efficiency audits have evolved since their introduction. They were initially conducted within a separate division of the AAO. This was later disbanded and staff located within divisions responsible for regularity audits. At first,

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12. INTOSAI Auditing Standards, op. cit.

TABLE 11.1

Efficiency Audits By Type of Auditee, 1979-1988<sup>1</sup>

Type of Auditee	Number of Efficiency Audits <sup>2</sup>
Departments	23
Departmental Outriders	22
Statutory Authorities	3
Government Business Enterprises	4
Companies	0
Total	52

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1. E Hay to P Nicoll, JPCPA, 24 November 1988.

2. This list was current to 31 December 1988. Fifty efficiency audits, including 21 of departments, were completed by 30 June 1988.

staff were recruited to work on efficiency audits. This was followed by the expectation that AAO staff should be able to conduct both performance and regularity audits. Now there seems to be some movement within the AAO towards a separate recruitment and career structure for performance, specifically efficiency, audit staff.

11.23 The AAO itself has sought to streamline the efficiency audit process and to reduce costs. One way would be to select smaller, discrete topics for audit. However, this would leave the Audit Office open to challenges that it missed 'the big issues'.

11.24 In turn, efficiency audits have become subsumed within comprehensive audits. The Audit Office refers to comprehensive auditing as auditing which looks to legal compliance and financial regularity as well as to managerial effectiveness and efficiency. These topics may be addressed in a single audit or in separate audits<sup>13</sup>.

11.25 Efficiency audits are conducted under section 48 of the Audit Act, while project audits are executed under section 54 or section 63G<sup>14</sup>.

11.26 Efficiency audits are distinguished from project audits by the former's greater magnitude, complexity and significance of the subject matter<sup>15</sup>. Notwithstanding, some project audits are large and complex. Examples of large project audits include:

- . Fleet Underway Replenishment Ship - HMAS Success.  
An audit of Department of Defence management of

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13. Australian Audit Office, General Audit Manual, AAO, Canberra, 1988, Chapter 5.

14. Section 48C (1) of Division 2 states that:  
'The Auditor-General may carry out, at such intervals as he thinks fit, an efficiency audit of all or any of the operations -  
(a) of a Department;  
(b) of a public authority of the Commonwealth; or  
(c) of a Commonwealth organisation.  
Section 54 is stated at the commencement of this Chapter.  
Section 63G states that:  
'The Auditor-General shall inspect and audit the accounts and records of financial transactions of the authority and records relating to assets of or in the custody of, the authority, and shall forthwith draw the attention of the appropriate Minister to any irregularity disclosed by the inspection and audit that is, in the opinion of the Auditor-General, of sufficient importance to justify his so doing.'

15. AAO, General Audit Manual, op. cit., 7.15.



the project including definition and design aspects and the contractual and production stages of the project.

- . Basic Pilot Training Aircraft. A review of the effectiveness of Department of Defence management of the project.
- . Systems for the Detection of Fraud and Overservicing by Medical Practitioners. Audit examined the procedures adopted by the Department in implementing the surveillance and investigation program.
- . Direct Credit of Pensions and Allowances to Financial Institutions, Department of Social Security.

11.27 Project audits can arise from financial or regularity audits or they can be small efficiency audits. Their dual origins are complications in their classification.

11.28 In 1986-87 and 1987-88 respectively, the Audit Office allocated 21 per cent and 11 per cent of its resources to project audits. Seven per cent of its resources were for efficiency audits in 1986-87 and 6 per cent in 1987-88<sup>16</sup>. Clearly, the emphasis on resource deployment for performance audits was on project audits, while most auditee attention and criticism was on efficiency audits. As explained in an earlier chapter, the major reduction in resources for project audits experienced between 1986-87 and 1987-88 was due to the Auditor-General's need to find more resources for the increasing amount of regularity audit work. Regularity audits were mandated while project and efficiency audits were conducted at the Auditor-General's discretion.

11.29 For various reasons, project audits tend to be overlooked or even forgotten as a source of Commonwealth sector scrutiny and renewal. The Committee believes that this is regrettable and seeks to draw more attention to them.

11.30 The Committee recommends that:

- . The Auditor-General list project audits in his annual report to Parliament.

11.31 The major difference between the two kinds of performance audit is in the legal requirements surrounding

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16. Chapter 3, Table 3.8.

efficiency audits compared with the relative simplicity of initiation, conduct and reporting of project audits. Efficiency audits are tabled in Parliament in separate volumes and are allocated to Parliamentary committees for scrutiny and possible action.

11.32 The 1979 legal provisions surrounding efficiency audits which cover several pages in the Audit Act, permitted the Auditor-General to conduct his first efficiency audits of certain Federal agencies, statutory authorities and government companies. Thus, for example, after 1979 the Australian Taxation Office was subjected to efficiency audits for the first time. The Audit Act also permitted efficiency audits of government companies, although these audits are conducted only at the request of the minister whose portfolio encompasses the company. No efficiency audits have been conducted of government companies at the behest of ministers. Notwithstanding, it is important that this legislative provision remain because new accountability provisions for government companies outlined in the Government's October 1987 White Paper on 'Policy Guidelines for Commonwealth Statutory Authorities and Government Business Enterprises' emphasise ministerial responsibility.

11.33 Project audits are mentioned alongside regularity audits in the Auditor-General's March and September reports to Parliament on audits completed in the previous period. Efficiency audits are reported separately.

11.34 Both kinds of performance audit have made useful contributions to improved Commonwealth sector efficiency and effectiveness and should continue to do so under any new arrangements.

## New Legislation

11.35 Should the distinction between project and efficiency audits remain? In answering this question, reference was made to the Auditor-General's submission to the Royal Commission on Australian Government Administration<sup>17</sup> and to the Royal Commission's report. Neither document gave much attention to project performance audits, and neither commented on the future of project audits were efficiency audits to be introduced (which, of course, they were). No information was available on the number of project audits completed or resources allocated to project audits before or in 1979, the year in which the Auditor-General was empowered to undertake efficiency audits, or in 1980, the year

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17. Auditor-General, Submission by the Auditor-General to the Royal Commission on Australian Government Administration, An Examination of Proposals for Extending the Role and Activities of the Auditor-General, and of Related Concepts, to Improve Efficiency in All Government Areas, Auditor-General's Office, Canberra, October 1974.



after. Therefore, it was not possible to determine whether more performance audits were completed before the 1979 amendments or whether more resources have been allocated to performance audits since efficiency audits were introduced.

11.36 The Committee believes that, since the major differences between project and efficiency audits are in the size and complexity of the problems addressed, there is less reason than in 1979 (when efficiency audits appeared as radical innovations) for separate efficiency audit legislation.

11.37 The Committee recommends that:

- . New Commonwealth audit legislation maintain the Auditor-General's authority to:
  - . undertake large and small performance audits;
  - . access Commonwealth departments and other agencies;
  - . report the results of performance audits.

11.38 It should be noted that (2) and (3) in the above recommendation are provisions which apply to regularity audits as well. Therefore, one set of provisions covering (2) and (3) and applying to regularity and performance audits would suffice in any new legislation.

11.39 As discussed elsewhere in this report, there is a need to state unequivocally that the Auditor-General is not entitled to question government policy objectives<sup>18</sup>. Revision of the legislation must take this into account in drafting new clauses on performance audits.

11.40 Canada's Auditor-General Act provides a good example of simply and concisely written audit legislation<sup>19</sup>. Under the heading 'Duties', the Act states that each report of the Auditor-General shall call attention to anything that he considers to be of significance and of a nature that should be brought to the attention of the House of Commons, including any cases in which he has observed that -

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18. This matter is discussed further in the next chapter.

19. Report of the Auditor-General of Canada to the House of Commons, Fiscal Year Ended 31 March 1987, Appendix A, Auditor-General Act 1977, Minister of Supply and Services, Canada, 1987.



7(d) money has been expended without due regard to economy or efficiency; or

(e) satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented.

11.41 Fears have been expressed that a possible consequence of the suggested simplification of performance and regularity auditing legislation would be that, henceforth, the Audit Office must proclaim all project audits as efficiency audits. If this were the case, project audits might become as lengthy, formal and as costly as efficiency audits, thereby further reducing the number of performance audits undertaken. The Committee believes that this is unlikely to happen. What is intended to occur is that project audits would be lifted out of the shadow of efficiency audits, and that both would be accepted more widely as performance audits. From this perspective, the most important difference (but not the only difference) within the category of performance audits would be the size of performance audits.

## Reducing the Costs of Efficiency Audits

11.42 Evidence was given that legal requirements governing efficiency audits lengthened their duration<sup>20</sup>. Therefore, the various procedures associated with both sets of performance audits were examined to determine how their execution could be improved. If economies could be made in either kind, then more resources would be free for other audits. Table 11.2 sets out the major steps involved in project and efficiency audits.

11.43 The main differences between the two types of audits were as follows:

- . in general, efficiency audits varied from 1000 - 5000 hours while project performance audits varied from 100 - 1000 hours;
- . efficiency audit teams had higher ranking staff than project audit teams. Division and Branch heads were more involved in efficiency audits;

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20. Minutes of Evidence, Joint Committee of Public Accounts, Reform of the Australian Audit Office, Thursday 8 September 1988, p. 1151.

**TABLE 11.2**

**Major Steps in Project and Efficiency Audits**

Project Audits	Efficiency Audits
1. Topics selected on basis of factors listed in (1) below.	1. Topics selected on basis of factors listed in (1) below. An efficiency audit may also develop from a project audit.
2. AAO plan of proposed audit's objectives, resources and methodology.	2. AAO interview with auditee.
3. AAO interview with auditee.	3. Preliminary diagnostic study of proposed subject matter of audit (AAO Auditing Standards, 3.2.3.8.).
4. Audit field work.	4. AAO decision to proceed or not to proceed with an efficiency audit.
5. Progressive AAO - auditee meetings.	5. AAO management plan of proposed efficiency audit's objectives, resources, and methodology.
6. AAO exit interview with auditee.	6. Opening AAO interview with auditee to communicate the audit plan.
7. AAO drafts management letter incorporating comments from exit interview.	7. Audit field work.
8. Auditee response to management letter prepared,	8. Progressive AAO - auditee meetings.
9. AAO report revised if necessary.	9. AAO draft discussion paper in form of the findings and recommendations sections of an <u>Audit Act</u> Section 48F3 report.
10. Audit report completed.	10. Exit interview using as the agenda item the discussion paper in (a) above.
	11. Formal auditee response to draft report.
	12. AAO incorporates auditee's responses in draft report.
	13. Final AAO report to auditee who has 28 days to respond.
	14. AAO considers auditee comments, and revises draft report if necessary.
	15. Audit report tabled in Parliament.
1. A decision on whether a project or efficiency audit will be undertaken depends on the proposed audit subject matter's:	
. materiality;	
. risk and sensitivity; and	
. vulnerability to misuse and incorrectness.	

- . efficiency and project audit teams, respectively, had five and three formal meetings with auditees during audits;
- . efficiency audit reports were generally longer than project audit reports;
- . efficiency audits were longer in duration than project audits; and
- . efficiency audits were more costly than project audits. Exact cost differences were unavailable.

11.44 A number of project and efficiency audits were examined more closely to try and explain these differences. The analysis suggested that:

- . cost differences between the two kinds of audits were due to differences between types of problems addressed. Although there was overlap between the two audits in terms of the size of the financial or organisational phenomena audited, in general, the fact that efficiency audits addressed larger and more complex problems led to their higher cost;
- . auditees were more attentive to the conduct of efficiency audits because of the greater magnitude of the problems addressed. More was at stake with efficiency audits than with project audits. Greater AAO auditee interaction led to more drafts of efficiency audit reports;
- . consequently, efficiency audit reports were longer than project audit reports;
- . the practice of providing separate efficiency audit reports to Parliament with a high probability of examination by a Parliamentary committee gave efficiency audits a higher profile. Section 48F(8) gave him the right to make special reports to Parliament. In comparison, project audit reports were not tabled. The higher profile of efficiency audits bestowed greater formality on their execution and reporting; and
- . efficiency audit legislation could be invoked where an auditee opposed a project audit. For example, a previous Auditor-General invoked his powers under the efficiency audit provisions of the Audit Act in order to undertake comparatively small audits which otherwise would have been labelled as project audits. His authority under the legislation was called upon because the Australian Taxation Office, ATO, would not permit



project audits of certain aspects of the ATO's operation.

11.45 One viewpoint expressed to the Committee was that efficiency audits would take less time if the requirement to have separate efficiency audit reports were removed. As indicated earlier, the practice of publishing separate efficiency audit reports was a decision of successive Auditors-General and not of Parliament. Even if the original practice were revised of including findings of efficiency audits in biannual reports without separate efficiency audit reports, it is doubtful whether the greater length and cost of efficiency audits would be reduced substantially. To reiterate, the reason was that their greater duration and cost were more functions of the greater size and complexity of the problems they addressed than they were of legislative requirements.

### **Efficiency Audits and the Efficiency Scrutiny Unit Process**

11.46 One way to reduce the time and cost of efficiency audits would be to adopt the modus operandi of the former Efficiency Scrutiny Unit, ESU. The latter was introduced in September 1986 by the Prime Minister as a major initiative in achieving public sector reform. The Unit, which was directed by David Block and staffed by a total of seven people, was disbanded in 1988<sup>21</sup>.

11.47 Distinguishing features of the analytical and recommendatory processes adopted by the ESU were:

- . Prime Ministerial support;
- . leadership by a prestigious individual;
- . tight deadlines, - scrutinies were conducted in ninety days;
- . responsibility for the entire process from selection of topics to methodology, and for advice on recommendations and their implications;

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21. Department of the Prime Minister and Cabinet, Annual Report, 1986-87, AGPS, Canberra, 1987, pp. 35-38.

- . scrutineers were chosen by the departmental secretary in consultation with the Unit. Scrutineers were usually of branch head or section head level, and were seconded from departments and from the private sector. All scrutineers were trained in basic consultancy skills;
- . co-operation with departmental secretaries who nominated topics for scrutinies;
- . the Unit had an advisory and supportive relationship with departments;
- . reports were brief, no longer than ten pages with a two-page executive summary and were prepared for the minister responsible for the department and for the Prime Minister. Reports were not published; and
- . an action plan was prepared for endorsement by the minister, outlining the recommendations, timetable for implementation and, if any recommendations were rejected, the reasons for their rejection. The action plan was submitted to the Unit, which reported to Cabinet's Expenditure Review Committee.

11.48 Major differences between the AAO's efficiency audits and the ESU's work included:

- . different positions on the spectrum between consensus and conflict. The ESU approach did not engender the same suspicion from departmental secretaries as efficiency audits. Notwithstanding, unease often existed within scrutinised agencies because of the knowledge that the ESU had the Prime Minister's support;
- . their sponsorship. The ESU was part of the executive's attempt to improve public sector efficiency. The Auditor-General is less clearly identified with the executive although also very involved in improving public sector efficiency. His independence from the executive places his office in a more adversarial role than with the ESU;
- . their duration. The longer duration of efficiency audits in comparison with the ESU's reviews was due to the greater likelihood of conflict between auditors and auditees, audit legislation, lesser average experience of the auditors in comparison with the scrutineers, and reporting provisions. Scrutinies were probably less costly than audits because of the former's shorter duration. However,

no formal cost comparisons have been undertaken. It is unclear at this stage whether differences in duration of the two kinds of investigation were because of differences in topics addressed; and

- . openness of their reports to public readership. Efficiency audit reports are:
  - much longer than ESU reports;
  - published - while ESU reports were, in general, not published<sup>22</sup>.

11.49 The preceding analysis suggests that the cost of efficiency audits could be reduced if they were shorter in duration. Some legislative change may be necessary to permit this to be achieved (section 48F).

11.50 The Committee recommends that:

- . The Auditor-General be required to provide a final efficiency audit report within six months of initiation of selected efficiency audits. Further, that this requirement be introduced on an experimental basis for a two year period to determine the effects on resources, selection of topics, and accountability to Parliament.
- . For selected efficiency audits, the Auditor-General consult with the departmental secretary or chief executive officer of the instrumentality to be audited to permit temporary appointment of an auditee staff member or members to the efficiency audit team.

## Skills Required for Performance Audits

### Generalists or Specialists

11.51 A number of auditees used their submissions to criticise the AAO for not including specialist staff in audit teams. The views of two government authorities, the Parliament House Construction Authority and the CSIRO, and two departments of state, the Department of Employment, Education and Training and

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22. Most ESU reports have recently become public (some time after they were completed) because of a Senate Committee on Finance and Government Operations inquiry. That inquiry's report will contain a far more detailed appraisal of the ESU process.



the Department of Primary Industry and Energy, are quoted on this issue.

11.52 The Parliament House Construction Authority, PHCA, criticised<sup>23</sup>:

...The system which requires officers to undertake audits of highly specialised and complex projects without providing on the audit team adequately and appropriately qualified and experienced officers.

The primary concern of the Authority was the AAO's apparent inability and even unwillingness, during the audit of the management of the Parliament House Project to assign to the audit team some officers appropriately qualified and experienced in the fields of project and/or construction management, or other related disciplines.

11.53 In reply to criticisms of its efficiency audit of the Parliament House Construction Authority, the Auditor-General asserted that<sup>24</sup>:

The Chairman... has misunderstood the AAO's position regarding the competence requirements for performance auditors. And he refers to 'professional management and technical decisions' of the Authority and its agents in a context that could imply that all their management decisions involve the exercise of technical judgement by specialist professionals.

If indeed that is intended it is as though I were to say that, because the AAO is managed by professional public sector auditors, no one other than (these) could understand its management systems and procedures and management decision-making processes. Were I to say that, I would speak nonsense. The analogy holds good for other specialist organisations.

More specifically, it will be apparent from a reading of the report that the focus of the audit was on the adequacy of the Authority's management decision-making processes, not its technical judgements.

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23. Parliament House Construction Authority Submission, 5 September 1988.

24. E Hay to Secretary, JPCPA, 13 October 1988.

11.54 CSIRO argued that for audits which went beyond simple compliance, staff with experience in the management of government services were essential<sup>25</sup>.

Many of the issues which arise in technically organisations are complex and difficult to understand. It is frequently found that matters explained at the entry conference and on many occasions during the worse of the audit are still not understood at the time of the exit conference. Misunderstandings of this magnitude can easily find their way into audit reports and generate excessive effort to resolve.

11.55 The Department of Employment, Education and Training's view was that<sup>26</sup>:

...The AAO does not appear to augment its inventory of skills (e.g. with outside consultants, contractors, or seconded officers from other Commonwealth Departments). This sometimes results in important aspects of systems not receiving adequate scrutiny. This augmentation could provide fresh ideas on auditing Commonwealth programs, expand the skills base of the AAO by providing officers with experience in policy formulation, processes and program administration, and facilitate the training of Public Service employees in the requirements and importance of audit and control mechanisms within Departmental systems.

11.56 The Department of Primary Industries and Energy argued that<sup>27</sup>:

To enable full benefit to be gained from the reviews by the AAO it is considered desirable that their review teams include (where appropriate) consultants that are expert in specified fields. It is considered that a generalist auditor is often unable to comment meaningfully on scientific and business aspects.

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25. CSIRO Submission, 15 August 1988.

26. Department of Employment, Education and Training Submission, 22 August 1988.

27. Department of Primary Industries and Energy Submission, 10 August 1988.

TABLE 11.3

Subject Specialty of AAO Staff<sup>1</sup>

Subject Specialty	Staff Replies <sup>2</sup>	Percentage of Staff Replies
Accounting	365	73.4
Economics	66	13.2
Law	20	5.0
Administration	20	4.0
Computers	51	10.2
Politics/Govt	7	1.4
Other	41	8.2
Total	574	100.0

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1. C Monaghan to Secretary, JPCPA, 11 August 1988.

2. 497 or 84.6 per cent of AAO staff responded to the AAO questionnaire. The number and percentage of staff replies were greater than 497 because replies reflected responses of multiply qualified staff.



11.57 On occasion, the Public Accounts Committee has criticised the AAO for lack of expertise in particular areas. For example, the Committee's review of the AAO's efficiency audit of the Australian Wool Corporation's property operations criticised the Audit Office for not presenting a detailed assessment of the relevant property market<sup>28</sup>. The Committee did not believe that the Audit Office had particular expertise in assessing either the market or the economy, and neither did the Committee expect the Audit Office to have such expertise. Therefore, the Committee did not accept that Audit's views were authoritative or based on a professional analysis of the property market.

11.58 Table 11.3 shows the subject specialty of AAO staff. 73.4 per cent were accountancy majors or staff who specialised in accounting in their tertiary studies. Sixty per cent were members of the Australian Society of Accountants or the Institute of Chartered Accountants. The dominance of accounting specialists amongst AAO personnel was a logical reflection of the concentration of AAO effort on financial or regularity audits. There was some evidence to suggest that the professional accountants who are the backbones of the Office's staff preferred regularity to efficiency audits.

11.59 No data were available on the professional experience of AAO staff. Thus, the percentages of staff with experience in program management or financial administration and management were not known. Notwithstanding, it was certainly the perception of many auditees that AAO staff lacked management experience, and that therefore the AAO was limited in its capacity to identify and recommend efficient management practices.

#### The Audit Office Replies

11.60 Previous Auditors-General have replied to these charges in two ways: first, by denying the need to employ subject matter specialists, and second, by employing subject matter specialists. These approaches are examined in turn.

11.61 Classical AAO - auditee interaction over the degree of specialist knowledge necessary for performance audits is contained in the AAO report on the Observations Program of the Bureau of Meteorology<sup>29</sup>. Although the Bureau accepted the major thrust of the audit report and accepted most recommendations:

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28. JPCPA, Australian Wool Corporation, op. cit., p. 14.

29. Report of the Auditor-General upon the Financial Statements prepared by the Minister for Finance for the year ended 30 June 1984. Section 3: Report of the Auditor-General on an Efficiency Audit, Observations Program of the Bureau of Metrology, AGPS, Canberra, 1984.

The Bureau consider(ed)... that the conduct of the audit by a team with no meteorological expertise substantially limited its scope and potential value.

11.62 The Auditor-General replied as follows:

The Audit Office does not concede that one needs to be an expert in meteorology in order to comment validly upon the management of the Bureau of Meteorology. The Office does lay claim to an acceptable level of competence in the auditing of procedures and methods and in measuring whether the taking or avoidance of decisions has followed adequate consideration and has been properly documented. Audit is concerned to determine and report whether these basic requirements have been met, that they have not ... is not to be hidden behind the veils of professional mystique.

11.63 The second course of action has been for the AAO to recruit a specialist consultant for particular audits.

11.64 The AAO gave evidence of consultants being used on four of its 52 efficiency audits, (Appendix 9)<sup>30</sup>:

- . Commonwealth Administration of Nursing Home Programs, 1983;
- . Administration of Public Hospitals by the Capital Territory Health Commission, 1983;
- . Management of the Australian Army's Main Battle Tank, 1983; and
- . The Australian Taxation Office. A Study of International Profit Shifting, 1987.

11.65 Three of the four instances occurred when there was a separate Efficiency Audit Division in the Audit Office. In the four years since the Efficiency Audit Division was disbanded and the work assigned to other Divisions, an outside consultant was employed on only one occasion.

11.66 The debate focuses on the skills necessary to conduct efficiency audits. Should efficiency audits be conducted only by accountants? Can efficiency audits be conducted by other occupational groups? Should efficiency audit teams include persons with a variety of occupational and analytical skills?

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30. C Monaghan to Secretary, JPCPA, 11 August 1988, Attachment 2.



11.67 A justification of the Royal Commission on Australia Government Administration for arguing that the Australian Audit Office should have responsibility for efficiency audits was the Royal Commission's promotion of value for money audits<sup>31</sup>. The Commission argued strongly that more than working to rule was involved in obtaining value for money. The design of the relevant program, the means adopted for its organisation, the pattern of organisation chosen and relationships established with other agencies all influenced the cost of achieving the purposes of a program. The Auditor-General's financial information on auditees was relevant for efficiency audits. Therefore, it was proposed that the Auditor-General should examine efficiency in organisational matters as well as in financial management. In other words, the most useful organisational studies should 'follow the money trail'.

11.68 The Committee does not dispute this view. Efficiency studies are more than financial analyses since they focus on decision - making and procedures adopted by management in particular policies or programs. That is, by their very nature efficiency audits are interdisciplinary.

11.69 It follows that while efficiency audit teams should employ accountants, they should also employ persons with highly developed analytical skills who are not accountants. These staff may have management skills, with skills in the policy or program subject areas, or they may have demonstrated in other ways that they have mastered how to study organisations and programs and provide proper advice.

11.70 Were efficiency audits to be conducted by teams so qualified, there would be two main advantages, as follows:

- . the audit team would be better equipped to focus on how the auditee's efficiency could be improved; and
- . auditees would be more inclined to believe that the efficiency audit (or performance audit) team was properly equipped. It must be conceded that this may have the unintended consequence of raising the degree of conflict surrounding the audit because the auditee would be more convinced that the auditors had the skills to identify problems.

11.71 Both advantages would add to the credibility of efficiency audit reports. The recommendation to broaden the skill base of efficiency audit teams is not meant as a criticism of all AAO efficiency audits. A large majority of these have led to

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31. RCAGA, op. cit., p. 48.



substantial reform either directly as auditees implemented recommendations of audit reports, or indirectly through subsequent inquiries initiated by Parliamentary committees. The recommendation to broaden the skill base of efficiency audit teams is a way of improving the overall impact and acceptance of resultant reports.

11.72 More efficiency audits have been conducted of the Australian Taxation Office than of any other Government agency. Mr Trevor Boucher, the Commissioner of Taxation, in evidence before the Committee, argued that from his experience it was not only helpful but necessary for efficiency audits to be conducted by multi-disciplinary teams<sup>32</sup>.

11.73 National audit offices in Canada, New Zealand, the United Kingdom and the United States all employ more specialists for efficiency or value for money audits than does the Australian Audit Office. Typical of employment trends is the plan by the British National Audit Office to use ten per cent of its resources for value for money audits to employ specialist consultants over the next five years<sup>33</sup>.

11.74 The Committee does not wish to specify what proportion of non-accountants should be employed for efficiency audits. That remains a matter for the Auditor-General's judgement.

11.75 The Committee recommends that:

- . The general principle that efficiency audits be conducted by multi-disciplinary teams be accepted. Further, in conducting efficiency audits, the Auditor-General ensure that a sufficient level of experience and expertise relevant to the audit subject is available to the efficiency audit team.

11.76 This can be done by:

- . recruiting permanent staff from a wider range of disciplinary backgrounds; and
- . employing specialist staff on contracts.

11.77 These specialist staff may be recruited from inside or outside the Commonwealth Public Service.

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32. Minutes of Evidence, Joint Committee of Public Accounts, Reform of the Australian Audit Office, 21 November 1988, p. 1794.

33. National Audit Office, The National Audit Office Corporate Plan for 1989-90 to 1993-94, NAO, London, 1988.

11.78 The Committee envisages that many Senior Executive Service, SES, staff and senior Administrative Service Officers, ASOs, in other parts of the Commonwealth sector who have management and administrative experience have the skills to work on the AAO's efficiency audits. Presently, such officers are more inclined to remain as administrators than as analysts of other people's management. This is a reflection of the lack of incentives for these staff to broaden their professional experience. However, there are ways to overcome this problem to the benefit of efficiency audits, the Audit Office, auditees and staff.

11.79 Numbers of Senior Executive Staff, SES, have fallen in the last few years, meaning a reduction in promotion opportunities for senior ASO staff in particular. Consequently, very large numbers of these staff will remain where they are for years. This stability has advantages since officers have become ever more familiar with their work, but potential disadvantages are considerable including the stagnation and decreased morale associated with repetition of the same work year after year. It is from awareness of this environment that the Committee recommends that secondment to the Audit Office for a limited period to conduct efficiency audits should be explored as a way of diversifying the experience of SES and ASO staff in the Commonwealth sector, while simultaneously broadening the skill base of efficiency audit teams. It is not necessary for seconded officers to be involved in efficiency audits of their "home" agencies although that could occur. Any attempt by departments and other agencies to solve the problem of locating surplus unattached officers by expecting them to be placed with the Audit Office must be discouraged. Audit would retain the resources and thus the authority to recruit on a temporary basis whomever it thought appropriate. Temporary appointment to the Audit Office to work on efficiency audits can be developed as a prestigious career broadening opportunity as it was for those staff recruited for limited periods by the Efficiency Scrutiny Unit.

11.80 The nature of problems addressed in efficiency audits requires the involvement of AAO's SES staff with field work done by SES or ASO personnel. Any increase in the number of efficiency audits will place more demands on SES staff who are already stretched. The alternative of nominating the senior ASO staff member in charge of field work as the responsible auditor is not desirable since ASO auditors would be auditing decisions made by SES level officers. If AAO SES offices are to continue to be identified as the efficiency auditor, then the number of SES positions in the Audit Office must be reconsidered.

## **Audits of Program Evaluation Plans**

11.81 In 1987 and 1988 Cabinet upheld the importance of program evaluation. The Department of Finance has promoted



program evaluation to assist in its resource allocation recommendations. The quality of program evaluation across the Commonwealth sector is patchy because of a lack of technical expertise and because of fear of the results of systematic assessment.

11.82 An important issue is whether the Auditor-General has the legislative authority to evaluate the merits of policies adopted by departments and other government agencies. This issue arose in Committee Hearings during discussion of efficiency audits. The Auditor-General indicated that he did not believe that he had the legislative right to examine Government policy in any field, nor did he wish to do so.

11.83 The Committee accepts that, in principle, the Auditor-General should not comment on government policy. However, in the Committee's view, if an efficiency audit team discovers that a change in government policy has affected a Commonwealth organisation's efficiency, then the Auditor-General may identify this as a factor.

11.84 Another example where it may be appropriate for the Auditor-General to comment is where restrictions on the availability of personnel as a result of a government decision impede program delivery in an audited agency. This points towards two factors:

- . the need for efficiency audits to describe and explain public sector inefficiencies. An efficiency audit contributes if it identifies inefficiencies and it is even more valuable if it explains the reasons why these occurred; and
- . the distinction between commenting on a government's policies in particular programs and commenting on the effects of a government's policies on the agency itself. The former commentary is not appropriate but the latter could be acceptable.

11.85 DOF suspected that the limits of efficiency audits were ambiguous. To overcome this problem, the DOF argued that the efficiency audit role of the Auditor-General should be more explicitly defined, making clear the distinction between the review of administrative effectiveness, which is an Auditor-General responsibility, and review of policy effectiveness, which is the executive's responsibility<sup>34</sup>.

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34. DOF Submission, op. cit., p.3. Such a definition of the Auditor-General's role would require change in the legislation.



11.86 The Audit Office's written submission did not broach this question of the limits of efficiency auditing in regard to improving the effectiveness of the Commonwealth sector. Thus, for instance, the AAO Corporate Plan asserted that the first goal was to improve the economy, efficiency and accountability of the Commonwealth sector<sup>35</sup>. There was no mention in the Plan of any AAO role in improving the effectiveness of public administration. This omission is at odds with some AAO efficiency audit reports which have commented on the appropriateness of auditee measures to determine whether programs have succeeded or failed<sup>36</sup>.

11.87 For example, the AAO drew attention to shortcomings in the success claimed by administrators of the now defunct Community Employment Program, CEP<sup>37</sup>. The CEP utilised more than \$1 billion in Commonwealth funds and was the largest labour market program ever funded by the Commonwealth Government. The audit cast doubt on how satisfactorily the program had achieved its objectives.

11.88 The CEP example dramatised the dangers of program managers being responsible for deriving ways of assessing the success or failure of their programs. The onus for honest reporting places responsibility for program performance where it should be with program managers. However, since there are few kudos for managers reporting a program's limited success or failure, successes are more likely to be found than their opposites. Therefore, there is room for neutral agencies, such as the DOF and the AAO, to comment on managers' evaluation plans. It should be remembered that there is a distinction between auditing and evaluation.

11.89 Section 6 of the National Audit Act in the United Kingdom states that<sup>38</sup>:

The Comptroller and Auditor-General may carry out examinations into the economy, efficiency and effectiveness with which any department, authority or other body to which this section applies has used its resources in discharging its functions.

Sub-section (1) above shall not be construed as entitling the Comptroller and Auditor-General to question the merits of the

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35. Auditor-General, Annual Report 1986-87, op. cit., p.100.

36. For example, Auditor-General, Efficiency Audit Report, Department of Employment and Industrial Relations, Community Employment Program, AGPS, Canberra, 1987.

37. Ibid.

38. National Audit Act 1983, op. cit.

policy objectives of any department, authority or body in respect of which an examination has been carried out.

11.90 The Canadian Audit Act states that the Auditor-General should report whether:

satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented.

11.91 Adoption of similar provisions in Australian legislation would permit the Australian Audit Office to comment on evaluation planning without commenting on the merits of programs and policies. The DOF has emphasised the importance for agencies of evaluation planning in adoption of a thorough approach to resource allocation<sup>39</sup>. Results of evaluations should be considered in determination of budget priorities.

11.92 Program and policy evaluation is at an early stage in many areas of Federal Government activity, and there is a dearth of qualified personnel able to plan and execute evaluations. Meanwhile, the need for dispassionate scrutiny of evaluation plans and evaluation actions is very great. As indicated earlier, a clearer statement of the Auditor-General's and the Audit Office's roles would reduce the constraints on the Audit Office contributing to a more effective public sector while prohibiting the Audit Office from appraising Government policy. Such an arrangement would provide even greater assurance to Parliament of better management and informed resource deployment within the Commonwealth sector.

11.93 The Committee recommends that:

- . Audit legislation state that the Auditor-General must report whether satisfactory procedures have been established to measure and report on the effectiveness of programs.
- . The Auditor-General give priority to development of the capacity to criticise constructively auditees' evaluation plans without commenting on the merits or otherwise of government policies and recruit staff with the skills necessary to analyse evaluation plans and practices.

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39. DOF Submission, op. cit., Attachment, p.34.



## Selection of Topics

11.94 Two observations stand out on the question of selection of topics for efficiency audits:

- . efficiency audits with minimum exception focus on topics within single programs; and
- . topics are selected after minimum consultation with the legislature and executive.

11.95 The Efficiency Scrutiny Unit illustrated the potentiality of broader studies in its cross-department reviews which included:

- . computerisation of personnel records;
- . Fringe Benefits Tax - calculation of liability by departments/agencies;
- . library services in departments' Canberra offices;
- . major purchases of ADP equipment;
- . payment of accounts;
- . travel; and
- . processing of accounts.

11.96 Each of these studies was concerned to improve public sector efficiency in a particular area. Savings to taxpayers from consideration and implementation of these reports was considerable. Similar if not greater cost savings in programs could be made if the Australian Audit Office adopted an equally broad approach to topic selection. This may have the unintended benefit of increasing the co-operation of departmental secretaries since they would not feel as singled out and vulnerable. An example of a possible topic for these cross-department or sector-wide reviews is utilisation of program budgeting data. The practice of issuing special reports on service wide topics has also been followed successfully by the Victorian Auditor-General<sup>40</sup>.

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40. For example, the audit of the Victorian Government's use of motor vehicles. Total Victorian Government investment in motor vehicles was \$170m with operating costs of \$63m. Auditor-General of Victoria, Motor Vehicles, Special Report No. 7, Government Printer, Melbourne, 1987.



11.97 Efficiency audits should continue to include topics which focus on single programs within individual departments or other agencies. There is no shortage of suitable topics within individual agencies.

11.98 The Committee recommends that:

- . The Auditor-General initiate each year a number of efficiency audits spanning more than one program or agency. This focus could coincide with experimentation in audit reports, for example, through release of discussion papers on audit topics.

11.99 This would permit the Auditor-General to contribute towards improvements in the economy and efficiency of public administration in a broader way.

11.100 The second observation refers to how the Australian Audit Office has limited consultation in its selection of topics. On the one hand, the solitary nature of the Auditor-General's decision-making is an excellent manifestation of his independence. He should continue to make the final decisions. However, it is clear that broader consultation with the executive and legislature has the potential to increase both the level of interest in efficiency audits and their impact. In particular, the Committee was surprised to discover that the Department of Finance made very few suggestions to the Audit Office on suitable topics. The Department of Finance has enormous responsibility for the forward estimates part of the Budgetary process. Its responsibility is exercised in intensive discussions throughout the year with Budget-dependent agencies. Efficiency audit reports were used by the Department of Finance's Supply Divisions in their provision of advice on agencies' forward estimates. However, it was a matter of luck as to whether an efficiency audit report was available to aid difficult decisions. The consequence was a loose articulation and under-utilisation of the efficiency audit process in Budgetary decisions.

11.101 This situation could be improved if the Department of Finance's Supply Divisions, who are responsible for advising on each portfolio's estimates, were expected to make suggestions on topics for efficiency audits. The Auditor-General would be under no obligation to accept Finance's suggestions. However, such prior consultation would reduce allegations that efficiency audits often addressed inconsequential problems. The major advantage of non-binding discussions between the Department of Finance and the Audit Office on selection of efficiency audit topics would be greater usage of efficiency audit reports in the Budgetary process. Under these circumstances, follow-up of efficiency audits by the Department of Finance would be more rapid and thorough than at present.

11.102 The Committee recommends that:

- . The Auditor-General and the Secretary of the Department of Finance consult on topics for efficiency audits. Further, the Auditor-General also consult with Parliamentary committees on topics for efficiency audits.

11.103 On occasion, ministers draw to the Auditor-General's attention possible matters for study through efficiency audits. This arrangement should continue. Yet the Auditor-General receives few suggestions from Parliamentary committees on topics for efficiency audits. He would be better advised of Parliament's needs if he received more non-binding suggestions. Chapter 5 discussed this matter at length.

## Relationships With Auditees

11.104 The fact that the Auditor-General's primary obligation is to Parliament, his client, does not mean that he is without obligations to auditees. The question is what are the natures of the latter obligations? Can he provide a service to Parliament and to auditees at the same time? Must auditees' requirements always take second place behind those of Parliament? Is it possible to harmonise the auditing requirements of Parliament and auditees?

11.105 Two extreme answers to these questions were as follows:

1. Parliament is the Auditor-General's client and the Auditor-General is under no obligation to provide any services to auditees; and
2. the primary obligation of the external auditor of any government agency is to the auditee;

11.106 No participant in the debate held to either viewpoint in its extreme form. In general, however, parliamentarians were closer to (1) and auditees were closer to (2). In particular, many government business enterprises and statutory marketing authorities have moved closer to (2) above as a result of legislation establishing them as companies and because of Government initiatives to reduce its controls over their operations<sup>41</sup>.

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41. Reforming Government Business Enterprise, An Address by the Minister For Transport and Communications, Senator Gareth Evans, to the Australian Institute of Management, Canberra, 1 September 1988.



11.107 Successive Auditors-General have interpreted their role as being closer to (1) above. This has contributed to development of an auditing style wherein Audit Office staff have focused on variations in auditees' accounts, records, and financial statements from provisions of the Audit Act and the associated Department of Finance Regulations and Directions. This task has been and will remain critical. However, overall, there is the widespread belief that this focus on variations from legislative requirements has not been matched by a concern with contributing to a solution to auditees' problems. That is, the perception is that fault finding has not been accompanied by advice to auditees.

11.108 An additional contributing factor has been the Audit Office's interpretation of its independence. Traditionally, the Audit Office was reluctant to provide advice and recommendations to auditees because of the belief that, if auditees acted on those recommendations and the Auditor-General subsequently audited the same area, then he would feel inhibited about assessing the situation. Strictly speaking, this may be true. Yet hypothetical advantages arising from creation of an idealised independence must be balanced against the negative consequences of this application of the concept. These negative consequences have often included auditees' frustration with the results of audits, not because the latter were wrong but because, from their points of view, the audits were incomplete.

11.109 Another dimension was that the Audit Office has been reluctant to provide an audit opinion on accounting questions posed by auditees. For example, an auditee may have proposed to record financial transactions in a particular manner in the financial statements, and have telephoned the Audit Office to seek advice on whether this would be acceptable. The common perception has been that Audit Office staff were tardy to respond for fear of compromising independence, and were slow to advise because of the long hierarchy and difficulty in identifying the decision-maker.

11.110 One Government agency seeking a private sector auditor expressed its preferences for a private sector auditor in this manner. It wanted:

Continuing involvement with management in providing timely advice in respect of significant matters arising from the audit, (and) the accounting and financial implications of current and proposed transactions,...

The private sector audit firm provides a high level of senior partner commitment to the client, ensuring speedy response to issues. Generally



management will have the comfort of a 'direct line' to the senior audit partner and this type of communication is vital where completion deadlines are threatened by controversial matters.

11.111 Both the reluctance to provide immediate advice to auditees in advance of preparation of auditees' financial statements, and the reluctance to offer professional advice in audit reports are out of step with modern audit practice. This knowledge is a major factor contributing to the desire of many large and important auditees to replace the Auditor-General with another auditor.

11.112 The Committee believes the Auditor-General's attempt to devolve more responsibility to staff may improve relations with auditees. Under this plan, regional managers would have far more responsibility for the planning and execution of certain audits, and, in some cases, local staff will be more likely to sign audit reports. This will eliminate some levels of review, and give auditees more confidence that the auditors they meet will have more say in preparation of the final audit report. Auditors are more likely to be in the same city as auditees, thereby reducing auditees' criticisms of the difficulty of access to the officers who sign audit reports.

## Reporting to Parliament

11.113 The Auditor-General tables four kinds of reports at different times of year:

- . a report on the financial statements prepared by the Minister for Finance each financial year. This is generally tabled each November;
- . a report on audits to 30 June each year and a report on audits to 31 December. These reports are tabled in March and September, and encompass the results of regularity audits and project audits of a regularity or performance kind;
- . efficiency audit reports which are tabled when they become available throughout the year; and
- . an annual report.

11.114 Separate reporting of efficiency audits is an effective way of drawing to Parliament's attention issues of major importance in public administration. The disadvantage is that the separation of efficiency audit reports from reports on regularity and project audits intensifies fragmentation of knowledge about programs and portfolios. It also complicates the task of priority

setting by the several committees in both Houses of Parliament which have responsibility for studying and reviewing the Auditor-General's reports.

11.115 The Committee recommends that:

- . The main results of efficiency audits be included in the Auditor-General's biannual reports on audits completed in the previous six months.

11.116 Efficiency audit reports would be tabled as separate material supporting the biannual reports. Presently, efficiency audit reports are tabled when they are completed, permitting the Parliament and the public immediate access to the analysis and findings. There is no reason to change this system. Of note is that the first efficiency audits were reported in biannual reports. However, for various reasons, including the need to satisfy the requirements of Parliamentary committees, the practice has developed of publication of separate efficiency audit reports with no mention of them in biannual reports. Of note is that there is no legislative requirement on the Auditor-General to provide separate efficiency audit reports, although the legislation gives him that option (section 48F(8)).

11.117 The requirement to record in biannual reports the major findings of efficiency audits alongside the findings of regularity and project audits would bestow more responsibility on the Auditor-General to identify the most important matters to report while providing Parliament with the information necessary for it to reach its own decision on significant issues.

11.118 It is noteworthy that there have been some steps in this direction since September 1988. Then, the Auditor-General included for the first time in one of his biannual reports an overview which identified audits with good results, auditees which had demonstrated improvements, and audits which required attention. This part of his reports could be developed further.

11.119 Biannual reports to Parliament are divided into sections on:

- . departments; and
- . statutory authorities and companies.

11.120 This reporting division into kinds of auditees has less relevance given the current emphasis in Government policy on re-invigorated ministerial responsibility for statutory authorities and government business enterprises. Government

emphasis on the responsibility of ministers for agencies within their portfolios has never waned. However, the doctrine of ministerial responsibility has been given new life in:

- . Reform of Commonwealth Primary Industry Statutory Marketing Authorities. A January 1986 White Paper;
- . Policy Guidelines for Commonwealth Statutory Authorities and Government Business Enterprises. An October 1987 White Paper; and
- . the Treasurer's May 1988 Economic Statement on Reform of Commonwealth Business Enterprises in the Transport and Communications Portfolio.

11.121 The Committee recommends that:

- . Consistent with ministerial responsibility, audits mentioned in the Auditor-General's biannual reports be grouped and discussed by portfolio.



## Chapter 12

### EFFICIENCY AUDITS OF STATUTORY AUTHORITIES, STATUTORY MARKETING AUTHORITIES, GOVERNMENT BUSINESS ENTERPRISES AND GOVERNMENT COMPANIES

12.1 Table 11.1 in the previous chapter showed that of the 52 efficiency audits completed by the Audit Office:

- . 23 were of departments;
- . 22 were of departmental outriders;
- . 3 were of statutory authorities (SAs);
- . 4 were of government business enterprises (GBEs);
- . none were conducted of companies.

12.2 The Royal Commission on Australian Government Administration (RCAGA), proposed that the Auditor-General's concern with the monitoring of efficiency should extend to all agencies which he audited in respect of financial regularity<sup>1</sup>. The RCAGA recognised that this would bring under examination some statutory corporations and government companies then outside the scope of Public Service Board and Treasury review. In total, the Royal Commission's proposals meant extending efficiency audits to over 100 agencies operating outside the public account with widely ranging purposes, functions, organisation and management. At that time, the Auditor-General was the external auditor of all statutory authorities with one exception<sup>2</sup>, and the external auditor of almost all government controlled companies. That situation has changed.

12.3 As discussed earlier, 1979 amendments to the Audit Act, formulated with the Royal Commission's recommendations in mind, gave the Auditor-General the authority to undertake efficiency

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1. Report of Working Party of Officials on Efficiency Audits, AGPS, Canberra, 1977, p. 24.
  2. The Australian Industry Development Corporation.

audits of departments, SAs and GBEs. No authority was given to the Auditor-General to conduct efficiency audits of government companies except at the request of ministers (section 48C). Since 1976 when the Royal Commission reported, there has been rapid growth in the numbers of SAs and GBEs, and a proliferation of government companies and subsidiaries.

12.4 The Committee believes that the justification for efficiency audits of most statutory authorities, government business enterprises and government companies is the same as for efficiency audits of government departments. The justification is in the need to review the performance of managers and organisations as they are given more functions and discretion where they are not operating in a truly competitive environment. Additional functions and discretion are justified on efficiency grounds. Greater freedom from control by the executive arm of government, no matter what the efficiency gains, does not require a lessening in the accountability of government managers and organisations to Parliament.

12.5 The 1979 amendments upheld these general principles with the exception of efficiency audits of government companies which, as was stated, could be undertaken only with the permission of ministers. Neither the Minister assisting the Prime Minister in Public Service Matters, who gave the Government's response to the Royal Commission's recommendations<sup>3</sup>, nor the Minister for Finance in introducing the 1979 amendments to the Audit Act<sup>4</sup>, explained why the Auditor-General would not be given the authority to initiate efficiency audits of government companies when he was their external auditor. The Committee considered this anomaly alongside auditees' perceptions of efficiency audits.

## Loss of Auditees

12.6 As described in Chapter 7, the Commonwealth Government has given statutory marketing authorities, SMAs, in the Department of Primary Industries and Energy and government business enterprises, GBEs, in the Department of Transport and Communications the right to advise on who should be their external auditor. Organisations which take advantage of the legislation remove their decision-making from the Auditor-General's scrutiny. The majority of these SMAs and GBEs have maintained the Auditor-General as their external auditor for the present, since, at time of writing, one SMA and one GBE had appointed a private audit firm as their external auditor. An

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3. Mr Street, Minister for Employment and Industrial Relations and Minister assisting the Prime Minister in Public Service Matters, 'Efficiency Audits, Ministerial Statement,' Hansard, House of Representatives, 7 November 1977, pp. 2965-2966.
  4. Mr Robinson, Minister for Finance, Audit Amendment Bill 1978, Second Reading, Hansard, House of Representatives, 12 September 1978, p. 824.



increase in the small number of efficiency audits completed in SMAs and GBES would probably accelerate their appointment of private audit firms as external auditors.

12.7 Table 12.1 identifies efficiency audits in SMAs in the Department of Primary Industries and Energy and GBES in the Department of Transport and Communications. The Table shows that efficiency audits have been conducted in only one of the ten SMAs. Two of the six GBES entitled to appoint private audit firms as external auditors have had efficiency audits. Australia Post and Telecom, both of which are required by the Government to maintain the Auditor-General as external auditor, also have had efficiency audits.

12.8 The Auditor-General is in a bind. If he undertakes more efficiency audits of SMAs and GBES, these may seek his replacement by private audit firms which do not undertake unsolicited efficiency audits. Loss of auditees, especially large and important organisations such as those in Table 11.1, is a blow to any auditor. On the other hand, if the Auditor-General does not undertake efficiency audits of these organisations where he believed he should do so, he would not be fulfilling his statutory responsibilities.

12.9 His dilemma is alleviated partially by the necessity of reducing resources for efficiency audits in order to maintain compulsory regularity audits. Therefore, few new efficiency audits are likely to be pursued in the immediate future of organisations listed in Table 12.1. This 'default solution' means that SMAs and GBES will have less reason for opting for external auditors from the private sector.

12.10 A further 'solution' appears from the Government's policy to establish some of these organisations as companies under the Companies Act. Once established, the Auditor-General can undertake efficiency audits only at a minister's request. No minister has ever requested the Auditor-General to undertake an efficiency audit of a government company.

12.11 Because efficiency audits of government companies can be conducted only at the behest of ministers, an Auditor-General who believed that a company required an efficiency audit must first convince the appropriate minister. Existing legislation permits the Auditor-General to approach ministers on such matters. However, other than for an approach to the Prime Minister to audit the Australian Bicentennial Authority, no data are available on the number of occasions Auditors-General have approached ministers with such requests. Nor are there data on the number of ministerial refusals. All that is known is that there has never been an efficiency audit of a government company. The primary reason could be that ministers, in most cases, would not benefit from having an agency for which they were responsible publicly acknowledged as having possible efficiency problems.



**TABLE 12.1**  
**Selected Information on Efficiency Audits in Statutory Marketing Authorities, SMAS, and Government Business Enterprises, GBES, 1979-88**

Type of Organisation	Efficiency Audits	External Auditor
<b>SMAS</b>		
Australian Wool Corp	Property Operations, November 1985	Auditor-General
Australian Wheat Board		Private Audit Firm
Australian Meat and Livestock Corp		Auditor-General
Australian Dairy Corp		Auditor-General
Australian Canned Fruits Corp		Auditor-General
Australian Dried Fruits Corp		Auditor-General
Australian Apple and Pear Corp		Auditor-General
Australian Wine and Brandy Corp		Auditor-General
Australian Honey Board		Auditor-General
Australian Tobacco Board		Auditor-General
<b>GBES</b>		
Australian Post	Philatelic Service, May 1988	Auditor-General
Australian Telecommunications Commission		Auditor-General
AUSSAT	Vehicle Fleet Management, March 1987	Private Audit Firm
Australian Airlines		Auditor-General
Australian National Line		Auditor-General
Australian National Railways Commission		Auditor-General
Overseas Telecommunication Commission	Commission Traffic, March 1988	Auditor-General
QANTAS	Control over Manpower and Policy, September 1984	Auditor-General

12.12 Since the rate of creation of government companies appears to be faster than the rate of creation of other kinds of government bodies, an increasing proportion of the Audit Office's auditees will be outside the scope of efficiency audits. The Auditor-General should draw ministers' and Parliament's attention to the difficulties in ensuring proper accountability in such circumstances.

12.13 It is obvious that there are severe constraints on the capacity of efficiency audits to examine the efficiency and effectiveness of commercially oriented government organisations. A relatively small number of efficiency audits has been undertaken in this area and the Auditor-General is not permitted by legislation to initiate efficiency audits of certain categories of these organisations.

12.14 For other categories of commercially oriented organisations, particularly those of strategic importance to the nation's transport and communications systems and other organisations essential for export of Australia's agricultural production, a decision to initiate an efficiency audit may lead to loss of valued auditees. There would be further effects from loss of auditees such as: first, the Department of Finance would then make a corresponding reduction in the Audit Office's resources, and second, the Audit Office's loss of prominent auditees would make it more difficult to attract quality staff. Some project audits have been completed of these organisations.

12.15 The Committee recommends that:

- . The Auditor-General publish in his annual report details of all or any instances of a Minister refusing the Auditor-General's request to conduct an efficiency audit of government instrumentalities where such permission is required.

12.16 The Committee has recognised elsewhere in this report that the need for an efficiency audit of a company which is subject to a truly competitive environment is far less likely to arise than where such pressures do not apply.

12.17 The Committee further recognises that the Auditor-General's competing priorities will rarely result in efficiency audits being conducted of government companies subject to market forces. However, the Committee believes that the determination of whether an efficiency audit should be conducted should be a matter for the Auditor-General and recommends that the section 48C of the Act be amended accordingly.

12.18 The Committee is rather concerned that the definition of 'eligible incorporated company' is excessively narrow in that it is limited to circumstances where the incorporated company is one over which the Commonwealth is in a position to exercise control. Such a definition excludes a company which is incorporated at the intention of the Commonwealth and which receives the majority of its funding from the Commonwealth but which for some public policy reason has a representative board of directors in which Commonwealth representatives are in a minority. An example is the Australian Bicentenary Authority, ABA, which was incorporated at the behest of the Commonwealth, performed important national functions and which received the majority of its funds from the Commonwealth. The Auditor-General did not have power under the 1979 Amendments to conduct an efficiency audit of the ABA without the permission of the ABA or the Minister.

12.19 The Committee believes that the Audit Act should be amended to ensure that such eligible incorporated companies can be the subject of an efficiency audit at the Auditor-General's discretion.

12.20 The Committee recommends that:

- . Section 48C of the Audit Act 1901 be amended to permit the Auditor-General to conduct an efficiency audit of an eligible incorporated company without a minister's permission. Further, the definition of eligible incorporated company be amended to give effect to the Committee's concerns that the current definition excludes a company which is incorporated as an initiative of the Commonwealth and which receives the majority of its funding from the Commonwealth but which for policy reasons has a board of directors on which Commonwealth representatives are in a minority.

## **Auditee Criticisms of Efficiency Audits**

12.21 The inquiry found that GBEs and statutory authorities operating in commercial environments had five major concerns about efficiency audits. Although no efficiency audits have been conducted of government companies in ten years, presumably they would have the same criticisms. These criticisms were also voiced by some departments, although those organisations are not the focus in this part of the discussion.



12.22 A general point is that these complaints are made about efficiency audits rather than project audits. No submission to the inquiry criticised project audits. The previous chapter canvassed some of the possible reasons for this. The five criticisms were as follows:

- . inadequate skills of audit teams (discussed in previous chapter);
- . their high cost with inadequate benefits;
- . redundancy of efficiency audits due to introduction of program budgeting;
- . lack of confidentiality; and
- . redundancy due to greater emphasis on managerial responsibility.

12.23 These will be considered in turn. Efficiency audits and commentaries on government policy will also be discussed.

### Costs and Benefits

12.24 Some submissions to the inquiry, such as the submission of the Australian National Railways Commission<sup>5</sup>, argued that efficiency audits imposed extra costs which their private sector competitors did not have. The costs were in the large amounts of time devoted to these audits by senior staff. The opportunity costs of this 'lost time' were considerable. When performance, particularly efficiency, audits were considered from a cost-benefit perspective, many auditees also complained that benefits were insufficient to justify costs. Another factor for those organisations which may be subject to efficiency audits was the need to take into account the extent to which the organisations were subject to market forces.

12.25 A complicating factor in interpreting auditees' cost-benefit appraisals of efficiency audits was that these receive Parliamentary attention. As discussed earlier, legislative provisions for the initiation, conduct and reporting of efficiency audits are formal. Reports are to the minister responsible for the audited organisation, to the Minister for Finance, sometimes to the Prime Minister, and always to Parliament. The stakes for auditee management are very high and the consequences of an adverse efficiency audit report unpleasant for management to contemplate. Thus, it was not surprising that auditees were not enamoured of efficiency audits. Auditee questioning of the cost-benefit ratios of efficiency audits may

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5. Australian National Railways Commission Submission, 18 August 1988.

have camouflaged these other concerns. This is not to deny that a number of efficiency audits can be criticised for excessive duration and cost with few tangible benefits.

## Performance Indicators and Performance Audits

12.26 The introduction of program budgeting with the associated clarification of program and organisational objectives may improve Commonwealth sector efficiency. Certainly the performance indicators which are essential components of program budgeting will sharpen the focus of large numbers of government programs and organisations. They will permit program managers to determine more readily whether their programs are succeeding and, if so, their degree of success or failure. These performance indicators will also be used by the DOF in negotiations with Commonwealth-budgeted organisations over annual appropriations. In fact, the introduction of performance indicators should enhance the negotiating and decision-making capacity of the DOF with all kinds of Commonwealth sector organisations. Instrumentalities which are not Budget-dependent are not required to adopt program budgeting, which increases the importance of the Auditor-General's links with these instrumentalities and with Parliament.

12.27 Bottom-line or rate of return figures suggested for GBEs are one form of performance indicator. The Department of Finance wondered whether efficiency audits were still necessary when a rate of return on government investment in an enterprise was specified<sup>6</sup>.

12.28 The Secretary of that Department determined ultimately that<sup>7</sup>:

It is no good asking for the rate of return on assets if it is incorrectly reported or if it is misleading. We will be very dependent on the auditor in that context.

12.29 Finance could use performance data to determine weak points in government organisations and take appropriate action. Therefore, for that central agency, the introduction of the new approach to budgeting meant that efficiency audits were far less important than previously, and perhaps they were superseded. Few civil service managers have ever liked efficiency audits. The arrival of program budgeting and performance indicators meant that from a managerial viewpoint there was less need than ever

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6. Minutes of Evidence, Joint Committee of Public Accounts, Reform of the Australian Audit Office, 10 October 1988, p. 1300.
  7. Joint Parliamentary Committee of Public Accounts. Minutes of Evidence, Reform of the Australian Audit Office, 10 October 1988, p. 1321.



before for efficiency audits. In other words, there was a form of tacit consensus between the Department of Finance and auditees.

12.30 Wider usage of program budgeting within the Commonwealth sector provides two major advantages to the Audit Office. First, the Office will be able to examine data on performance indicators to assist decision making on which performance audits will be undertaken. Second, since both the DOF and the AAO want to maximise public sector efficiency as measured by performance indicators, the latter's availability may facilitate closer collaboration between these two organisations.

12.31 It has been argued that presentation of performance data in Budget explanatory notes for Budget-dependent agencies and in annual reports for other agencies will improve these bodies' accountability to Parliament. Thus it was surprising to learn that five of the six Senate Estimates Committees which reviewed the proposed expenditure of Budget-dependent agencies for the 1988-89 financial year criticised program budgeting in principle and in practice<sup>8</sup>. From a study of a sample of annual reports, there were very few annual reports of government agencies not Budget-dependent which contained useful performance indicator data in program budgeting format. Consequently, any improvements in accountability arising from the application of program budgeting techniques have not yet been realised.

12.32 The Department of Finance has claimed that these were transitional problems and that performance indicators would 'get better.' The alternative possibility was that continued difficulties in their development pointed to basic flaws in this approach to budgeting.

12.33 The unreliability, inconsistency and unevenness of program budgeting data meant that other means were necessary to assess organisation, programmatic and managerial performance. Efficiency audits are an alternative.

12.34 Even if program budgeting were working well and valid and reliable performance indicators of achievement of program objectives were in place and reported to Parliament, program budgeting would be insufficient to ensure the efficiency of public sector organisations. This was because of the distinction between stipulation of a program objective and knowledge of how to achieve it.

12.35 Specification of objectives will not always be sufficient to ensure a program's success. That this is so is evident from the many programs which have had clearly defined objectives, considered reasonable at the time, but which have had

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8. Senate Estimate Committees B, C, D, E, F were critical of program budgeting.



little success or have failed. Every portfolio could produce a list of such programs. Nor should it be considered sufficient to specify a bottom line profit figure or rate of return on government investment for GBEs or companies because the same qualifications apply for these organisations as for programs designed and administered by departments.

12.36 To be more responsive to the market place is fashionable and the idea may have virtue. However, even a casual glance at the market-place reveals immediately that there are large numbers of private companies which collapse. As well, there are large numbers of private companies which operate at low profit levels. Owners and managers of these companies may have very clear ideas of what those companies are established to do and have productivity and profit objectives clearly defined. They may even have corporate plans, but for some reason these companies are not performing adequately. The discipline of the market may take a long time to alter this situation since profitability may stay low<sup>9</sup>.

12.37 Returning to Commonwealth GBEs, the expectation that they should operate at the highest level of efficiency is justifiable. Just as reasonable is the expectation that the relationship between their commercial and social objectives should be known<sup>10</sup>. However, neither the Commonwealth Government nor the DOF in particular should be under the delusion that this expectation of high levels of efficiency combined with program budgeting will be sufficient for all GBEs to achieve the desired levels of efficiency and productivity.

12.38 Often, for example, a hard working management may not know how to raise efficiency. The DOF may perceive that GBE or company efficiency is lower than expected but not have the expertise or time to assist it to improve its performance. Because of the strategic importance in the economy of the GBE, statutory authority or company, the Government has a vested interest in raising the organisation's efficiency and in reducing the organisation's chance of not achieving its objectives. In this situation two approaches are open to the organisation and to Government.

- . a management review; or
- . a performance audit.

12.39 Both of the above would attempt to identify the reasons for the low performance and could make suggestions about how the

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9. Sometimes there is a deus ex machina and the company is subjected to a take-over to 'resolve' the situation.

10. An example of the latter relationship is the expectation of Telecom that it make a profit while subsidising the costs of telephone services to rural areas.

latter could be raised. The difference between the two approaches is that the first may be sponsored by the organisation's management and the second by the organisation's owner, that is, by the Government and ultimately by taxpayers. Both the management review and the performance audit have a role to play in improving performance, although recommendations of both can succeed only if they are accepted by management. The Committee upholds the view that the Commonwealth as the 'owner' of these organisations should exercise its right to have performance audits conducted of GBEs, statutory authorities and companies.

12.40 This discussion can now return to the starting point, which was whether the introduction of program budgeting removed the need for efficiency audits. The Committee's viewpoint on this is no. Performance audits, assuming that they are reliable and valid, are one of the very few mechanisms whereby the reasons for a program or organisation not performing to the level required by its performance indicators can be identified. It is wrong to believe that organisational acceptance of performance indicators means that the organisation knows how to achieve those indicators. Performance audits can help to fill this gap.

## Lack of Confidentiality

12.41 Several submissions referred to the need for confidentiality of audit reports in order to avoid the risk of compromising the position of GBEs and SAs operating in markets. Those submissions were, in fact, arguing that the Auditor-General should have greater recourse to section 48F of the Act which states that:

- (5) The Attorney-General may issue to the Auditor-General a certificate certifying that the disclosure of information concerning a specified matter, or the disclosure of the contents of a specified document would be contrary to the public interest...
- 5(e) ...by reason that the disclosure would be prejudicial to the commercial interests of a public authority of the Commonwealth or other body...
- (6) Where information, or the contents of a document, to which a certificate under sub-section (5) applies is disclosed to the Auditor-General in the course of the carrying out of an efficiency audit of operations of a relevant body, the Auditor-General may include any of the information, or any of the contents of the document, in a restricted report of the results of the audit prepared by him, and, if he does so, he shall also prepare and sign a separate report of the results of the audit



that does not include any of the information or any of the contents of the document.

- (7) Where the Auditor-General prepares a restricted report of the results of an efficiency audit of operations of a relevant body, he shall forward copies of the report to the Prime Minister, to the Minister and to the Public Service Board and, if the relevant person in respect of the body is not the Prime Minister or the Minister, he shall also forward a copy of the report to the relevant person in respect of the body.

12.42 Therefore, the Act appears to have ample provisions to safeguard auditees' commercial position without abandoning accountability requirements. The question is whether confidentiality and accountability have been compatible in practice.

12.43 Only one submission stated that an efficiency audit report had revealed commercially valuable information to the auditee's competitors. On closer examination, it appeared that the breach of security occurred because of a misunderstanding between the auditee and the Audit Office.

12.44 Apparently, then, efficiency audits have safeguarded commercially important information while pursuing accountability. Notwithstanding, fear of loss of commercial advantage as a result of an Auditor-General's report remained strong with some auditees. Inadequate data were available to show how successive Auditors-General had coped with this auditee unease. One theory was that Auditors-General had set aside auditees' fears and pursued efficiency audits regardless of the consequences. Little evidence was found to support this view. Another theory was that successive Auditors-General had responded to auditee unease by restricting the number of audits of commercially oriented government organisations and by selecting topics not central to those organisations' operations. The fact that there were only four efficiency audits of GBEs in ten years, and one audit of commercially oriented statutory authorities<sup>11</sup>, pointed towards the legitimacy of this view.

12.45 The inquiry considered whether efficiency audit reports of commercially oriented government organisations should be published. The argument in favour was that publication opened their administrative efficiency and effectiveness to public and Parliamentary scrutiny. The potential impact of perceived unfavourable audit findings was considerable on such matters as credit ratings and market share in a climate where market pressures were finely balanced and where competitive advantages could be quickly eroded. Therefore, there may be instances where

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11. The Australian Wool Corporation.



full reporting of audit reviews to the whole Parliament may not be desirable. A powerful argument against publication was that the latter placed certain kinds of government organisations at a commercial disadvantage compared with their competitors who were not subject to such scrutiny. These are repeats of arguments surrounding whether these organisations should be subject to efficiency audits at all. We have seen that the consequence of this game with three players - Parliament, the Auditor-General, and auditees, is that very few efficiency audits have been conducted of these organisations in the last decade. Unless action is taken, efficiency audits will remain few in number and may decline even further.

12.46 The Audit Mandate Chapter recommended that the Auditor-General be maintained or restored as the external auditor of all SAs, SMAs, GBEs and government companies. Acceptance of this recommendation will give the Auditor-General the security necessary to tackle more efficiency audits of organisations in this important sector without fear of losing auditees. While acceptance of this recommendation would be an important step, it would do little to alleviate auditees' suspicions of efficiency audits. It is not a bad thing for auditees to be wary of these. However, the defensive mode which auditees adopt is not conducive to acceptance of audit findings.

12.47 The Committee recommends that:

- . The Auditor-General trial for two years the conduct of efficiency audits of commercially oriented government organisations with restricted reporting as provided for under section 48F of the Audit Act 1901. Further, restricted reports be provided to the Minister responsible for the auditee organisation and to the Public Accounts Committee.

12.48 The objective would be to explore the implications for the selection of audit topics, and to observe whether there were any beneficial changes to relations between the Auditor-General and the auditee favourable to implementation of audit recommendations. This trial approach to audit reporting would maintain the auditee's accountability to Parliament.

### **Efficiency Audits and 'Let the Managers Manage'**

12.49 There were two viewpoints put to the Committee on the role of audit, particularly efficiency audit, when managers were given more responsibility. The first view was of Mr John Nethercote, Deputy President of the ACT Division of the Royal

Australian Institute of Public Administration<sup>12</sup>, who claimed that:

It would be quite unwise to assume that, as a matter of course, managerial autonomy invariably leads to efficiency: this is not necessarily so. It can easily lead to complacency, backwaters and fiefdoms.

12.50 Audit, as a means of ensuring accountability, had a role in exposing these undesirable consequences of managerial autonomy.

12.51 The second view was put by Mr David Block, who argued that stronger emphasis on managerial responsibility with greater discretion for public service managers meant that where organisational and administrative problems were so severe that audits were necessary, then it was time to replace management. Efficiency audits were last resort weapons that should not be necessary. Auditors should not be able to tell managers how to do their jobs<sup>13</sup>.

12.52 Greater discretion for civil service managers may be desirable. However, it was constrained by the doctrine of ministerial responsibility for activities of the portfolio. The relationship between ministerial responsibility and managerial discretion was not chartered in evidence before the Committee. Therefore, there was uncertainty about the limits of the 'let the managers manage' notion.

12.53 Civil service managers were accountable to the chief executive officers of their organisations. In turn, chief executive officers were accountable to their ministers. Therefore, it was argued before the Committee that an emphasis on managerial responsibility had not weakened the accountability of either the civil service or ministers to Parliament.

12.54 The doctrine of ministerial responsibility remains fundamental to the Australian system of government. However, there is a danger that its upholding will promote the delusion that ministers are aware of all the strengths and shortcomings of agencies within their portfolios. It is desirable to hope for ministerial omniscience, but in practice it is unrealistic. Furthermore, it may not be in the interests of a departmental secretary, chief executive officer of a government corporation or other agency, or of a minister to have it be known that there is an under-performing agency or program.

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12. J. Nethercote, Public Auditing in Australian Government Administration. Memorandum on Some Machinery of Government Aspects, Royal Australian Institute of Public Administration, ACT Division, Canberra, 1988.
13. Minutes of Evidence, Joint Committee of Public Accounts, Reform of the Australian Audit Office, 21 November 1988, D. Block.



12.55 Consequently, the accountability connection between the line manager, the departmental secretary and the minister is not flawless in the modern public service. If it were, one argument is that the accountability of managers was best pursued by Parliament keeping ministers 'up to the mark'. This argument would mean that Parliament would have no data on individual portfolios other than that provided by ministers. In other words, outside the Senate Estimates Committee process, managers would be accountable to Parliament indirectly. The Committee rejects this view and upholds the need for line managers, departmental secretaries and chief executive officers to be both accountable to their ministers and directly accountable to Parliament. Efficiency audits are one way to maintain the direct accountability of public service managers to Parliament.

12.56 More efficiency audits have been conducted of the Australian Taxation Office and the Department of Defence than of any other Commonwealth organisations. Notwithstanding, it was observed that in evidence before the inquiry that the Commissioner of Taxation and the Secretary of the Department of Defence supported the continuation of efficiency audits<sup>14</sup>.

12.57 The Commissioner for Taxation stated that:

...it would have to be true that external scrutiny of the Tax Office by...the Audit Office was a pressure point on us to perform or improve.

We were being put under the spotlight... and that, having happened, it was necessary to respond.

I guess that that series of reports (on the Tax Office) was one of the pressure points, one of the catalysts for change and improvement within the Office.

12.58 After the Australian Taxation Office, the Department of Defence had the next largest number of efficiency audits. Mr Tony Ayres, the Secretary of the Department of Defence, said in regard to these efficiency audits.

We are the third biggest spender...within the Commonwealth departments and if we had less than (seven efficiency audits) I think the taxpayer would have something to complain about. In other words, we have got to be prepared...to stand up and justify what we are doing.

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14. Minutes of Evidence, op. cit., 21 November 1988, pp. 1778: 10 October 1988, p. 1356.



12.59 Similar political systems have experimented with devolution of administrative authority and had uneven success. In Canada, for example, devolution of greater financial authority to public service managers took place after the report of a Royal Commission on government organisation<sup>15</sup>. Fourteen years later, the Canadian Auditor-General reviewed the situation and concluded that Parliament and the Government were losing control of public finance<sup>16</sup>. Subsequently, the Auditor-General was given a stronger role in relation to departments in order to strengthen financial procedures and information systems<sup>17</sup>.

12.60 The Public Accounts Committee supports the principle of further devolution of authority to public service managers. However, it believes that a more balanced approach to the strengths and weaknesses of this principle is overdue.

## **Efficiency Audits and Commentaries on Government Policy**

12.61 There is consensus on the need for the audit mandate to be restricted so as to avoid the auditor commenting on Government policy. However, should the Auditor-General be barred from commenting on the policies of Government agencies which determine their own agendas? These agencies include SAs, GBEs and incorporated companies.

12.62 A prior question is whether the doctrine of ministerial responsibility outlined in Government White Papers means that such agencies necessarily reflect Government policy. If the answer is yes, then the Auditor-General should not comment on their policies. Of note is how a recent White Paper indicated that the

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15. The Royal Commission on Government Organisation, Volume 1, Management of the Public Service, the Queen's Printer, Ottawa, 1962.

16. In 1976 the Auditor-General stated that:

'I am deeply concerned that Parliament - and indeed the Government - has lost, or is close to losing, effective control of the public purse'

The irony was that he suspected that this situation had come about because certain key recommendations on financial management and control made by the Royal Commission were not implemented.

Report of the Auditor-General of Canada to the House of Commons for the Fiscal Year ended March 31 1976, Minister of Supply and Services, Ottawa, 1976, para 2.1

17. Report of the Auditor-General of Canada to the House of Commons, Fiscal Year ended 31 March 1987, Minister of Supply and Services, Ottawa, 1987, para. 1.8.

responsible minister can suggest to the enterprise board that a preferred corporate strategy be reconsidered to better reflect Government policies<sup>18</sup>. This is not quite the same as a ministerial request of a Government enterprise to alter its plans and priorities, although obviously that possibility exists and will continue to do so. Therefore, there is a 'grey area' wherein statutory authorities and government enterprises can be expected to follow Government policy but may not automatically do so. A further factor is that Government does not have policies on many areas of these agencies' operations. Thus, the search for principles on which a platform can be built to stop the Auditor-General examining the effectiveness of policies of statutory authorities, especially those commercially oriented, and government business enterprises and companies will not be fully effective if the only principle is that the Auditor-General should not criticise Government policy. It is not obvious what other principles can be used to support the view that the achievement or effectiveness of these organisations' policies should not be examined by the Auditor-General.

12.63 The PAC's 1987 review of the efficiency audit of the Australian Wool Corporation's property operations also drew attention to this area<sup>19</sup>. In that report, the Committee noted how the distinction between 'program efficiency' and 'policy' may be difficult to maintain in audits of commercial enterprises. This was because government business enterprises and statutory marketing authorities unlike government departments, were not primarily involved in administering or implementing predetermined government policy but rather were independent, self-managing business setting their own commercial and investment policies within the framework of their legislative guidelines. (This repeats the point made previously in this discussion.)

12.64 Other jurisdictions are concerned about similar issues. A notable recent statement on these matters was the Report of the New South Wales Commission of Audit. One thrust of that report was to improve public sector efficiency, another concern was with accountability. The Commission recommended that in addition to annual reviews of SAs, full strategic audits should be done every five years with input from the private sector. This five year review cycle is similar in principle to the AAO's preferred audit cycle<sup>20</sup>. The Commission of Audit recommended that these audits should focus on<sup>21</sup>:

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18. Policy Guidelines for Commonwealth Statutory Authorities and Government Business Enterprises, Information Paper issued by the Minister for Finance, Senator The Hon Peter Walsh, October 1987, AGPS, Canberra, 1987.

19. JPCPA, Australian Wool Corporation, op.cit.

20. In 1983 when comprehensive auditing was introduced, a three year audit cycle was adopted by the AAO. Due to resource shortages, that cycle has never been achieved: AAO Submission, op. cit., Chapter 4.

21. New South Wales Commission of Audit, op. cit., p. 24.



- . financial performance as measured by rate of return on assets and other measures;
- . the adequacy of performance indicators;
- . the measurement of performance against targets;
- . comparison with bodies in similar industries, both local and overseas;
- . operational practices;
- . the adequacy of liability provisions;
- . the overall condition of the organisation's assets; and
- . the effectiveness of the maintenance program.

12.65 Another example is from Canada where 1984 amendments to the Financial Administration Act called for special examinations to be carried out of all parent Crown corporations scheduled under the Act, and of their wholly-owned subsidiaries, at least once every five years<sup>22</sup>.

12.66 The PAC's view is that efficiency audits should concentrate on issues of efficient and effective management. Policies of statutory authorities and government business enterprises should not be the direct focus of efficiency audits. However, attention may be drawn to their implications in the study of efficient and effective management. This is a less strict separation of policy effectiveness questions from other matters than is required in efficiency audits of government departments where government policy is more obvious and encompassing. Audits of SAs, SMAs, GBES, and government companies can examine policies of those organisations by reviewing, for example, whether these were achieved. Essentially the focus of efficiency audits is a matter for the Auditor-General's judgement. In the conduct of efficiency audits in these organisations, the Auditor-General should not feel constrained if efficiency audit reports comment on auditees' policies. However, to emphasise, a commentary or analysis on government policies in ministerial departments will remain beyond the Auditor-General's charter.

12.67 The Committee reaffirms that the recommendation of its review of the efficiency audit of the Australian Wool Corporation's property operations that a details review of efficiency auditing guidelines for government busienss enterprises should be undertaken. This review should be undertaken by the Auditor-General who should develo new guidelines. In addition,

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22. Office of the Auditor-General of Canada, A Framework for the Conduct of Special Examinations in Crown Corporations, Office of the Auditor-General of Canada, Ottawa, 1987.



the review should develop new guidelines for efficiency audits of statutory authorities, statutory marketing authorities, and government companies, and it should involve representatives of those organisations and the Department of Finance. The review would benefit Parliament, the Auditor-General and auditees.

12.68      The Committee recommends that:

- .      A detailed review of efficiency audit guidelines for government business enterprises be undertaken, as recommended in the Committee's Report on the Australian Wool Corporation's property operations (Report 282). Further, this review should be undertaken by the Auditor-General and include new guidelines for statutory authorities, Statutory Marketing Authorities and government companies, involving representatives of those organisations and the Department of Finance.



## **PART D**

### **SELECTED ISSUES**





## Chapter 13

### THE IMPLEMENTATION GAME

13.1 What happens to the Auditor-General's reports after they are tabled in Parliament? Are findings acted upon?

13.2 By drawing matters which he considers important to Parliament's and therefore to the public's attention, the Auditor-General can exert enormous pressure on audited organisations to modify their behaviour. Notwithstanding, the Auditor-General does not have the formal authority to compel any audited organisation to change its behaviour.

13.3 There are a large number of matters raised in any single audit report and often there are many associated recommendations. Therefore as expected, some issues raised by the Auditor-General receive more Parliamentary, media and public attention than others. The corollary is that it is very easy for many important issues and recommendations to be overlooked in public and political arenas. Even in the unlikely event of consensus between all interested parties on the most important audit findings, it is high improbable that all of these would receive adequate Parliamentary and public coverage. Consequently, mechanisms are necessary to ensure that all audit recommendations are considered seriously by auditees.

13.4 It is acceptable for an auditee not to implement audit recommendations in some circumstances. An extreme case, for example, would be where an audited program no longer existed. Another instance would be where audit recommendations were outdated by large-scale change in an organisation or program. Therefore, the proportion of audit recommendations implemented can be a misleading indicator of audit success.

13.5 The questions at the start of this Chapter will be answered by referring to the roles of auditees, Parliamentary committees, the Department of Finance and the Auditor-General in the process of implementation of audit findings. First, however, an overview is necessary.

## Audit Reports and Pontius Pilate

13.6 Especially in regard to efficiency audits, once audit findings were clear:

- . Parliament committees said that follow-up was an Executive Government responsibility;
- . the Department of Finance disclaimed the major responsibility to ensure that audit findings were acted upon;
- . the AAO said that it was not its responsibility to follow-up audit findings. That was the responsibility of Executive Government;
- . auditees may have promised to consider audit findings or they could be ignored.

13.7 For each party, implementation and monitoring of implementation of audit findings was someone else's responsibility. The Committee labelled this 'the Pontius Pilate' approach to audit follow-up.

## Auditees

13.8 Auditees are not obliged to act upon any audit findings, although they are expected to give them serious consideration. Often, likely recommendations are considered by auditees during audits. Auditee financial or organisational behaviour may alter before the audit report is finished thus resolving differences between auditor and auditee or alleviating the auditor's concerns. Alternatively, differences between auditor and auditee may widen and harden, and audit findings rejected before they are made. These circumstances are not favourable for implementation of audit recommendations after the report to Parliament.

13.9 From a Parliamentary and from a Department of Finance perspective, conflict between auditor and auditee may be perceived. A Parliamentary committee, or, in rare cases, Parliament itself may step in to resolve the conflict, possibly through the auspices of the responsible minister; or the Department of Finance which may have the authority to recommend to Government on the auditee's appropriation, may agree or disagree with audit findings. If the Department of Finance has budgetary authority over the audited organisation, agrees with



audit findings and the latter are seen as important, then in most cases the auditee will have few other options but to implement audit recommendations.

13.10 Parliamentary committees and the Department of Finance can assess the importance of audit findings and whether they agree or disagree with audit recommendations. If neither the Department of Finance nor any Parliamentary committee believes that audit findings are important or if both reject audit recommendations then it is optional for the auditee to act upon audit findings. There are no data available to show what proportion of these 'optional' recommendations lead to change in auditees' financial or other management.

13.11 An auditee may accept audit recommendations and decide to act upon them. A statement in such terms removes pressure on the auditee from Parliament and the Department of Finance. Yet it is easy for implementation action to slip once an auditee has decided to accept audit recommendations. For this reason, the House of Representatives Standing Committee on Transport, Communications and Infrastructure recently affirmed that<sup>1</sup>:

Where an auditee accepts the proposals for change made by the Auditor-General in an efficiency audit report, the auditee should provide the relevant Parliamentary committee with a timetable for implementation at the commencement of the Parliamentary inquiry.

13.12 The Public Accounts Committee supports and extends this recommendation and will expect such audit report implementation timetables from auditees at the commencement of future Public Accounts Committee reviews of all regularity and performance audits.

13.13 The Committee recommends that:

- . In accordance with the recommendations of the House of Representatives Standing Committee on Transport, Communications and Infrastructure, where an auditee accepts the proposals for change made by the Auditor-General in an efficiency audit report, the auditee provide the relevant Parliamentary committee with a timetable for implementation at the commencement of the Parliamentary inquiry.

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1. Efficiency Audit Review: Australian National's Commission Traffic, Report from the House of Representatives Standing Committee on Transport, Communications and Infrastructure, AGPS, Canberra, 1988.

13.14 In accordance with arrangements established in 1980 and confirmed by the Prime Minister in March 1984, all ministers are required to furnish returns to the Minister for Finance at three monthly intervals outlining action taken or to be taken by departments and authorities within their portfolios to correct matters which the Auditor-General has adversely commented on in his reports.

13.15 The minister rather than the secretary of the department or the chief executive officer of a portfolio agency reports to the Minister for Finance. This emphasis on ministerial accountability for his or her portfolio's response to the Auditor-General's reports is a powerful strategy and should continue.

13.16 Where the Public Accounts Committee releases a review of an efficiency audit report, the auditee must contribute to a response in a Finance Minute. This will be described later when the Public Accounts Committee's involvement with audit reports is discussed.

13.17 Guidelines introduced by the Prime Minister in November 1987 and approved by the Public Accounts Committee required departmental annual reports to contain<sup>2</sup>:

information regarding any reviews by the Auditor-General or Parliamentary committees which directly affect the department showing recommendations arising from such reviews and the action taken to address them.

13.18 It is a requirement of the Public Service Act 1922 that departmental secretaries prepare annual reports in accordance with the guidelines. In May 1988 the Committee wrote to all departmental secretaries stating that in future the Committee would monitor annual reports for compliance with this and other relevant guidelines.

13.19 An analysis of all 1987-88 departmental annual reports tabled during the 1988 Budget sittings showed that the majority of departments had not complied with this particular guideline as it related to audit reports. Only one-third of reports contained adequate information on results of audits and action taken. The Committee was most disturbed to find that several reports appeared to disregard this guideline completely or made a perfunctory reference and directed readers to other, not always public, sources for additional information. The Committee intends to continue its monitoring of this matter.

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2. Hansard, 17 November 1987, p. 2163.

13.20 Notwithstanding difficulties in the implementation of guidelines for departmental annual reports, guidelines for preparation of annual reports by statutory authorities do not contain any similar requirements<sup>3</sup>.

13.21 The Committee recommends that:

- . A requirement necessitating the inclusion of information on reports of the Auditor-General or of Parliamentary committees relevant to the agency similar to that for departmental annual reports be introduced into guidelines for preparation of annual reports by statutory authorities.

13.22 An exception may be necessary for confidential audit reports.

## Parliamentary Committees

13.23 Section 8 of the Public Accounts Committee Act 1951 states as follows:

13.24 The duties of the Committee are:

- (ab) to examine all reports of the Auditor-General (including reports of the results of efficiency audits) copies of which have been laid before the Houses of the Parliament;
- (b) to report to both Houses of the Parliament, with such comment as it thinks fit. Any items or matters ... to which the Committee is of the opinion that the attention of the Parliament should be directed.

13.25 As a result of this legislation the Public Accounts Committee examines more reports of the Auditor-General than any other Parliamentary committee. The Public Accounts Committee is responsible for examining the following categories of Auditor-General's reports:

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3. Hansard, 11 November 1982, p.2261.



- . reports on financial statements prepared by the Minister for Finance;
- . biannual reports on regularity and project audits;
- . the Auditor-General's annual report; and
- . various efficiency audit reports.

13.26 Importantly, there are several other Parliamentary committees with major responsibility for reviewing efficiency audit reports, including:

- . Finance and Public Administration;
- . Transport, Communications and Infrastructure; and
- . Publications.

13.27 These committees are responsible for monitoring the implementation of audit findings: implementation of the latter is a responsibility of auditees. Appendix 10 lists the Parliamentary committees with responsibility for examining the eight efficiency audit reports released in 1987-88. Appendix 11 lists efficiency audit reports which have not been reviewed by Parliamentary committees since 1979. Forty five of the 50 efficiency audit reports tabled by 30 June 1987 were reviewed or are in the process of being reviewed by Parliamentary committees.

13.28 When reviewing efficiency audits, committees may examine the substance of audit reports as well as the manner in which efficiency audits were conducted. Examples of where the substance and methodology of efficiency audit reports were studied by Parliamentary committees are:

- . the review of the Auditor-General's efficiency audit report into construction project management practised by the Department of Housing and Construction. The report was prepared by the House of Representatives Standing Committee on Expenditure<sup>4</sup>; and
- . the review of the efficiency audit of Australian National's Commission Traffic undertaken by the House of Representatives Standing Committee on Transport, Communications and Infrastructure<sup>5</sup>.

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4. An Efficient Organisation, Or, An Efficient Audit? op. cit.

5. Efficiency Audit Review: Australian National's Commission Traffic, op. cit.

13.29 Customarily, Parliamentary committees table separate reports on their reviews of efficiency audits. These reports indicate whether the committee agrees with audit findings and whether it believes the auditee should respond to the latter. The responsible minister must provide a response in Parliament within three months of the committee report's tabling. This arrangement is for committees other than the Public Accounts Committee. The leader of the House may also make a consolidated response on behalf of the Government to Parliamentary committee reports.

13.30 With the Public Accounts Committee there is a system known as the Finance Minute. Once the Public Accounts Committee completes a review of an efficiency audit report, the PAC report is sent to the Minister for Finance. The Department of Finance pursues matters raised in the PAC report with the original auditee. At an appropriate time, the Minister for Finance replies to the PAC report with responses to each PAC recommendation. These responses outline what the relevant minister proposes to do and not necessarily what he or she has done. The time or delay involved in this process sometimes has been of concern to the PAC. Further interaction between the PAC, the Minister for Finance and the original auditee can follow depending on judgements the importance of issues. This Finance Minute system places the onus on the Department of Finance, particularly on its Supply Divisions, for pursuing those Australian Audit Office recommendations not implemented by auditees yet determined by the Public Accounts Committee as being of most importance.

13.31 In the United Kingdom, departmental secretaries and chief executive officers of government instrumentalities attend each meeting of the Public Accounts Committee when audit reports on their particular agency are being discussed. This system is highly important in the United Kingdom for maintaining the accountability to Parliament of senior public sector management. The Australian Public Accounts Committee is moving to adopt a similar system.

## **Department of Finance**

13.32 The Department of Finance has authority over Commonwealth agencies subject to the Audit Act and no authority over bodies not subject to the Act. However, the Minister for Finance can attempt to persuade the minister for a Federal organisation not bound by the Audit Act to ensure that an audit report is acted upon by that organisation.

13.33 The Department of Finance analyses responses sent every three months by ministers to the Minister for Finance. These responses are from organisations bound by the Audit Act and those not so covered. Supply Divisions within the Department of Finance responsible for advising their Minister on each portfolio's annual estimates assess whether the response from each minister



is appropriate. Each minister's response on every audit recommendation is classified as:

- . action completed: all criticisms raised in relation to a matter were addressed and the appropriate action taken;
- . action progressing satisfactorily; and
- . action not progressing satisfactorily.

13.34 The Department of Finance then assesses whether it should pursue recommendations where action was not progressing satisfactorily. A progress report is prepared for the Minister for Finance every six months. The report contains details on all matters identified by the Department as progressing unsatisfactorily and assessed as being significant enough to bring to the Minister for Finance's attention. The latter may then write to the relevant minister detailing appropriate action for the agency within his or her portfolio to take.

13.35 Other data provided by the Department of Finance revealed the following patterns:

- . Auditor-General's reports from March 1986 to March 1988 listed 495 unsatisfactory audit findings;
- . 317 of these were classified as being resolved;
- . progress was satisfactory on 171 findings;
- . progress was unsatisfactory on 7 findings.

13.36 In other words, according to the DOF, auditees responded positively by implementing or giving sound reasons why they should not take action on 488 or 98.6 per cent of the 495 unsatisfactory audit findings. The Committee felt ambivalent about these statistics. On the one hand the data suggested high auditee responsiveness and even compliance with audit advice. However, the data may also have pointed to premature classification of auditees' responses as having resolved outstanding matters or as progressing satisfactorily.

13.37 DOF is dependent on government agencies providing accurate information on their response to audit reports. As the Secretary of the Department of Finance said<sup>6</sup>:

Most of them probably are telling the truth.

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6. Joint Parliamentary Committee of Public Accounts, Minutes of Evidence, Reform of the Australian Audit Office, 10 October 1988, p. 1351.



13.38 DOF does not have the resources to determine whether these agencies are always truthful.

#### Efficiency Audit Reports

13.39 The follow-up procedure on efficiency audits is the same as for other kinds of audits. However, there are differences in procedures for recording ministers' responses to efficiency audit reports. Notably, each Supply Division keeps its own records on auditee progress in consideration and implementation of recommendations. These data are generally not stored on computer unlike data on auditee's responses to the Auditor-General's March and September reports on regularity and project audits. This decentralisation of responsibility for judgement on the necessity for follow-up is warranted given the Supply Divisions' critical role in recommending each portfolio's forward estimates.

13.40 On occasion, Supply Divisions in the Department of Finance have underestimated the importance of efficiency audit findings and overestimated auditees' responses. An example was the Department of Veterans' Affairs response to efficiency audits of Repatriation General Hospitals. Documentation made available to the Committee by the Department of Finance suggested that although the latter was concerned about the Department of Veterans' Affairs responses to the efficiency audit findings, the Department of Finance did not apply significant pressure to the Department to rectify major inadequacies in the management of Repatriation General Hospitals. Public Accounts Committee interest in the issue led to a Parliamentary report which strongly criticised the Department of Veterans' Affairs slowness to respond to serious criticisms<sup>7</sup>.

13.41 The Department of Finance appeared to examine quarterly responses from the Minister for Veterans Affairs in a mechanical way with little actual analyse of those responses. What was disturbing to the Committee was:

- . the lack of specificity by the Department of Veterans Affairs on the issue of monitoring the extent of services provided by visiting medical specialists;
- . the apparent Department of Finance failure to note this inadequacy; and

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7. Joint Parliamentary Committee of Public Accounts, A Better Deal For Our Veterans. The Management of Repatriation General Hospitals by the Department of Veterans Affairs, AGPS,

- . the inconsistency in the Department of Finance's own response since in other circumstances the Department of Finance was pressing for more attention to program monitoring.

13.42 While the Department of Finance looks at ministers' quarterly responses on behalf of their portfolios, there was no evidence of whether the Department of Finance's Supply Divisions noted patterns of non-implementation or examined whether auditees experienced recurring difficulties in their responses to audit reports. Clearly, however, the Supply Divisions are well placed to undertake such trend analysis.

13.43 Such oversight and analysis is consistent with one of the main functions of the Department which is<sup>8</sup>:

(to foster) the efficient and effective use of resources through assistance in overseeing human resource management, and the finances and financial practices of departments and statutory authorities.

13.44 The Committee supported the Department of Finance's plans for its Financial Management and Improvement Branch to examine ministers' quarterly returns with the purpose of determining where departments and other auditees had problems, for example, in preparation of financial statements or in the derivation of performance indicators. After such analysis, the Financial Management and Improvement Branch should be able to advise auditees on how to overcome such problems.

13.45 The Committee recommends that:

- . The Secretary of the Department of Finance ensure that Supply Divisions upgrade their effective oversight and analysis of ministers' quarterly reports.
- . The Department of Finance should provide to the Public Accounts Committee on a quarterly basis copies of ministers' responses received by the Minister for Finance and make those responses publicly available.
- . In specific cases where there are policy reasons why the reports cannot be made publicly available, then they be supplied to the Public Accounts Committee on a confidential basis.

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8. Department of Finance, Annual Report 1987-88, op. cit., p.2.



13.46 These recommendations should have a positive effect on the quality of ministers' initial responses.

## The Auditor-General

13.47 Once regularity audit reports are tabled, unsatisfactory findings are followed-up in the next audit report due one year later. There are no mechanisms for automatically following-up unsatisfactory findings in performance audits of a project or efficiency audit kind, although the Auditor-General may do so.

13.48 In comparison, the Canadian Auditor-General tracks all audit reports two years after they are released to determine auditee response<sup>9</sup>. This is in addition to any Parliamentary follow-up. A chapter in the Canadian Auditor-General's report to Parliament is devoted to follow-up of recommendations in previous reports<sup>10</sup>.

13.49 In general in Australia, action arising from unsatisfactory findings in performance audits is seen by Audit as the responsibility of Parliamentary committees and the Department of Finance rather than as its responsibility. A further factor which weakens the Australian Audit Office's follow-up of its recommendations is that such action requires resources. The proportion of Australian Audit Office resources able to be devoted to efficiency audits has fallen in recent times, decreasing the number of efficiency audits. Absorption of resources into reviewing auditees' responses to efficiency audit reports would reduce the number of efficiency audits even further. This is highly likely given the protracted nature of auditor-auditee discussion of efficiency audits and senior staff's involvement.

13.50 The Audit Office has chosen to undertake as many efficiency audits as it can in preference to following-up existing reports. The Committee understands the reasons for the Audit Office's choice, and supports the Auditor-General's right to decide which recommendations in which reports he will pursue at a later date. There is no alternative but for the Auditor-General to exercise his judgement on follow-up priorities in view of the very limited resources available for efficiency audits. Notwithstanding, the Committee believes that the virtual abandonment of any systematic follow-up of performance, especially efficiency, audits is a premature withdrawal of Audit Office pressure on auditees to consider report recommendations. Further,

9. Minutes of Evidence, Joint Committee of Public Accounts, Reform of the Australian Audit Office, 26 October 1988, p.1672.

10. Report of the Auditor-General of Canada to the House of Commons, Fiscal Year Ended 31 March 1987, Minister of Supply and Services, Ottawa, 1987, Chapter 16.



since financial statement audits are followed-up automatically and performance audits are not, the entire system of performance audits is threatened with relegation to second-class status. The lack of systematic follow-up of performance audits also calls into question the Audit Office's corporate objectives which state that its goal is to improve the economy and efficiency of public administration in the Commonwealth sector. The obvious retort is that the Audit Office has given performance audit follow-up a lesser priority in preference to the commissioning of new performance audits. The Committee is not entirely satisfied with this response since it expects the Auditor-General to accept responsibility for follow-up of his own recommendations.

13.51 The Committee recommends that:

- . The Auditor-General devote significant resources to follow-up of performance audits, and adopt a systematic approach to follow-up of performance audit findings.

13.52 The dominating pattern of audits has been that statutory authorities have been subjected to financial statement audits with very few performance audits, while departments and their outliers have had performance audits without financial statement audits. This emphasis has not provided adequate audit coverage, and has made nonsense of the Audit Office's attempt to develop comprehensive audits. In future, as argued elsewhere, more efficiency audits should be undertaken of statutory authorities, and because of Government action on a long-standing Public Accounts Committee recommendation, departmental outriders will now prepare financial statements which will be audited.

13.53 Consequently, Audit must return to departments more often; similarly with statutory authorities where more efficiency audits are likely.

13.54 The Committee recommends that:

- . Follow-up procedures for performance audits be linked to follow-up procedures for regularity audits in the Audit Office.

13.55 This will lead to an annual review of progress in responding to performance audit findings. The Auditor-General, as highlighted earlier, should retain the right to decide which performance audit recommendations are of most importance and should be followed-up. There is no expectation that auditees should automatically act upon audit findings, but they should demonstrate, if they do not implement recommendations, that they have sound reasons for their decisions.

13.56 The Auditor-General retains the power to report to Parliament if he is not satisfied with auditees' responses to audit recommendations. This power has not always been exercised with efficiency audit recommendations. Awareness of this led the House of Representatives Standing Committee on Expenditure to recommend in 1986 that the Australia Audit Office should advise Parliament at the first available opportunity of deficiencies in the consideration and implementation of efficiency audit recommendations<sup>11</sup>. The Committee supports and restates this recommendation.

13.57 The Committee recommends that:

- . In accordance with the recommendation by the former House of Representatives Standing Committee on Expenditure in 1986, the Australian Audit Office advise the Parliament of deficiencies in the consideration and implementation of efficiency audit recommendations.

13.58 There are other initiatives which the Auditor-General can take to raise the profile of auditing within government. One such initiative is personally and regularly to brief ministers and Prime Ministers on principal audit findings, including major findings from his biannual reports. (Sections 45, 63G and 63L give him that authority already). This practice was adopted in Victoria by a previous Auditor-General who briefed the State Premier on results of major audits. Briefing should occur immediately before report tabling to remove any suggestion that an Auditor-General could weaken audit findings to please Government.

13.59 The Committee recommends that:

- . The Auditor-General brief Ministers and the Prime Minister regularly on significant audit findings.

13.60 The Auditor-General's messages on efficiency and effectiveness are not always palatable to Executive Government. Therefore, despite the importance of many audit findings, there is an understandable reluctance of governments of all persuasions and auditees to acknowledge audit findings publicly. It is very easy in these circumstances for audit findings to be buried. The media can be a useful tool for the Auditor-General to draw attention to critical findings. The Committee noted the Canadian practise

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11. A Taxing Problem, op. cit.



whereby the media are permitted access to the Auditor-General's annual audit report a few hours before it is tabled in Parliament. Access is granted in a secured environment similar to the media 'lock-up' for the Australian Budget. The Canadian media have a well-developed interest in the Auditor-General's reports, and media reports maintain pressure on the Canadian Government to consider audit findings. Development of a similar relationship between the Auditor-General and the media in Australia is warranted. In turn, this would maintain public pressure on government and Parliament to increase action on public sector probity and efficiency.

13.61 There is much more that the Audit Office could do to inform and educate Parliamentarians about audit: for example, the Audit Office could brief Members and Senators on critical findings in notable reports. Also, the Audit Office could experiment with communication about its work, for instance, through preparing brief video reports on some audits. The Canadian Auditor-General has found that brief video reports can assist busy Parliamentarians who may not have time to read an entire report.

13.62 Through giving more attention to relations with the media, the public and parliamentarians, the level and amount of debate on audit findings will increase.

## Summary

13.63 The main features of the current approach to consideration of audit findings are:

- . there is no single approach to consideration and implementation of audit findings. Rather there is a loosely connected set of approaches which have developed over a very long period;
- . many players are involved, - the Auditor-General, auditees, auditees' ministers, Parliamentary committees, the Department of Finance;
- . each major participant or group of participants can have different estimates of the importance of audit findings. Therefore, some conflict is inevitable in discussion of these;
- . findings of regularity audits are followed-up systematically by the Auditor-General;
- . there is almost no attention given by the Auditor-General to follow-up of efficiency audits;



- . more could be done by the Auditor-General to raise the profile of significant audit findings; and
- . there is a necessary duplication and overlap of responsibilities. Equally, there are some responsibilities identified here which should be pursued more vigorously.



## Chapter 14

### INTERNAL AUDIT

14.1 The discussion in earlier Chapters highlighted the slow real growth in funds for the AAO, and how the increase had not matched growth in the size and complexity of AAO responsibilities. A 'softening' thought on this imbalance was that improvements in the internal audit of Commonwealth organisations may have reduced the need for the same extent of external audit coverage.

14.2 The Institute of Internal Auditors has defined internal auditing as an independent appraisal activity for the review of accounting, financial and other operations as a basis for service to management. It is a managerial control which functions by measuring and evaluating the effectiveness of controls<sup>1</sup>. If effective internal controls, such as internal audit, are in place, then public service managers, ministers and Parliamentarians can have more faith in the accuracy of Budget - dependent agencies' financial statements and forward estimates. A major distinction between internal and external audit is that the former is an arm of management while external audit is accountable to its client, which in the case of the Commonwealth sector is the Commonwealth Parliament.

14.3 If reliance cannot be placed on the work of internal audit units, the work of the AAO has to be expanded to ensure that financial systems are in place and capable of providing accurate information.

14.4 Many factors affecting the Audit Office and described earlier also affected internal audit. Thus, internal audit has become involved in efficiency audits<sup>2</sup>. This was an example of how the roles of internal and external auditors overlapped or were complementary. Consequently, this Committee believed there was considerable value in the Commonwealth giving more attention to how the standard of internal audit could be maintained.

14.5 The AAO's usage of internal audit was criticised during the course of the inquiry. The main criticism was of how the AAO

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1. Joint Parliamentary Committee of Public Accounts, Internal Audit in the Australian Public Service, - A Discussion Paper, 184th Report, AGPS, Canberra, 1981, p.11.
  2. Coopers and Lybrand Submission, 27 August 1988.



duplicated the work of internal audit by examining areas which internal audit had reviewed recently or was in the process of reviewing<sup>3</sup>. A second criticism was that the Audit Office interpreted co-operation with internal audit as a one-way street. It was alleged that departments must supply copies of audit manuals and annual plans to the Audit Office, but received little, if anything, in return<sup>4</sup>.

14.6 In reply to these criticisms, the AAO advised that it undertook extensive discussions with internal audit so that their plans could be taken into account in planning the AAO's work. If internal audit had undertaken a recent audit, then the AAO would defer its own examination and rely on the work of the internal audit. The AAO also reviewed internal audit to assess the quality of its work<sup>5</sup>.

14.7 Evidence presented to the Committee did not indicate that there was a high degree of duplication of internal audit work by the AAO. In any case, some duplication of effort was warranted in order for the Audit Office to be able to provide assurances of the quality of internal audit. Notwithstanding, the Audit Office should continue to monitor any overlap with internal audit to ensure that where duplication of effort occurred it occurred for good purpose.

14.8 Speculation is necessary on how government organisations have responded to the reduction in resources for external audit relative to the size of the audit task. This trend was chartered in Chapter 3. Undoubtedly, some organisations would have responded by raising the prominence of internal audit and strengthening internal controls. Other organisations would have given less attention to internal audit. No longitudinal data were available to indicate which was the major trend. However, some 1988 data were available.

14.9 In July and August 1988, the Audit Office conducted a limited sample survey of internal audit in 18 departments and outliers and 41 statutory authorities and government companies. The survey was undertaken to provide more information on issues raised in the inquiry. The findings of the sample survey were as follows<sup>6</sup>:

14.10 From July 1987 to July 1988:-

- . the internal audit establishment fell from 776 to 713, or by 9.2 per cent;

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3. DEET Submission, op. cit., para. 42.

4. Institute of Internal Auditors, Australia, Canberra Chapter, Submission, 2 August 1988, para. 7.

5. C Monaghan to Secretary, JPCPA, 11 August 1988.

6. D Hill to Secretary, JPCPA, 2 September 1988.

- . actual internal audit staff numbers fell from 747 to 674 or by 10 per cent. This reduction in resources for internal audit may have been an example of risk management;
- . most departments and outriders devoted less than 50 per cent of their audit resources to compliance and regularity auditing;
- . the majority of statutory authorities and companies devoted most internal audit resources to compliance and regularity auditing;
- . almost 25 per cent of all departments and outsiders had combined their internal audit resources with other areas, such as management improvement, evaluation and review and performance monitoring; and
- . 29 per cent of organisations surveyed, including 41 per cent of statutory authorities and Government companies, had contracted all or part of the internal audit function to the private sector.

14.11 Three models of internal audit were evident in the Commonwealth sector, with a focus on:

- . performance auditing and monitoring;
- . performance and regularity auditing; and
- . regularity, including compliance and financial, auditing.

14.12 Machinery of government changes, including formation of large departments, occurred in the period covered by the survey. Reductions in staff numbers shown above, therefore, partly reflected economies required by the merging of administrative functions. In 1987-88 in agencies subject to staff budget control, average staffing levels fell by between 5.5 and 0.7 per cent (depending on which definitions were used)<sup>7</sup>. Management service areas were subject to greater cut-backs in staff than many other areas after the July 1987 administrative rearrangements. Even so, it appeared that internal audit had been particularly hard hit at a time when it was facing new demands. These new demands arose from the requirement that departments and other authorities should prepare financial statements for the first time and commencing with the 1988-89 financial year. It is expected that management of Commonwealth sector organisations will rely even more than previously on internal audit as a result of this innovation.

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7. Portfolio Program Estimates 1988-89, Budget Paper No. 3, AGPS, Canberra, 1988, p.9.



14.13 What was unclear was whether the reduction in resources for internal audit suggested by the Auditor Office's limited 1988 survey was offset by improved efficiencies in the internal audit function. No evidence was presented to the Committee to suggest that this was the case. A caveat, though, is that the Audit Office survey presented suggestive rather than definitive evidence on the state and role of internal audit.

14.14 If the Commonwealth sector as a whole was devoting fewer resources to internal audit, the the reduction in attention to this vital internal control will require greater attentiveness and more work by the Audit Office, and more resources.

14.15 It is possible that more staff will be allocated to internal audit during 1988-89 to assist in preparation of departmental financial statements. If so, then mid - 1988 will be seen as internal audit's nadir. It is too early for any patterns to be clear at this stage.

14.16 The Committee recommends that:

- . The Australian Audit Office undertake an efficiency audit of internal audit in the Commonwealth sector. The efficiency audit should include a comprehensive survey of internal audit.

14.17 The former Public Service Board had a role in improving financial management including internal audit. Since the Public Service Board's disbandment, the DOF has further developed its role in financial management improvement in Budget-dependent agencies. However, the DOF does not appear to have a clear role or, indeed, any charter at all to ensure that internal audit in Budget-dependent agencies is adequate. The latter is now almost exclusively seen as a responsibility of departmental secretaries and chief executive officers.

14.18 In the Committee's opinion, these officials undoubtedly have the primary responsibility for maintaining satisfactory internal financial controls of which internal audit is a part. But there remains the important task of monitoring the quality and adequacy of internal controls across the Budget sector, and of taking initiatives to address common problems. The Department of Finance is the logical executive government agency to have this responsibility since the latter would be an addition to its existing responsibility to promote the quality of financial management. Yet the DOF has no formal charter to take steps to improve internal audit.

14.19 An example from the State sector is pertinent. The Victorian Department of Management and Budget has a similar role



in State Government as the DOF has in Federal Government. Recently, the Department of Management and Budget has taken steps to improve the quality of internal control across the Victorian State Government sector<sup>8</sup>.

14.20      The Committee recommends that:

- .      The Department of Finance develop a stronger interest in the adequacy of internal audit in Budget-funded agencies through, for example, sponsorship of inservice education including seminars.

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8. Victorian Department of Management and Budget, Internal Audit in the Victorian Public Sector: An Introduction to the Function for Management and Staff, Department of Management and Budget, Melbourne, 1987.



## Chapter 15

### PROFESSIONAL ASSOCIATIONS AND AUDIT STANDARDS

15.1 Major links between the Australian Audit Office, the auditing profession and private sector audit practice were as follows:

- . 55 per cent of AAO staff were members of the Australian Society of Accountants, ASA;
- . 5 per cent of AAO staff were members of the Institute of Chartered Accountants, ICA;
- . successive Auditors-General have been members of the Australian Society of Accountants Auditing Standards Board;
- . the AAO issued auditing standards, which itself and other auditors of Federal Government organisations must follow; and
- . for the future, the Committee has recommended that the Auditor-General employ private sector auditors on contract in certain situations.

15.2 A decision is necessary on whether the range of formal contacts between the AAO, the audit profession and private sector practice should be augmented. An argument in favour of increased linkages was that these may break down one image of the Audit Office as being an insular or inward looking organisation.

15.3 Major difficulties in the AAO attracting and retaining quality staff were because of:

- . income differences between private and public sector auditors (these are discussed elsewhere in this report); and
- . the Audit Office's image.



15.4 Images of the Audit Office within the profession were confused and sometimes contradictory. Often they were based on outdated information. Notwithstanding, they were factors which could not be ignored. Essentially, within the audit profession, the Audit Office was seen as having valuable clients but not being at the 'cutting edge' of the profession. One exception was in the conduct of efficiency audits of Government agencies where the Audit Office was considered to have more experience. Another exception was that the Audit Office was seen to be more knowledgeable about government rules, regulations and procedures than private sector auditors. It was not surprising to discover that the Audit Office was believed to have advantages in these two areas. Nevertheless, the largest accounting firms believed that they were 'in front' of the Audit Office in the audits of financial statements and accounts and records of commercially oriented organisations. It was unclear to what extent this had developed because of legislative constraints on the AAO.

15.5 The Committee did not seek to prove or disprove these claims. However, that they were widely held was incontestable. This image problem creates difficulties for the Audit Office in attracting and maintaining staff. To some extent, recruitment of graduates and of persons beginning in the profession was made easier by starting salaries comparable or a little better than in the private sector. However, Audit Office salaries lagged far behind those in the private sector from the level of audit manager upwards. It will be recalled that only 3 of the 85 staff recruited to the AAO in 1987-88 came from the private sector<sup>1</sup>.

15.6 Setting aside the salaries issue, what can be done to improve the image of the Audit Office within the accounting profession? There could be much more interaction with the private sector on strategic and technical issues, greater recruitment of senior staff from the private sector, and regular interchanges with audit firms. This latter has some risks because of possible 'poaching' or the attraction of higher salary.

15.7 The Committee recommends that:

- . The Auditor-General appoint a consultative or advisory committee with representatives from the private sector, universities and auditees. The committee would advise him on developments in private sector audit. It would assist in identifying emerging problems or issues, and would be a source of strategic advice including contracting of audits (section 11 of the Audit Act 1901). Further, the committee's

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1. C. Monaghan to Secretary, JPCPA, 11 August 1988.

terms of reference be drafted to avoid any impression that it would reduce the Auditor-General's independence and status.

- . The Auditor-General appoint a separate consultative or advisory committee on audit practices and standards. This committee would provide technical advice to the Australian Audit Office and ensure that the Audit Office's practices and standards were formed with knowledge of private sector practices without necessarily adopting those. This group may be a subcommittee of the major consultative or advisory committee.
- . An interchange scheme be initiated wherein Australian Audit Office staff would work in private sector audit firms.
- . There be major recruitment of senior staff from either within or outside the public sector.

15.8 The Committee believes it is essential that such a recruitment program succeed. This recommendation is made fully realising that large increases in salaries will be necessary for some key officers.

15.9 The AAO has given great attention to the development of international co-operation in public sector audit through membership of the International Organisation of Supreme Audit Institutions, INTOSAI. Currently, the Australian Auditor-General is INTOSAI chairperson, which indicates the high regard in which the AAO is held internationally.

15.10 Within Australia, the AAO participated in regular meetings of Auditors-General from the States and the Northern Territory. The New Zealand Auditor-General frequently participated in these meetings.

15.11 These national and international meetings, which pointed to the sharing of ideas and approaches in public sector audit, were essential for maintenance of the quality and integrity of public sector audit in Australia.

15.12 The irony was that the AAO did not appear to have given the same attention to development of its relationship with private sector auditors in Australia. The above recommendations seek to redress this imbalance.



15.13 As quoted earlier, 55 per cent of AAO staff were ASA members while 5 per cent were ICA members. Considering the largest accounting firms with which the AAO compared itself, the AAO had an under-representation of ICA members. This may or may not have changed the Office's effectiveness. Young auditors who wish to become Institute members do so by having a year of professional training with an Institute member, preferably a partner in an audit or accounting firm. No member of the 24 person AAO Senior Executive Service, SES, which was the Office's leadership and management, was an Institute member. Therefore, there was no one within the Audit Office with the background necessary to train a young auditor for Institute membership.

15.14 The AAO had many highly skilled, first class auditors who were not Institute members. However, in order to attract greater numbers of quality young auditors, the AAO must be able to offer to them the further education and training to which many aspired. It must be stressed that the AAO is competing for staff when there is a severe shortage of qualified accountants.

15.15 Turnover amongst audit staff within the private and public sector has increased in recent years. There is no sign of a decrease in the rate of staff mobility, even amongst the most prestigious private firms. Therefore, the general pattern of recruitment of young graduates or graduates with a few years experience, followed by on-the-job experience and training for a number of years, and then movement to other auditing or accounting employment (or to employment elsewhere in the financial sector) will remain. This will continue to be accompanied by movement of staff between the private and public sectors.

15.16 In the long term, the AAO's image will be improved if, first, it acknowledges more openly that this pattern of staff mobility is likely to remain for the foreseeable future, and, second, if it designs staff recruitment and training policies with this pattern of staff mobility in mind.

15.17 Many young graduates do not seek AAO employment because the AAO cannot offer the training and experience necessary for them to become members of the Institute. Current recruitment policies were appropriate for those young auditors and accountants who wished to become ASA members, but they were unsatisfactory for those who wished to become ICA members. In the Committee's view, ASA and ICA membership was of equal utility to the AAO. However, the Committee's views were less important than the opinions of the auditors whom the AAO needs to recruit. The reality is that, since many of these want to become ASA members and many wish to become ICA members, AAO recruitment policy should be responsive to both sets of aspirations.



15.18 Presently, the AAO is almost powerless to change its recruitment policies because:

- . any senior AAO staff with ICA membership were likely to be attracted to the private sector in search of higher incomes, while experienced private sector auditors with ICA membership were unwilling to apply for AAO jobs because of the likely severe fall in income; and,
- . even if senior staff had ICA membership, the AAO could not unilaterally declare that it was training auditors for the Institute. Beforehand, the Institute's approval must be gained.

15.19 ICA membership involves training in other fields such as taxation, business evaluations and insolvencies, and cost accounting. The AAO cannot offer training in all fields. Notwithstanding, there is still much training which the AAO could offer, perhaps in co-operation with other parts of the Commonwealth sector such as the Australian Taxation Office and commercially oriented government organisations. Of note is that the Canadian Institute of Chartered Accountants classifies the Canadian Auditor-General's Office as being equivalent to a firm of chartered accountants for training purposes.

15.20 The Committee recommends that:

- . Membership of both of the major professional accounting bodies, the Institute of Chartered Accountants and the Australian Society of Accountants, be adequately represented amongst the Australian Audit Office's senior and other staff.
- . The Australian Audit Office commence negotiations immediately with the Institute of Chartered Accountants to permit young accountants who wished to become Institute members to have their professional training in the Audit Office.

15.21 The objectives of these recommendations are to raise the profile of the AAO in the auditing profession. In some ways, this will mean that the AAO will move closer to the model of the largest accounting firms which have many more chartered accountants than the AAO. If the recommendations are accepted, then, within five years, the proportion of AAO who are Institute members will be significantly greater than the current level of 5 per cent, and a significant proportion of SES staff will be Institute members, or even of both bodies.



## Chapter 16

### INDEPENDENT AUDITOR OF THE AUSTRALIAN AUDIT OFFICE

16.1 An innovation with the 1979 amendments was the introduction of the position of Independent Auditor of the Australian Audit Office. The functions of the Independent Auditor are to<sup>1</sup>:

- . carry out audits of the Australian Audit Office's accounts, records, and financial statements; and
- . execute efficiency audits of the Australian Audit's Office operations.

16.2 The first Independent Auditor was appointed in May 1979 for a three year term. He was re-appointed in May 1982 and May 1985 for further three year terms. In June 1988, the Minister for Finance announced the appointment of a new Independent Auditor for three financial years commencing with the 1987-88 financial year.

16.3 Each year the Independent Auditor's opinion on the Australian Audit Office's financial statements has been published as an Appendix to the Auditor-General's report on the Financial

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1. Section 48K of the Audit Act 1901 states:

- '(1) The Minister may, on behalf of the Commonwealth, make arrangement for time to time, with a suitable person to exercise the powers and perform the functions of the independent auditor under this Division.
- (2) For the purposes of this Division, the functions of the independent auditor are:
  - (a) to carry out audits of the accounts and records kept, in accordance with section 40, in relation to the Australian Audit Office;
  - (b) to examine such parts of the statements transmitted to the Auditor-General under section 50 as relate to the Australian Audit Office;
  - (c) to examine the accounts of the stores of the Australian Audit Office;
  - (d) to carry out efficiency audits of the operations of the Australian Audit Office;
  - (e) to furnish, in accordance with this Division, reports of the results of audits and examinations so carried out by him.'



Statements prepared by the Minister for Finance for the previous financial year, (Appendix 12). The Independent Auditor also undertook audits of the Australian Audit Office's accounts and records, the results of which were reported in the Auditor-General's annual reports<sup>2</sup>. Two efficiency audit reports on the Australian Audit Office were released in March 1982 and December 1987<sup>3</sup>.

## Appointment

16.4 The two Independent Auditors were appointed from the private sector. The firms to which they belonged did not have audit business with the Federal Government at the time of appointment. Contracts for the position of Independent Auditor were signed with the individuals as required by the Audit Act (section 48K), not with the audit firms.

16.5 An existing criterion for appointment, which is an expectation that the firm of the individual appointed to the position of Independent Auditor must not have an audit contract with the Government, should be relaxed. However, the individuals's firm should not have contracts with the Audit Office for audits or other activities.

16.6 The Committee recommends that:

- . Applicants for the position of Independent Auditor of the Australian Audit Office be selected from individuals who do not have current audit contracts with the Commonwealth Government, and further from a firm which does not have current contracts with the Australian Audit Office.

16.7 The Independent Auditor is appointed by the Governor-General on the advice of the Minister for Finance. This arrangement was instituted because the Minister for Finance has been responsible for administering both the financial management and audit provisions of the Audit Act. The next Chapter recommends repeal of the Audit Act and its replacement by two separate acts, a financial management act and an audit act. Chapter 5 recommended establishment of an Audit Committee of Parliament, which would have responsibility for recommending the Audit Office's annual appropriation.

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2. Annual Report of the Australian Audit Office, op. cit., 1984-85, p.96; 1985-86, p.105; 1986-87, p.83.

3. E. Cameron, Report of the Independent Auditor on an Efficiency Audit of the Auditor-General's Office under the Audit Act 1901, AGPS, Canberra, 1982. E. Cameron, op. cit., 1987.

16.8 The Committee recommends that:

- . Future recommendations for appointment to the position of Independent Auditor be the responsibility of the Audit Committee of Parliament. The Governor-General would continue to have the power to appoint the Independent Auditor but on the advice of the Prime Minister who, in turn, would be advised by the Audit Committee of Parliament.

16.9 Appointment should be for a limited period. Tenure should be sufficient for the Independent Auditor to be able to acquire the knowledge of the Australian Audit Office necessary to conduct efficiency audits.

16.10 The Committee recommends that:

- . Appointment of Independent Auditor of the Australian Audit Office be for a minimum term of three years and a maximum term of five years.
- . The outgoing Independent Auditor make available to the incoming Independent Auditor relevant letters, working papers and other documentation to facilitate the change-over of auditors.

## Role

16.11 The Independent Auditor can be a source of independent criticism and advice for the Audit Office. To perform this role satisfactorily, more performance audits will be necessary in addition to financial and regularly audits. Between 1979 and 1987, two performance audits of the Australian Audit Office were undertaken. The first efficiency audit was undertaken when efficiency audit methodology was new, and the second was attempted when the methodology was better developed. These efficiency audits did not lead to any serious re-thinking within the Australian Audit Office of its approaches. Nor did these efficiency audits alert Parliament to any fundamental problems in the Australian Audit Office, which have included very high staff turnover and acute resource shortages for all kinds of audits.

16.12 Therefore, in practice, the Independent Auditor's major contribution over nearly a decade was to affirm the accuracy of the Australian Audit Office's financial statements. This remains a very important function. However, this contribution was insufficient to reassure Parliament that the Audit Office's work



was in accord with the best professional practice, and that the Australian Audit Office was well managed.

16.13 One reason for this inadequacy was that the PAC was remiss in never meeting with the first Independent Auditor during his appointment from 1979 to 1987. Therefore, the first Independent Auditor never received any Parliamentary advice on his responsibility. That advice always came from executive government through the Department of Finance. The PAC has sought to develop its relationship with the Independent Auditor by meeting with the second incumbent in 1988 nine years after the position was established by legislation. Regular meetings are planned in future.

16.14 Clearly it is the Auditor-General's responsibility to alert Parliament to major problems in administration of his or her legislated functions. Auditors-General have largely accepted this responsibility, although since the first separate annual report by an Auditor-General was prepared only as recently as 1985, there has been a distinct lack of one notable avenue by which an Auditor-General's concerns could be communicated to Parliament.

16.15 An Independent Auditor's examination and statements on similar matters provide Parliament with another benchmark. This notion of establishing a benchmark or reference point for looking at the Australian Audit Office has been of high importance since the position of Independent Auditor was created. Notwithstanding, the Independent Auditor was under-utilised by both the executive and legislative arms of government from 1979 when the first Independent Auditor was appointed until 1988 when his successor was installed. Under-utilisation resulted in less pressure on the Audit Office to keep up to date than was warranted.

16.16 This situation will not be acceptable in future. The Audit Committee of Parliament must have a clear brief which includes responsibility for advising the Independent Auditor on his or her role. This advisory role would include provision of advice or guidance on the number of performance audits to be undertaken and the subject matter of those audits. A situation where there were more performance audits, for example, of audit methodology or of resource deployment, would provide Parliament with better assurances than it has currently of the suitability of the Audit Office's techniques and the efficiency of its resource usage. Notwithstanding, under the proposed arrangements, the Independent Auditor would remain free to choose the numbers and kinds of performance audits necessary, in addition to audits of financial statements and accounts and records.

16.17 This stronger, better defined role for the Independent Auditor would strengthen the Auditor-General's accountability to Parliament.



## **PART E**

### **THE FUTURE**



## **Chapter 17**

### **FUTURE FUNDING**

17.1 The question of the future level of funding of the AAO is addressed separately for regularity and performance audits. An overall comment is that total funding for the AAO is inadequate since resources must be directed from performance audits in order to maintain regularity audits.

#### **Regularity Audits**

17.2 There was no evidence presented to the Committee to indicate that resources for financial audits were inadequate. In other words, formulas used to set resource levels for financial audits appeared to be satisfactory. Notwithstanding, the analysis in Chapter 3 of AAO resources and responsibilities over a ten year period raised doubts about current approaches to determining the adequacy of resources for regularity audits.

17.3 Economies are possible in financial audits. Audits of financial statements prepared by the Minister for Finance, for example, consume approximately 10 per cent of the AAO's resources and is the AAO's largest single audit. Introduction of financial statements by departments and other Budget - dependent agencies provides the Audit Office with an opportunity to reconsider its approach to audit of the financial statements prepared by the Minister for Finance, and second, whether economies can be made in the audit. Such reconsideration may liberate resources for additional financial statement audits although it would have no effect on total resources for financial audits.

#### **Performance Audits**

17.4 The present situation wherein resources are diverted from efficiency audits to fund financial or regularity audits is unjustifiable. It is a direct result of how efficiency audits are discretionary while financial or regularity audits are mandatory. When the efficiency audit legislation was enacted most discussion was of the need to legitimise efficiency audits as a valid activity for the Audit Office. Far less, if any, attention was given to the question of how many efficiency audits were



desirable and necessary. Prior to the 1979 amendments, Parliamentary debate and analysis within administrative circles emphasised the need for the Audit Office to build up its resources slowly for the new activity. This was done. After ten years experience, the Audit Office still devotes only a relatively small amount of resources for efficiency audits. This situation was not expected when the 1979 amendments were passed. Meanwhile, resources for performance audits as a whole, including both efficiency and project audits, are approximately half of what they were at the introduction of efficiency audits.

17.5 The inconsistency in the legislation is that although efficiency audits are discretionary, they are also highly useful tools to maintain the efficiency of public sector organisations and programs. Notwithstanding, there are other ways of improving public sector efficiency.

17.6 The DOF's emphasis on program budgeting and greater devolution of responsibility to managers are major innovations to improve public sector efficiency and effectiveness. In fact, the purported additional discretionary authority and responsibility of program managers does not diminish and may increase the need for accountability mechanisms. Program budgeting is not developed sufficiently to permit heavy reliance on it to ensure that Parliament is kept informed of changes in efficiency. Consequently, and as argued earlier, these innovations do not reduce the need for efficiency audits.

17.7 The Audit Act does not specify how many efficiency audits should be done. It does not even require the Auditor-General to conduct efficiency audits since these are at his discretion. On the other hand, the Auditor-General is expected to undertake financial and regularity audits.

17.8 Parliament has never indicated to the Auditor-General how many efficiency audits he should do, nor how many resources should be allocated to this kind of audit.

17.9 Executive government, as far as can be determined, has never officially informed the Auditor-General of its opinion of how many resources he should allocate to efficiency audits nor how many of these he should aim to complete. The Department of Finance, nevertheless, on behalf of executive government has determined the Audit Office's resources.

17.10 The Auditor-General is free to determine how many resources he sets aside for efficiency audits, but this freedom is circumscribed by the mandated requirement to undertake financial and regularity work. With a given amount of resources it is true to say that he has the discretion to commence as many efficiency audits as he wants. However, resource requirements of the methodologies necessary to address particular problems are

limits on his choice. This last kind of limit applies to any level of resources the Auditor-General might have.

## Effects of Current Resources

17.11 The audit cycle is defined as the number of years it takes to subject all programs with certain characteristics to an audit. In the case of audits of financial statements of statutory authorities, the audit cycle is one year since financial statements are audited annually. The audit cycle for efficiency audits of programs is far longer. In 1987-88, the Commonwealth government funded 826 programs. 350 of these programs had income or expenditure of at least \$10m and 476 had less than \$10m in income or outlays.

17.12 Table 17.1 shows that if 1987-88 trends continued, it would take approximately 40 years with current resources before every program with income or expenditure greater than \$10m was subjected to an efficiency audit.

17.13 Table 17.2 provides more information, indicating that if 1987-88 trends continued, it would take the following number of years to complete efficiency audits of all programs with income or expenditure of \$10m or more in the following kinds of government organisations:

- . 54 years in statutory authorities;
- . 48 years in departments; and
- . 20 years in departmental outriders.

17.14 In that year, no efficiency audits were conducted in government companies or in departmental commercial undertakings.

17.15 In 1987-88 the AAO:

- . completed 8 efficiency audits;
- . allocated \$1m for staff costs for these; and
- . set aside 6 per cent of total AAO resources for efficiency audits.

17.16 The 350 programs with individual allocations of at least \$10m had a combined value of approximately \$84b. In other words, \$1m was available for the efficiency audits of programs with a value of \$84b.

TABLE 17.1

Summary of Costs of Various Cycles of Efficiency Audits

Length of Efficiency Audit Cycle (in years)	Resources (\$m)
1987-88 40 year average	1.0
10 years	8.2
5 years	15.5
3 years	20.9
AAO Preferred	16.7



17.17 These statistics indicated that efficiency audits were an activity of marginal importance to improving the efficiency and effectiveness of public administration in Australia.

## Overseas Comparisons

17.18 In other countries, efficiency audits are often called value for money audits. In 1988-89, 10 per cent of the New Zealand Audit Office's resources were allocated to value for money studies and other special investigations. The target is to apply 25 per cent of total resources to value for money and related reporting activities.

17.19 42.8 per cent of resources of the Canadian Audit Office were set aside for value for money audits in 1988-89<sup>1</sup>. 45 per cent of staff resources of the National Audit Office in the UK were for value for money audits in 1988-89. The objective is to increase this to 54 per cent within 5 years by 1993-94. This will involve an increase in the number of reports from 39 to 53<sup>2</sup>.

17.20 The AAO devotes substantially fewer resources to efficiency or value for money audits than national audit offices in any of these countries. No good reason was given during the inquiry for continuation of this situation.

## Principles

17.21 The Committee believes that the funding of efficiency audits should be based on the following four principles, which would be the basis of a funding formula to be adopted by the Audit Committee of Parliament:

- . A legislative requirement for efficiency audits;
- . Separate determination of the budget for regularity and performance, specifically efficiency, audits;
- . Linkage of funds for efficiency audits with growth in government income and outlays, and with change in the structure of government programs; and
- . Funding should be based on the AAO's performance in regard to efficiency audits.

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1. Office of the Auditor-General of Canada, 1988-89 Estimates, Part III, Expenditure Plan, Minister of Supply and Services, Ottawa, 1988, p.27.
  2. The National Audit Office Corporate Plan for 1989-90 to 1993-94, NAO, London, 1988.

#### A legislative requirement for efficiency audits

17.22 This requirement would have two components:

- . inclusion in audit legislation of the need for the Auditor-General to plan and execute a cycle of efficiency audits; and
- . special examinations on a regular basis, within every portfolio. These activities which would be selected by the Auditor-General, may include a program or programs, or they may involve a special examination of an entire organisation. Such a distribution of effort across portfolios would ensure a coverage of all government activities.

17.23 Design of a cycle of efficiency audits must consider the duration of programs since there are probably more short-term programs, for example, of three years duration than there were a decade ago. The approach to and need for efficiency audits of short-term and long-term programs may be different.

#### Separate determination of the budget for regularity and performance, specifically efficiency, audits

17.24 Insulation of the funding basis for efficiency audits from the funding of financial audits was essential to counter the current arrangement wherein increases in the number of financial statement audits automatically diminished the number of efficiency audits. However, the Auditor-General must be given the discretion to reallocate a proportion of funds from one kind of audit to another depending on the need for and costs of various audits.

#### Linkage of funds for efficiency audits with growth in government income and outlays, and with change in the structure of government programs

17.25 The purpose of this linkage would be to ensure, for example, that as government income and expenditure increased, more resources were made available for efficiency audits. No linear relationship is required between funds for audits and increases in government income and expenditure. The level of funds for efficiency audits must also be linked to the structure of government programs or service delivery since that structure is a major determinant of audit workload. For instance, \$1b could fund one or ten programs, possibly justifying a minimum of one or a maximum of ten efficiency audits.

Funding should be based on the AAO's performance in regard to efficiency audits.

17.26 This performance factor would provide an incentive for the AAO to maintain and develop its contribution to improving the efficiency and effectiveness of public administration. The AAO would be required to demonstrate its contribution annually. The requirement will compel the Audit Office to collect data on the effects of its findings and recommendations.

17.27 These principles must be combined into a funding formula which would be used by the Audit Committee of Parliament. Utilisation of this funding formula would mean adoption of a zero-based approach to the financing of efficiency audits.

17.28 The Committee recommends that:

- . The funding of efficiency audits be based on the following four principles, which would be the basis of a funding formula to be adopted by the Audit Committee of Parliament:
  - . a legislative requirement for efficiency audits;
  - . separate determination of the budget for regularity and performance, specifically efficiency, audits;
  - . linkage of funds for efficiency audits with growth in government income and outlays, and with change in the structure of government programs; and
  - . the Australian Audit Office's performance in regard to efficiency audits.

## Financial Options

17.29 Remembering that it would take approximately 40 years to conduct efficiency audits of all large income and expenditure programs if 1987-88 expenditure trends continued, and ignoring the cost of conducting efficiency audits of small programs, Table 17.1 provides estimates of the costs of efficiency audit cycles of briefer duration. Further data are in Table 17.2. These costs are as follows:

- . a 40 year audit cycle costs \$1m;
- . a 10 year audit cycle would cost \$7.2m;
- . a 5 year audit cycle would cost \$14.5m; and



Table 17.2Costs of Various Cycles of Efficiency Audits, by Type of Government Organisation<sup>1</sup>

Length of Efficiency Audit Cycle (in years)	Organisation Type	No. of Programs	No. of Efficiency Audits <sup>2</sup>	Total Additional Cost (\$m) <sup>3</sup>
<u>1987-88<sup>4</sup></u>				
0	Govt Companies	21	0	n.a.
54	Statutory Authorities	108	2	n.a.
0	Departmental Commercial Undertakings	18	0	n.a.
48	Govt Departments	144	3	n.a.
20	Outriders	59	3	n.a.
Subtotal <sup>6</sup>			8	1.0 <sup>5</sup>
10	Govt Companies	21	2	0.4
	Statutory Authorities	108	11	2.4
	Departmental Commercial Undertakings	18	2	0.4
	Govt Departments	144	14	2.8
	Outriders	59	6	1.2
Subtotal			35	7.2
5	Govt Companies	21	4	0.8
	Statutory Authorities	108	22	4.5
	Departmental Commercial Undertakings	18	4	0.8
	Govt Departments	144	29	6.0
	Outriders	59	12	2.4
Subtotal			71	14.5

3	Govt Companies	21	6	1.2
	Statutory Authorities	108	36	7.3
	Departmental Commercial Undertakings	18	6	1.2
	Govt Departments	144	48	9.7
	Outriders	59	20	0.4
Subtotal			116	19.9
AAO Preferred				
20	Govt Companies	21	1	0.3
10	Statutory Authorities	108	11	2.4
5	Departmental Commercial Undertakings	18	4	0.8
3	Govt Departments	144	48	9.8
5	Outriders	59	12	2.4
Subtotal			76	15.7

1. The efficiency audit cycle refers to the number of years to complete an efficiency audit of all programs with an expenditure greater than \$10m.
2. Approximately 50 per cent of efficiency audits do not proceed beyond the diagnostic studies. These estimates are based on that expectation.
3. A labour on-costs and indirect costs overhead factor of 1.62 was obtained from the Department of Finance's discussion paper: DOF, Guidelines for Costing of Government Activities, AGPS, Canberra, May 1988.
4. The current average efficiency audit cycle for all programs with expenditure greater than \$10m is approximately 40 years.
5. This was actual 1987-88 expenditure on efficiency audits: n.a. is not applicable.
6. Estimates in the final column may not total due to rounding.

- . a 3 year audit cycle, which is the maximum life of a Parliament and a Government, would cost \$19.9m.

17.30 The need to re-appraise funding for project audits is ignored in these estimates.

17.31 The Committee requested advice from the Audit Office on how often it believed programs should be subjected to efficiency audits. The Audit Office replied that programs in different kinds of organisations should have different audit cycles, as follows (Table 17.2):

- . 20 years in government companies;
- . 10 years in statutory authorities;
- . 5 years in departmental commercial undertakings;
- . 3 years in departments; and
- . 5 years in departmental outriders.

17.32 The Committee suspects that although no government company has ever had an efficiency audit, these will occur in future but only very occasionally. Notwithstanding, the expectation of one efficiency audit of a government company every 20 years is probably an underestimate.

17.33 Audit estimated that based on these efficiency audit cycles, an additional \$15.7m was necessary. This is also shown in summary form in Table 17.1 and in more detail in Table 17.2. A funding increase of that order of magnitude would mean that 50 per cent of the Audit Office's resources would be for efficiency audits and 50 per cent for project and regularity audits. This is approximately the same distribution as in national audit offices in the United Kingdom and Canada. A substantial funding increase would permit efficiency audits to make the contribution towards increased public sector productivity envisaged by the Royal Commission on Australian Government Administration in 1976.

17.34 The Committee is inclined to recommend an increase in funds for efficiency audits in a major effort to improve public sector efficiency. Consequently, substantial savings in government expenditure and improved program effectiveness is expected from greater outlays on efficiency audits. In the long run, net savings to the public purse should be greater than gross outlays on this kind of audit.



17.35 The AAO's 1988-89 budget is \$26.9m. A \$15.7m increase would be almost a 60 per cent increase in resources. The AAO could not be expected to manage such a large increase in a short period without considerable stress. Further, the Federal Government has placed strict limits on growth in public outlays.

17.36 The Committee recommends that:

- . The Australian Audit Office adopt the following cycle of audits for all programs with expenditure or revenue greater than \$10m:
  - . a 20 year cycle for government companies;
  - . a 10 year cycle for statutory authorities;
  - . a 5 year cycle for departmental commercial undertakings;
  - . a 5 year cycle for departmental outriders; and
  - . a 3 year cycle for departments.

17.37 This will require an additional \$15.7m. These audit cycles should be developed over a five year period from 1989-90, and be operational by 1994-95. An initial grant of \$3.1m in addition to current funding should be made in 1989-90 with the additional expenditure being phased in over five years.



## Chapter 18

### NEW LEGISLATION

#### 18.1 New audit legislation is necessary:

- . to establish the Audit Committee of Parliament;
- . to identify the Auditor-General more clearly as an officer of the Parliament;
- . to establish the procedures for appointing future Auditors-General, and to change procedures for their removal;
- . to change the term of appointment of future Auditors-General;
- . to define the Auditor-General's authority to settle the terms and conditions of employment of Australian Audit Office staff;
- . to extend the Auditor-General's power to delegate his authority;
- . to affirm that the Auditor-General is the external auditor of all Commonwealth Government bodies and organisations in which the Commonwealth has a controlling interest;
- . to affirm the Auditor-General's authority to initiate efficiency audits of all Commonwealth instrumentalities;
- . to place beyond doubt the Auditor-General's authority to contract audits to whom he or she considers appropriate;
- . to simplify statements of the Auditor-General's authority in relation to regularity and performance audits;
- . to rename the Australian Audit Office (see below); and



- . to reaffirm the role of the Independent Auditor of the Australian Audit Office in light of these legislative changes.

18.2 There is a further reason for new legislation:

- . to provide the Australian Audit Office with a clearer definition of its role in government.

## Role of the Australian Audit Office

18.3 The Audit Act 1901 defines the responsibilities of the Auditor-General to include<sup>1</sup>:

- . appointment of persons to inspect, examine and audit any accounts, records or stores required by the Act or other relevant legislation. Such persons must report the results of such work to the Auditor-General, (section 11). These persons have the same powers of inspection as the Auditor-General;
- . appointment of persons to conduct efficiency audits;
- . reporting to the minister for the audited department or authority on matters arising out of the exercise of his powers (section 12); and
- . reporting significant matters from efficiency audits to the Prime Minister, the Minister for Finance as well as to the minister responsible for the audited department or authority.

18.4 The Auditor-General is granted extensive powers:

- . to require persons to appear personally before him and to produce accounts and records the Auditor-General deems necessary, (section 13);
- . to search records in the custody of ministers and other persons in public office; and
- . to have access to any accounts and records he deems fit (section 14B).

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1. Chapter 2 of the AAO Submission to this inquiry contains a complete list of the Auditor-General's functions.

18.5 References to the Audit Office are made under the following sections of the Act<sup>2</sup>:

2. 'Auditor-General's Office' means the branch of the Australian Public Service under the direct control of the Auditor-General.

11. The Auditor-General may, ...

(a) appoint a person to inspect, examine and audit any accounts, records or stores which are required by this Act.

48K(1). 'The Minister may...make arrangements with a suitable person... to exercise the powers and perform the functions of the independent auditor.

(2). ...the functions of the independent auditor are -

(a) to carry out audits of the accounts and records kept... in relation to the Auditor-General's Office.'

18.6 The Audit Amendment Act 1988 referred to the Australian Audit Office by name for the first time.

18.7 In comparison, the National Audit Act 1983, which was drafted after a major revision of audit legislation in the United Kingdom, refers throughout to the National Audit Office, NAO, which is the equivalent of the AAO<sup>3</sup>.

18.8 The AAO stated that the role of the AAO followed the role of the Auditor-General. The AAO defined its role as improvement of<sup>4</sup>:

- . the economy;
- . efficiency; and

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2. Audit Act 1901.

3. National Audit Act 1983, op. cit., section 3.

4. AAO Submission, op.cit.,p.19.

- . accountability of the Commonwealth public sector through comprehensive auditing of the executive and its agencies and through reporting on audits.

18.9 The Department of Finance agreed with the AAO on its role, affirming that the AAO's Corporate Plan reflected its mandate. DOF accepted that the latter was exercised through:

- . undertaking comprehensive auditing of the executive and Commonwealth agencies;
- . reporting to ministers and the Parliament and assisting Parliamentary committees.

18.10 There was no clear path from legislative descriptions of the role of the Auditor-General and the AAO, to the interpretation of the Audit Office's role agreed to by the Audit Office and the Department of Finance. Of note was that the Public Accounts Committee was attracted to the objectives stated in the Audit Office's Corporate Plan despite the Audit Act's circumspect definition of the Office's role. In fact, nowhere did the Act state the Audit Office's role as expressed in the Audit Office's Corporate Plan. The latter had outstripped legislative statements on what the AAO should do.

18.11 A separate consideration was the relationship between auditing standards devised by the auditing and accounting profession, and called Australian Audit Standards, and accounting standards that the Audit Act requires the Auditor-General to devise (section 63MB). A modern audit act is necessary to require the Auditor-General to carry out his duties in accordance with Australian Audit Standards, except where the AAO's standards address issues inadequately covered in Australian Audit Standards. This requirement reflects the Auditor-General's current practice. The Auditor-General's audit standards should neither be lesser nor narrower than Australian Audit Standards, and they should properly reflect the responsibilities of public sector auditors.

18.12 The Committee recommends that:

- . The Audit Act 1901 be rewritten to clarify the role of the Auditor-General and his Office.



18.13 The significance of many recommendations in this report is so great that they will provide the Audit Office with an opportunity for a new beginning. To indicate the break with the past, the Committee believes that the Australian Audit Office should be renamed as the Australian National Audit Office.

18.14 The Committee recommends that:

- . The Australian Audit Office be renamed the Australian National Audit Office.

## The Audit Act's Two Purposes

18.15 The preamble to the Audit Act 1901 states that it is:

An Act to make provision for the Collection and Payment of the Public Moneys the Audit of the Public Accounts and the Protection and Recovery of Public Property and for other purposes.

18.16 The Act provides a legislative basis for:

- . the financial management and administration of Commonwealth sector organisations and programs; and
- . the audit of those organisations and programs.

18.17 Table 18.1 indicates how some parts of the Act deal with financial management and others with audit. Other parts combine the Act's two purposes. For example, Part XI, section 63D(1) states that:

The (public) authority may open and maintain an account or accounts with an approved bank or approved banks and shall maintain at all times at least one such account....

18.18 While section 63G(1) affirms that:

The Auditor-General shall inspect and audit the accounts and records of financial transactions of the authority and records relating to assets of, or in the custody of the authority,...

TABLE 18.1

Principal Provisions of the Audit Act 1901

Part	Heading
i	Preliminary
ii	The Auditor-General
iii	Accounting Officers
iv	Collection of Moneys and Securities
v	Payment of Moneys
vi	Audit and Inspection
vii	Statements and Their Audit
viii	The Loan Fund
ix	The Trust Fund
x	Moneys Outside Australia and Naval Expenditure
xi	Financial Provisions Relating to Public Authorities and Certain Other Bodies
xii	Penalties
xiii	Miscellaneous

18.19 Consequently, the current Act is ill-named being more accurately titled the Financial Administration and Audit Act<sup>5</sup>.

18.20 In comparison, both the United Kingdom and Canada have separate financial administration and audit acts<sup>6</sup>. The above preamble to the Australian Audit Act 1901 can be compared with the preamble to the British National Audit Act 1983 which affirms:

An Act to strengthen Parliamentary control and supervision of expenditure of public money by making new provision for the appointment and status of the Comptroller and Auditor-General, establishing a Public Accounts Commission and a National Audit Office and making new provision for promoting economy, efficiency and effectiveness in the use of such money by government departments and other authorities and bodies...

18.21 In Australia the Department of Finance is responsible for drafting regulations and directions under the Act. Government organisations are required to abide by these, while it is the work of the Auditor-General to determine to what extent this has been done. In this task, the Auditor-General can claim he has little, if any, involvement in drafting the regulations and directions which executive departments and authorities have responsibility for implementing. This division of responsibility between the Department of Finance and the Audit Office is not always clear to auditees. The latter often claim that the Audit Office gives too much attention to auditee adherence to Finance Regulations and Directions which are impediments to efficient administration. The Audit Office's reply is that it has a statutory obligation to implement the Audit Act and to ensure that the Act's regulations and directions are followed. Of relevance is that only 27 per cent of AAO resources are allocated to the audit of Commonwealth agencies bound by Finance Regulations and Directions<sup>7</sup>.

18.22 There is a widely shared perception by auditees that Finance Regulations and Directions do not always promote efficient and economic administration. Hopefully, such reservations apply to a minority of provisions. The Committee urges that the DOF give more attention to communicating the

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5. Acknowledgement of the dual functions of similar legislation is in the title of one of the more recent examples of State government legislation, the Financial Administration and Audit Act 1985 of Western Australia.
  6. In the U.K., these are the National Audit Act 1983 and the Exchequer and Audit Departments Act(s). Canada has the Auditor-General Act 1977 and a Financial Administration Act.
  7. AAO Submission, May 1988, op. cit., pp.62-63.



purposes of the regulations and directions to agencies to which they apply, and to increasing the rate of revision of those provisions to ensure a sharper focus on efficient financial administration.

18.23 Since the authority to make such revisions rests with the DOF, many criticisms of the AAO have been misplaced. This is one reason for splitting the current Act into two pieces of legislation, a Financial Administration Act and an Audit Act. Such division would demonstrate more clearly that responsibility for modernisation of Finance Regulations and Directions was the Department of Finance's responsibility. Thereafter, the Audit Office should be subject to less criticism.

18.24 The Committee recommends that:

- . The Audit Act 1901 be repealed, and be replaced by two new laws, a Financial Administration Act and an Audit Act.

18.25 Legislative change would not be sufficient to transform the Audit Office's image. Two other changes are necessary for that purpose. The first change arises from DOF dissatisfaction with the Audit Office's lack of participation in revisions of Finance Regulations and Directions. According to the DOF, the Audit Office was in a unique position to comment and advise on Regulations and Directions through its scrutiny of records and procedures in every portfolio. DOF welcomed a strong Audit Office involvement in revisions of Regulations and Directions. DOF also believed that the AAO was not more deeply involved because of fear that it would compromise its independence if these were changed and the Audit Office commented on later implementation of those changes.

18.26 The Audit Office participated in a working party on revision of Finance Regulations and Directions, and it had advised on these in other circumstances. Nevertheless, the Committee believes that the Audit Office could use its strategic position to greater advantage in providing advice on revisions of Regulations and Directions, for example, from a cost-benefit perspective. This would mean that the Auditor-General would utilise section 54 of the Act more often. Section 54 states that:

The Auditor-General may ...recommend any plans and suggestions for the better collection and payment of the public moneys and any improvement in the mode of keeping the public

accounts and generally report upon all matters relating to the public accounts moneys and stores, and such plans and suggestions shall be considered and dealt with by the Ministers.

18.27 Clearly, the Audit Office has interpreted this section of its Act excessively narrowly.

18.28 The second change would require the Audit Office to be seen more often by auditees to be balancing its concern with implementation of the Audit Act (through commenting on adherence to Finance Regulations and Directions) with a concern with efficient public sector management. Some auditees have criticised the Audit Office for a lack of balance in these matters. Of course, where the Regulations and Directions are both written and interpreted to allow maximum organisational efficiency, the question of balance is already answered. Yet application of certain Regulations and Directions to particular kinds of decisions in some auditee organisations may lead to the adoption of less efficient means of operation.

18.29 Resolution of this 'choice' between pursuit of maximum accountability and maximum efficiency can explain many management decisions. Auditee criticisms of the Audit Office suggested that managers were doubtful of the Audit Office's appreciation of the dilemmas they confronted in ensuring that both public service accountability and efficiency were maintained. No auditee suggested that the Audit Office should turn a blind eye to the Audit Act. However, there were suggestions that in interpreting adherence to the Act the Audit Office should also draw attention to the efficiency implications of the financial or other procedures which were being examined.

18.30 Greater attention to the efficiency aspects of audited administration would require the Audit Office to consider the perspectives of management without diminishing the importance of upholding the client's, that is, Parliament's, concerns. An irony was that Auditors-General have complained in recent years about reductions in the numbers of performance audits. In the situation described here, auditee management stressed that it would like the Audit Office to provide more comments on efficiency aspects of financial administration in ways which would have minimal impact on the demand for Audit Office resources.





## Chapter 19

### CONCLUSION

19.1 It will be remembered that the inquiry's terms of reference were to investigate:

- . whether the Australian Audit Office had kept pace with developments in regard to the public audit function in the States and Territories and in comparable countries; and,
- . whether current arrangements guaranteed the independence and resources necessary for the Australian Audit Office to fulfil its role as determined by the Audit Act 1901.

19.2 The Committee has answered with a conditional no to the first question, and no to the second question. The most important reasons for this situation were outside the Audit Office's control.

19.3 At the commencement of this inquiry, at a minimum, the AAO could be described as having major problems. At a maximum, the AAO was in a state of crisis. Its problems included:

- . a bare adequacy of resources for regularity audits and insufficient resources for performance audits;
- . discrepancies between performance audit legislation and resources. This was suggested by how the AAO allocated the smallest percentage of resources to performance audits of all comparable national audit offices. No good reason was given to the Committee for the continuation of this situation;
- . the AAO's most important auditee was the principal advisor on the AAO's resources, compromising the former's independence;

- . loss of major auditees;
- . loss of experienced staff at all levels; and
- . an image problem within the accounting profession.

19.4 These problems were so noticeable and severe that they demanded an explanation. In the Committee's view, they had developed for the following reasons:

- . parliamentary complacency. Parliament had been well served by the Audit Office since Federation. The quality and length of service had led to a dulling of Parliament's capacity to perceive that the AAO had difficulties, and perhaps to disbelief that the AAO could ever have major problems;
- . the Auditor-General and his Office fell between two stools, the legislature and the executive. His almost unique freedom from political control coupled with ambiguous relations with executive government led to parliamentary and governmental neglect. Considering the confusion over whether he was an officer of the executive or the legislature, neither appeared enthusiastic about claiming responsibility for the Office's condition. This was an unfortunate consequence of his independence;
- . there were no mechanisms in place to permit Parliament to assume responsibility for the AAO;
- . until very recently, the AAO gave a higher priority to the economy of its operation than to reappraising its contribution to government. This report has argued that the AAO must attend to both concerns. A better understanding of the possibilities of auditing in government will be a result; and
- . lack of public awareness of the importance of government audit.

19.5 The Committee has suggested solutions to the AAO's problems. The solutions include:

- . reaffirmation of the necessity of the Auditor-General being free of political control;
- . a new Audit Act. This was necessary to establish the Auditor-General as an officer of the Parliament and to affirm the Audit Office's service role to Parliament, to establish the Audit

Office as a statutory authority, to give the Auditor-General the authority to determine the terms and conditions of employment of staff, and, amongst other objectives, to indicate for which Commonwealth agencies he was the external auditor;

- . establishment of an Audit Committee of Parliament to permit better parliamentary scrutiny of the AAO's estimates and to pursue a general oversight role of the AAO on Parliament's behalf;
- . a major increase in funding for performance or efficiency audits. In 1987-88, \$1m. was allocated to the efficiency audits of government programs which had a combined value of \$84b. A major increase was warranted to develop the current marginal contribution of efficiency audits to improvements in public sector management; and
- . encouragement of competition between the AAO and accounting firms. This competition will encompass audit productivity, methodology and technology.

19.6 New legislation and formation of the Audit Committee of Parliament are immediate necessities. The funding increase should be staged over five years to permit the Audit Office time to consolidate. The result of these directions for change will be to affirm the AAO's leadership in public sector audit, nationally and internationally. Ultimately, acceptance of recommendations in this report will mean an acceleration of moves to make government both more accountable and more efficient, as well as more responsive to taxpayers.

19.7 Presently the Commonwealth sector is a world where economists reign, and where attention is on large-scale policy choices. Success in developing the best administrative machinery to implement political choices is uneven. The public sector is in need of microeconomic reform such has occurred elsewhere. The Audit Office has made a contribution to improving productivity in that sector and should continue to contribute.

19.8 A good deal of this report focused on sorting out who was the Auditor-General's client, and also with encouraging the Auditor-General to balance differently than in the past the interests of the client, who is Parliament, and auditees. Although Parliament is the Auditor-General's client, it is ironic to consider that few Parliamentarians know much about the Australian Audit Office or even where it is located. The issue of the Audit Office's location is timely since the Audit Office has been compelled to move from its central office in Canberra because of structural problems in the rented building. A new location must be found. Consistent with the report's concern with strengthening the links between Parliament and the Audit Office, there is a final recommendation.



9.9 The Committee recommends that:

- . The Australian Audit Office plan for a new building either within the Parliamentary Triangle or on State Circle adjacent to the new Parliament House, and that the building be called Audit House<sup>1</sup>.

R E Tickner, MP  
Chairman  
9 March 1989

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1. 'The building selected for locating the central staff and myself is situated in Swanston Street, Melbourne, and is some distance from all other Commonwealth offices, no other suitable premises nearer to the latter having been found'. This extract from the first annual report of an Australian Auditor-General in 1902 suggests that some problems take a long time to solve: Report of the Auditor-General for the Commonwealth upon the Treasurer's Statement, op.cit., 1902, p.128.

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## **APPENDICES**



APPENDIX 1

LIST OF SUBMISSIONS TO THE INQUIRY

Commonwealth Government Organisations

ACT Administration, Department of the Arts, Sport, the  
Environment, Tourism and Territories  
AUSSAT  
Australian Broadcasting Corporation  
Australian Government Retirement Benefits Office  
Australian National Railways Commission  
Australian Taxation Office  
Commonwealth Scientific and Industrial Research Organisation  
Department of the Arts, Sport, the Environment, Tourism and  
Territories  
Department of Employment, Education and Training  
Department of Foreign Affairs and Trade  
Department of Primary Industry and Energy  
Department of Social Security  
Department of Transport and Communications  
Department of Veterans' Affairs  
Mr C Monaghan, Acting Auditor-General  
Parliament House Construction Authority  
Qantas  
Snowy Mountains Engineering Corporation  
Mr J Taylor, Auditor-General  
Telecom

Individuals

Ms J Abbott  
Mr R Baker  
Mr E Cameron former Independent Auditor of the Australian Audit  
Office, KPMG Peat Marwick Hungerfords  
Mr Leonard  
Mr G Lillicrap  
Ms M Meyers  
Mr J Monaghan former Auditor-General  
Mr J Stewart  
Captain K Walsh

Other

Mr H Backman, President, Royal Australian Institute of Public  
Administration  
Mr V Doyle, Auditor-General of Queensland  
Mr K Dye, Auditor-General of Canada  
Mr R Humphrey, Auditor-General of Victoria  
Intstitute of Internal Auditors, Canberra Chapter  
Mr E Isaacson, Auditor-General, Northern Territory



Mr E Janssen, Federal Industrial Officer, Professional Officers  
Association  
Mr D Kirby, Auditor-General of Tasmania  
Mr R Lamond, KPMG Peat Marwick Hunderfords  
Mr M McKenna National Director, Australian Society of Accountants  
Mr J Nethercote, Royal Australian Institute of Public  
Administration, Canberra Division  
Mr K Robson, Auditor-General of New South Wales  
Mr P Robson, National Secretary, Administrative and Clerical  
Officers Association  
Mr T Sheriden, Auditor-General of South Australia  
Mr A Smith, Auditor-General of Western Australia  
Mr R Switzer, KPMG Peat Marwick Hungerfords  
Mr M Weeks, MWP Management Consultants

APPENDIX 2

PUBLIC HEARINGS AND WITNESSES IN THE INQUIRY<sup>1</sup>

<u>Date of Hearing</u>	<u>Witnesses</u>
2 June 1988	AUSTRALIAN AUDIT OFFICE  Mr R Alfredson, Project Director, Information Technology  Mr E Hay, Assistant Auditor-General, Policy and Development Branch  Mr M Jacobs, First Assistant Auditor-General, Audit Division B  Mr D McKean, Acting Assistant Auditor-General, Planning and Resource Management  Mr C MacPherson, Acting First Assistant Auditor-General, Corporate Management Division  Mr C Monaghan, Acting Auditor-General  Mr J Riding-Hill, Assistant Auditor-General, Branch 11  Mr M Shanahan, Assistant Auditor-General, Information Technology Branch  Mr G Williams, First Assistant Auditor-General, Audit Division A  Mr R Humphry, Auditor-General of Victoria  Mr J Monaghan, former Auditor-General  Mr T Sheridan, Auditor-General for South Australia
14 June 1988	AUSTRALIAN AUDIT OFFICE  Mr R Alfredson, Project Director, Information Technology  Mr E Hay, Assistant Auditor-General, Policy and Development Branch  Mr C MacPherson, Acting First Assistant Auditor-General

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1. All hearings were conducted in Canberra

1 July 1988

Mr C Monaghan, First Assistant  
Auditor-General, Corporate Management Division

Mr J Taylor, Auditor-General

AUSTRALIAN SOCIETY OF ACCOUNTANTS

Ms E Alexander, National President

Mr C Baragwanath, Deputy President

Mr M McKenna, National Director

ADMINISTRATIVE AND CLERICAL OFFICERS  
ASSOCIATION

Mr W Bibby, workplace Delegate and Senior  
Auditor, AAO

Mr S Farrer, ACOA Member and Principal  
Auditor, AAO

Mr P Hargreaves, Workplace Delegate and  
Assistant Director, AAO

Mr R Lapthorne, Workplace Delegate and  
Assistant Director, AAO

ACT ADMINISTRATION, DEPARTMENT OF THE ARTS,  
SPORT, THE ENVIRONMENT, TOURISM AND  
TERRITORIES

Mr P Hunt, Assistant Secretary, Management  
Improvement Branch

Mr J Peck, First Assistant Secretary, Policy  
Planning and Corporate Management Division

Mr B Rae, Director Audit Review

DEPARTMENT OF FINANCE

Dr M Keating, Secretary

Mr I McPhee, Assistant Secretary, Public  
Administration and Accounting Development  
Branch

Mr D Shand, First Assistant Secretary,  
Financial Management and Accounting Policy  
Division



21 July 1988

AUSTRALIAN WHEAT BOARD

Mr T Flugge, Board Member

Mr R Paice, General Manager

Mr J Nethercote, Deputy President, Royal  
Australian Institute of Public Administration,  
Canberra Division

Mr K Robson, Auditor-General of New South  
Wales

Professor R Walker, School of Accounting,  
Faculty of Commerce and Economics, University  
of New South Wales

8 September 1988

TELECOM

Mr G Cameron, Executive Director, Corporate  
Finance and Control

Mr S Helfenbaun, Manager, Corporate Accounting

SOCIAL SECURITY

Mr J Cooper, Acting Assistant Secretary,  
Internal Audit Branch

Mr V Rogers, First Assistant Secretary,  
Performance and Control Division

DEPARTMENT OF EMPLOYMENT, EDUCATION AND  
TRAINING

Mr B Coulter, Acting Assistant Secretary

Mr G Lillicrap, Director Risk Management  
Section

Mr J Muir, First Assistant Secretary  
Management Division

Mr M Sheen, Assistant Director, ADP Risk  
Management

AUSTRALIAN BROADCASTING CORPORATION

Mr P Lidbetter, General Manager, Finance

Mr G Meredith, Corporate Chief Accountant

Mr E Hay, Senior Assistant Auditor-General,  
Policy and Development Branch, AAO

10 October 1988

DEPARTMENT OF DEFENCE

Mr A Ayres, Secretary

Mr F Harvey, Inspector-General

Mr R Richards, Assistant Secretary, Management  
Audit

QANTAS

Mr L Fisk, Corporate Secretary

Mr M Haworth, Acting General Manager, Finance,  
and Director, Treasury and Associated  
Companies

DEPARTMENT OF FINANCE

Dr M Keating, Secretary

Mr I McPhee, Assistant Secretary, Public  
Administration and Accounting Development  
Branch

Mr D Shand, First Assistant Secretary,  
Financial Management and Accounting Policy  
Division

Mr E Hay, Senior Assistant Auditor-general,  
Policy and Development Branch, AAO

17 October 1988

COMMONWEALTH BANK

Mr B Barry, Senior Manager, Accounting

Mr I Payne, Deputy Managing Director

Mr S Grant, Partner, Peat Marwick Hungerfords

Mr E Hay, Senior Assistant Auditor-General.  
Policy and Development Branch, AAO

26 October 1988

Mr K Dye, Auditor-General of Canada

21 November 1988 Mr D Block, Consultant, Prime Minister and Cabinet

AUSTRALIAN TAXATION OFFICE

Mr T Boucher, Commissioner of Taxation

Mr J Wheeler, Assistant Commissioner,  
Management Improvement and Evaluation Branch

19 December 1988 AUSTRALIAN AUDIT OFFICE

Mr E Hay, Senior Assistant Auditor-General,  
Policy and Development Branch

Mr M Jacobs, First Assistant Auditor-General,  
Audit Division B

Mr C Monaghan, First Assistant  
Auditor-General, Corporate Management Division

Mr J Taylor, Auditor-General

Mr G Williams, First Assistant  
Auditor-General, Audit Division A

Mr M Sharpe, Independent Auditor, Australian  
Audit Office, Coopers and Lybrand





APPENDIX 3

AUDITORS-GENERAL OF AUSTRALIA

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Name	Years of Service
J W ISRAEL, ISO	1901-1926
C J CERUTTY, CMG	1926-1935
H C BROWN, CBE	1935-1938
R ABERCROMBIE, OBE	1938-1946
A C JOYCE, CBE	1946-1951
J BROPHY, ISO	1951-1955
H C NEWMAN, CBE	1955-1961
V J W SKERMER, CBE	1961-1973
D R STEELE CRAIK, CB, OBE	1973-1981
K F BRIGDEN, AO	1981-1985
J V MONAGHAN, AO	1985-1987
J C TAYLOR,	1988

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## APPENDIX 4

## COMMONWEALTH SECTOR - RECEIPTS AND EXPENDITURE

	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89
	\$M	\$M	\$M	\$M	\$M	\$M	\$M	\$M	\$M	\$M	\$M est
General Government Sector	55,191	55,659	58,416	60,155	63,347	68,904	75,054	76,284	75,379	75,084	78,044
Public Trading Enterprises	0	0	0	1,538	1,488	1,665	1,720	1,851	1,697	1,912	2,105
TOTAL CURRENT OUTLAYS	55,191	55,659	58,416	61,693	64,836	70,569	76,774	78,134	77,076	76,996	80,149
General Govt Sector	8,017	7,570	7,315	5,396	6,334	6,480	6,691	6,284	5,487	3,323	3,714
Public Trading Enterprises	0	0	0	2,711	2,495	2,965	2,597	3,330	3,441	1,941	4,234
TOTAL CAPITAL OUTLAYS	8,017	7,570	7,315	8,107	8,828	9,445	9,288	9,615	8,928	5,264	7,948
Public Trading Enterprises	8,034	8,181	8,385	9,806	10,603	10,646	11,393	11,298	11,942	14,023	15,153
OPERATING EXPENDITURE	8,034	8,181	8,385	9,806	10,603	10,646	11,393	11,298	11,942	14,023	15,153
TOTAL EXPENDITURE	71,242	71,409	74,115	79,606	84,267	90,660	97,455	99,047	97,946	96,283	103,250
General Government Sector	53,013	56,134	60,756	64,661	63,264	64,772	73,127	75,724	77,979	80,765	87,539
Public Trading Enterprises	10,664	10,653	10,854	11,684	12,066	12,615	13,943	14,012	14,614	16,656	17,969
TOTAL REVENUE	63,677	66,787	71,610	76,345	75,330	77,387	87,071	89,735	92,592	97,321	105,508
TOTAL EXPENDITURE & REV.	134,920	138,197	145,725	155,951	159,597	168,048	184,526	188,783	190,539	193,604	208,758
TOTAL EXP. + REV. 1977-78 BASE	102.1	104.6	110.3	118.1	120.8	127.2	139.7	142.9	144.3	143.5	145.0

1. Figures are in average 1987-88 prices.

2. Australian Bureau of Statistics Year Books. Australian Bureau of Statistics Government Financial Estimates 1987-88.



APPENDIX 5

COMMONWEALTH ORGANISATIONS WHICH PAY AUDIT FEES TO THE  
AUDITOR-GENERAL BY PORTFOLIO

Parliamentary Departments

Nil

Aboriginal Affairs

Aboriginal Development Commission  
Edward River Crocodile Farm Pty Ltd  
Aboriginal Hostels Ltd

Administrative Services

Commonwealth Accommodation and Catering Services Ltd  
Commonwealth Hostels Provident Fund

Arts, Sport, the Environment, Tourism and Territories

ACT Forestry Trust Account  
ACT Transport Trust Account  
Australian Capital Territory Electricity Authority  
Australian Film Commission  
Australian Institute of Sport  
Building and Construction Industry Long Service Leave Board  
Canberra Municipal Accounts  
Canberra Public Cemeteries Trust  
Canberra Theatre Trust  
ACT Health Authority  
ACT Rental Housing Operations  
Cocos (Keeling) Islands Postal and Philatelic Service  
Christmas Island Services Corporation  
Festival of Pacific Arts Ltd  
Australia Sports Aid Foundation  
Phosphate Mining Company of Christmas Island  
ACT Gaming and Liquor Authority  
Milk Authority of the ACT  
National Exhibition Centre Trust  
Phosphate Mining Corporation of Christmas Island  
Norfolk Island Administration

Attorney-General's

National Companies and Securities Commission



Community Services and Health

Commonwealth Serum Laboratories Commission  
Health Insurance Commission

Defence

Army and Air Force Canteen Service  
Australian Military Forces Relief Trust Fund  
Aerospace Technologies of Australia Pty Ltd  
Royal Australian Air Force Welfare Trust Fund  
Royal Australian Navy Relief Trust Fund

Employment, Education and Training

Anglo - Australian Telescope Board  
AMC Search Ltd

Finance

SFIT (Office of)  
Jena (SFIT) Pty Ltd  
Jena Unit Trust  
The Tubbo Estate Company Pty Ltd  
A E Trethowan Pty Ltd  
Goolgumbula Pty Ltd

Foreign Affairs and Trade

Australian High Commission, Great Britain -  
Overseas Employees Pension Scheme  
Commission for the Conservation of Antarctic Marine Living  
Resources

Immigration, Local Government and Ethnic Affairs

Albury Wodonga Development Corporation

Industrial Relations

Stevedoring Industry Finance Committee

Industry, Technology and Commerce

Australian Industry Development Corporation  
AIDC Securities Ltd  
Southern Alloys Venture Pty Ltd  
AIDC Leasing Pty Ltd  
Interscan Holdings Pty Ltd  
Interscan International Ltd  
CSIRO  
NASA  
National Protocol Support Centre Ltd

SIROTECH Ltd  
SMEC Superannuation Pty Ltd  
Snowy Mountains Engineering Corporation  
Australian Nuclear Science and Technology Organisation  
Export Finance and Insurance Fund (Australian Trade Commission)

Primary Industries and Energy

Australian Meat and Livestock Resources and Development Corporation  
Australian Wheat Board  
Coal Mines Insurance Pty Ltd  
Joint Coal Board  
Pipeline Authority  
Snowy Mountains Hydro-Electric Authority  
Australian Apple and Pear Corporation  
Australian Canned Fruits Corporation  
Australian Dairy Corporation  
Australian Honey Board  
Australian Dried Fruits Corporation  
    (Australian Horticultural Corporation)  
Australian Meat and Livestock Corporation  
Australian Pork Corporation  
Australian Tobacco Board  
Australian Wine and Brandy Corporation  
Australian Wool Corporation  
Murray - Darling Basin Commission  
    (River Murray Commission)

Prime Minister and Cabinet

Australian Bicentennial Authority  
Australian Bicentennial Authority Superannuation Fund

Social Security

Nil

Transport and Communications

Australian National Railways Commission  
Australian Postal Commission  
Australian Shipping Commission  
Australian Telecommunications Commission  
Omega Navigational Facility  
Qantas (UK) Retirement Benefits Scheme  
Qantas Staff Provident Fund  
Qantas Airways Limited  
    Qantair Limited  
    Qantas Info Tech Ltd  
    Q.H. Tours Limited  
Aussat Pty Ltd  
Aussat Finance Ltd  
Telecom Aust (International) Ltd

Telecom Technologies Pty Ltd  
QPSX Communications Pty Ltd  
OTC (International) Ltd  
Sprintpak Pty Ltd  
ANL Cargo Operations Pty Ltd  
Australian National Shipping Agencies Pty Ltd (ANSA)  
Australian National Container Management Pty Ltd (ANCM)  
Australian Airlines Ltd  
Australian Regional Airlines Pty Ltd  
    Air Queensland Pty Ltd  
        Air Queensland Engineering Pty Ltd  
        Air Queensland Investments Pty Ltd  
        Aerial Investments Pty Ltd  
        B.P.A. Pty Ltd  
        Bush Pilots Airways (Charter) Pty Ltd  
        Lizard Island Lodge Pty Ltd  
        Cape York Wilderness Lodge Pty Ltd  
        Air Queensland Travel World Pty Ltd  
        Queensland Airlines Pty Ltd  
        Bush Pilots Airways (PNG) Pty Ltd  
Australian Regional Airlines (Queensland) Pty Ltd  
Australian Resorts Pty Ltd  
    Parkview (Keppel) Pty Ltd  
    Great Keppel Holdings Pty Ltd  
    Great Keppel Island Pty Ltd  
    Keppel Investments Pty Ltd  
    Great Barrier Reef Hotel Pty Ltd  
    Bedarra Island Resort Pty Ltd  
    Hideway Island Pty Ltd  
    Bingal Bay Cruises Pty Ltd  
    Brampton Island Pty Ltd  
    Silverwake Reef Pty Ltd  
    Thrinakia Pty Ltd  
    The Charybdis Trust  
TAA Aviation Pty Ltd  
    Danrule Pty Ltd  
    Denmell Pty Ltd  
    Denmint Pty Ltd  
    Denmost Pty Ltd  
    Denold Pty Ltd  
    Denpen Pty Ltd  
    Denpet Pty Ltd  
    Denpost Pty Ltd  
    Denrac Pty Ltd  
    Denroll Pty Ltd  
    Densale Pty Ltd  
    Denseed Pty Ltd  
    Denshore Pty Ltd  
    Densip Pty Ltd  
    Densound Pty Ltd  
    Olenya Holding Pty Ltd  
    Olerano Holdings Pty Ltd  
    Olesa Holdings Pty Ltd  
    Olfusa Holdings Pty Ltd



Olgiy Holdings Pty Ltd  
Oliana Holdings Pty Ltd  
Overseas Telecommunications Commission (Australia)  
Keylink  
Australia/Indonesia/Singapore Cable System Management Committee  
ABC - Senior Executive Superannuation Fund

Treasury

CBFC Ltd  
Housing Loans Insurance Corporation  
Commonwealth Development Bank of Australia  
Commonwealth Bank of Australia  
Commonwealth Savings Bank of Australia  
Commonwealth Management Services  
Corporation Properties Ltd  
CTB Australia Ltd  
Collateral Leasing Pty Ltd  
Collateral Leasing (No.2) Pty Ltd  
Collateral Leasing (No.3) Pty Ltd  
Collateral Leasing (No 4) Pty Ltd  
Collateral Leasing (No 5) Pty Ltd  
Collateral Leasing (No 6) Pty Ltd  
Collateral Leasing (No 7) Pty Ltd  
CTB Leasing Pty Ltd  
CTB Leasing (No 3) Pty Ltd  
CTB Nominees Ltd  
Pluteus (No 194) Pty Ltd  
Pluteus (No 195) Pty Ltd  
Pluteus (No 206) Pty Ltd  
Pluteus (No 218) Pty Ltd  
Satellites No 2 Pty Ltd  
Commonwealth Savings Bank Approved Deposit Fund  
CBFC Leasing Pty Ltd  
CBFC Properties Pty Ltd  
Australian European Finance Corporation Ltd  
AEFC Equities Ltd  
AEFC Investments Pty Ltd  
AEFC Leasing Pty Ltd  
AEFC Nominees Pty Ltd  
AEFC Securities Pty Ltd  
Travelstrength Ltd  
Travelstrength Services Pty Ltd  
Manors of Mosman  
Commonwealth Banking Corporation Officers' Superannuation Fund  
Prudential Supervision  
Reserve Bank of Australia  
Reserve Bank of Australia Officers' Superannuation Fund

Veterans' Affairs

Defence Service Homes Insurance Trust Account



APPENDIX 6

APPOINTMENT OF AUDITORS IN THE PRIVATE SECTOR

In the private sector, the usual practice for appointment of an auditor to a new company is for the company's chief executive officer to recommend a choice of auditor to the board of directors. Alternatively, the board of directors may establish an audit committee to select the auditor. The auditor retires at the company's first annual general meeting and shareholders vote on his or her re-appointment. Shareholders have the ultimate say in the choice of auditor.

Where a change of auditors occurs for an established company, the auditor resigns although he or she maintains the right to seek re-appointment at the annual general meeting. On the auditor's resignation, the directors start the search for a new auditor. Their recommendation must be approved at the next annual general meeting of shareholders.





APPENDIX 7

EFFICIENCY AUDITS COMPLETED BY 31 DECEMBER 1988<sup>2</sup>

<u>Title</u>	<u>Date of Report</u>
1. Department of Administrative Services:	
- Australian Property Function	17 April 1980
2. Department of Health:	
- Administration of Nursing Home Programs	3 February 1981
3. Department of Foreign Affairs:	
- Australian Development Assistance Bureau. Administration of Australia's Bilateral Overseas Aid Program	28 October 1981
4. Department of Business and Consumer Affairs:	
- The Collection of Excise Duties and Deferred Customs Duties	11 March 1982
5. Capital Territory Health Commission:	
- Administration of Public Hospitals	3 May 1983
6. Department of Defence:	
- The Management of the Main Battle Tank	3 May 1983
7. Department of Employment and Industrial Relations:	
- Special Youth Employment Training Program	11 October 1983
8. Department of Aviation:	
- The Installation and Maintenance of Airway Facilities	27 June 1984
9. Department of Immigration and Ethnic Affairs:	
- Control of Prohibited Immigration	27 June 1984

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2. These efficiency audits were carried out under Division 2 of Part VI of the Audit Act 1901.

10. Department of Social Security:
  - Administration of Widows' Pensions and Supporting Parents' Benefits 27 June 1984
11. Australian Taxation Office:
  - Collection of Sales Tax 27 June 1984
12. Department of Veterans' Affairs:
  - Administration of the Disability Pension and Service Pension Schemes by the Repatriation Commission and the Department 27 June 1984
13. Bureau of Meteorology (part of Dept of Science and Technology):
  - Observation Program 4 October 1984
14. Overseas Telecommunications Commission (Aust):
  - Control over Manpower and Property 4 September 1984
15. Export Development Grants Board:
  - Administration of the Export Market Development Grants Act 1974 4 September 1984
16. Department of Defence Support:
  - Administration of the Offsets Policy 4 October 1984
17. Department of Defence:
  - Administration of the Australian Industry Participation Program in Relation to Overseas Procurement 4 October 1984
- Australian Taxation Office:
  - 18. - Controls over Processing of Income Tax Assessments 7 December 1984
  - 19. - Processing and Assessment of Income Tax Returns 7 December 1984
  - 20. - Checking of Dividends and Interest Disclosed in Income Tax Returns 7 December 1984
  - 21. - Processing of Income Tax Instalment Declarations 7 December 1984



22. Department of Primary Industries:
  - Administration of Quarantine Services 26 November 1985
23. Australian Wool Corporation:
  - Property Operations 26 November 1985
24. Department of Territories:
  - ACT Internal Omnibus Network 26 November 1985
25. Department of Housing and Construction:
  - Construction Project Management 28 November 1985
  - The National Acoustics Laboratory and Ultrasonics Institute 28 November 1985
  - The Australian Defence Force Academy 28 November 1985
26. Defence Science and Technology Organisation:
  - Task Cost Management 19 March 1986
- Australian Taxation Office:
  - 27. - External Sources of Information 19 March 1986
  - 28. - Disclosure of Diesel Fuel Rebates 19 March 1986
  - 29. - Partnership and Trust Distribution 19 March 1986
  - 30. - Late Lodgment Penalties 19 March 1986
31. Department of Primary Industry:
  - Administration of Meat Inspection Services by the Export Inspection Services 5 June 1986
32. Australian Taxation Office:
  - Unpresented Group Certificates 21 August 1986
33. Commonwealth Schools Commission:
  - Administration of Capital Grants to Non-Government Schools 23 September 1986
34. Australian Taxation Office:
  - Prescribed Payments System 25 September 1986

35. Department of Defence:
  - Principal Item Stock Control and Entitlement System 18 November 1986
36. Australian Telecommunications Commission
  - Vehicle Fleet Management 31 March 1987
37. Department of Housing and Construction:
  - Repairs and Maintenance of Commonwealth Assets 7 May 1987
38. Parliament House Construction Authority:
  - Construction Project Management 2 June 1987
39. Australian Customs Service:
  - Licensing and Administration of Customs Agents 3 June 1987
40. Department of Employment and Industrial Relations:
  - Community Employment Program 3 June 1987
41. Department of Resources and Energy:
  - Offshore Petroleum Royalties and Excise 4 June 1987
42. Department of Defence:
  - Army Mapping 4 June 1987
43. Australian Government Publishing Service 18 November 1987
44. Australian Taxation Office:
  - International Profit Shifting 26 November 1987
45. Australian Taxation Office:
  - Taxpayers in Unincorporated Businesses 4 December 1987
46. Department of Defence:
  - RAAF Explosives Ordnance 4 December 1987
47. Australian National Railways Commission:
  - Commission Traffic 24 March 1988

48. Department of Defence:
- Safety Principles for Explosives 18 April 1988
49. Department of Community Services and Health:
- Home and Community Care Program 24 May 1988
50. Australian Postal Commission:
- Administration of Philatelic Services 24 May 1988
51. Department of Social Security:
- Review of Continuing Entitlement to Unemployment Benefit 1 November 1988
52. Department of Arts, Sport, the Environment, Tourism, and Territories:
- ACT Administration: Building Control 29 November 1988





APPENDIX 8

ACHIEVEMENTS OF EFFICIENCY AUDITS

The AAO was asked to provide examples of where efficiency audits had led:

- . to major improvements and reforms in Commonwealth management and administration;
- . to significant cost savings;
- . to increased government outlays in order to overcome administrative deficiencies.

The AAO's reply comprises Appendix 8.





1. Notable Achievements of Efficiency Audits

- . Effects of Efficiency Audits on Australian Taxation Office - summary of various audits
- . Commonwealth Administration of Nursing Home Programs - 13 February 1981.
- . Administration of Australia's Bilateral Overseas Aid Program - 28 October 1981.
- . Collection of Excise Duties - 11 March 1982.
- . Administration of the Offsets Policy - 4 October 1984.
- . Australian Wool Corporation - Property Operations - 26 November 1985.
- . Defence Science and Technology Organisation - Task Cost Management - 19 March 1986.
- . Commonwealth Schools Commission - Administration of Capital Grants to Non-Government Schools - 22 September 1986.
- . Department of Defence - Safety Principles for Explosives - 18 April 1988.
- . Department of Community Services and Health - Home and Community Care Program - 24 May 1988.

2.

1. NOTABLE ACHIEVEMENTS OF EFFICIENCY AUDITS

Effects of Efficiency Audits on Australian Taxation Office (ATO)  
- summary of various audits

The combined effect of 13 efficiency audits and the consequential scrutiny by Parliamentary Committees into ATO operations which had never before been subjected to external review has been commonly acknowledged as having provided a catalyst accelerating the change initiatives which have produced a marked improvement in the ATO's performance. It is extremely difficult if not impossible to ascribe particular improvements to specific causes and views will always differ. The audits have however made a large number of worthwhile recommendations which have been accepted and implemented by the ATO.

There is a view that the spate of artificial tax-avoidance schemes of the late 1970's had compelled ATO to misallocate its resources and by the early 1980's it was again on the right path and generating internally the impetus for performance improvement. However, given the state of its systems which had never previously been reviewed by an agency external to the ATO, and the severe criticism resulting from the audits, it must be at least very doubtful that it would be in the position it is now if the efficiency audits had not taken place.

Commonwealth Administration of Nursing Home Programs  
- 13 February 1981

Two substantial issues were control over the growth in nursing home beds and the determination of nursing home fees and these were dealt with by 1984 amendments to the Nursing Homes Assistance Act and the National Health Act which were aimed at providing more effective ministerial and departmental control.

3.

In a paper on the evaluation of social programs given to the ACT Bicentennial Accounting Congress on 17 November 1988 the Deputy Secretary of the Department saw the Nursing Homes and Hostels review in 1985-86 which flowed from the efficiency audit and the parliamentary reports as a significant example of a review which led to major program change.

Administration of Australia's Bilateral Overseas Aid Program  
- 28 October 1981

The audit set up a management model for the administration of aid and set out administrative changes which would lead to improved effectiveness and efficiency in aid delivery. Changes in expenditure levels were not considered in view of the way in which aggregate aid expenditure was set. The Department of Foreign Affairs accepted and implemented the majority of some 35 recommendations. Particular attention was given to increased aid effectiveness with key developments including strengthened appraisal and evaluation functions.

Collection of Excise Duties - 11 March 1982

The audit recommended the creation of management and control programs based on assessments of the risk to revenue for each excisable commodity. The then Department of Business and Consumer Affairs Customs Bureau developed a systems based investigation methodology aimed at evaluating firms' reporting and control systems and checking points of revenue risk. It was expected that commodity risk management policies would evolve when information flowed from investigations of companies.

Administration of the Offsets Policy - 4 October 1984

This audit identified shortcomings involving lack of administrative control, non-compliance by suppliers and poor administrative records. During the course of the audit the Government formed an independent committee to review the operation and effectiveness of the existing offsets policy. The report of this committee which was published in 1985 took into



4.

account some of the efficiency audit recommendations and the recommendations of the committee formed the basis for the revised offsets policy announced by the Government in January 1986.

Australian Wool Corporation Property Operations  
- 26 November 1985

The AAO recommended that the Corporation seek to have its responsibilities for the operation of its property function on a commercial basis clearly defined. Although this recommendation was initially not accepted by the Corporation an amendment to the Wool Marketing Act in 1987 established full ownership and control and set up the Wool Stores Board of Management to manage these stores, including the demolition of uneconomic wool stores, and the redevelopment and purchase of new wool stores.

Defence Science and Technology Organisation -  
Task Cost Management - 19 March 1986

The audit outlined cases where expenditure limits were circumvented and disclosed inadequacies in procedures for estimating, allocating and controlling the use of resources within the organisation. This, combined with the absence of an effective management information system at DSTO's Central Office, reduced management's ability to monitor and control the deployment of resources effectively at its laboratories. The recommendations were aimed at improving DSTO's management procedures and systems for directing and monitoring resources used in its research and development program and were all accepted by the Department.

The Joint Committee of Public Accounts supported the recommendations (Report 280, 2 June 1987) and the Chairman, Mr R.E. Tickner, MP noted that many of the Auditor-General's criticisms of DSTO's management procedures and systems had been addressed with significant improvements in the administration of DSTO's resources.

5.

Commonwealth Schools Commission - Administration of Capital  
Grants to Non-Government Schools - 22 September 1986

The Department of Education considered that the experience gained in responding to the observations made in the audit report had been very useful in the preparation and refinement of administrative procedures for the introduction of block capital grants in 1988. It said that the report proved a useful reference point against which to assess proposals for fundamental changes in the approach to the delivery of Commonwealth financial assistance to non-government schools for building and equipment projects. The report also served a similar purpose in relation to new program responsibilities acquired after the audit had been completed.

Department of Defence -  
Safety Principles for Explosives - 18 April 1988

The audit reviewed the administrative effectiveness of the Department's procedures and practices relating to its operations involving the storage and handling of explosives.

Notable achievements of the audit included actions taken to improve safety at numerous locations, including Sydney Harbour, increased departmental and public awareness of safety in relation to explosives storage and handling, increased departmental compliance with its adopted safety principles and the submission of Public Risk Waiver applications to the Minister. The audit has also resulted in a complete revision of the departmental instructions relating to safety principles and has led to the clarification of the legal status of Defence Instructions. Issues of public accountability and responsibility have also been raised. Further structural or organisational changes are anticipated.

6.

Department of Community Services and Health -  
Home and Community Care Program - May 1988

The audit found that the Program, which had commenced more than two years previously, was not yet achieving its objectives and that the Department still did not have data from the States about services actually provided under the Program.

Audit made numerous recommendations to improve Program operations. The Department agreed to implement many of them. The audit report is now being examined by a Parliamentary committee. The audit recommendations will be further considered in the Joint Ministerial review of the Program this year.



7.

2.       Significant Cost Savings Arising from Efficiency Audits

- .       Capital Territory Health Commission - Administration of Public Hospitals - 3 May 1983.
- .       Department of Employment and Industrial Relations - Special Youth Employment Training Program - 11 October 1983.
- .       Australian Taxation Office - Collection of Sales Tax - 27 June 1984.
- .       Department of Social Security - Administration of Widows' Pension and Supporting Parents' Benefits - 27 June 1984.
- .       Overseas Telecommunications Commission - Control over Manpower and Property - 4 September 1984.
- .       Bureau of Meteorology - Observation Program - 4 October 1984.
- .       Australian Taxation Office - Processing and Assessment of Income Tax Returns - 7 December 1984.
- .       Australian Taxation Office - Checking of Dividends and Interest Disclosed in Income Tax Returns - 7 December 1984.
- .       Australian Taxation Office - Processing of Income Tax Instalment Declarations - 7 December 1984.
- .       Department of Primary Industries - Administration of Quarantine Services - 26 November 1985.
- .       Australian Taxation Office - External Sources of Information - 19 March 1986.
- .       Australian Taxation Office - Unpresented Group Certificates - 21 August 1986.

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8.

- . Australian Taxation Office - Prescribed Payments System  
- 25 September 1986.
- . Department of Defence - Principal Item Stock Control  
and Entitlement System - 18 November 1986.
- . Australian Telecommunications Commission - Vehicle  
Fleet Management - 31 March 1987.
- . Department of Employment and Industrial Relations -  
Community Employment Program - 3 June 1987.
- . Australian Government Publishing Service -  
18 November 1987.
- . Australian Taxation Office - Taxpayers in  
Unincorporated Businesses (Additional Revenue) -  
4 December 1987.
- . Australian National Railways Commission - Commission  
Traffic - 24 March 1988.
- . Australian Post - Administration of Philatelic Services  
- 24 May 1988.

9.

2. SIGNIFICANT COST SAVINGS ARISING FROM EFFICIENCY AUDITS

Administration of Public Hospitals in the ACT - 3 May 1983

The most important areas of improvement identified in the audit report related to improved procedures for bed planning and for peer review of clinician utilisation of hospital facilities. The report indicated that closer adherence to achievable bed norms would reduce patient length of stay by 11-15%. The JCPA enquiry found that whilst the ACT Health Authority generally supported the audit recommendations there had been only limited substantive changes in administration. Following its own Report (Report 238, 9 October 1985) however, the Committee was able to find itself satisfied with implementation of recommendations (Report 275, 6 May 1987). Revised bed planning, peer review and length-of-stay monitoring procedures had been introduced.

Special Youth Employment Training Program - Department of Employment and Industrial Relations - 11 October 1983

The audit found that a majority of the placements in an audit sample failed to meet the criteria for eligibility. The need for tightened management control and avoidance of such payments was evident.

The audit made a variety of recommendations to more closely target and thereby reduce program expenditure and to improve program administration. The 1984-85 Annual Report of the Department of Employment and Industrial Relations noted that placements and expenditure (\$98m) were lower than the previous year (\$120m) because of the improved labour market and measures introduced in early 1984-85 to improve the cost-effectiveness of the program. The modifications followed the efficiency audit recommendations and took account of recommendations of the Interim Report of the Kirby Committee of Inquiry into Labour Market Programs. Factors leading to expenditure reduction included amendments to the guidelines on use of the scheme and vacancy receipt procedures which were designed to further protect against possible misuse of the scheme by employers.



10.

The JCPA's report on its review of the audit (Report 277, 6 May 1987) noted that Audit's findings and recommendations regarding program deficiencies appeared to have had considerable impact on the revised JOBSTART program set up to replace the Special Youth Employment Training Program.

Collection of Sales Tax by the Australian Taxation Office - 27 June 1984

This audit report drew attention to the slow reaction to sales tax avoidance and evasion and the absence of a clear policy for the selection of high risk cases as part of the regular investigation program. In its review of this audit the House of Representative Standing Committee on Expenditure in 1986 stated that "Shortly after the (efficiency audit) report's release, ATO established a Sales Tax Working Party to review all aspects of sales tax operations incorporating those points raised by the Auditor-General. This party has since introduced a two volume report, the recommendations of which are currently being implemented".

The Commissioner's 1986-87 Report stated that the implementation of the findings of the Sales Tax Review Committee has resulted in a more efficient and cost effective enforcement program and that, in all, tax and penalties from sales tax audit related activities increased to \$89 million in 1986-87 from \$48.5 million in 1985-86.

Administration of Widows Pensions and Supporting Parents' Benefits - 27 June 1984

In respect of payments the audit recommended that the use of direct credit would reduce problems of dual negotiation of benefit cheques (96 000 in NSW in 1981-82 of which 50% were dual negotiations). JCPA Report 277 indicated that 94% of payments are now made by direct credit.

11.

Control over Manpower and Property by the Overseas  
Telecommunications Commission - 4 September 1984

In respect of property the audit found that procedures for control and reporting on resources did not provide an adequate review mechanism to ensure properties were being utilised economically. The Report on the audit by the House of Representative Standing Committee on Expenditure (Call us Again, November 1986) noted "It does appear that the audit was a catalyst that has resulted in OTC disposing of 16 surplus properties the total value of which amounted to \$1.3 million and in taking action to dispose of a further 11 properties."

Observation Program of the Bureau of Meteorology - 4 October  
1984

The audit found that the Bureau had not maximised the quantum and quality of meteorological information obtained with minimum duplication, redundancy and resource use generally.

Opportunities for cost effective application of technology had not been taken up. The Bureau needed to improve its recruitment, training and monitoring procedures in order to reduce the incidence of errors in the labour intensive co-operative observer network. The Bureau agreed with the thrust of the report and accepted most of the recommendations.

Processing and Assessment of Income Tax Returns -  
7 December 1984

The audit found that there was a fundamental weakness in the process of assessing returns in that the taxpayer's statement of gross income was generally accepted without check, and that there was a high cost benefit ratio from the assessing function. Audit concluded that the Taxation Office should move to greater computerisation of the assessing function in order to release assessors for deployment on more productive tax auditing and investigation work.

12.

At the time of the audit, the ATO indicated that it had reservations about Audit's conclusions but said that it had the assessing function under review. More recently, however, the ATO has adopted greater computerisation of assessing in the move to self-assessing procedures and has expanded the resources applied to tax auditing. It appears that about half of the total staff of 2500 assessors will be moved to tax auditing activities.

This audit, and two of the other audits in ATO also reported in December 1984, were the first efficiency audits of income tax operations and the audits disclosed significant weaknesses in ATO revenue collection procedures and failure to take advantage of computer capabilities.

Checking of Dividends and Interest disclosed in Income Tax  
Returns - 7 December 1984

The audit found that, because of deficiencies in checking procedures, the ATO had little prospect of collecting some \$300-\$500 million p.a. in evaded tax on interest income omitted from individuals' tax returns. The ATO replied that there would be some improvement in the situation from an increase in penalties and the number of staff applied to the tax checking process.

When reviewing the audit the House of Representatives Standing Committee on Expenditure said that it was astounded by the ATO's labour intensive approach and that the inadequacy of the ATO approach was distressing.

More recently, the ATO has indicated that it will be giving greater attention to its procedures for checking disclosure of interest income. This should have significant benefits for revenue.



13.

Processing of Income Tax Instalment Declarations - 7 December 1984

The audit found that employees' instalment declarations, which given employees significant tax savings, routinely were destroyed by the ATO without checking their validity. The ATO was aware that some declarations were false but had found it too costly to check all declarations to discover the false declarations. Audit proposed that the ATO should check a sample of the declarations each year from employees in selected industries.

More recently the ATO has acknowledged the benefit of checking a sample of instalment declarations and has begun operations which have brought to light numerous false declarations by part-time or casual employees in Sydney.

Administration of Quarantine Services - 26 November 1985

The Department agreed with the general thrust of the report which, inter alia, was to ensure that the animal and plant quarantine services are delivered in an efficient and cost effective manner by the States with clear control procedures emanating from the Commonwealth. Action by the Department was expected to result in organisational and administrative changes to allow delivery of a better coordinated and quality service at a reduced cost, and increased revenue via more efficient cost recovery for services then provided either free or at below cost.

Australian Taxation Office - External Sources of Information - 19 March 1986

The ATO had estimated that unincorporated businesses disclosed in their returns no more than 75% of reportable income. The audit found, however, that the ATO did little to check the validity of the income disclosed by taxpayers. Audit proposed that the ATO should adopt a program to tap sources of external information to check the validity of returns, and that these

14.

might include collecting details of the owners of luxury cars and boats and other indicators of income.

At the time of the audit the ATO showed little inclination to adopt such a program but more recently it has said publicly that it is moving to check that the owners of luxury cars and boats and other 'life style' assets have disclosed incomes that are commensurate with those assets.

Australian Taxation Office -

Unpresented Group Certificates - 21 August 1986

This audit sought to determine the validity of ATO's conclusion that it was not cost effective to take regular action to seek returns from employees who had not presented their group certificates. As a result, Audit concluded that previous ATO projects had resulted in more refunds than debit assessments because of cursory procedures by ATO. Investigations of the sample selected by Audit returned net additional revenue of more than \$200 000.

Audit recommended that ATO should institute a program to clear selected categories of unpresented group certificates and amend the Income Tax legislation to require employees to provide their tax file number to employers, to require employers to enter that number on group certificates and to require employers to deduct tax at standard rates where employees fail to provide their tax file number.

Publicity in mid 1988 attached to an investigation by ATO's Chatswood Branch of unpresented group certificates in the cleaning and hotel industries (which were two nominated by Audit) have reported spectacularly successful results with the discovery of a large proportion of employees with false names. These results indicate not only the soundness of the Audit recommendation but also that ATO is now implementing it.

15.

Other Audit recommendations are now reflected in the new tax file number policy and legislation. The inclusion of the tax file numbers together with automated matching suggested in other audits has the potential to recover tax due in this area.

Australian Taxation Office -

Prescribed Payments System (PPS) - 25 September 1986

Income Checks

The audit report recommended that tax returns lodged for the first time as a result of the PPS should be examined carefully for indications of omitted income. Statistics collected by the ATO indicated that returns from previous non-lodgers generally disclosed income lower than that disclosed by normal regular lodgers. Audit found that returns from previous non-lodgers were still accepted at face value and subjected to only the normal assessing procedures in practice at that time.

Subsequent to the Audit recommendation, ATO applied approximately 25% of its national audit resources to the follow-up check of PPS cases for seven months. By March 1987, approximately half way into the investigation, it had completed 61 cases for total additional revenue of \$2.1 million.

Department of Defence -

Principal Item Stock Control and Entitlement System (PISCES) -  
18 November 1986

The audit highlighted delays and deficiencies in the development and implementation of the computer based stock control and entitlement system that prevented early realisation of expected major benefits.

The Department accepted most of the recommendations and the JCPA noted that the problems with development and implementation of PISCES identified by Audit have been resolved (Report 294, 23 November 1988).

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16.

Vehicle Fleet Management in the Australian Telecommunications  
Commission - 31 March 1987

This audit referred to a number of problems associated with the determination and control of vehicle numbers in Telecom. The audit report suggested that most States are approaching or have reached saturation point in respect of vehicles and Telecom should review the productivity benefits arising from the present number of vehicles and consider whether there is justification for retaining the present fleet strength. The report contained recommendations aimed at achieving better control over vehicle numbers and these recommendations were accepted by Telecom.

Tables contained in the efficiency audit report showed that in the four years prior to the report vehicle numbers had increased at an average rate of almost 800 per year. In the two years since the report was completed the number of vehicles has declined by 500. At an average cost per vehicle in 1985 of \$10 000 the new level of vehicles was \$20 million lower than the previous trend.

Department of Employment and Industrial Relations - Community  
Employment Program (CEP) - 2 June 1987

The CEP was a program to help the long-term unemployed and other disadvantaged unemployed people gain permanent employment and this Commonwealth/State program financed mainly by the Commonwealth cost the Commonwealth about \$1,100 million in the three years before the audit. Using surveys by the former Bureau of Labour Market Research, Audit found that the CEP was of doubtful value in achieving its objective - it seemed that less than 6% of participants gained employment as a result of the CEP. Audit also found that the projects lacked training for participants and that there were various program inefficiencies.

17.

Although the CEP had been extended for a further three years during the course of the audit, the Government announced shortly after the audit results were put to the Department that the CEP would be abolished. It was replaced by employment programs involving less expenditure by the Commonwealth and more training for participants.

It seems clear that the audit resulted in a significant saving in Commonwealth expenditure and a better focus for employment programs.

Australian Government Publishing Service -  
18 November 1987

This audit examined the costs of printing in the Government Printing Office and concluded that a significant volume of printing work being undertaken by the Printing Office could have been performed by commercial printers at a reduction in cost of \$5 million.

The Report of the Joint Committee on Publications of November 1988 noted that the AGPS reaction to the efficiency audit supported this conclusion and recommended that there should be some freeing up of the present system requiring Commonwealth bodies to use AGPS. The Committee also supported other audit recommendations aimed at reducing costs in the Printing Office and achieving more efficient operations.

Australian Taxation Office -  
Taxpayers in Unincorporated Businesses - 4 December 1987

Additional revenue

This audit initiated the investigation by ATO of a sample of taxpayers from three groupings - owners of luxury Gold Coast units, Canberra builders and Hobart restaurants. Audit made a preliminary analysis of taxpayers chosen at random and from that

18.

recommended to the ATO certain avenues of enquiry in respect of each case selected for the sample. Investigations of the cases selected by Audit have returned almost \$4 million in additional tax and penalty with several of the larger more complicated cases, which are expected to return proportionately more revenue, still to be finalised.

The sample detected the inadequacy of ATO procedures for ensuring its records of taxpayers are complete and that each taxpayer pay the due tax. The audit report made 54 recommendations, a large proportion of which were directed at improvements in the selection, management, review and quality assurance of tax audit cases and supporting processes and procedures.

Almost all the recommendations were either absorbed into ATO system improvements initiated while the audit was in progress or accepted and implemented after the report was tabled.

Australian National Railways Commission (AN) - Commission  
Traffic - 24 March 1988

The audit examined Commission traffic - the way it transports its own staff, stores and equipment. Although only a small component of its operations, Commission traffic has an influence on AN's operating performance disproportionate to its size. Audit found that management controls were weak and that there was considerable scope for improving productivity and reducing costs.

Audit recommended that rolling-stock used for Commission traffic should be rationalised and that management of this area should be revised with a view to reducing costs. AN agreed to implement many of the recommendations. The House of Representatives Standing Committee on Transport, Communications and Infrastructure, which reviewed the audit, generally supported the findings.



19.

Australia Post - Administration of Philatelic Services -  
24 May 1988

Audit estimated that philatelic products with an average production cost of approximately \$1.5 million were returned unsold during 1985-86. That represented about 30% of philatelic production for that year. Audit recommended that with improved management information the level of returns can be minimised with a corresponding, and ongoing impact on profits. Australia Post has undertaken to determine an appropriate level of wastage and action will be taken to enhance the Postmasters Stock Movements system to provide reports on wastage levels.

20.

3.     Examples of Greater Expenditure to Overcome  
       Deficiencies
  - .       Effects of Efficiency Audits on Australian Taxation  
         Office - summary of various audits.
  - .       Department of Social Security - Administration of  
         Widows' Pensions and Supporting Parents' Benefits -  
         27 June 1984.
  - .       Department of Housing and Construction - Repairs and  
         Maintenance of Commonwealth Assets - 7 May 1987.
  - .       Department of Resources and Energy - Offshore Petroleum  
         Royalties and Excise - 4 June 1987.
  - .       Australian Taxation Office - International Profit  
         Shifting - 26 November 1987.
  - .       Department of Defence - RAAF Explosives Ordnance -  
         4 December 1987.
  - .       Australian Taxation Office - Taxpayers in  
         Unincorporated Businesses (Management of Audits) -  
         4 December 1987.

21.

3. EXAMPLES OF GREATER EXPENDITURE TO OVERCOME  
DEFICIENCIES

Effects of Efficiency Audits on Australian Taxation Office -  
summary of various audits

The audits in the ATO of assessment of tax returns, checking of dividends and interest and processing of tax instalment declarations urged the ATO to make greater use of computer capabilities. This has led the ATO to incur significant expenditure on computer facilities in the interests of gaining a far greater return in tax revenue.

The ATO is currently at the stage of allocating contracts for the complete re-equipment of its central computer installation and the redevelopment and expansion of its DP systems which is expected to cost in total approximately \$667 million over 12 years (net project benefit of \$588 million). Such expansion of computerisation of its processes is overdue and DP capacity has been a severely constricting influence on its system development for some years. The matching of dividend and interest income with taxpayers and the operation of its national taxpayer register are two in which needed improvements have been constricted. The pressure arising from Audit's criticism of current practices and recommendations for improvements reinforced by comment from Parliamentary Committees have provided a great deal of weight to the case for allocation of additional resources.

Administration of Widows' Pensions and Supporting Parents'  
Benefits - 27 June 1984

Because of difficulties occasioned by legislation, AAT decisions and Federal Court judgements in determining a recipient's domestic circumstances, Audit recommended that the Department increase its emphasis on confirming a recipient's income by undertaking more field officer and office reviews for recipients whose circumstances as identified by risk analysis are likely to have changed.

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22.

Repairs and Maintenance of Commonwealth Assets - May 1987

The audit identified a significant maintenance backlog (\$134 million in 1985-86). Recommendations were aimed at reducing the time frame involved in the planning and execution of planned specific maintenance. A reduction in the backlog, as recommended by Audit and the Finance and Public Administration Committee, would require additional expenditure by the Government, particularly in the Defence area.

A precise estimate of any increase in expenditure cannot be given but could conceivably involve expenditure in the order of \$50-\$60 million.

Department of Resources and Energy -  
Offshore Petroleum royalties and Excise - 4 June 1987

Royalties are payable on the 'net well-head value' of petroleum production and it is necessary that the production from each of the 12 offshore platforms is determined. The producer uses a computer program to carry out the required production calculations and also to calculate the royalty payment. A copy of the program is maintained and operated by the Department as its check on the royalty calculation.

The audit found deficiencies in the Department's verification of the program, controls over development and testing of program changes, and the accumulation of serious processing backlogs. Recommendations were made for independent verification of the computer program, review of the Department's system for operation and maintenance of the program, and removal of processing backlog by allocation of appropriate priority.

23.

These recommendations resulted in the short term retention of consultants and the allocation of additional resources for development of procedures and overcoming the processing backlog but were acknowledged as necessary by the Department.

Australian Taxation Office -  
International Profit Shifting - 26 November 1987

The objective of this audit was to assess the effectiveness and efficiency of the ATO's coverage of international profit shifting. The audit has been successful in providing a focus for examination of the problems of profit shifting, tax havens and transfer pricing.

The audit concluded that there was prima facie evidence that the profit shifting problem warranted greater attention than the ATO had previously allocated to it. In 1986 ATO had estimated there were 40,000 corporations in Australia with the structural or organisational potential to shift profits although this figure has since been refined to 12,000 - 18,000. During 1985-86 only 13 determinations were made under the specific profit shifting legislation. These 13 cases yielded more than \$300 million in additional tax and penalties.

In 1984 ATO had only 30 staff working on international cases but by the end of 1985-86 staff assigned to this area had been increased to 103 and again to 161 in 1986-87.

This audit also produced recommendations directed at improvements in resource management and training and development of auditing skills particularly in computer use. While there is an addition to expenditure on these resources, there will be a positive return in the increased additional tax obtained from audit cases.

313

24.

Department of Defence -

RAAF Explosive Ordnance - 4 December 1987

This audit involved a review of selected management aspects relating to the procurement, storage and issue of RAAF explosive ordnance. Having regard to the nature of the material examined during the audit, the Minister for Defence sought and obtained a certificate from the Attorney-General under sub-section 48F(5) of the Audit Act 1901, on the basis that disclosure of certain information contained in the proposed report would be contrary to the public interest, in that it would prejudice the security and defence of Australia. Accordingly, a restricted report was issued in accordance with the Act, and a separate report that did not contain details of a classified nature was prepared and transmitted to Parliament.

That report led to reductions in holdings of condemned explosives awaiting demolition and, together with the restricted report and the later Efficiency Audit report on Safety Principles for Explosives, led to the initiation of a Defence Facilities Policy Committee Review of requirements for storage of explosives. Other achievements of the audit included improvements in provisioning systems and stimulation of proposals to computerise some labour intensive stock recording functions.

Australian Taxation Office -

Taxpayers in Unincorporated Businesses - 4 December 1987

Management of audits

This audit in part reviewed the methods by which tax audits are selected and carried out and made a series of recommendations (30 to 43) aimed at correcting various observed deficiencies in the management, coordination and review of audit tasks. Many of these were incorporated in the new Audit Management System which first commenced operation in November 1986 and was further refined and developed during 1987. Others were incorporated in other initiatives. Additional expenditure was incurred on DP



25.

hardware and software as well as on personnel but a more effective administrative mechanism resulted to manage the rapidly increasing volume of tax audits which followed the introduction of self assessment.



APPENDIX 9

AAO USAGE OF CONSULTANTS FOR EFFICIENCY AUDITS

Audit Title	Consultants' Tasks
Department of Health - Commonwealth Administration of Nursing Home Programs (May 1983)	To provide professional advice upon certain medical and welfare aspects related to the administration of the nursing home program.
Capital Territory Health Commission - Administration of Public Hospitals by the Capital Territory Health Commission (May 1983)	To undertake an objective analysis of clinical performance in terms of practical length of stay and selected clinical activities.
Department of Defence - Management of the Main Battle Tank (May 1983)	To provide technical advice and comment on technical aspects of draft report.
Australian Taxation Office - International Profit Shifting (November 1987)	Expert appraisal of final audit report, AAO recommendations and ATO responses.





APPENDIX 10

PARLIAMENTARY COMMITTEES WITH RESPONSIBILITY FOR  
REVIEWING EFFICIENCY AUDIT REPORTS TABLED IN 1987-88

PUBLIC ACCOUNTS

Department of Defence

- . RAAF explosives ordnance
- . Safety principles for explosives

FINANCE AND PUBLIC ADMINISTRATION

Australian Taxation Office

- . International profit shifting
  - . Taxpayers in unincorporated businesses
- Department of Community Services and Health
- . Home and Community Care Program

TRANSPORT, COMMUNICATIONS AND INFRASTRUCTURE

Australian Postal Commission

- . Philatelic services

Australian National Railways Commission

- . Commission traffic

PUBLICATIONS (of both Houses)

Department of Administrative Services

- . Australian Government Publishing Service





APPENDIX 11

EFFICIENCY AUDITS TABLED BY 30 JUNE 1987 AND NEVER REVIEWED BY  
PARLIAMENTARY COMMITTEES

Observation Program of the Bureau of Meteorology

Australian Telecommunications Commission - Vehicle fleet  
management

Parliament House Construction Authority - Construction project  
management

Department of Employment and Industrial Relations - Community  
Employment Program



APPENDIX 12<sup>3</sup>

REPORT OF THE INDEPENDENT AUDITOR UNDER THE AUDIT  
ACT 1901 FOR THE YEAR ENDED 30 JUNE 1986

In compliance with sub-section 48N (1) of the Audit Act 1901, I have examined the part of the statement prepared by the Minister for Finance under sub-section 50 (1) of the Act for the year ended 30 June 1986 that related to the Auditor-General's Office as furnished to me in accordance with sub-section 48L (3) of the Act. This part shows total receipts of \$6 689 034 and total expenditure of \$22 225 366.

In my opinion, this part of the statement agrees with the accounts and records of the Auditor-General's Office kept in accordance with section 40 of the Act.

I did not carry out an efficiency audit during the year 30 June 1986.

(Sgd) EVAN DUFF CAMERON

Independent Auditor  
Appointed under Section 48K  
of the Audit Act 1901

7 November 1986

Canberra, A.C.T.  
17 November 1986

J.V.Monaghan  
Auditor-General

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3. The Auditor-General, Report on the Financial Statements prepared  
by the Minister for Finance for the year ended 30 June 1986,  
AGPS, Canberra 1986.



