Auditing in the State's Interest

A Review of the Audit Office of New South Wales

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Mr J Tripodi
Chairman
Public Accounts Committee
Parliament House, Macquarie Street
SYDNEY 2000

Dear Chairman

I have conducted a Review of the Audit Office of New South Wales in accordance with the requirement in the *Public Finance and Audit Act 1983,* section 48A. My report is attached.

I wish to acknowledge the co-operation and assistance of the Auditor-General and his staff. In addition, I wish to thank the numerous individuals in the New South Wales public sector and in Audit Offices in Australia and overseas who have given generously of their time.

Yours faithfully

Allen T Craswell
Professor of Accounting
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17th December 1999

CONTENTS

OPINION AND CONCLUSIONS

The performance of the Audit Office has been compared to best practice of public sector auditors in Australia and overseas. The decision to use these benchmarks was influenced by two fundamental assumptions: there are substantive differences between public and private sector auditing; and the ultimate aim of auditing is to improve the quality of management. In general, the Audit Office can be seen to be operating at a level consistent with best practice and at a level to be expected by the Parliament and the public of New South Wales.

Management of the Office: The Office is well managed and staff are obviously proud to be part of a professional organisation. The report contains a number of recommendations on specific staff management issues which will lead to improvements in staff development, training, intra-office communication and the implementation of EEO policies.

Financial statement audits: The financial statement audits are completed using methodology that is contemporary and consistent with best practice. In general, clients indicate satisfaction with the quality of the staff and their performance. The report highlights the need to place greater emphasis on risk management.

Performance audits: Performance audits are the most controversial of the Audit Office's operations. However, when reviewed in terms of criteria adopted overseas, the Performance Audit Branch compares favourably with international best practice. Notwithstanding, there is considerable potential to enhance the value-added to the management of the NSW public sector by changing the focus away from specific decisions to management issues of relevance to the public sector as a whole, and improving staff training.

Implementation of the 29 recommendations contained in the report will lead to:

- increased effectiveness, efficiency and improved communication within the Audit Office;
- better management and operational effectiveness of financial and performance audits through the development of improved training of staff;
- an improvement in the management of risk in the NSW public sector; and
- greater oversight by the Public Accounts Committee to ensure the implementation of reports issued by the Audit Office.

The recommendations provide the basis for a more effective and efficient oversight of public sector management while retaining the capacity to respond to changes in auditing and public sector management.

EXECUTIVE SUMMARY

INTRODUCTION

This Review was undertaken in compliance with the requirement in the *Public Finance and Audit Act 1983*, section 48A, which provides for the Auditor-General's Office to be reviewed at least once every three years. The Review, which bears some of the characteristics of a performance audit, involves an examination of the auditing practices and standards of the Auditor-General to determine compliance with the requirements of the *Public Finance and Audit Act*.

In undertaking the Review, two fundamental assumptions were made in identifying the appropriate benchmarks to be used to assess performance and the role of the Auditor-General in public sector management: there are substantive differences between public and private sector auditing; and the ultimate aim of auditing is to improve the quality of management.

In previous reviews of Auditors-General in Victoria, Queensland and New South Wales, it has been assumed that the efficiency, economy and effectiveness of an audit office is to be assessed in comparison with private sector audit firms. Such an approach fails to recognise the fundamental differences between public and private sector auditing. For example, there are significant differences in the nature of the audit client and the scope of the duties of the Auditor-General. Unlike private sector auditing, the scope of public sector audits extends beyond financial statement audits to providing assurance on compliance and other matters. Because of these differences, the practices and procedures of public sector auditors can be expected to differ from those adopted in the private sector.

In this Review, the performance of the Audit Office is assessed by reference to other Australian Audit Offices (in Victoria, Queensland and Western Australia), and best practice in British Columbia, the National Audit Office in the United Kingdom and the General Accounting Office in the United States.

When seen in a broader context, the role of Audit Office is to monitor financial management in the NSW public sector with the ultimate aim of enhancing the efficiency of public sector management. In this regard, the Auditor-General acts in partnership with a number of other parties and agencies including the Parliament, the Public Accounts Committee, Treasury and the administration of departments and agencies. Improvements in public sector management can be achieved only if the various groups and agencies work co-operatively. In this report, opportunities to facilitate improvements in financial management are explored in terms of their relative contribution to the partnership of interests.

SUMMARY OF FINDINGS

Management of the Audit Office

The Audit Office is highly dependent on a suitably qualified and motivated staff. Staff are obviously proud to be part of a professional organisation and there is a genuine perception that, as individuals and as team members, they add value to public sector management.

Considerable effort has been made to improve the performance appraisal system based on six key performance indicators. The new performance appraisal system devolves much of the responsibility for the efficient management of human resources to immediate supervisors. The new system has the potential to deliver real benefits to both individuals and the organisation as a whole. However, to date, performance appraisal has not been applied consistently throughout the organisation, mainly because training for those conducting performance appraisals has not been delivered for approximately three years.

The Office operates within the constraints of the NSW public sector and there are difficulties associated with appropriate exit strategies for poor performers. This area is receiving increased attention with active performance improvement programmes being developed for employees thought to be "at risk".

The majority of training programmes during the year were directed towards the implementation of the SAGE methodology. New appointees appear very satisfied with the induction programme, and the level of training received. Even though a large amount of the training is "on the job", this is seen as one of the key benefits of joining the organisation. Attracting high calibre graduates leads to higher expectations from these individuals in terms of the opportunities within the organisation. The high quality of the training received by Audit Office staff is recognised by both the staff and public and private sector employers.

The Audit Office needs to provide additional resources to the Professional Development Unit which should continue to develop existing internal programmes but should also investigate opportunities to obtain courses from external providers.

An integral part of flexible work practices at the Audit Office is the secondment of staff to public and private sector organisations, both locally and overseas. This is a useful method of providing staff with a broader perspective, and improved electronic communication allows the staff to continue to identify with the Audit Office whilst on secondment. Staff are generally positive about the experience and return to the Audit Office with a different perspective and varied skill set. Staff secondments are of benefit to both the Audit Office and the public sector and should be encouraged.

The majority of staff view flexible working hours — which provide a method of legitimately allowing the fulfilment of family commitments — as a positive condition of employment at the Audit Office. However, inconsistencies exist between various branches in relation to the treatment of time in lieu and variations also exist in relation to travel time. These inconsistencies need to be addressed.

The Audit Office has introduced a number of EEO measures — a spokeswomen programme is operational and grievance counsellors have been appointed. However, women are not well represented in the Senior Executive Service and the role of women within the organisation needs to be emphasised. In terms of potential retention of female members of staff, it is important that opportunities for progression within the organisation are well publicised.

In regard to the pornographic material on laptops, the majority of staff interviewed are satisfied that action was taken in a timely and appropriate manner. While staff would have preferred earlier communication in relation to this issue, the Auditor-General was commended by some staff for taking a firm stance on this issue. The majority of staff are confident that standards of acceptable behaviour are now well defined and that inappropriate behaviour will be met with swift action. Senior managers will need to reinforce the commitment of the organisation to an environment free from inappropriate behaviour.

Communication within the organisation has improved with the use of the computer network. In particular, communication with the Performance Audit Branch has improved with the use of email to all staff in the Audit Office, prior to issues being reported in the media. However, more work is needed to ensure regular communication between senior management and staff. This process will need to be embraced by senior management and will involves some cultural changes.

Financial statement audits

To assess the financial statement audit function, the methodology employed by the Audit Office was reviewed, management letters sent to clients were evaluated and data on over 300 audits completed in 1997 and 1998 were collected.

The Audit Office has recently purchased a new financial statement audit package from one of the large private sector audit firms. This new system represents the latest in private sector audit technology and is designed to focus on risk management. Because of the differences in the audit mandate, outlined above, the audit package has been adapted to accommodate the public sector audit mandate. The strengths of the approach are in the emphasis placed on understanding the risks facing the client and the control of those risks.

Because the new methodology has been implemented only recently, the first audits completed under the new system were those with December balance dates, for example the audits of universities. For June balance dates, audits under the new approach are only just being completed. Consequently, the audits reviewed were those recently completed under the old methodology.

To assess the efficiency of the financial audits, the fees charged for audits of universities in New South Wales were compared with those in other Australian States and New Zealand. In comparing the audit fee structure across different jurisdictions, it is necessary to control for differences in audit mandates. Universities were chosen because they are subject to federal government financial control and, consequently, the publicly available financial information is relatively consistent.

As noted in the report, the fees paid by NSW universities were comparable to those in other States, with some being higher (South Australia and the ACT) and some being lower (Victoria, Western Australia and Tasmania).

The amount of testing undertaken during an audit is determined using professional judgment based on a series of risk assessments: as the perceived risk increases, the time taken and the fees charged can be expected to increase. The sensitivity of audit fees to those risk assessments was analysed for 150 audits completed in 1997. The audit fees were positively related to the perceived level of client risk, the complexity of the agencies’ operations and the sensitivity of the portfolio. This represents a consistent application of the methodology.

The time allocated to audits was also reviewed. When the time taken to complete audits was analysed over time, evidence of significant time reductions and efficiencies were identified.

Of over four hundred financial statement audits completed in 1998, approximately half could be classified as small (fewer than 120 hours) and over one quarter were very small (fewer than 50 hours). For many of these small audits, the cost of auditing may well represent a financial burden. The imposition of a mandatory audit requirement on these small agencies is a source of inefficiency. Treasury and the Audit Office need to investigate ways of reducing the burden of the audit cost.

In addition to the mandatory external audit requirement, agencies are also subject to internal audit. To the extent that internal and external auditing are substitutes, it might be expected that there would be co-ordination of procedures. For the 150 financial audits, the average assessment of the contribution of internal audit to the financial statement audit was very low. This raises two possibilities:

- the work undertaken by internal audit does not affect the external auditor's assessment of control risk; or
- there is a lack of co-ordination of between the internal and external auditors.

These issues were discussed on site visits and it became evident that there is considerable variation in both the type and quality of internal auditing being undertaken. In addition, opportunities exist for greater consultation between internal and external auditors.

Performance audits

This type of audit is very different from financial statement audits which are structured, follow a consistent approach with common objectives and are subject to numerous professional standards. Performance audits vary considerably in their objectives and approach and, consequently, are much more difficult to evaluate.

Discussions with senior staff of the General Accounting Office (GAO), Washington DC, indicated that their approach was to evaluate the processes rather than assess the outcomes. This view was also expressed in discussions with senior staff of the National Audit Office (NAO), London, and the Auditor-General of British Columbia (AGBC).

When this approach is applied, the profile of the staff in the Performance Audit Branch in New South Wales is similar to those in the NAO and AGBC, projects are initiated in similar ways, and the planning and execution are similar.

The major difference are:

- the NAO places considerably more emphasis on client clearance. The NAO performance auditors and the agency, subject to the performance review, usually reach an agreement during the clearance process which can extend over a number of months. This has not been the case for only one or two reports; and
- the NAO has a contract with an academic to undertake a quality review, which is only available within the NAO, as part of the quality control procedures.

The clearance procedures adopted by the NAO have the effect of ensuring greater co-operation in the implementation of recommendations in the performance audit reports and increases the likelihood that improvements in public sector management will result.

The performance audit reports issued in by the Audit Office cover a wide range of subjects. Suggestions for studies are received from the Parliament, from departments and agencies, and from the financial statement auditors. The procedures adopted for assigning priorities are consistent with overseas practice.

The effectiveness of the performance audits is enhanced if the recommendations that flow from the audits lead to improvements in management across the public sector. To achieve this, the primary focus should be on management issues rather than specific decisions. For example, while a study of the sale of, say, the TAB might indicate that the price obtained was too low (or too high), the real issue is how effective were the procedures and how might they be improved. Performance audits which do not lead to improvements in public sector management are of limited value.

In the private sector, auditors are formed into teams to ensure that the skills needed to understand the business of the client are available. The new methodology adopted for financial statement audits emphasises risk assessment and control. The skill set of performance audit staff can now be applied to financial statement audits and consideration should be given to the benefits of integrating the staff.

Outsourcing

Outsourcing of public sector audits is widely practised, both nationally and internationally. As part of the Review, the practices of the Audit Commission in the United Kingdom, the GAO, Audit New Zealand and the audit offices in all States were reviewed. The main reasons for the widespread practice of outsourcing are the strategic advantages:

- audits in remote locations are more efficiently audited by local firms;
- it may be more efficient to outsource audits requiring specialised knowledge; and
- outsourcing provides an opportunity to benchmark costs and procedures against private sector firms.

However, the approach to using private sector contractors must not reduce the Auditor-General's discretion and strategic involvement in audits to ensure effective oversighting of the Government's operations and reporting to the Parliament and the community.

There is an extra cost associated with outsourcing because, while private auditors may efficiently undertake the collection of evidence, this is then subject to a higher level review by the Auditor-General who reports to the Parliament.

Because of their strategic importance and sensitivity and in order to maintain expertise and industry knowledge, the audits of the some agencies should be excluded from the outsourcing system. For example:

- agencies responsible for policy formulation and the purchase of services;
- agencies that interface across governments;
- at least one government-owned service provider in each industry segment (for example, a hospital audit); and
- agencies that have a significant risk exposure for the community.

Client satisfaction

To assess the level of client satisfaction, the chief financial officers of a number of departments and agencies in urban and regional centres were interviewed. In the main, those interviewed were very complimentary of the Audit Office staff. In the few instances in which concerns had been expressed, the Audit Office had moved quickly to resolve the problems.

In respect of the audit process, many of those interviewed expressed an interest in the Audit Office increasing the level of assurance that might be given in respect of the client’s internal control environment. In addition, a number of those interviewed would have benefited from advice from the Audit Office on alternative systems used in similar agencies.

Accountability

As noted above, the ability of the Auditor-General to ensure improvements in public sector management depends upon the co-operation of the various partners. While reports issued by the Audit Office have the potential to improve management procedures, they do not always have the impact expected. In Victoria, Queensland and Western Australia, the Public Accounts Committees have a role in ensuring that the Auditor-General’s reports are implemented. The Public Accounts Committee’s areas of responsibility should include a specific requirement to monitor the reports and assess their impact on the efficiency and effectiveness of financial management. The Public Accounts Committee should take a more active role to ensure the implementation of reports issued by the Audit Office.

Funding the Audit Office

Funding of public sector audits may be provided by appropriations from the Parliament or by fees charged to departments and agencies. The approaches adopted in Victoria, Queensland and Western Australia were reviewed and the advantages and disadvantages noted. In terms of efficiency, the system currently in force in New South Wales of charging fees to departments and agencies creates the right incentives for both the auditor and the client. The auditor is required to justify the fee while the client has an incentive to prepare for the auditor's arrival and to facilitate the process. A system of funding which combines direct funding and appropriations, as adopted in Western Australia, seems unnecessarily complicated.

LIST OF RECOMMENDATIONS

Management of the Audit Office

Recommendation 1: The Audit Office should develop further the new performance appraisal system by:

- providing, on a regular basis, training in how to conduct performance appraisals for existing staff and staff joining the organisation who will be required to appraise staff; such training should undertaken within six months of joining the Office;
- improving communication with staff about what to expect from the appraisal process;
- ensuring that appraisals are conducted by managers/supervisors; and
- developing appropriate benchmarks for appraising information systems staff, while maintaining the integrity of the system for the entire organisation.

Recommendation 2: The system of 360 degree feedback should be reviewed prior to implementation beyond pilot stage and the benefits of the process should be communicated to participants.

Recommendation 3: The Professional Development Unit should continue to develop existing internal programmes but these need to be supplemented, on a regular basis, with courses given by external providers.

Recommendation 4: The Audit Office should investigate the possibility of providing value-adding training services on a fee basis to public sector clients.

Recommendation 5: The Audit Office should integrate the EEO programme with other human resource initiatives, to increase the profile of senior women as role models for junior employees and to raise the profile of spokeswomen.

Recommendation 6: Detailed procedures should be developed for grievance counsellors as a matter of priority.

Recommendation 7: Senior management should continue to reinforce their commitment to EEO programmes and acceptable standards of behaviour.

Recommendation 8: Guidelines for flexible working hours that are consistent between branches should be developed and implemented uniformly.

Recommendation 9: Staff should be actively encouraged to undertake secondments as a way of increasing their skill set.

Recommendation 10: Reimbursement of allowances should be standardised and budgeted appropriately.

Recommendation 11: Communication within the Audit Office should be increased by:

- continuing to place the Board of Management minutes on the network drive; and
- senior management demonstrating a commitment to ongoing communication skills and training by actively participating in the programme.

Recommendation 12: Steps should be taken to improve communication between audit teams and the Performance Audit Branch.

Financial statement audits

Recommendation 13: The Auditor-General should discuss with Treasury alternative proposals for auditing small clients.

Recommendation 14: Audit controllers should undertake greater consultation with internal auditors in order to explore opportunities to co-ordinate the compliance work and risk management.

Recommendation 15: Audit controllers should be given the discretion to identify account items for detailed compliance testing which are relevant to the operations of the audit client.

Recommendation 16: The Auditor-General's mandate should be extended to include the monitoring and expression of an opinion on the risk management disclosures included in the annual reports of government departments and agencies.

Recommendation 17: The Auditor-General's mandate should be extended to include the monitoring and expression of an opinion on the relevance and measurement of performance indicators included in the annual reports of government departments and agencies .

Recommendation 18: The Auditor-General should investigate alternative methods of training staff in risk assessment.

Performance audits

Recommendation 19: The Performance Audit Branch should give priority to projects which have a broad scope and will lead to the improvement of public sector management.

Recommendation 20: The Auditor-General should consider the benefits of integrating the staff in the Performance Audit Branch with the Financial Audit Branch to establish teams that are skills based and can more efficiently identify areas for improvement in public sector management.

Recommendation 21: The Auditor-General should investigate opportunities to ensure staff in the Performance Audit Branch receive appropriate training in survey design and analysis.

Outsourcing

Recommendation 22: The Auditor-General should continue the policy of contracting out audits in remote locations that can be more efficiently performed by contractors.

Recommendation 23: As a means of monitoring the quality of work carried out by contractors, the Auditor-General should adopt a policy of rotating audits that are undertaken internally as well as those outsourced.

Recommendation 24: The policy of involving client employees in the selection of contractors should be continued.

Recommendation 25: The policy of ensuring that strategic audits are not outsourced should be continued.

Client satisfaction

Recommendation 26: The Auditor-General should endeavour to improve the value-added elements of audits by ensuring that:

- the areas of concern to management are specifically addressed;
- management letters address the major risk areas of the department or agency; and
- minor matters are resolved as part of the audit and not included in reports.

Accountability

Recommendation 27: The Public Accounts Committee should take a more active role in assessing Government financial management by, *inter alia*, considering the recommendations for improvements in public sector management contained in reports issued by the Auditor-General.

Recommendation 28: The Auditor-General should give further consideration to the establishment of an Advisory Panel.

Funding the Audit Office

Recommendation 29: The present system of funding the Audit Office, based on fees collected from audit clients, should be retained.

ACRONYMS

AGBC	Auditor-General of British Columbia.
ANAO	Australian National Audit Office.
CPA	Certified Practising Accountant.
GAO	General Accounting Office, Washington DC.
EEO	Equal Employment Opportunity.
NAO	National Audit Office, London.
NSWAO	Audit Office of New South Wales.
NZA	New Zealand Audit.
PAB	Performance Audit Branch.
SAAO	South Australian Audit Office.
SAGE	System of Auditing for Government Entities.
SEA	Service Efforts and Accomplishments.
TAO	Tasmanian Audit Office.
VAO	Victorian Audit Office.
WAAO	Western Australian Audit Office.

1. INTRODUCTION

1.1 Nature of the Review

This Review has been undertaken in compliance with the requirement in the *Public Finance and Audit Act 1983*, section 48A, which provides for the Auditor-General's Office to be reviewed at least once every three years. The Review, which bears some of the characteristics of a performance audit, involves an examination of the auditing practices and standards of the Auditor-General to determine compliance with the requirements of the *Public Finance and Audit Act*. The previous review of the Audit Office of New South Wales was completed in 1996.

1.2 Assumptions underlying the Review

In undertaking the Review, two fundamental assumptions were made in identifying the appropriate benchmarks to be used to assess performance and the role of the Auditor-General in public sector management:

- there are substantive differences between public and private sector auditing; and

- the ultimate aim of auditing is to improve the quality of management.

1.2.1 Public versus private sector auditing

In previous reviews of Auditors-General in Victoria, Queensland and New South Wales, it has been assumed that the efficiency, economy and effectiveness of an audit office is to be assessed in comparison with private sector audit firms. However, such an approach fails to recognise the fundamental differences between public and private sector auditing.

The audit approach of private sector auditors is risk based and generally focuses on substantive tests. Comparatively little attention is given to auditing the client's systems of control or to regulatory and compliance issues. This approach is consistent with the private sector audit mandate where the audit objective is merely to provide the client — the shareholders or company — with an opinion on the financial statements. In the public sector, the client can include the Government, the Parliament and the electorate. In addition to the audit of the financial statements, considerable emphasis needs to be placed on compliance with legislation and government regulation. For example, in Queensland and Western Australia, the reports of Auditors-General specifically refer to the two arms of the audit mandate — financial statement and compliance — and the words used in the opinion are linked to the prescribed requirements. In addition, because the Auditor-General is the auditor of the Parliament, consideration must be given to the elimination of inconsistencies within and between government authorities and agencies.

The question of the identification of the audit client is not often an important issue for private sector auditors. Technically, the auditor is appointed by the company and reports to the members, while — in practice — the auditor is usually appointed on the recommendation of the directors or the managers. The rationale for appointing external auditors lies in the separation of the ownership of the company and the control of its resources. In addition, the owners — that is, shareholders — rely upon managers to supply information to be used in evaluating the performance of the managers.

Understandably, involvement of managers in the appointment of the auditor can give rise to questions about the auditor's independence in reporting on the financial statements. For example, the Chief Accountant of the United States Securities and Exchange Commission, Walter P Schuetze, referred to "situations in which auditors are not standing up to their clients on financial accounting and reporting issues when their clients take a position that is, at best, not supported in the accounting literature or, at worst, directly contrary to existing accounting pronouncements" (Schuetze 1994). Given the concern expressed over "creative accounting" and "opinion shopping", this comment is as appropriate to Australia as it is to the United States. Competitive pressures represent a threat to auditor independence.

In the public sector, the Parliament relies on information supplied by departments and other authorities to evaluate performance. The Parliament is, thus, analogous to the owners of companies. The Auditor-General is appointed by the Parliament and reports to the Parliament on the management of public assets by the departments and other authorities.

Because of these differences, the practices and procedures of public sector auditors can be expected to differ from those adopted in the private sector. Consequently, in this Review, the economy, efficiency and effectiveness of the Audit Office of New South Wales is assessed by reference to other Australian Audit Offices (in Victoria, Queensland and Western Australia), and — after consultation with the Public Accounts Committee — best practice in British Columbia, the National Audit Office in the United Kingdom and the General Accounting Office in the United States.

1.2.2 Improving public sector management

The role of auditors has evolved over time from "bloodhound" to "watchdog" and, more recently, is focussing on the "value added" to the client's operations.

The role of an auditor-general also evolves, albeit more slowly as a result of the need to change legislation.

The main focus of public sector auditors has been — and is likely to remain — the enhancement of accountability. However, there are signs that the focus is becoming broader. The Auditor-General of British Columbia, George Morfitt, recently stated that "accountability is not an end in itself: it should not only serve to inform the Legislative Assembly and the public, it should also lead to improvements in the performance of government" (Morfitt 1997, p. 35). Indeed, the Office of the Auditor-General in British Columbia provides independent assessments and advice that enhance government accountability and performance.

In Australia, this broader role is implied by the mission statements appended to publications issued by the Victorian Audit Office (VAO), "Auditing in the Public Interest", and the Audit Office of New South Wales (NSWAO), "Auditing in the State's Interest": the interests of the public and the State clearly extend beyond accountability to the efficiency of public sector management.

When seen in this broader context, the role of Audit Office can include monitoring financial management in the NSW public sector with the ultimate aim of enhancing the efficiency of public sector management. In this regard, the Auditor-General acts in partnership with a number of other parties and agencies including the Parliament, the Public Accounts Committee, Treasury and the administration of departments and agencies. Improvements in public sector management can be achieved only if the various groups and agencies work co-operatively.

In this report, opportunities to facilitate improvements in financial management are explored in terms of their relative contribution to the partnership of interests.

1.3 Conduct of the Review

At the commencement of the Review, the Auditor-General provided office space and access to computer and other facilities to facilitate the collection of material. Over the period of the Review, extensive contact was had with the Auditor-General and his staff who were extremely co-operative and helpful.

In accordance with the terms of reference set out in Appendix A, the evidence — on which this Review is based — was collected in private interviews with Auditors-General and their staff in the six Australian States (New South Wales, Queensland, South Australia, Tasmania, Victoria and Western Australia) and overseas (Canada, New Zealand, the United States and United Kingdom).

Private interviews were also held with public sector employees of government departments and agencies. A list of those interviewed is contained in Appendix B. Interviews were also held with senior staff of the NSWAO.

The auditing of financial statements accounts for approximately 80 per cent of the resources of the NSWAO. To assess the financial statement audit function, the methodology employed by the Office was reviewed, management letters sent to clients were evaluated, data on over 300 audits completed in 1997 and 1998 were collected, and discussions were held with executives of audit clients.

To provide a data base to benchmark financial statement audits, data were collected on 100 government audits from other States.

The sixteen performance audit reports published in 1998 were reviewed and the audit approach was benchmarked against best practice in Australia and overseas. The performance audit reports were discussed with senior executives and managers of public sector agencies in New South Wales.

Submissions were invited from the public through an advertisement in the national financial press; no submissions were received. Clients were surveyed and interviewed, and focus groups were conducted with a broad section of staff of the NSWAO to discuss issues related to the operations of the Office.

1.4 Response to the previous review

The previous review of the Audit Office included a number of recommendations for changes in the organisation of the Office and the procedures adopted. Most of these recommendations were implemented. The responses to the following recommendations are to be noted.

Recommendation 1 of the previous review proposed the establishment of an independent advisory panel. This recommendation was not implemented on the grounds that the function was better achieved through the Public Accounts Committee.

Recommendation 2 proposed a separate Audit Act administered by Premier's Department. The *Public Finance and Audit Act* is currently under review.

Recommendation 11 proposed that the Auditor-General be given a discretion in performance audits to weight economy, efficiency and effectiveness using professional judgment. Present legislative requirements were considered satisfactory and the recommended changes unnecessary.

Recommendation 20 of the previous review called for legislative changes to the Auditor-General's mandate to provide specific power to undertake compliance auditing as part of the normal function. These legislative changes were not considered necessary. Notwithstanding, annual audits now include compliance testing as part of financial attest audits.

Recommendation 29 proposed that performance audits be funded by the Audit Office from fees received from financial statement audits. The Audit Office prefers Parliamentary appropriation.

Recommendation 30 provided for the integration of the Performance Audit Branch staff into the Financial Audit Branch. This has not been implemented.

2. MANAGEMENT OF THE AUDIT OFFICE

The management structure of the NSWAO is similar to those in other States. The Office is divided into four branches:

- Financial Audit;
- Performance Audit;
- Information System Audit; and
- Corporate Services.

The Auditor-General is supported by a Deputy Auditor-General, responsible for the Corporate Services Branch, and five Assistant Auditors-General, responsible for Financial Audit and Performance Audit Branches. The Financial Audit Branch is divided into four sub-branches.

The relative size of the NSWAO can be gauged from Table 2.1.

Table 2.1: Relative sizes of State audit offices

	NSW	Qld	Vic	WA
Number of employees	218	171	133	99
Number of financial statement audits	384	627	540	188
Total audit office income ($ million)	22.272	12.370	17.699	12.011
Total consolidated public sector revenue ($ million)	27,490	14,061	25,700	14,214

Source: Annual reports of State audit offices.

These figures illustrate some important differences in the work performed. While the number of financial statement audits conducted in New South Wales is fewer than in Queensland and Victoria, the average size of audits completed in New South Wales is greater than in the other States. The explanation for this is that, in Victoria and Queensland, the Auditors-General are responsible for local government audits.

2.1 Overall staff satisfaction levels

The Audit Office is highly dependent on a suitably qualified and motivated staff. Staff are obviously proud to be part of a professional organisation and there is a genuine perception that, as individuals and as team members, they add value to public sector management.

The Human Resources Unit is actively engaged in the graduate intake programme. The new performance appraisal system devolves much of the responsibility for the efficient management of human resources to immediate supervisors.

2.2 Performance appraisal

Considerable effort has been made to improve the performance appraisal system based on six key performance indicators:

- knowledge, skills and experience;
- problem solving;
- communicating and influencing;
- client focus and quality;
- teamwork; and
- accountability and responsibility.

The new system has the potential to deliver significant benefits to both individuals and the organisation as a whole. To date, performance appraisal has not been applied consistently throughout the organisation, mainly because training for those conducting performance appraisals has not been delivered for approximately three years.

Additionally, the delivery of performance appraisals requires standardisation. Some individuals obviously make a large effort to provide feedback to their staff and the formal review between the supervisor and the appraised staff member is very comprehensive. At the other end of the spectrum, some staff may have little input into the process. This diminishes the real benefits in terms of the staff development and performance improvement that can be gleaned from this process.

Variations exist between branches in relation to who actually completes the performance appraisal. In one branch, reports are completed by an Administration Manager, who does not necessarily work with the staff member on a regular basis. This creates a perception that appraisals are less meaningful in some branches. Additionally, some managers complete reports for audit staff who do not actually work for them, and this can undermine the staff's confidence in the integrity and potential outcomes of the process.

Information systems staff are concerned that the benchmarks applied to their performance are unrelated to the rest of the organisation. Some technical staff claim that they do not have position descriptions, or that they bear little relationship to reality. The position descriptions of these individuals are currently under review.

Recommendation 1: The Audit Office should develop further the new performance appraisal system by:

- providing, on a regular basis, training in how to conduct performance appraisals for existing staff and staff joining the organisation who will be required to appraise staff; such training should be undertaken within six months of joining the Office;
- improving communication with staff about what to expect from the appraisal process;
- ensuring that appraisals are conducted by managers/supervisors; and
- developing appropriate benchmarks for appraising information systems staff, while maintaining the integrity of the system for the entire organisation.

The system of 360 degree feedback is in its pilot stage and some staff have obviously benefited from the process. However, feedback forms may be viewed as simply more paperwork and could lead to a perception of over appraisal. The benefits associated with 360 degree feedback will need to be clearly explained and promoted within the organisation if this mechanism is to be truly successful. An effective way to do this would be to showcase staff who think that they benefited from the process.

Opportunities for promotion at the Audit Office are perceived to be limited as there are some in the organisation who have reached their "comfort level" and are perceived to be blocking the path of more ambitious and talented junior members of staff. One of the continuing challenges for the performance appraisal system will be to motivate staff when promotional opportunities are not imminent.

The Office operates within the constraints of the NSW public sector and there are difficulties associated with appropriate exit strategies for poor performers. This area is receiving increased attention with active performance improvement programmes being developed for employees thought to be "at risk".

Recommendation 2: The system of 360 degree feedback should be reviewed prior to implementation beyond the pilot stage and the benefits of the process should be communicated to participants.

2.3 Training and staff development

The majority of staff training programmes during the year was directed toward the implementation of the SAGE (System for Auditing Government Entities) methodology. This accounted for up to 8 days of staff training which averaged 9.8 days (Audit Office of New South Wales, 1998). The Professional Development Unit continues to offer courses to the organisation, in conjunction with specialist courses that are now purchased from organisations such as DDI and PricewaterhouseCoopers. The Intranet is being developed to enhance opportunities for self-paced learning. Specific training needs are discussed in Sections 3.10 and 4.6.2.

Recommendation 3: The Professional Development Unit should continue to develop existing internal programmes but these need to be supplemented, on a regular basis, with courses given by external providers.

New appointees appear very satisfied with the induction programme, and the level of training received. Even though a large amount of the training is "on the job", the opportunity to obtain professional auditing training and experience is seen as one of the key benefits of joining the Audit Office. Attracting a high calibre of graduates also leads to higher expectations from these individuals in terms of the opportunities within the organisation. The high quality of the training received by Audit Office staff is recognised by both the staff, and public and private sector employers. Support is provided for staff undertaking the Institute of Chartered Accountant's Professional Year and the Australian Society of Certified Practising Accountants' CPA programmes.

There was little evidence of the mentoring programme, with the exception of the "friendly face" initiative which is a "buddy system" for graduate recruits. This programme appears to work well, although the close rapport and professional relationships developed within the audit team appear to be more significant.

The financial officers of departments and agencies who were interviewed frequently expressed the view that more help was needed in identifying administrative systems and procedures which improve efficiency and effectiveness of their operations. The view was also expressed that the NSWAO staff have experience across the public sector and would be aware of what works and what does not.

Given that the NSWAO has both the experience and key strengths in providing public sector training, closer partnerships with the Audit Office's clients would be a way of adding value. The Audit Office should actively consider providing training / benchmarking services to clients on a fee-paying basis.

Recommendation 4: The Audit Office should investigate the possibility of providing value-adding training services on a fee basis to public sector clients.

2.4 EEO and standards of professional behaviour

While females are not represented in large numbers within the Senior Executive Service, there are senior women within the organisation. A spokeswomen programme is operational but it does not appear to have a high profile and role models for women within the organisation need to be showcased more prominently. In terms of potential retention of female members of staff, it is important that opportunities for progression within the organisation are well publicised.

Recommendation 5: The Audit Office should integrate the EEO programme with other human resource initiatives, to increase the profile of senior women as role models for junior employees and to raise the profile of spokeswomen.

The appointment of grievance counsellors in the organisation has been a positive step. Most staff are now aware that there is an additional "circuit breaker" in place if they have a problem that they feel they cannot comfortably discuss with their immediate supervisor. This is a relatively new initiative, and the detailed procedures for grievance counsellors are still in the development phase.

> **Recommendation 6**: Detailed procedures should be developed for grievance counsellors as a matter of priority.

In regard to the pornographic material on laptops, the majority of staff interviewed are satisfied that action was taken in a timely and appropriate manner. The Auditor-General was commended by some staff for taking a firm stance on this issue. However, staff would have preferred earlier communication in relation to this issue as knowledge of the problem among clients caused embarrassment to some staff.

The majority of staff are confident that standards of acceptable behaviour are now well defined and that inappropriate behaviour will be met with swift action. Senior managers will need to reinforce the commitment of the organisation to an environment free from inappropriate behaviour.

> **Recommendation 7**: Senior management should continue to reinforce their commitment to EEO programmes and acceptable standards of behaviour.

2.5 Flexible working arrangements

The majority of staff view flexible working hours as a positive condition of employment at the Audit Office. However, there are inconsistencies in the application of the policies between the various branches.

Flexible working hours provide a method of legitimately allowing the fulfilment of family commitments and the Audit Office is generally sympathetic and accommodating to these responsibilities. However, the nature of audit work on remote client sites may not be family friendly. An interim policy in relation to flexible working hours has now been released. However, ongoing consultation and monitoring will be required to assess the success of the arrangements, particularly as they relate to actual practice.

Telecommuting has been made available for at least one member of staff, but there are practical limitations to the extension of this programme.

Inconsistencies exist between various branches in relation to the treatment of time in lieu. For example, some branches have a one-for-one policy while others have two for one and some staff questioned the fairness of this. Variations also exist in relation to travel time: for some branches this can be granted as time in lieu while for others it can not.

Recommendation 8: Guidelines for flexible working hours that are consistent between branches should be developed and implemented uniformly.

Secondments are an integral part of flexible work practices at the Audit Office. Staff are encouraged to "look beyond" the Audit Office, and have been seconded to public and private sector organisations, both locally and overseas. Sites to which staff has been seconded include Duesburys, The National Audit Office and the Audit Office in British Columbia, as well as the NSW Premier's Department. This is a useful method of providing staff with a broader perspective and improved electronic communication allows the staff to continue to identify with the Audit Office whilst on secondment. Staff are generally positive about the experience. Some staff return to the Audit Office with a different perspective and varied skill set —for example, having benefited from more exposure to internal audit — whilst others may choose to transfer within the public sector to a client on a permanent basis. This is of benefit to the Audit Office and the public sector as the training received at the Audit Office is applicable and appropriate to other organisations.

Recommendation 9: Staff should be actively encouraged to undertake secondments as a way of increasing their skill set.

2.6 Payment of allowances

Payments in relation to use of private motor vehicles and other forms of transport are not consistently applied. These inconsistencies are viewed by some staff members as inequitable. These problems exist because of the semi-autonomous nature of the branches and steps are needed to ensure consistency.

Recommendation 10: Reimbursement of allowances should be standardised and budgeted appropriately.

2.7 Intra-office communication

Communication within the organisation has improved with the use of the computer network to distribute the Board of Management minutes. However, some staff expressed the view that the minutes were overly brief in content and that they did not understand why particular resolutions were made or why some matters were an issue in the first place. Staff can also browse the network drive for information relating to other issues. However, more work is needed to ensure regular communication between senior management and staff. This process will need to be embraced by senior management and will involve some cultural changes.

Recommendation 11: Communication within the Audit Office should be increased by:

- continuing to place the Board of Management minutes on the network drive; and
- senior management demonstrating a commitment to ongoing development of communication skills and training by actively participating in the programme.

Communication with the Performance Audit Branch has improved with the use of email, to all staff, prior to issues being reported in the media. Notwithstanding this, some staff remain unfamiliar with the activities of this group. This is not necessarily the fault of the Performance Audit Branch as some staff do not think they really need to know details of the activities of this Branch. For some staff, the Performance Audit Branch is virtually a separate organisation. However, on the occasions when Performance and Financial Audit have worked together, the experience appears to be very positive and value has been added to both groups.

Recommendation 12: Steps should be taken to improve communication between audit teams and the Performance Audit Branch.

3. FINANCIAL STATEMENT AUDITS

The auditing of financial statements accounts for approximately 80 per cent of the resources of the NSWAO. To assess the financial statement audit function, the methodology employed by the Office was reviewed, management letters sent to clients were evaluated, data on over 300 audits completed in 1997 and 1998 were collected, and discussions were held with executives of audit clients.

3.1 Audit methodology

In 1998, the NSWAO called for expressions of interest from accounting firms to supply a new financial statement audit package and subsequently received offers from three of the Big 5 international accounting firms. This practice of acquiring a private sector methodology has been previously used effectively in the NSWAO and other jurisdictions, for example, Queensland and Western Australia.

The purchase decision recommendation was made by a project evaluation team which ranked the three systems on offer on seven criteria:

- business focus;
- public sector risk;
- ease of use;
- application to different types and sizes;
- economy;
- contemporary; and
- change management.

The system chosen represents the latest in private sector audit technology and is designed to focus on risk management and to add value to the client's business.

Because of the differences in audit mandate, outlined in Section 1.2.1, the audit package was adapted to accommodate the public sector audit mandate. The strengths of the approach are in the emphasis placed on understanding the nature of the client's business, the risks facing the client and the control of those risks.

A pilot study of the new methodology and technology was undertaken using seven audits with June 1998 balance dates. The first audits completed under the new system were university audits which have December balance dates. Other audits with June balance dates are in the process of completion. Consequently, the majority of audits analysed as part of this Review were those recently completed under the old methodology.

3.2 Audit pricing

The *Public Finance and Audit Act* confers on the NSWAO monopoly powers over the audit of public sector bodies. The main risk with monopolies is that they can lead to cost inefficiencies. Here the concern is more likely to be with over-auditing than under-auditing. This issue can be addressed by comparing the costs of audits over time or with other public sector auditors.

If comparisons are made over time, it is expected that, as the auditor becomes more knowledgeable about the client, the audit will become more efficient and the time taken to complete the audit, and hence the audit fee charged, will decline. That is, a so-called learning curve effect will become apparent. However, in a study of audits undertaken by one of the large accounting firms in the United States, O'Keefe, Simunic and Stein (1994) were unable to identify a learning curve effect.

Problems arise in undertaking time series analysis where there have been structural changes as a result of reorganisation. For example, in New South Wales, area health services have undergone amalgamations and departments have been restructured, which limit the opportunities to make comparisons over long periods of time.

To assess the extent to which the auditing of NSW public sector agencies becomes more efficient over time, the audit fees charged in 1998 were compared with those charged on 1995, 1996 and 1997. Because of restructuring of agencies, the number of audits reviewed is not constant over the three years.

Three comparisons were made for each of the three years and the results are set out in Table 3.1. For the total samples, in each of the three comparisons the number of fee reductions is greater than the number of fee increases. This is consistent with an increase in the efficiency. Because larger audits provide greater opportunities for efficiencies, the total sample was divided into large and small clients based on the size of the audit fee in 1998. The evidence of fee reductions for the smaller audits is consistent across the three years. However, the evidence of fee reductions is not consistent for the larger clients. A possible explanation for this is the restructuring that occurred in ministerial portfolios.

Table 3.1: Comparison of audit fees charged in 1998 with prior year fees

	Frequency		
Comparison	1995	1996	1997
Total sample			
Fee reduction	202	183	232
Fee increase	130	159	146
Larger clients			
Fee reduction	38	80	110
Fee increase	128	91	79
Smaller clients			
Fee reduction	92	103	122
Fee increase	74	68	67
Sample sizes	332	342	378

In comparing audits across different States or different countries, it is important to control for regulatory differences in, for example, the audit mandate and to ensure that the number of observations is sufficiently large to obtain reliable estimates. In addition, comparisons are limited by the availability of data from those other jurisdictions.

In Australia, there are 39 universities publishing annual reports. These reports are standardised to comply with Federal Government requirements and, consequently, provide a source of data (including the fees paid for auditing) with which to make comparisons.

To assess the efficiency of the financial audits, the fees charged for audits of universities in New South Wales were compared with those in other Australian States and New Zealand. The method of analysis used to compare audit fees paid by clients has been used extensively in Australia and overseas to analyse audit fees in both the private and public sectors. In essence, the approach compares audit fees after allowing for differences in the size of the audit and othe characteristics of the client.

As is evident from the results reported in Appendix C, the fees paid by NSW universities were considerably less than those paid by universities in the ACT and less than those in South Australia. Compared to Queensland, the average audit fees in New South Wales were not significantly different. In respect of Victoria and Western Australia, the audit fees paid in New South Wales were significantly higher.

In considering the audit fees charged in the various States, the relative size of the NSWAO needs to be considered. The details of the number of audits performed in 1998, as set out in Section 2, indicate that the number of audits undertaken in Queensland and Victoria is significantly larger than the number for New South Wales. This leads to a pricing advantage as the average fixed cost per audit is considerably less in Queensland and Victoria.

In discussions with the Auditor-General of Western Australia, it became apparent that a policy of cutting audit costs had been implemented for the past few years. This approach is consistent with experience in the private sector where the evidence of audit fees charged to listed companies during the decade of the 1980s indicates considerable price reductions (Craswell 1992).

Audit fees are only one side of the equation and fee reductions need to balanced against the quality of the service provided. Consequently, while the Auditor-General needs to monitor audit fees, cost cutting which has the effect of reducing the level of assurance needs to be avoided.

3.3 Audit effort

The fees charged by the NSWAO are calculated according to the time taken, the predetermined charge out rates and an overhead rate. Consequently, the time taken by different levels of staff is a primary determinant not only of efficiency but also of the fees charged to clients. To assess the effects of increased knowledge and understanding of the audits, the time taken to complete audits in 1998 was compared to the time required to complete the audit of the same client in 1995, 1996 and 1997.

As with the audit fee data, three comparisons were made for each of the three years. The results are set out in Table 3.2. For the total samples, in each of the three comparisons, the number of reductions in total audit time is greater than the number of fee increases. This is consistent with the audit fee comparisons and indicates an increase in audit efficiency.

As with the audit fee data, the total sample was divided into large and small clients based on the size of the audit fee in 1998. The evidence for the smaller audits is consistent across the three years and indicates that more than half the audits were completed in less time. In the case of the larger clients, reductions exceed increases in two of the three years; increases exceed reductions only in 1995 and even here the difference is small.

Table 3.2 Comparison of audit hours in 1998 with prior years

Comparison	Frequency 1995	1996	1997
Total sample			
Reduction in time	189	208	250
Increase in time	143	133	128
Larger clients			
Reduction in time	81	98	124
Increase in time	85	73	65
Smaller clients			
Reduction in time	108	110	126
Increase in time	58	60	63
Sample sizes	332	341	378

While the evidence presented in Table 3.2 indicates that the time taken to complete audits in 1998 is generally less than in the preceding three years, the evidence does not indicate the magnitude of the changes. To gauge the extent of changes, the average percentage changes in fees and hours were calculated for the three years and these are set out in Table 3.3.

Table 3.3: Changes in audit fees and hours from 1995 to 1998

Comparison	Average percentage change [a] 1995	1996	1997
Total sample			
Audit fees	64.2	4.7	–3.2
Audit hours	57.4	–1.0	–7.7
Increase sub-sample			
Audit fees	132.3	42.8	30.9
Audit hours	182.8	43.9	29.5
Decrease sub-sample			
Audit fees	–40.2	–25.8	–22.4
Audit hours	–35.8	–26.9	–24.5

[a] Percentage changes are calculated relative to 1998.

The results reported in Table 3.3 indicate considerable variation in the changes over time. For example, the average percentage change in audit fees for 1995, 64.2 per cent, is driven by a number of large changes which result from changes in the size and complexity of the audit clients. This is particularly evident from the results reported for the sub-samples.

While, for the sub-sample of increases in time and cost, changes in size and complexity are likely to be a confounding effect, this is less likely to be the case for the sub-sample of decreases. For the latter sub-sample, the average reductions in fees are consistent with those for hours and the reductions in all three years exceed 20 per cent. As this sub-sample represents more than 50 per cent of the total number of audits completed, the economies achieved over the period 1995 to 1998 are quite significant.

3.4 Audit judgments

Discussions with staff in the NSWAO established that the time taken to complete an audit is not calculated according to some formula but is based upon the risk assessments made by the audit controllers. The same approach is widely adopted by private and public sector auditors in Australia and overseas where the planning of an audit is dependent upon the professional judgement of the auditor.

Consequently, the key to the allocation of resources to a specific audit is the ability of staff to make professional judgments. Of particular interest, in this context, is the means by which auditors develop professional judgment and how consistently it is applied. When these issues were raised with public sector auditors in Australia and overseas, the unanimous view was that professional judgement is developed using an apprenticeship approach; that is, on the job training.

To test the relationship between judgements and the time taken to audit, audit staff were asked to complete the questionnaire set out in Appendix D. The aim of this questionnaire was to obtain details of the judgments made in respect of audits completed in 1997 in order to analyse the relationship between judgements and audit time.

The questionnaire was developed based on specific judgements called for by the audit methodology, with reference being made to specific forms completed. Because the judgments are made in respect of a particular account item, it was necessary to identify an account which is common to all audits. The account item selected was expenditure.

Questionnaires were distributed to audit controllers who were asked to extract, from the working papers for 1997 audits, details of their risk assessments. On this basis, audit judgements were obtained for a sample of 150 audits. To analyse how time taken varied with audit judgements, details of the size, complexity and risk of the audits were extracted from annual reports of the sample clients.

Details of the judgements are set out in Table 3.4. In regard to the judgements made in respect of inherent risk, control risk and analytical review, the controllers were assessing the level of assurance (high, medium or low) rather than the level of risk. If the level of assurance from inherent risk is judged to be high, the level of risk is consequently low.

Table 3.4 Audit judgments on 1997 audits

Variable	Mean	Standard deviation	Median	Mode	Minimum	Maximum
Assurance from:[a]						
Inherent risk	1.5	0.6	1	1	1	3
Internal control	2.7	0.9	3	2	1	4
Analytical review	3.0	0.6	3	3	1	4
Sensitivity of the audit [b]	1.4	0.6	1	1	0	3
Complexity of the audit [c]	2.1	0.6	2	2	0	3
Effectiveness of internal audit	3.5	2.6	3	0	0	9
Overall risk	4.9	2.3	5	7	0	10

[a] Levels of assurance were coded high = 1, medium = 2 and low = 3.

[b] Sensitivity of the financial statements was coded Not particularly sensitive = 1, Sensitive = 2 and Very sensitive = 3.

[c] Complexity of the client was coded Complex = 1, Average = 2 and Simple = 3.

The reported results in respect of levels of assurance from internal control indicate a mean value of 2.7, which is associated with low assurance (high risk), and the modal value (the highest number of judgments) of 2.0. In respect of analytical review, the mean and modal values of 3.0 represent low assurance (high risk). These results suggest that the controllers adopt a risk averse strategy. This is also the case in respect of the judgments regarding analytical review.

Additional analyses were undertaken using a model similar to the audit fee model described in Appendix C. The dependent variable in the model is audit hours and the independent variables included controls for size, complexity and risk as well the variables described in Table 3.4. For the sample of 150 audits, the model explained approximately 70 per cent of the variation in total hours spent on the audits. Separate regressions were estimated for each of the experimental variables.

The results of the regression analyses indicate that audit fees charged to clients are positively related to:

- the perceived level of client risk;
- the complexity of the agency's operations; and
- the sensitivity of the portfolio.

These results are consistent with the application of the methodology. However, the results also suggest that there are positive benefits to be gained from improving the ability of audit staff to make professional judgments.

3.5 Small audits

The time allocated to audits was also reviewed. Of over four hundred financial statement audits completed in 1998, approximately half could be classified as small (fewer than 120 hours) and over one quarter were very small (fewer than 50 hours). For many of these small audits, the cost of auditing may well represent a financial burden. The imposition of a mandatory audit requirement on these small agencies is potentially a source of inefficiency. For example, the registration boards under the control of the Department of Health are small, have few or no assets but are required to issue separate annual reports that are subject to audit.

This problem is not unique to New South Wales. The Victorian Auditor-General also commented on the problems of compulsory audits for small agencies. However, this is not an issue that can be resolved unilaterally. Treasury and the Audit Office need to investigate ways of reducing the burden of the audit cost on small clients.

Recommendation 13: The Auditor-General should discuss with Treasury alternative proposals for auditing small clients.

3.6 Internal audit

In addition to the mandatory external audit requirement, agencies are also subject to internal audit. To the extent that internal and external auditing are substitutes, it might be expected that there would be co-ordination of procedures. As evident from Table 3.4, the mean assessment of the contribution of internal audit to the financial statement audit was 3.5 and the modal value was zero, for the 150 financial audits analysed. This can only be regarded as very low. The regression analysis of internal audit judgements and audit fees did not identify a significant relationship. This raises two possibilities:

- the work undertaken by internal audit does not affect the external auditor's assessment of control risk; or
- there is a lack of co-ordination between the internal and external auditors.

The question of the role of internal audit was raised on site visits with clients. From the discussions, it became evident that there is considerable variation in both the type and quality of internal auditing being undertaken.

Not all internal auditing is of relevance to the financial statement audit. In some cases, the internal auditors undertake tests of the internal control environment while, in other cases, the work completed involves performance evaluation and is akin to management advisory services. However, internal auditing could be expected to reduce risks and be relevant to compliance work.

The trend in private sector auditing is to greater co-ordination between internal and external auditors with the aim of reducing the total cost of auditing. In discussions on site visits and with internal and external public sector auditors, it appeared that the extent of the co-operation between auditors could be improved by more formal meetings when the audit plans are being prepared.

Recommendation 14: Audit controllers should undertake greater consultation with internal auditors in order to explore opportunities to co-ordinate the compliance work and risk management.

3.7 Compliance testing

Following the 1996 review of the NSWAO, the time allocated to testing compliance with government legislation, regulations and guidelines was set at 10 per cent of the total audit time. The focus of this compliance testing is determined by a list published each year and made available to audit staff.

The advantage of this approach is that it should lead to consistency and ensure broad coverage of account items. By ensuring that the same issues are tested in all departments and agencies, the evidence collected is more likely to highlight weaknesses and identify the need for changes in regulations. Over time, the system will ensure that all sensitive areas are subject to compliance testing.

A weakness in this approach is that the issues identified in any year may not be relevant or may not be associated with high risk. For example, issues relating to the Senior Executive Service are relatively minor and pose little risk for many of the audits.

An approach which is more consistent with the risk-based methodology adopted by the NSWAO would involve the identification of compliance testing issues to match an individual client's risk profile.

Recommendation 15: Audit controllers should be given the discretion to identify account items for detailed compliance testing which are relevant to the operations of the audit client.

3.8 Risk management disclosure

Included in NSW public sector annual reports are Risk Management Statements. Notwithstanding the growing importance of risk identification and management, the quality of these statements is extremely variable. In some departments and agencies, considerable effort is made to identify the risks and explain the control procedures in place. In other cases, the statements are not very informative.

The SAGE audit methodology recently introduced by the NSWAO requires an auditor to develop an understanding of the client's business and the strategic and operating risks. Because of this, audit staff can be expected to have a comparative advantage in the identification of risks.

If disclosure of risk management is to be taken seriously, some form of monitoring is required and the NSWAO would be ideally placed to assess the quality of the disclosure of risk management in annual reports.

Recommendation 16: The Auditor-General's mandate should be extended to include the monitoring and expression of an opinion on the risk management disclosures included in the annual reports of government departments and agencies.

3.9 Performance indicators

The use of performance indicators to encourage improvement in public sector performance is widespread not only in Australia but also overseas. As documented by Pierce and Puthucheary (1997), many NSW agencies are already including performance indicators in annual reports and Treasury negotiates financial targets and performance indicators with government businesses. However, as noted by Walker (1999), the presentation of performance indicators has not been "tightly prescribed".

More recently, the Council on the Cost of Government, which undertook a review of performance statements published by public sector agencies in New South Wales, indicated a preference for the term SEAs — Service Efforts and Accomplishments. As explained by Walker (1999, p. 8), SEAs "are intended to be 'High level' indicators explaining what is done within public sector agencies, and providing an overall view of efficiency and effectiveness of those activities". Supported by Treasury and the Premier's Department (through the Council on the Cost of Government), it seems that the use of SEAs or performance indicators will become more widespread in New South Wales.

In Western Australia, performance indicators have been used for a longer period of time and more systematically than in New South Wales. An important characteristic of the Western Australian experience has been the role of the Auditor-General who is required to express an opinion on performance indicators included in annual reports. The experience with performance indicators in Western Australia was discussed with the Auditor-General of Western Australia. In his view, after more than three years, agencies' objectives have become more realistic and better articulated. He expects that, in the next three years, performance indicators will be more extensively used and will be incorporated as part of strategic and operating plans and performance.

While, in the initial stages of their introduction, the nature and significance of performance indicators are subject to debate, in the long term, performance indicators provide an opportunity to motivate managers. However, as with risk management, the Western Australian experience suggests that it is essential that the reporting of indicators is monitored.

Walker (1999, pp. 32–35) expresses some reservations about the capacity of an auditor to express an opinion on the relevance and appropriateness of published indicators. Notwithstanding these concerns, the experience in Western Australia suggests that the Audit Office is the appropriate agency to monitor published indicators. While audit staff will need to receive appropriate training, the Audit Office has the advantage of an extensive knowledge base obtained while undertaking financial statement audits and, therefore, is well placed to undertake the monitoring of SEAs or performance indicators.

Recommendation 17: The Auditor-General's mandate should be extended to include the monitoring and expression of an opinion on the relevance and measurement of performance indicators included in the annual reports of government departments and agencies.

3.10 Training in risk assessments

There can be little doubt that risk management has become a management priority in both the private and public sectors. The evidence of this is to be seen in annual reports, in the restructuring of the large accounting firms and in the focus of government reports relating to such diverse issues as quarantine, casino surveillance and fire fighting.

The modern approach to auditing adopted by KPMG is described by Bell, Marrs, Solomon and Thomas (1997). The approach relies upon audit staff possessing very different skills from those traditionally associated with auditing. For example, considerable emphasis is placed on understanding the nature of a client's business and the strategies employed to manage political, economic, social and technological factors affecting the operations of the business. These are the skills normally associated with performance auditors.

As noted in Section 3.1, the new SAGE methodology introduced in 1998 places particular emphasis on understanding a client's business, associated risks and the management of those risks. Implementation of the methodology will require staff to develop an enhanced appreciation of risk, both strategic and operating. The NSWAO will need to explore opportunities to deliver programmes to ensure that staff develop the level of skills needed.

In Queensland, the Auditor-General has entered into an alliance with the Graduate School of Business, Queensland University of Technology, to develop a leadership development programme for targeted key staff. One of the advantages of this alliance is that staff who successfully complete the programme receive credit toward a Master of Business Administration.

In response to changing demands of the audit, the skill set of financial statement auditors is changing. This has two important consequences.

First, staff in the financial statement audit branches will benefit from closer contact with staff undertaking performance audits.

Second, existing staff at all levels will be called upon to make different judgements and assessments. The type and extent of training will need to reflect the changing needs. The staff of the Audit Office would benefit from the development of a broader range of skills and the increased mobility than comes with another tertiary qualification if a system similar to that operating in Queensland resulted in staff undertaking training receiving credit toward a tertiary qualification.

Recommendation 18: The Auditor-General should investigate alternative methods of training staff in risk assessment.

4. PERFORMANCE AUDITS

The operations of the Performance Audit Branch are funded from three sources: Parliamentary allocations to fund audits commissioned by the Parliament; funds generated internally by the Audit Office; and miscellaneous income. In 1998, the cost of operating the Performance Audit Branch of the NSWAO was $2,161,204 of which $1,041,667 was provided by Parliamentary allocations, $837,054 was generated by a surcharge on financial statement audits conducted by the Audit Office, and the balance was from other miscellaneous income. The reports produced by the Branch during 1998 are listed in Appendix E, together with other reports issued during the period 1996 to 1999.

A performance audit is very different from the financial statement audits discussed in Section 3. Whereas financial statement audits are structured, follow a consistent approach with common objectives and are subject to numerous professional standards, performance audits vary considerably in their objectives and approach. The idiosyncratic nature of performance audits makes them much more difficult to evaluate.

4.1 Method of evaluation

One method of evaluating performance audits is to review the outcome of the process. Under this approach, individual reports are reviewed and a judgement made on each. The problem with this approach is that evaluating the report necessarily involves value judgements which are a matter of opinion and difficult to substantiate.

Discussions with senior staff of the General Accounting Office (GAO), Washington DC, indicated that their approach was to evaluate the processes rather than to assess the outcomes. The benefits of reviewing processes rather than reports were reiterated in discussions with senior staff of the National Audit Office (NAO), London, and the Auditor-General of British Columbia (AGBC). Under this approach, the quality of performance audits is assumed to depend on:

- the qualifications of performance audit staff;
- the means by which projects are selected; and
- the method of analysis employed in the audit.

These criteria are used to assess the performance of the Performance Audit Branch.

4.2 Benchmarking performance audits

4.2.1 Qualifications of staff

The qualifications of financial statement auditors are prescribed by the requirements for membership of the professional bodies. However, in the case of performance audits, the work is more varied in scope and the skill set of the auditors is more diverse. Because of this diversity, the scope and tenor of performance audit reports depends — to a large extent — on the qualifications of the staff. For example, where staff are trained in economics, the reports can be expected to emphasise economic considerations, where the training is in law, the reports will have a legal tenor. Consequently, the educational qualifications of performance auditors are extremely important.

The staff of the Performance Audit Branch in New South Wales (PAB) have similar qualifications to those in the NAO and the AGBC who have diverse backgrounds in social science, law, statistics, economics and, in the AGBC, architecture. Where staff of the PAB do not possess the special skills required for a particular audit, contract staff are engaged.

4.2.2 Project selection

In deciding whether to undertake a performance audit, the PAB evaluates the suitability of projects according to the following criteria:

- Financial magnitude: high, medium or low.
- Significance of the programme: high, medium or low.
- Impact of the audit: high, medium or low.
- Savings: yes / no.
- Complexity of the audit: high, medium or low.
- Is there a precedent: yes / no.
- Time period for the audit: long, medium or short.
- Application to the public sector: wide or narrow.

In applying these criteria, the Performance Audit Branch uses the total expenditure and asset acquisition for budget sector agencies as a measure of their importance. The aim is to obtain a distribution of the PAB's budget that matches the relative importance of the agencies in the NSW public sector. The procedures adopted for assigning priorities are consistent with practice in the GAO and AGBC.

However, the approach used by the NAO to select projects is very different from that used by the NSWAO. In selecting projects, the NAO aims to save, annually, eight times the cost of running the Office (that is, approximately £320 million per annum). Using this approach seems unnecessarily complicated and can lead to bias in selecting projects. In addition, the approach is costly to implement as outcomes from performance reports must be identified and saving totals agreed with departments. While the Audit Office adopts a different and less precise approach, it is preferable to the NAO approach.

4.2.3 Method of analysis

The procedures adopted by the Performance Audit Branch are set out in Appendix F. While, in general the procedures are similar to those adopted by the NAO and AGBC, there are two important differences.

- The NAO places considerably more emphasis on client clearance. During the clearance process prior to the finalisation of a performance audit, staff of the NAO reach an agreement on the tone and content of the report with the department subject to the performance review. This clearance process can be very protracted and can extend over a number of months. Staff of the NAO have not been able to reach agreement in only one or two reports. A similar, but less rigorous, clearance procedure is adopted by the AGBC.

- The NAO also adopts a rigorous post-reporting evaluation. A professor at the London School of Economics, in collaboration with colleagues and others, undertakes a quality review and scores each report for seven characteristics on a scale of 0 to 5. This review, which is only available for use within the NAO, is an important part of their quality control procedures.

The benefits of the clearance procedures adopted by the NAO are that there is greater focus on the substantive content of performance audit reports and greater co-operation in the implementation of recommendations. Consequently, the performance audit reports are less likely to be controversial and more likely to lead to improvements in public sector management. However, these benefits could also be achieved at a lower cost if the partnership approach discussed in Section 1.1.2 were adopted.

4.3 Scope of performance audits

As indicated previously, the performance audits completed by the PAB during the period 1996 to 1999 are listed in Appendix E, together with their date of issue. Some of these reports, for example, *Sale of the TAB* and *Review of Walsh*

Bay, refer to specific issues or events and were commissioned by the Parliament. The aim in such reports is to evaluate specific government decisions. However, an assessment of the price obtained for the sale of the TAB (or the sale of the State Bank) is of limited benefit unless the report contains an evaluation of the procedures employed and recommendations for improvement in those procedures.

Other reports, for example, the *Management of Sickness Absence*, *Corporate Governance*, *1999–2000 Millennium Date Rollover* and *Redundancy Arrangements*, refer to issues which are common across the public sector and, thus, are broader in scope and relevance.

The effectiveness of performance audits is enhanced if the recommendations that flow from the audits lead to improvements in management across the public sector as a whole. To achieve this, the primary focus should be on management issues rather than specific decisions. For example, while a study of the sale of, say, the TAB might indicate that the price obtained was too low (or too high), the real issue is how effective were the procedures in ensuring that the best price was obtained and how might they be improved. Performance audits which do not lead to improvements in public sector management are of limited value.

Recommendation 19: The Performance Audit Branch should give priority to projects which have a broad scope and will lead to the improvement of public sector management.

4.4 Defining policy objectives

Performance audits are frequently controversial. This is the case not only in New South Wales but also in other States and overseas. The problem lies in the basic objective of performance audits to assess the economy, efficiency and effectiveness of government operations which requires the identification of government policy.

This issue was the subject of Recommendation 12 of the 1996 review which recommended that, prior to the commencement of a performance audit, the Auditor-General should request the responsible Minister to provide a written statement of policies.

Staff of the NAO indicated that, in the past, the difference between policy and policy objectives was not clear. However, the clearance process now being adopted helped to identify and express government policy. Similar comments were made by staff of the AGBC.

Notwithstanding changes in the PAB procedures, it is unlikely that this issue will be resolved unless a more co-operative approach is adopted.

4.5 Integration of audit staff

As noted in Section 3.10, auditors in the private sector are now formed into teams to ensure the breadth of skills needed to understand the business of the client is available. The new methodology adopted for financial statement audits emphasises risk assessment and control. The skill set of performance audit staff which focuses on understanding the nature of a client's business and the strategies employed to manage political, economic, social and technological factors affecting the operations of the business, can now be applied to financial statement audits. The efficiency of the NSWAO would be enhanced by the integration of audit staff — financial and performance — into audit teams which address risk management issues.

Recommendation 20: The Auditor-General should consider the benefits of integrating the staff in the Performance Audit Branch with the Financial Audit Branch to establish teams that are skills based and can more efficiently identify areas for improvement in public sector management.

4.6 Perceptions of performance audit reports

In discussions with executives and managers in public sector agencies in New South Wales, a number of issues were raised in respect of performance audits.

4.6.1 Funding performance audits

In a number of interviews, concern was expressed that the cost of financial statement audits was inflated by a surcharge which is used by the Audit Office to fund some of the performance audits.

The use of a surcharge to cross-subsidise audit office activities is not without precedent. In other Australian States, for example, Queensland, performance audits are not directly funded and recourse is had to "savings" accumulated within the office.

The ability of the Audit Office to justify cross-subsidies depends upon the outcomes achieved. In Western Australia, the responsibilities of the Compliance Audit Branch include auditing compliance with legislation and government policies, auditing the effectiveness of systems of control (including information systems) and conducting investigations into agency accounts

(Office of the Auditor General of Western Australia, 1999). Thus, the audit findings published by the Compliance Audit Branch are more likely to be of general benefit to public sector agencies and, consequently, any cross-subsidies may be easier to justify to financial-statement-audit clients.

As noted above, the focus of performance audits in New South Wales has tended to be on accountability and this is primarily of interest to the Parliament. It is questionable whether the agencies that pay for the audits receive any benefit. Implementation of Recommendation 19 (see Section 4.3) would go some way to redressing this problem.

4.6.2 Quality of the analysis

The response by the Premier's Department to the report on the NSW Senior Executive Service contains serious criticisms of the method of analysis used in preparing the report.

For example, the response indicates that the Report contains "errors of fact and interpretation" and that "the evidence if examined is actually contrary to the Audit Office's assertions". As outlined above, the NAO places considerable emphasis on client clearance such that, prior to the finalisation of a performance audit, staff of the NAO reach an agreement on the tone and content of the report with the department subject to the performance review. A similar, but less rigorous, clearance procedure is adopted by the AGBC. While, such clearance procedures can be very protracted and add to the cost of reports, criticisms such as those made by the Premier's Department distract attention away from the main outcomes and detract from the impact of the report. Additional consultation is needed to ensure errors of fact and interpretation are avoided. These criticisms reinforce the need for the changes outlined in this report in regard to the Performance Audit Branch.

Concern is also expressed that the "survey and interviews with an excessively small sample" does not provide "a sound foundation for making rigorous and objective testing of the opinions expressed".

Survey analysis is a highly structured and technical method of collecting evidence and the quality of the inferences drawn from sample data depend upon the size and representativeness of the sample. The response to the audit of the Senior Executive Service by the Premier's Department is critical of the nature and scope of the survey and the inferences drawn from "the extremely small interview sample size (33) " (Gellatly, 1998).

The survey forming the basis of the report on the Senior Executive Service was outsourced to the University of Technology, Sydney. Because of the technical nature of some performance audits, it is to expected that, from time to time, it will be necessary to obtain specialist advice. A similar situation arises for financial statement audits. However, in the latter case, the practice is not so much one of outsourcing but involves "buying in" expertise. The risk in outsourcing is that there is a loss of co-ordination and this seems to have occurred in the Senior Executive Service audit — the response to the audit by the Premier's Department suggests that some opinions are not tested and some of the evidence is "contrary to the Audit Office's assertions". Under a system of "buying in" specialist knowledge, the experts become part of the team; not only would the quality of the analysis be improved but also the skills of the Audit Office staff would be enhanced.

As surveys are an important technique for performance audits, consideration needs to be given to developing expertise in survey design and analysis within the Audit Office. Courses are available in most Australian universities and the staff in the Performance Audit Branch would benefit from formal training in survey design and analysis.

Recommendation 21: The Auditor-General should investigate opportunities to ensure staff in the Performance Audit Branch receive appropriate training in survey design and analysis.

4.6.3 Focus of reports

As noted above, the impact of performance audit reports is likely to be greater and to lead to greater cost savings if the primary focus is on management issues rather than specific issues or decisions. In some performance reports the focus is misdirected and this has led to criticism of the work of the PAB. This can be illustrated by reference to a report issued in 1998, *Redevelopment Proposal for East Fairfield (Villawood) Estate.*

The nature and character of the Villawood Report can be summarised as follows:

- Aim of the audit: to examine "the processes which led to the Government's decision to demolish and sell the East Fairfield (Villawood) housing estate at a cost of $32m gross ($17m net) " (page 2).

- Audit concerns: to assess whether the demolition and redevelopment of Villawood was "the most efficient and effective outcome" (page 3).

- Audit outcome: the decision was not transparent nor was it adequately justified by available evidence (page 3).

As is always the case with performance audit reports, the Villawood Report contains a response from the relevant department and, in this report, the response is provided by the Director General of the Department of Housing.

However, a detailed examination of the Villawood Report suggests that the implications of the Report are far wider than the Department of Housing. Throughout the Report reference is made to the Treasury requirements for economic appraisals to be used as a basis for choosing between competing projects. As stated in the Report, the Department of Housing commissioned an economic appraisal for the East Fairfield estate. Consequently, the broader issue underlying the Villawood Report is the appropriateness and suitability of the Treasury guidelines for economic appraisals.

If, as recommended in this report, the PAB’s focus were on improving public sector management, the Villawood Report would have been directed to Treasury and the Department of Housing. As presented, the Report is a criticism of the Department of Housing and this creates a risk that the wider implications for the NSW public sector are ignored.

5. OUTSOURCING

Outsourcing of public sector audits is widely practised, both nationally and internationally. The practices of the Audit Commission in the United Kingdom (which is responsible for National Health Service and local government audits), the GAO, Audit New Zealand and the audit offices in all States were reviewed to assess the extent to which private sector auditors were contracted to perform public sector audits and the motivation for outsourcing.

The extent of outsourcing varies considerably. For example, in the Northern Territory the system of outsourcing results in 100 per cent of audits being outsourced, while in Queensland and Western Australia approximately 25 per cent of audits are under contract to private sector audit firms. In Western Australia, outsourcing is restricted to statutory authorities.

In New South Wales, the proportion outsourced is much smaller with approximately four per cent of financial statement audits under contact.

5.1 Motivations

The reasons for the widespread practice of outsourcing are varied but, generally, are strategic.

5.1.1 Service remote locations

In Queensland and Western Australia, audits in remote locations involve additional costs of travel and accommodation. Similar circumstances arise in New South Wales. Consequently, it is more efficient to engage local firms to act as agents for the Auditor-General.

The practice of appointing local firms was supported in interviews with chief financial officers who appreciated the opportunity for closer contact with the auditor as well as the benefits to the business community.

Recommendation 22: The Auditor-General should continue the policy of contracting out audits in remote locations that can be more efficiently performed by contractors.

5.1.2 Acquire specialist services

Some audits require specialist skills. For example, bank audits require a knowledge of prudential requirements, the characteristics and risks associated with derivatives and innovative securities. Auditors-General may find it inefficient to develop skills in bank auditing for only one bank: typically, the Federal and State Governments operated just the one bank. Consequently — as a general rule — bank audits were outsourced. The same principles apply to other audits involving highly specialised operations — such as derivative trading — for which it is not economical to develop the skills internally.

5.1.3 Increase efficiency

As discussed in Section 3.2, the public sector auditor's monopoly can lead to inefficiency in the cost and quality of auditing. Consequently, one of the reasons for outsourcing is to expose public sector auditing to a competitive market in which the equilibrium price and quality can be established.

Competitive tendering can be expected to drive the cost of auditing to an efficient level only if the tendering process is competitive. However, this is not always the case. In the United States, senior staff of the GAO indicated, in interviews, that only a limited number of audit firms participated in the tendering process. In the United Kingdom, the Audit Commission also experiences difficulty in attracting bids for National Health Service and local government audits.

5.1.4 Reduce costs

If audit firms have excess capacity, they can tender for public sector audits at marginal cost. Thus, the Auditor-General obtains audits below total cost and effectively reduces the costs of auditing the public sector. It should be noted, however, that the Auditor-General incurs costs of monitoring the work of private sector firms and this must be added to the tender price to assess the total cost to the Audit Office.

5.1.5 Encourage innovation

The idea here is that private sector auditors may use the latest audit technology in public sector work and this is effectively captured by the public sector. However, senior staff at the Audit Commission indicated that private sector auditors are unwilling to innovate and are content to complete audits in minimum time. Consequently, it seems unlikely that outsourcing audits will lead to improvements in the quality of public sector audits.

5.1.6 Manage peak period overload

The General Accounting Office in the United States outsources most of the financial statement audits in order to have staff available to undertake special audits required by the Congress. Similarly, in other jurisdictions, outsourcing is a means of overcoming demands on staff during peak periods.

5.2 Quality control

As noted in Section 1.2.1, important differences in the audit mandate and the audit client result in private sector audits not being directly substitutable for public sector audits. This raises the issues of how to control the quality of work performed by private sector auditors and how to assess the relative differences in cost for public and private sector audits.

It is generally recognised that it is extremely difficult — and costly — to assess the quality of private sector auditors' work, except in cases of business failure. While standards are maintained by the professional bodies, there is clear evidence that, from time to time, an auditor fails to identify and report errors in financial statements and weaknesses in controls. This is evidenced by the litigation against auditors arising from the excesses of the 1980s, for example, the cases involving AWA, Rothwells, Tricontinental and the State Bank of South Australia.

Consequently, where private sector auditors undertake public sector audits, it is necessary to exercise care in monitoring the work being undertaken. In the United Kingdom, the NAO assigns responsibility for each contract to a director who must ensure that the quality of the services delivered is as specified in the contract. The Audit Commission maintains control over the quality of work undertaken by private firms by reviewing plans, working papers, management letters and any qualifications to the audit report, prior to any discussions with the client. In the United States, the GAO monitors quality in four ways: site visits (file reviews), office visits (to monitor the quality-control systems of the audit firms), product readings (management letters and advice to clients) and client satisfaction surveys. The assigned GAO manager is required to stay with the audit and is required to be present at the important meetings — entrance and exit — to review plans, programmes and working papers, and to undertake some reperformance (that is, look at actual documents, particularly high audit-risk areas).

Similar procedures are adopted in Australia. For example, in Queensland, a system of compulsory rotation every three years is used to allow the Auditor-General to take over an audit and assess the risks before that audit is contracted out again. In addition, a system of review and post-review is employed to assess the quality of the work undertaken by the contracting auditor.

This problem of audit quality does not have the same significance in the private sector because market analysts have access to more public information about listed companies and have more highly developed methods of evaluating performance. Because market analysts do not monitor public sector organisations to the same extent, the safeguards provided by public scrutiny are not available for public sector organisations and alternative methods are required to ensure that the quality of audits is maintained.

Consequently, there is an extra cost associated with outsourcing because, while private auditors may efficiently undertake the collection of evidence, this is then subject to a higher level review by the Auditor-General who reports to the Parliament.

Recommendation 23: As a means of monitoring the quality of work carried out by contractors, the Auditor-General should adopt a policy of rotating audits that are undertaken internally as well as those outsourced.

5.3 Client involvement

It is common practice in Australia and overseas for representatives of the client to be included in the panel selecting a contract auditor. While it is essential that the Auditor-General retains responsibility for the selection of the auditor, the participation of client representatives is likely to improve auditor–client relationships.

In British Columbia, where one third of financial statement audits are completed by contractors, the decision to appoint the auditor is made by the Minister on advice from the Auditor-General. This is, however, atypical.

As noted in Section 5.1.1, the practice of appointing local firms was supported in interviews with chief financial officers who appreciated the opportunity for closer contact with the auditor as well as the benefits flowing to the local business community.

Recommendation 24: The policy of involving client employees in the selection of contractors should be continued.

5.4 Retention of strategic audits

Any approach to using private sector contractors must not reduce the Auditor-General's discretion and strategic involvement in audits to ensure effective oversighting of the government's operations and reporting to the Parliament and the community.

Because of their strategic importance and sensitivity and in order to maintain expertise and industry knowledge, the audits of the some agencies should be excluded from the outsourcing system. For example:

- agencies responsible for policy formulation and the purchase of services;
- agencies that interface across governments;
- at least one government-owned service provider in each industry segment (for example, a hospital audit); and
- agencies that have a significant risk exposure for the community.

Contracts would usually extend from three to five years but be renewed each year, subject to satisfactory performance.

Recommendation 25: The policy of ensuring that strategic audits are not outsourced should be continued.

6. CLIENT SATISFACTION

It is common practice for audit firms to survey clients to obtain feedback on their perceptions of the quality of their audit services. This is also a common practice in the audit offices visited as part of this Review. In most of the public sector offices, the surveys are conducted by office staff. The NSWAO has regularly surveyed clients and in 1998 commissioned a consultant to survey clients and Parliamentarians.

6.1 Audit Office surveys

6.1.1 Questionnaire

The NSWAO undertakes client satisfaction surveys on a regular basis and the results of the 1997 survey of clients and Members of Parliament were reviewed. The client questionnaire included 22 questions which asked respondents to rate the Audit Office on a seven-point Likert scale; 79 responses were received. Questions 1 and 2 of the survey included 22 performance criteria, for which the seven-point scale ranged from extremely poor to excellent. The remaining questions consisted of a series of statements about the 1996–97 financial statement audit which respondents were asked to score on a five-point scale, ranging from strongly disagree to strongly agree. Respondents were also given an opportunity to make general comments. In general, the questionnaire sent to clients is similar in style and content to those used in the private sector.

The survey of Parliamentarians covered both general reports and performance reports and asked respondents to rate the reports on a three-point scale, ranging from very useful to not useful; a total of 40 responses was received.

6.1.2 Results

Survey results need to used with caution: response rates tend to be low, for example, only 28 per cent of NSW Parliamentarians responded to the 1997 survey, and the nature of the response bias is unknown. It should also be noted that only eight (10 per cent) of the respondents chose to remain anonymous.

In regard to the client survey, respondents tended not to use the whole scale; for example, hardly any respondents indicated they strongly disagreed with statements and few simply agreed. Because of this, average scores tend to be high. It should also be noted that the proportion of neutral responses was as high as 0.56 for clients and 0.44 for Parliamentarians. Such responses could be interpreted as indifference.

One of the difficulties of interpreting survey results is identifying an appropriate comparison. For example, is the client satisfaction index score of 69 per cent, obtained in 1997, a good score? While there may be uncertainty about how to interpret average survey responses, changes over time may be indicative of changes in perceptions. In terms of the overall response, there is very little difference between the client satisfaction index of 1996 (71 per cent) and the 1997 score of 68 per cent.

However, a result that is of concern is what appears to be a significant reduction in the proportion of respondents indicating the NSWAO as the preferred financial auditor: the proportion declined from 0.80 in 1996 to 0.67 in 1997. The reasons given for not preferring the NSWAO could be interpreted as relating mainly to perceptions of the value added. This suggests that public sector clients want the NSWAO to suggest improvements in financial management. This is consistent with the arguments in Section 1.1.2 recommending a co-operative or partnership approach.

6.2 Independent surveys

In 1998, the NSWAO commissioned a consultant to undertake an independent survey of clients based on personal and telephone interviews. The sample was smaller than the 1996 and 1997 surveys and consisted of 62 clients.

The report from the consultant states: "As audit clients are coming under more pressure and increased accountability, their demands of The Audit Office will continue to grow markedly, and their need is for an 'auditor' who will more closely work ‘with’ them rather than ‘against’ them". From the perspective of this Review, this is an important finding because it supports the call for a more co-operative approach on the part of the NSWAO.

As part of this Review, the chief financial officers of a number of departments and agencies in urban and regional centres were interviewed to assess the level of client satisfaction. In the main, those interviewed were very complimentary of the staff in the Financial Statement Audit Branch. In the few instances in which concerns had been expressed, the Audit Office had moved quickly to resolve the problems.

In respect of the audit process, many of those interviewed expressed an interest in the Audit Office increasing the level of assurance that might be given in respect of the client's internal control environment. In addition, a number of those interviewed would have benefited from advice from the Audit Office on alternative systems used in similar agencies.

Recommendation 26 The Auditor-General should endeavour to improve the value-added elements of audits by ensuring that:

- the areas of concern to management are specifically addressed;
- management letters address the major risk areas of the department or agency; and
- minor matters are resolved as part of the audit and not included in reports.

7. ACCOUNTABILITY

As noted at the outset, the ability of the Auditor-General to ensure improvements in public sector management depends upon the co-operation of the various partners. Reports issued by the Audit Office have the potential to lead to improvements in management but they do not always have the impact that might be expected.

7.1 The role of the Public Accounts Committee

In the United Kingdom, the NAO works closely with the Committee of Public Accounts of the House of Commons and most of their investigations are based on NAO reports. When conducting investigations, the Committee of Public Accounts takes evidence from senior officials of departments and agencies on issues raised in NAO reports and then publishes its own report. The Government response to the Committee's comments and recommendations is monitored by the NAO which reports to Parliament if progress is unsatisfactory.

In Queensland, the Public Accounts Committee operates in a manner similar to the Committee of Public Accounts. The Queensland *Parliamentary Committees Act 1995*, Division 3, establishes the responsibilities of the Public Accounts Committee:

> 18. The Public Accounts Committee's area of responsibility is to assess the integrity, economy, efficiency and effectiveness of government financial management by —
>
> (a) examining governmental financial documents; and
>
> (b) considering the annual and other reports of the auditor-general.
>
> 19. The committee may refer issues within its area of responsibility to the auditor-general for consideration.

In Victoria, the Public Accounts and Estimates Committee seeks advice from the Auditor-General on technical issues relating to budget estimates and maintains a close relationship with the Auditor-General. In Western Australia, the Public Accounts and Expenditure Review Committee has a role in ensuring that the Auditor-General's reports are implemented.

The co-operation between the Audit Office and the Public Accounts Committee in the United Kingdom, Queensland, Victoria and Western Australia ensures that the recommendations in Audit Office reports are more likely to lead to improvements in public sector management. The adoption of similar arrangements in New South Wales could also be expected to lead to improvements in the economy, efficiency and effectiveness in public sector management. The Public Accounts Committee's areas of responsibility should include a specific requirement to monitor the reports issued by the Audit Office and assess their impact on the efficiency and effectiveness of financial management.

Recommendation 27: The Public Accounts Committee should take a more active role in assessing government financial management by, *inter alia*, considering the recommendations for improvements in public sector management contained in reports issued by the Auditor-General.

7.2 Advisory panel

Recommendation 1 of the previous review proposed that the Auditor-General establish an external, independent advisory panel. As noted in Section 1.4, this recommendation was not implemented on the grounds that the function was better achieved through the Public Accounts Committee.

In Victoria, the Auditor-General has established an External Policy and Practices Advisory Panel which has been in operation for a number of years. Members of the Panel are appointed by the Auditor-General and include an academic, accounting practitioners and a member of the Australian Accounting Research Foundation. The purpose of the Panel is to provide advice on accounting and auditing developments and practices in the public sector.

The Victorian Auditor-General has also appointed an Audit Committee to provide independent advice on management issues and internal and external audit operations. In 1998, this Committee provided advice on matters such as risk exposure, internal audit and financial reporting practices.

The appointment of an independent advisory panel is not intended to inhibit the independence of the Auditor-General but to provide independent advice. The appointment of such a panel in New South Wales should be reconsidered when the accountability issues are being redefined.

Recommendation 28: The Auditor-General should give further consideration to the establishment of an Advisory Panel.

8. FUNDING OF THE AUDIT OFFICE

There are two basic models for funding the office of an auditor-general:

- by parliamentary appropriations; and
- by payments from departments and agencies.

Of these two models, the most frequently used and preferred in the State audit offices visited is the second system whereby fees are collected from departments and agencies. This is the system currently operating in New South Wales in respect of the funding of financial statement audits.

Examples of the former model are not frequently found. In Western Australia, a combination of the methods is used, with the former system used for government departments and the latter system for government enterprises. In the overseas audit offices visited, the former model is used in British Columbia where the funding of the Office of the Auditor-General is by parliamentary appropriation. The stated reason for adopting this system is that the audit office is funded in a manner similar to government departments.

The major weakness of this approach is that the independence of an auditor-general may be threatened by limiting the funding of the office, However, in British Columbia, the Auditor-General has the opportunity to go public if funding of the office is inadequate.

In British Columbia, the perceived advantage of parliamentary appropriations is that the Legislative Assembly is the client and, as such, pays for all types of audits, including performance, compliance and financial statement audits. However, in British Columbia, some Crown Corporations are audited by private sector auditors who are paid by the corporations. Consequently, an inconsistency in the method of payment has developed and this has called into question the appropriateness of the system of funding. The system of funding is expected to change.

In terms of efficiency, the system currently in force to fund financial statement audits in New South Wales, where fees are charged to departments and agencies, creates appropriate incentives for both the auditor and the client. The auditor is required to justify the fee to the client and the client has an incentive to prepare for the auditor's arrival, facilitate the process and help to minimise the cost of auditing. The system of funding in Western Australia which combines direct funding and appropriations seems unnecessarily complicated.

Recommendation 29: The present system of funding the Audit Office based on fees collected from audit clients should be retained.

APPENDIX A: TERMS OF REFERENCE

Management of the Office

To assess:

- the economy, efficiency and effectiveness of:
  a) resource use
  b) management structure, including recent restructuring
  c) devolution of responsibilities
  d) staff training
- the suitability of the office premises.

Human resources

To assess:

- the appropriateness and effectiveness of available skills and competencies in the Office.
- the impact of statutory provisions on performance monitoring and human resources management.
- the recruitment, training and professional development of staff.
- promotion, career development and incentive structures.
- appropriateness of remuneration structures.

Financial statement audits

To assess:

- the adequacy and appropriateness of the methodology, practices and procedures of the Audit Office to determine the extent by which the audit opinions issued by the Office comply with applicable professional standards and practices, and in particular that they are:
  a) supported by adequate plans and work papers; appropriate audit evidence and appropriate quality control procedures;
  b) appropriately planned and co-ordinated, having regard to agencies' internal audit and technology inside the Audit Office. In this connection, the efficiencies gained by the Audit Office from agencies' internal audit should be evaluated.

- the adequacy of the new financial audit methodology and technology recently adopted by the Audit Office.
- the use of the audit risk model to assess the extent of over-auditing.
- the extent of compliance auditing. This assessment should cover compliance auditing as currently practised in the Audit Office, as well as the level of compliance auditing which the Reviewer considers appropriate for the future.
- the nature of reported errors and the mechanisms for reporting them.

Performance audits

To:

- review the procedures and criteria used to identify issues for investigation;
- review the skill base, training and experience of the performance auditors;
- compare with the methodology adopted in other jurisdictions;
- assess the planning and control of the performance audits, including the adequacy of the investigative process;
- assess the productivity of the Performance Audit Branch;
- assess the appropriate level of resources which the Audit Office should devote to performance auditing.

Outsourcing

To assess the economy, efficiency and effectiveness of:

- the procedures in the Audit Office for evaluating tenders from private audit contractors to carry out public sector audits;
- contract management;
- quality control and assurance;
- the appropriateness of rotation between public and private sector auditors, and the respective value of different rotation models.

Agencies subject to audit by contractors, including those in regional areas, should be interviewed to assess their perception of the process and their satisfaction with the audit outcomes. In addition, successful and unsuccessful tenderers should be invited to comment on the tender process.

Client Satisfaction

Comprehensive and systematic surveys will be conducted, together with focus groups of stakeholders including:

a) Members of Parliament. The survey of Members of Parliament will include, but not be limited to, issues such as the desired level of compliance auditing, and the appropriate coverage of the Audit Office's annual report.

b) Staff of the Audit Office. The survey of Audit Office staff will include, but not be limited to, issues such as the impact on staff of Audit Office human resources policies and practices; the management culture in the Office; the adequacy of resources and training given to staff; the most appropriate future direction of the Audit Office's management of human resources.

c) Auditees. The survey of Auditees will include, but not be limited to, issues such as the comprehensiveness, the fairness and the value of the Audit process; the use to which agencies' own internal audit has been put by the audit office; the appropriateness and effectiveness of the Audit Office resources, including human resources, deployed on audits; the objectivity, balance and workability of Audit Office recommendations.

d) the public.

Public submission should be called in the first instance, and the survey of the public will largely be based on the content of those submissions.

Accountability

By reporting to Parliament on the financial and management practices of agencies, the Audit Office helps ensure that agencies are fully accountable to the public, the Parliament and the Public Accounts Committee.

The review should examine and evaluate:

- the functional relationship between the Audit Office and the Public Accounts Committee, and between the Audit Office and the Treasury in the context of ensuring greater accountability by agencies to the public;
- the value of the full version of the Audit Office's annual report provides a useful view to members of Parliament of financial and other management in the public sector;
- responses to management letters;
- agencies' responses to internal audit reports;

- responses to issues raised in audit reports;
- the communication methods used by the Audit Office.

Funding of the Audit Office

Review the current funding arrangement and their impact on the operations of the Audit Office by considering:

- approaches adopted in other States;
- relative contributions of client fees and appropriations;
- policy and practice on recovery of costs; and
- the relationship of the Audit Office to Treasury.

APPENDIX B: CONSULTATION

Auditors-General

Ches Baragwanath, Auditor-General, Victoria

Tony Harris, Auditor-General, New South Wales

David Macdonald, Controller and Auditor-General, New Zealand

Ken Macpherson, Auditor-General, South Australia

Arthur McHugh, Auditor-General, Tasmania

Des Pearson, Auditor-General, Western Australia

Len Scanlan, Auditor-General, Queensland

Australian Audit Offices

Mike Blake, Deputy Auditor-General, Western Australian Audit Office

Joe Manders, Assistant Auditor-General, Victorian Audit Office

Michael Morris, Director-Resource Management, Queensland Audit Office

Errol Mulvahil, Assistant Auditor-General Performance Audit, Queensland Audit Office

Paul Shipperley, Assistant Auditor-General Audit, Queensland Audit Office

Tony Johnson, Manager Human Resources, Queensland Audit Office

Russell Walker, Assistant Auditor-General, Victorian Audit Office

Peter Wilkins, Director, Western Australian Audit Office

Government agencies

George Blackwell, General Manager, Orange Base Hospital

David Callaghan, Financial Accountant, Newcastle Port Corporation

Angus Dawson, General Manager, Honeysuckle Development Corporation

Col Gellatly, Director General, Premier's Department, New South Wales

Alan Gleeson, Executive Director (Administration), NSW Agriculture

Ian Greentree, Director, Port Kembla Port Corporation

Paul Hingston, Special Projects Manager, Audit & Project Services, NSW Agriculture

Christine Kibble, New England Area Health Service

Thuy Mellor, Superannuation Administration Authority

Euan Melville, Financial Accountant, Newcastle Port Corporation

Bill Middleton, Department of Education and Training

Ian Neale, Executive Director , Financial Management, NSW Treasury

Francis Nichols, University of New England

Craig Norman, Financial Controller, Honeysuckle Development Corporation

David Ooi, State Transit Authority

Reg Ryan, State Transit Authority

Ian Southwell, Illawarra Area Health Service

Terry Thompson, Superannuation Administration Authority

Brian Ward, Director, Port Kembla Port Corporation

Alf Zawadzki, Chief Executive Officer, Internal Audit Bureau

Overseas Audit Offices

Abe Akresh, Assistant Director, General Accounting Office, Washington DC

Frank Barr, Deputy Auditor-General, British Columbia

Ada Chiang, Assistant Manager, Financial Auditing, British Columbia

Brian Crowley, Assistant Comptroller General, General Accounting Office, Washington DC

Robert Dacey, Director, General Accounting Office, Washington DC

Gordon Dawson, Assistant Auditor-General Compliance Auditing, British Columbia

Martin Evans, Audit Commission, London

Chris Fabling, Director, Audit New Zealand

Frank Heard, Manager, Information Technology, British Columbia

Helen Hsing, Director, General Accounting Office, Washington DC

Susan Jennings, Senior Project Leader, Performance Auditing, British Columbia

Brian Jones, Audit Manager, Financial Auditing, British Columbia

Venecia Kenah, Senior Evaluator, General Accounting Office, Washington DC

Nick Lacy, National Audit Office, London

Terry Mackian, Senior Principal, Financial Auditing, British Columbia

Sam Madonia, Assistant Director, General Accounting Office, Washington DC

Donna Milner, Human Resource Manager, British Columbia

Jane McCannell, Senior Project Leader, Performance Auditing, British Columbia

Mike Norman, Audit Commission, London

Errol Price, Senior Principal, Performance Auditing, British Columbia

Kevin Simpkins, Assistant Auditor-General, Accounting and Audit Policy, New Zealand

Don Woollen, Director, Tendering and Contracting, New Zealand

Public Accounts Committees

Leanne Clare, Research Director, Queensland Public Accounts Committee

Michelle Cornwell, Research Director, Victorian Public Accounts Committee

Anita Secret, Research Officer, Queensland Public Accounts Committee

Catherine Watson, New South Wales Public Accounts Committee

APPENDIX C: A COMPARATIVE ANALYSIS OF AUDIT FEES

Considerable research has been undertaken in Australia and overseas in an endeavour to understand the pricing of audit services in both the private and public sectors. In Australia, the cross-sectional audit fee regression model has been used to identify fee premia associated with audit specialists (Craswell, Francis and Taylor 1995) and with brand name reputation (Francis 1984).

The audit fee models use a set of variables to control for cross-sectional differences in factors that affect fees such as client size, audit complexity and auditor–client risk sharing (Simunic 1980). These models have demonstrated good explanatory power (R^2s of 0.70 and higher) and have been robust across different samples, time periods, countries, and to sensitivity analyses for model misspecification (Francis and Simon 1987).

Similar models have been used to explain audit fees in the public sector and to test for cross-sectional differences. For example, Deis and Giroux (1992) examined the determinants of audit quality in the public sector and Rubin (1988) analysed the determinants of municipal audit fees.

The OLS regression model estimated in this study is specified as:

$$LAF = b_0 + b_1 LTA + b_2 LRev + b_3 CATA + b_4 Sub + b_5 Opin + b_6 Auditor + e$$

where:
LAF = natural log of total audit fees ($ thousands);
LTA = natural log of total assets ($ thousand);
LRev = natural log of total revenue ($ thousand);
CATA = ratio of current assets to total assets;
Sub = square root of the number of subsidiaries;
Opin = indicator variable (1=qualified opinion); and
Auditor = a series of indicator variables to identify different auditors.

In the context of this Review, the inclusion of indicator variables, "Auditor", in the model provides a method of comparing the fees charged for university audits in New South Wales, other Australian States and New Zealand.

Sample characteristics

Data were collected from 177 annual reports of Australian and New Zealand universities for the period 1993 to 1997.

A number of audits in the sample were completed by private sector firms. The audits of the Northern Territory University are completed by private sector auditors under contract to the Auditor-General. The Australian Catholic University is audited by KPMG and five of the New Zealand audits were completed by Ernst & Young.

Results

The combined universities audit fee model explained nearly 80 per cent of the variation in audit fees. This is consistent with prior research using the model.

The model used NSWAO as the basis of comparison and the significant differences observed are set out in Table C.1.

Table C.1: Comparison of audit fees of universities

Audit office	Coefficient	Per cent difference
Australian National Audit Office (ANAO)	0.605**	83
New Zealand Audit (NZA)	–0.294**	–25
South Australian Audit Office (SAAO)	0.169**	18
Tasmanian Audit Office (TAO)	–0.455**	–37
Victorian Audit Office (VAO)	–0.260**	–23
Western Australian Audit Office (WAAO)	–0.148**	–14

**Significant at less than 0.05.

The above results suggest that, after allowing for differences in size and structure, the fees charged by the NSWAO for university audits are less than those charged by the ANAO and SAAO but greater than those charged by the other offices listed above. In respect of the other sample universities, the fees charged by the NSWAO were not significantly different from the private sector audits and the Queensland and Northern Territory audits.

In interpreting these results, consideration needs to be given to factors not included in the analysis. In particular, consideration needs to be given to differences in the audit mandates — the WAAO is required to give an opinion on performance indicators — and differences in labour and other costs of operating the office. The costs of operating in Sydney would be greater than in most other capital cities.

APPENDIX D: SURVEY OF PROFESSIONAL JUDGMENT

Engagement: Number 1997

In respect of the above audit engagement for **1997**, please indicate the judgments you made in respect of **PURCHASES** account area by circling the appropriate response.

Assurance from Inherent Risk Reference: Forms 136 and 116	High	Medium	Low	
Assurance from Internal Control Reference: Forms135 PSE and 116	High	Medium	Low	Nil
Assurance from Analytical Review Reference: Form 116	High	Medium	Low	Nil

The financial statements of this agency are: Reference: Form 112 item 8	Not particularly sensitive	Sensitive	Very sensitive
This agency is classified as:	Complex	Average	Simple

Please mark on the scale, your assessment of the effectiveness of the **internal audit function** to the **financial statement** audit of this agency:

Low					Medium					High
0	1	2	3	4	5	6	7	8	9	10

Please mark on the scale, your assessment of the **relative** importance of purchases to this engagement:

Low					Medium					High
0	1	2	3	4	5	6	7	8	9	10

Please mark on the scale, your **overall assessment of the audit risk** for this client in **1997**:

Low					Medium					High
0	1	2	3	4	5	6	7	8	9	10

Reference: Form 112 (e.g., item 3 Standard Index, item 2 Small Audits Index)

APPENDIX E: PERFORMANCE AUDIT REPORTS: 1996–1999

Department of Education and Training: *The School Accountability and Improvement Model* (12 May 1999).

Olympic Coordination Authority: *The Sydney 2000 Olympic and Paralympic Games — Review of Estimates* (14 January 1999).

NSW Treasury: *Sale of the TAB* (23 December 1998).

Department of State and Regional Development: *Department of State and Regional Development: Provision of Industry Assistance* (21 December 1998).

NSW SES: *NSW Senior Executive Service: Professionalism and Integrity: Volume 1 Part 1: Summary and Research Report* (17 December 1998).

NSW SES: *NSW Senior Executive Service: Professionalism and Integrity: Volume 1 Part 2: SES Research Report* (17 December 1998).

Walsh Bay: *Review of Walsh Bay* (17 December 1998).

Rural Fire Service: *The Coordination of Bushfire Fighting Activities* (2 December 1998).

NSW Health: *Management of Research — NSW Health: Infrastructure Grants Program — A Case Study* (25 November 1998).

NSW Public Sector: *Follow-Up of Performance Audits: 1995–1997* (17 November 1998).

Hospital Emergency Departments: *Planning Statewide Services* (21 October 1998).

NSW Police Service: *Police Response to Fraud* (14 October 1998).

NSW Public Sector: *Management of Sickness Absence NSW Public Sector: Volume 1: Executive Briefing* (27 August 1998).

NSW Public Sector: *Management of Sickness Absence NSW Public Sector: Volume 2: The Survey — Detailed Findings* (27 August 1998).

Office of State Revenue: *The Levying and Collection of Land Tax* (5 August 1998).

Casino Surveillance: *Casino Surveillance as undertaken by the Director of Casino Surveillance and the Casino Control Authority* (10 June 1998).

Corporate Governance: *On Board: Guide to Better Practice for Public Sector Governing and Advisory Boards* (7 April 1998).

Fraud Control: *Status Report on the Implementation of Fraud Control Strategies* (25 March 1998).

NSW Police Service: *Police Response to Calls for Assistance* (10 March 1998).

Department of Housing: *Redevelopment Proposal for East Fairfield (Villawood) Estate* (29 January 1998).

Department of Public Works and Services: *Government Office Accommodation* (11 December 1997).

Sydney Showground, Moore Park: *Lease to Fox Studios Australia* (8 December 1997).

Department of Public Works and Services: *1999–2000 Millennium Date Rollover: Preparedness of the NSW Public Sector* (8 December 1997).

Roads and Traffic Authority: *Review of Eastern Distributor* (31 July 1997).

The Law Society Council, the Bar Council, and the Legal Services Commissioner: *A Review of Activities Funded by the Statutory Interest Account* (30 June 1997).

Department of Community Services, and Ageing and Disability Department: *Large Residential Centres for People with a Disability in New South Wales* (26 June 1997).

Public Service wide: *Corporate Governance — Volume One: In Principle* (17 June 1997).

Public Service wide: *Corporate Governance — Volume Two: In Practice* (17 June 1997).

Public Service wide: *Corporate Governance — Supplement to Volume Two: Survey Findings* (17 June 1997).

NSW Health Department: *Immunisation in New South Wales* (12 June 1997).

Public Service wide: *Redundancy Arrangements* (17 April 1997).

NSW Agriculture: *Review of NSW Agriculture* (27 March 1997).

NSW Health Department: Medical Specialists: *Rights of Private Practice Arrangements* (12 March 1997).

Corporate Credit Cards: *The Corporate Credit Card* (23 January 1997).

State Rail, *Accountability and Internal Review Arrangements t State Rail* (19 December 1996).

NSW Fire Brigades, *Fire Prevention* (5 December 1996).

State Rail Authority, *Tangara Contract Finalisation* (19 November 1996).

Department of Public Works and Services, *Sales of the State Office Block* (17 October 1996).

Ambulance Service of New South Wales, *Charging and Revenue Collection* (26 September 1996).

Newcastle Port Corporation, *Protected Disclosure* (19 September 1996).

Building Services Corporation, *Inquiry into Outstanding Grievances* (9 August 1996).

State Rail Authority of New South Wales, *Internal Control* (14 May 1996).

APPENDIX F: PERFORMANCE AUDIT PROCEDURES

The Performance Audit Branch adopts the following procedures to select audit issues and to assign priorities.

- **Project listing (the "long" list)**

A list of projects is prepared to include suggestions from staff in the Audit Office (Performance and Financial Audit Branches), Parliamentarians, individuals, and Government Departments and agencies. This list could contain more than 100 proposals.

- **Business plan**

From the so-called long list, 40 to 45 projects are selected for inclusion in the business plan. Initially, the proposals are discussed with the Assistant Auditors-General and a preliminary scoping study (a two page summary) is prepared. Where appropriate, the Independent Commission Against Corruption and Ombudsman are contacted with a view to obtaining co-operation. In consultation with the Auditor-General and the Board of Management of the Audit Office, the list is culled to approximately 18. This list is then sent to Parliamentarians with a request for additional proposals.

The list of projects is then added to the current programme, and projects that can be started within the next 18 months are identified.

- **Project commences**

When the Auditor-General approves the commencement of a project, a more detailed scoping is undertaken based on research undertaken in the Audit Office. The purpose of this scoping is to ensure that the project is viable.

- **Notification of Departments**

If the project is found to be viable, the relevant Minister and Chief Executive Officer are advised and provided with details of the scope and objective of the audit. At this time the Minister has the opportunity to identify the appropriate policy objectives.

The aim of the meeting with the CEO is to ascertain what information is available in the Department and to identify a liaison person who has the authority to make decisions on routine matters for the duration of the project.

- **Project definition**

Where the scope of the project is clear, the scope, objectives and the criteria to be applied are defined and agreed with the CEO. In some cases, agreement may not be reached but the PAB aims to adopt a collaborative, "no surprises" approach.

- **Issues papers**

During the course of the audit, issues papers are prepared which are given to the liaison officer. The purpose of these papers is twofold: to inform the Department and to remove errors of fact.

- **Draft report**

The issues papers are collated to form the draft report which is presented to the Auditor-General and forms the focus of the exit interview with the Department which is held two weeks after submission of the draft.

- **Final report**

Following presentation of the final report, the Department and the Minister are given 28 days to prepare a response to the report.

APPENDIX G: PUBLICATIONS

Awareness

The Office's publication, *Awareness*, is produced on a regular basis by the Policy and Research Section of the NSWAO. The publication is produced as a newsletter and provides staff and clients with the latest news on developments in accounting standards, auditing standards and public sector issues relevant to accounting and auditing. It is available to clients and staff as a reference source and includes contact names within the Office of people who can provide additional information. It is a useful source of information about the views, comments and policies in respect of the changing public sector audit and accounting environment.

Professional Update

The Office produces a *Professional Update* every six months, in January and July, to coincide with the main financial year-ends of clients. The *Updates* include details of recent major developments in accounting and auditing requirements. The *Updates* contain only brief details with more information being available in the relevant issue of *Awareness* which is referred to at the end of each article. The *Updates* are issued to staff and clients.

APPENDIX H: GUIDES TO BETTER PRACTICE: 1995–1999

Contracting Out Review Guide	June 1999
Public Sector Corporate Governance — Ready Reckoner	April 1999
Methodology for the Review of Residential Services for People with Disabilities	June 1998
On Board: Guide to Better Practice for Public Sector Governing and Advisory Boards	April 1998
Corporate Credit Card	January 1997
Debtors Administration	September 1996
Administration of Grants	December 1995
Joint Operations in the Education Sector	September 1995

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