



Request for Tender

Review

of the

NSW Audit Office

Background to the Request

The *Public Finance and Audit Act 1983* details the legal basis for the accounting and auditing arrangements for the NSW Public Sector. The public sector for the purposes of the legislation includes the central revenue and spending powers of the State, the various government departments, statutory authorities and related bodies such as Area Health Services and State Owned Corporations.

Under the Act the Public Accounts Committee has a statutory obligation to appoint a reviewer to conduct a review of the Auditor-General and his office. The appointment is to be made on a three-year cycle. The review is to examine the auditing practices and standards of the Auditor-General and to determine whether the Auditor-General is complying with those practices and standards.

In the very recent times corporate governance practices and the role of auditors, particularly in the private sector, has come under close public scrutiny in the media. In particular, the audits of HIH Insurance and One-Tel in Australia, and Enron and WorldCom in the USA, has resulted in a series of questions being asked on the adequacy of professional auditing practices and of auditing standards.

In preparing for this review, the Committee consulted with MPs, agencies (through Ministers), the Audit Office, industry bodies and academics. The Audit Office also provided copies of its client survey, undertaken in February 2001, which covered MPs, financial audit clients and performance audit clients.

The Committee would like to thank all organisations and individuals who assisted in this consultation. The Committee has used the results to draw up the terms of reference because they present opportunities to either improve the Audit Office's operations or resolve issues between the Audit Office and its stakeholders.

The Public Accounts Committee

The Public Accounts Committee is a statutory committee of the New South Wales Parliament and, like the Auditor-General, draws its legal authority from the *Public Finance and Audit Act 1983*. The Committee has a broad charter, as the audit committee of the Parliament, to review and report on the financial management and accountability matters across the NSW public sector.

The Committee's charter, arising from functions imposed under the Act, include an oversight role on the Auditor-General. Under section 48A, the Committee is required, every three years, to appoint a reviewer to review and report on the NSW Auditor-General.

The Auditor-General

The Auditor-General is the external auditor for the NSW public sector. The Auditor-General is appointed to office by the Governor following a selection process that, since 1992, has involved the Public Accounts Committee. The Public Accounts Committee has a right of veto over a proposed appointment. In the two appointments since 1992, the Public Accounts Committee has participated in the selection process but has not exercised the power of veto.

The Audit Office of NSW

To provide the Auditor-General with the staff and resources to undertake his responsibilities, the Government has established the Audit Office of NSW as a department to engage staff and provide the necessary professional and support services. Staff engaged by the office are state employees or contractors. In some cases whole or part of audit engagements are contracted out to audit firms in the private sector. Private sector audit contractors are usually engaged on the basis of specialist skills required for specific audits or for audit engagements located in areas where it is more economical to contract out the whole audit process.

The Reviewer

The legislation provides for the Audit Office to be reviewed by an independent reviewer every three years. The Public Accounts Committee has the responsibility for the selection and appointment of the reviewer, and for determining the terms and conditions of appointment and remuneration. When conducting the review process, the reviewer must comply with any directions given by the Committee.

The reviewer does not have an on-going role in the review of the Audit Office beyond the specific terms and conditions of the review.

Post Review Engagements

The Public Accounts Committee does not have a firm policy position that prohibits post review engagements between the Auditor-General, the reviewer, and business associates of the reviewer. However, the Committee would expect that a reasonable period of time should elapse between engagements so as to demonstrate the independence of the review process and any subsequent engagements between the reviewer and the Auditor-General.

Confidentiality and the Review Process

In addition to the client confidentiality provisions of the Code of Professional Conduct issued by the Professional Accounting Bodies, the *Public Finance and Audit Act 1983* has specific secrecy provisions that apply to the Auditor-General and staff and contractors of the Audit Office. Under section 48A, these conditions also apply to the reviewer and support staff undertaking the review.

The general features of the review contract, however, will be subject to disclosure by the Committee 90 days after the award of the contract, as discussed in Premier's Memorandum 2000-11.

Communication during the Review

During the course of the review, the reviewer is to inform the Public Accounts Committee, as appropriate, as to the progress of the review and the extent to which agreed target dates are and have been met. It is likely communication between the Public Accounts Committee and the reviewer will take the form of liaison between the manager of the Committee and the reviewer and could include briefings by the reviewer to the Public Accounts Committee.

The Committee is open to discussion during the review process for the reviewer to make comment and suggestion for additional matters to be included or modified or otherwise dealt with. Under the legislation, the Committee has sole responsibility for the terms and conditions of the review.

Liaison with the Auditor-General

During the course of the review, the reviewer will by necessity liaise with the Auditor-General and his staff. The Public Accounts Committee anticipates the usual professional courtesies would be maintained between auditor and client.

The Reviewer's Report

The reporting requirements for the review are fully detailed under section 48A of the Public Finance and Audit Act, and are summarised for the purposes of this paper:

- The reviewer is to report to the Auditor-General as to the results of the review and may include such other matters “*as in the judgment of the reviewer call for special notice.*”
- Before making a report, the reviewer must give the Auditor-General a summary of the findings and proposed recommendations at least 28 days before the reviewer proposes to complete the report on the review.
- The reviewer must include in the report any written submission or agreed summary of submissions and comments by the Auditor-General.
- The reviewer's report:
 - may include such information as the reviewer thinks desirable in relation to the subject of the review;
 - must set out reasons for opinions expressed in the report; and
 - may include such recommendations arising out of the review as the reviewer thinks fit to make.

The Auditor-General is to forward the report of the reviewer to the Public Accounts Committee within two months of the receipt of the report and the Chairman of the Public Accounts Committee is to table the report in accordance with the usual Parliamentary practices. The report is not to be publicly released by any method, other than by tabling in the Parliament.

Selection Criteria and Capability Statement

The selection criteria for the tender are:

- The degree of understanding of the Committee's requirements demonstrated by the bidder.

- The appropriateness and quality of the method the bidder proposes to follow, including the approach to the task and the proposed schedule and timetable of activities.
- The bidder's relevant experience.
- The expertise and experience of the people proposed to do the work.
- The total cost, including any significant, additional use of the Parliament's personnel and facilities etc, a bid might require.

The Committee would wish to be assured staff nominated in the proposal would actually perform the majority of the work of the review. Any changes in the staff of the review team during the course of the review would require approval from the Public Accounts Committee prior to the change occurring.

Engagement

The successful tenderer will be required to enter into terms of engagement, subject to negotiation, in the format in Appendix 1.

Costs

In responding to this request prospective firms should indicate an appropriate break up of costs and a preferred pattern for progress payments, if required, covering work undertaken on a pro rata basis and reimbursement of any agreed outgoings.

Quality Control

The Public Accounts Committee would expect the individual or firms undertaking the review would have in place and maintain appropriate quality control practices and procedures so as to demonstrate the highest level of competency and professional standards are maintained.

Conflict of Interest

The Public Accounts Committee acknowledges that, during the course of the review, the appointed reviewer, support staff and any associated firm face the potential of a conflict of interest in that they will have access to Audit Office records and working papers, including access to working papers of private sector firms under contract to the NSW Audit Office.

As an essential part of the tender process, all tenders must include details as to how the tenderer proposes to handle any conflict of interest situations.

Types of Public Sector Audits

Under Australian Auditing standards and in accordance with accepted audit practice, auditing in Australia, particularly public sector audits comprise the following:

- **Financial audits** where the audit report is a short form audit report in the form and content laid down in the standards.
- **Compliance audits** involving the examination of compliance with, for example, laws and regulations and policy directives of central agencies; there is no defined format for reporting on compliance audits.
- **Performance audits** considering the economy, efficiency and effectiveness of agencies. The usual form of reporting is a long form report. Under the Australian auditing standards, the auditor must include in the report “*a description of facts and findings that form the basis for the auditors opinion.*” The standards also provide that the audit report on a performance audit must include “the objectives and scope of the audit report.”

Contact

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Lodgement of Tenders

The Public Accounts Committee will host a pre-tender briefing in the Jubilee Room at Parliament House, Macquarie Street, at 2 pm on Friday, 25 October 2002. The briefing will include time for questions and prospective tenderers are encouraged to attend.

Tender documents, marked “TENDER - REVIEW OF THE NEW SOUTH WALES AUDIT OFFICE” should be lodged at the tender box at the front desk of the Legislative Assembly by 5pm on Friday, 15 November 2002.

Terms of Reference for the Review

1 Auditing Standards and Practices

1.1 Financial Audits

This work is the Audit Office's main function. It scored well in this aspect of the client survey, with the main concerns being staffing and whether the Audit Office was too legalistic and pedantic.

The reviewer should examine and evaluate:

- whether the Audit Office has adequate and appropriate methodology, practices and procedures;
- whether the audit opinions issued by the Office comply with applicable professional standards and practices;
- whether the audits are supported by adequate plans and work papers, appropriate audit evidence and appropriate quality control procedures; and
- whether the audits are appropriately planned and co-ordinated, having regard to agencies' internal audit and technology inside the Audit Office.

1.2 Compliance Audits

There is no Australian Auditing standard relating to compliance audits. About 10 or more years ago an Exposure Draft was issued for a proposed Australian Standard but the profession could not reach agreement. The exposure draft lapsed. It appears there is considerable difference between private sector and public sector views on compliance auditing.

In the private sector, the common practice appears to be for a specific engagement, for example "to review compliance with tax laws" and not a general engagement to cover all laws and regulations. This type of specific engagement is covered by the standards as AUS 904 "*Engagement to undertake agreed upon procedures.*" The main feature of AUS 904 is that the auditor and the client agree in advance with the scope and extent of the audit. On this basis it is not applicable to compliance audits in the public sector.

Until recently, the Audit Office tested all agencies for compliance with certain laws and guidelines. In the 1999/2000 review, Professor Craswell commented on the advantages and disadvantages of this approach (p 23). The Audit Office now bases the results of its compliance audits on a sample of agencies.

The reviewer should examine and evaluate:

- whether the Auditor-General should develop an internal standard for compliance auditing or, alternatively, whether the Auditor-General should

join with other public sector audit agencies and develop a compliance auditing standard that would apply across Australia;

- the effectiveness of compliance audits and their reporting in NSW; and
- how the effectiveness of compliance auditing is assessed by the Audit Office in the absence of an Australian Auditing Standard for Compliance Audits.

1.3 Performance Audits

Performance audits, which under the auditing standards examine the effectiveness, efficiency and economy of agencies, grew out of governments managing the bureaucracy through demanding results, rather than using process and control. However, audits are traditionally compliance focussed. Academic research has noted Auditors-General carry the most public authority when they focus on compliance, and are more at home with efficiency and economy issues, rather than effectiveness.¹

In the client survey, the two main issues of concern were the Audit Office should thoroughly understand the activities it audits and should provide a fair and objective report related to the audit's scope and objectives. There was also a significant proportion of respondents that agreed with the suggestion that the selection of topics for performance audits could be influenced by pressure groups.

The reviewer should examine and evaluate:

- a number of performance audit reports to determine the extent to which the Audit Office has:
 - complied with the performance auditing standards; and
 - complied with the statutory requirement to avoid comment on matters of government policy, including whether the Audit Office has appropriate processes to make sure it complies with this requirement.
- the extent to which the final reports on performance audits have stayed within the scope and objectives;
- whether final audit reports on performance audit reports are only issued after key date and factual information critical to the audit findings have been cleared with the agency concerned;
- whether the performance audits represent value for money; and
- the criteria the Audit Office uses in selecting performance audits, including compliance with the criteria; whether the focus of the reports should be consistent with the criteria; whether the criteria are adequate and capable of attaining the best value for money from performance auditing; and transparency in applying the criteria.

¹ See Mulgan "Auditors General: Cuckoos in the Managerialist Nest?" (2001) 60(2) *Australian Journal of Public Administration* 24-34.

Following the 2001 amendments to the *Public Finance and Audit Act 1983*, the Audit Office now includes a section on performance issues for the larger agencies, which generally comprises material on performance indicators.

The reviewer should examine and evaluate:

- the Auditor General's reporting on performance issues in his general reports to Parliament, including any possible improvements.

1.4 Partnership of Interests

In the previous review, Professor Craswell suggested the Audit Office could play a collaborative role in improving the performance of the public sector. Indeed, the Audit Office already does this to some extent:

- The Audit Office has collaborated with central agencies in the past to produce guidance such as the Risk Management Toolkit.
- It has produced Better Practice Guides of its own, including an e-government readiness assessment guide.
- As a by-product of the financial audit process, the Audit Office produces a management letter with recommendations to improve an agency's internal control structure, risk assessment and management procedures etc.

However, central agencies traditionally have the role of providing general guidance to line agencies. Sometimes these central agency directives have the force of law (eg, Treasurer's Directions). The Committee would like to ensure agencies have access to good guidance and advice and that there is no confusion about what principles and rules they should follow.

The reviewer should examine and evaluate:

- whether it would be appropriate for the Auditor-General, once he has fulfilled his assurance role, to assist agencies in achieving their corporate goals and reduce their exposure to risk;
- whether the Auditor-General could also assist in addressing issues common to agencies across the public sector;
- whether Audit Office guidance been inconsistent with guidance from central or other agencies and, if so, whether this created difficulties for agencies in their dealings with those "guidance" agencies or the Audit Office; and
- how the Audit Office should coordinate this work with central agencies and other agencies that provide guidance.

1.5 Audit Communication

Communication between the Audit Office and its agency clients is of the utmost importance. In its current inquiry "Delegation by the Minister for Health" the

Committee is examining communication between the Department of Health and the Audit Office. Further, raising issues early in an audit allows agencies the maximum time to rectify those matters. In the survey of performance audit clients, it was considered very important that the Audit Office listen to the auditee's side of the story.

The reviewer should examine and evaluate:

- the effectiveness of communication between the Audit Office and the audited agencies.

2 Audit Office Management

2.1 Staff of the Audit Office

The employment and retention of competent professional staff is a critical factor in enabling the Auditor-General and the Audit Office to achieve their task of auditing the public sector and reporting to the Parliament on the results of the audit.

The reviewer should examine and evaluate:

- the Audit Office's current practices in the recruitment, training, competency, remuneration, retention and professional development of staff, and whether they equip the Audit Office to achieve its task, both for financial/compliance audits and performance audits;
- whether appropriate internal reporting practices are in place to enable the Auditor-General and his management to ensure value for money is being obtained in undertaking audit engagements; and
- whether there are appropriate time recording and costing systems in place to establish the costs of resources, both human and physical, allocated to audits.

2.2 Audit Office Management

The Committee understands the Audit Office often needs to replace staff leaving to the private sector. Further, installing private sector practices could improve the Audit Office's flexibility and, therefore, its efficiency and effectiveness. One option to address these issues would be to commence sections 33A and 33B of the *Public Finance and Audit Act 1983*, which would remove the staff of the Audit Office from the jurisdiction of the *Public Sector Employment and Management Act 2002*.

The reviewer should examine and evaluate:

- whether the fact the Audit Office is under the governance of the *Public Sector Employment and Management Act 2002* is an impediment to its good administration; and

- whether commencing sections 33A and 33B of the *Public Finance and Audit Act 1983* or introducing some other private sector model would improve the management of the Office.

2.3 Costs and Charges

The Auditor-General has a statutory mandate to undertake external audits across the NSW Public Sector and can choose to have the audit carried out by the Audit Office or by an external auditor. The Audit Office is not obliged to tender for audits allocated to it. The Audit Office, as an agency of government, has to comply with public sector practices in the acquisition of goods and services including salaries. On this basis, is it appropriate for a comparison to be made with private sector business practices?

The reviewer should examine and evaluate:

- whether a private sector competitive tender process would be useful in assessing the comparative costs of audit;
- whether the audit fees charged for financial audits are reasonable;
- whether the Audit Office should be able to provide non-audit services to clients on a fee for service basis and how to manage any possible conflicts of interest; and
- whether the Audit Office should cross subsidise the costs of performance and compliance audits with the profit made from financial statement audits.

2.4 Outsourcing

The Audit Office outsources approximately 10% of its financial audits. The Audit Office gains efficiency benefits (audits in regional centres) and quality benefits (benchmarking) from this practice.

The reviewer should examine and evaluate:

- the Audit Office's procedures for evaluating tenders from private audit contractors to carry out public sector audits;
- the Audit Office's procedures for contract management, quality control and assurance; and
- the Audit Office's systems for rotating public and private sector auditors.

3 Audit Office Performance Measurement

3.1 Performance Measurement

The reviewer should examine and evaluate:

- whether key performance indicators are an appropriate method of determining the performance of the Auditor-General and of his office;
- the Audit Office's performance indicators and targets;
- the Audit Office's reporting of its performance against the indicators and targets;
- whether the Audit Office uses the indicators to improve its own performance.

3.2 Quality Assurance Programs

The reviewer should examine and evaluate:

- the effectiveness of the Audit Office's quality assurance programs.
- whether these programs ensure the Audit Office has well-developed and appropriate methodologies and that these methodologies are consistently applied;
- the external and internal verification of the effectiveness of the quality assurance processes;
- whether the quality assurance procedures in the Audit Office extend to financial audits, compliance audits, performance audits, audit reporting and the internal administration of the Audit Office.

4 Reporting to Parliament

The Auditor-General presents up to seven volumes of reports to Parliament each year, which present the findings of financial audits of government agencies. The Auditor General has outlined his approach to these reports in an engagement letter contained in volume one of the *Auditor General's Report to Parliament 2002*.

The Committee made comments on the style and content of these documents in its report, *Inquiry into the Collapse of the Grains Board*. The Committee is also looking at these issues in its current inquiry into a delegation by the Minister for Health.

4.1 Efficiency

For over 100 years, the Auditor General's Annual Report to Parliament has included a detailed discussion and analysis on the financial and related operations of government departments and statutory authorities. Over the past twenty years there has been a significant increase in the number of Government Departments and authorities as the overall scope of operations of government has increased.

Over the same time, the adoption of accrual accounting by both departments and authorities, together with introduction of annual reporting legislation, has increased the number of government agencies that report separately to Parliament.

The reviewer should examine and evaluate:

- whether the Auditor-General's Reports to Parliament contain information already reported to Parliament;
- whether the Parliament is better informed by a separate discussion and analysis of the operations of departments and agencies as prepared by the Auditor-General and his staff;
- the costs of the Auditor-General in preparing the reports to Parliament and whether the reports provide value for money;
- whether there are lower cost options in the style, format and contents for the Auditor-General's Annual Reports to Parliament.

4.2 Expectations on the Reporting of Public Sector Audit

The expectation gap for audit generally has been thoroughly discussed in the literature. However, the Audit Office, as a public sector auditor, may face additional expectations, especially in relation to its reporting.

The reviewer should examine and evaluate:

- how the Audit Office ascertains the expectations of the various users of the Auditor General's reports and whether it meets them; and
- how the Audit Office reconciles the varying expectations of users with legislative requirements and audit practice.

5 General

Any matter that may be referred to the reviewer by the Committee during the course of the review.