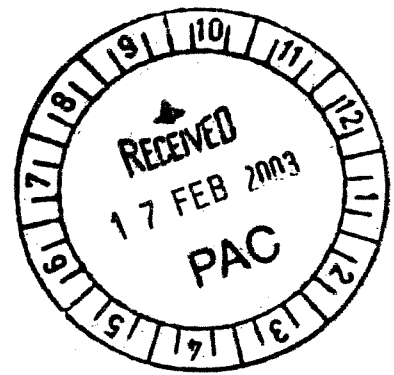


Minister for Agriculture



02/6030
(119641)

Mr Joseph Tripodi MP
Chairman
Public Accounts Committee
Legislative Assembly, Parliament House
Macquarie Street
SYDNEY NSW 2000

11 FEB 2003

Dear Mr Tripodi

Thank you for your letter of 27 November 2002 inviting submissions to an inquiry of the Public Accounts Committee.

The inquiry to which I refer is the review into the reporting and auditing requirements for small agencies.

My Agriculture portfolio responsibilities have a number of diverse and complex small agencies, or entities, which are included in Schedules of the *Public Finance and Audit Act 1983*, and where the Audit Office provides an audit report to Parliament.

Because of the complexity, it was not possible to make a single response. Consequently, I have attached a number of extensive comments, which I am sure will assist you in understanding the many issues to which your review is directed. These cover:

- Agricultural Scientific Collection trust;
- Ovine Johne's Disease Industry Contribution Fund;
- Ovine Johne's Disease Industry Levy Fund;
- Eight statutory authorities reported on by NSW Agriculture; and
- CB Alexander Foundation.

Should you require any further information, please contact Mr Paul Hingston, Manager, Audit and Corporate Administration, on telephone 6391 3434.

Yours sincerely

**RICHARD AMERY MP
MINISTER FOR AGRICULTURE**

NEW SOUTH WALES OVINE JOHNE'S DISEASE - EFFECTIVENESS AND EFFICIENCY OF REPORTING REQUIREMENTS FOR SMALL AGENCIES.

The Division of Animal Industries response to the questions asked by the Public Accounts Committee are detailed below.

1. Ovine Johne's Disease Industry Contribution Fund
2. Ovine Johne's Disease Industry Levy Fund

1. Who are the users of financial and annual reports? The Parliament? The Government? The public?
 - i. Parliament - The Livestock Disease Control Funding Act 1998 requires the funds to be placed before parliament each year.
 - ii. The Public - NSW Farmers and Industry Organisations have a close interest in the funds

2. Do the Parliament and the public need to know the detailed financial circumstances of very small entities?
 - i. Industry and public have requested this information be published on the NSW Ag Website.

3. Does the need for accountability for public money and assets outweigh any possible efficiency gains by reducing the number of agencies required to prepare reports and be audited?
 - i. Possible savings if the report could be included in the NSW Agriculture Annual Report.

4. Would there be any benefit in reducing the level of scrutiny for small agencies? If so, what criteria would be appropriate?
 - i. As in 3.

5. Is it essential to maintain a link between financial reporting requirements and the need to prepare an annual report?

- i. There is a strong link between the two.
6. Would the State's financial reporting be subjected to any additional risks by creating differential levels of reporting?
 - i. No, the level would be dependant on the sensitivity of the agency
7. Who should review classifications under a system of differential reporting? How often? Should these reviews be subject to Parliamentary scrutiny?
 - i. No information available
8. What level of resources are required to prepare annual and financial reports? Is this onerous for small agencies?
 - i. This is an onerous task for low amounts of funding, for the level of scrutiny
9. Would it be appropriate to enable smaller, low risk agencies to prepare less comprehensive financial reports?
 - i. Reporting is required on an accrual basis / Australian Accounting Standards - difficult to make less comprehensive
10. If so, what criteria would provide the right balance between risk and accountability?
11. What should be included in a concise financial report?
 - i. Heads of expenditure, heads of revenue
12. How often should decisions be made about an agency's reporting requirements?
13. What are the risks if the level of audit for small entities is reduced?
 - i. Probably low risk after initial audit

14. Has the Audit Office added any benefit by performing reviews of very small agencies included in the PFA Regulations by identifying accounting control problems or other financial management issues?
- i. Yes in the initial stages, issues were addressed and no further problems
15. Who should decide whether organisations are subject to this level of scrutiny? The Government? The Treasury? The Parliament?
- i. Govt / Parliament
16. What should be the criteria for deciding the reporting requirements for agencies? For instance, should it be the size of the budget, assets or whether their activities are commercially focussed?
- i. Political sensitivity
17. Should there be a regular revision of the organisations included in the invited audits list?
- i. Regular review essential

Please contact Bruce Longhurst on 3667 if further information is required.



Renata Brooks
Chief
Division of Animal Industries
20 January 2003

Paul Hingston
Manager, Audit & Corporate Administration



**Effectiveness and Efficiency of Reporting Requirements
for Small Agencies - Agricultural Scientific Collections Trust (ASCT)**

Please find below a submission, in the form of answers to the questions supplied, regarding the effectiveness and efficiency of reporting requirements for small agencies, as it relates to the ASCT.

1. Who are the users of financial and annual reports? The Parliament? The Government? The public?

The Trustees are supplied with a copy of the annual report that includes the financial report. The annual report is also tabled in Parliament and is available to the public if requested.

2. Do the Parliament and the public need to know the detailed financial circumstances of very small entities?

I do not believe they do. The ASCT is such a small entity that the amounts are shown in the annual financial report to the nearest dollar. All other entities for which I have ever prepared financial reports have the amounts rounded to the nearest thousand dollars. The annual government grant provided to the ASCT of \$15,000 is listed separately in the NSW Agriculture accounts and can therefore be accessed by interested persons.

3. Does the need for accountability for public money and assets outweigh any possible efficiency gains by reducing the number of agencies required to prepare reports and be audited?

The ASCT is a controlled entity of NSW Agriculture. The policies and procedures of NSW Agriculture are therefore adopted by the ASCT as a matter of course and the financial report of NSW Agriculture includes all transactions of the ASCT. Due to this, the accountability for public money and assets of the ASCT would not be compromised by separate annual financial reports not being prepared and audited.

4. Would there be any benefit in reducing the level of scrutiny for small agencies? If so, what criteria would be appropriate?

In the case of the ASCT, there would be financial benefits in reducing the level of scrutiny by not producing and auditing an annual financial report. The criteria that would be appropriate to scrutinise the ASCT would be an annual review by the Financial Services Unit. This would compliment the ongoing monitoring currently performed by the Management Information Officer.

5. Is it essential to maintain a link between financial reporting requirements and the need to prepare an annual report?

For such a small entity as the ASCT, I believe that the cost of producing the financial report dictates that it should not be included in the annual report. Also, the Annual Reports Acts do not apply to the ASCT.

6. Would the State's financial reporting be subjected to any additional risks by creating differential levels of reporting?

Additional risk would not be created in the case of the ASCT.

7. Who should review classifications under a system of differential reporting? How often? Should these reviews be subject to Parliamentary scrutiny?

Treasury would be best placed to review these classifications every three years. It is questionable whether the reviews should be subject to Parliamentary scrutiny.

8. What level of resources are required to prepare annual and financial reports? Is this onerous for small agencies?

It is estimated that preparation of the annual financial report for the ASCT and assisting the Audit Office with audit queries takes a Clerk, Grade 7/8 one week per year (with salaries of approx. \$1,200). There is also time taken by the Chairman, Director and Secretary of the ASCT to discuss the financial report. The audit fee for 2001-2002 was \$2,900 (GST exclusive). The combination of costs of preparing and auditing the financial report equates to 27.33% of the \$15,000 annual grant, even though these salaries are not charged to the ASCT.

The preparation of the financial report is not an overly onerous task.

The Annual Report is prepared by officers of NSW Agriculture and takes approximately two days, including time for preparation of reports by separate officers and collating these by the Director of the Collections. There is also a cost involved in designing the front cover, preparing layout and printing. The time and cost taken in preparation of the Annual Report, as separate from the Financial Reports, are justified by the benefit gained through dissemination of information about the activities of the Trust and the associated collections that is possible through preparation of the report.

9. Would it be appropriate to enable smaller, low risk agencies to prepare less comprehensive financial reports?

It would be appropriate for the ASCT, being a very small, low risk entity to prepare less comprehensive financial reports. If a cost / benefit analysis could be performed, I believe that the preparation of a full set of financial statements, as occurs now would not be warranted. Unfortunately, it is questionable as to whether the benefits can be quantified.

10. If so, what criteria would provide the right balance between risk and accountability?

Reports sourced directly from SAP would be sufficient to review the performance of the ASCT.

11. What should be included in a concise financial report?

A Statement of Financial Performance would be the only report required. As, under the Accounting Standards, the collections are not required to be valued, I do not believe it is necessary to produce a Statement of Financial Position for the ASCT. A cash balance for the ASCT can easily be established.

12. How often should decisions be made about an agency's reporting requirements?

The ASCT transactions are relatively low volume and very low value. Given this, a review of the reporting requirements would not be required more frequently than every three years.

13. What are the risks if the level of audit for small entities is reduced?

The risks would not increase in the case of the ASCT as, being a controlled entity of NSW Agriculture, all internal controls are in line with those of NSW Agriculture and the transactions are available for audit as part of NSW Agriculture's financial reporting requirements.

14. Has the Audit Office added any benefit by performing reviews of very small agencies included in the PFA Regulations by identifying accounting control problems or other financial management issues?

I do not believe that there is any additional value added by the Audit Office reviewing the ASCT. Since I began producing the annual financial report for the ASCT in 1997, I cannot recall any major accounting control, or other financial management issues being identified by the Audit Office.

15. Who should decide whether organisations are subject to this level of scrutiny? The Government? The Treasury? The Parliament?

In the case of the ASCT, Treasury would be best placed to decide on the level of scrutiny required.

16. What should be the criteria for deciding the reporting requirements for agencies? For instance, should it be the size of the budget, assets or whether their activities are commercially focussed?

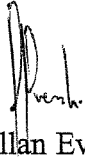
The criteria for deciding the reporting requirements of the ASCT should include:

- The nature of the entity's operations and the associated level of risk;
- The minimal value of the aggregated annual transactions;
- The immaterial level of funding provided by Government and the fact that the value of this grant (\$15,000) is included in the annual report of NSW Agriculture;
- The negligible value of reliably measurable assets as required by the Australian Accounting Standards (\$15,312 in 2001-2002);
- The fact that the ASCT is a controlled entity of NSW Agriculture.

Sections 17 and 18 of the *Agricultural Scientific Collections Trust Act 1983* would need to be amended in order to escape the necessity to produce a financial report and have it audited by the Audit Office.

17. Should there be a regular revision of the organisations included in the invited audits list?

Yes



Allan Everett
Accounts Manager
14 January 2003

Manager, Audit and Corporate Administration

Copy for your information:
Executive Director (Research, Advisory and Education)
Director of the Collections
Finance Manager

STATUTORY AUTHORITIES OVERSEEN BY
THE ECONOMIC SERVICES UNIT OF NSW AGRICULTURE

Comments prepared with reference to the current inquiry
by the Public Accounts Committee
into
the Effectiveness and Efficiency of Reporting Requirements for Small
Agencies

1. THE STATUTORY AUTHORITIES IN REVIEW

The Economic Services Unit of NSW Agriculture (ESU) contributes to the Department's oversight of statutory authorities that can generally be classified as either marketing boards or industry service committees that fund their activity through the imposition of a compulsory charge. Collectively, such authorities might also be classified as industry funded and industry managed.

The relevant authorities, as far as a reporting requirement is concerned, are:

- The Rice Marketing Board for the State of New South Wales
- The Wine Grapes Marketing Board for the City of Griffith and the Shires of Leeton, Carrathool and Murrumbidgee
- The Murray Valley (NSW) Wine Grape Industry Development Committee
- Riverina Citrus
- The NSW Nursery Industry Services Committee
- The Murray Valley Citrus Marketing Board
- NSW Grains Board
- The Banana Industry Committee.

With the exception of the Murray Valley Citrus Marketing Board, all authorities are listed in Schedule 2 of the Public Finance & Audit Act. In the case of the Murray Valley Citrus Marketing Board, the requirement for audit by the NSW Auditor-General (or his Victorian counterpart) is specified in s.38 of the (NSW) Murray Valley Citrus Marketing Act and the equivalent section of the Victorian Act of the same name.

Some of these authorities are in, or near to, the classification of 'small' for the purposes of the inquiry. Latest audit costs for those organisations having a lower audit cost are as follows:

• Murray Valley Wine Grape IDC	\$2,250*
• Murray Valley Citrus Marketing Board*	\$5,700* (\$10,300 in 2001)
• Wine Grapes Marketing Board	\$10,300
• Riverina Citrus	\$11,600
• Banana Industry Committee	\$13,000
* Paid to Victorian Auditor-General	

Additionally, the NSW Nursery Industry Services Committee can be expected to be at the lower end of the cost scale but is yet to be subject to an audit.

In addition to the 8 authorities mentioned above, the oversight responsibilities of the ESU extend to a further three statutory bodies that do not have funds and are not themselves subject to an annual reporting requirement. These bodies are:

- The Selection Committee constituted under the Murray Valley Citrus Marketing Act
- The Selection Committee constituted under the Grain Marketing Act
- The Grain Marketing Consultative Committee constituted under the Grain Marketing Act.

Given the current circumstances relating to the NSW Grains Board, both of the latter two bodies are inactive.

As a further indication of the diversity in statutory arrangements, it is noted that there are current proposals for the Murray Valley Citrus Marketing Board in NSW and Victoria to be reconstituted as a single legal entity under Victorian legislation with extra-territorial power to operate in NSW. An essentially similar proposal also exists in relation to the Murray Valley Wine Grape Industry Development Committees in both States.

Should these proposals materialise, there will be a situation in which constituents of NSW will become subject to Victorian legislation for the purposes of the arrangement. There will be no direct reporting of the arrangement to Parliament or bureaucracy in NSW. To further understand the possible emergence of such a situation, it is noted that the relevant legislation of NSW and Victoria provides that:

- Whenever an industry seeks to establish such a cross-border arrangement, the choice of which State the proposed arrangement will be constituted in will rest with industry; and
- When a proposal is submitted for consideration, proposed constituents of the arrangement will be polled in each State to determine their acceptance of the proposal. Such a poll cannot be triggered without the concurrence of the relevant Ministers in both States.

Such legislative provisions will be further supported by an Inter-Governmental Agreement covering administrative matters, including information sharing.

2. MATTERS OF PRINCIPLE

The nature of the authorities referenced above brings to the fore a number of points of principle that bear on the matter being addressed by the Public Accounts Committee.

2.1 Public Funds

Significantly, the funds raised and spent by the above statutory authorities are not 'public' in the same sense as Consolidated Revenue. They are raised from a defined set of constituents who are individually identifiable (as a general rule) and are to be used for the benefit of those constituents. While the monies concerned still have a 'public' nature to them, the relevant public are the constituents of the arrangement rather than the constituents of the State.

In all cases, accounting for the collection and disbursement of funds is the responsibility of the authority established for the purpose. There is no involvement of any key public sector agency, such as NSW Agriculture, in the accounting process. While there may be a case for some relief from statutory auditing costs for at least some of these administering agencies, giving the relief through an auditing of the funds in conjunction with an audit of, for example, NSW Agriculture is not an option.

It is of further note that the authorities concerned are established to operate without any assistance from Consolidated Revenue funds. They may become a cause for a Government funded contribution to the industry as is currently exemplified with the failed NSW Grains Board. However, with the effective demise of all such traditional marketing boards, the probability is that such demands for assistance from the public purse are unlikely to be repeated. (All authorities other than the NSW Grains Board that are a marketing board in name are not involved in the physical aspects of commodity marketing. With the exception of the Rice Marketing Board, that is a special case, they are service-providing organisations that fund their activity through the imposition of a compulsory charge).

Having indicated that these authorities are established on the basis that they will operate independently of public funds of the State, it may be relevant for current purposes to note that the activities of any authority having an industry service function can lead to some associations with public funds. For example, an authority having a function of facilitating research and development on problems of its constituents can

- (a) be a party to receiving project funding through (Commonwealth) assisted research funds; and
- (b) be a party to granting monies to a State or Commonwealth organisation for the conduct of a specific research project.

Such matters are generally well addressed in the reporting by both the funding and recipient bodies, as well as in the contractual relationship between them. Nonetheless, the issue remains one for continuing scrutiny.

2.2 The directional nature of accountability

Accountability is a directional concept as reflected by the question statement, accountable to whom for what?

If it is assumed that the kind of industry service organisations discussed above (providing services that are funded through a compulsory charge in relation to functions considered appropriate to such an arrangement under Competition Policy guidelines) present absolutely no financial risk to Government, then it may be argued that:

- An organisation's accountability for financial performance rests with its constituents; and
- Government's primary interest in the organisation's activity is that the statutory powers delegated to it are being used only for the purposes for which they were given.

The points that flow from this position are that the organisation might be able to arrange its own audit and annual report. The regular report that the organisation should be required to provide to Parliament could be something quite different to a traditional annual report.

While it is unlikely that there could ever be an absolute guarantee of no financial risk to Government, the possibility of such a risk and the probability of its occurrence are sufficiently low that some movement towards the position indicated could be considered in public accountability legislation.

2.3 The autonomy-accountability relationship

Autonomy and accountability are directly related. The more autonomy that is to be given to an organisation, the stronger must be the accountability requirements on the organisation.

Following on from the above comments on accountability, the greater the financial autonomy that a statutory body is to have from Government, the stronger must be the provisions for an organisation's accountability to constituents. In particular, constituents must be empowered in a way that they can exercise control over the actions (and intended actions) of appointed committee members when and if necessary.

In this regard, it needs to be said that the traditionally legislated provisions for Committee accountability to constituents are too weak and too blunt for an increase in the financial autonomy along the lines discussed above. Such tradition provisions are taken to be:

- A requirement to hold an annual general meeting
- A requirement to hold a special general meeting when requested to do so
- Constituent ability to influence the appointment of the Board of Directors, (at least the majority, if not the whole Board), whether through election or some other process; and
- An ability to trigger a winding up of an authority.

This principle of increasing a Committee's accountability to its constituents was addressed at the time of drafting the Agricultural Industry Services Act 1998. The particular provision then introduced was a means by which the

constituents of a Committee could give a binding direction to a board of directors. Equally importantly, this provision was positioned within a set of provisions that were intended, as far as possible, to ensure that there would be on-going and effective communication between a committee and its constituents. If effective communication could be achieved, the need to invoke the provision to issue a binding direction should be unlikely to arise. The fuller set of relevant provisions is as follows.

- A board of directors must contain a majority of constituents
- A committee must maintain a publicly accessible register of its constituents
- A committee must convene an annual general meeting of its constituents and special general meetings as appropriate
- A committee must prepare a 5-year strategic plan, update it annually and provide a copy to each constituent
- A committee must prepare an annual report and provide a copy to each constituent
- A committee must set its annual compulsory charge in consultation with constituents (through a meeting or poll process) before the charge is introduced. By implication, constituents must be advised of the specific (services/projects) that the Committee intends to pursue in the budget year.
- Accounting for funds must be maintained on a function/project basis, with limitations and conditions imposed on any re-allocation of funds
- Constituents can issue a binding direction to a board of directors
- Constituents can petition to wind-up an arrangement at any time.

2.4 Communication between a committee and its constituents.

The key to effective accountability in any direction lies in effective communication which is fundamentally a 'people' skill.

The prescription of effective communication (through legislation, policy statements or any other means) can only go so far in achieving a desired outcome. Equally importantly, an over-prescriptive approach (specifying what to say, when to say it, how to say it and to whom to say it) can impede effective communication if attention is diverted from the primary purpose at hand.

Many parameters can come into play in planning communication. To illustrate the point, reference is made to agricultural industries that request the kinds of arrangements here discussed.

- Industries can be geographically confined or widely dispersed. This characteristic bears on the practicality of meetings, and the possible need to provide for proxy voting and polling procedures.
- An industry can involve few or many participants. The larger the number of participants and the more dispersed they are, the more difficult it becomes to know who they all are, let alone communicate with them.

- Some industries can experience annual variation in the persons participating in them (either through the choice of annual farming activity such as in grain cropping or through change in business ownership, either through sale or business failure, such as the nursery industry).

Such factors bring to the fore a consideration of the various means of communication (radio, television, newspapers (national, local, rural) and industry association publications) from the point of view of whether there is a means of reaching the target population. The additional alternative is direct mail which raises consideration of the cost of printing and postage.

The inability to prescribe effective communication has been a significant factor in the emergence of Corporate Governance as a matter for director training and conscious decision-making by boards of directors. Recognition of this point opens up issues relating to qualifications for appointment as a director, the approach taken to selection of directors and training of appointed directors.

3. In Conclusion

Answers to questions posed by the PAC in its issues paper, or at least the direction in which an answer might be framed, are contained within the above discussion of principles.

There may be some circumstances in which a firm answer might be given to some of the questions posed by the PAC. However, the view taken in the Economic Services Unit is that answers across the range of statutory bodies will require consideration of principles and issues as outlined above.

Given the nature of the statutory bodies overseen by the Economic Services Unit and the views expressed in this submission, the Economic Services Unit is willing to further discuss the matters raised with the PAC, should it so wish. Further contact with the Unit should be directed through the General Manager, Mr Scott Davenport who can be contacted by telephone on (02) 6391 3629.

Unit staff are also aware that a number of the authorities mentioned have concerns about the cost of audits performed by the Auditor-General and would welcome the opportunity to make their own comments. Contact details for all of the authorities mentioned are contained within the attached copy of the latest Annual Report on the Administration of Agricultural Statutory Authorities.

STATUTORY AUTHORITIES OVERSEEN BY
THE ECONOMIC SERVICES UNIT OF NSW AGRICULTURE

Appendix on cost of Statutory Audit relative to Annual Income of Authority

One definition of "Small" in the term "Small Agencies" could apply to the annual income of the authority from its usual sources (dominantly the statutory charge collected from constituents).

Authority	latest audit cost	latest annual income	audit per cent of income
audited by NSW Auditor-General			
Wine Grapes Marketing Board	\$10,300	\$578,233	1.8%
Rice Marketing Board	\$18,000	\$8,290,000	0.2%
Riverina Citrus	\$11,600	\$698,726	1.7%
Banana Industry Committee	\$13,000	\$451,000	2.9%
audited by Victorian Auditor-General			
Murray Valley Wine Grape IDC	\$2,250	\$443,830	0.5%
Murray Valley Citrus Marketing Board	\$5,700	\$1,278,693	0.4%


Amongst the authorities audited by the NSW Auditor-General there is a correlation between income and the percentage of that disbursed for audit costs.

Currently there are no really small agencies, but the NSW Dried Prune Industry Marketing Committee, which was wound up in March 2000, had a relativity between income and audit cost as shown below:

	2000 audit cost	1999/2000 annual income	audit per cent of income
NSW Dried Prune Industry Marketing Committee	\$1,600	\$7,350	21.7%

The cost of audit was highly significant to that Committee, despite efforts by the Auditor-General to minimise the costs.

In the upper table of recent audit costs, it is also interesting to note the lower relative costs of audit in Victoria.


Tony Moody
Acting Program Leader, Industry Policy
17 January 2003

COPY

**Effectiveness and Efficiency of Reporting Requirements
for Small Agencies**

CB ALEXANDER FOUNDATION

The matter requires a fair amount of consideration, in particular by the members of the C B Alexander Foundation however they do not meet until February and the deadline for this is earlier. There has however been considerable informal debate by the Foundation regarding the costs of audit by the Auditor General and the efficiencies therein. I therefore believe the Foundation would be amenable to changing the system however without reducing the risk management area of audit.

The costs in the current system of audit which effectively is a double audit, results in audit being far higher cost than otherwise necessary. Audit is extremely important and should be continued however the current system needs some streamlining.

The matter will be placed on the agenda for the next meeting of the C B Alexander Foundation and the discussion paper circulated to members prior to the meeting.

W J COURTNEY
Secretary
CB ALEXANDER FOUNDATION



THE AUDIT OFFICE
OF NEW SOUTH WALES

CONTACT NAME
TELEPHONE 9285.0101
OUR REFERENCE A263
YOUR REFERENCE

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

12 February 2003

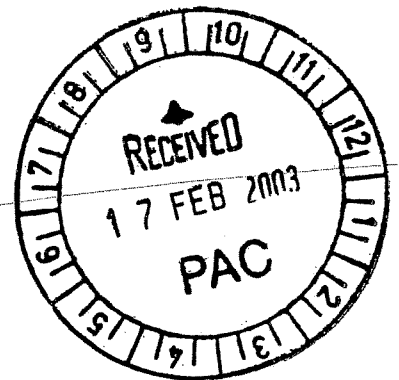
Dear Mr Tripodi

Review of Reporting Requirements for Small Agencies

In response to your letter of 26 November 2002 inviting submissions to the above inquiry, would you please regard my letter of 22 October 2002 as my submission to the inquiry.

Yours sincerely

R J Sendt
Auditor-General





Mr Joseph Tripodi MP
Public Accounts Committee
Legislative Assembly, Parliament House
Macquarie Street
SYDNEY 2000

Contact Name
Telephone 9285.0101
Our Reference A195
Your Reference

22 October 2002

Dear Mr Tripodi

Thank you for your letter dated 26 September 2002 on the Public Accounts Committee investigation into issues relating to the audit of small agencies.

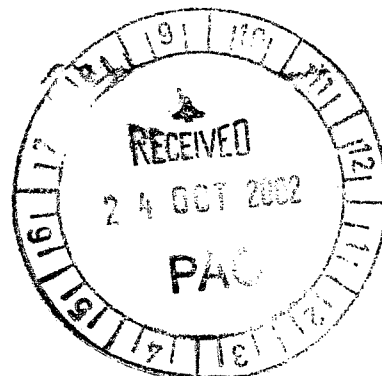
This matter has been an area of discussion by the Audit Office for some time, both internally and externally. We recognise that, for some agencies, the cost of the annual audit has been of considerable concern. Equally, the costs of reporting (aside from audit costs) may be an issue for these smaller agencies. However there is a need to balance accountability with economy.

To assist the Committee's consideration of this issue, I attach a briefing paper prepared by the Office's Policy and Research Section. This paper covers fixed costs of an audit, the number of small audits currently being performed and options available other than an audit.

I look forward to working with the Committee and reaching an appropriate outcome on this issue.

Yours sincerely

R J Sendt
Auditor-General



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Fixed Costs

It is difficult to quantify the fixed costs associated with audits because relevant factors will vary in each audit. The type of agency, the nature of its operations, etc can significantly affect the number and grading of the audit staff involved and hence the cost.

However, one way of looking at this issue is to list the professional and statutory obligations that apply to an audit regardless of the size of the agency.

To satisfy Australian Auditing Standards, the following must occur for each agency:

- issue an engagement letter
- ensure the quality of the audit process through appropriate supervision
- properly document the audit eg plans, programs, evidence, etc
- review annual reports to confirm that disclosed information is consistent with the audited financial report
- obtain representations from management (usually in the form of a letter)
- investigate subsequent events, and
- test the going concern assumption
- issue an Independent Audit Report.

To comply with the *Public Finance and Audit Act 1983* (PF&A Act) the following must occur for each audit:

- issue a Statutory Audit Report to the Minister, Treasurer and agency head, and
- report to Parliament

For companies, the *Corporations Act 2001* also imposes certain audit and reporting obligations. For example, even if a company is small, if it is limited by guarantee, it is a public company and it must report and be audited accordingly.

It can be seen that the mandatory steps are quite extensive and the associated costs to complete them are contingent on many factors.

Number of Small Audits

The term small audit is a subjective one and is discussed in AGS 1048.

.05 The meaning of "small entity" in this context gives consideration not only to the size of an entity but also to its typical qualitative characteristics. Quantitative indicators of the size of an entity may include balance sheets totals, revenue and the number of employees, but such indicators are not definitive. Therefore, it is not possible to give an adequate definition of a small entity solely in quantitative terms.

.06 For the purpose of this AGS, a small entity is any entity in which:

- (a) there is concentration of ownership and management in a small number of individuals (often a single individual)²; and

² The word "individual" denotes ownership by a natural person, rather than by another entity. An entity owned by another entity may, however, be regarded as a "small entity" for the purpose of this Statement if the owner exhibits the relevant characteristics.

- (b) one or more of the following are also found:
 - (i) few sources of revenue;
 - (ii) simple record-keeping;
 - (iii) limited internal controls with the potential for management override of internal controls.

.07 The qualitative characteristics described above are not exhaustive, they are not exclusive to small entities and small entities do not necessarily display all of those characteristics. For the purposes of this AGS, small entities will ordinarily display characteristic (a), and one or more of the characteristics included under (b).¹

Accordingly, it is a matter of judgement what audits might be classified as small.

Nevertheless, to give some understanding, we currently have in excess of 150 audits where the time spent is less than 100 hours. The total fees charged for these audits are roundly \$530,000, suggesting an average fee of approximately \$3,500. However, the individual fees range from \$1,000 to more than \$8,000.

Of the 150 audits, about two-thirds are stand-alone entities. They consist of statutory boards (eg Architects, Pharmacy, Liquor Administration), trusts/trustees, joint ventures or small companies. The remaining one-third are controlled entities of a larger organisation.

These 150 audits represent approximately one third of the 420 audits undertaken.

Options

Developing alternative arrangements is constrained by the factors already mentioned as well as professional obligations which remain regardless of the size of the audit.

Schedule 2 and 3 agencies

It would be difficult to justify varying current reporting and auditing arrangements for the more than 130 statutory bodies listed in Schedule 2 to the PF&A Act - even where these bodies are small. Various Acts establish these agencies. Given that Parliament has seen it appropriate to legislate their creation, it seems likely that there are people who would depend upon general purpose financial reports for their information needs. A similar argument would seem to exist for the 53 departments listed in Schedule 3 to the PF&A Act.

Particular audits

There are a further 45 statutory bodies prescribed for the purposes of Division 4 of Part 3 of the PF&A Act. These bodies are prescribed because the Auditor-General's mandate is not established elsewhere in the PF&A Act. While it is appropriate for Auditor-General to audit these entities, it may not be essential that the smaller bodies prepare general purpose financial reports.

¹ Extracted from CPA Australia Members' Handbook June 2002 issue , AGS1048 Special Considerations in the Audit of Small Entities.

Providing the power to exempt agencies from preparing financial statements

The PF&A Act currently requires “controlled” entities of departments and statutory bodies to prepare financial statements and have them audited in the same way as those of the parent.

It may be that such obligations are not appropriate in all cases. A lead could be taken from the Australian Securities and Investments Commission, which issues a class order exempting wholly owned subsidiaries from preparing financial reports. Perhaps the PF&A Act could be amended along those lines or to provide the Treasurer with the power to exempt subsidiaries on a case-by-case basis. (Currently the Act does not allow exemption from the preparation of financial statements in any circumstances.) If this eventuated, any agency granted an exemption would not incur the cost of preparing financial statements or having them audited. We would only need to gather sufficient evidence on the entity’s operations to support relevant entries in the parent entity’s consolidated financial report.

Separating annual reporting and auditing requirements

Separating the requirement for annual reporting from annual auditing requires further consideration. Currently the annual reporting legislation requires scheduled agencies to include the financial statements and audit opinion for all their controlled entities in their own annual report. While this arrangement ensures accountability, it may be unduly onerous.

Alternative financial reporting

Linked to the preceding two points is the possibility of requiring some form of differential reporting. Rather than exempting all small agencies from preparing general purpose financial statements, perhaps some could be required to prepare concise financial reports. Alternatively, parent entities might be required to include financial highlights relating to controlled entities in their annual reports.

Triennial audits

It has also been suggested triennial audits as an alternative. This would probably not reduce the audit effort if the agency were still obliged to produce annual reports. Any savings would be offset by time lag difficulties such as tracing transactions and locating records.

Audit focus

If the reporting arrangements for small agencies change, so perhaps should the focus of the audit. For such entities, the risks lie more with fraud or non-compliance than with financial accounting. An audit program directed at these areas of risk would most likely meet public and Parliamentary expectations.

Situation in other jurisdictions

We have made inquiries into the any arrangements for small audits in other Australian jurisdictions. Preliminary responses suggest that most other jurisdictions do not have differential reporting and/or auditing arrangements for small entities. The on-going replies will be monitored.

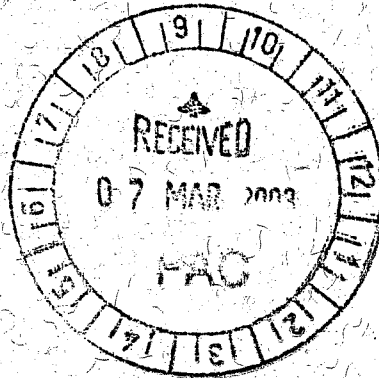


New South Wales

MINISTER FOR INFORMATION TECHNOLOGY,
MINISTER FOR ENERGY, MINISTER FOR FORESTRY, AND
MINISTER FOR WESTERN SYDNEY

DITM Ref: D17988
MEU Ref: 02/01654

Mr Joseph Tripodi MP
Chairman
Public Accounts Committee
Legislative Assembly
Parliament House
Macquarie Street
SYDNEY NSW 2000



21 FEB 2003

Dear Mr Tripodi *Joe*

Thank you for providing me with an opportunity to comment on the Public Accounts Committee's discussion paper on the Review of Reporting Requirements for Small Agencies.

I am advised that while there may be potential cost savings in streamlining or simplifying financial reporting and audit obligations for smaller agencies, there are significant benefits in maintaining the status quo, including:-

- Consistency of reporting across all government agencies
- Compliance with legislation and accounting pronouncements
- Government commitment to transparency and accountability
- Users of financial statements understand this reporting format
- Audit input minimizes financial misrepresentations and potential fraud
- Audited financial statements published in the Annual Report represents the definitive financial position of the agency for that period.

I am comfortable with the current arrangements. However, I fully support the Committee's inquiry and understand the challenges involved to achieve efficiencies in financial reporting without compromising the integrity of individual agencies.

Should you wish to discuss this issue further please contact Bruce Morcombe, Manager Finance, at the Ministry of Energy and Utilities on 9901 8686.

Yours sincerely

Kim Yeadon MP
Minister for Energy

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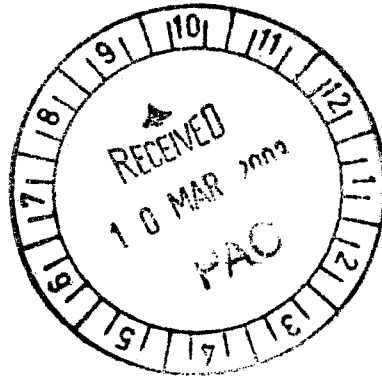


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(03196)

4 March 2003

The Manager
Public Accounts Committee
Parliament House
Macquarie Street
SYDNEY NSW 2000



Dear Sir/Madam,

This office has received from the Minister for Agriculture, the Hon Richard Amery MP, a copy of correspondence dated 27 November 2002 from the Chairman of your Committee concerning a Review of Reporting Requirements for Small Agencies.

Comment on this matter was invited by 7 February 2003. However, an extension of time was granted for State Council to lodge its submission.

As an adjunct to lodging the submission herewith, State Council would appreciate the opportunity of offering a verbal submission to the Committee in due course.

Yours sincerely


Steve Orr
Chief Executive Officer

**SUBMISSION BY THE STATE COUNCIL OF RURAL LANDS PROTECTION BOARDS
TO THE PUBLIC ACCOUNTS COMMITTEE**

**INQUIRY INTO REPORTING REQUIREMENTS
FOR SMALL AGENCIES**

Background

Rural Lands Protection Boards are the frontline for animal health management and pest animal control in NSW. Boards manage 600 000 hectares of travelling stock reserves and a number of stock identification schemes. Funding for Boards predominantly comes from rates collected from landholders in the Boards district. Importantly Boards do not receive an annual allocation of public funding from the NSW Government to deliver their functions, and do not deal with public money as defined under the Public Finance and Audit Act (1983).

Each individual Board is a statutory body in its own right. The annual income for Boards ranges from under \$100 000 to over \$1.3million. The number of staff which a Board employs ranges from 1 to 20. Boards are managed by a Board of eight directors who are elected into their position by the ratepayers within the Board district. The term of a director is four years at which point re-election may be sought.

Prior to falling under the Public Finance and Audit Act (1983), Board audit arrangements were prescribed in the Rural Lands Protection Act (1989). These arrangements required Boards to appoint a qualified auditor to audit the Boards accounts in accordance with Australian Auditing Standards. On completion of the audit the Board provided a copy of the audit report to the State Council Accounting Committee for review.

As with the auditing arrangements, the annual reporting arrangements were prescribed in the Rural Lands Protection Act (1989). In short Boards submitted information to the State Council who used this information to compile a state wide annual report for the Rural Lands Protection Board system. This report was submitted to the Minister for Agriculture who in turn laid it before Parliament.

In September 2001 the Rural Lands Protection Act (1998) was commenced and with it the scheduling of Boards under the Public Finance and Audit Act (1983). There was significant concern in the Board system as to the implication of this new auditing arrangement primarily from a cost perspective, this concern existed despite reassurances from the former Auditor General that cost increases would be negligible.

Significant changes also occurred with regard to annual reporting as Boards were subject to the Annual Reports Act (1984). However the Rural Lands Protection Act (1998) did provide a mechanism for the State Council to prepare a report for the Board system which was not inconsistent with the Annual Reports Act (1984).

A further issue is that by virtue of being scheduled under the Public Finance and Audit Act (1983), the Board system is now subject to the State Records Act (1998), the Privacy and Personal Information Protection Act (1998), and the Community Relations Commission and Principles of Multiculturalism Act 2000.

The State Council of Rural Lands Protection Boards is opposed to Boards being scheduled under the Public Finance and Audit Act (1983) as Boards: have faced a significant increase in cost and workload; do not deal with public money, and the benefits of falling under the Public Finance and Audit Act are non-existent. The State Council does not support the current arrangements with regard to annual reporting. In the view of State Council the previous arrangements for audit and reporting, with some modifications, provide a similar outcome for a reduced cost.

Comments on questions raised in the discussion paper

1. Who are the users of financial and annual reports? The Parliament? The Government? The Public?

From the perspective of the Board system the missing category is Board ratepayers who should be the primary audience for this information given that they provide the funding to enable the activities of Boards. Of the remaining categories all three are obviously users of the information but questions must be asked as to how these categories currently use the information and whether the costs of preparation are commensurate with the benefits of how it is used.

2. Do the Parliament and the public need to know the detailed financial circumstances of very small entities?

No they do not, they need to know that appropriate auditing and reporting standards are in place for these entities.

3. Does the need for accountability for public money and assets outweigh any possible efficiency gains by reducing the number of agencies required to prepare reports and be audited?

As the Board system does not deal with public money or public assets, there must be questions as to why Boards are subject to these arrangements. Nevertheless the level of accountability and reporting must be matched with the capacity of the organisation to undertake such accountability and reporting. From the perspective of the Board system, Boards are now struggling to deliver core functions as a consequence of the increase level of auditing and reporting.

4. Would there be any benefit in reducing the level of scrutiny for small agencies? If so, what criteria would be appropriate?

Yes there would be a benefit as it would free agency resources to concentrate on delivering their core functions. Criteria may include, the functions of the agency, the level of risk associated with the agency, current means of risk minimisation, the budget of agency, and the level of assets controlled by the agency.

5. Is it essential to maintain a link between financial reporting requirements and the need to prepare an annual report?

No it is not essential.

6. Would the State's financial reporting be subject to any additional risks by creating different levels of reporting?

This would be subject to the new levels of reporting required and the risks attached to this level of reporting.

7. *Who should review classifications under a system of differential reporting? How often? Should these reviews be subject to Parliamentary scrutiny?*

Parliament should approve a system of differential reporting, with the Minister for the organisation responsible for determining what level of reporting is required.

8. *What resources are required to prepare annual and financial reports? Is this onerous for small agencies.*

Yes it is a significant burden on Rural Lands Protection Boards. 2002 was the first reporting period under these new arrangements. As a result, Boards audit preparation accounting fees have risen by 181.28% from approximately \$57 000 to \$159 000. There is a direct connection between the reduced time for audit preparation (halved, from 12 weeks to 6 weeks) and the increase in accounting fees. Boards' financial year coincides with the calendar year, productively is lost in public holidays, office closures and staff taking leave. Also, Board rates are calculated and distributed in January. The accumulation of these factors force Boards to outsource much of the audit preparation and production of financial report in order to met the statutory timeframe provided under the PF&A Act.

In addition to the increased audit preparation cost, Board audit fees have risen by nearly 75% from \$170 000 to \$295 000. These increased administrative costs must be funded by their ratepayers at a time when primary industry can least afford it.

Reporting under the Public Finance and Audit Act (1983) has impacted heavily on Board staff and monetary resources. While costs have increased dramatically, there are no clear benefits to the Boards or their ratepayers compared to previous auditing and reporting arrangements.

9. *Would it be appropriate to enable smaller, low risk agencies to prepare less comprehensive financial reports?*

Under the previous RLP Act 1989, Boards prepared almost identical financial statements in accordance with the Australian Accounting Standards and were audited by registered company auditors in accordance with Australian Auditing Standards. State Council under Ministerial delegation reviewed the Boards financial statements and audit reports and reported to the Minister the standard of Boards' audit performance in its annual report.

Under the Public Finance and Audit Act (1983) the Auditor General is required to compile a report on the performance of Board audits to the parliament. Presumably, the cost of this additional report is the 12.5% the Audit Office charges Boards over the contractual costs charged by his agents, to conduct Board audits.

Increasing the complexity of reporting is in adherence to additional requirements of Treasurers Directions, often, regarding complex issues which are largely irrelevant to small agencies and add little if anything to the usefulness of the information contained in the financial report.

It is inappropriate, unnecessary and uneconomical for Boards (as small, low risk agencies) to report in accordance with the PF&A Act.

10. If so, what criteria would provide the right balance between risk and accountability?

The criteria needed to ensure a balance is met between risk and accountability is that small agencies (who are not publicly funded) must prepare financial reports in accordance with the Australian Accounting Standards. That financial statements and accounts are audited by a registered company auditor in accordance with the Australian Auditing Standards.

A report on the agencies audit performance should be submitted to the relevant minister and their audit report and audited financial statements made available as public documents to ensure accountability to the government and the public.

This criteria, as outlined would not significantly increase the risk of maladministration, misappropriation or improbity or indeed provide less accountability if audited financial statements and audit reports were assessable to the persons and entities the small agencies are accountable too. This solution would however, provide significant cost benefits.

11. What should be included in the concise financial report?

The concise financial report would include:

- General purpose financial report produced in accordance with the Australian Accounting Standards.
- Directors Statement asserting to the solvency of the agency and that the financial report is a true and fair view representation of the agencies accounts, and
- Independent Auditors report.

The report to the relevant Minister should be summary financial information from the audited statements and a summary of the independent audit report. This would be included in the agencies annual report.

Small agencies generally do not have dedicated financial accountants and consequently, should be given realistic timeframes to prepare financial reports and accounts for audit.

For example, previously Boards had 12 weeks (to 31 March) to prepare reports and the independent auditor had 4 weeks (to 30 April) to conduct the audit and report on his audit opinion. Under the provisions of PFA, agencies have 6 weeks to submit reports and the auditors have 10 weeks to audit and report. Under PFA regulations audit preparation time has been halved for the agency and more then doubled for the audit itself.

12. How often should decisions be made about an agency's reporting requirements?

Such decisions should be made no more frequently than five years.

13. What are the risks if the level of audit for small entities is reduced?

There are risks associated with such action. These could be addressed by risk management, appropriate penalties for offences, and possibly by requiring more detailed audits for (say) five years where problems arise.

14. Has the Audit Office added any benefit by performing reviews of very small agencies included in the PFA Regulations by identifying accounting control problems or other financial management issues?

State Council is unable to comment on this matter at this stage.

15. Who should decide whether organisations are subject to this level of scrutiny? The Government? The Treasury? The Parliament?

It should be the relevant Minister.

16. What should be the criteria for deciding the reporting requirements for agencies? For instance, should it be the size of the budget, assets or whether their activities are commercially focussed?

See answer to question (4).

17. Should there be a regular revision of the organisations included in the invited audits list?

Yes.