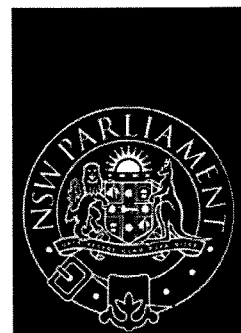


LEGISLATIVE ASSEMBLY



Public Accounts Committee

REVIEW OF THE AUDIT OFFICE UNDER SECTION 48A, PUBLIC FINANCE AND AUDIT ACT 1983

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MASTERS LE MESURIER

LEGISLATIVE ASSEMBLY OF NEW SOUTH WALES
NEW SOUTH WALES PUBLIC ACCOUNTS COMMITTEE
REVIEW OF THE NEW SOUTH WALES AUDIT OFFICE
FINAL REPORT

JUNE 2006



PITCHER PARTNERS



MASTERS LE MESURIER

Mr Bob Sendt
Auditor-General of New South Wales
The Audit Office of New South Wales
Level 15, 1 Margaret Street
Sydney NSW 2000

27 June 2006

Dear Mr Sendt

Please find enclosed our Final Report for the Legislative Assembly of New South Wales, Public Accounts Committee – Review of the New South Wales Audit Office.

I would like to take this opportunity to thank you for the assistance that you have provided to ourselves and Pitcher Partners during the course of this Review.

Yours sincerely
Masters Le Mesurier

Chris Le Mesurier
Director

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MANDATE AND APPROACH FOR REVIEW

INTRODUCTION:

The *Public Finance and Audit Act 1983* (the Act), details the legal basis for the accounting and audit arrangements for the New South Wales Public Sector. The public sector for the purposes of the Act 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.

The role and functions of the Auditor-General of New South Wales and the Public Accounts Committee are established under this Act.

Under Section 48A of the Act, the New South Wales Public Accounts Committee is obliged to appoint a Reviewer to conduct a review of the Auditor-General and the Office at least every three years. The review is to examine the auditing practices and standards of the Auditor-General and to determine whether the Auditor-General is complying with these practices and standards. The most recent independent review was tabled in the New South Wales Parliament in November 2003.

In accordance with the Act, the New South Wales Parliament Legislative Assembly Public Accounts Committee was required to conduct a review of the New South Wales Auditor-General during 2006. As the result of a competitive tender process, Masters Le Mesurier and their formal alliance partner, Pitcher Partners were appointed in March 2006 to undertake this review. For the purposes of the engagement Masters Le Mesurier were appointed as the prime contractor for the review. Mr. Christopher Le Mesurier of Masters Le Mesurier was given the responsibility for all oversight and management of the review.

THE ROLE OF THE AUDITOR-GENERAL:

Sub-section 27B (1) of the Act provides that there is to be an Auditor-General for the State. The role and functions of the Auditor-General are defined in sub-sections 27B (3) - (5):

- The Auditor-General's functions include the following:
 - To audit the Total State Sector Accounts and any other financial reports that the Auditor-General is required or authorised to audit by law,
 - To provide any particular audit or audit-related service to Parliament at the joint request of both Houses of Parliament,
 - To provide any particular audit or audit-related service to the Treasurer at the request of the Treasurer or to any other Minister at the request of that other Minister,
 - To report to Parliament as required or authorised by law, and
 - To do anything that is incidental to the exercise of the Auditor-General's functions.¹
- The Auditor-General may exercise his or her functions in such manner as the Auditor-General thinks fit. However, the Auditor-General is required:
 - To have regard to recognised professional standards and practices, and
 - To comply with any relevant requirements imposed by law.
- The Auditor-General may, in the exercise of his or her functions, have regard to whether there has been:
 - Any wastage of public resources, or
 - Any lack of probity or financial prudence in the management or application of public resources.²

¹ The primary client of the Auditor-General is the Parliament of New South Wales. To enable easier reading of this report we have widened this definition of 'client' to also include New South Wales Government Departments, Agencies and State Owned Corporations.

² *Public Finance and Audit Act 1983*, Sub-Section 27B (1), (3) - (5).

EXECUTIVE SUMMARY

REPORT FORMAT

The Review Team has addressed each of the Terms of Reference separately as detailed in the "Scope of the Review" section of the report.

Our response to each Term of Reference is provided based on the completion of the work which is summarised in the "Methodology of the Review" section of the report.

Our work included:

- Detailed review of New South Wales Audit Office files;
- Detailed review of New South Wales Audit Office documentation of policies, procedures and related communications;
- Interviews with the Director- General, Chief Financial Officer and Chief Internal Auditor (or equivalent) of fifteen Client Agencies;
- Discussions with the Auditor-General, Deputy Auditor-General, Assistant Auditor-Generals and Audit Leaders as required; and
- Requests for information from and interviews with the Auditor General/ Audit Office in other States and New Zealand in respect of Performance and Compliance Audit.

For Terms of Reference One to Five, the findings and recommendations of the Review Team are reported in the following format:

CONCLUSION(S):

This is designed to provide an overall and balanced response to each term of reference. The conclusion is designed to provide context to the Findings and Recommendations where any exceptions and non-compliance are generally described. The Report does not attempt to detail all of our findings where we are satisfied with the operation of the New South Wales Audit Office.

FINDING(S):

This is designed to describe in additional detail the approach and methodologies applied in providing a response to the Term of Reference. In addition any areas identified as non-complying or requiring improvement are described.

RECOMMENDATION(S):

Where a recommendation is appropriate, we have provided our recommendation in this section. Where no recommendation is appropriate, we have clearly stated that we have made no recommendations relating to that finding.

Where possible the work on the three different components of audit work performed by the New South Wales Audit Office and reviewed under the Terms of Reference, that is Financial Audit, Performance Audit and Compliance Audit have been reported upon separately.

The recommendations are summarised in the Summary of Recommendations section of this report to assist the users of this report. The summary should be read in conjunction with the detailed conclusions, findings and recommendations contained in the Findings and Recommendations section of this report.

The key findings and recommendations from this review are:

FINANCIAL AUDIT

The Review Team concludes that Financial Audit materially complies with the professional and legal requirements except for a few examples as noted. Some of these requirements have changed subsequent to the Previous Review.

Discussions with the Client Agencies reflected a high level of satisfaction with the quality of the Financial Audit process, the professionalism of Financial Audit team members and the level of communication during the Financial Audit process. This is consistent with recent independent research findings on the satisfaction of Executives of Client Agencies.

The reliance on internal audit continues to be unsatisfactorily documented or communicated to Client Agencies although there appears to have been some improvement since the Previous Review. Our report contains recommendations to address this finding.

The review also concludes that the New South Wales Audit Office provides value for money Financial Audit services relative to those provided to comparable entities by private sector firms. This is despite both the Office's monopolistic position and the absence of the competitive tendering processes that exist in the private sector.

PERFORMANCE AUDIT

The Review Team concludes that Performance Audit complies with the professional and legal requirements.

There are numerous inputs for the selection of Performance Audit topics. Greater transparency is required to enable Performance Audit topics undertaken to be linked back to the inputs which include, but are not limited to:

- Strategic Plan
- Whole of government risk assessment
- Members of Parliament and Executives of Client Agencies.

It is acknowledged that the Performance Audit methodology has changed significantly since the Previous Review with the adoption of a "Lines of Inquiry" approach. As a result, audit objectives are specific as opposed to previously generic objectives. This change in methodology has been well received by Client Agencies although in at least one occasion, there appears to have been a significant change in objectives during the audit. The process for selecting Performance Audit topics has also been improved significantly since the Previous Review.

Communication with Client Agencies also appears to have improved since the Previous Review based on feedback from the Client Agencies, and as observed in Client Surveys.

Due to the complexity and variety of most Performance Audit topics the detailed or specific knowledge of the particular industry or business is always going to challenge the New South Wales Audit Office. They have therefore adopted a methodology that allows for the use of experts where considered necessary. Further the New South Wales Audit Office faces significant difficulties selecting "independent" experts for some Performance Audits. Consideration should be given to the level and timing of expert involvement throughout the entire process, documentation of their selection and evaluation of their work.

COMPLIANCE AUDIT

The Review Team concludes that Compliance Audit complies with the professional and legal requirements.

There are numerous inputs for the selection of Compliance Audit topics and selection of Client Agencies. Greater transparency is required to enable Compliance Audit topics undertaken to be linked back to the input and the process for selecting the topic.

Compliance Audits are undertaken by Financial Audit staff so the adequacy of resources for this function has been factored in to our consideration of Financial Audit Resources.

PREVIOUS REVIEW

It is pleasing to note that many of the Recommendations from the Previous Review, that we have been requested to specifically consider, have now been implemented by the New South Wales Audit Office.

ACKNOWLEDGEMENTS

The Review Team is extremely appreciative of the time given to us by the Auditor General and his staff from the Audit Office during the conduct of this review and in particular, the Auditor-General, Deputy Auditor-General and Assistant Auditor-General Performance Audit.

We would also like to thank representatives of selected government agencies for making themselves available to enable us to complete the review within the agreed timetable. In addition, Auditors-General in several other jurisdictions were responsive to our enquiries and requests for information.

AUDITOR-GENERAL OF NSW RESPONSE TO THE REPORT



CONTACT NAME R Sendt
TELEPHONE 9275 7101
OUR REFERENCE D0621495/A3248/et
YOUR REFERENCE

Ms Noreen Hay MP
Chairman
Public Accounts Committee
Parliament House
Macquarie Street
SYDNEY NSW 2000

20 June 2006

Dear Ms Hay

Triennial Review of the NSW Audit Office

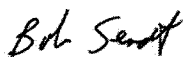
This letter is my response to the 2006 review of the Audit Office, carried out under section 48A of the *Public Finance and Audit Act 1983*.

At the outset I should state that the Audit Office and I welcome these independent reviews of our activities. We are committed to a culture of continuous improvement and these reviews can help us achieve that aim. We also believe that we should be no less accountable than the agencies we audit.

Overall the review's findings are a very positive endorsement of our performance and the contribution we make to better government in New South Wales. The exceptions to the positive findings - while limited - will be acted on.

We accept all the recommendations made by the reviewers and will implement them as soon as possible. Together with the other observations and findings in the report, they will assist the Office in achieving our vision of being a centre of excellence in auditing.

Yours sincerely



RJ Sendt
Auditor-General

SCOPE OF THE REVIEW

REVIEW SCOPE:

The scope for the Review of the New South Wales Audit Office was approved by a full meeting of the Public Accounts Committee on 5 April 2006 and included:

TERM OF REFERENCE ONE - AUDITING FUNCTION:

- a) Compliance with current professional standards and legal requirements in undertaking auditing of all types;
- b) Whether Agencies' Internal Audit Functions have been adequately addressed in performing Financial Audits; and
- c) Audit Office efforts to prepare for the transition to new Australian Equivalents to the International Financial Reporting Standards (AEIFRS).

TERM OF REFERENCE TWO - COSTS AND CHARGES:

- a) Whether the Audit Office is providing value for money Financial Audit services in comparison with the services and fees of similar organisations; and
- b) Whether Performance Audits provide value for money by meeting their objectives and contributing to improved accountability by Agencies within New South Wales.

TERM OF REFERENCE THREE - PLANNING:

- a) Whether the process of selecting topics for performance and Compliance Audits is based on robust methodology including a consideration of whole of government risk management and Central Agency priorities; and
- b) Whether the selection of Agencies for inclusion in Compliance Audits is robust and based on a consideration of the particular risks of that Agency.

TERM OF REFERENCE FOUR - MANAGEMENT AND RESOURCES:

- a) Whether the Audit Office has adequate resources to conduct its functions; and
- b) Whether appropriately skilled staff are undertaking Performance Audits.

TERM OF REFERENCE FIVE - COMMUNICATION WITH CLIENTS:

Effectiveness of communication with clients in particular in relation to:

- a) Establishing a joint understanding of expected audit fees and potential variations;
- b) The scope of the performance and compliance programmes and of individual audits within these programmes; and
- c) Provision of adequate notice of draft reports to Parliament for larger Agencies to provide informed comment.

TERM OF REFERENCE SIX - PREVIOUS REVIEW:

Assessment of the Audit Office's response to the agreed or partially agreed recommendations for the 2003 Review of the Audit Office, being recommendations 1, 3, 11, 12, 18, 19, 57, 64, 66, 67, 70, 75 and 78.

GENERAL:

Any matter that may be referred to the Reviewer by the Committee during the course of the Review.³

³ It should be noted that no matters were referred to the Review Team by the Committee during the course of the Review.

METHODOLOGY OF THE REVIEW

FINANCIAL AUDIT

- The New South Wales Audit Office's audit methodology, Practice Manual, and audit-enabling technology were reviewed in detail for compliance with the various legal and professional requirements applicable to the conduct of Financial Audit by a member of a professional accounting body.
- Eleven Financial Audits, where the reports were signed within the twelve months immediately preceding the commencement of our review, were selected. Our selection included two audits conducted by a contracted audit agent. The electronic and manual working paper files for these audits were reviewed and where necessary issues were discussed. Specifically, a checklist of all the mandatory requirements of Australian Auditing Standards (AUS) applicable to these audits, was prepared and compliance or non-compliance noted.
- These reviews were supplemented by interviews with the Director-General, Chief Financial Officer and Chief Internal Auditor (or equivalents) of the selected Client Agencies to discuss specific Terms of Reference and other issues identified during our file reviews.
- Policies and procedures were also reviewed as necessary to ensure compliance with the professional and legal requirements.
- Assess the role of internal audit within the Client Agencies for the Financial Audits selected under Term of Reference One (A) and the reliance upon internal audit by the New South Wales Audit Office.
- Review the application of AUS 604 'Considering the Work of Internal Auditing'.
- Discuss the interaction, communication and reliance on the internal audit function with the Chief Internal Auditor, or equivalent, of the Client Agencies selected under Term of Reference One (A).
- Review the training provided to staff of the New South Wales Audit Office on Australian equivalents to International Financial Reporting Standards.

- Review all communication available from the NSW Treasury website including policies and guidance provided for consideration during our review of the work of the NSW Audit Office.
- Review the audit work performed in respect of the audit of restated opening balance sheets under AEIFRS.
- Assess the sufficiency of audit evidence and documentation in the audit files of the Client Agencies selected under Term of Reference One (A).
- Ensure that the audit evidence obtained related to Financial Audit only.
- Compare fees to our understanding of fees for entities with similar risk profiles in the private sector provided by firms with similar resources to those of the Office. ASX-Listed Companies with similar gross assets, net assets and/or gross revenue were identified as entities with similar risk profiles. Middle-tier and Big 4 firms were identified as firms with similar resources.
- To assess adequacy of resources quantitatively, staff numbers and levels were assessed through analysis of staff numbers over the last few years at various experience levels. In addition, the New South Wales Audit Office's "running rate" was calculated and compared to the Reviewer's knowledge of running rates in other professional firms with similar resources.
- The average hourly rate of time charged on the Financial Audits selected were considered in light of the New South Wales Audit Office's assessment of risk and our understanding of the Client Agencies.
- Review all correspondence between the Office and the Client Agency including:
 - Initial planning documentation;
 - Compliance Audit topics;
 - Progress reports;
 - Audit issues raised and considered;
 - Management Representation Letters; and
 - Issues raised at the conclusion of the audit (Management Letter).
- Review of documentation in respect of the anticipated audit fee and all other communications amending the audit fee.

- Discussion with representatives of the Client Agencies in respect of negotiations and discussions on expected audit fees and any variations during the review period.

PERFORMANCE AUDIT

- Five Performance Audits were reviewed in detail, including all working papers and Reports tabled in Parliament.
- Analysis of all planning documentation to ensure that the Audit had been appropriately planned, resourced, budgeted and scoped. This included assessment as to whether the staff assigned to the Performance Audit had the necessary skills and qualifications. Additionally, we assessed whether experts were or should have been used as part of the Performance Audit. Each Performance Audit was assessed against the requirements of professional Auditing Standards and legal requirements.
- Determination as to whether there had been adequate discussions between the New South Wales Audit Office and key stakeholders as to the terms of the Performance Audit, the purpose of the Performance Audit and the most efficient and effective manner in which it should be conducted.
- Detailed review of all Audit working paper files to determine whether the audit evidence gathered was sufficient and justified to support the Performance Audit Report tabled in Parliament. This included assessment of the conduct of the Audit by the New South Wales Audit Office against AUS 808, "Planning Performance Audits" and AUS 806, "Performance Auditing."
- Detailed discussions with the Director-General, Chief Financial Officer and Chief Internal Auditor (or equivalents) to discuss the Performance Audits conducted in their Client Agency in detail.
- Review of the Performance Audit Report tabled in Parliament to assess the appropriateness of the findings and recommendations in terms of the audit file reviewed and whether the conclusions drawn were satisfactory.
- Analysis as to whether the Final Report tabled in Parliament was reflective of the original scope signed off at the commencement of the Performance Audit.

- Review of the final costs of the Performance Audit and whether this reconciled to the original budget for the Audit.
- Assessment as to whether the Performance Audit had achieved value for money by meeting its stated objectives and whether it had contributed to improved accountability by Agencies within New South Wales.
- Assessment of the results of the Performance Audit, against the New South Wales Performance Audit methodology for selecting Performance Audit topics as utilised at the commencement of the financial year.

COMPLIANCE AUDIT

- Five Compliance Audits were reviewed in detail, including all working papers and Reports tabled in Parliament.
- Analysis of all planning documentation to ensure that the Compliance Audit had been appropriately planned, resourced, budgeted and scoped. This review was undertaken taking into account all professional Auditing Standards and relevant legal requirements.
- Determination as to whether adequate discussions had been undertaken within the New South Wales Audit Office and with key stakeholders as to the terms of the review, the purpose of the review and the most efficient and effective manner in which it should be conducted.
- Full review of all working papers to determine whether sufficient work had been performed to justify and support the findings in the Compliance Audit Report tabled in Parliament.
- Analysis as to whether the final scope as stated in the Parliamentary tabled Report was reflective of the original scope signed off at the commencement of the Audit.
- Detailed discussions with a selection of Director-Generals, Chief Financial Officers and Chief Internal Auditors (or equivalents) to discuss the Compliance Audits conducted in their Agency in detail.

TERM OF REFERENCE 6 - PREVIOUS REVIEW

Responses were sought from the New South Wales Audit Office on actions subsequent to the previous review and current status.

These responses were confirmed to review evidence wherever possible.

SUMMARY OF RECOMMENDATIONS

No	Term of Reference	Review Team Recommendations	Pages
FINANCIAL AUDIT			
1	One (A)	A specific selection criterion should be included in the current review of available methodologies and audit-enabling software to ensure that the New South Wales Audit Office is able to cost-effectively and efficiently update them for changes in professional or legal requirements on an ongoing basis. As evidenced by the following finding, the ad-hoc approach to updates outside the core methodology or audit-enabling software may increase the risk of non-adoption or compliance of Professional Standards or Legislation.	21-25

No	Term of Reference	Review Team Recommendations	Pages
2	One (A)	<p>The New South Wales Audit Office should communicate the requirements under AUS 212 'Other Information in Documents Containing Audited Financial Reports' to all staff.</p> <p>The standard management representation letter issued at the completion of the audit and often before the drafting of the Annual Report should be updated. The standard letter currently details the responsibility of the Client Agency in respect of the electronic publication of the financial report (subsequent to New South Wales Audit Office "sign-off" of the financial report). The letter should also detail the requirement for the Annual Report (in final proof) to be provided to the New South Wales Audit Office for review.</p> <p>A formal approval process should be adopted and a formal letter of clearance issued by the New South Wales Audit Office. The management representation letter should state that the Annual Report will not be printed or otherwise published until the formal letter of clearance is provided.</p> <p>The Client Service Plan (CSP) should also specifically address the requirements of AUS 212 'Other Information in Documents Containing Audited Financial Reports'.</p>	21-25
4	One (B)	<p>The 'Reliance on Internal Audit' section of the Client Service Plan should be re-worded to require a more positive statement in respect of the planned reliance upon Internal Audit. This statement may conclude that Internal Audit will not be relied upon (although issues raised may require additional External Audit work where material) or identify the audit work that will be reviewed and relied upon dependent on the quality of the work and the satisfactory review of the working papers. Where the Internal Audit work is not to be relied upon, the New South Wales Audit Office should provide reasons.</p>	34-37

No	Term of Reference	Review Team Recommendations	Pages
PERFORMANCE AUDIT			
3	One (A)	<p>The New South Wales Audit Office gives consideration to:</p> <ul style="list-style-type: none"> <input type="radio"/> The use of consistent terminology for scope and criteria elements in Audit Plans; <input type="radio"/> Ensuring that scope items included in Audit Plans are appropriately reflected in Final Reports; <input type="radio"/> Reviewing detailed actual costs of Performance Audits with the detailed budgeted costs; <input type="radio"/> Utilising TOPS more effectively, including updating the system on a timely basis for budgeted and achieved Audit milestones; <input type="radio"/> Providing specific risk elements in Risk Management Plans for Audits and ensuring that Risk Plans are regularly updated during the course of each Audit; <input type="radio"/> Utilising specific rather than generic terminology in Communication Plans; <input type="radio"/> Ensuring that the source of all documents retained on Audit Files is appropriately documented including, date the document was received, where it was received from and the name (if appropriate) of the person providing the document; <input type="radio"/> Further streamlining the presentation of Performance Audit Reports; <input type="radio"/> Refining the use of Performance Scorecards during Performance Audits so that they are more effectively utilised; <input type="radio"/> Reviewing the systems in place for the use of experts including involving them in particular phases of a Performance Audit and formally evaluating their performance at the conclusion of the Audit; <input type="radio"/> Ensuring that working paper files are a complete and accurate record of all work undertaken during the course of the Performance Audit. 	25-33



No	Term of Reference	Review Team Recommendations	Pages
5	Two (B)	<p>That the Performance Audit Branch continues with, and continuously seeks improvements in, the following initiatives:</p> <ul style="list-style-type: none"><input type="radio"/> Independent surveys of parliamentarians and clients;<input type="radio"/> Peer Reviews;<input type="radio"/> Benchmarking with other Audit Offices; and<input type="radio"/> Performance Measures.	41-47

No	Term of Reference	Review Team Recommendations	Pages
6	Three (A)	<p>The Audit Office of New South Wales gives consideration to:</p> <ul style="list-style-type: none"> ○ Reconciling the issues listed in the Strategic Audit Plan and the audit topics listed in the Annual Audit Plan with the Total State Sector Environment Analysis and watching briefs; ○ Indicating within watching briefs and risk assessments which issues have been or are being audited and which are planned to be audited; ○ Reviewing and further documenting the methodology for arriving at the percentage of audits to be conducted across the various performance sector areas; ○ Ensuring appropriate follow up of suggestions from Members of Parliament and Agency Heads, including provision of advice as to what action has been taken on their suggestions. The level of response from Members of Parliament and Agency Heads should be monitored on an annual basis. ○ Including suggested topics in a database for the purposes of monitoring and discerning trends over time. Procedures would need to be put in place for adding, deleting or changing topics. 	50-54

No	Term of Reference	Review Team Recommendations	Pages
8	Four (B)	<p>O That the New South Wales Audit Office consider means of communicating the level of skills and experience of audit staff to clients so that they can be assured that the audit team has the appropriate skills;</p> <p>O That the engagement of experts be communicated to clients; and</p> <p>O That the selection process and performance evaluation of experts be documented.</p>	59-60
9	Five (B)	That any changes in audit objective or scope be approved by the Assistant Auditor General and agreed with the agency involved.	62-64
COMPLIANCE AUDIT			
7	Three (A)	It is recommended that the New South Wales Audit Office Audit Manual and Programme for each financial year clearly document the linkages between the Total State Sector Environment Analysis and the Compliance Audit Topics selected. Evidence of the linkage of individual risks by Agency against the Compliance Audit topics selected should also be documented.	55-56

FINDINGS AND RECOMMENDATIONS

TERM OF REFERENCE ONE – AUDITING FUNCTION

A. COMPLIANCE WITH CURRENT PROFESSIONAL STANDARDS AND LEGAL REQUIREMENTS IN UNDERTAKING AUDITING OF ALL TYPES.

CONCLUSION:

The Review Team is satisfied that the New South Wales Audit Office materially complies with current professional standards and legal requirements in undertaking auditing of all types.

FINANCIAL AUDIT:

The Approach:

As part of this Review, we assessed the Audit Office's audit methodology⁴, Practice Manual⁵, audit-enabling technology⁶ and various other policies that had been issued by the New South Wales Audit Office. We also conducted a detailed review of eleven Financial Audit files for the financial years ending 31 December 2004 or 30 June 2005. The Financial Audit files chosen for detailed review were selected at random with no more than two selected for any one Business Team Leader and two Audits conducted by a Contract Audit Agent.

We considered the following professional standards and legal requirements as they applied to the selected entities:

- Auditing Standards (mandatory requirements);
- Auditing and Assurance Guidance Statements;
- Current Codes of Professional Conduct (issued by the ICAA and CPA);
- Miscellaneous Professional Statements (issued by the ICAA and CPA);
- Public Finance and Audit Act 1983;
- Corporations Act 2001;
- Superannuation Industry (Supervision) Act 1993;
- Charitable Fundraising Act 1991;

⁴ Audit Approach Manual (Master 22/2/1999) commonly referred to as the SAGE methodology within the NSW Audit Office

⁵ The Audit Office Practice Manual (as updated at March 2006)

⁶ Audit System/2 AS/2 published by Deloitte

- *Local Government Act 1993;*
- *Public Lotteries Act 1996;*
- *Protected Disclosures Act 1994;*
- *State Records Act 1998;*
- *State Owned Corporations Act 1989;*
- *Professional Standards Act 1994;*
- *Annual Reports (Statutory Bodies) Act 1984;*
- *Annual Reports (Departments) Act 1985;*
- *Public Finance & Audit Regulation 2001;*
- *Public Finance & Audit Regulation 2005;*

As *Auditing Standards (AUS)* and *Auditing and Assurance Guidance Statements (AGS)* and other professional requirements are updated regularly, the methodology, Practice Manual, audit-enabling technology and other policies were compared against the current versions of AUS, AGS and other requirements listed above. The selected Financial Audit files were compared against the versions applicable for the relevant reporting periods.

A significant amount of time was spent by the Review Team reviewing the methodology, Practice Manual and audit-enabling technology. The above professional and legal requirements were cross referenced to the methodology, Practice Manual, audit-enabling software and other policies published in TRIM⁷. These were found to comply with the professional and legal requirements listed above.

FINDINGS:

Audit methodology:

Several professional Auditing Standards have been introduced or updated since the adoption of the Audit Office's audit methodology, Practice Manual and audit-enabling technology licensed from an external provider. For these new auditing standards, the 'Implications to Audit Methodology & Controlled Documents' analysis as conducted by the New South Wales Audit Office was reviewed to ensure that the analysis adequately addressed any new or updated requirements including recommendation for changes to the audit methodology, Practice Manual and audit-enabling technology.

The analysis and conclusions reached by the New South Wales Audit Office were considered both appropriate and adequate.

⁷ The repository for documents used by the NSW Audit Office.

However, the implementation of these recommendations was generally limited by the inability to incorporate these changes into the audit methodology or the audit-enabling technology. Due to the cost of ad-hoc changes to the methodology and audit-enabling technology (required to be made by an external provider), the conclusions were addressed by the New South Wales Audit Office through the establishment of word processing documents containing the additional requirement(s) rather than embedding them into the audit methodology or templates for the audit-enabling technology. The changes to the methodology were communicated to staff via email communications and published on TRIM.

Review of Working Paper Files:

Our detailed analysis of the eleven working paper files selected during this review highlighted the following areas of non-compliance with the relevant Australian Auditing Standards:

- AUS 210 'The Auditor's Responsibility to Consider Fraud and Error in an Audit of a Financial Report'⁸
 - The New South Wales Audit Office has developed specific forms (not embedded into the audit-enabling technology) that are required to be completed to comply with the requirements of this standard. These forms were updated for recent amendments to these standards and published on TRIM. The necessity to complete these forms was communicated to New South Wales Audit Office Staff by internal email. Two of the nine files, where the Financial Audit work was undertaken by New South Wales Audit Office staff did not include these forms and as a result do not satisfy the requirements of the auditing standard.
 - These Financial Audit files were reviewed by the Engagement Controller and Audit Leader as required in the Practice Manual. The files, where these forms were not completed, were not subject to quality control review under the QARC/QC Policy (by another Assistant Auditor General not directly involved in the engagement) therefore we are not able to comment if this failure to complete forms would have been identified under the QARC/QC Policy.

⁸ Auditing Standard 210 The Auditor's Responsibility to Consider Fraud and Error in an Audit of a Financial Report, issued by the Australian Accounting Research Foundation on behalf of CPA Australia and the Institute of Chartered Accountants in Australia, January 2002.

- AUS 212 'Other Information in Documents Containing Audited Financial Reports'⁹
 - Client Agencies publish an Annual Report that contains the financial report audited by the Audit Office together with other information. AUS 212 'Other Information in Documents Containing Audited Financial Reports' requires the auditor to read the other information to identify whether there are material inconsistencies with the audited financial report.
 - The files reviewed provided clear evidence that the content of the financial report are agreed to the audit lead sheets, adds checked, comparative checked to the previous year and all disclosures referenced to supporting working papers. This is required as part of the Approval in Principle and Audit Completion Memorandum processes.
 - The documentation of the review of the other financial information was not found on three of the nine files where the Financial Audit work was undertaken by New South Wales Audit Office staff. Interviews with Client Agencies during this Review provided varying feedback as to whether the New South Wales Audit Office were reviewing their Annual Reports. Whilst some Clients confirmed that feedback had been provided to them requiring adjustment of certain information within their Annual report, a three of the eleven Client Agencies interviewed indicated that they either did not provide their Annual Report to the New South Wales Audit Office prior to publication, or if they did, they were not provided with feedback on the Report.
 - If this other information has not been reviewed the New South Wales Audit Office has not complied with AUS 212 'Other Information in Documents Containing Audited Financial Reports'. If the review had been conducted but no evidence of the review is documented on file then the New South Wales Audit Office has not complied with AUS 208 'Documentation'¹⁰.

⁹ Auditing Standard 212 Other Information in Documents Containing Audited Financial Reports, issued by the Australian Accounting Research Foundation on behalf of CPA Australia and the Institute of Chartered Accountants in Australia, October 1995.

¹⁰ Auditing Standard 208, Documentation, issued by the Australian Accounting Research Foundation on behalf of CPA Australia and the Institute of Chartered Accountants in Australia, July 2002.

RECOMMENDATION 1:

A specific selection criterion should be included in the current review of available methodologies and audit-enabling software to ensure that the New South Wales Audit Office is able to cost-effectively and efficiently update them for changes in professional or legal requirements on an ongoing basis. As evidenced by the following finding, the ad-hoc approach to updates outside the core methodology or audit-enabling software may increase the risk of non-adoption or compliance of Professional Standards or Legislation.

RECOMMENDATION 2:

The New South Wales Audit Office should communicate the requirements under AUS 212 'Other Information in Documents Containing Audited Financial Reports' to all staff.

The standard management representation letter issued at the completion of the audit and often before the drafting of the Annual Report should be updated. The standard letter currently details the responsibility of the Client Agency in respect of the electronic publication of the financial report (subsequent to New South Wales Audit Office "sign-off" of the financial report). The letter should also detail the requirement for the Annual Report (in final proof) to be provided to the New South Wales Audit Office for review.

A formal approval process should be adopted and a formal letter of clearance issued by the New South Wales Audit Office. The management representation letter should state that the Annual Report will not be printed or otherwise published until the formal letter of clearance is provided.

The Client Service Plan (CSP) should also specifically address the requirements of AUS 212 'Other Information in Documents Containing Audited Financial Reports'.

PERFORMANCE AUDIT:

The approach:

Our review of Performance Audit included:

- Detailed review of a sample of five Performance Audits conducted since November 2003. This review included analysis of working paper files and the Report ultimately tabled in Parliament;
- Review of the New South Wales Audit Office Performance Audit methodology against AUS 806 and AUS 808 to ascertain whether the

methodology and the manner in which Performance Audits were conducted complied with these Professional Standards¹¹;

- Benchmarking of the New South Wales Audit Office Performance Audit methodology against that of the Auditor-Generals of Victoria, Queensland, Western Australia, New Zealand and the Commonwealth of Australia; and
- Detailed discussions with a sample of clients that had been subject to a Performance Audit during the period covered by this Review.

Overall Summary:

The review of Performance Audit covered the period since the last Triennial Review was tabled in Parliament in November 2003. The approach to Performance Audit by the New South Wales Audit Office was subject to significant revision during the intervening period. During the financial year ended 30 June 2005, the Performance Audit Branch adopted the International Organisation of Supreme Audit Institutions Performance Audit method.

The sample of Performance Audits reviewed during this Audit included one Audit conducted under the former Performance Audit methodology and four Audits conducted under the new Performance Audit methodology.

Implementation of the revised approach to Performance Audit has seen significant enhancement of the New South Wales Performance Audit methodology and the manner in which Performance Audits are conducted by the New South Wales Audit Office. The Review Team noted from its detailed review that:

- There is now greater alignment between the Performance Audit methodology and Australian Auditing Standards;
- Audit objectives are specific as opposed to the previously used generic objectives. Under the new methodology, audit objectives are known as 'Lines of Inquiry';
- Greater emphasis is now placed on relationship management, leading to a more collaborative approach and ensuring that there are 'no surprises' in the Audit process;

¹¹ Auditing Standard 806, *Performance Auditing*, issued by the Australian Accounting Research Foundation on behalf of CPA Australia and the Institute of Chartered Accountants in Australia, July 2002. Auditing Standard 808, *Planning Performance Audits*, issued by the Australian Accounting Research Foundation on behalf of CPA Australia and the Institute of Chartered Accountants in Australia, October 1995.

- Focus has been given to conducting a greater number of follow-up Performance Audits each financial year. This approach is designed to assess whether the recommendations of the original Performance Audit have been adopted and whether there has therefore been a 'value add' to the Parliament and Public of New South Wales;
- The revised Performance Audit methodology compares satisfactorily with the methodologies utilised by the Auditor-Generals of Victoria, Queensland, Western Australia, New Zealand and the Commonwealth of Australia.

Legislative and Professional Requirements:

The New South Wales Audit Office operates under the *Public Finance and Audit Act 1983* (the "Act"). Division 2A of the Act specifically deals with Performance Audit and provides the Auditor-General discretion in determining the nature and extent of Performance Audits and reporting requirements. Section 38C provides that the Auditor-General report to the Head of the Authority, the responsible Minister and the Treasurer as to the result of any Performance Audit and that a maximum of 28 days should be provided for agencies to comment on the report. This Section also stipulates that the Auditor-General set out reasons for opinions expressed in the report. Section 38D provides for the Auditor General to present reports to Parliament.

The Australian Accounting Research Foundation, on behalf of CPA Australia and the Institute of Chartered Accountants in Australia has issued two standards relating specifically to Performance Auditing. These are:

- AUS 806 "Performance Auditing"; and
- AUS 808 "Planning Performance Audits".

AUS 806 establishes standards and provides guidance on the objective and general principles governing a Performance Audit.

AUS 808 establishes standards and provides guidance on planning a Performance Audit. It is a requirement that it be read in conjunction with AUS 106 and AUS 806.

Other standards which relate in part to Performance Auditing include AUS 110, 204, 208, 302, 306, 402, 406, 502, 606, 710, 810, APS 2, 4 & 5.

Compliance of the New South Wales Audit Office Performance Audit methodology with Professional Standards and Legal Requirements:

Both the new and former Performance Audit Methodologies utilised during the period covered by this review were compared against the requirements of the Australian Auditing Standards listed above and the Act. Our assessment concludes that both the new and former methodologies are compliant with the requirements of these Standards and the Act.

FINDINGS:

Detailed review of the conduct of Performance Audits during the Period Covered by this Review:

Having determined that the methodologies were consistent with Professional Standards and the Act, the Review Team then assessed the application of the methodologies in practice. This assessment involved detailed review of the selected sample of Performance Audit files, discussions with relevant Performance Audit Branch Team Members and review of the tabled Report for the Review.

As indicated above, implementation of the revised approach to Performance Audit has seen significant enhancement of the New South Wales Performance Audit methodology and the manner in which Performance Audits are conducted. Whilst noting this, the Review Team identified a number of areas during its review of the sampled Performance Audits where greater compliance with the Performance Audit methodology by Performance Audit Teams would lead to improvements in the Performance Audit process.

Audit Planning

Objectives, Scope, Criteria, Procedures:

- Whilst most audit plans referred to scope and criteria, one audit plan used the terms “hypotheses” and “sub hypotheses”. Audit Directors were previously given a degree of latitude in the approach to audits, but we understand from discussions with the Assistant Auditor-General, Performance Audit, that all staff are now being encouraged to use consistent terminology.

- Tabled reports generally reflect the agreed objectives scope and criteria. However, one report had completely different objectives, criteria etc. to that of the original Audit plan and there was no evidence that changes had been agreed with client. The audit objective was also not included in the introduction section of the Report. It is noted that this Audit was conducted under the former Performance Audit methodology utilised by the New South Wales Audit Office.
- The Review Team noted that two audits conducted using the new Performance Audit methodology had scope items which were not covered in the final reports.

Budgets:

Budgets were prepared on the basis of the audit phases and level of staff involved. In one case the budget was first submitted for the scoping phase only, then subsequently for the remainder of the audit. We note that budgets were approved, and were monitored during the course of the audits. However, actual costs were compared with overall budget costs rather than with the detailed budget, so it was difficult to see whether in fact the work was in line with original expectations. Of the five audits reviewed, three were delivered under budget, whilst the remaining two exceeded their budgets.

Schedules or milestones:

Schedules for the conduct of the Performance Audits were generally based on tabling dates. It was noted that the timetable for each phase of the Performance Audit was set by working back from this date. Five milestones were noted to be used, of which the conduct phase was typically the longest. It is our understanding that Performance Audit Teams were required to use these schedules for monitoring purposes with the TOPS system. However, this was not considered to be effective. In some instances either the budgeted or achieved milestones were not entered.

Risk Management Plans:

Risk Management Plans are required for each audit plan, and these were noted to be documented on file for each of the sampled Performance Audits. However, we found the plans to be generic rather than specific. Additionally there was no evidence on file of any review of the risk plans during the audit.

Communications Strategy:

Communications strategies are required to be implemented for each Performance Audit. The Review Team noted that this had been undertaken for each of the sampled Audits. However these were again noted to be generic rather than specific and there was no evidence of review of the communications strategy during the conduct of the Performance Audits.

Evidence

Audit files included numerous documents obtained from various websites, publications and from client sources. Whilst the source of the documents is usually noted (e.g. report name and name of issuing organisation), it is often not clear as to whether the documents were obtained from general research or provided by specific individuals, whether the document is a draft or final version, and what the original purpose of the document was. It is important that such matters be documented on Audit Files so that there is sufficient justification to support the conclusion that evidence gathered is of a reliable nature, relevant to the audit, and sufficient to support the opinions formed.

Reporting

Tabled Reports are generally in a standard format and are easily readable, although one report was found to very statistical in nature. The formatting of recommendations differs between reports, with some clearly highlighted and others less so. Some reports use an "Improved Practice" tick to indicate areas of improvement, but these are not used in all reports. In one report the audit objective was not stated in the introduction section to the report. We were advised by the Assistant Auditor General, Performance Audit that there is a focus now on standardising the reports and this will lead to greater consistency in presentation between Performance Audit Reports.

Performance Scorecards

Performance scorecards are required to be completed at the conclusion of each audit so that the lessons learned can be shared with the team that conducted the Audit and the rest of the Performance Audit Branch. The scorecard is included as part of the checklist. However, we noted that they are not always completed in detail or with comments for improvement. It was not clear to the Review Team how these scorecards fed through to performance management.

Use of Experts

The Performance Audit Standards require that Audits be conducted by persons who currently have or have obtained sufficient knowledge of the business to enable the auditor to identify and understand the events, transactions and practices that may have a significant effect on the performance information, the audit or the report.

We are advised by the Assistant Auditor-General, Performance Audit that Performance Audit staff are recruited and trained to have generalist audit skills and may not have expertise in the areas which they are auditing. Accordingly, where an audit was being conducted that required specialist knowledge, experts would be used to assist the Audit Team.

The Assistant Auditor-General, Performance Audit advised the Review Team that whilst formal performance assessments are undertaken of each member of the Performance Audit Branch, there are no summaries available of the knowledge, skills and experience of current Audit staff. It was therefore difficult for the Review Team to determine whether Audit staff assigned to the Performance Audits reviewed had sufficient skills and qualifications for the subject matter that they were reviewing.

It is however noted from a review of the current year's performance assessments for the Audit Staff that were involved in the Performance Audits reviewed by us, that staff were performing in accordance with the requirements of their job responsibilities.

To ensure that appropriate knowledge of the business is brought to the audit, consultants or experts are engaged as required by the New South Wales Audit Office.

Experts were used on three of the audits selected for detailed assessment during our Review. We noted that the process for selecting these experts was not always formally documented. It was therefore difficult to see the basis for selection of the expert. Further, the experts engaged were typically not involved until the Audit had progressed to the stage of discussing the issues arising with the Client and the drafting of the Report.

Discussions with clients that had been subject to a Performance Audit during the period covered by this Review identified that they were not aware that the Performance Audit Team has utilised experts on their Audit and therefore a perception was created that the auditors used during the Audit lacked the business or technical knowledge of the subject matter being reviewed to adequately conduct the Audit.

The Review Team also noted no evidence, during its detailed review of working paper files during this Audit, that the New South Wales Audit Office was formally evaluating the performance of experts at the conclusion of the Audit for which they had been engaged.

Workpapers

To comply with the requirements of Australian Auditing Standards it is important that working paper files adequately reflect the work performed, are sufficient enough in detail to support the findings and conclusions drawn in Audit Reports, that there is evidence that work has been reviewed and that the working papers are complete.

Our review of the working paper files for the five sampled Performance Audits noted inconsistency in the manner in which working papers were prepared, reviewed and filed:

- Four standard files (management, Performance Audit, cross referenced report, project) are normally maintained. These files were maintained differently for each of the Audits reviewed. We noted some to be extensively indexed and cross referenced, whilst others contained minimal evidence of this. If files are not sufficiently cross referenced it would be difficult to determine whether working paper files were complete or whether documents had been misplaced or added over time;
- It was difficult to determine whether all emails, minutes of team meetings and correspondence had been documented in the Audit files; and
- In the Audits we reviewed, there were inconsistency in the storage of documentation in paper or electronic form, which is a matter the Audit Office needs to address.

RECOMMENDATION 3:

The New South Wales Audit Office gives consideration to:

- The use of consistent terminology for scope and criteria elements in Audit Plans;
- Ensuring that scope items included in Audit Plans are appropriately reflected in Final Reports;
- Reviewing detailed actual costs of Performance Audits with the detailed budgeted costs;
- Utilising TOPS more effectively, including updating the system on a timely basis for budgeted and achieved Audit milestones;
- Providing specific risk elements in Risk Management Plans for Audits and ensuring that Risk Plans are regularly updated during the course of each Audit;
- Utilising specific rather than generic terminology in Communication Plans;
- Ensuring that the source of all documents retained on Audit Files is appropriately documented including, date the document was received, where it was received from and the name (if appropriate) of the person providing the document;
- Further streamlining the presentation of Performance Audit Reports;
- Refining the use of Performance Scorecards during Performance Audits so that they are more effectively utilised;
- Reviewing the systems in place for the use of experts including involving them in particular phases of a Performance Audit and formally evaluating their performance at the conclusion of the Audit;
- Ensuring that working paper files are a complete and accurate record of all work undertaken during the course of the Performance Audit.

COMPLIANCE AUDIT:

A sample of five Compliance Audits was selected at random by the Review Team for detailed analysis as part of this Review. The analysis included a detailed review of the working paper files for the Compliance Audit, the Report that had been issued to Parliament and discussions with a sample of Client Agencies that had been subject to the Compliance Audit.

For the sample selected, the Review Team noted that in each instance:

- A Compliance Testing Guide (CTG) had been prepared prior to conduct of the Audit. This CTG clearly set out the background, scope and objectives of the testing. Additionally a detailed test plan for the Audit was included within each CTG;
- The Compliance Audit had been conducted in accordance with current professional standards, relevant legal requirements and the CTG set for the respective Audit;
- There was evidence that the Agencies that had been selected for inclusion in the Compliance Audit were fully briefed on the results of the Audit for their organisation, prior to the Compliance Audit Report being formally drafted by the New South Wales Audit Office; and
- Detailed findings and conclusions as contained in the working paper files were accurately reflected in the Compliance Audit Reports.

There are no recommendations for this finding.

B. WHETHER AGENCIES' INTERNAL AUDIT FUNCTION HAS BEEN ADEQUATELY ADDRESSED IN PERFORMING FINANCIAL AUDITS.

CONCLUSION:

Documentation on the consideration given to the work of Internal Auditing differs significantly between audit files reviewed. Whilst discussions with the New South Wales Audit Office and the Client Agencies suggested significant interaction in respect of Internal Audit, the audit files often failed to reflect such consideration. Client Service Plans issued to Agencies each financial year should clearly reflect the planned reliance on Internal Audit more clearly and specifically.

FINDING:

AUS 604 'Considering the Work of Internal Auditing'¹² requires:

- *As part of obtaining an understanding of the Internal control structure, that the External Auditor assess Internal Auditing and its effect, if any, on control risk for the purpose of planning an audit and developing an effective audit approach;*
- *The auditor to obtain an understanding of Internal Auditing to make a preliminary assessment of its effect, if any, on control risk, and in determining External Audit procedures; and*
- *When the External Auditor intends to rely on specific Internal Auditing work to support a preliminary assessment of control risk, that the External Auditor evaluate and test that work to confirm its adequacy for the External Auditor's purposes.*

It is clear from interviews conducted with Client Agencies during this Review that representatives from the New South Wales Audit Office are invited and regularly attend Agency Audit Committee meetings. The Internal Audit Plans and the key findings are generally tabled and discussed at these meetings. Clients were generally satisfied with the involvement of the New South Wales Audit Office in those discussions and value the Office's input on various audit issues. Clients emphasised that it was ultimately management of the client that determines the Internal Audit Programme although suggestions from the New South Wales Audit Office and efforts to avoid duplication were appreciated.

Clients were less convinced about the reliance of the New South Wales Audit Office on the Internal Audit work and the impact that this would have on the assessment of control risk, External Audit procedures or the External Audit fee. Consistent feedback from Client Agencies was that the New South Wales Audit Office used the work of Internal Audit as a basis for determining significant risk areas and for addressing specific issues but often failed to identify whether there could be any efficiency gains in the External Audit process through reliance on Internal Audit work.

¹² Auditing Standard 604, Considering the Work of Internal Auditing, issued by the Australian Accounting Research Foundation on behalf of CPA Australia and the Institute of Chartered Accountants in Australia, October 1995.

It should be noted that the objectives of Internal Audit may differ significantly from those of external audit. In addition, the Review Team noted in a number of Client Agencies that the Internal Audit function focused predominantly on operational/efficiency issues rather than financial controls. It should therefore not be assumed that the existence of an Internal Audit function requires the External Auditor to consider reliance on their work. In addition, prior to relying on the work of Internal Audit to support the assessment of control risk, the External Auditor is required to evaluate and test the work.

However, given the New South Wales Audit Office's role it would be expected that the Office should seek to identify opportunities to avoid duplication of work where efficient to do so.

Several of the Client Service Plans assessed by the Review Team simply stated, "Where appropriate we will evaluate and test the work to confirm its adequacy for reliance to support our assessment of control risk" or "We anticipate relying on Internal Audit's work wherever practicable, so that we do not duplicate work they have performed". Other Client Service Plans reviewed detail the specific Internal Audit work undertaken and what work would be considered for reliance.

This lack of clarity in the Client Service Plan, the primary planning correspondence with the client, is supported by the responses from several Clients interviewed. These clients indicated that they were not aware if the New South Wales Audit Office relied on the work of Internal Audit. If the New South Wales Audit Office has made an assessment that they are not able to rely on the Internal Audit work or it would not be efficient to do so, the Client Service Plan should state that the Internal Audit work will not be relied upon.

In addition, several of the preliminary risk assessment working papers reviewed showed no evidence of consideration of Internal Audit. This appeared to be particularly poorly handled for smaller audits where an appropriate comment in the Client Service Plan would have clarified the assessment not to rely on Internal Audit.

It is noted that the New South Wales Audit Office has introduced a new 'Form 1151A – Internal Audit Assessment' for audits in respect of the financial year ended 31 December 2005. This requires an assessment to be made of Internal Audit and requires consideration of organisational status, scope of Internal Auditing, technical competence and due professional care. Due to the timing of this Review we have not been able to satisfy ourselves that this new form has resulted in an improved focus on the consideration of Internal Audit work. We have reviewed the new form and believe that it is consistent with our stated recommendation below. It is however noted that the form does not require that the assessment conducted be summarised in the Client Service Plan.

RECOMMENDATION 4:

The 'Reliance on Internal Audit' section of the Client Service Plan should be re-worded to require a more positive statement in respect of the planned reliance upon Internal Audit. This statement may conclude that Internal Audit will not be relied upon (although issues raised may require additional External Audit work where material) or identify the audit work that will be reviewed and relied upon dependent on the quality of the work and the satisfactory review of the working papers. Where the Internal Audit work is not to be relied upon, the New South Wales Audit Office should provide reasons.

C. AUDIT OFFICE EFFORTS TO PREPARE FOR THE TRANSITION TO NEW AUSTRALIAN EQUIVALENTS TO INTERNATIONAL FINANCIAL REPORTING STANDARDS.

CONCLUSION:

The Review Team is satisfied that the New South Wales Audit Office efforts to prepare for the transition to new Australian Equivalents to International Financial Reporting Standards has been satisfactory.

FINDINGS:

Training of Audit Office Staff

A seven hour training course was conducted for all Financial Audit staff during February/March 2005. Business Team Leaders and Audit Leaders also attended a three hour training course during the same period, specifically relating to the restatement of opening balances.

The seven hour training course was conducted again in November 2005. In addition, selected Financial Audit staff completed self-paced training on selected International Accounting Standards.

The content of these training sessions was reviewed and assessed by the Review Team and found to be satisfactory.

Some staff also attended the AEIFRS financial reporting update conducted by NSW Treasury in June 2005.

During the review of the Financial Audit files selected in our sample, documentation on the transition to AEIFRS, specifically the review of the restated opening balances at 1 July 2004 submitted to NSW Treasury, were reviewed. This was undertaken in order to assess the level of knowledge of New South Wales Audit Office staff. Based on our review we believe that the senior audit staff appear to possess sufficient knowledge on AEIFRS to review the application of these standards by Agencies and satisfy themselves on their appropriateness.

Provision of Advice to Audit Office Clients on AEIFRS

The New South Wales Audit Office's stated policy is that they are not able to provide advice to clients on the application of AEIFRS due to the potential threat to independence that would be created through self-review under Professional Statement F1 issued jointly by CPA Australia and the Institute of Chartered Accountants in Australia. We believe that this is an appropriate response to potential independence issues. The Audit Office has advised clients that they should seek independent external advice from other service providers as required.

The Review Team notes the New South Wales Treasury website which states that Treasury is *“playing a leading role in assisting the New South Wales public sector to be ready to implement the changes required under AEIFRS”*. Their strategy includes the following steps:

- *Analyse and comment to the Australian Accounting Standards Board on all exposure drafts of standards;*
- *Identify and assess the impacts of all significant changes in pending and finalised standards and make this information available to all agencies*
- *Develop new or amended policies and guidance as necessary;*
- *Establish and maintain an up-to-date website to keep all stakeholders continuously informed; and*
- *Present training and development seminars to all New South Wales public sector agencies.*

It is on this basis, the New South Wales Audit Office maintains that New South Wales Treasury is primarily responsible for the readiness of Agencies for transition to AEIFRS.

Agencies were required to prepare and submit to Treasury their draft AEIFRS opening 1 July 2004 balance sheet, based on Treasury’s indicative mandates prior to 30 June 2005. The draft AEIFRS opening 1 July 2004 balance sheet was also required to be submitted to the New South Wales Audit Office for audit prior to 30 June 2005. The New South Wales Audit Office reviewed Agency restated opening balances for 2004. Any issues noted were advised to Agencies in their management letter and to Treasury via the New South Wales Audit Office Treasury Audit Team. These advices were reviewed for the selected Financial Audits.

Our discussions with Client Agencies indicated some frustration with the Audit Office’s position on independence although they were generally satisfied with the responsiveness of the New South Wales Audit Office in providing “clearance” on the Agency’s interpretation of the impact of AEIFRS once a position had been adopted by the Agency.

There are no recommendations for this finding.

TERM OF REFERENCE TWO – COSTS AND CHARGES

A. WHETHER THE AUDIT OFFICE IS PROVIDING VALUE FOR MONEY FINANCIAL AUDIT SERVICES IN COMPARISON WITH THE SERVICES AND FEES OF SIMILAR ORGANISATIONS.

CONCLUSION:

Based on our findings described below, the New South Wales Audit Office provides value for money Financial Audit services in comparison to Private Sector firms.

FINDINGS:

To assess value for money, the Review Team undertook a benchmarking of the fees charged by the New South Wales Audit Office for the selected Financial Audits against a sample of ASX-Listed Companies. ASX-Listed Companies were selected as the most comparable private sector entities. The disclosure and reporting requirements of ASX-Listed Companies are also largely consistent with the reporting requirements of New South Wales Government Agencies. The relevant information was also publicly available.

A selection of approximately 100 ASX-Listed Companies were selected at random from all listed ASX-Listed companies in May 2006. Data was collected including gross revenue, profit from ordinary activities (before taxation), gross assets, net assets and number of employees. It was concluded that gross revenue (including funding), gross assets and net assets were likely to be the most appropriate base for comparison given that not all Agencies are profit focused and the industries of the ASX-Listed Companies largely dictate staff numbers not size or complexity. The audit fees for the selected ASX-Listed Companies were extracted from the published annual reports on the ASX website and relate only to the audit of the financial report, not other services.

Our analysis supported our assessment that gross revenue, gross assets and net assets are appropriate bases for comparison of audit fees between entities as audit fees tracked closely to all three of these bases.

This analysis supports our opinion that the fees for Financial Audits conducted by the New South Wales Audit Office are not consistently greater or lower than fees charged by the Private Sector professional firms for entities of similar gross revenue, gross assets or net assets.

The analysis conducted by the Review Team was supplemented by asking clients during the interviews conducted as part of this Review, about whether they believed they were receiving value for money. Many of the interviewees have been in the New South Wales public sector for many years and therefore may not have an up to date knowledge of the fees being charged for comparably sized entities in the private sector. However, perhaps surprisingly, all interviewees believed that the Financial Audit fees were “reasonable” or “not ridiculously high”.

It was noted by almost every client that the fee is adjusted by a set percentage increase. This was consistent with our analysis of fee increases for the selected audits.

There are no recommendations for this finding.

B. WHETHER PERFORMANCE AUDITS PROVIDE VALUE FOR MONEY BY MEETING THEIR OBJECTIVES AND CONTRIBUTING TO IMPROVED ACCOUNTABILITY BY AGENCIES WITHIN NEW SOUTH WALES.

CONCLUSION:

It is our opinion that the Performance Audits are increasingly providing value for money by meeting their objectives and contributing to improved accountability by agencies within New South Wales.

FINDINGS:

Under Section 38B of the Act, the Auditor-General may “conduct an audit of all or any particular activities of an authority to determine whether the authority is carrying out those activities effectively and doing so economically and efficiently and in compliance with all relevant laws.”

Whilst the New South Wales Audit Office has adopted various performance measurements around how economically and efficiently they undertake their activities, the determination as to whether the audits are providing value for money will depend on whether Parliament, the Agencies and the community perceive that to be the case.

The New South Wales Audit office contracts an independent research company to survey satisfaction levels of Members of Parliament and Agency Executives with Performance and Financial Audits every two years.

Through a review of the independent survey of Parliamentarians and Agencies, and through interviews with Agencies, we believe that there is increasing satisfaction with the audits conducted. However, the survey of Parliamentarians and agencies did not address the issue of the cost of the Performance Audits.

Through our analysis of the New South Wales Audit Office performance measures, and benchmarking with several other Audit offices, we believe that the New South Wales Audit Office has implemented appropriate methodologies to improve the levels of efficiency in their operations.

Thus with improving levels of satisfaction with audit reports and outputs, and with improving efficiencies in operations, the Performance Audits are providing increasing value.

The New South Wales Audit Office has conducted biennial independent surveys of Parliamentarians and Agency Executives. These surveys are conducted by an organisation which provides these surveys to most of the other Audit Offices in Australia.

The latest Parliamentary and Client survey was published in August 2005, and included Financial and Performance Audits.

The Parliamentary survey results for Performance Audits were consistent overall with the previous survey, but there was a significant improvement (from 82% to 91%) in the stated ease of understanding Performance Audits. However there was a slight decrease (from 82% to 76%) in the level of identification of significant issues in the reports. This survey was conducted prior to the implementation of the new methodology. This new methodology addresses this concern by focusing on specific "lines of inquiry". The 2004 – 2005 Performance Audit Plan had targeted an 80% level of satisfaction.

For Performance Audits, the Report for the survey concluded that "a large majority of Performance Audit clients provided positive assessments of the quality of the audit process and reporting." The report went on to say that "for most quality aspects tested in the survey, the results were more positive in 2005 than in 2003".

However the “perceptions of value added were not as positive as perceptions of process and reporting quality.” 60% of respondents agreed that “the Performance Audit had made a valuable contribution by providing their organisation with a sense of assurance regarding the administration of the audited activity”, and only 50% agreed “that the Performance Audit would help their organisation to improve the administration of the audited activity.” However, this still represents an improvement on the 2003 survey result “when only 33% of respondents agreed that the Audit assisted their Agency to identify areas for improvement.”

In order to improve the New South Wales Audit Office’s relationship with Performance Audit clients, the 2005 survey findings suggested focusing on the following:

- Adopting a more collaborative, open audit approach with clearly defined scope;
- Providing the Agency with ample opportunity to react to the Audit findings and conclusions, and being prepared to take on board Agency comments;
- Lack of surprise at the audit reporting stage;
- Providing practical suggestions for improvement that have not already been identified by the Agency;
- Clearly advise the Agency of the use of experts and consider introducing the experts earlier in the Performance Audit process;
- Producing fair and accurate conclusions; and
- Developing a sound understanding of the operating environment of the Agency.

The Review Team notes that the issues identified during the 2005 survey as listed above are consistent with the feedback provided by Client Agencies who were interviewed during the conduct of this Review.

The Audit Office has followed up on these suggestions:

- The new methodology is based on “lines of inquiry” which is designed to be much more focused than the previous audits. The lines of inquiry are agreed at the outset with the client;

- The new methodology provides for greater discussion of findings and recommendations during the course of the audit rather than at the reporting stage. This allows for more input from the client and eliminates any element of surprise, and ensures that conclusions are fair and accurate. The need for enhanced communications with clients has also been acknowledged in the 2005 Annual Report as the focus for 2005-6; and
- With the limited resources in the Performance Audit Branch, it is not possible for staff to become industry specialists. The Performance Audit Branch aims to achieve some level of understanding through the use of “watching briefs” to keep abreast of general issues in the industry, and through engaging experts for individual audits.

The 2005 Survey of clients was conducted at one point in time which could have been up to one year after conclusion of the individual audits. The methodology for surveying satisfaction levels has since been revised, so that individual audit clients are surveyed approximately one to two months after the audit report has been tabled. It is considered this may better reflect client opinions while their memories of the audit are still fresh. This practice is also being adopted by other Audit Offices.

Benchmarking with other Audit Offices:

During the course of the review, as agreed with the New South Wales Public Accounts Committee, we have obtained information from and interviewed the Auditor-Generals of Victoria, Queensland, Western Australia, New Zealand, and the Australian National Audit Office.

The focus of the benchmarking was on the audit planning and topic selection methodologies which are covered in Section 3A of this Report. The benchmarking also included brief analysis of performance measures adopted by each of the Audit offices. The following section on Performance Measures includes this analysis.

The Performance Audit Branch arranged for a “Peer Review” of their audit methodology in December 2005 by members of the New Zealand and Western Australian Audit Offices. The report contains the comments and views of the two reviewers, which may or may not reflect the views of the respective Audit Offices. The review was limited to a review of four audit reports, looking at the context of the report, the structure, presentation and format of the report, use of graphics and statistics, scope, methodology, conclusions and recommendations.

The Peer review was quite positive. They found that audits were generally strong in scoping and planning, and that the approach to obtaining evidence and generating findings was “sound”. They found that “generally the report’s key findings and recommendations were clearly and persuasively presented, were supported by relevant evidence, and provided insights on the issues addressed.”

They did suggest improvements in the following areas:

- Technical words and terms could be used more consistently in reports;
- Summary recommendations and recommendations set out in the main body of the report should have the same wording;
- Evidence should always be presented in a balanced and impartial way;
- Policy exclusions should be clearly set out at the beginning of the report;
- Technical terms used in reports could be explained more clearly, to give readers a better understanding of the term or terms;
- Some reports would benefit from more analytical comment on key issues;
- Reports could make better use of graphics and tables.

One of the audits they reviewed was also included in our sample of audits. Whilst our review focused on the compliance with Performance Audit Standards, the Peer review looked more at the wording of the reports and whether they reflected the documentation and evidence provided. In several areas we concurred with their findings and recommendations in relation to planning and evidence and these are mentioned elsewhere in this Report.

In our discussions with the Assistant Auditor General Performance Audit, he indicated acceptance of the findings and suggestions of the Peer Review. Several of the suggestions relate to the wording used in the reports and the need to make them more readable. The New South Wales Audit Office engaged The Plain English Foundation to prepare a Performance Audit Style Guide, which sets out the structure of reports, expression, language, use of numbers, punctuation, etc. Audit staff are receiving regular training in the use of this style guide.

Some of the other Audit Offices interviewed indicated that they also conduct similar peer reviews. As a member of the Australian Council of Auditors General (ACAG), New South Wales is also participating in initiatives for the benchmarking of performance measures, but this still requires agreement on certain measures.

Performance Measures:

The Performance Audit Branch has adopted and refined various performance measures which are included in the Annual Business Plan.

In addition to the parliamentary and client satisfaction surveys referred to previously, performance measures include:

- Reporting timetables met;
- Audit Budgets met;
- Acceptance of Recommendation;
- Mix of audits;
- Chargeable Time;
- Production levels; and
- Costs of Production.

The Business Plan for the last two years included a target of >80% of reports being tabled on the due date. This was not achieved in 2004 – 2005. However, current indications are that this will be achieved in 2005 – 2006.

There is currently no requirement in New South Wales for the New South Wales Audit Office to follow up on report recommendations. However the acceptance of recommendations is seen as a measure of the impact of audits. It should be pointed out that although recommendations may be accepted, it is no guarantee that they will be implemented or implemented in an effective way. The 2004 – 2005 and the 2005 – 2006 Business plans target for acceptance of recommendations as >80%. During 2004 – 2005 the actual rates of acceptance were 84%, and the evaluation of the Business plan undertaken in March 2006 indicates that the acceptance level this year is running at 90%.

It is not possible with the current resource levels for the New South Wales Audit Office to follow up each Performance Audit. However, clients need to be aware that there may be a follow up audit at any time, so it is necessary to plan sufficient follow-up audits to make this a real possibility. The current Business Plan has therefore introduced a requirement for a mix of audits to include 20% follow-up audits. The current years plan is for 3 follow up audits.

Increases in the number of reports produced each year are an indication (provided that quality and scope remain constant) that productivity has increased. In 2004 – 2005 the target was set at 12 reports, and this was exceeded (15). For the current year the target was increased to 14 reports. It would currently appear that this target will be achieved for the financial year ended 30 June 2006.

The average cost of audits was targeted at <\$200,000 in 2004-5, and at <\$225,000 in 2005-6. These targets have not been achieved, with an average cost in 2004-5 of \$238,000, and current estimates for 2005-6 of \$260,000. Other cost measures for new audits and for follow-up audits are also exceeding the targets set. It is difficult to benchmark these costs with other Audit Offices as the costing systems vary across each jurisdiction.

The range of performance measures adopted by the New South Wales Audit Office are in line with those used in other Audit Offices, although the levels will vary depending on the nature of the audits conducted and the size and structure of the organisation. With the exception of the level of audit costs, the other performance measures have improved over the last two years. Further refinement of performance measures each year should see further improvements in the efficiency of the Performance Audit Branch.

RECOMMENDATION 5:

That the Performance Audit Branch continues with, and continuously seeks improvements in, the following initiatives:

- Independent surveys of parliamentarians and clients;
- Peer Reviews;
- Benchmarking with other Audit Offices; and
- Performance Measures.

TERM OF REFERENCE THREE – PLANNING

A. WHETHER THE PROCESS OF SELECTING TOPICS FOR PERFORMANCE AND COMPLIANCE AUDITS IS BASED ON ROBUST METHODOLOGY INCLUDING A CONSIDERATION OF WHOLE OF GOVERNMENT RISK MANAGEMENT AND CENTRAL AGENCY PRIORITIES.

CONCLUSION:

The Review Team is satisfied that the process for selecting Compliance Audits is based on robust methodology including a consideration of whole of government risk management and central agency priorities.

On the basis of the Performance Audits reviewed by us, we believe that the process of selecting topics for Performance Audits is based on robust methodology including a consideration of whole of government risk management and central agency priorities.

FINDINGS:

COMPLIANCE AUDIT:

The Financial Audit Executive (FAE) is responsible for appointing a Business Team Leader to be responsible for the New South Wales Audit Office's compliance strategy. Each year the appointed Business Team Leader develops an annual compliance testing strategy for the FAE to consider. The FAE then approves the strategy and assigns topics to individual Business Team Leaders.¹³

¹³ New South Wales Audit Office, Compliance Testing Manual of Procedures, Overview, April 2006.

The annual strategy has the following key inputs:

- Consideration of topics suggested by staff during the financial year;
- Review of all Premier's and Treasury circulars and memoranda issued by central agencies during the year;
- Review of Premier's and Treasury circulars and memoranda issued in previous years;
- Review of topics selected in previous years and whether it is a good time to revisit the subject matter; and
- One topic for each of the taxation and governance streams.¹⁴

Each financial year, the New South Wales Audit Office undertakes an analysis of the Total State Sector Environment. The stated purpose of the analysis is so that Audit Teams can:

- Have a better understanding of client business environments;
- Make a risk assessment based on that understanding;
- Link the nature, timing and extent of audit procedures at individual agencies and for the Total State Sector Accounts to the risks identified at the Total State level;
- Identify possible audit efficiencies by dealing centrally with common issues;
- Leverage the combined knowledge of the Financial and Performance Audit Branches; and
- Use the risk assessment to assist the selection of:
 - Compliance Audit topics;
 - Management diagnostic topics; and
 - Performance Audit topics.¹⁵

We are satisfied based on our review that the current process for selecting topics is based on a robust and appropriate methodology.

There are no recommendations for this finding.

¹⁴ New South Wales Audit Office, Compliance Testing Manual of Procedures, April 2006, Pages 1 & 2.

¹⁵ New South Wales Audit Office, Audit Analysis of Total State Sector Environment 2004-05, Page 3.

PERFORMANCE AUDIT:

FINDINGS:

Background:

Section 38B (1) of the Act provides that the Auditor-General may, when the Auditor-General considers it appropriate to do so, conduct an audit of all or any particular activities of an authority to determine whether the authority is carrying out those activities effectively and doing so economically and efficiently and in compliance with all relevant laws. The decision to conduct a Performance Audit is ultimately up to the discretion of the Auditor-General and there would not necessarily be any requirement in terms of complying with the Act for the Auditor-General to engage any particular methodology in making these choices.

Strategic Planning:

In 2004, the New South Wales Audit Office implemented a 3 year strategic plan which sets out the framework for classifying government activity on a performance outcome area basis. Prior to this, the New South Wales Audit Office only prepared an Annual Plan listing the audits that had been selected.

The Strategic Plan allocated the total New South Wales Government sector into seven key performance areas.¹⁶ These were outcome areas including infrastructure, transport, law & order, health & welfare, education, environmental protection & sustainable management of resources, and governance & public sector management.

These performance areas were used rather than the traditional portfolio, Agency or expenditure basis, as it was considered that many areas of potential review could be considered across the board issues. Within each of these performance outcome areas, issues were identified on the basis of input from senior Performance Audit and Financial Audit staff and from issues arising from the annual input from Parliamentarians and key Agency Executives. The issues are broadly stated to allow several topics to be covered over the three year plan. There are between three and six issues included in each performance outcome area. Each year, these issues are reviewed, but typically only two of the issues may be changed or deleted. This is to ensure that the Strategic Plan remains relatively constant whilst allowing for some minor modifications.

¹⁶ These key performance areas were taken from the framework used by the Council on the Cost and Quality of Government.

The New South Wales Audit Office also reviews the research activity undertaken by New South Wales Parliamentary Library staff for Parliamentarians. This research commenced in 1997 and has continued through to the present. This research activity was allocated across the seven key performance outcome areas previously identified as part of the strategic planning process by the New South Wales Audit Office.

The Parliamentary Library research was separated by the New South Wales Audit Office into seven key performance areas, expressed as a percentage and compared with previous Performance Audit areas, indicating areas that might have had more or less coverage than previously.

A whole of government risk assessment has been undertaken for some years by the Financial Audit Branch (The Total State Sector Environment Analysis). For the last two years this whole of government risk assessment has included input from the watching briefs prepared by the Performance Audit Branch. This risk assessment comprises 2 – 3 page summaries of issues in each of the government sectors (e.g., health, transport). Whilst this risk assessment lists the issues, it does not attempt to evaluate the consequences and likelihoods to arrive at a prioritised level of risk. The risk assessment is a useful tool for providing audit staff with background information on the issues in the areas they may be auditing, and is used in the overall strategic planning process, but it is difficult to see any clear linkage between the risk assessment and the key performance issues listed in the Performance Audit Strategic Plan.

Once the performance issues had been agreed upon, it was considered necessary by the New South Wales Audit Office to agree on the number of audits to be carried out over the three year period based on known resources and average audit costs. It was estimated that thirty five new audits, plus ten follow up-audits would be conducted over the three year period. This estimate was based on an average of fifteen audits per annum inclusive of follow-up audits.

The level of follow-up audits was estimated at 20 – 25% of total audits, an increase on previous levels. The audits were then allocated by the New South Wales Audit Office Board of Management, to each of the seven performance areas after consideration of the various inputs that had been used as part of the planning process.

In noting the above process, topics could be substituted at any time, should the Auditor-General decide to do so, based on assessment that a new topic was of particular relevance and required review instead of one of the current scheduled audits.

Analysis of the process:

Our analysis of the Strategic Planning process noted that:

- Strategic planning files did not provide sufficient indication of the basis on which the final allocation of audits was made. Whilst the process is documented, and the various inputs acknowledged, there is no reasoning documented on file as to how the number of audits to be conducted in each performance area had been determined;
- Whilst the Strategic plan was prepared by several teams of Performance Audit staff with input also from Financial Audit staff and was approved by the Board of Management, it is an internal document available to staff only and is not published on the New South Wales Audit Office website;
- The whole of government risk assessment as discussed previously is useful, but we noted several audits which were conducted had not been included as issues in the risk assessment. If the audit topic was indeed of importance, we are concerned that it was not reflected in the original risk assessment or the watching brief. The risk assessments and watching briefs were also inconsistent in some cases where an issue was listed it was also noted that an audit was underway, whereas in other cases no mention was made of this. There appears to be little feedback from the audit planning process back into the watching brief or risk assessment;
- Whilst input into the strategic planning process is sought from Members of Parliament and Client Agency Heads, our review of the lists containing their feedback indicated that few of their suggestions ended up as audit topics for the year. Whilst suggestions were acknowledged, there is no documentation of any feedback being given to those Members of Parliament and Client Agency Heads who had made suggestions, as to whether audits would be conducted in the areas that they had identified. We did note, however, that suggestions made by Client Agency Heads and Members of Parliament were not carried forward to the next year's topic selection;
- Whilst we acknowledge that several inputs are used in the process for selection of audits, there appears to be no clear linkage between the selected audits and the source or origin of the suggested audit (i.e. whether it arose from a Client Agency Executive or Parliamentarian or from the watching brief, etc); and

- Criteria for the selection of audit topics within the performance issues include the level of expenditure on activity, the potential to improve service levels or value, whether the topic is applicable in other agencies, other recent reviews and resources needed to conduct the audit. From the documentation provided to us by the New South Wales Audit Office, it is not clear as to the weighting given to each of these criteria and how the audit topics should be ranked in order of priority.

Benchmarking of the Performance Audit Methodology:

To inform our assessment of the robustness of the New South Wales Performance Audit methodology, the Review Team undertook a comparison of this methodology with the Auditor-Generals of Victoria, Queensland, Western Australia, New Zealand and the Commonwealth of Australia.

Strategic Planning was noted to be a relatively new concept within Audit Offices throughout Australia. Of the four Australian jurisdictions with which we benchmarked our findings, only two have already implemented a Strategic Plan. The remaining two jurisdictions advised us that they were either in the process of implementing a strategic planning process or considering doing so.

The Audit Offices we contacted undertake the selection of audit topics utilising different methods. We noted that there is no standard or uniform approach across the Australian and New Zealand jurisdictions. Most of the Audit Offices interviewed indicated that they do not seek input from Members of Parliament, but in some jurisdictions proposed audit topics are provided to the relevant Public Accounts Committee (or its equivalent) for approval. There is also no uniformity in the use of whole of government risk assessments. Several jurisdictions do not use government wide risk assessments in the selection process. Criteria for selection of topics also varies between jurisdictions, and include various combinations of materiality, public interest, coverage of departments, single/multiple agency, "right" mix, etc.

Most of the Audit Offices contacted have similar planning processes to that of the New South Wales Audit Office, in that information is gathered by various individuals and then discussed in meetings and planning sessions before being approved by the Auditor-General, and in the case of some jurisdictions, by the Public Accounts Committee or its equivalent.

RECOMMENDATION 6:

The Audit Office of New South Wales gives consideration to:

- Reconciling the issues listed in the Strategic Audit Plan and the audit topics listed in the Annual Audit Plan with the Total State Sector Environment Analysis and watching briefs;
- Indicating within watching briefs and risk assessments which issues have been or are being audited and which are planned to be audited;
- Reviewing and further documenting the methodology for arriving at the percentage of audits to be conducted across the various performance sector areas;
- Ensuring appropriate follow up of suggestions from Members of Parliament and Agency Heads, including provision of advice as to what action has been taken on their suggestions. The level of response from Members of Parliament and Agency Heads should be monitored on an annual basis.
- Including suggested topics in a database for the purposes of monitoring and discerning trends over time. Procedures would need to be put in place for adding, deleting or changing topics.

B. WHETHER THE SELECTION OF AGENCIES FOR INCLUSION IN COMPLIANCE AUDITS IS ROBUST AND BASED ON A CONSIDERATION OF THE PARTICULAR RISKS OF THAT AGENCY.

CONCLUSION:

The Compliance Audit program could be further strengthened by documenting the linkages between the Total State Sector Environment Analysis, the Compliance Audits selected and the Client Agencies included within the testing sample for each Compliance Audit.

BACKGROUND:

The ultimate responsibility for the selection of agencies for inclusion in the Annual Compliance Audit Program is that of the Financial Audit Executive. In making their decision, the Financial Audit Executive considers:

- Client Agencies known to have a “history” on the topic;
- Client Agencies that have a high level of activity of the type being reviewed; and
- If the topic is a follow-up one, inclusion of some of those Client Agencies where non-compliance was found last time.

The Financial Audit Executive then refers the draft selection to the relevant Business Team Leaders for their consideration. Agencies where the topic is deemed to be inappropriate are then removed from the sample and replaced with another Agency where that is possible. The relevant Business Team Leader is required to approve the selection of the replacement Agency as well.¹⁷

The New South Wales Audit Office Compliance Testing Manual of Procedures also states that:

- At least one Compliance Audit Topic will be tested in all medium and large Client Agencies;
- In the top 50 Agencies plus subsidiaries two Compliance Audit topics will be tested each year; and

¹⁷ New South Wales Audit Office, Compliance Testing Manual of Procedures, April 2006, Page 2.

- Business Team Leaders have the discretion whether to undertake compliance testing in small Agencies (i.e. those with an audit fee of \$25,000 or less GST exclusive).¹⁸

FINDINGS:

As discussed previously in our Report, each financial year the Audit Office undertakes an analysis of the Total State Sector Environment. The Review Team was advised by the Deputy Auditor-General that the Financial Audit Executive utilise this risk analysis to determine the Compliance Audits that should be conducted in each Agency.

Whilst noting this, the Review Team found it difficult to identify clear linkages between the Total State Sector Environment Analysis and the Compliance Audit topics selected in 2004-05.

RECOMMENDATION 7:

It is recommended that the New South Wales Audit Office Audit Manual and Programme for each financial year clearly document the linkages between the Total State Sector Environment Analysis and the Compliance Audit Topics selected, where these linkages exist. Evidence of the linkage of individual risks by Agency against the Compliance Audit topics selected should also be documented.

¹⁸ New South Wales Audit Office, Compliance Testing Manual of Procedures, April 2006, Page 3.

TERM OF REFERENCE FOUR – MANAGEMENT AND RESOURCES

A. WHETHER THE AUDIT OFFICE HAS ADEQUATE RESOURCES TO CONDUCT ITS FUNCTIONS.

CONCLUSIONS:

The Review Team has concluded that the New South Wales Audit Office has adequate resources to perform their Financial Audit functions. The number of Financial Audit staff is less than optimal, reflecting the tight employment market, but we would not conclude it to be inadequate.

FINANCIAL AUDIT:

FINDINGS:

Details of Financial Audit staff levels over the last 18 months were obtained and reviewed. It is noted that staff numbers at 31 March 2006 are less than those at 31 January 2005. This decline is largely attributable to a reduction in audit staff with two to three years audit experience. The New South Wales Audit Office is experiencing similar difficulties to those being faced by other audit firms, namely staff attraction and staff retention. At our entry interview with the New South Wales Audit Office these issues were discussed.

It is acknowledged that the New South Wales Audit Office is currently in the market for Financial Auditors.

Adequacy of resources is both a quantitative and qualitative measure. To assess the quality of Financial Audit staff we reviewed the recruitment policies, remuneration policies, qualifications of staff, induction process, staff training schedule and attendances, staff appraisal and staff training content. The review of the selected Financial Audit files also provided the Review Team with information to support our assessment.

Quantitative

Based on details of fees for the calendar year ended 31 December 2005, staff numbers during that period and average hourly rate charged to WIP, we calculated a running rate for the New South Wales Audit Office. Running rate is defined as the percentage of time recovered through fees over total time available. We benchmarked this against our understanding of industry standard. The running rate was on the high end of the expected range. This may be a reflection of:

- Better than industry standard efficiency;
- Staff of the audit office working greater than industry standard overtime; or
- Less than optimal resources.

Based on the Audit Office's own analysis some additional Financial Audit staff would be optimal for the New South Wales Audit Office although this is an issue across the industry.

Qualitative

As with any professional organisation, the New South Wales Audit Office is required to invest significant time and resources into their staff. Subsequent to the previous report, several human resource initiatives have been implemented and a new award for New South Wales Audit Office staff¹⁹ has been implemented (Previous Review Recommendation – 47). Human Resource policies were reviewed and discussed as required. In addition training schedules, induction programme materials and training notes were reviewed for quality.

In respect of an assessment of the quality of staff within the New South Wales Audit Office, our assessment is based on the work performed by audit staff on the selected Financial Audits together with a review of the most recent performance appraisals for selected staff.

We conclude, based on our examination of the above that the Human Resources and Training functions within the New South Wales Audit Office are supporting the qualitative requirements of the New South Wales Audit Office for Financial Audit staff.

There are no recommendations for this finding.

¹⁹ Crown Employees (Audit Office) 2004 Award

B. WHETHER APPROPRIATELY SKILLED STAFF ARE UNDERTAKING PERFORMANCE AUDITS.

CONCLUSION:

We are unable to form an opinion as to whether Performance Audit staff are appropriately skilled as we have been unable to review records of their qualifications and experience. Expert assistance is sought on some Performance Audits, but the selection and evaluation processes are not clearly documented.

FINDINGS:

Whilst our review of several reports indicated that the audit staff understood Performance Audit standards and methodology, and had some understanding of the technical issues covered by the reports, we have not been able to obtain records to indicate their level of knowledge of the industries, qualifications or their experience.

We were advised that curriculum vitae or summaries of the auditor's skills and experiences are not maintained by the New South Wales Audit Office. It was suggested by the New South Wales Audit Office that we review recent performance assessments of the auditors concerned. These performance assessments listed the requirements for the position description and whether the auditor had met those requirements. These performance assessments were reviewed by the auditor's immediate supervisor. The performance assessments relate only to the current year and do not make any references to their qualifications, skills or experience.

Experts were used on only three of the five audits reviewed. The selection process for experts is not always documented, so it is difficult to see the basis for selection. There is also no evidence of evaluation of the performance of the expert at the conclusion of the audit.

The Parliamentary and Client survey indicated that audit staff lacked knowledge of the particular industry or business, and this was confirmed in our interviews with Agency Executives. The survey and interviews however praised the level of professionalism of Audit Staff. The Agencies were unaware of the use of experts. If Clients were made aware of the use of experts, and were made aware of the skills and experience of the Audit Staff, they may be more accepting of the audits.

RECOMMENDATION 8:

- That the New South Wales Audit Office consider means of communicating the level of skills and experience of audit staff to clients so that they can be assured that the audit team has the appropriate skills;
- That the engagement of experts be communicated to clients; and
- That the selection process and performance evaluation of experts be documented.

TERM OF REFERENCE FIVE – COMMUNICATION WITH CLIENTS

A. EFFECTIVENESS OF COMMUNICATION WITH CLIENTS IN PARTICULAR IN RELATION TO ESTABLISHING A JOINT UNDERSTANDING OF EXPECTED AUDIT FEES AND POTENTIAL VARIATIONS.

CONCLUSION:

Given the New South Wales Audit Office's monopoly position, it is evident that there is less negotiation on audit fees than in the private sector. Discussions with Client Agencies indicated that the audit fees set by the New South Wales Audit Office were largely accepted by them. Few of the clients appear to believe that they have the right to query or ask the New South Wales Audit Office to justify the fee as no alternative auditors exist.

This situation is exacerbated by the fact that Parliament is really the New South Wales Audit Office's client not the Client Agencies themselves, despite our construction of the word 'client' in this review.

Where the client has entered dialogue with the New South Wales Audit Office, the Office has been prepared to discuss the audit approach on which the fee is based, etc. This should be read in conjunction with our response to the Term of Reference Two (A) which concluded that the New South Wales Audit Office provided value for money Financial Audit services.

Potential variations appear to be communicated appropriately.

FINDING:

Formal communication of the audit fee is included in the Client Service Plan. Both the audit fee and the budgeted hours are compared to the prior year within the Client Service Plan. Prior to communication of the audit fee, the fee is approved by the Engagement Controller or Auditor General.

Our interviews with clients indicated that anticipated audit fees are often discussed at Audit Committee meetings. It is however noted that due to the New South Wales Audit Office's position that there is rarely a process of negotiation in respect of the audit fee. Where there have not been any significant changes to the client since the last audit, the clients expect a set percentage increase as discussed in the section of value for money. This expectation was supported by our review of fees for the selected Financial Audits over the last few years where percentage fee increases were largely consistent for all Client Agencies in any year.

Where the client has been proactive and requested details of the expected audit approach, staff and hours by level, the Engagement Controller or Audit Manager has been happy to discuss these matters and made themselves open to input. Several of the clients have undertaken this and those clients have a greater appreciation of the basis of their audit fee.

Few of the selected Financial Audits experienced variations in respect of the review year. Where a variation had occurred, reasons were provided and they were generally satisfied with the information provided to support the additional fee. For the Financial Audits under review, an additional fee was raised in respect of the review of AEIFRS opening balances. This expected fee was not included in the Client Service Plan other than a disclaimer that the quoted fee did not include this additional work. None of the clients queried the reasonableness of the additional fee for the review of AEIFRS opening balances.

There are no recommendations for this finding.

B. EFFECTIVENESS OF COMMUNICATION WITH CLIENTS IN PARTICULAR IN RELATION TO THE SCOPE OF THE PERFORMANCE AND COMPLIANCE PROGRAMMES AND OF INDIVIDUAL AUDITS WITHIN THESE PROGRAMMES.

CONCLUSIONS:

On the basis of the Performance and Compliance Audits reviewed by us, we believe that the Audit Office has effectively communicated the scope of the audits with clients.

FINDINGS:

COMPLIANCE AUDIT:

As previously discussed in this report, we selected a sample of five Compliance Audits for detailed review as part of this Audit. The Review Team met with a sample of Client Agencies that were included within those Compliance Audits. These interviews addressed communication and it was noted that in all instances Client Agencies were satisfied with the manner in which the scope of Compliance Audits had been communicated to them and the manner in which the Compliance Audit had been undertaken and reported by New South Wales Audit Office staff.

There are no recommendations for this finding.

PERFORMANCE AUDIT:

Suggestions from various sources are considered in arriving at the planned Performance Audit programme for the year. Before finalising the programme, the Audit Office writes to affected Agency CEOs to see if there is any impediment to the audit proceeding. The list of planned audits is then published on the Audit Office website. Agencies are therefore aware of any planned audits in their area, although the exact timing may not be known at that stage.

When the audit is about to commence, the Head of the Agency is contacted and asked to provide a liaison person for the audit. This person is then the main point of contact between the Agency and the Audit Office. The draft Audit Plan is provided to the Agency for discussion, including the scope of the audit. Any suggestions for changes to the scope of the audit are considered, and if thought appropriate, revised in the draft plan. The scope of the audit is included in the appendix of the final published Report. Our review indicated that the scope generally did not change during the course of the audit.

However in one Report it was noted that the original objective and scope of the audit contained in the audit plan had changed during the course of the audit, and that it also differed in the appendix of the tabled Report. The objective of the audit was also not mentioned in the introduction section of the tabled Report. It is not clear whether the changes in the objective and scope had been agreed with the Client during the course of the audit. It should be noted that this particular audit was conducted during the period when there was a major handover from both the Assistant Auditor General and the Audit Director responsible for the audit upon their retirements.

RECOMMENDATION 9:

That any changes in audit objective or scope be approved by the Assistant Auditor General, Performance Audit and agreed with the agency involved.

C. EFFECTIVENESS OF COMMUNICATION WITH CLIENTS IN PARTICULAR IN RELATION TO THE PROVISION OF ADEQUATE NOTICE OF DRAFT REPORTS TO PARLIAMENT FOR LARGER AGENCIES TO PROVIDE INFORMED COMMENT.

CONCLUSIONS:

On the basis of our review of Performance, Compliance and Financial Audits we believe that the New South Wales Audit Office has provided adequate notice of draft reports to Parliament for larger agencies to provide informed comment.

FINANCIAL AUDIT:

Based on discussions with Client Agencies, there is a general satisfaction with the time frames provided by the New South Wales Audit Office in terms of the Agency providing informed comment on draft reports. Where the New South Wales Audit Office staff has kept the Client Agencies aware of issues as they arose or requested the Agency to review certain disclosures as prepared rather than at the report writing stage, the Agency has been prepared to accept shorter time periods than might otherwise have been provided in relation to the provision of comments.

There are no recommendations for this finding.

COMPLIANCE AUDIT:

Our discussions with Client Agencies during this Review indicated that the majority were satisfied that they were provided with sufficient time to comment on matters raised in Compliance Audit Reports that affected their Agency.

There are no recommendations for this finding.

PERFORMANCE AUDIT:

It is a requirement under Section 38C (2) of the Act that the Auditor-General must not table a report of a Performance Audit, unless at least 28 days before making the report, the Auditor-General has given the Head of the Authority, the responsible Minister and the Treasurer a summary of finding and proposed recommendations in relation to the audit.

The Performance Audit files we reviewed during this Audit had all documented the issue of Final Reports (formerly known as "28 Day reports" (which were subsequently tabled between 29 to 41 days later). In addition to the formal 28 day period, the report files we reviewed indicated that clients had opportunities to review and comment upon issues and draft reports in the weeks and months leading up to the issue of the Final reports.

We have conducted an analysis of reporting and tabling dates for reports issued in 2005 – 2006 and noted that the date between the issue of the "28 Day Report" and the tabling of the report in Parliament was less than 28 days. However, we note that Section 38C (3) of the Act allows reports to be tabled with less than 28 days notice provided that the client is in agreement. All clients interviewed during the conduct of this Audit indicated that they had been given sufficient time to assess Performance Audit Reports and provide comment on them. Additionally, all clients were aware of the legislative provisions of the Act and that they could enforce the 28 Day response time should they have chosen to do so.

There are no recommendations for this finding.