

TERM OF REFERENCE SIX - RECOMMENDATIONS FROM PREVIOUS REVIEW

BACKGROUND

The Terms of Reference for this review required the Review Team to test the New South Wales Audit Office's response to a selection of the agreed or partially agreed recommendations of the 2003 Review of the New South Wales Audit Office.

The following section of this Report:

- Identifies the selection of agreed or partially agreed recommendations of the 2003 Review of the New South Wales Audit Office;
- The response of the New South Wales Audit Office in 2003;
- New South Wales Audit Office action to date/current status;²⁰ and
- The current Review Team's analysis of action taken by the New South Wales Audit Office.

²⁰ The Audit Office action to date/current status report was provided to the Review Team by the Auditor-General at the commencement of this Audit in March 2006.

FINANCIAL AUDIT

RECOMMENDATION 1 (LOW PRIORITY)

The Audit Office should maintain their surveillance of the market in relation to changes in Audit Methodologies and automated technology solutions. Based on this surveillance, in line with standard government purchasing policy, it is recommended that on an annual basis, the Audit Office, formally document whether it is still appropriate to keep the current methodology and automated working papers or whether the market should be tested.

AUDIT OFFICE RESPONSE (2003):

Accepted.

We will continue our surveillance of the market. We will document our view on an annual basis on retention of the current methodology/technology.

AUDIT OFFICE ACTION TO DATE/CURRENT STATUS:

We have continued to monitor this issue on an annual basis. Findings and recommendations are discussed at the Financial Audit Executive and Information Management and Technology Steering Committee meetings and where appropriate, considered as part of our annual corporate planning process.

In July 2005, responsibility for market surveillance of methodology and technology was moved to the newly created Professional Services Unit for better coordination and focus.

CURRENT REVIEW TEAM'S ANALYSIS OF ACTION TAKEN BY THE AUDIT OFFICE:

We have reviewed the response from the NSW Audit Office in respect of action to date and current status and confirm that the response is valid. We have been advised that the New South Wales Audit Office is currently undertaking its annual review of methodology and audit-enabling technology. This is particularly important given the introduction of re-issued Australian Auditing Standards applicable to audits for financial years commencing on or after 1 July 2006. The contract with the existing external provider has ended and the additional selection criteria recommended in response to Term of Reference One (A) should be considered.

RECOMMENDATION 3 (HIGH PRIORITY)

The Audit Office should reinforce to its staff the requirement to assess whether a client's Internal Audit function can be relied upon during the Financial Audit process. This should include a requirement that all audit files contain documentation setting out how any Agency's Internal Audit function has been assessed and the conclusions drawn by the Audit Team. The Audit Office should also ensure that Agencies are made fully aware through the Client Service Plan and through entrance meetings for all Financial Audits how its Internal Audit function will be used and what impact this has had on audit fees.

AUDIT OFFICE RESPONSE (2003):

Accepted in part.

The Previous Reviewer has not understood our methodology. Our methodology already requires an assessment of internal audit for all agencies in our planning documents. If we assess that reliance can be placed on internal audit, then the methodology already requires the completion of the Preliminary Assessment of the Internal Audit Function. We will reinforce with the audit teams the importance of emphasising our reliance on internal Audit at the preparation and presentation of the Client Service Plan.

AUDIT OFFICE ACTION TO DATE/CURRENT STATUS:

We have continued to reinforce this issue at Financial Audit Branch management meetings and other appropriate forums.

As an example, in December 2005 Financial Audit Branch held a two-day workshop for all Business Team Leaders and Audit Leaders. The need to ensure that our consideration of the use of internal audit functions of clients is clearly documented in audit files was reinforced at the workshop.

CURRENT REVIEW TEAM'S ANALYSIS OF ACTION TAKEN BY THE AUDIT OFFICE:

Our recommendations under Term of Reference One (B) are similar to those made by the previous reviewer. We have reviewed both the new Form 1511A to be used for 31 December 2005 year end audits and the notes from the 2 day workshop held in December 2005. If the Form is completed appropriately and the workshop content is put into practice this issue should be addressed. Due to the timing of the review and the timing of the new form and workshop we are not able to conclude on the application of these "reinforced" policies.

COMPLIANCE AUDIT

RECOMMENDATION 11 (MEDIUM PRIORITY): (ACCEPTED IN PART)

The Audit Office should develop and implement a continuous improvement cycle for its Compliance Audit programme to enable the efficiency and effectiveness of the programme to be determined. This continuous improvement program should ensure that an area subject to a Compliance Audit is followed up and reviewed again in the following financial year. The results of this continuous improvement cycle should be reported to Parliament.

AUDIT OFFICE RESPONSE (2003):

Accepted in part.

Conducting a follow-up review in the following financial year is too soon as compliance reports are not tabled until 5-6 months into that year. We believe our process of allowing central agencies time to write new policies or legislation and agencies time to adopt them and put them into practice with a subsequent follow-up review by the Audit Office is more appropriate.

AUDIT OFFICE ACTION TO DATE/CURRENT STATUS:

The Office's Financial Audit Executive annually reviews its compliance programme with a view to improving its efficiency and effectiveness.

We still do not accept that every compliance review should be followed up. Given the resources that we are able to devote to compliance reviews, we assess the inherent risks in each possible area for review and the benefits to be gained from each review, whether new or follow-up. The program that we then determine is the mix of new and follow-up reviews that maximises value from our available resources.

Having said that, most significant issues that have been subject to a compliance review are reviewed again subsequently.

For example, the 2003-04 Compliance Audit programme included a Trust Accounts (follow-up of the 1999 review), GST (follow-up of the 2001 review), and Public Sector Employment and Management Act (follow-up of the 2000 review). The 2004-05 program included the use of credit cards (follow-up of the 2001 review). The 2005-06 program includes Fines and Penalties (follow-up of the 2001 review).

CURRENT REVIEW TEAM'S ANALYSIS OF ACTION TAKEN BY THE AUDIT OFFICE:

The Review Team concurs with the follow-up comments of the New South Wales Audit Office and believes the Office has taken satisfactory action in response to the previous Reviewer's recommendation.

RECOMMENDATION 12 (HIGH PRIORITY)

The Audit Office should track the costs of each compliance review to assist in assessing cost/benefit. This would also assist in the planning for reviews by budgeting for proposed reviews to assess where resources would best be spent under the risk assessment framework.

AUDIT OFFICE RESPONSE (2003):

Accepted.

However, costs of compliance reviews at the agency level are already monitored by each of the audit teams.

AUDIT OFFICE ACTION TO DATE/CURRENT STATUS:

The Office has now established specific costing codes in our practice management system for each compliance review. This will allow us to monitor the individual cost of each compliance review, by agency and in total. Our new Practice Management System, planned for implementation in late 2006, will give us greater capacity to monitor and analyse costs of these reviews.

CURRENT REVIEW TEAM'S ANALYSIS OF ACTION TAKEN BY THE AUDIT OFFICE:

The Review Team notes the follow-up comments of the New South Wales Audit Office. It is noted that for the financial year ended 30 June 2005, there was one code in TOPS that time spent on Compliance Audits could be charged to. This meant that where multiple Compliance Audits were conducted in an Agency, it was not possible to separate out the individual costs of each Compliance Audit. However, whilst noting this, the overall costs of conducting Compliance Audits would have been materially correct overall.

It is noted that for the financial year ended 30 June 2006, separate codes for each Compliance Audit have been created in TOPS. This will allow the New South Wales Audit Office to identify the costs of Compliance Audits on a global and individual basis.

The Review Team believes that satisfactory action has been taken by the New South Wales Audit Office in relation to the previous Reviewer's recommendation.

PERFORMANCE AUDIT**RECOMMENDATION 18 (HIGH PRIORITY)**

Detailed context specific audit objectives be formulated and reported for each audit in lieu of generic objectives.

AUDIT OFFICE RESPONSE (2003):

Accepted.

AUDIT OFFICE ACTION TO DATE/CURRENT STATUS:

Generic objectives are no longer used.

As is fairly common in Performance Audit reports globally, our overall audit objective used to be expressed in a form such as "the audit will examine the effectiveness, efficiency and economy of ...".

Instead, our overall audit objective is now expressed in terms of the specific issue or activity that we are seeking to form an opinion about, and the performance aspect/s of those issues/activities that we are focusing on.

During 2004 and 2005 Performance Audit Branch experimented with a variety of forms for doing this. The results were reviewed by Branch management and an agreed approach determined. This has been documented in a guidance paper for our staff, which has also been codified into our ISO 9001 Guidance Note and a new Reporting Style Guide. PAB staff have been briefed in detail on the changes to both of these reference sources.

CURRENT REVIEW TEAM'S ANALYSIS OF ACTION TAKEN BY THE AUDIT OFFICE:

The Review Team notes the follow-up comments of the New South Wales Audit Office. The Performance Audit methodology has been revised during the last twelve months and now requires specific audit objectives, known as 'lines of inquiry' to be used. The stated aim of this new approach is to help the Performance Audit Branch to reduce over auditing and cost overruns, and to clarify for audit clients what the audit will achieve.²¹

As previously mentioned in this Report, detailed analysis of five Performance Audits were undertaken as part of this Review.

²¹ New South Wales Audit Office, Annual Report 2005, Page 39.

Of these five Performance Audits, one was conducted under the old Performance Audit methodology and four under the new Performance Audit methodology. The Review Team noted that the stated objectives for the Audit conducted utilising the old methodology were generic, rather than specific. However, all four Performance Audits conducted utilising the new methodology complied with the 'lines of inquiry' approach, with audit objectives that were specific. These audit objectives remained consistent from the planning stage through to the final report.

The Review Team is satisfied that the Audit Office has satisfactorily implemented the recommendation of the previous Reviewer.

RECOMMENDATION 19 (HIGH PRIORITY)

The statement of audit objectives accurately reflects the aspects of the mandate dealt with in the audit report.

AUDIT OFFICE RESPONSE (2003):

Accepted.

AUDIT OFFICE ACTION TO DATE/CURRENT STATUS:

As agreed, processes have been introduced to ensure that the aspects of performance dealt with in the report are directly linked to the overall audit objective. Refer also to comments under Recommendation 18.

CURRENT REVIEW TEAM'S ANALYSIS OF ACTION TAKEN BY THE AUDIT OFFICE:

Based on our response to Recommendation 18, the Review Team is satisfied that the Audit Office has satisfactorily implemented the recommendation of the previous Reviewer.

COSTS AND CHARGES

RECOMMENDATION 57 (HIGH PRIORITY)

Under consultation with the Public Accounts Committee, the Auditor-General should prepare a funding paper to be presented to the Department of Treasury seeking full funding for the costs of the Compliance and Performance Audit Programs.

AUDIT OFFICE RESPONSE (2003):

Accepted in part.

The Office has previously initiated discussions with Treasury regarding the level of funding for its Performance Audit programme, and has commenced a cost analysis.

We view Compliance Audits as part of the broader Financial Audit of agencies and as such their costs are recovered in the Financial Audit fee.

AUDIT OFFICE ACTION TO DATE/CURRENT STATUS:

The Auditor-General has raised the issue of full budget funding for Performance Audit with the Treasury Secretary who indicated in-principle agreement with the proposal. The Office has provided information to Treasury to support full Treasury funding of Performance Audit. We expect a decision on this matter shortly. If implemented, the new funding arrangements are expected to start on 1 July 2006.

CURRENT REVIEW TEAM'S ANALYSIS OF ACTION TAKEN BY THE AUDIT OFFICE:

We have reviewed the response from the NSW Audit Office in respect of action to date and current status. We have also met with the Deputy Secretary, Resources and Budget, NSW Treasury and confirm that the response from the New South Wales Audit Office is consistent with his understanding of the current position although he was not able to confirm the anticipated quantum of Treasury funding.

OUTSOURCING

RECOMMENDATION 64 (HIGH PRIORITY): (ACCEPTED IN PART)

It should be required that a formal assessment of the outsourced providers work is undertaken by completing of the "Contract Audit Agent Annual Performance Evaluation" and the "Client Feedback on Performance by Contract Audit Agents" each financial year at the completion of the audit process.

AUDIT OFFICE RESPONSE (2003):

Accepted in part.

This is already undertaken for individual audits. This will now be consolidated annually.

AUDIT OFFICE ACTION TO DATE/CURRENT STATUS:

An annual review of the performance of the contract audit agents is performed by the relevant Business Team Leader responsible for the client audit. In addition clients are asked to review the performance of the contract agents and provide the Audit Office with their assessments. Client feedback is now requested annually by the contracting out task force.

The December 2004 and June 2005 reviews have been delayed by the lack of response from a number of clients (mainly Rural Land Protection Boards).

Any poor ratings identified by our clients are discussed with the contractors and if need be noted on our register for future action.

CURRENT REVIEW TEAM'S ANALYSIS OF ACTION TAKEN BY THE AUDIT OFFICE:

We have reviewed the response from the NSW Audit Office in respect of action to date and current status and confirm that the response is valid. Two outsourced Financial Audits were selected for review under our scope and the feedback provided by the clients in respect of these Audits is consistent with the "Contract Audit Agent Annual Performance Evaluation" and the "Client Feedback on Performance by Contract Audit Agents" forms completed and reviewed in respect of the financial year ended 30 June 2005.

RECOMMENDATION 66 (HIGH PRIORITY)

It is recommended that the rationale for rotation and the reasons for rotation of individual Audit clients be clearly documented, retained in Audit Office databases and reported to the senior management for review by the Contracting out Taskforce.

AUDIT OFFICE RESPONSE (2003):

Accepted.

A database of possible outsourced audit clients is now maintained which records full particulars on current and potential audit service providers. The database will in future provide full reasons for rotation of clients as well as particulars on partner/manager engagement periods. Periodic review of the database by the Task Force should ensure that audit partner rotation etc is appropriate.

AUDIT OFFICE ACTION TO DATE/CURRENT STATUS:

The rationale for the contracting out of audit clients has been documented and the database of clients has been established. Both have been recorded in TRIM.

Each year the Office assesses the portfolio and database to determine which clients should be contracted out in the next cycle.

Partner involvement is looked at as part of the tender process. Where a firm is appointed for a second term (in specialist industries such as superannuation), the task force ensure that there is a rotation of the partner.

CURRENT REVIEW TEAM'S ANALYSIS OF ACTION TAKEN BY THE AUDIT OFFICE:

We have reviewed the response from the NSW Audit Office in respect of action to date and current status and confirm that the response is valid.

RECOMMENDATION 67 (HIGH PRIORITY): (ACCEPTED IN PART)

As part of its continuous improvement process the Audit Office should review and expand the nature and detail of its performance indicators, given the outcome of our analysis above.

AUDIT OFFICE RESPONSE (2003):

Accepted in part.

We support the concept of greater accountability and will continue to review our performance indicators and expand as appropriate.

We already review what other Audit Offices report and are working with them to make published indicators more comparable.

AUDIT OFFICE ACTION TO DATE/CURRENT STATUS:

The Office's performance indicators are reviewed annually as part of our strategic planning process. Performance against these indicators is subsequently included in the Office's Annual Report.

Since the last triennial review, the Office has significantly enhanced the indicators used and published. The NSW Audit Office has also been an active partner in a range of benchmarking initiatives through the ACAG process. These include common core questions in parliamentarian and audit client opinion surveys now being carried out by most Australian audit offices.

In addition a work group has been established to review internal performance and operational indicators for Financial Audit business teams.

CURRENT REVIEW TEAM'S ANALYSIS OF ACTION TAKEN BY THE AUDIT OFFICE:

The Annual Reports for the New South Wales Audit Office for years ended 30 June 2003, 2004 and 2005 were reviewed. The performance indicators included in the Annual Reports reviewed have been expanded significantly in each Annual Report subsequent to the previous review.

QUALITY ASSURANCE

RECOMMENDATION 70 (HIGH PRIORITY)

Review of QARC operation and resourcing be finalised as soon as possible and the Practice Manual be updated accordingly.

AUDIT OFFICE RESPONSE (2003):

Accepted.

The review of QARC's operation and resourcing is one aspect of a more comprehensive review of the quality assurance framework throughout the Office.

AUDIT OFFICE ACTION TO DATE/CURRENT STATUS:

A review of the quality assurance processes is underway as part of the overall review of a QA framework. The overall Quality Assurance Framework is planned to go to the Board of Management in April 2006.

A new Quality Control Process has been implemented to meet the "monitoring" requirements of AUS 206 and APS 4/5. The Deputy Auditor-General now has overall responsibility for the process. Launch of the process was preceded by a comprehensive peer review by the Queensland Audit Office in 2005. The process is supported by enhanced inspection checklists addressing audit effectiveness and efficiency.

CURRENT REVIEW TEAM'S ANALYSIS OF ACTION TAKEN BY THE AUDIT OFFICE:

An adequate QARC/QC process has been implemented since the previous review although it is important to recognise that the operation and resourcing of any QARC/QC should be subject to a continuous improvement process. Whilst the "current" QARC (as at the time of Previous Review) has been "finalised" the QARC/QC process can never be "finalised" as previously recommended as it is subject to continuous improvement.

The continuous improvement process also needs to address changes in legislative and professional requirements, for example the new and updated requirements of AUS 206 'Quality Control for Audit Work'²², APS 4 'Statement of Quality Control Standard'²³ and APS 5 'Quality Control Policies and Procedure'²⁴.

The current QARC/QC policy requires the Top 50 clients and selected other Financial Audits to be reviewed by another Assistant Auditor-General or Engagement Controller. The reviewer for each file is recorded together with the specific review requirements of the quality reviewer. The implementation of the QARC was evidenced during our examination of the selected Financial Audit files. Monitoring procedures also appear adequate to comply with the new monitoring requirements as discussed above.

We are satisfied with the efforts of the NSW Audit Office in response to the recommendations of the Previous Reviewer.

²² Auditing Standard 206, Quality Control for Audit Work, issued by the Australian Accounting Research Foundation on behalf of CPA Australia and the Institute of Chartered Accountants in Australia, July 2002.

²³ APS 4, Statement of Quality Control Standard, issued by the Institute of Chartered Accountants and CPA Australia, May 1982

²⁴ APS 5, Quality Control Policies and Procedure, issued by the Institute of Chartered Accountants and CPA Australia, May 1982

RECOMMENDATION 75 (HIGH PRIORITY)

The review of QARC terms need to ensure there is a continuous improvement cycle whereby we could see recommendations flowing out of QA reviews, a management plan as to how the recommendations are going to be implemented and then a follow up QA review that assesses whether recommendations have been satisfactorily implemented and whether there has therefore been improvement.

This process should ideally be reported through the Audit Committee.

AUDIT OFFICE RESPONSE (2003):

Accepted.

AUDIT OFFICE ACTION TO DATE/CURRENT STATUS:

The new QC Process embraces the continuous improvement concept that was included in the old QARC process through follow-up QA reviews for any issues or deficiencies detected that may be systemic or part of a trend.

The results of the QC Process are reported to the Financial Audit Executive to ensure any necessary remedial action has been taken. Any issues raised are discussed at the Audit practice workshop to ensure all Business team leaders and Audit Leaders are aware of them. Subsequent QC reviews look to see that such actions have been implemented.

CURRENT REVIEW TEAM'S ANALYSIS OF ACTION TAKEN BY THE AUDIT OFFICE:

Refer to our analysis in respect of Previous Review Recommendation 70 above.

We are satisfied with the efforts of the NSW Audit Office in response to the recommendations of the Previous Reviewer.

REPORTING TO PARLIAMENT – EFFICIENCY**RECOMMENDATION 78 (MEDIUM PRIORITY): (ACCEPTED IN PART)**

Subsequent to legislative backing, the Auditor-General facilitate establishment of a high level Committee with the Department of Treasury and the Premiers Department that has the aim of establishing a clear and concise framework for the use of key performance indicators and benchmarking data within Department and Agency Annual Reports. As a result of this process the Auditor-General should undertake high level workshops with Departments and Agencies to assist them in understanding how to set effective quantitative and qualitative performance indicators and how to undertake appropriate benchmarking of their activities. Once this framework has been established the Auditor-General should provide comment and opinion on the key performance indicators and benchmarking data within Department and Agency Annual Reports in his Annual Report to Parliament.

AUDIT OFFICE RESPONSE (2003):

Accepted in part.

We have already raised the need for a performance indicator framework in at least three reports to Parliament and have written to the Premier twice on this matter.

We would be fully prepared to assist the central agencies on this issue but responsibility lies clearly with Executive Government.

If the framework is established and the Auditor-General given the mandate to audit performance indicators, then our Reports to Parliament would include the type of comments suggested by the Reviewer.

AUDIT OFFICE ACTION TO DATE/CURRENT STATUS:

As indicated in the recommendation, progress depends on the Government introducing legislation to provide this wider mandate.

The Auditor-General and the Audit Office have continued to raise this issue with Government. The Auditor-General met with Treasurer Egan and the heads of Treasury, Premier's Department and Cabinet Office in 2004 to pursue the issue. He met with Treasurer Refshauge in early 2005 and Premier and Treasurer Iemma in late 2005 to argue for the wider mandate.

In Volume Three of the Auditor-General's 2005 Report, the Auditor-General again raised the issue of the need for the Government to provide whole-of-government performance reporting and recommended the identification of key outcomes, development of a suite of performance indicators and annual reporting on them. In addition in the Office's Annual Report for 2005, the Auditor-General re-iterated the same recommendations.

While there has been no agreement by Government to the Auditor-General's proposals, the Premier announced his commitment in December 2005 to a new "Performance Management and Budget System". This may provide a basis for enhanced performance reporting. The Audit Office will continue to pursue this issue.

CURRENT REVIEW TEAM'S ANALYSIS OF ACTION TAKEN BY THE AUDIT OFFICE:

We conclude that there has been little progress in this area since the previous review. Where possible we have confirmed the validity of the response through sighting the relevant publications. Any further action by the New South Wales Audit Office continues to be dependent on legislative backing.