REVIEW OF

THE AUDIT OFFICE OF NSW

UNDER SECTION 48A

OF THE

PUBLIC FINANCE AND AUDIT ACT 1983

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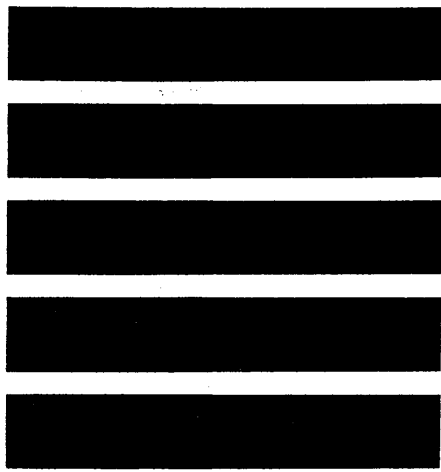# KEY DOCUMENTS

VOLUME 2

REPORTS FROM CONSULTANTS
FULL TEXT

PUBLIC ACCOUNTS
COMMITTEE

Review of the Audit Office of
New South Wales

The Conduct of Financial Audits

October 1995

ERNST & YOUNG

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Appendices

1   Executive Summary

1.1   Conclusion

We have reviewed the conduct of financial audits by the Audit Office of New South Wales in accordance with the requirements of the Public Accounts Committee.

Based on our Review, we advise that:

- the audit methodology practices and procedures being applied by the Audit Office meet the requirements of the Public Finance and Audit Act 1983, and satisfy Australian Auditing Standards and related professional pronouncements;

- audit opinions issued by the Audit Office are supported by:
  - adequate plans and workpapers;
  - appropriate audit evidence; and
  - appropriate quality control procedures; and
  are reported in accordance with the statutory responsibility of the Auditor-General.

While the Audit Office's financial auditing processes meet professional and technical requirements, there is potential for achieving improved audit efficiency and effectiveness, in the short term through:

- improved Client Engagement processes;

- better integration of Information System audit and financial audit planning processes;

- closer linkage in planning to agency internal audit activity;

- strengthening the use of professional audit judgement in determining the extent of audit testing; and

- re-focusing quality assurance procedures in practice so as to better achieve continuous improvement and best practice across the Audit Office.

In the medium term we believe it is important that the Audit Office respond to sound contemporary benchmarks in audit methodology enabling financial auditing to better meet auditee business needs and risks. This means, in particular, initiating developmental work on:

- adopting a continuous audit methodology; and

- re-focussing auditing activity to give greater emphasis to value adding as an integral element of audit activity.

Such developmental activity is necessary to ensure the Audit Office stays abreast of "best practices" and hence, delivery of best value for money.

1.2 Recommendations

The Report contains a number of recommendations for improving Audit Office methodologies, processes and practices. For ease of reference, these recommendations (identified by the Section of the Report to which they relate) are listed below.

Recommendation (Section 3.5)

That the Audit Office review existing practices for determining acceptable confidence levels against the background of developments in the large Accounting Firms, so as to promote effective exercise of audit judgement and efficient audit conduct.

Recommendation (Section 3.5)

That the Audit Office pursue as a priority its stated intention to recommend to the Auditor-General that inherent risk assessments be limited to significant account areas. In formulating its revised policy, the Audit Office should note the following: Inherent risk assessments should be performed for significant account areas taking into account the related business and audit risk of the client.

Recommendation (Section 4.4)

That the Audit Office strengthen its processes for ensuring that required review processes and their complete documentation be undertaken in accordance with Audit Office Guidelines.

Recommendation (Section 4.6)

That the Audit Office upgrade its planning processes to take account of the review observations in relation to:

* planning meetings;
* documentation of significant accounting and auditing issues; and
* identifying value adding initiatives.

Recommendation (Section 4.9)

That Audit Office audit documentation identify the need to consider compliance requirements associated with all legislation relevant to the audit.

Recommendation (Section 4.9)

That the Audit Office ensure that effective processes are applied in implementing its Policy Statement 95/19 on the use of Client Service Reports, to ensure client value is delivered.

Recommendation (Section 7)

That the Audit Office seek to increase its liaison with agency internal audit groups to ensure maximum coordination between respective audit programs, and overall, greatest value for money to clients.

Recommendation (Section 8.1)

That 'best practice' outcomes of Quality Audit Review Committee reviews be presented to all levels of staff to best promote continuous improvement.

Recommendation (Section 9.2)

That the Audit Office initiate changes to its audit methodology to enable a stronger focus to be placed in the audit process on value adding by better understanding client business needs and addressing key business issues.

Recommendation (Section 10.3)

That the Audit Office initiate research into the adoption of a continuous audit approach to its financial auditing.

2   Introduction

2.1   Background

The Audit Office of New South Wales (the Audit Office) conducts a substantial financial audit practice. In excess of 400 organisations and activities are subject to financial audit with fees income in the order of $15 million per annum.

The Public Finance and Audit Act 1983 (the Act) governs public sector financial administration and audit in NSW. It extends to both NSW Government departments and statutory bodies. Section 34 of the Act prescribes the primary duties of the Auditor-General:

> *"the Auditor-General shall audit the Public Accounts and such other accounts as*
> *the Auditor-General is authorised or required to audit in such a manner as the*
> *Auditor-General thinks fit having regard to the character and effectiveness of the*
> *relevant internal control and recognised standards and practices"*

As part of its three yearly review of the operations of the Audit Office of New South Wales, the Public Accounts Committee (the Committee) has engaged Ernst & Young to review and provide a report on the conduct of financial audits by the Audit Office. In terms of Clause 48A(1)(2) of the Act the purpose of the review is as follows:

> *"The review is to examine the auditing practice standards of the Auditor-*
> *General and to determine whether the Auditor-General is complying with those*
> *practices and standards in the carrying out the Auditor-General's functions*
> *under this Act"*

In developing an approach to the conduct of this review, we recognised that it needs to give the Committee assurance that:

*   the Audit Office is applying methodologies and audit management processes consistent with contemporary best practices in financial auditing;

*   the conduct of financial statements audits by the Audit Office is efficient, economical and effective; and

*   the Audit Office financial audits adopt a "value adding" dimension going beyond a simple "attest" opinion to offering advice and comment on the quality of audited business/ operational processes.

To provide this assurance to the Committee, our review has included broad comparisons of Audit Office methodologies with 'best practices' applying in the major Accounting Firms. Benchmarking in this way ensures that Audit Office practice is examined in the context of best alternative approaches.

2.2 Review Objectives

Against the background of the Act and our assessment of the Committee's requirements, we have defined the audit objectives as to:

- examine the adequacy and appropriateness of the methodology, practices and procedures of the Audit Office;

- determine the extent to which the audit opinions issued by the Audit Office comply with applicable operational standards and practices and in particular that they are:
  - supported by adequate plans and workpapers;
  - supported by appropriate audit evidence involving tests and other procedures;
  - supported appropriate quality control procedures; and
  - reported in accordance with the statutory responsibility of the Auditor-General.

In the context of the review and without limiting its scope, attention was also to be given to:

- the effectiveness of the planning and co-ordination of the financial audit, having regard to internal audit and technology;

- the extent to which the Auditor-General can add value to the financial audit process; and

- the efficiency of the financial audit process.

2.3 Methodology

The review adopted in this review comprised the following key phases.

Phase 1   Project Initiation

Meetings and discussions were held with representatives of the Committee and the Audit Office to:

- clarify the Review's objectives and scope;
- obtain an overview of the Audit Office's functions and future direction;
- co-ordinate and clarify roles with conjoint consultants; and
- collect preliminary information.

Phase 2   Data Collection And Analysis

In the context of the audit objectives and the areas of assurance required by the Committee, we undertook a detailed examination of the extent to which policies, procedures and practices relating to the conduct of financial audits had been developed, were sound and were implemented.

This key phase of the review included the following activities:

- review of the Audit Office's Policy and Procedures Guidelines for the conduct of financial audits;

- review of relevant legislation and operational standards;

- examinations of selected audits and related working papers (refer Appendix A);

- interviews and conducting a workshop with relevant Audit Office staff (refer Appendix B);

- discussions with selected Audit Office clients (refer Appendix C); and

- meetings with conjoint consultants.

Phase 3   Recommendations And Reporting

At the conclusion of our data collection and analysis, we discussed preliminary findings with the Committee and the Audit Office, and provided a draft report for comment prior to report finalisation.

3   Review Of The Policy & Procedure Guidelines

3.1   Introduction

The Policy & Procedure Guidelines (the Guidelines) were revised and reissued in April 1995. The Guidelines provide guidance to auditors on the conduct of financial audits in accordance with the Public Finance and Audit Act 1983. The Guidelines provide a general framework for financial auditing practices and approaches, and in addition specify Audit Office policies and procedures.

The Guidelines draw on practices and methodologies in financial auditing both in Australia and the United Kingdom. They represent a significant achievement in bringing together information on financial audit approaches for reference by Audit Office staff.

The current structure of the Guidelines is in four parts:

- Part I   The Public Sector Audit Environment;
- Part II   The Attest Audit Process;
- Part III   The Performance Audit Process; and
- Part IV   Client Service.

Parts I, II and III are relevant to this review.

3.2   Description Of The Financial Audit Methodology

A Risk Based Audit methodology approach (RBA) is adopted by the Audit Office. The key elements of the RBA methodology are described in Appendix D together with the audit planning framework adopted by the Audit Office.

Overall, the RBA methodology applied by the Audit Office encompasses the following broad phases:

- planning, familiarisation and preliminary consideration of factors which may have an impact on the conduct of the audit;

- identification and assessment of internal controls and the overall control environment which exists at the audit client level. This process involves completion of:
    - Form 134 - *Preliminary Systems Evaluation Overall Control Environment*;
    - Form 130 - *High Level General Control Review* by the ISA staff; and
    - Form 130E - *Preliminary Computer Systems Examination;*

- assessment of inherent risk for the entity as a whole (Part 3 of Form 112) as well as an assessment of the impact of the Government-wide review of controls and risks on the entity;

- assessment of inherent risk for each account area. This process involves completion of Form 136 - *Inherent Risk Assessment*;

- updating the principal features of the client's financial systems for each account area, and an overall description showing the interaction of those systems. This process is known as *Outline Systems Descriptions (OSD);*

- Preliminary System Examination (PSE - Form 135) will be prepared for each account area and then if it is anticipated that reliance will be placed on the system, a detailed examination and evaluation of the system will be performed;

- where the system is computerised, Form 131 - *Preliminary Computer Systems Evaluation* (PCSE) is completed prior to completing Form 135A to J - *Key Controls Questionnaires*;

- based on the degree of reliance which is expected to be obtained from the assessment of inherent risk and the evaluation of internal controls, the audit approach is determined. This may involve:
  - Direct Substantive Testing (DST); or
  - Systems Based Approach (SBA) combined with a reduced level of DST; and

- the audit approach may require modification depending on the results of compliance testing and the emergence of other factors affecting risk assessment.

3.3   Use of the Risk Based Audit Methodology

We endorse the Audit Office's use of the Risk Based Audit methodology in the audit of financial statements. We believe that the RBA approach is consistent with good auditing practice and its application provides a basis for addressing the differing levels of risk associated with each account area.

In recent years, there have been significant changes in the range of forms of public sector organisations, including increased use of statutory authorities, companies and joint ventures to carry out specific functions. These changes have had consequential effects on public sector auditing in that they have given rise to the need for public sector financial audits to address complex and technical issues previously confined to private sector operations. With these issues can go increased risk. We consider that the RBA approach allows Audit Office staff to react positively to the environment in which they are auditing and to address the varying degrees of risk involved.

3.4   Application Of The RBA Methodology By The Audit Office

In our view the RBA model applied by the Audit Office meets the test of an effective risk based audit methodology. In reaching this view, we reviewed selected account areas from the following Audit Office client files. These were selected because we considered that they were a sufficient test of the Audit Office's application of the RBA.

Audit Office Client	Account Area Reviewed
Sydney Electricity	Inventories
Police Service of NSW	Traffic Penalty Collections

Our review of the account areas selected disclosed:

• appropriate risk assessments were performed in accordance with the RBA methodology;

• risk assessments covering both inherent and control risk;

• a preliminary system examination was conducted to assess the adequacy of internal controls and the degree of reliance which could be placed on them by Audit Office auditors;

• all the required forms of the Audit Office model were duly completed;

• depending on the assurance derived from the evaluation of:
    - inherent risk;
    - control risk; and
    - analytical review procedures,
    a confidence level based on the Assurance Guide contained in the Guidelines was established for DST;

• the sample size for DST was established; and

• audit programs/procedures which were responsive to inherent and control risk were developed and performed.

3.5 Our Assessment Of The Application of the Risk Based Audit Methodology

The Review identified a number of issues as follows.

3.5.1 A "Form Driven" Approach

Observations

Audit Office current audit methodology requires staff to complete numerous forms. A listing of the forms are contained in Appendix F. Whilst we acknowledge that these forms represent a management control tool and source of guidance to staff in relation to risk assessment, we believe that the completion of these forms is onerous and time consuming and may reduce the efficiency of the audit. Our observation was confirmed by field auditors at the workshop where the following comments were noted:

• there is significant consumption of time in the preparation of the forms. In particular where there is a revision of these forms the whole process of completing the new forms has to be completed; and

• if forms are not used the reasons for such actions are to be documented

Steps Taken By The Audit Office

The significant amount of time and the resources required in completing the required forms was acknowledged by several Directors and also at the workshop held with field auditors. However, senior policy and research staff of the Audit Office observed that the RBA methodology does provide wide scope for financial auditors to apply professional judgements so as to ensure the economy, efficiency and cost-effectiveness of financial audits.

Audit Policy Statement 95/22 requires all RBA forms to be used only on large audits (those with fees greater than $25,000). Part II Section 9 of the Guidelines provides guidance to auditors on use of a modified approach for smaller audits.

> " For the purpose of this modified approach, a small organisation is one where the audit would normally take less than 30 days, or where the Engagement Controller decides at the planning stage that an audit is 'small' and suitable for this approach. "

In exercising this flexibility, the application of professional judgement by Engagement Controllers and Senior Audit Managers is critical. Our review of selected audit files indicated that professional judgements had been duly exercised by senior audit personnel, and documented in the Audit Plans. This was also evident from our discussions with Engagement Controllers and Senior Audit Managers.

Comment

While recognising the value of applying the "30 days" criteria adopted in the Guidelines to test whether reduced documentation can be accepted, it is equally important for small agencies that risk be adequately considered by Audit Office staff during the planning phase.

3.5.2   95% Confidence Level

Observations

Auditors must develop a sufficient level of assurance that they have reached the correct conclusions on the financial statements. For the Audit Office, this assurance level has been set at 95% confidence, or conversely an audit risk of 5% that an incorrect conclusion will have been reached. This is the level of risk that the Auditor-General is willing to accept.

The following issues of Audit Office practice are noted:

- the use of a 95% confidence level by the Audit Office contrasts with contemporary audit practices. The majority of the major Accounting Firms are moving away from this benchmark and placing a greater emphasis on the informed exercise of professional judgement in reaching audit conclusions, taking into account an assessment of the risk, materiality and nature of the account under review;

- the practicality and efficiency of applying DST with a 95% confidence level for a large department. To achieve this degree of assurance, a high volume of transactions may need to be tested by the Audit Office.

The above issues were discussed with senior management who indicated that the RBA methodology is a flexible audit tool. Subject to the degree of reliance which is expected to be obtained from the assessment of inherent risk and the evaluation of internal controls, the confidence level can be reduced accordingly.

The Audit Office also advised that in addition to transactions testing, Audit Office policy and practice includes the use of analytic review procedures, reliance on the work of internal audit and reliance on controls. This may mean that under some circumstances a low level of transactions testing (including **no** transactions testing at all in some cases) may be performed in major account areas. (Section 6 of Part II of the Audit Office Policy and Procedures Guidelines refers.)

We note that the exercise of sound professional judgement and the use of effective planning procedures are key success factors in determining an acceptable confidence level for assurance purposes and that also is consistent with efficient audit conduct.

Steps Taken By The Audit Office

To ensure that the financial audit is carried out efficiently it is essential that auditors are not unduly risk averse, as this may result in unnecessarily high sample sizes. In this regard, we were advised that improved management and planning of audit processes have strengthened the Audit Office's disciplined approach in determining appropriate confidence levels.

Recommendation

That the Audit Office review existing practices for determining acceptable confidence levels against the background of developments in the large Accounting Firms, so as to promote effective exercise of audit judgement and efficient audit conduct.

3.5.3   Identification Of Significant Account Areas

Observations

We note that inherent risk assessment is performed for all account areas. Whilst it is essential that a sufficient risk assessment is carried out for all significant account areas, there is a question whether current Audit Office procedures are being applied more extensively than is needed, taking into account:

*   the impact on the overall efficiency of the financial audit including the documentation of risk assessments; and

*   the ensuing benefits arising from this risk analysis, in particular for low risk account areas.

Steps Taken By The Audit Office

The current practice to evaluate inherent risk for all account areas is being reviewed by the Audit Office Audit Methodology Committee. We understand that it is the intention of this Committee to make a recommendation to the Auditor-General that inherent risk assessments be limited to significant account areas. We support such an initiative, and it would be consistent with contemporary audit practice of the major Accounting Firms.

Recommendation

That the Audit Office pursue as a priority its stated intention to recommend to the Auditor-General that inherent risk assessments be limited to significant account areas. In formulating its revised policy, the Audit Office should note the following: Inherent risk assessments should be performed for significant account areas taking into account the related business and audit risk of the client.

3.5.4 Type Of Risk Consideration

Observations

One of the responsibilities of the Auditor-General is to ensure that the financial statements are presented fairly and comply with legislation. In addition, the Auditor-General must ensure that there is sound management and proper accountability for public funds.

We believe that there is a direct relationship between these responsibilities and the expectations of the Public Accounts Committee. There is the potential for greater emphasis to be placed in risk analysis on addressing accountability/probity risk of the client.

Steps Taken By The Audit Office

In accordance with contemporary best practices in financial auditing, there is a strong need for the Audit Office to merge both risk perspectives into its methodology. The Audit Office concurs with this view and advises that action is being taken to emphasise the need for both accountability and business risk to be addressed in Audit Office client risk assessments.

3.6 Other General Observations

The following observations were noted.

3.6.1 UIG Consensus View

The Urgent Issues Group (UIG) was recently established to provide timely guidance on urgent financial reporting issues which are not specifically dealt with in Accounting Standards. The guidance is given in the form of a UIG Consensus View which has been given the same authority as an Accounting Standard. During the course of the audit we noted the need for Audit Office Guidelines to be updated to recognise the authority of UIG Consensus Views.

Steps Taken By The Audit Office

The Audit Office Practice Statement 95/11 of 18 July 1995 and 95/22 of 22 August 1995 established as policy the immediate reference to "other mandatory professional reporting requirements (Urgent Issues Group Consensus Views)" in all audit opinions (independent audit reports), engagement letters, client service plans and outgoing audit reports.

4 Compliance With Professional Auditing Standards And Legislative Requirements

Our review focused on the Auditor-General's responsibility for forming and expressing an opinion on financial information, as required by the Public Finance and Audit Act 1983 and other enabling legislation. We sought to ascertain whether the conduct and reporting of financial statement audits complied with the Act and satisfied Professional Auditing Standards.

The results of our review indicate that the methodology applied by the Audit Office complies with the requirements of the Act and the professional Auditing Standards and Practice.

In addition, we noted that the Audit Office has developed a code of conduct which establishes the principles of conduct expected to be observed by Audit Office staff.

4.1 Timing and Release of Client Engagement Letters

We noted that engagement letters are issued to clients for each audit assignment, defining the audit objectives and audit scope. Reference is made to statutory requirements and associated responsibilities. In addition, a detailed client service plan is issued which includes the Auditor-General's responsibilities, the objectives of the assignment and the audit approach. The issue of these letters is consistent with the practices of the major Accounting Firms.

The terms of reference which determine the audit scope are documented in the audit plan and specific reference is made to applicable legislation.

From our review of selected files (refer Appendix A), it appears that the scope is sufficient to enable an expression of an opinion on the financial information being audited.

4.2 Integrity, Objectivity And Independence

Staff are required to complete and sign independence declarations periodically. A review was undertaken by the Audit Office in March 1995 to ensure that all required declarations by staff were completed. No matters were noted which would indicate that these standards are compromised. From our discussions with Price Waterhouse no exceptions or issues were noted.

4.3 Skills And Competence

Based on our review of Audit Office files and working papers, and discussions with audit management and staff, we are satisfied that the financial statement audits reviewed were undertaken by appropriately skilled and competent staff. The Price Waterhouse review of the Audit Office Management of Human Resources identifies a number of ways in which the Audit Office can strengthen its processes for maintaining staff at required levels of knowledge, skill and experience.

We comment in Section 5 on the benefits accruing to the Audit Office from its policy of recruiting at the Engagement Controller level from the major Accounting Firms. We note also in Section 6 action being taken by the Audit Office to better integrate the use of financial and information system skills in audit planning processes.

4.4 Work Performed By Assistants

Audit Office procedures require that work delegated to assistants be reviewed by supervisors. In addition, the Engagement Controller and Audit Manager are required to review the planning documents and all supporting workpapers. The Engagement Reviewer is required to perform a high level review of the overall results.

From discussions with Audit Office staff, we understand that the review by the Engagement Reviewer has not always been performed.

Our review of files established that the review process is not always documented on the 'Aplus' working papers. Examples where workpapers are not evidenced as reviewed on 'Aplus' include:

- Police Service of NSW:
    - some Outline System Descriptions;
    - Preliminary Systems Evaluations;
    - leadsheets; and
    - management letter;

- WorkCover Statutory Schemes:
    - audit plan;
    - approval in principle;
    - audit completion checklist;
    - management letter;
    - recommendation to issue audit opinion; and
    - PF&A (Statutory Bodies) Regulation Checklist (F113D); and

- Coal and Oil Shale Mine Workers Compensation Subsidy Fund:
    - audit completion checklist.

All sign-off checklists appeared to be properly completed and reviewed. In addition, notwithstanding gaps in review sign-offs on the 'Aplus' working papers, most of the above documents and checklists were available in hardcopy and were approved.

Recommendation

That the Audit Office strengthen its processes for ensuring that required review processes and their complete documentation be undertaken in accordance with Audit Office Guidelines.

4.5 Documentation

Workpapers were documented on 'Aplus' with supporting manual workpapers where appropriate. From our review of selected workpaper files, documentation appears sufficient and relevant, providing audit evidence to support the conclusions reached.

4.6 Planning

An extensive planning process is applied by the Office which includes the completion of a detailed Audit Planning Package. The planning process addresses relevant and pertinent items for the effective conduct of the audit in accordance with the Office's risk based methodology. Our review indicated that this planning is undertaken in accordance with professional practice as required by the Statements of Auditing Practice (AUPs) and used by major Accounting Firms, and that all required documentation was completed where applicable.

We make the following additional observations.

- We noted a lack of audit planning meetings involving client and engagement staff. Formalising planning meetings are integral to the efficient conduct of the audit. We believe that client planning meetings ensure that issues which impact the audit are identified at the outset and in addition strengthens and builds on client relations. The results of such meetings should be documented and incorporated into the planning documents. In addition meetings with the engagement team should be held at the outset to ensure all staff are aware of the issues and the appropriate audit approach.

  We do note, however, that regular contact is maintained by the Audit Office with clients, particularly on larger assignments, which ensures that relevant issues and business developments are communicated in a timely manner.

- Our review indicated that relevant accounting and auditing issues were properly addressed during the conduct of the audit. However, we believe that more emphasis should be placed on documenting and reporting significant accounting and auditing issues. The Audit Plan should summarise these issues, together with the recommended accounting treatment where appropriate. In addition, consideration should be given to reporting the issues identified (together with the resolutions taken) to the client in a 'closing report' at the conclusion of the audit. This will ensure that key results of the audit are formally communicated to management or a Board, including the impact on the financial statements.

Consideration should also be given to incorporating value adding initiatives in the overall planning process. These could include:

- identifying client and stakeholder needs and critical success factors;
- gathering information on the client business and industry;
- performing a SWOT analysis; and
- identifying other opportunities to add value out of the audit process.

The Audit Office advised that its Guidelines make it clear that audit planning meetings are to be held with the client in developing the audit plan. The opportunity for client feedback or proposed audit coverage is also provided for in the annual Engagement Letter.

Recommendation

That the Audit Office upgrade its planning processes to take account of the review observations in relation to:

*   **planning meetings;**
*   **documentation of significant accounting and auditing issues; and**
*   **identifying value adding initiatives.**

4.7   Internal Control Structure

From the files reviewed and discussions and review of the Audit Office Policy and Procedures Guidelines, it was clear that the Audit Office developed, in its audits, an appropriate understanding of the overall control environment and the internal control structure applying. The Audit Office methodology requires documentation of this aspect of the audit on specified forms.

4.8   Adherence to Audit Programs

We assess adherence to audit programs as satisfactory. Based on our review of selected audit files, we noted that the conclusions and results of each audit procedure were specifically documented.

4.9   Audit Conclusions And Reporting

Conclusions drawn from each audit and forming the basis of the audit opinion are specifically reviewed by the Audit Office. The following checklists are used:

*   Audit completion checklists;
*   Statutory bodies checklists; and
*   Checklists for accrual based and modified accrual bodies.

Compliance with legislative requirements is addressed in the above mentioned checklists. In addition to legislative requirements addressed in these checklists there is often other legislation specific to the client. It is important that compliance aspects for all relevant legislation be considered. To assist in this regard consideration should be given to highlighting the key legislative requirements of the enabling legislation in the audit program guides. This will ensure that compliance is considered as part of the audit process and specifically documented.

The Audit Office advised that its Guidelines require auditors to give due consideration to the **primary legislation** of the client, which is defined as:

> *... any legislation specific to the audit client (ie the client's enabling legislation*
> *and/or the Appropriation Act) and the provisions of any other Acts and*
> *Regulations which could have a material impact on the financial statements*
> (Part II, Section 1 - paragraph 1.2).

As well, there is a comprehensive section of the Guidelines which sets out how auditors should approach the matter of compliance / regularity on an audit (Part II, Section 2 - Appendix 1).

However, the Audit Office agreed that extension of the mandate can be proposed. This is consistent with comment in the 1994 Report to Parliament, Volume 2, pages 39-42 where the Auditor-General said that compliance work undertaken as part of the financial audit "might not be as expansive as Parliament or the public assumes".

Recommendation

That Audit Office audit documentation identify the need to consider compliance requirements associated with all legislation relevant to the audit.

Management letters are issued which highlight significant internal control weaknesses or other matters of concern noted during an audit. During the course of the audit we observed that consideration needed be given to implementing an audit closing report which encompassed other value added information to the client.

Steps Taken By The Audit Office

Audit Office Policy Statement 95/19 of 22 August 1995 established as policy the use of a Client Service Report to improve communications between the Audit Office and clients on the results of audit and major matters impacting on the audit approach, findings and value added areas. This policy was established following a recommendation of the internal 1994-95 Methodology and Quality Assurance Task Force Team. It provides for mandatory Client Service Reports for all clients with an audit fee in excess of $25,000. For others the use of a Client Service Report is at the discretion of the Engagement Controller.

The Review notes that it will be important for the Audit Office to closely monitor the effective implementation of the revised policy.

Recommendation

That the Audit Office ensure that effective processes are applied in implementing its Policy Statement 95/19 on the use of Client Service Reports, to ensure full client value is delivered.

4.10 Qualified Audit Opinions

During the course of the review, we examined selected files, working papers and correspondence between the Auditor-General and clients supporting the issuance of qualified audit opinions on the financial statements for the year ended 30 June 1994 of:

* New South Wales Treasury Corporation; and
* Roads and Traffic Authority.

The substance of the qualification on the New South Wales Treasury Corporation financial statements was non compliance with Australian Accounting Standard AAS10 *Accounting for the Revaluation of Non Current Assets* arising from a direction of the Treasurer of New South Wales requiring market value accounting for the Corporation's financial assets and liabilities. This direction required a retroactive revaluation adjustment of the 30 June 1993 non current financial assets and General Reserve (retained earnings) and accounting for non current financial assets on a market value basis for the year ended 30 June 1994.

Other qualification matters resulted from this treatment involving the disclosure of comparative figures and operating revenues.

It was noted in the Opinion that the qualification was in essence a 'technical' qualification and lending support to a change in AAS10 to allow the treatment. Amendments have been subsequently made to AAS10 to facilitate the accounting treatment adopted by the Corporation with effect from the subsequent reporting period 30 June 1995.

The Roads and Traffic Authority qualification expressed disagreement with the nature of the asset and value of the Authority's interest in the Sydney Harbour Tunnel and the non recognition of Tunnel toll revenues. A further qualification concerned the non recognition of the liability in respect of the Ensured Revenue Stream Agreement between the Authority and the Sydney Harbour Tunnel Company in the 30 June 1993 financial statements and comparative figures in the 30 June 1994 financial statements.

Both of these qualifications have, prior and subsequent to their release, caused significant debate between the Audit Office, the clients and other interested parties. Similarly the technical accounting and legal issues surrounding the treatments adopted by the entities have been reviewed and commented upon by various accounting experts and other advisers supporting the alternative treatments adopted. It is not within the scope of our review to comment on these treatments and it is not professionally sound for us to comment on the form and content of the qualified audit reports issued.

The Review believes that the audit working papers evidence the following processes as having been undertaken prior to issuance of the qualified audit opinions:

•   internal and some external technical opinions were obtained and extensive consultation was undertaken by audit staff with technical support personnel canvassing the potential non compliances with accounting standards and concepts;

•   significant discussion with the clients and documentation of the alternative accounting treatments proposed by the clients and their advisers was prepared or considered by audit and technical support staff; and

•   discussions and documentation of the circumstances as to why qualification was the necessary outcome in accordance with Auditing Standards.

The Review considers that the level of documentation on the audit files adequately evidences the considerations and processes undertaken by the Audit Office in resolving the issue of the qualified audit opinions.

5 Understanding And Application Of Technical Accounting Requirements

5.1 Staffing Strategy

In recent years, the Auditor-General has recognised the need to build up a high quality, technically sound and professionally experienced workforce within the Audit Office. This strategy is critical given the inexperience of some financial auditors, and the increasingly complex and significant issues under review in financial audits. The efforts of the Auditor-General in this respect had been reflected by recruitment of senior financial audit personnel from the major Accounting Firms.

The staff recruited hold key project leadership roles (Engagement Controllers) and must participate in and/or interact closely with the financial audit team throughout the course of the audit. The wealth of skills, professional judgement and experience which they bring to the conduct of financial audits represents a significant benefit to the Audit Office and the client.

The Review believes that the above strategy will ensure that the Audit Office is well placed to address technical issues arising from the conduct of financial audits.

5.2 Policy Research And Management Branch

The Policy Research and Management Branch provides technical support and assistance to financial auditors. Requests for assistance are addressed according to the complexity of issues, and are often initiated by Engagement Controllers and Audit Managers. If specialised assistance (eg taxation issues) is required, external consultants can be utilised.

6 Liaison With Information Systems Audit

6.1 Observations

The Audit Office has recognised that there is a lack of integration in audit planning processes between financial auditors and information system auditors.

6.2 Steps Taken By The Audit Office

Since the appointment of the Director, Information System Audit (ISA) in December 1994, the Audit Office has taken steps to improve the integration of ISA and field audit for all financial statements audits. Some of the initiatives provide for:

- a more formalised approach to be adopted through involvement of IS auditors with financial statement auditors during the planning phase and on a timely basis;

- providing an initial assessment of whether the client's general and application controls are sufficiently strong for audit reliance to be placed on them;

- CAATs to form an integral part of the audit procedures for large clients; and

- feedback to clients on areas of IS weaknesses and significant IS related risks.

There was evidence to suggest a greater involvement of IS auditors in the planning of financial statements audits is now taking place. We believe that such an involvement takes better account of available resources and enhances the quality and efficiency of financial audits.

The Review supports the above initiatives undertaken by the Audit Office.

7   Use Of Internal Audit

Internal audit is a key management control and it is the Audit Office's policy that appropriate reliance be placed on the work of internal audit. Assessments are made of the internal audit function including:

- ensuring the scope of the work performed is relevant to the objectives of the audit;

- ensuring sufficient work and audit evidence is obtained to support the conclusions reached; and

- where appropriate, re-performance of the work of internal audit on a sample basis to ensure that reliance can be justified.

The use of internal audit is specifically addressed in the Office's methodology and our review of the files and discussions with a number of Engagement Controllers/Audit Managers indicate that staff are placing reliance on internal audit where appropriate.

An assessment of internal audit is undertaken during the following stages of the audit:

- planning stage - a preliminary assessment is made concerning whether reliance can be placed on internal audit having regard to the scope of the work performed, audit methodology, the audit plan and the competence and quality of staff. To facilitate this process, Form 143A (Internal Audit Assessment - Organisational Status, Resources and Planning) is completed;

- during the course of the audit - confirmation is obtained to support reliance on internal audit and where appropriate re-performance of internal audit work is undertaken; and

- end of financial period - a review is undertaken of the reports issued, work performed, audit coverage, quality control procedures and audit techniques. In this regard, Form 143B (Internal Audit Assessment - Review of Work Performance and Reporting) is completed. This assessment will be reviewed during the planning stage of the subsequent audit as an indicator for planned reliance in the following period.

Where it is clear at the outset that reliance on internal audit will not be possible (for example, where internal audit concentrates on management or operational issues and not financial issues), completion of the above mentioned forms is not required.

Reliance on internal audit as a management control can reduce the level of audit effort by the Audit Office through:

- reduced sample sizes - that is, by reducing the level of control risk in the Assurance Guide for calculating DST sample sizes; and/or

- completion of Audit Office programs as part of the Internal Audit function.

More involvement at the internal audit planning stage is encouraged to maximise benefits from internal audit reviews and the efficiencies obtained in the conduct of the audit.

The Audit Office recognises the efficiency gains available from the closest liaison with agency internal audit units. Amongst steps taken to improve liaison has been the introduction of training courses for internal auditors.

Recommendation

That the Audit Office seek to increase its liaison with agency internal audit groups to ensure maximum coordination between respective audit programs, and overall, greatest value for money to clients.

8 Effectiveness Of Processes For Supervision / Quality Control Of Both Audit Office Staff And Of Contract Auditors

8.1 Quality Control By Quality Audit Review Committee

8.1.1 Observations

A Quality Audit Review Committee (QARC) was established in July 1992. The existence and effective operation of a well defined quality assurance process is an important element of the Auditor-General's strategic management framework for the conduct of financial audits. An effective quality assurance mechanism is a key instrument for satisfying quality requirements as well as monitoring compliance with the Guidelines, policies, operational standards and practices.

Based on our discussions with representatives of the QARC, we noted the following:

• a set of instructions and checklists has been developed to provide guidance to QA reviewers;

• quality assurance reviews are carried out on a six monthly basis as follows:
  - first review - assessment and evaluation of audit plans and planning process; and
  - second review - assessment and evaluation of workpapers and conduct of the financial audit;

• meetings with the Engagement Controller and Audit Manager to discuss findings are conducted at the end of the review; and

• detailed reporting takes place to the Auditor-General. A summarised report is prepared and circulated to all Audit Office staff.

8.1.2 Assessment Of The QARC

The Review concluded that the quality assurance process, as observed in practice was limited to a review of compliance with existing Audit Office procedures. While this compliance focus is itself an essential component of an effective audit operation, it does not achieve all the objects of a comprehensive quality assurance process. In particular, the stated aim of QARC does not include a role of providing an ongoing strategic re-assessment of practices with a view to continuous improvement. That function is provided by the Audit Office Methodology Review Committee which includes a representative of QARC.

We note that the QARC has used operational staff to assist the committee in carrying out the quality review function. The Review fully supports this initiative.

The Audit Office advised that Audit Policy Statement 95/17 of 11 August 1995 established revised (and broadened) objectives for QARC covering the need identified by the Review for QARC processes to address issues associated with ongoing improvements in audit efficiency and effectiveness. The amendments stemmed from recommendations made by QARC in January 1995 and endorsed by the Board of Management on 27 June 1995.

The Review agrees with the broadening of the QARC role as expressed in Statement 95/17. Fundamental to its effectiveness in practice, however, will be how well best practices and improvements are converted into guidance and communicated to all audit staff. The Audit Office should ensure this occurs.

Recommendation

That 'best practice' outcomes of Quality Audit Review Committee reviews be presented to all levels of staff to best promote continuous improvement.

8.2 Quality Control Of Contract Auditors

8.2.1 Observations

On the basis of our review we are satisfied that the coordination and quality assurance processes over work performed by contractors are well controlled.

A Calendar of Audit Events was established by the Audit Office stipulating the key timing requirements for reports, review processes and submission of documents. In the area of our review all deliverables were met within the required timeframe and a close interaction was maintained between the Audit Office and the Contract Auditor. In addition, detailed instructions were issued to the contract auditor to facilitate fulfilment of the audit duties and contract requirements.

In order to obtain reasonable assurance that work performed by the contract auditor was adequate and in compliance with the terms of reference detailed reviews were carried out by Audit Office staff. These reviews appeared to be carried out in a timely manner in accordance with the above mentioned Calendar of Events.

9 Extent To Which The Auditor-General Can Add Value To The Financial Audit Process

The current major Accounting Firms' vision for financial audit service delivery is for such audits to reduce client operating cost and risks, maximise efficiency and increase the value the audits provide to clients. The major Accounting Firms aim to achieve those goals by focusing on the client's business and its major processes. Understanding the audit in this way will enable the auditors to link the client's business risks better with the auditor's financial statements risks. This change in audit approach has broadened the traditional audit approach where the auditor can spend much time piecing together the financial statements without an overall view of the business context in which they are generated.

The Review and the Audit Office consider that, while the risk based approach to financial audits is sound, there is a need for the methodology to be further improved by adopting some of the above initiatives developed by the major Accounting Firms.

Some of the initiatives that should be considered by the Audit Office include:

9.1 Analysis of Client And Stakeholder Needs

Analysing needs helps to develop service options that address stakeholders issues. Currently, the Guidelines have identified the stakeholders (or clients) of the Auditor-General as:

* at the highest level:
  - the first client being the NSW Parliament, representing the people of NSW; and
  - the second client being the Government of NSW; and

* at the next level:
  - the individual organisation being audited.

The financial risk exposure of the Auditor-General may go beyond the above mentioned clients to other stakeholders such as creditors of Government agencies or development partners. It is essential the risk analysis should embrace all key stakeholders. The Auditor-General must communicate with the client and stakeholders directly or through facilitated sessions, and align stakeholders needs with business risks and possible added value services.

9.2 Generation of Business Intelligence

This initiative has been addressed by the Audit Office through the establishment of Industry Specialisation Groups. The objectives of the specialised industry groups are to help the Auditor-General to focus on the most critical business risks and issues and bring new ideas to the client. It is also the intention of the Audit Office that the Industry Specialisation Groups will bring significant efficiencies in the conduct of the financial audits and more value for the client through improved Audit Office understanding of client business and related industry operations.

The Review considers that the present processes could be enhanced through the use of SWOT analysis for each client. The SWOT assessment would encompass the following:

* strength analysis:
  - internal to the client's business
  - contributing factors to the success of the client's business
  - areas that should be maximised;

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- weaknesses analysis:
  - critical elements of the client's business
  - reasons why competitors or other State agencies perform better
  - must improve for long-term success
  - represent vulnerable areas of the client's business;

- opportunities analysis:
  - changing market (or legislation) conditions
  - benchmarking (eg comparisons with other State or international agencies)
  - vulnerability in a competitor
  - strengths may enable opportunities; and

- threats analysis:
  - aspects of the client's business that are at risk in the future
  - may be business or financial risks
  - likely to impact business.

The Audit Office has advised that the need for value adding initiatives is included in the Client Service Plan, subject to the constraints on ability to provide these initiatives under existing legislation based on a Crown Solicitor's opinion.

In our view, value adding initiatives need to be taken as part of the audit process itself. These would not be in the nature of special, additional accounting services, but rather would represent more effective auditing.

Recommendation

That the Audit Office initiate changes to its audit methodology to enable a stronger focus to be placed in the audit process on value adding by better understanding client business needs and addressing key business issues.

10 Continuous Audit

10.1 New Service Delivery

The concept of continuous audit is currently being investigated by the major Accounting Firms. This new service delivery approach will fundamentally alter the auditor's work focus on the conduct of financial audits.

Conventionally, financial audits are performed over an annual time span in two stages, interim visits and year end procedures to attest the financial statements. During these stages, substantial amounts of time are spent on tests of account balances, test of controls and similar tasks.

In the future audit process, significant time will be spent on developing business intelligence and working with clients to analyse their processes, business issues, and understand the opportunities and risks they face. These processes will value add by helping clients resolve problems and address opportunities for improvement. Using the broader base evidence available through more extensive intelligence gathering, the auditors will spend more "face to face" time with clients.

Audit activities will be undertaken continuously throughout the year. The continuous audit approach will help the auditors focus on the most critical business risk and issues on a timely manner, bring new ideas to the client and should result in a more efficient audit as well as meeting the client's reporting requirements. Our discussion with the Deputy Auditor General indicated that the reporting deadlines for some departments will be brought forward in the 1995/96 financial year. In this regard, the adoption of the continuous audit approach will assist the Audit Office to issue its audit reports within the prescribed timeframe of the Parliament.

One aspect of the application of continuous audit is that the auditors view the year end close procedures as a financial process to be reviewed and assessed to establish the degree of reliance that can be placed on the processes of preparing accounts. If reliance can be established, the auditors will reduce their level of testing of account balances at the end of the year thereby placing greater focus on non routine processes and subjective judgement areas (where the audit risk is higher), and minimising their post year end audit involvement.

10.2 Objectives of Continuous Audit

The objectives of continuous audit are:

- improve the planning process by **making the engagement controller and manager the project leaders in the planning process** responsible for planning and directing the implementation of the audit strategy for each client. The client should be involved more fully in the planning process to ensure that the planned audit approach is also consistent with the client's objectives;

- improve the audit efficiency by **placing more reliance on the client's processes.** This will require the auditors to focus on the 'what could go wrongs' inherent in those processes and direct the audit work to those issues. This should limit the number of tests performed as unfocused representative samples;

- emphasise **greater participation of the engagement controller and manager in the audit process.** The emphasis here is on getting it right first time and minimising the review and rework time;

- make **more effective use of electronic tools** - especially those where the auditors can bring 'value added'; and

- **improve the close out process** and deliver to the client a close out product that meets the needs agreed with the client at the inception of the audit.

10.3 Adopting Continuous Audit - A Future Challenge For The Audit Office

We believe that it is timely for the Audit Office to begin development work directed to moving to a continuous audit process in the conduct of financial audits. In adopting this forward looking approach, the Audit Office will be maintaining itself within the leading area of best financial audit practice, with benefits to clients and taxpayers. However, there will be many challenges ahead as the new audit service delivery approach will demand a significant cultural and behavioural change within the Audit Office and understanding and acceptance of its benefits by key stakeholders. Issues to be addressed will include:

- the availability of appropriately skilled and experienced resources;
- adequacy of supporting technology;
- leadership for and motivation to change;
- the expectations of the Public Accounts Committee; and
- client reactions.

Recommendation

That the Audit Office initiate research into the adoption of a continuous audit approach to its financial auditing.

11 Relationship Between The Audit Office And Clients

11.1 Overview

As part of the Review, we met with the following Audit Office clients:

* Central Sydney Area Health Service;
* State Rail Authority of NSW;
* Police Service of NSW;
* NSW Treasury; and
* Road and Traffic Authority.

The objective of these visits was to seek their views as auditees of the Audit Office on the following:

* the overall conduct of the financial audit;
* the experience and skill of Audit Office staff;
* their understanding of the client's business and industry;
* communication between the clients and the Audit Office;
* use of internal audit; and
* provision of valued added services.

11.2 Results Of Our Interviews With Audit Office Clients

Overall, there appears to be a good relationship between the Audit Office and its clients. The positive comments noted were:

* Audit Office staff display a good understanding of public sector reporting requirements and the relevant legislation which governs the entity;

* in recent years, there has been increasing effort made by Audit Office staff to enhance their knowledge of the client's business and industry;

* Audit Office staff were very helpful, constructive, approachable, and willing to assist clients in resolving issues;

* senior members of Audit Office staff (including the Auditor-General) attend Audit Committee meetings, and actively providing valuable input;

* communication between Audit Office and the client has been good; and

* there has been a conscious effort made by the Audit Office to use the work performed by the internal auditors.

The following areas of suggested improvement are illustrative of key issues identified by the auditees:

* engagement letters not provided to clients on a timely basis;

* better utilisation of internal audit needed;

* more timely communication of issues in particular with senior management of the client;

- the management letter issued by the Audit Office should focus on significant issues rather than minor "house-keeping" matters;

- where new financial systems are implemented, there should be more active participation by the Audit Office to ensure that appropriate internal controls are being considered by the client;

- more feedback on the processes and outcomes of the financial audits should be forthcoming;

- more value added should emanate from the financial audit process;

- in carrying out the risk assessment, the Audit Office should give consideration to other stakeholders in addition to the Parliament; and

- there is a perception that the Audit Office adopts a very rigid interpretation of the accounting standards. Audit Office should exercise more professional judgement and consider the application of accounting standards in conjunction with the "truth and fairness" of the financial statements or the "substance over form" of the transactions.

We note, again, that these observations need to be assessed in the context of sound, and improving Audit Office/auditee relationships in regard to financial audit. We believe the recommendations made in this Report would strengthen the Audit Office's ability to more thoroughly understand auditee needs, and risks, and respond flexibly to them, while most efficiently providing audit assurance also to NSW Parliament and the taxpayer.

Appendix A

Review of Selected
Audit Office Files

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Review of Selected Audit Office Files

During the course of the Review, the following audit files were reviewed:

1   WorkCover Statutory Schemes

2   Coal and Oil Shale Mine Workers Superannuation Fund/Compensation Subsidy Fund

3   South West Tablelands Water Supply

4   Police Service of NSW

5   Northern Sydney Area Health Service

6   Sydney Electricity

7   Road and Traffic Authority   )
)   Reviewed in relation to support for qualified audit opinions
8   NSW Treasury Corporation)

Appendix A

ERNST & YOUNG

Appendix B

Interviews with Selected Audit Office Staff

Interviews with Selected Audit Office Staff

During the course of the Review, interviews were conducted with:

(A)   Audit Office Staff

1	Tony Harris	Auditor-General
2	Jim Mitchell	Deputy Auditor-General
3	Eric Lumley	Assistant Auditor-General
4	Phil Thomas	Assistant Auditor-General
5	Tony Whitfield	Assistant Auditor-General
6	Lee White	Director
7	Peter Carr	Director
8	Maria Spriggins	Director
9	Roger Henderson	Director
10	Jon Tyers	Director
11	Jack Kheir	Director
12	Steve Fryer	Senior Audit Manager
13	Assaf Yamine	Senior Audit Manager

(B)   Consultants

1	Harry Mantzouratos	KPMG

(C)   Workshop Attendees

1	Kelly Koutzas	Audit Senior
2	Robert Josevski	Graduate
3	Barbara Richardson	Auditor
4	Aldo Dal Pozzo	Auditor
5	Gordana Nicoska	Audit Senior
6	Monique Bisby	Senior Audit Clerk

7	Robert Berman	Auditor
8	Patrick Kelly	Graduate
9	Cirelle Ruxton	Senior Audit Clerk
10	Nellam Bhala	Audit Senior

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Appendix C

Discussions with Selected Audit Office Clients

Interviews with Selected Audit Office Clients

- Central Sydney Area Health Service

  - Dr Diana Horwath

- State Rail Authority of NSW

  - Gordon Messiter
  - Dick Dunn

- Police Service of NSW

  - Neil Taylor
  - Neil Bridge
  - John Thoms

- NSW Treasury

  - Michael Lambert
  - Thuy Mellor

- Road and Traffic Authority

  - Russell Balding
  - Kevin Fort
  - Sue Sinclair

Appendix C

Appendix D

Appendix D

Risk Based Audit Methodology

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Risk Based Methodology (RBA)

Definition

The following key elements underpins a risk based audit approach:

- emphasis on obtaining an understanding of the client's business and industry and of its internal control environment in order to identify potential areas of risk associated with the business, to communicate more effectively with management and to develop client service objectives that will result in the provision of a 'value-added' service to the client;

- a business focus that enables identification of significant accounts and high-risk areas. Consideration is given to client stakeholder needs, critical success factors and environmental aspects in deciding "what could go wrong" and by focusing on the client's estimation/judgment processes separately from the routine and non-routine data processes;

- a risk assessment process that is central to the audit approach and provides the basis for planning the minimum effort necessary to hold audit risk in each area to an acceptable low level. This process enables audit effort to be responsive to the likelihood of errors of audit importance, and to select audit procedures that address the associated risks;

- recognition of small business which generally do not have complex accounting systems. Flexibility and professional judgement is applied to streamline the risk assessment and documentation processes;

- recognition of the importance of engagement economics and staff utilisation by providing for auditing judgment and flexibility in performing work - audit effort increases commensurate with the risk; and

- recognition of specialised industry needs.

The following broad audit phases are typical in a risk based methodology:

(a)   Planning Phase

During this phase significant accounts and high risk areas are identified having regard to client stakeholder needs, critical success factors, business and environmental aspects.

The initial planning effort forms the foundation of the risk-assessment process and helps to identify potential audit problems. Initial planning is designed to achieve:

- early identification of important accounting, auditing, and reporting issues;
- an understanding of client expectations;
- optimal timing of audit work;
- assignment of personnel with appropriate experience and specialised skills;
- communication of audit objectives to the engagement team; and
- timely and efficient execution of audit and review responsibilities.

Appendix D

(b)   Understand And Evaluate The Significant Sources Of Information

The client's accounting estimation processes are considered separately from routine and non-routine data processes in recognition that the risks of material misstatement associated with accounting estimates are often higher than the risks associated with routine and non-routine data.

(c)   Perform Risk Assessments

Risk assessments are separately performed for each significant source of information that affects significant account balances, thereby providing for a better focus to address the differing levels of risk associated with each source of information. Risk assessments and planned audit procedures that are designed to be responsive to the risk assessments.

Audit risk involves three factors: inherent risk, control risk, and detection risk.

*   inherent risk is the susceptibility of an account balance or class of transactions to material misstatement, before considering the effectiveness of internal controls;

*   control risk is the risk that internal controls will fail to prevent or detect misstatements on a timely basis; and

*   detection risk is the risk that auditing procedures will lead an auditor to conclude that misstatements that could be material do not exist when, in fact, such misstatements do exist.

Inherent risk and control risk differ from detection risk in that they exist independently of the audit of financial statements, whereas detect risk relates to audit procedures, which can be changed at the auditor's discretion. The RBA methodology is developed to hold audit risk to an acceptable low level by developing procedures that are responsive to inherent risk and control risk.

(d)   Develop And Execute Audit Approach

The general nature, timing, and extent of the audit procedures to be performed is determined. The objective of this phase is to develop the most efficient and effective balance of procedures. Audit procedures are directed toward the high-risk areas to fit the client circumstances, and to avoid doing excessive work in low-risk areas.

The audit approach should recognise the importance of engagement economics and staff utilisation by providing for flexibility in performing work and for auditor judgment in selecting the nature and extent of audit procedures.

(e)   Draw Overall Audit Conclusions

The results of audit procedures are evaluated to arrive at the overall audit conclusions.

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Appendix E

Audit Planning Framework of the Audit Office

PART II *SECTION 3*

PLANNING

3.1 Audit Planning Framework

The broad framework for audit planning is illustrated below. Detailed guidance on the various aspects of the framework is in the body of this Section.

* **Familiarisation and Preliminary Considerations**

*	Update of information base
*	Scope of audit
*	Form of audit report
*	Consider planning materiality
*	Consider account areas
*	Consider reliance on Internal Audit (IA)
*	Other

Overall Outline Systems Descriptions (OSDs) — Understanding of accounting systems and internal controls — Overall Preliminary Systems Examination (PSEs and PCSEs)

Account Areas

Materiality Levels

Estimate of Most Likely Error (MLE)

Preparation of the Audit Plan

Inherent Risk — Risk Assessment — Control Risk

Systems Based Audit (SBA) — Planned Audit Approach (by account area) - SBA or DST — Direct Substantive Testing (DST)

Sample Sizes — Sample Sizes

The Audit Plan

Planning Package (Form 112 and related Forms)

| Summary and scope of audit approach | Administrative arrangements and budget | Supporting workpapers |

Appendix F

Audit Office Forms

LISTING OF FORMS FOR USE ON ATTEST AUDITS

Form Number	Title
100A	Systems Control Evaluation for Income and Expenditure Account Areas
100B	Systems Control Evaluation for Balance Sheet Account Areas
107	Summary of Matters for Attention
110	Financial Statements Approval in Principle
112	Audit Planning Package
113A	Financial Reporting Code Checklist
113B	Corporations Law Checklist
113C	PF and A (Departments) Regulation Checklist
113D	PF and A (Statutory Bodies) Regulation Checklist
113E	Statement of Cash Flows Checklist
113F	Treasury Circulars Checklist
114	Audit Completion Checklist
114A	Audit Report Recommendation for Clients other than Companies
114B	Audit Report Recommendation for Companies (Including State-Owned Corporations)
114C	Reporting Dates, Audit Times and Costs
114D	Auditor-General's Report Comment Checklist
114E	Outgoing Audit Report Checklist
115	Account Area Lead Schedule and Conclusion Form
116	Account Area Planning Form
117	Financial Statements Planning Summary Form
118	Materiality and Expected Error Planning Form
119	Substantive Test Extent Planning Form
120	Account Area Error Evaluation Form
121	Account Area Summary of Errors Form
122	Unadjusted Errors Summary
125	Debtors Verification - Summary Control Schedule
130	PCSE: Evaluation of Computer Installation and General EDP Controls
131	PCSE: Application Controls
132	PCSE: New Application - System Testing and Data Transfer

PUBLIC ACCOUNTS COMMITTEE

Review of the Audit Office of New South Wales

The Management & Use of Technology

31 October 1995

Table of Contents

INTRODUCTION

The purpose of this assignment was to review the adequacy and management of Information Systems audit and the conduct of Information Systems Audit work.

The scope of the assignment was documented in the proposal of February 1995.

As part of the assignment, we performed the following:

- Interviewed the IS Audit Director.

- Interviewed Assistants Auditor General, Directors of Audit and Senior Audit Managers from all the three Audit Branches.

- Attended an overview briefing by the Audit Office including an overview of the IS Audit unit presented by the IS Audit Director.

- Interviewed staff members within the IS Audit unit.

- Reviewed briefly the Audit Policy and Procedure guidelines volumes 1 and 2.

- Reviewed the following documents :

  - "Submission for the Proposed IS Audit Division Organisation Structure and Staffing Numbers" memorandum dated 8 June 1994

  - NSW Audit Office - Standard Office Workpapers "Risk Based Audit Methodology"

  - Standard IS Audit workpapers dated 14 July 1995

  - IS Audit division - proposed organisation structure

  - IS Audit staff scheduling for the month of July 1995

  - New South Wales Government Position Description for Information Systems Audit Clerk, Information Systems Auditor and Information Systems Audit Manager

  - Information Systems Audit year to date performance report for all staff

  - List of clients and ISA contact assigned to each of them

  - Information Systems Audit Unit Client Service Plan

  - Budgeted cost for April to June Quarter dated 28-2-95

  - Guidelines for selection committee members

  - Induction Program - 1995

-       Draft Terms of engagement for the provision of computer audit services to the
        Auditor-General of New South Wales

-       Information Systems Audit - 1994-95 operating budget memorandum

-       AWL training manual for EDP Audit

-       Completed 130 Forms for the following audit clients:
-       Central Sydney Health Service - Concord Hospital for year ended 30 June 1994
-       NSW Department of Agriculture for year ended 30 June 1995
-       NSW Lotteries for year ended 30 June 1994

-       Completed 131 Forms for the following audit clients:
-       Sydney Water - Aurion Payroll System
-       Maritime Services Board - Chairman General Ledger

-       IS Audit Planning Memorandum for a number of audit clients

We have now completed the assignment and report as follows.

EXECUTIVE SUMMARY

Positive feedback regarding IS Audit has been received from engagement controllers and managers we interviewed. They were pleased with the improvements made in many areas during the last twelve months. Management is aware of most issues arising out of this assignment and is taking steps to address them. The major issues and conclusions noted were :

- ### *Adequacy of Numbers of IS Audit Staff*

    The current staff level is seven short of the planned staff numbers to provide an adequate level of IS Audit service. Three more managers are required to supervise and control engagements and four more non management staff should be hired to bring the total number of staff to the approved number. This situation has been recognised as extremely important by the Audit Office and is being addressed. However, because of the difficulties involved in the market for employing suitably skilled personnel, until the situation is rectified, the Office faces a significant issue in this area.

- ### *Personal development plans for individual staff members*

    Personal development programs are not prepared and enforced to ensure staff skill levels are continuously upgraded and a continuous education program is in place.

- ### *Staff performance appraisal procedures*

    The new Performance Management System has recently been implemented to improve the staff performance appraisal process.

- ### *Planning and reporting for June 1995 IS Audit work*

    IS Audit did not participate in a timely manner with the attest auditors in the planning for the June 1995 audits. Audit strategies proposed by IS Audit could not always be incorporated into the overall audit strategies because they were not received in time by the engagement management. However, plans are in place to ensure integrated planning for the June 1996 will be conducted on a timely basis.

- ### *Documentation and control over Computer Assisted Audit Techniques (CAAT's)*

    There is no documentation standard and checklist to ensure there are adequate controls over the development and processing of CAAT's.

- ### *Integration of IS Audit with attest audit*

    Integration of the application reviews, rotation of attest auditors through the IS Audit area, implementing suggested CAAT's and audit strategy into the overall audit process, integration of planning, involvement of IS management in client's meetings are some of the initiatives that should be taken to improve integration of IS Audit with attest audit.

- ### *Adequacy of IS Audit coverage for computer dominant clients*

    A review of all clients should be performed by the IS Audit and attest audit management to ensure there is adequate IS coverage on all computer dominant clients.

- **Control over non productive time and overtime**

  Control, accountability and monitoring of non productive time and overtime should be improved to provide an accurate assessment of actual time spent on engagements and reduce the risk of IS work being performed but not charged to engagements.

- **Compliance with government directives**

  A refresher course should be conducted for IS Audit staff to reinforce the awareness of government directives regarding computer based systems. A review of Forms 130 (General Controls Review) and 131 (Application Controls Review) should be performed to ensure there is adequate coverage of Documentation Controls and Micro Computer Controls stipulated in the Treasurer's directions.

- **Register for CAAT's**

  A central register for CAAT's developed and used on engagements is to be compiled to determine the extent of CAAT usage and raise the awareness of CAAT solutions. The register can be used as a reference for all auditors to exchange knowledge and reduce the risk of inefficiency in CAAT development.

- **Audit Support Software**

  The Audit Office's technology (PC's, APLUS audit software and the IDEA CAAT tool) is appropriate for the work conducted, and its use is well advanced and comparable with the large accounting firms. Before any decisions are made regarding the upgrade of either APLUS or IDEA, comprehensive evaluations need to be conducted. In addition, a new IDEA co-ordinator should be appointed and the procedures and controls for downloading data from client sites need to be evaluated.

- **IT Management and organisation**

  Given the size and role of the Audit Office, appropriate hardware and software is employed and the Office is making good use of the technology. However, internal IT processes and documentation need to be formalised and implemented as soon as possible. In addition, following the implementation of remote dial-in, the Office's IT Plan should be updated for the next 3 to 5 years to take account of emerging industry trends.

RESULTS

1.   The appropriateness of the IS Audit organisation structure and staffing

Current situation

The IS Audit unit has twelve staff members consisting of an IS Audit Director (SES level), two managers (grade 9 - 12), four Auditors (grade 5 - 8), four audit clerks (grade 1 - 4) and a clerical officer. The planned staff level, which is considered reasonable for the Office, is nineteen and therefore there is a shortage of seven staff. Contractors are engaged where appropriate to assist in IS Audit work resulting from the shortage of staff available or to supplement available skills.

Position descriptions have been published for each of the three staff levels. The existing staff members all have the formal qualifications required for their job positions. Only two of the eleven professional staff have been with the Audit office for more than three years. However as noted in the discussions with the IS Audit director and attest auditors, they are generally pleased with the competence of the staff particularly those at the audit clerks and auditor levels.

Staff were allocated in the months of July and August 1995 to complete IS Audit work for the year ended 30 June 1995 was prepared.

Strengths

IS Audit has recognised the need for adequate staff numbers at the appropriate levels to provide a competent level of the service demanded and has gained approval from the Board of Management for additional staff. This approval for additional staff was made in June 1994 and the IS Audit director is in the process of hiring the appropriate additional staff.

The qualification and competence level of current IS Audit staff has been reviewed and assessed to be adequate by the IS Audit director. His assessment has been confirmed by our discussion with the interviewed Attest Audit Directors.

Job description/duty statements have been documented.

The IS Audit Director has begun to collate the time spent on 30 June 1995 engagements to obtain a better appreciation of the amount of IS Audit work that is required for the June audit engagements. Significant progress has already been made in this process for the December 1995 audit engagements. The collated information together with the planning for 30 June 1996 audit engagements in October/November 1995 would lead to a better estimation of the numbers and levels of IS Audit staff required to service the June engagements.

Engagements have been assigned to individual ISA staff so that there is an ISA contact for each audit job. This initiative forces the ownership of engagements and accountability, improves communication with attest auditors and clients, and continuity on engagements.

Areas for improvement

The "Submission For The Proposed IS Audit Division Organisation Structure and Staffing Numbers" report dated 8 June 1994 was the first attempt to address the staffing issue. The report was based on forms 133A, (requests from attest auditors for IS Audit assistance), which may not have been completed for all audit clients requiring IS Audit work to be done. A more accurate assessment of the amount of IS Audit work and thus the required staff numbers should be performed.

There is a definite shortage of IS Audit staff to perform the planned IS Audit work. As a result, some of IS Audit work for the 30 June 1995 engagements has been contracted out or performed in August (eg TAB).

To reduce dependence on contractors, maintain adequate contacts with audit clients and retain of IS Audit knowledge in-house, the required staff numbers should be attained.

There are only two IS Audit managers. Therefore some engagements' ISA contacts have to be assigned to more junior staff (ie Auditor level) which may not be appropriate. It should be noted that for those engagements where the ISA contact has been assigned to non managers, the IS Audit director does assume overall responsibility.

The staff allocation and scheduling of staff to IS Audit engagements was not efficiently carried out because there was inadequate IS Audit planning for the June 1995 audit engagements. However, detailed planning in October/November for June 1996 engagements should help prevent the recurrence of the problem next year.

The direction that IS Audit is moving towards

The IS Audit Director and the IS Audit managers will be involved in the detailed planning for audits for the year ending 30 June 1996. This exercise would help determine more accurately the amount of IS Audit work to be performed and assist in estimating the number and the experience of staff required to perform the planned IS Audit work.

Recommendations

1.1   Improvement in planning for IS Audit work would lead to a better staffing strategy and reduce the risks of inadequate staffing or the deferral or non-performance of necessary IS Audit work. The proposed detailed planning in October/November 1995, for IS Audit work for the year ending 30 June 1996 should be completed and a reassessment of the head counts made.

1.2   Based on the most recent approval of required head count, three more IS Audit
        managers should be employed so that all significant audit engagements have an
        ISA audit manager assigned to them. It is important that the staff responsible
        for the planning, supervision, quality assurance, liaison with the audit clients
        and attest auditors is experienced and senior enough to perform those tasks. In
        addition, the IS Audit managers can then assist the IS Audit Director in
        Administration work including staff scheduling.

        The four existing IS Audit clerks (grade 1-4) should be promoted to Auditors
        (grade 5-8) within the next twelve months. When that happens, there would be
        four vacancies for IS Audit clerks (grade 1-4). These vacancies must be filled
        as soon as possible so that there will be a constant flow of experienced staff
        through the ranks.

1.3   The job description within each of the bands (ie grades 1-4, 5-8, and 9-12)
        should be expanded to include differential accountability and responsibilities
        within each band. This will provide a distinction between the different grades
        within a band and will serve as a promotion to staff within the band. Staff
        members would be more motivated to achieve as there are differentials between
        grades within a band.

1.4   The plan to assign attest auditors to the IS Audit unit and vice versa should be
        formalised and implemented. There would be benefits through this arising from
        a better understanding of each other's work, improved communication between
        IS and Attest auditors and better integration of IS Audit into the entire audit
        process. The Attest Auditors who have been trained and have experience in
        performing IS Audit work can assist in performing some of the IS Audit work
        for their engagements as they would be more knowledgeable about the client and
        can better integrate IS and Attest audit work.

1.5   Some of the more senior IS Auditors have previously focused on CAAT's and
        technical aspects of IS Audit. This could lead to a lack of experience and
        knowledge in performing other IS Audit work such as General Controls
        Reviews and Application Controls Reviews. Consideration should be given to
        cross training of all IS Auditors in performing different types of IS Audit work
        so that they are skilled and experienced in performing all types of IS Audit
        work. A policy of ensuring all IS Audit staff are involved in all aspects of IS
        Audit work is to be pursued. The allocation of work amongst the IS Auditors
        should be closely reviewed by the IS Audit Director and managers to ensure
        every staff member is given broad exposure to all IS Audit work.

2.   Adequacy of staff planning, recruitment and induction procedures

Current situation

Staff allocation and planning has only been conducted on a four to six week rolling basis. The staff planning and allocation is prepared by the IS Audit Director. A twelve months staffing plan for the coming June 1996 audit will be prepared after the detailed planning in October/November 1995.

There is a standard staff recruitment procedure and induction program.

Strengths

The recruitment process is systematic and procedures have been implemented to ensure a consistent approach to recruitment.

All new staff members have to attend the five day induction program to familiarise themselves with the Audit Office.

Areas for improvement

The recruitment of staff, as dictated by Public Service requirements, can be a lengthy process which sometimes takes up to two months and there is a high chance that the potential employee may accept other job offers.

The direction that IS Audit is moving towards

The IS Audit Director will be involving the managers in staff planning and scheduling.

Recommendation

2.1   Refer to recommendation 1.1 above regarding improving planning for IS Audit work.

2.2   The interview panel members should try to speed up the recruitment process for desirable candidates to improve the chance of recruiting them.

2.3   The IS Audit managers should be more involved in staff planning and scheduling so that they gain experience in this administrative task as well as improve the allocation and scheduling process as they would have more knowledge of the amount of work required on their engagements and also the appropriate level of staff to be assigned.

3.   Adequacy of IS Audit staff training and staff development programs

Current situation

New graduates are given twenty-five days of attest audit training during the first six months but this excludes IS Audit. After the first six months, the IS Audit clerks attend a three days in-house training course in IS Audit conducted by a contractor.

Three hour ISA technical sessions are conducted monthly by invited speakers or in-house managers.

For higher level staff, training is provided by attending third party courses.

Strengths

There is a formalised training structure for new graduates.

Areas for improvement

The IS Audit training is generic and does not incorporate training the graduates in the proper completion of forms 130 and 131.

No individual staff development program has been developed for IS Audit staff.

The direction that IS Audit is moving towards

An evaluation of a suitable basic IS Audit training course for new graduates is being carried out by the IS Audit Director.

Intermediate training for the IS Auditors (grade 5 - 8) is to be conducted in 1996. A decision will be made to select a suitable training course or to develop in-house training courses supplemented by appropriate technical reference material on more specialised topics such as operating system security and emerging technology.

Recommendations

3.1   A personal development plan for each IS Audit staff member should be prepared and enforced to ensure staff skill levels are continuously upgraded and a continuous education program is in place.

For the preparation of each staff member's personal development plan, a matrix of skills for each staff level to be able to perform their job effectively should be initially developed. Then, each staff member's existing skills should be matched to the matrix to determine additional skills to be acquired and then documented in their personal development plan.

3.2   An IS Audit integration module should be developed as part of the basic IS Audit training course to train IS Auditors on how IS Audit work is integrated into the overall audit. (Implementation of this recommendation by the Audit Office has now commenced.)

3.3   An Information Systems Audit technical support function similar to the Attest Audit support provided by PRM should be added to provide technical support to IS Auditors.

4. Adequacy of controls over outsourcing of IS Audit work

Current situation

There is one existing contract for IS Audit work (in force till 30 April 1996). This contract allows the IS Audit Director to contract out IS Audit work that the IS Audit unit is unable to complete. On occasions, special IS Audit work is also contracted out to other third parties. The contracting out of IS Audit work is handled by the IS Audit Director using the draft, revised "Guidelines for the engagement and use of contractors" produced by the Office of Public Management NSW Premier's department and advice from the Audit Office's Contract Coordinator.

Strengths

All contracting of IS Audit work must now be channelled through the IS Audit Director who is familiar with the nature of the work and can make a better assessment of which contractor is more appropriate to perform the task. There is also an improvement in the supervision of the contractor's work as the Director is responsible for quality assurance.

All IS Audit work including the use of contractors has to be approved by the Audit controller through the IS Audit budget.

Areas for improvement

There is at present adequate control over the outsourcing of IS Audit work.

The direction that IS Audit is moving towards

IS Audit will endeavour to perform most of the IS Audit work requested by the attest auditors. Only in situations where the IS Audit Director has assessed that IS Audit staff do not have the experience and knowledge to perform the requested work or where no in-house staff are available would the IS Audit work be contracted out. The IS Audit director would still perform the overall quality assurance.

Recommendation

4.1   We agree with the approach taken by the IS Audit Director for the control and supervision of IS Audit work to be performed by contractors.

4.2   Similar to the Audit Office's approach for selecting tax advisors and the outsourcing practice adopted by a number of public sector organisations, we suggest a panel of suitable IS Audit consultants be established for a fixed period. From this panel, the Audit Office can then select the most appropriate consultant to perform a particular task when needed. This method enables the Audit office to gain an understanding of the skills and expertise, and hourly rates of each consultant in advance and to be used to select the most appropriate consultant for a particular assignment.

5.   Adequacy of performance appraisal procedures

Current situation

For the appraisal of IS staff, an "IS Audit staff review form" is supposed to be completed for large individual engagements to provide feedback to staff members. However, the form is not always completed.

A "performance appraisal form" is used for yearly appraisal. We reviewed some of the appraisal forms completed last year and noted that they were completed.

We have been advised that staff are given feedback on their performance on engagements but this is informal and not documented.

The Audit office has introduced a new Performance Management System and IS Audit management has attended a training course on its implementation.

Strengths

The Audit office has recognised the need to improve the staff appraisal process by implementing the new Performance Management System. The new system will allow the accountability/goals and work plan of staff members to be agreed at the beginning of the year and monitors progress during the year before the final performance review is completed at the end of the year.

Areas for improvement

The new performance management system is still not implemented by IS Audit because the IS staff below the manager level have yet to attend the training course.

The direction that IS Audit is moving towards

The IS Audit Director intends all staff to attend the "Performance Management System" training course in November 1995 before implementing the new appraisal system.

Recommendation

5.1   The new Performance appraisal system should be implemented by the IS Audit Unit as soon as the training for the staff has been completed.

6. Adequacy of IS Audit planning

Current situation

An IS Audit business plan for the year ended 30 June 1995 was not prepared due to the major restructuring of the IS Audit unit in the second half of 1994. During that period, a number of IS managers left the unit and the incumbent IS Audit director was subsequently employed.

The Deputy Auditor-General has instructed IS Audit to concentrate only on providing support to the engagement teams and not to perform "special" IS Audit work such as pre-implementation reviews, disaster recovery planning assistance etc.

Strengths

The approach of concentrating only on the support of the attest auditors in the audits is considered to be an effective use of the limited IS Audit resources.

Areas for improvement

IS Audit management is aware of the problem and has taken steps to correct the situation.

The direction that IS Audit is moving towards

A three year IS Audit business plan will be prepared after a full assessment of the nature and extent of IS Audit work required for the 30 June 1996 audits. The assessment will be conducted in November 1995 when planning for the June 1996 audits is conducted.

When the management and control of the IS Audit work to support the audits is put in place, a request for IS Audit to provide other non audit support services (ie pre-implementation reviews, security reviews, IT department performance reviews etc) will be put forward for approval by the Deputy Auditor-General.

Recommendation

6.1   The IS Audit unit should continue to concentrate on the support of the audit function in the next twelve months to ensure it is properly carried out. We agree that in the longer term, the IS Audit unit should build its expertise in other non audit support services and provide such services to the audit clients. This will provide IS staff with new challenges and improve their skills in other areas of IS Audit. These plans should be documented in an IT business plan for approval by the Board of Management.

7. **Whether there is adequate communication of audit plans and timetables to ensure effective scheduling of resources and minimise potential conflicts**

Current situation

An IS Audit Planning memorandum is prepared and submitted for approval by the audit controller for every IS Audit engagement since February 1995. Because of a lack of participation by the IS Audit unit in the planning of 30 June 1995 engagements, the scheduling of staff to support the 30 June 1995 audits was not as effective as it could have been with participation in the planning process. However, where there is conflict in the allocation of IS Audit staff, they are resolved by the IS Audit Director with the engagement controllers. When IS Audit staff are unavailable, the work is outsourced.

Strengths

The IS Audit planning memorandum is informative and details the nature and extent of IS Audit work proposed to be performed on each audit and a time and cost budget. The plan and budget are approved by the engagement controller and engagement manager.

The IS Audit Director and his managers meet once a fortnight to discuss staff scheduling and resolve any potential conflicts.

Areas for improvement

None.

The direction that IS Audit is moving towards

Steps have been taken to improve the scheduling of IS Audit resources to engagements for the coming June 1996 audits.

Recommendation

None.

8. Adequacy of IS Audit methodology for key areas

Current situation

General EDP controls and Application controls reviews

The NSW Audit Office Standard Office Workpapers "Risk Based Audit Methodology" documents proscribe forms to be used for General controls reviews (Preliminary Computer Systems Exam - form 130) and application controls reviews (Preliminary Computer Systems Exam Application Controls - form 131). IS Audit also use software and a methodology licensed from an accounting firm to assist in application reviews.

A selection of workpapers were reviewed to determine whether policies and methodologies documented in the audit manuals were being followed. The following observations arose from our review of the workpapers completed for three general EDP controls reviews and two application controls reviews:

- An IS Audit plan and budget was not included in two of the files (one for 1994 and the other for 1995).

- There was no completion memo issued to the engagement controllers.

- No management letter was issued for one engagement.

- The file control matrix and Transaction control matrix used on the two application reviews differ.

- An analysis of the time spent against the budget was not prepared for the detailed application controls review.

CAAT's

The Standard Office Workpapers document contain is no CAAT control checklist or documentation standards.

Systems under development, security reviews and Fraud control

IS Audit is not involved directly in the detailed review of systems under development and security reviews. Fraud control audits are performed by the Performance audit branch.

Strengths

The workpapers for one of the application reviews that we reviewed were very detailed and comprehensive.

There is consistency in the approach and documentation through the use of standard forms and checklists.

The IS Audit Director has issued a discussion paper "Standard IS Audit Workpapers" dated 15 July 1995 to give further guidance on the nature of workpapers to be prepared for each IS Audit assignment.

Emphasis is on ensuring IS Audit provide a high quality, consistent service to attest auditors for General Controls, Application Controls and CAAT's before undertaking other non audit support IS Audit areas.

Areas for improvement

There is no documentation standard or control checklist for CAAT work to ensure adequate controls have been adopted in the development and processing of CAAT's.

We have been informed by the engagement controllers that audit strategy documents prepared by the IS Audit team for 30 June 1995 audits could not be incorporated into the overall audit approach as they were not received in time. This problem is recognised by IS Audit and there is a plan to improve for the year ending 30 June 1996.

The direction that IS Audit is moving towards

A methodology review committee is working on how form 131 (Preliminary Computer Systems Exam Application Controls) can be incorporated into forms 135A to K (Preliminary Systems Examinations for each account area) to reduce duplication of work.

Improvements in the planning and timing of IS Audit work to ensure the IS Audit results can be incorporated into the overall audit strategy are planned.

More detailed questionnaires are to be added to the general EDP controls review form to prompt and assist the IS Auditor to better complete the form.

Recommendations

8.1   A detailed CAAT control checklist should be developed to control future CAAT development and ensure adequate documentation is prepared for the efficient and effective on-going processing and maintenance of CAAT's even if there is turnover of support staff. The checklist should be added to the audit manual and the completed checklist should form a part of the CAAT support file.

8.2   Standards and guidelines for the performance of pre-implementation and security reviews should be developed and promulgated if IS Audit unit is to move towards the future provision of those services.

9.   Adequacy of IS Audit reporting procedures

Current situation

For general EDP controls reviews, the completed form 130 is given to the attest auditors.

At the completion of IS application controls reviews, an "Audit pack" consisting of flowcharts, narratives, transaction control and file control matrices, strengths and weaknesses and overall conclusions, is forwarded to the engagement controller/manager.

There is no handover procedure for CAAT's.

Strengths

Reporting procedures have been recently put in place and the IS Audit Director is ensuring that they are adhered to by adopting a high level quality assurance function.

"Audit packs" for application controls reviews are well received by engagement controllers / managers, who find them very useful, particularly the audit strategy portion.

Areas for improvement

The reporting of IS Audit work is not timely enough and so, improvements in efficiency and effectiveness in the overall audit cannot be achieved.

The "Standard IS Audit workpapers" discussion paper should be expanded to include the reporting procedures for CAAT's to the engagement team.

The direction that IS Audit is moving towards

IS Audit is aware that the contribution of the IS Audit work can be greatly improved by improving the timeliness of delivery of IS Audit results. There is a plan to improve the timeliness of reporting in 1996.

Recommendations

9.1   Improve the timeliness in the reporting of IS Audit results and conclusion that would improve the effectiveness and efficiency of the audit.

9.2   Ensure that an IS Audit completion memorandum is issued for all engagements.

10. Adequacy of Integration of IS Audit with attest audit

Current situation

Efforts have been made in the past twelve months to improve the integration of IS Audit with attest audit. The introduction of IS "audit packs" for reporting to financial auditors, suggested audit strategy, introduction of an IS Audit planning memorandum and budgets, recommendations for CAAT's are the areas where significant progress has been made.

Strengths

There has been positive feedback from engagement directors and managers we interviewed regarding the improvement in communication and integration of IS work into the overall audit strategy.

Areas for improvement

A lack of integration in planning June 1995 engagements has been recognised and effort will be made by IS and Attest Audit to integrate planning for June 1996 engagements.

The audit strategy proposed by IS Audit for each job should be forwarded to the Attest Auditors on a timely basis to enable incorporation into the overall audit approach.

The direction that IS Audit is moving towards

IS Audit management has planned to participate in the integrated planning for June 1996 audits. With adequate planning, IT audit resources can be properly organised on a timely basis to ensure required work is performed and integration benefits can be achieved.

The Policy and Procedures Guidelines section II-S3 notes that IS Audit is developing a more detailed methodology for integrating the IS Audit process within the overall audit.

Recommendations

10.1   There should be an integration of the forms 131 and forms 135 A to K with IS Audit and attest auditors working together in application reviews. The integration would also help reduce the possibility of duplication of effort and improve the audit services provided to the clients and promote better cooperation and integration between IS and Attest Auditors.

As part of this integration, the suitability and appropriate integration of an application review methodology/software licensed from a third party should be considered.

10.2   Rotation of Attest Auditors through IS Audit should be enhanced to improve co-ordination and co-operation and increase awareness of the high risks in auditing computerised systems without IS Audit participation. Training of attest auditors in IS Audit work must be carefully planned to ensure they use the skill and knowledge acquired during the training. They should then be empowered to perform IS Audit work covered in the training program. If it is decided that the training is to only raise their IS Audit awareness and not intended to equip them to conduct IS Audit work, the objective must be clearly communicated to avoid disappointment and frustration.

10.3   Increased emphasis should be placed on the development of CAAT's recommended by IS Audit to improve audit efficiency which is one of the areas attest audit has indicated they would value highly.

10.4   The Audit Office's policy on audit planning should make it mandatory for the involvement of IS Audit in the planning process. The Attest auditors should also provide IS Audit with information on the high risk areas based on their knowledge of the client's business so that IS Audit can focus on the high risk areas.

10.5   Attest audit management in conjunction with IS Audit management should review all audits and ensure that there is adequate IS Audit coverage including General EDP controls reviews and Application reviews (of significant applications).

10.6   Engagement controllers on large and computer dominant clients should involve the IS Audit manager responsible for the audit in important client meetings (eg. planning and closing meetings) to increase IS Audit's sense of ownership and accountability for the audit and improve client service.

11. Balance of resources devoted to CAAT's, IS Audit work, Attest audit support and IT (hardware and software) support

Current situation

There is no accurate information on the time spent on the various types of audit support work by IS Audit. The IS Audit Director has estimated that 20 % of IS Audit resources is spent on planning, management and control of engagements, 50 % on Application controls reviews, 15 % spent General Controls reviews and 15 % on CAAT's.
It should be noted that CAAT's are also developed and processed by attest auditors.

Strengths

IS Audit is not involved in hardware and software support or other non audit support work thereby allowing concentration on the quality of core audit support work.

Areas for improvement

The appropriate balance of resources to all aspects of IS Audit work is being addressed.

The direction that IS Audit is moving towards

IS Audit is aiming towards appropriate IS involvement in General EDP controls reviews and application controls reviews for computer dominant audits.

Recommendations

11.1   We agree with conducting a review to ensure there is adequate IS Audit involvement in computer dominant clients. General EDP controls reviews should be performed or updated at least yearly as adequate administration and control of the EDP general processing environment has a major impact on the proper functioning of computerised application controls. More emphasis should be given to perform update reviews of the general EDP controls environments that processed significant applications.

11.2   The IS Audit Director and the Deputy Auditor-General should continue to monitor the progress of IS Audit support work with a view to develop expertise and allow IS Audit to provide services in non audit support areas such as disaster recovery planning, Security reviews, pre-implementation reviews, Systems development life cycle review etc.

11.3   For application controls review, IS Audit should work together with the Attest Auditors so that IS Audit resources can be channelled towards the review of the computerised portion of the application system. This will free up some IS resources for other work.

11.4   If IS Audit resource allows, more emphasis should be placed on the development and use of CAAT's in audits to improve efficiency and reduce costs. Engagement controllers and managers place a lot of emphasis on cost reduction and IS Audit can contribute to it.

11.5   Consideration should be given to cross training all IS Auditors to perform different types of IS Audit work including CAAT's. A policy to ensure all IS Audit staff are involved in all aspects of IS Audit work is to be pursued.

12. Adequacy of project management and budgeting controls

Current situation

Budgets are submitted in writing for approval by engagement controllers and managers before IS Audit work is performed. IS Audit time is charged directly to the audit code under a "D" classification. The Work in Progress reports, used by engagement management to monitor cost and progress of a job, separately report hours charged by IS Audit. IS Audit management also monitors cost using reports produced by the Work In Progress system. The reports are produced weekly and are available on-line.

Strengths

The present system works well for both IS Audit and engagement management.

IS Audit budgets are now negotiated and prepared by IS Audit managers and therefore they are accountable for them.

Improvements to the cost reporting system (including a write off facility) are in progress.

Areas for improvement

None.

The direction that IS Audit is moving towards

Any potential cost overrun is reported by IS Audit staff to the IS Audit Director who informs the appropriate engagement controller and provides reasons for the overrun.

An analysis of actual versus budget hours and costs is to be included in the IS Audit completion memorandum at the end of an engagement.

IS Audit managers begun to be involved in budgeting to gain experience in preparing accurate estimates. Previously, all IS Audit budgets were prepared by the most senior IS Audit Manager. Therefore the other managers are not experienced in preparing budgets.

Recommendation

12.1 The control, accountability and monitoring of non productive time and overtime should be improved to reduce the risk of IS work being performed but not charged to engagements thereby giving an inaccurate picture of the amount of time actually spent on engagements.

13. Adequacy of IS Audit coverage for compliance with appropriate government directives

Current situation

IS Audit is aware of the requirements regarding internal controls for computer based financial systems in the "Treasurer's Directions Public Finance And Audit Act, 1983". The coverage of the Treasurer's direction is in the general EDP controls review - Form 130 and in the application controls review - form 131.

Quotes from the "Best Practices on Information Technology" issued by the Premier's office are used to expand management letter points.

Strengths

Treasurer's directions regarding internal controls for computer based systems are covered by forms 130 and 131.

Areas for improvement

The form 130 does not directly deal with the documentation controls and micro computer controls sections in the Treasurer's Directions.

The direction that IS Audit is moving towards

The IS Audit Director wishes to raise awareness of staff regarding government directives.

Recommendations

13.1   A refresher course should be conducted for all IS Audit staff by the IS Audit management in conjunction with the Policy Research Management (PRM) unit to reinforce IS Audit staff awareness of government directives regarding computer based systems. PRM should forward any new directives to the IS Audit Director for dissemination to the IS Audit unit.

13.2   A review of the forms 130 and 131 should be performed to ensure there is adequate coverage of Documentation Controls and Micro Computer Controls.

14.   Indicators to measure IS Audit performance

Current situation

There is no formal feedback on IS Audit performance. Feedback is mostly verbal.

Strengths

The IS Audit Director has prepared an "Information System Audit Unit, Client Service Plan" dated 30 June 1995 to define service standards that IS Audit will provide and how and when its performance is to be measured.

Areas for improvement

None.

The direction that IS Audit is moving towards

The IS Audit Director in conjunction with the Deputy Auditor-General will conduct a survey of Engagement Controllers and managers in October 1995 to obtain formal feedback on IS Audit performance for the last ten months.

Recommendation

14.1   The "Information System Audit Unit, Client Service Plan" dated 30 June 1995 should be discussed and agreed with the appropriate person in the Audit Office and implemented.

15. Determine the extent of usage of CAAT's

Current situation

Most CAAT's have been developed and processed directly by the attest auditors using the IDEA software. Only complicated CAAT's have been developed by IS Audit and some CAAT's have been developed using the SAS audit software.

Strengths

In application reviews, IS Audit suggest CAAT's to improve efficiency and effectiveness.

Attest auditors are using CAAT's to assist in the audit process.

Areas for improvement

At this point in time, there is no accurate assessment of the extent of CAAT usage.

Suggested CAAT's are not followed up to ensure they are developed wherever effective.

There is possible duplication of effort by auditors developing similar types of CAAT's.

There is no control checklist or documentation standards for CAAT's. There is no quality assurance of CAAT's by the IS Audit unit.

IDEA audit software installed on one computer cannot be easily transferred to another. This increases difficulty in its use by requiring swapping computers to use the software.

The direction that IS Audit is moving towards

The IS Audit director is testing other CAAT software including "STAR" (regression analysis) and "Oracle Browser" (extract Oracle Database data) to increase CAAT use.

All future licensing of audit software will be based on a "site" license basis to eliminate the existing problems with machine specific licences.

The IS Audit Director is collecting information on the use of IDEA in each audit group so the software can be reallocated to maximise the use of the 40 licensed copies.

Recommendations

15.1   A central register of all CAAT's on all engagements should be compiled. This will identify the extent and purpose of the use of CAAT's in the Audit Office, provide a reference point for all Auditors and reduce any duplication of effort.

15.2   The use of appropriate CAAT's would improve system understanding by auditors and improve the audit process. Some CAAT's (eg. Exception reporting) may also be used by clients to monitor and control systems and add value. The increased use of CAAT's would demonstrate the use of technology and up to date techniques to help earn client respect and confidence. More emphasis should be given to the use of CAAT's.

16. Adequacy of Budgeting, cost control / recovery mechanisms

Current situation

An IS Audit budget is prepared by IS Audit and approved by the engagement controller and manager before IS Audit work is performed. The IS Audit budget is included in the overall audit budget and approved by the Auditor-General before the audit fee for the overall audit is agreed with the client. Any justified additional fee recovery above that initially agreed must go through the same review and approval process.

IS Audit staff members charge time spent on an audit directly to the audit cost code but with a "D" code. Costs for outsourced IS Audit costs are charged at the same rate as in-house staff with any additional costs absorbed by the IS Audit unit.

Strengths

As discussed in section 12, the IS Audit Director and the Attest Audit controllers and managers are satisfied with the existing budget, cost control and recovery procedures.

Overruns are communicated with the engagement controllers immediately and the analysis of actual versus budget IS Audit costs forms part of the conclusion memo sent to the engagement controller at the completion of the IS Audit assignment.

Areas for improvement

None.

The direction that IS Audit is moving towards

The IS Audit Director will continue to raise the staff awareness of costs.

Recommendation

None.

17. Adequacy of supervision & quality assurance over IS Audit work

Current situation

All IS Audit staff working on engagements are to be supervised and their work quality assured by IS Audit managers. However due to a shortage of managers (grade 9-12), some supervision and quality assurance has been delegated to the more senior auditors (grade 5-8) with overview supervision by the IS Audit Director.

Prior to December 1994, some quality assurance was contracted to outside consultants due to a lack of staff and a sudden build up of workpapers that needed to be reviewed.

Strengths

The IS Audit Director performs quality assurance on all IS Audit Planning Memoranda, management letters, IS Audit completion memoranda and client correspondence.

A Quality Assurance checklist for form 130 - General EDP controls review and 131 File review QA checklist have been introduced.

Areas for improvement

Heavy reliance is placed on the IS Audit Director to perform quality assurance.

The direction that IS Audit is moving towards

Some of the quality assurance over documents sent to the clients and the engagement controllers will be delegated to the other IS Audit managers.

Proposal to include external IS Audit resources, in the Quality Assurance Review Committee (QARC), to perform annual quality assurance reviews so that IS Audit workpapers are also independently quality assured.

An IS Audit Practice manual to cover Quality assurance, standard IS Audit forms, pro forma IS Audit planning memorandum, completion memorandum, staffing, testing guidelines etc will be developed.

Recommendation

17.1   Procedures are in place to address the problems noted.

18. Assess use of audit support software & extent of automation of audit workpapers

Current situation

APLUS

The Audit Office uses APLUS with the primary objective of automating the preparation of audit working papers. In addition, APLUS has other functionality including the ability to prepare lead schedules, trial balances and financial statements, state information in data bases, importing and exporting of files with other software packages and messaging. The messaging function is not used.

Every Attest Auditor has been issued with a PC which has a copy of APLUS. User training and support of APLUS is performed by a contractor who reports directly to the Assistant Auditor-General.

IDEA

The IDEA software is used to develop and process Computer Assisted Audit Techniques (CAAT's) in audits to improve efficiency. Each audit branch has a number of copies of IDEA. Comments regarding the use of IDEA as a CAAT tool are detailed in the "Determine the extent of usage of CAAT's" section of the report.

Strengths

The use of PC's, APLUS auditing software and IDEA CAAT tool has helped to equip the Attest Auditors with computer knowledge and expertise in using PC's and audit software.

The use of PC's and auditing software in audits is appropriate for the Audit Office and is consistent with what the big six accounting firms are doing.

The use of the APLUS auditing software helps in ensuring a consistent approach in the preparation and organisation of workpapers. Consistency in the preparation and referencing of workpapers also makes it easier for supervisors to review the workpapers.

Where appropriate, Attest Auditors are encouraged to download data from their client's computer system into IDEA and APLUS to eliminate the need to manually key in data to create the trial balance.

Areas for improvement

The download of client's data into IDEA and APLUS without adequate completeness and integrity checking procedures being performed could potentially result in an increased risk of errors and reliance on data that are incomplete and inaccurate.

The manager responsible for IDEA implementation, training and in-house support has transferred back to attest audit and no one has been officially appointed to replace him. As a result, there is not a person who is responsible for the administration, control and training for IDEA.

Training for IDEA is not structured and formalised. Training is provided on a "sporadic" basis.

We have been advised that the latest version of IDEA (Version 5) has many "bugs" and some users have reverted back to using the older version. The use of software that has "bugs" increases the risk of errors, cause user frustration and loss of time and effort to redo work lost or corrupted.

The direction that the Audit Office is moving towards

An evaluation of the new version of APLUS which is called Audit System 2 (AS2) is being carried out by the APLUS consultant, the IS Audit Director and one of the Audit Branch's Assistant Auditor-Generals. The APLUS consultant has also obtained overviews of other auditing software.

There is a plan to obtain approval from the Board of Management to form a Practical Audit Technology group whose main function is to direct, administer and control the use of auditing software. The group and the APLUS consultant will report to the IS Audit Director.

Recommendation

- Attest Auditors are encouraged to download data from the client's computer but this process should be better controlled to reduce the risk where data are downloaded without any plan for how they are to be interrogated and what audit objectives the download are to achieve. We suggest that the purpose for downloading a particular file from the client's computer be documented and approved by the engagement controller before effort and time is spent on downloading the files.

  A completeness and integrity control checklist should be implemented to ensure the data supplied and downloaded is complete and accurate.

  The steps to perform the download should be documented for each job so that there is reduced risk of delays and problems the next time the download is to be performed especially if there is a change in the audit staff on the job.

- Currently, a substantial amount of time is spent on co-ordinating and organising with the clients to produce the data files that are to be downloaded to the Audit PC's. A software package, AUTOIMPORT, has been trialed so that print files which are already produced by the clients as part of their reporting routine can be used for the download instead of specially created files. We suggest that an evaluation of the cost effectiveness of using the AUTOIMPORT approach be prepared and more copies of the software be purchased if appropriate. A training module incorporating download control procedures should then be prepared and users trained in the use of the AUTOIMPORT software.

A data extraction and documentation strategy and policy incorporating all the above points should be prepared and promulgated.

- The training for IDEA should be formalised to ensure users are familiar with the software and can use it correctly and will get the full benefits out of their use of IDEA.

- A new in-house coordinator for IDEA should be appointed to fill the position vacated about three months ago.

- Before the Audit Office commits itself to upgrading to AS2 or any other workpaper automation software in the near future, a number of factors should be considered:

    (a)   the resources and costs for training in the use of the new software;

    (b)   reliability of the software;

    (c)   ease of transition;

    (d)   cost of upgrade or replacement of existing hardware;

    (e)   any potential improvement in audit efficiency and effectiveness;

    (f)   adequacy of support and maintenance of the software;

    (g)   whether the software follows/supports the audit methodology adopted by the Audit Office; and

    (h)   whether the software works with the same PC operating system (ie Windows etc) and other applications (ie Word, Excel etc) adopted by the Audit Office.

- An evaluation of the impact of using the latest version of IDEA which has many "bugs" should be performed. An informed decision can then be made to discontinue using the latest version of the software if considered appropriate.

19. IT Management and Organisation

The IT section is divided into two groups: Systems Development and Operations. Within the section there are two managers and seven staff (one is on secondment to ICAC). Our analysis from interviews with IT staff and its customers identified the following:

- The business users interviewed were satisfied with the service provided by IT staff and believe that they are responsive to their needs, consultative in approach, and generally receptive to new ideas.

- From our experience, the staff numbers are adequate to support an organisation the size of the Audit Office. With respect to PC support, the Gartner Group estimates that one IT support person is required for every 80 users. This is broadly in line with Audit Office staffing when excluding systems development and management activities.

- The organisation is "point sensitive"; the expertise in the operation and maintenance of specific software packages and technology is vested in a few staff. This is difficult to avoid with a small department, but specific attention should be given to ensuring that there is adequate long term support for the DBQ database management system and associated systems. Currently, Mick Carr is the DBQ specialist. If he left the organisation, it would be difficult to hire a replacement with his technical and business knowledge and skills. A better option would be to train someone internally to provide backup for the technical aspects of his position.

- There appears to be a gap in IT planning and coordination, and in the management of issues relating to the IT-business interface. We understand these activities were the responsibility of the IT Director, a role that no longer exists, although the responsibilities are currently shared across the two managers (Development and Operations) and the Assistant Auditor General. We understand that the Development Manager may be considering leaving the organisation. If this occurred, we recommend the Audit Office consider merging the two positions and recruit a business analyst to be responsible for progressing new initiatives, through feasibility to approval by the BOM. This restructure will improve co-ordination and ensure that IT is aligned with the business direction and is focused on business needs. This analyst should report to Geoff Oliver rather than to the IT section.

- The Systems Development Group appears to spread their efforts across systems development and maintenance. They are not a large group yet are required to support a range of technologies and applications. This approach may not yield the optimum value for the Audit Office. Consideration should be given to greater use of packages and outsourcing for all significant new system developments.

20. IT Processes

20.1 IT Procedures and Documentation

IT procedures and documentation are informal. Despite this informality, the IT section appears to have been responsive to business needs.

Lack of formal procedures and documentation is likely to adversely impact the effectiveness of the section in the future as:

- key staff leave;

- the organisation works towards achieving and maintaining quality accreditation;

- the degree of electronic connectivity between staff, with clients, and to external information sources increases;

- technology applications becomes more sophisticated.

It is critical that IT procedures and documentation be formalised and implemented early if the organisation is seriously trying to achieve quality certification. This is to enable staff to become familiar with the procedures and to start using them.

Areas that need attention include:

- Logging & management of change requests (project scope & application changes);

- Logging and management of issues;

- Logging of Help Desk calls and resolutions;

- Documentation of business requirements and conceptual system designs;

- Business case development and approval appropriate to the size of the investment.

20.2 Business Alignment - IT Planning

The current Network Development Strategy is nearing the end of its lifecycle and will be completed with the implementation of remote dial-in capabilities. This strategy provides field staff with portable equipment, through which they can access professional tools, communicate via E-Mail and obtain remote dial-in access to head office systems. Following the implementation of remote dial-in, the IT plan should be updated to take the Audit Office forward to the end of the decade.

This planning project should include the development of an *improvement portfolio* to outline all key initiatives and their *value propositions* (specific, quantified opportunities to improve business results). Those initiatives delivering the greatest value are assigned the highest priority. Value can be measured along a number of dimensions, including financial return, client service, regulatory, strategic support, etc.

Managing applications as a *portfolio* will enable:

* more effective resource management;
* tighter alignment with business objectives;
* balancing of short-term and long-term returns;
* the total IT investment value to be determined.

20.3 More Effective Implementation of IT Projects

The role of the *Business Sponsor* for IT projects must be formalised to ensure a focused definition of requirements and effective implementation. The Business Sponsor is an important role in fostering ownership among audit staff for IT initiatives. Ownership is critical to ensure that the appropriate adjustments to behaviour and processes are made to realise the full benefits from technology projects.

We understand that this is so for the WinStaff project, the only current significant application project.

The adoption of a formal project management methodology should be considered, to:

* set procedures and standards for IT projects;
* facilitate learning from past experiences and promote continuous improvement;
* assist in managing the scope of projects to ensure they are consistently finished within time and budget.

20.4 Training

It appears that training is well managed. Audit staff who were interviewed were confident in using the IT support tools that were available.

21. Technology

Given the size of the Audit Office, the number of users and usual budgetary constraints, the technology employed is appropriate and the Office is making good use of it :

- A network environment has been established to promote the sharing of information and knowledge.

- Office automation (word processing, spreadsheet and electronic mail) is based on industry standard software.

- A good support structure has been established.

- Users appear to be receiving good basic training in the use of the tools available.

- User feedback indicates they are comfortable with the level / use of technology.

This provides a good foundation for the future development of Information Technology. Based on our experience of developing and working in a similar, but larger environment, the following comments are given to highlight areas we believe advancements could be made.

21.1 Core Business Support Applications

Our assessment of the core business applications is outlined below:

FMIS

This base package was included for minimal cost when DBQ was purchased. In 93/94 the package was customised to suit the needs of the office for Debtors and General Ledger, and was implemented for the 94/95 financial year. There appears to have been some initial staff reluctance to use the system, which was likely influenced by the lack of customised user procedures as well as the FMIS user interface. However, this has now been overcome and, overall, the users believe that the system is meeting the business needs and is a cost effective solution.

Acorn

Acorn was developed in DBQ as the Audit engagement management system (engagement work-in-progress and management reporting). The system was developed for a small investment. The development was undertaken due to there not being a package that suited the business requirements and was available on the Audit Office's platform. Our discussions with Head Office and field staff indicate that the system meets the needs of the business. There were gaps in management reporting, however these should be satisfied by recent enhancements.

One current weakness is the inability to enter timesheets and access engagement information from the field, although hardcopy weekly reports are provided to relevant field staff. The lack of online access has lead to some field staff keeping duplicate information in spreadsheets to ensure that they have access to the up-to-date engagement work-in-progress figures. This problem will be addressed by remote dial-in which is discussed later in the report.

AIMS

The AIMS Library Management System does not run on the latest installed release of DBQ. Following the upgrade there was a period of time when the system could not be used, however, DBQ have now provided a fix to enable it to operate on the old release. A new release of the AIMS should be available early in the new year which will run on the latest release of DBQ. Before this is installed, the business issue of whether the Audit Office should have a dedicated library should be resolved.

WinStaff

Staff scheduling is recognised as an area that could provide significant benefits in improving resource utilisation and management. We estimate that utilisation can be improved by at least 5% in professional organisations that have effective resource management tools and associated processes. The WinStaff system has attempted to address this area, so far with limited success. Current initiatives, including the provision of remote access facilities are aimed at resolving the remaining problems. We believe that this initiative has significant value with respect to improved efficiency and personnel/business management.

DBQ Database Management System and Development Tools

DBQ is an Australian product supported by BHA. DBQ is not among the industry leaders in relational technology and due to the size of its revenue base is likely to slip further behind the competition. Due to its limited market there is only a small range of packaged software that will run under DBQ. However, as the Audit Office is relatively satisfied with the current DBQ systems there is a limited need for new back-office applications. In addition, the support provided from BHA is currently good. Therefore there are no immediate concerns with DBQ.

We understand that Oracle and Ingress are being reviewed as potential alternatives to DBQ. We endorse this review and further recommend that before any strategic initiatives are commenced, a review be undertaken concerning the most appropriate development platform.

The IT strategy review should also consider the following:

- Whilst the Unix platform is open/industry standard and has many applications available for it, is its scale required for an organisation the size of the Audit Office? The Intel/Netware platform may be a satisfactory and less expensive option for the Office. Many applications using Netware are available and usually at less cost than similar Unix applications. We understand that the Audit Office has considered this issue and have found that Unix is currently a cheaper platform. They also have concerns over systems performance and the risk in relying on a Windows platform for all of their corporate applications. These concerns are understandable, however, we believe that the Audit Office should continue to monitor developments on the Intel/Netware platform.

- If greater use is made of packages, less development support will be required, enabling the IT section to concentrate more on implementation support and maximising the strategic use of technology.

21.2 Office Automation

Remote Dial-in

Work has commenced to establish remote dial-in facilities and should be completed by November 1995. As over half the staff are located at remote locations whilst working on clients, this facility will provide significant benefits by improving communications and reducing wasted time when staff must travel to the office to access electronic mail and electronically transfer data files. There are a range of technical issues that must be satisfactorily resolved before remote dial-in can be successfully implemented. These include:

* *Security*

  The level of security required depends on the sensitivity of information stored on the network and the level of risk that the Audit Office is willing to accept that people may try to electronically break into the network with malicious intent. There will always be a level of risk as soon as remote dial-in is made available. The current approach being followed is to rely on software security at the time of dial-in complimented by the normal network security. This provides reasonable protection. Alternative and more secure approaches that require the use of tokens and hardware devices are available if considered necessary after assessing the risk and sensitivity of the information contained in the network.

* *Communications*

  Most modems available on the market are analog. Increasingly the PABX's and handsets used by organisations are digital. If an Auditor is working at a client that only has a digital phone system, the Auditor will not be able to access the remote dial-in facility. Consideration will need to be given to making digital modems available or analog/digital converters. To date, we have not been able to locate an Australian distributor for the analog/digital converts and as far as we know, they are not Austel approved.

* *Electronic Mail.*

  The MS Mail software currently available for PC's does not work effectively over remote dial-in links and, depending on the size of the global address book, has a number of performance problems. Our testing has indicated that these issues are resolved by the version of MS Mail that will be released in Windows 95. We understand that for Field Staff the Audit Office is planning to provide facilities to remotely access Mail located on the server.

Electronic Fax

A facility has been established so that faxes can be distributed electronically by one individual in the Audit Office. Research is under way to extend this so that anyone on the network can transmit faxes electronically, providing that the fax was created on the network. There are a number of areas that this research could be extended including:

* *Fax distribution*

  A number of carriers provide fax services, for example Telstra's 0015 service. These services include a number of features like enabling an organisation to transmit a fax once and the service provider will automatically distribute the fax based on a predetermined and maintainable distribution list.

* *Fax transmission*

  Despite implementing an electronic fax system, most organisations still require manual fax machines to transmit documents that are not stored on the network. Consideration could be given to utilising scanning technology (perhaps in conjunction with imaging) so that all documents can be transmitted using the electronic fax facilities.

* *Fax receipt*

  In addition to continuing to receive faxes manually, two different approaches can be investigated for incoming fax. Firstly, most electronic fax systems have the ability to receive incoming faxes. Documents received in this way can either be stored on the network for someone to manually distribute by either printing them or distributing them through the Electronic Mail system. Secondly, Telstra are currently setting up a service that will permit incoming faxes to be diverted directly to an Electronic Mail system like MS Mail.

Network Design

The current Novell network is set up with 3 production servers, these are located in two of the buildings occupied by the Audit Office.

Future consideration should be given to the way that the servers are implemented to add flexibility and robustness to the network environment. Ideally the three main servers should be configured with equivalent hardware, software and the same set up so that they can act as a backup for each other in the event of a failure. For example, the Novell user license level should be the same on all servers and backup facilities should be the same so that they can restore each others data. We understand that this option is not currently practical due to budgetary constraints.

PC Hardware Environment

The personal computers in use at the moment are set up using either a DOS or Windows environment. The Audit Office are planning to replace all DOS machines with Windows capable equipment by February 1996, this fits in with the current 3 year PC replacement cycle.

Voice Mail

During our discussions, use of Voice Mail as a service within the Audit Office seemed to be dismissed without really considering what the technology provided or the potential productivity benefits it could deliver. Our experience and that of many service organisations is that it rivals Electronic Mail as an effective and productive communications tool.

Voice Mail is effectively Electronic Mail for your telephone system. It can be used to receive and store messages, send messages, forward messages to another user with or without additional comments and to broadcast messages to a number of users in one step. It can also be accessed remotely and can be set up to automatically forward messages to a user, even when they are not in the office or paging service.

The benefits that are gained from this facility are:

- All staff are used to telephones and therefore become effective users of the system very quickly.
- The system eliminates telephone tag and the time required for staff to manually record messages.
- The system can be used to record messages that would normally be missed, for example out of hours or when staff are on holidays.
- A recorded message means that the full message is received including the tone of the person giving the message, not just a short hand, written interpretation of the message.
- The ability to forward and broadcast messages saves considerable time.

Longer term consideration can be given to linking the Voice Mail and Electronic Mail system into one universal communication tool.

22. Industry Trends

The following section outlines technology trends in professional firms. We have observed that the Audit Office is already implementing or considering the majority of these capabilities. However, technology is advancing extremely rapidly in a number of these areas and therefore the IT Strategy review should comprehensively examine all of these trends. Government research should be utilised where available, such as the recent Internet studies.

Professional firms are changing their technology focus away from back-office systems to providing technology that will enable their professional staff to improve efficiency and add additional value to their clients. The following trends are becoming clear:

- Professional staff equipped with personal computers with access to the firm's network via remote dial-in facilities.

- Use of electronic mail and diary systems to improve communications and scheduling.

- Use of resource management software and skills databases to improve the quality of resource allocation and overall staff utilisation.

- Automated audit tools for: access to methodology guidance, automated working papers, and project planning and tracking.

- On-line knowledge bases for information such as precedents and best practices.

- Discussion groups who share knowledge concerning specific topics through the use of workgroup software such as Lotus Notes.

- Use of templates and simple workflow to automate, as far as possible, everyday administrative tasks.

- Use of the Internet and electronic mail communication with clients.

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Public Accounts Committee

Review of the New South Wales Audit Office:
Performance Audit Function

Final report

November 1995

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for Business

Executive Summary

Executive summary

Our review

Our broad mandate was to review the efficiency and effectiveness

The Public Accounts Committee requested Coopers & Lybrand Consultants to undertake a review of the Performance Audit function in the NSW Office of the Auditor General. The main item in the terms of reference was to "review the efficiency and effectiveness of the management and conduct of performance audits".

Some issues were itemised for particular attention:

- Criteria for the selection of performance audits

- Planning and control of performance audits

- Criteria for measuring the efficiency and effectiveness of performance audits

- Performance audit investigation processes and quality control procedures

- Compliance with statutory requirements for reporting and applicable professional standards

- Skills and competency of staff

- Productivity of the performance audit branch

- Performance audits as agents for change in the public sector.

Efficiency and effectiveness

The office is efficient and effective in production but costs could be reduced

We are of the view that the cost of providing performance audit reports is high compared to other, non-audit, review approaches. The high cost is an outcome of the application of performance audit methodology.

Our general view is that, over the past three years, the Office has achieved a position where it is both efficient and effective in terms of producing reports that are relevant and useful for Parliament and management. There is, however, room for initiatives to reduce the cost of performance audit assignments.

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- Changes to the Public Finance and Audit Act

- The performance audit branch preparing a business plan

- The Audit Office adopting an integrated approach to audit

- Integration of performance audit work with that of the finance audit branches over a period of three to five years

- The current performance audit branch continuing as a separate unit, but concentrating on building best practice criteria, methodologies, manuals and particular audit work.

Performance audits should focus on three main streams

We see future work in relation to performance audit in the Audit Office falling into three streams:

- economy, efficiency and effectiveness of agency management practices, operations and service delivery

- broad sector or government wide studies to identify audit criteria, benchmarks and best practice with a view to preparing and disseminating audit guides - undertaken in the present Performance Audit Branch

- development of methodologies and approaches - particularly in relation to attest audit of performance statements and indicators - also undertaken in the present Performance Audit Branch.

A concentration on operations rather than on programs

The first stream indicates that there should be more concentration on the economy, efficiency and effectiveness of *management practices, operations and service delivery* than on *program effectiveness.*

The bases of this view are as follows:

- audit based methodologies are well suited to review of management practices, operations and service delivery, - that is:

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- it is relatively straight forward to identify "audit criteria" and follow procedures set out in manuals and audit standards

- approaches are closely aligned to traditional financial audit methodologies

- audit methodologies are not well suited to program effectiveness review - compared to other (research based) methodologies

- there are many other government agencies and organisations involved in program effectiveness review and evaluation (though none are involved in reporting to Parliament the outcome of these reviews)

- reviews of program effectiveness almost inevitably raise matters about the appropriateness of policies (explicit or implied) that are in place concerning the delivery of a program compared to the policy objectives or goals that the program ought to be achieving.

Topic selection should flow from an understanding of the agency

Internal topic selection for specific performance audits should flow from assessment and understanding of an agency's financial systems, management processes, information technology, staffing and service delivery arrangements. Agencies should be subject to a detailed financial-performance audit on a cyclical basis - perhaps once in every four to five years.

Government-wide studies are the focus of the second stream

In the second stream, the focus should be broad sector studies, on issues and concerns with implications across a number, or all, government agencies. Important work has been undertaken in relation to fraud awareness, advertising and administration of grants. There are in addition, for example, major "whole of government" issues concerning economy, efficiency and effectiveness in relation to:

- property holdings and the management and disposal of property

- information technology acquisition and software selection procedures

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- telecommunications

- financial planning, budgeting and monitoring in a program management environment

- management accounting systems and practices

- purchasing, contracting, market testing

- human resource management - including performance management, training and staff development

- regionalisation of service delivery.

The third stream involves building methodologies

In relation to the third stream, the Performance Audit Branch has made a major contribution to the development of methodologies and approaches to performance audit. The "melting pot" culture in the present Performance Audit Branch, with skills and expertise drawn from a range of professional backgrounds, is a major strength.

The Public Accounts Committee should have responsibilities in relation to the performance audit program

We have recommended that the Public Accounts Committee take an active role in relation to the performance audit program, including:

- reviewing the forward plan
- recommending on required resources
- reviewing audit conclusions.

Topic Selection

Audit selection should be linked to the outcome of financial audit work

In our views, performance audits should be much less of a "major event" and more closely linked to the outcome of financial audit work.

Planning and control

The planning and control is detailed, automated and open to further improvement

The Performance Audit Branch has put a lot of time and effort into the development of guidelines and recent files demonstrate the success of their application. The key methodological component is the identification of audit criteria and serious disagreement over these will seriously challenge the success of the audit.

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Management information systems have been enhanced and comprehensive information is available in a simple format.

A review of the procedures will take place shortly.

Criteria for measuring

We identified efficiency, effectiveness and outcome criteria

In our opinion, relevant criteria for measuring performance audits are:

- Efficiency criteria:
  - cost per report
  - actual time taken
  - staff input to reports prepared compared to budget
  - time to complete reports

- Effectiveness criteria:
  - number of reports completed - compared to expectations
  - timeliness of reports in relation to problems and issues addressed
  - relevance, usefulness and completeness (quality issues)
  - customer and client satisfaction

- Impact and outcome
  - contribution to improved performance - in terms of recommendations implemented
  - contribution to enhanced public accountability.

Quality control and compliance

There are extremely detailed procedures for investigation and quality control but we do still have some concerns

The performance audit procedures are driven by compliance with auditing standards ED47 & 48. Extremely detailed procedures exist to guide the audits. It is conceded that there is a requirement to maintain extensive and detailed working papers to support conclusions.

However, they are very time consuming and can lead to an overdue emphasis on process.

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We are also concerned that the terms of reference for the majority of studies are often only finalised three months into the project.

Staff

The skills of the staff are broad based

The Performance Audit Branch has broad based capacity with an emphasis on accounting related disciplines. It has a high proportion of senior people.

Training in performance improvement is required

There has been a lot of effort put into identifying appropriate training courses. We recommend that the Audit Office explore the opportunity for Performance Audit Branch staff to become proficient in performance improvement tools and techniques developed by the major professional services firms and which are relevant to performance audit work.

Productivity

Comparisons indicate good productivity

The branch has produced 19 reports since its inception and has developed add-on value-adding services. It is difficult to make comparisons with other audit offices but on the basis of information we could gather the performance of the branch companies very favourably with other offices.

Areas for change

Some significant achievements were noted but there were some concerns on policy issues

In approaching this issue, we sought to identify the impact and outcome of performance audit work in relation to improved management practices, resource allocation, work processes, accountability and client service. These issues were discussed with people in organisations that had been subject to performance audit review.

The views conveyed by people in organisations subject to performance audit concerning audit impact was mixed as might be expected. Significant achievements were referred to in relation to work that focussed on management practices and improvements in work processes and procedures.

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Contributions were also acknowledged in the development of broad based audit criteria and approaches. The work on Joint Operations in the Education Sector and on Fraud Control, for example, is highly regarded.

Criticisms were made where organisations had considered that the Auditor General had encroached on matters concerning government policy decisions and directions. However, the definition and interpretation of what constitutes a "policy" matter has been, and continues to be, a matter of conjecture and debate.

Handling matters of policy

It is important to note that public policies and programs often serve multiple goals and constituencies

In many instances, the political process gives rise to the development and implementation of policies and programs designed to maintain and/or engender political support - as well as reflecting a logical and consistent approach to addressing an identified problem or need.

Nonetheless, in the current public sector management environment it is important, for the purposes of public accountability, that policy goals and program objectives be clearly stated in all respects - even where intended outcomes serve secondary, and less logical or more obscure, objectives (such as provision of rail services to maintain regional employment - as well as providing a passenger service).

The Auditor General has an important role to draw attention to the Parliament, and the Government, the existence of situations and circumstances where policy goals and program objectives are unclear or ambiguous or inconsistent with subsidiary policies: that is, where there is uncertainty concerning what the government is intending to achieve through a particular intervention. These situations are not isolated occurrences - they occur across the full range of government activity and influence.

We consider, however, that the most appropriate mechanism for addressing the policy issue is through a change in emphasis in performance audit away from the *direct* audit approach currently followed to one that involves assuring the Parliament ("*attesting*") as to the validity, relevance and accuracy of management

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representations on economy, efficiency and effectiveness contained in program performance statements (reports) and indicators. (This would require legislative changes to the audit mandate and to agencies' reporting requirements.)

The development of attest audit procedures will require the development of guidelines for the preparation of performance reports and performance indicators and their adoption throughout government. These developments will be facilitated with implementation of initiatives in relation to output budgeting that are being pursued in various parts of the public sector.

Funding

Our conclusions in relation to funding of performance audit work are:

- all performance audit work should be funded from a Parliamentary Appropriation to the Audit Office

- agencies should re-imburse the Audit Office for the cost of the audit where savings have been identified and are realisable.

Integration of financial and performance audit responsibilities

While we acknowledge that Audit Offices generally maintain a separation between financial and performance audit functions, it is our view that financial and performance audit work should be *integrated* within the organisational structure with an organisational focus on *audit clients and audit client service*. An audit client focus has the main advantage of:

- generating a greater capacity to understand "the business" and the business issues confronting the agency being subject to audit

- bringing an integrated approach to audit

- providing a single "interface" between the Audit Office and its clients Parliament, Government and agencies)

- maximising the opportunity for professional and career development of staff

- facilitating the introduction of attest audit of performance statements - which would be undertaken (we expect) in the same framework as audit of financial statements.

The present Performance Audit Branch would, in this contex, be responsible for technical issues concerned with performance audit and the management of sector wide studies. It would also provide a technical resource for attest auditors in all performance matters.

The development of an integrated performance-financial audit management structure would, in our view, take two to three years to fully implement. It will require attention to be given to management and organisation arrangements, position profiles and competencies, training and staff development. Implementation should be in the context of a specific *change management program.*

Distinction between performance audit and program evaluation

In reviewing the performance audit function, it is important that a distinction be drawn between "performance audit" and "program evaluation". The key differences are summarised below:

	Performance Audit	Program Evaluation
Focus	To provide assurance in an accountability relationship (Parliament) in relation to economy, efficiency and effectiveness	An aid to management for setting priorities, allocating resources and targeting implementation
Methodology	Audit based, "criteria" methods	Research "problem" based methods
Approach	Assessment by an independent auditor	Focussed assessment by a project team nominated by management
Selection of references	By auditor - may not be welcomed by management	By Minister or management - in response to a specific problem
Audiences	Parliament Government (Ministers), the Agency subject to audit, the community	The "Sponsor" Government (Minister) the Agency commissioning the work, the community (if published)
Publication of findings and recommendations	All reports tabled in Parliament	Publication at discretion of Ministers, Agencies

On the basis of these differences we do not consider that the Auditor General should be involved in program evaluation.

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Summary of Recommendations

The work of the Auditor General in the area of performance audit have a   21
focus on:

- economy, efficiency and effectiveness of agency management
  practices, operations and service delivery - developing and
  applying "criteria based" audit methodologies

- broad sector or government wide studies to identify audit
  criteria, benchmarks and best practice that have general
  application for use in direct audit assignments across
  particular agencies

- development of frameworks and the auditing of the accuracy
  and relevance of performance statements prepared by agencies
  (attest audit)

- auditing of performance statements and indicators contained
  in performance statements as to validity, relevance and
  accuracy

Efforts be made to enhance training of staff engaged in performance audit
work to performance improvement tools and techniques, including process
analysis, TQM, benchmarking and best practice.

Performance Audit be defined in the Public Finance and Audit Act as   28
relating to a review or examination of the economy and/or efficiency and/or
effectiveness of practices, operations and service delivery arrangements of an
agency

References to Special Audit in Section 38B be replaced by references to
Performance Audit

The Act make specific provision for the Auditor General to certify, or attest,
that performance statements and indicators prepared by management are a
relevant, reliable and fair representation of the economy, efficiency and
effectiveness of an agency's management, operations and service delivery
arrangements

References to compliance be removed from Section 38B. A new Section of
the Act be drafted to specify the roles, responsibilities and accountabilities of
the Auditor General in relation to compliance and regularity audit.

The cost of performance, compliance and regularity audit be met from   34
either:

- Parliamentary Appropriation; and
- Fee for service arrangements

The Public Accounts Committee adopt the following responsibilities in   35
relation to the Auditor General and the conduct of performance audit

- review and discuss the annual and forward performance audit
  plan with the Auditor General
- recommend for Parliamentary approval the resources required
  to undertake the Audit Plan
- review Performance Audit conclusions and recommendations
  following tabling in Parliament

In reporting on a performance audit, and without questioning the merits of   38
policy objectives, the Auditor General draw attention to areas where

- there is lack of clarity, ambiguity or inconsistency in policy
  goals and program objectives
- assumed policies are not supported by documentation and
  evidence of the intention of Government and/or Ministers.

The Performance Audit Branch prepare a Business Plan that clearly   43
identifies:

- Current Mission
- Goals and Objectives that are realistic and achievable over the
  short to medium term
- Key business issues
- The six or eight strategies to achieve goals and objectives
- The resource implications
- The performance indicators that will be used to report on
  achievement

The Audit Office adopt an integrated approach to audit that combines: 80

- review of financial and accounting systems

- assessment and attestation of financial reports

- considerations of arrangements to minimise risk

- assessment of the overall performance of individual services (on a cyclical basis)

- assessment of the effectiveness of management arrangements

- assessment and attestion of performance statements and indicators.

Strategies be put in place that will achieve integration of performance audit   81
work with the finance audit branches over a period of three to five years.

The Auditor-General work closely with the Parliament and the Central   83
Agencies in developing a systematic approach for performance reporting in
the NSW Budget Sector

The Auditor General be given responsibility for undertaking attest audits of
Performance Statements prepared by agency management and reporting on
the accuracy, relevance and reliability of performance indicators.

The current Performance Audit Branch continue as a separate organisational   84
unit with an ongoing responsibility for:

- undertaking broad based, sector wide performance audits with a view to developing audit criteria, benchmarks and best practice for use in performance audit work undertaken in operational areas

- developing the Office's methodology for audit of performance statements

- maintenance of performance audit manuals

- undertaking performance and related compliance and regularity audit work that does not fit easily within the client service focus and responsibilities of finance-performance audit branches.

The Public Accounts Committee have a specific responsibility for review of   85
Audit Office findings and conclusions and making recommendations to
Government

The Government be required to respond to Public Accounts Committee
reports within a six month time frame.

Main Report

1   Introduction

1.1 Terms Of Reference

Coopers & Lybrand was requested by the Public Accounts Committee to undertake a Review of the Performance Audit Function in accordance with the following terms of reference:

- To review the efficiency and effectiveness of the management and conduct of performance audits undertaken by the Audit Office of NSW

- In the context of that Review and without limiting its scope, attention should be given to:

  - Criteria for the Selection of Performance Audits
  - Planning and Control of Performance Audits
  - Criteria for Measuring the Efficiency and Effectiveness of Performance Audits
  - Performance Audit Investigation Processes and Quality Control Procedures
  - Compliance with Statutory Requirements for Reporting and Applicable Professional Standards
  - Skills and Competency of Staff
  - Productivity of the Performance Audit Branch
  - Performance Audits as Agents for Change in Public Sector

1.2 Approach To The Review

In approaching the terms of reference, we developed a number of "audit criteria" which have been used to assess the efficiency and effectiveness of the performance audit function. These are set out in the following broad terms:

1.2.1 Efficiency Criteria

Efficiency is the relationship between "inputs" and "outputs". For the Performance Audit function, inputs relate mainly to the time and cost of staff in the Performance Audit Branch. Outputs, or products or services, are completed Performance Audit Reports.

We have identified the key efficiency measures relevant to assessment of the Performance Audit function as follows

- Cost per unit of output - that is, the cost of completing a Performance Audit Report

- Time utilisation - the amount of time taken to complete a task compared with a standard

- Productivity - the relationship between work output and staff input

- Cycle Time - the elapsed time between the commencement of a Performance Audit Project (selection of the topic) and the completion of the Project (tabling in Parliament)

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Information to address these issues was obtained form the internal management, administrative and accounting records of the Performance Audit Branch.

1.2.2 Effectiveness Criteria

Effectiveness is the measure of output (product/service) conformance to specified requirements and expectations. For the Performance Audit Branch, requirements and expectations fall into two broad areas:

- *accountability to the Parliament* - by reporting on

  - uneconomic, inefficient and ineffective practices involved in the delivery of government services

  - matters that are referred to the Auditor by Parliament for specific review and opinion (such as the sale of the State Bank)

- *performance improvement* - assisting managers not only identify problems that contribute to poor performance but also identifying and suggesting ways that performance might be improved.

These expectations are expressed in one or more of the following ways:

- the provisions of the *Public Finance and Audit Act* - particularly Section 38B

- the wishes of the Parliament in relation to public accountability and reporting - reflected in

  - documents such as the 1990 and 1993 Reports of the Public Accounts Committee

  - specific Resolutions of the Parliament - such as requests to undertake Special Audits

- views of Ministers, public servants and academics about the relationship between Government and Parliament and the role of the Auditor-General in that relationship

- interpretations by the Auditor-General and his officers - expressed in reports, papers and presentations.

Within this framework, effectiveness indicators relevant to assessing the performance audit function relate to:

- *Quantity* - the number of reports produced and the extent to which the actual number conforms to what has been planned or expected

- *Timeliness* - the extent to which reports meet scheduled completion dates and are provided within a reasonable time frame

- *Acceptance* - he extent to which recommendations are (or will be) implemented

- *Quality* - assessed in terms of the extent to which:

  - audit criteria are relevant and appropriate to the subject matter of audit

  - collection, analysis and interpretation of data

  - the structure, consistency and logic of arguments

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- the validity of findings and recommendations in relation to the problems and issues being addressed

- reports are relevant and useful to a problem or situation being addressed

- the methodologies and approaches to investigation conform to professional and ethical standards.

- *Client Satisfaction* - the extent to which there is conformance with customer and client expectations - reflected in the views of the Parliament through the Public Accounts Committee and those of individual members.

Information to address these issues was obtained from:

- the reports themselves

- review of background and working papers

- discussion and consultation with agencies (Departments) that had been the subject of Performance Audits

- discussion with central agencies concerning the extent to which Performance Audit has been (and could be) the best instrument for tackling the issues that had been raised.

It was not possible during the review to obtain the views of Members of Parliament through direct consultation and interview.

1.2.3 Impact and Outcome

Many of the specific matters raised in the terms of reference refer not only to matters concerned with efficiency and effectiveness of the conduct of performance audits but also to the *impact and outcome* of performance audit work.

Our approach to assessing impact and outcome involved identifying from organisations subject to audit and other key stakeholders:

- what had been contributed through performance audit in areas such as improved management practices, resource allocation, work processes and client service

- the overall contribution of performance audit to enhanced public accountability and public sector performance improvement.

1.2.4 Other Matters

There are, in addition, a number of other structural factors that impact on the efficiency and outcome of the performance audits undertaken by the Office that are not specifically referred to in the terms of reference. These relate to:

- the management and organisation structure of the Performance Audit Branch and its relationship with the rest of the Audit Office

- the funding arrangements for performance audits

- coordination of performance audit activity with:

- the scrutiny and probity functions and responsibilities of other NSW Government agencies - such as
  - . the Council on the Cost Of Government
  - . ICAC
  - . the Ombudsman
  - . the Commissioner for Community Services
  - . the Parliamentary Public Bodies Review Committee

- the internal audit functions and responsibilities of Government Departments

- review and evaluation activity commissioned by policy areas within Departments

- Treasury and Premiers Department Review of Expenditure programs within the Budget process.

- the scope for the Audit Office to move away from direct reporting to attest auditing of performance indicators.

1.3 Key Issues To Consider

In preparing this Report, we have been mindful that there has been a great deal of discussion and advocacy about the role and function of performance audit in Government among audit professionals, legislators and academics during the 1970s and 1980s. Despite a great deal of development work, achievements have not always lived up to expectations in terms of developing robust methodologies and techniques, and clarifying the role of performance audit in the structure of responsibilities and accountabilities of an Auditor General.

It is accepted that the function of performance audit in an Office of an Auditor General needs to be clearly focussed in relation to the following issues:

- the scope of work that can be competently covered by performance audit

- the way in which performance audit relates to the "core business" of the Audit Office

- the contribution of audit based methodologies to the subject matter of performance audit

- the way in which performance audit can assist managers in developing strategies to improve operational performance

- accountability to the Parliament.

There is also the question whether the "topic based", direct reporting, approach to performance audit amounts to the best use of resources available compared to alternatives, such as:

- government wide studies of financial management issues

- regular "comprehensive" reviews, about once every four years or so, of a department or agency

- providing assurance to Parliament that performance reports and statements prepared by agencies are appropriate, complete and comprehensive (attest reports)

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- development of tools and techniques for performance measurement and performance indicators for use by agencies in the development of performance statements.

In this latter area, there has been a great deal of work undertaken within government, business, and the academic community, in relation to performance measurement and performance improvement. Connections are being made between some of the initiatives of performance auditing with TQM, total quality assessments and methodologies associated with ISO 9000, benchmarking, "best practice" and business process re-engineering.

It has become clear that the tools and techniques of performance audit are not the sole province of performance "auditors". In addition to traditional direct reporting audit criteria based approaches to performance audit (reflected in Auditing Standards), performance audits are undertaken by managers and business advisers using a wide range of process analysis techniques drawing on the traditions of industrial engineering, management accounting, quality management and information technology (through enterprise modelling and the application of CASE[1] methodologies).

1.4 Approach To The Review

It is against this background that we have approached the review of performance audit in the NSW Audit Office. It has not been our intention to look backwards and focus on criticisms and canvass debates about material that was, or was not, included in Performance Audit Reports. Nor do we intend to arbitrate whether a particular course of action was justified or not justified in the circumstances. Such an approach will deflect attention from the achievements that have been made and the opportunities that exist for performance audit to become an important element in the ongoing functional responsibilities of the Audit Office.

Our approach is to look forward and, drawing on the experience that has been gained, together with developments in performance measurement and performance improvement techniques, suggest ways in which performance audit can make a major contribution not only to public accountability but also to improvement in public sector management performance. This may involve substantial changes to the way in which the performance audit is organised and managed in the Audit Office.

Our observations and analysis in relation to matters raised in the Terms of Reference are included in this Report.

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[1] Computer Aided Software Engineering

2 The Performance Audit Framework

The purpose of this Section of the Report is to provide a framework for considering the way in which performance audit is planned, organised and undertaken in the NSW Audit Office. The framework will provide a basis for considering matters relating to efficiency, economy and effectiveness.

2.1 Scope And Coverage

The Auditing Standards Board of the Australian Accounting Research Foundation, defines an audit as the provision, by a party with "knowledge and experience commensurate with the nature of engagements", of a high level of assurance through:

(a)   the issue of a written report which expresses an opinion that enhances the credibility of a written assertion or set of assertions made by a party on a matter which is the responsibility of the party (**attest audit**) or

(b)   the preparation and issue of a written report which provides relevant and reliable information and the expression of an opinion about a matter where the party responsible for the matter does not make a written assertion. **(direct reporting audit)**[2]

Both attest and direct reporting audit have the objective to provide an auditor's opinion about the reliability of a matter that is the responsibility of another party. This is intended to ensure that the party which has been given responsibility for a matter is subject to an examination about their accountability.

The Audit Framework identifies three categories of audit:

Financial Report Audit: an independent systematic examination of an entity's financial report for the purpose of attestation, being the positive expression of an opinion on the financial report (or a component body) to enhance the credibility of the report.

Compliance Audit: an independent systematic examination of all or part of an entity's programmes, operations or activities to assess compliance with specific conditions which are imposed upon and govern those programmes, operations and activities. The conditions specified may be either external, for example the requirements of legislation or a contract, or internal, for example management directives.

Performance Audit: an independent systematic examination of all or part of an entity's programmes, operations or activities to assess economy and/or efficiency and/or effectiveness.

The Introductory Statement on Applicability of Statements of Auditing Standards and Statements of Auditing Practice, issued by the Institute of Chartered Accountants identifies a further category of *regularity audit* as:

an examination of financial information for the purpose of reporting on the legality and control of operations and the probity of those dealing with public funds, and including the expression of opinion on an entity's compliance with statutory requirements, regulations, rule, ordinances or directives that govern the activities of the entity.[3]

In addition to these audit categories, reference is often made to the concept of *comprehensive audit*. This has been defined in the following terms:

. . . an examination that provides an objective an constructive assessment of the extent to which:

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[2]   "Explanatory Framework for Guidance on Audit and Audit Related Services"
[3]   Para 5(b), p. 2005, Issued 3/87.

- financial, human and physical resources are managed with due regard to economy, efficiency and effectiveness; and

- accountability relationships are reasonably served

The comprehensive audit examines both financial and management controls, including information systems and reporting practices, and recommends improvements where appropriate.[4]

In this Review, and consistent with the Terms of Reference, the major focus of concern is with performance audit.

The Auditing Standards Board and the Australian Accounting Research Foundation are currently in the process of revising the Audit Framework. The proposed Auditing Standard AUS 806, *Performance Auditing*, provides:

"Performance audit means audit of all or part of an entity or entities to assess economy and/or efficiency and/or effectiveness. It includes any Audit directed to:

(a)   the adequacy of an internal control structure or specific internal controls, including those intended to safeguard assets and to ensure due regard to economy, efficiency and effectiveness

(b)   the extent to which resources have been managed economically and efficiently and

(c)   the extent to which activities have been effective.

"economy" means the acquisition of the appropriate quality and quantity of financial, human and physical resources at the appropriate times and at the lowest cost

"efficiency" means the use of financial, human and physical resources such that output is maximised for any given set of resource inputs, or input is minimised for any given quantity and quality of output

"effectiveness" means the achievement of the objectives or other intended effects of programmes, operations or activities.

While accounting standards, legislation and academic literature are unequivocal about the concerns of performance audit with matters of economy, efficiency and effectiveness, guidance contained in the academic and professional literature about the subject matter, and the methodology, of performance audit varies considerably. For example, the International Organisation of Supreme Audit Institutions (INTOSAI) regards performance auditing as embracing:

(a)   audit of the economy of administrative activities in accordance with sound administrative principles and practices, and management policies

(b)   audit of the efficiency of utilisation of human, financial and other resources, including examination of information systems, performance measures and monitoring arrangements, and procedures followed by audited entities for remedying identified deficiencies

(c)   audit of the effectiveness of performance in relation to the achievement of the objectives of the audited entity, and audit of the actual impact of activities compared with the intended impact.

The Task Force on Performance Auditing, that reported to the US Association of Government Accountants, identified the scope of performance audit in the following terms:

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[4]   Canadian Comprehensive Audit Foundation, *Comprehensive Auditing: Concepts, Components and Characteristics*

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. . . the systematic and objective assessment of the performance of an organisation, program, function or activity by an independent auditor, who reports findings, conclusions and recommendations to a party or group with a legal responsibility to oversee and/or initiate corrective action.

These, and other definitions can give rise to a view that performance audit is concerned with matters in all areas of the public sector management process - with the exclusion of policy decisions on the objectives to be pursued. These high level policy decisions provide the direction and context for the public sector management process. Responsibility for policy decision making on objectives is generally regarded as falling within the responsibility of elected representatives.[5]

The public sector management process can be represented diagrammatically below:

The Public Sector Management Process

| Policy Decisions: Purpose Mission | → | Strategies to Achieve the Mission (Programs) | → | Organis- ation Roles and Structures | → | Resources Funds People Assets | → | Work Processes [What is done] | → | Products and Services [What is produced] | → | Impacts and Outcomes [What is Achieved] |
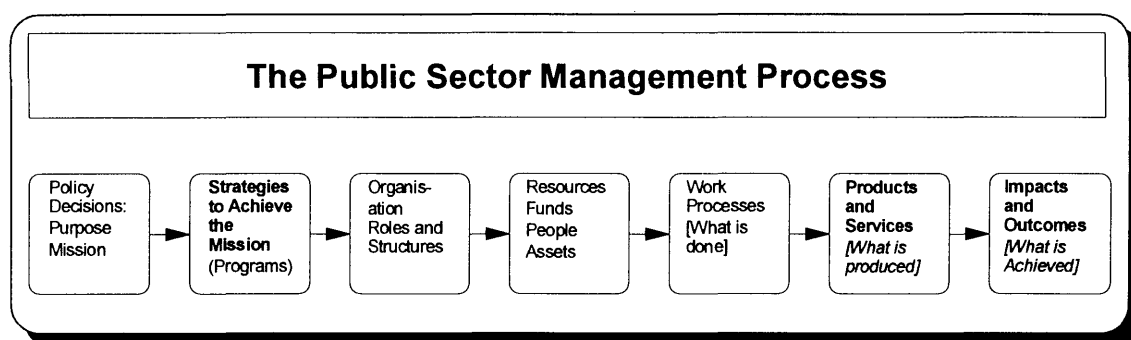
The diagram draws attention to a *relationship* that exists between the following elements:

- the broader *policy basis* - from which public sector management activity derives, that is, the rationale for government action and what is intended to be achieved[6]

- the more specific *implementation strategies*, or programs, that cover:

  - the way in which policy makers intended the interventions to be carried out

  - the specific initiatives put in place to give effect to the policy intentions

  - how those results contribute to the achievement of higher level program and/or policy objectives

- the *organisational arrangements* - the organisational structures developed for implementation of the project, covering the form of organisation, the division of management responsibilities and accountabilities (who reports to whom, coordination arrangements and committee structures)

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[5] It is the term policy, and the interpretation of its meaning, that raises some of the most contentious issues in the scope and coverage of performance audit. There is an extensive literature on the subject of public policy formulation. Moreover, the issue of separation of responsibilities and accountabilities for "policy" and "administrative" (management) work has occupied the minds of scholars in public administration and political science for many years. It is not intended to canvass that debate in this review.

[6] It is recognised that "policy decisions" are made in all aspects of the management process. This issue is addressed in Section 3.4.

- the *resource allocation and control* procedures - the management of personnel, skills, funds, property and legislation necessary to deliver identified services

- the *work processes and activities* undertaken with the resources available - identified in terms of specific tasks, processes, operations

- the *outputs generated* - the quantity, scope and coverage of products, services and information provided for the benefit of intended recipients

- the *impacts and consequences* - the achievements of actions and initiatives in relation to client outcomes and policy objectives - both intended and unintended.

A broad interpretation of the scope of performance audit work might involve a mandate to consider matters concerned with economy, efficiency and effectiveness in one or all of the elements of the public sector management process - that is

- program results
- organisation structures
- resource allocation arrangements
- projects
- functions
- operational processes
- activities.

In Audit Offices in Australia and overseas there is an interest on the part of legislatures and academics, as well as Auditors General, in including within the scope of performance audit not only matters concerned with the efficiency and effectiveness of operational processes but also the efficiency and effectiveness of programs (program results).

Such a broad and inclusive mandate of performance audit for an Audit Office may give rise to some questioning within Government about the interaction and inter-relationship between the role of the Auditor-General in performance audit and the responsibilities of other Government processes and instruments directed towards improving performance - particularly in relation to the review of program results and organisation structures.

It is important to acknowledge that the Auditor General is not the only agency involved in the performance audit business (although it is the only agency reporting to Parliament). Nor are the definitions and methodologies for performance audit, as set out in auditing standards and the accounting literature, the only ways to approach performance review in government. There are numerous government agencies involved in assessing economy, efficiency and effectiveness of government activities, using a variety of review tools and techniques.[8] These include:

- internal and inter-departmental policy and program effectiveness reviews

- reviews by the Council of the Cost of Government (for example, the review of corporate services functions)

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[8] The main difference between the Auditor General and other agencies is the unique direct reporting arrangement with the Parliament.

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- specific central agency initiatives (for example, outsourcing, cost reduction exercises)

- Treasury reviews in the budget context

- reviews undertaken by Departmental Internal Audit Teams.

The Auditor General is, however, unique in that:

- it is the only institution with a responsibility to report directly to Parliament

- performance audit work is clearly independent of the Executive Government[9].

The major focus of performance audit work in Britain and Canada has been in relation to the *performance of management* in securing economy, efficiency and effectiveness. Arrangements for securing economy, efficiency and effectiveness are integral to an agency's management structure and can only be sensibly considered in that context.

In Britain, the emphasis in audit work undertaken by the Audit Commission[10] has moved away from examination of economy and efficiency towards greater emphasis on effectiveness of management practices and arrangements and the quality of service provided. *Examination of service effectiveness does not necessarily involve evaluation of program effectiveness.*

In Canada, experience has demonstrated that attempts to change emphasis in performance audit from management practices to program results have met with limited success. The task of auditing program results, using audit based methodologies, is very difficult in a rapidly changing public sector environment - as departments are redefining (reinventing) their mandates, cutting costs, devolving and re-engineering processes and practices.

It does not follow, therefore, that a broad and inclusive mandate for performance audit, implied in the auditing framework, means that an Auditor-General should take responsibility for all aspects of performance audit work that can be or might be undertaken within Government. Indeed, there are many people within Government and in the accounting profession who consider that the Auditor-General should not be involved in undertaking performance audit at all.

In this regard, we note that the proposed Australian Auditing Standard reflects a new direction in relation to the use of the term "performance audit". There is now a distinct *operational* focus. This is a departure from the previous formulation in the Australian Auditing Framework and Auditing Standards which included reference to an "entity's programs" as being within the scope of performance audit.

For the purposes of illustration, the following chart identifies for each level of performance review, the tools and techniques that are generally adopted and the agencies that might be involved. *It is not intended that the chart represent a complete picture of performance review activity within Government.*

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[9] It is open for the Government to appoint other people and/or organisations to undertake "independent" performance review work - such as Commissions of Inquiry, members of the legal profession and former public servants whose reports may be released.

[10] The Audit Commission reports publicly but does not report to Parliament.

Focus of Performance Review	Review Tools and Techniques	Agencies Involved in Review Activity
Organisation Review	Management Strategy Analysis. Top Structure Review.	Central Agencies. Agency Executive Boards. External Advisers
Program Review	Program Evaluation. Policy Analysis.	Ministers. Program Managers. Internal Program Review Units. Inter-Agency Committees. External Advisers
Resource Review	Review of expenditure commitments and Budget priorities. Across the Board cost cutting,	Cabinet, Ministers, Treasury
Project Review	Cost Benefit Analysis. Economic and Financial Appraisal	Treasury. External Advisers
Function Review	Benchmarking, Best Practice	Council on the Cost of Government. External Audit
Management Process and Operational Process Reviews	Process Analysis	Internal Audit. External Audit.
Activity Review	Transactions Verification and Certification. Probity Assessment.	Ombudsman. ICAC. External Audit.

In approaching the performance audit task, it is important for the Auditor General to identify the areas of particular expertise and the areas where the greatest potential contribution to improved performance and accountability can be made. This expertise centres on:

- the knowledge of agencies' operational activities gained from financial audit and the work of people involved in financial audit work

- the opportunity to develop performance audit work from the financial audit base

- the capacity to develop and apply audit based methodologies in performance audit - as distinct from other problem solving/research based methodologies

- the "independence" of the office and the capacity to report directly to Parliament.

2.2 Forms Of Performance Audit

There are two broad forms of performance audit: direct reporting and attest. The structure of audit in this context is illustrated in the diagram below.

Audit Framework

AUDIT
High level of assurance required in accountability relationship

Auditor Responsible for scope of audit process
Systematic examination
Nature, timing and extent of audit procedures to provide sufficient appropriate audit evidence to enable reasonable conclusions to be drawn

ATTEST AUDIT	DIRECT REPORTING
Report Audit opinion on written assertion by another party	Report audit opinion where no written assertion is provided by responsible party

| Positive expression of opinion on accountability assertions | Report providing information relative to accountability issues and criteria and auditor's opinion as to achievements against the identified criteria |

Further comments on each form of audit are provided below.

2.2.1 Direct Reporting

Direct Reporting involves reporting of instances where responsible persons (eg auditors, Parliament, Board of Management) thought there had been a lack of due regard to value for money in the administration of public funds. Characteristics are:

- an observed instance in a specific transaction or decision

- an instance was observed as part of other audit activities: the observation did not result from systematic, planned approach to address value for money

- there are no pre-determined criteria to help assess what would or would not merit reporting

Audit reports emphasise findings and conclusions on whether or not due regard for value for money was evident. Specific evidence of deficiencies are reported.

There is an underlying philosophy in direct reporting, as distinct from attest audit, that presumes managers will make mistakes and from time to time need to be reviewed in order to identify where things have gone wrong and that this needs to be identified publicly as an incentive for improved performance.

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The approach tends to give reports a negative, or critical, flavour. To this end, management responses are included in the Report with a view to responding where thought necessary and appropriate in relation to audit finding and interpretations.

To date, consistent with the legislation, all performance audits in NSW have been undertaken as direct reporting assignments.

2.2.2 Attest Audit

The underlying philosophy of attest audit is to trust and work with managers and get them to report on their own performance - with the auditor adding some level of assurance that this information was appropriate, complete and comprehensive to meet the needs of the Parliament.

The approach involves the provision of audit opinions on reports that contain representations by management on efficiency, economy and effectiveness. The lack of such reports from Government agencies means that there is some difficulty in using the approach.

The task of preparing management representations is a *management* job. The audit task takes place after the representations have been prepared.[11] The overall audit approach is summarised in the current Audit Framework in the following terms:

> In situations where the auditor is engaged to form an opinion and report on a written assertions(s) provided by another party, the audit level of assurance is expressed as a positive opinion. In this case the auditor's opinion. In this case the auditor's opinion enhances the credibility of the information provided by the party responsible for the matters. ...

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[11] Most financial audit work is undertaken on an attest basis. The work of financial auditors involves forming opinions, reporting and certifying on the fairness and accuracy of financial statements prepared by management. In certain circumstances, Auditors may qualify or not certify accounts. This indicates that an auditor does not agree with management's representations.

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2.3   The Methodology Of Performance Audit

There is a great deal of mystique concerning the methodologies and approaches to performance audit and the professional disciplines that are associated with them. The United States Association of Government Accountants Task Force of Performance Auditing observed that:

> Unlike financial auditing, performance auditing is not the domain of a single profession or discipline; it is an activity that draws on the tools and techniques of many disciplines (particularly economics and the social sciences). Moreover, performance auditing often requires the use of advanced research methods, particularly when audits attempt to assess and document the cost-effectiveness and impact of government programs.

The tools and techniques of performance audit can be grouped into two broad methodological streams. These are:

- an accounting based "audit criteria" approach and

- a research based "problem orientation" approach.

Brief comments on each approach are set out below.

2.3.1   Audit Criteria Methodologies

Performance Auditing has, in a number of respects, been "claimed" by the accounting profession. The Auditing Standards Board of the Australian Accounting Research Foundation has allocated a great deal of time and effort to developing Auditing Standards in relation to performance auditing. The current draft standards provide a basis for greater focus and direction in the planning and conduct of performance audits.

An audit based approach involves a great deal of attention being given to planning, the development of audit criteria, documentation and reporting. The approach is highly process oriented which is reflected in the production of detailed manuals and requirement to complete and file forms and records.

The key methodological aspect of the audit based approach is the identification of "suitable criteria" to enable an auditor to assess the activities subject to an audit. The Proposed Audit Standard AUS 806, "Performance Auditing" provides:

> The provision of an audit requires that each matter being addressed is capable of evaluation against suitable criteria. Criteria are reasonable and attainable standards of performance against which the extent of economy, efficiency and effectiveness can be assessed.

Proposed Standard 808: Planning Performance Audits, defines suitable criteria as:

> . . . those that are relevant to the matters being audited and appropriate in the circumstances. . . . At the initial planning stage, criteria may be identified at a general level, however, more specific criteria will need to identified during the audit process.

The Standard also points out that:

> As there is no body of generally accepted criteria for all aspects of performance auditing, suitable criteria may be developed by management or by the auditor, and may be derived from:

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(a) regulatory bodies, legislation or policy statements

(b) standards of good practice developed by professions, associations or other recognised authorities

(c) statistics or practices developed within the entity or among similar entities

(d) criteria identified in similar circumstances

As the identification and use of "criteria" is the critical element in the audit approach, a large amount of time can be taken up in an audit in the search for suitable criteria.

The draft Audit Standards contain important and useful information in relation to the development of criteria, evidence, documentation and reporting. This material will, if the Standards are adopted, need to be examined to see whether any revision and enhancement of internal Performance Audit Manuals is required. However, there is very little information in the Standard or current manuals on particular tools and techniques that can be used in investigation and analysis.

The main advantage of the audit criteria approach is that it is systematic and disciplined. It is also considered to be highly objective. The methodologies are particularly appropriate to reviewing operational processes and procedures and identifying "benchmarks" that can be represented as good (or "best) practice.

Recommendations for improvement that flow from *operational* reviews that involve using audit criteria can be straight forward and non-controversial - providing the criteria are accepted and agreed by all parties. For example, benefits that derive from process improvement and reform of procedures and practices are often easy to quantify - as well as being straight forward to implement.

In direct reporting assignments audit criteria tend to be unique to the topic that has been selected. They tend to take a long time to develop and may have limited application outside the particular audit. However, benchmarks and best practice identified through the development of an audit criteria approach can be used on a wider scale in assessing performance in other agencies where there are similar functions, processes and activities being performed.

In Australia and overseas, more research is being undertaken within audit offices to develop audit criteria that have general application across particular government sectors (such as health, eduction, fire services, the environment). Criteria developed in this way can be used in both direct audit and attest audit work[12]. This is essentially the approach of the UK Audit Commission which is responsible for audit of Local Government and the National Health Service. Development of audit criteria in this way is time consuming and resource intensive: assignments in the UK can cost up to $600,000.

The audit based methodologies have been criticised in application because of the large amount of time involved in project scoping and their lack of problem orientation. In this regard, such methodologies are not particularly useful in relation to broad based program effectiveness reviews and organisation reviews where there are often quite complex issues to address. Audit criteria can sometimes be difficult, if not impossible to identify.

Program review and organisation review are generally directed towards resolving particular problems and difficulties that have arisen in implementation. Problems are

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[12] That is, *management* is required to prepare reports in relation to criteria for review by an auditor.

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often known in advance and corrective action is generally being sought by the review sponsor. Ministers and senior officers may not want broad dissemination about the nature of the problems and issues that are being addressed. Conclusions and recommendations can often be controversial as well as requiring careful consideration in implementation.

2.3.2 Problem Based Research Methodologies

Research based approaches to performance audit draw largely on the tools and techniques of economics and social research. The methodological structure is broadly:

- problem identification - identifying and clarifying the nature of the problem, or problems that are to be addressed

- development of an analytic/research framework - to provide a basis for the direction of research and analysis

- development of hypotheses concerning relationships between problems, causes and effects

- collection of information that will inform judgement and opinion in relation to cause-effect situations

- development of options that will lead to improvement - in terms of overcoming the problems that have been identified

- testing the practicality, desirability and feasibility of options

- recommending preferred courses of action.

Research methodologies are appropriate to organisation and management review and program review and evaluation. Such reviews are usually initiated when a problem has become apparent that requires resolution. Review work relies on a great deal of knowledge and experience, intuition and an understanding of what will or will not work in particular situations and circumstances that are prevailing at a given time. It is not possible to codify this knowledge in manuals and hand-books.

A research methodology involves a clear focus on a problem and a commitment to resolve it. However, methodologies drawn from the social sciences often have tendencies towards particular solutions and outcomes: they are not necessarily "value free".

2.4 Relevant Skills, Capability And Experience For Performance Audit

There is no academic qualification in "performance audit". As indicated, the discipline base derives not only from accounting, but also from economics, industrial engineering, management science, social psychology and policy analysis.

The tools and techniques from other disciplines that are relevant to the development of audit criteria include[13]:

- Process Analysis and Process Mapping (including story-boarding)
- Business Process Improvement/Re-engineering/Innovation
- Activity based costing (as well as conventional costing)
- Total quality management
- Benchmarking
- Cost Benefit Analysis
- Economic and Financial Modelling
- Management Analysis

There is a need to introduce people engaged in performance audit work to these and similar tools and techniques.

Professional services firms have made substantial investments in the development of performance improvement tools and techniques. Most can be obtained on the basis of "off-the-shelf" modules which have been designed to provide a focus in the development of criteria for performance improvement in operational areas. These can be acquired by Audit Offices in the same way that financial audit methodologies have been acquired.

The more general skills that are appropriate for performance audit are:

- Knowledge of government
- Knowledge of subject matter
- Problem solving
- Investigation and research
- Communication
- Team Players
- Ability to deal with complexity

The methodological basis of performance audit is such that it does not require a specialised discipline and career stream within an Audit Office: some people with experience in financial audit can, and do, learn and apply the tools and techniques appropriate to performance audit. Opportunities to work in both financial and performance audit can expand the career horizons and aspirations of young accountants entering the audit profession.

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[13] H. James Harrington, in *Total Improvement Management*, identifies 150 performance improvement tools and methods.

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2.5 Conclusion

Commenting on the Canadian experience with performance audit, a senior partner with Coopers & Lybrand, who spent a number of years in the Canadian Office of the Auditor General advancing the practice of value for money, performance and comprehensive auditing, has commented:

> There is a lot of "water under the bridge". We have made far more mistakes than anyone will care to admit. There is a great deal of literature, most of which would lead you completely astray, and most of which is nonsense.

There is a need to develop a clear focus on what performance audit can achieve in terms of accountability and performance improvement and what can be accomplished in the present institutional framework. It is particularly important to avoid:

- raising expectations about what performance audit can do in terms of improving performance in government - compared to other approaches

- seeing performance audit as a discipline in its own right and substantially different from other process improvement methodologies and techniques

- using performance audit assignments as instruments of compliance

- creating a perception that performance audit is a costly exercise requiring a substantial commitment of resources - not only by the Audit Office, but also by the agency being subject to audit.

These matters are addressed in further detail in later sections of this Report.

In NSW, the Auditor-General has a special and unique contribution to performance audit work. This relates to:

- the ability to develop and apply skills, knowledge and expertise in accounting and audit based methodologies in functional and operational aspects of performance audit work

- the independence of the Auditor General and the capacity to report directly to Parliament.

The tools and techniques that have been developed by accountants and auditors for performance audit are not generally suitable for all areas of performance audit work. The "criteria based" audit methodology is well suited for review of management practices and functional and operational review (particularly process analysis and benchmarking) while other problem oriented and research based methodologies are more suited to organisation and program review.

A focus on operational issues in performance audit is consistent with the widespread interpretation of economy, efficiency and effectiveness relationships. These are summarised below.

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3.1 The Performance Audit Mandate

3.1.1 Provisions in the *Public Finance and Audit Act 1983*

The *Public Finance and Audit Act* does not mention the term "performance audit". The Act gives the Auditor-General power to undertake *Special Audits*:

Special Audit by Auditor-General

38B (1) 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 relevant laws

(2) A special audit is separate from, and does not affect, any other audit required or authorised by or under this Act or any other Act.

38C (1) The Auditor-General, to report to the Head of the authority, the responsible Minister and the Treasurer as to the result of any special audit and as to such other matters as in the judgement of the Auditor-General call for special notice

(2) The Auditor-General must not make a report of a special audit under this section unless, at least 28 days before making the report, the Auditor-General has given the Head of the authority and the responsible Minister a summary of findings and proposed recommendations in relation to the audit

(3) The Auditor-General is to include in the report of a special audit under this section any submissions or comments made by the Head of the authority or a summary, in an agreed form, of any such submissions or comments.

Special audit not to question policy

38D Nothing in this Division entitles the Auditor-General to question the merits of policy objectives of the Government including:

(a) any policy objective of the Government contained in a record of a policy decision of Cabinet; and

(b) a policy direction of the Minister; and

(c) a policy statement in any Budget Paper or any other document evidencing a policy decision of the Cabinet or a Minister.

The effect of Section 38C(2) can preclude the Auditor-General from forwarding the draft report to any other authority during a 28 day time period - including other Ministers. The Solicitor General is of the view that the Auditor-General could forward a report to the responsible Minister with a request that the Minister confer on matters with his colleagues.[15]

There is an obligation on the part of the Auditor General, under Section 52 of the *Public Finance and Audit Act* to address compliance and regularity issues as part of a financial statement attest audit. Although the section refers specifically to public accounts, the Audit Office has interpreted it as applying to all financial statement audits. The relevant provisions are

Auditor-General's Reports

52 (1) After examining the Public Accounts transmitted to the Auditor General in accordance with Section 6(a) the Auditor-General shall prepare and sign a report

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[15] Opinion, p. 14

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that shall include full particulars in every case in which the provisions of this or any other Act or the prescribed requirements have not been carried out or adopted or have in any manner been varied or departed from and which, in the opinion of the Auditor General, are sufficiently material to the financial position disclosed in the accounts as to be brought to the attention of the Legislative Assembly.

(3) The Auditor-General may, in the report of the Auditor-General prepared under sub-section (1) or in any special report which the Auditor-General may at any time think fit to make, recommend any plans and make any suggestions for the better collection and payment of public money, and for more effectually and economically auditing and examining the Public Accounts and the accounts of statutory bodies to which Division 3 and 4 applies, and may generally report on any matter arising from audit which in the opinion of the Auditor-General should be brought to the attention of Parliament

Tabling etc. of special reports

52(B) The Auditor-General is, as soon as practicable after making a special report under Section 52(3), to present the report to the Legislative Assembly, if the Legislative assembly is then sitting.

3.1.2 Interpretation of The Special Audit and Special Report Provisions

The provisions of Section 38B have been interpreted by the Solicitor-General in a way that any audits undertaken that address efficiency, economy, effectiveness and/or compliance are considered to fall within the scope of Section 38B - notwithstanding the authority of the Auditor General to address compliance and regularity issues in the terms of Section 52(3). Accordingly, all Special Audit Reports are subject to the 28 day requirement for comment and confidentiality provisions and may include comments from the agency subject to audit.

The effect of this interpretation is that anything that is not a financial audit is regarded as a special audit. This is the case even when the Auditor-General completes a financial audit and puts resources into examining a complex compliance issue. The Auditor-General has observed that:

> So I am in this bind at the moment, but it also means that I am not sure what I am doing when I am doing it. When I sign an opinion I know what that is but if it is not a simple financial audit I do not know what it is. It could be a performance audit and it probably is, and that is a messy situation which I would rather not have.[16]

The combination of matters concerned with economy, efficiency and effectiveness (performance audit) with matters concerned with conformity with statutory, contractual and accounting standards (compliance audit) in the terms of Section 38B creates some major difficulties. These relate to:

- a presumption that performance audit is the same as compliance audit

- a confusion in relation to the methodologies and approaches that are appropriate to each particular type of audit

- a tendency for a performance audit to be seen as a "major event" and a matter of concern for the agency being the subject of audit

- the method and style of reporting and presentation.

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[16] Australia. Parliament. Joint Committee of Public Accounts, *Hansard*, 27 July 1994, p.259.

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The Auditing Standards, referred to in section 2.1 of this Report, clearly distinguish between performance audit and compliance audit - as well as regularity (probity) audit. However, in the absence of the provisions of Section 38B, matters concerned with compliance (and regularity) would only be addressed where a relevant transaction forms part of a sample selected for testing.

The Auditor General has commented in a recent Report to the Parliament that:

> The high degree and diversity of regulations that govern the operations of public sector entities is a key factor in the need for compliance/regularity audits in the public sector. This component is an essential consideration that Auditors General and others involved in public sector audits must take into account when planning and conducting their audit work.

> Probity issues are also seen as a significant part of the audit mandate of the public sector auditor. The issues of honesty and integrity in relation to public funds are important to the public accountability process. Any doubts over the probity of the people dealing with public monies or of the transactions in relation to these public funds should also be thoroughly investigated and reported to Parliament.[17]

We are of the view that the methodology and approach of performance audit is fundamentally different to the methodologies and approaches to compliance/regularity audits. The methodology of performance audit was canvassed in some detail in Section 2.1.3.

The methodology of compliance and regularity audit tends to focus on finding errors, mistakes, inconsistencies and departures from legal obligations, conditions and principles applying to operations and activities. The approach tends to be investigatory, and at times forensic, in its orientation and has an over-riding concern with, due process, correctness, honesty and integrity.

The outcomes of compliance/regularity audits are not necessarily the same, or consistent with, the tools and techniques of performance audit. Compliance reports are often directed towards identifying and attributing "blame" while performance reports are (or should be) directed more at identifying scope for improvement.

The combination of compliance with performance audit work in a single legislative directive and management framework has the potential for methodologies and approaches to become confused and for agencies to see performance audit in a negative way. *Moreover, an audit approach that is directed towards compliance with existing regulations and directions may overlook the need to change inappropriate/unnecessary regulations in order to improve overall operational efficiency and effectiveness.*

"Special" audits undertaken by the Auditor General which would be more generally regarded as compliance/regularity audits rather than performance audits are:

- Review of the Home Fund

- Special audit of the State Bank

- Review of accounting treatments of
    - the Sydney Harbour Tunnel
    - the M4 and M5 tollways

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[17] Auditor General, *Report, Vol.2*, November 1994

- Review of estimates for the Sydney Olympics

These reviews have constituted a significant and important part of the work of the Audit Office. We are of the view that the Auditor General should continue to be involved in compliance and regularity reviews - but in a separate framework to performance audit.

The Auditor General has pointed out that there is a range of compliance and regularity issues that are, "for the most part" not considered by Audit. The Auditor General has canvassed the possibility of greater attention to compliance issues in the following terms:

> A program of compliance could be developed as part of, and integrated into, the annual financial audit so that, over a modest number of years, all of the generally applicable major laws and policies affecting agencies are covered. On top of this, a compliance program looking at adherence by each entity to major (non financial) legislation and policies that are peculiar to it would also be necessary. This too should be designed to cover the field on a cyclical basis.[18]

3.1.3 "Whistle-Blower" Provisions

Recent amendments have been made to the Public Finance and Audit Act to complement the introduction of protected disclosures (whistle-blowers) legislation. These amendments have been made to give the Auditor-General clear powers to investigate disclosures made regarding serious and substantial waste. However, in so doing, the term "special audit" has been used.

This possibly raises, again, the spectre of definitional issues. While an investigation of a protected disclosure would not need to address all elements of economy, efficiency, effectiveness and compliance, it is not helpful that a report oriented solely to compliance issues should be managed in the same way as performance audits. Moreover, being a "special audit", reporting requirements may be inappropriate, and difficult to comply with.

It is our view that the "whistle-blower" provisions should be regarded as matters concerning regularity and/or compliance and should not fall within the ambit of Section 38B of the Audit Act.

3.1.4 Direct Vs Attest Reports

Parliamentary requests for the Auditor General to undertake "Special Audits" have indicated a preference for a direct audit approach - that is, detailed reports on specific topics. There is no systematic requirement, or request, for the Auditor General to produce reports on performance statements and indicators.

The effect of Parliament's requirements has had the effect of concentrating resources in the area of direct reporting. The level of resources that goes into preparing direct audit reports is extensive. This issue is addressed in further detail in Section 7.

An alternative approach to performance assessment is for the Auditor General to assist the Parliament, through the Public Accounts Committee in:

- undertaking more far-reaching audits of agencies on a regular basis

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[18] Harris, A.C., "The Changing Role of the Auditor in the Public Sector", paper for the CPA Congress, October 1995.

- recommending a structure of performance indicators and performance based information systems that can be used on a whole of government basis

- suggesting formats for agencies to prepare reports on performance and providing an assurance that the indicators are reliable and a reasonable representation of economy, efficiency and effectiveness in the use of resources.

These initiatives would be consistent with developments within Government in relation to output budgeting and management information systems. However, implementation of initiatives along these lines would require amendments to the *Public Finance and Audit Act*.

3.1.5 Future Directions

In our view, there is a continuing and major role for the Auditor-General to undertake performance audit of agency operations to ensure that resources are being used and allocated efficiently, effectively and economically. This is a logical extension of financial audit work.

It is also our view that the Auditor-General, on the basis of the independence of his Office, is in a good position to continue to undertake special investigations of compliance issues. These issues relate to:

- compliance with relevant laws, standards and protocols concerning the treatment and recording of financial transactions

- regularity in relation to the financial management of an organisation

- investigations of probity in relation to financial dealings

We do not consider, however, that this work should be confused with performance audit responsibilities. Moreover, because of the special project nature of compliance work, and the size and scale of assignments, it is appropriate that the work be managed independently of the ongoing financial and performance audit work of the Office.

We consider that a great deal can be achieved in performance audit work through the development of more relevant and appropriate audit criteria, indicators and benchmarks that can be used in the ongoing audit function and working towards a system of performance reporting. A great deal of progress has been made in the last year in this area.

Recommendation

> *Performance Audit be defined in the Public Finance and Audit Act as relating to a review or examination of the economy and/or efficiency and/or effectiveness of operations of an agency*

> *References to Special Audit in Section 38B be replaced by references to Performance Audit*

> *The Act make specific provision for the Auditor General to certify, or attest, that performance statements and indicators prepared by*

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management are a reliable and fair representation of the economy, efficiency and effectiveness of an agency's operations

References to compliance be removed from Section 38B. A new Section of the Act be drafted to specify the roles, responsibilities and accountabilities of the Auditor General in relation to compliance and regularity audit.

Further considerations in relation to selection of performance audit topics and the initiation of compliance audits are addressed in later parts of this Section.

Proposed arrangements for the management of performance and compliance audit are canvassed in Section 8 of the Report.

3.2   Selection Of Performance Audit Topics

3.2.1   Background

The Public Accounts Committee, in its 1993 Report, *Review of Special Auditing Function of the NSW Auditor-General's Office,* was of the opinion that the Auditor-General had not undertaken any "special audits" on the basis that the four reports completed at that time had not addressed all of the elements of economy, efficiency, effectiveness and compliance. The Committee noted:

> A literal reading of Section 38B(1) may lead to the conclusion that where the Auditor-General undertakes an audit under this Section, that audit must encompass an audit as to economy, efficiency *and* effectiveness. An audit which examines some, but not all, of these issues, and which does not examine compliance with legislation, may well not be an audit under Section 38B(1).[19]

When the Committee's Report was received, the Audit Office determined that, although it did not agree with the approach taken by the Public Accounts Committee, it would comply with their directions. This was stated in the Office's Annual Report, and factored into the selection, planning and execution of performance audits for 1994.

This interpretation of Section 38B had encouraged the Auditor-General in 1994 to select matters for performance audit that focus on *all* matters concerned with economy, efficiency, effectiveness and compliance. However, not only had it been difficult to identify audit topics that cover this mandate, it has also made the conduct of assignments particularly broad ranging and resource intensive.

On the basis of our review of performance audit reports completed to date, and discussions with agencies and program managers that have been responsible for programs subject to audit, the approach that was adopted had given rise to some difficulties in the development of performance audit capability[20]. There was a strong view that audits should be more limited in their scope and less ambitious in their deliverables.

Advice from the Solicitor-General during 1994 appeared to dismiss the Public Accounts Committee view. In the absence of any further clarification or debate of the issue, the

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[19]   Report, p. 41
[20]   Our analysis of Performance Audit Reports is set out in Sections 5, 6 and 7 below.

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planning of the Performance Audit 1995 program sought to include a balanced mixture of performance audits.

The Performance Audit Branch has indicated that it will continue to appraise the mix of audits currently being undertaken, with a view to conducting smaller (shorter) audits with a mix of longer audits. This has the potential to further increase output (in terms of the number of reports and reduce the average costs per report).

3.2.2 Sources of Special Audit References

The Audit Office has identified five sources of Special Audit references. These are:

- Parliament - where Parliament agrees to a motion to require the Auditor to examine a particular matter

- Parliament - Other - where the Premier or a Minister or one or more Parliamentarians requests that the Auditor undertake a review

- Requested and paid for by Agency - where requests are made and costs are met by an agency

- Financial Audit - a review arising out of issues identified by audit staff working on a financial audit

- Performance Audit Branch - where performance audits are initiated by the Audit Office as part of the Performance Audit Branch's strategic planning process.

The performance audits that have been completed, in progress or about to commence, according to this classification are listed below.

Reference Source and Reference	Agency	Status
Parliament		
Special Audit of the Homefund Program	Homefund Program	Complete
Special Audit Report: Proposed Sale of the State Bank	State Bank	Complete
The M2 Motorway	RTA	Complete
Statutory Interest Account	Attorney General's Department	In Progress
Parliament - Other		
Statutory Investments and Business Enterprises	Aboriginal Land Council	Complete
Review of Estimates	Sydney Olympics 2000	Complete
Luna Park	Luna Park Trust	In Progress
Review of the 3x3 Program	RTA	In Progress
Government Advertising	Government Advertising	In Progress
Administration of Grants	Ethnic Affairs Commission	In Progress
Ongoing Review of Estimates	Sydney 2000 Olympics	To commence
Requested and Paid by Agency		
DRIVES Computer System	RTA	Complete
Technology Risk management	14 Agencies	Complete
Internal Control	SRA	In Progress
Financial Audit		
Air Travel Arrangements	Police Service	Complete
Masterplans for TAFE Sites	TAFE Commission	Complete

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Reference Source and Reference	Agency	Status
Aboriginal Land Claims	Aboriginal Land Council	Complete
Private Provision in the Provision of Public Infrastructure (Accounting Treatments for harbour Tunnel, M4 and M5 Tollways)	RTA	Complete
Medical Specialists: Rights of Private Practice Arrangements	Department of Health	In Progress
Performance Audit Branch		
Fraud Control Strategies	Government wide	Complete
Countrylink: A Review of Costs, Fare Levels, Concession fares and CSO Arrangements	SRA	Complete
Training and Development for the State's Discipline Services	Ambulance Service, Fire Brigade	Complete
Pre-School and Long Day Care	Children's Services	Complete
Management of the Courts	Department of Courts Administration	Complete
Review of Establishment, Management and Effectiveness Issues	Joint Operations in the Education Sector	In Progress
Effective Use of School Facilities	Department of School Education	In Progress
Implementation of Performance Audit Reports and Best Practice for Follow-Up Mechanisms	General	In Progress
Same Day Admissions	Department of Health	In Progress
Licensing, Contamination of Land Sites	EPA	In Progress
Maintenance of Capital Assets	General	To Commence

Of the 30 references listed above, 11 have been requested through the Parliamentary process, three have been requested and paid for by an agency and 16 have been sourced internally - 11 of which were nominated by the Performance Audit Branch.

3.2.3 Performance Audit Branch Selection Process

In the background Briefing Paper provided to the Review Team, the Audit Office advised that

> The main criterion for project selection has been, and continues to be, the potential for generating improved efficiency, effectiveness, economy and accountability within the public sector. Developments over the last two years have been about widening coverage, about dovetailing the selection process to respond to emerging issues of public concern in NSW and about improving our base, and sources of, information to support the process.

> Our chief commitment, and overriding strategy, continues to be for producing output and generating outcomes. The Branch is cautious of adopting any approach or practices which would impede our productive ability (as has, at times, occurred elsewhere). Nonetheless, to maximise, we recognise that project selection is a critical part of successful performance auditing.

> For this reason, before implementing the revisions we have already developed to our strategic planning process, the Branch sought advice from our sister Offices at the recent Australasian Senior Audit Executive Conference (Healesville, Victoria, June 1995). All participants highlighted the ineffectiveness of a mechanistic selection process or overly elaborate and time consuming data gathering for strategic planning purposes.

> It is clear that all Audit Offices face similar challenges in project selection, trying to balance:

> - the high cost of breaking totally new ground. In undertaking "new" audits that cover effectiveness, efficiency, economy and accountability we need to seek to share development costs with other audit agencies or build on earlier work wherever possible

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- the importance of "timing" to successful performance audits, and the need to maintain a "rapid reaction" capability outside the longer-term project selection and allocation process to meet urgent requests from Parliament and the Auditor-General in the public interest (eg. State Bank, M2, Luna Park, SRA Internal Control)

- a judgement on the sort of topics where a performance audit is the most effective instrument of change, and where it is not.

The current approach to selection of topics by the Audit Office is, in effect, to funnel a large range of potential topics into a narrower range of potential topics. These topics are then further investigated, discussed with agency management, and a preliminary decision is made to focus on one issue. A preliminary study is then conducted, which can take up to three months, and is the basis of confirming the Terms of Reference for the full study.

The Audit Office advised that the following process was used in the selection of performance audit topics for 1994:

- all inner budget sector portfolios were scanned for issues of current public concern

- priority was given to selecting topics in agencies with the highest recurrent expenditure (agencies have been ranked in order of recurrent expenditure)

- a review was made of reports produced in recent years by all of the major Audit Offices within Australia, as well as those in New Zealand, UK and Canada (both national and provincial/local organisations in the case of UK and Canada)

- a short list of possible topics is developed and options discussed with the CEOs of the agencies involved to get their input and preferences

- a final selection was made in the light of current progress by agencies in addressing issues of concern, and a judgement by the Auditor-General and Board of Management (BoM) on the potential of the audit to add value.

The net result of these efforts was the selection of a number of audits primarily concerned with operational effectiveness: namely Children's Services (covering three agencies) Same Day Admissions (health). The "3x3" road building program (RTA) was also selected.

The framework established in 1994 was used again in 1995, but with some additional elements and changes of emphasis. The Branch advised that:

- it sought topics where results could be applied across a range of agencies, to provide coverage to departments with smaller recurrent expenditure (eg. TAFE/School Education Joint Operations, Government Advertising, Administration of Grants)

- some topics were also necessarily included on the Performance Audit Branch Program (even if their scope did not encompass a balance of economy, efficiency and effectiveness) because of requirements set down in new legislation and referrals from Parliament (Home Fund; State Bank; M2 Motorway) or Government (Luna Park).

The Branch sought comments on its project selection process as part of the audit practice review initiated by the Branch at the end of 1994. This project was undertaken by Ernst & Young. The subsequent report recommended:

- a more structured process and a wider range of factors than materiality to be taken into account in selecting audit topics

- developing closer links with agency clients to identify topics with greatest audit potential.

The Office has responded by:

- including a revised process in its latest policy and procedures manuals with the emphasis on "the risks to good performance" as a criterion for project selection

- improving links with (and intelligence on) major agencies, by

  - assigning portfolio responsibilities within the Branch (but on a limited selective basis given the limited size of the Branch)

  - participating in Audit Office Committees, Industry Specialisation Teams and Client Service Teams (with attest audit colleagues), as part of the Office's corporate planning initiatives.

The Office advised that in the future it will be seeking to explore opportunities for greater cooperation between Audit Offices. It is actively attempting to promote discussion of joint audits between State and Commonwealth Offices at the next meeting of the Australasian Council of Auditors-General (ACAG).

The Office has been involved in discussions with the Council on the Cost of Government, Treasury and other review agencies in an endeavour to ensure that there is no duplication or overlap in performance review work being undertaken at any one time.

3.2.4 Comment

The drivers behind performance audit topic selection are extensive, and include materiality, topical public and agency issues, and possible governmental concerns. The audit can be targeted at any level of the program structure, that is, from the high level program definition to specific activities of a more functional nature.

From a review of selected audit reports and working papers, we found that the Audit Office has generally followed and implemented its guidelines for project selection. The more recent audits, such as Day Surgery, involved the sensible translation of broad terms of reference into specific audit criteria and objectives which would guide the audit process.

Notwithstanding the good points in the selection process, we believe that there are some key difficulties with the currently-used approach to project selection.

- the wide potential scope for audit selection has meant that the Audit Office has conducted audits at every level of the public sector management process - but the higher the level in the structure (ie, at the program results level), the increased likelihood that the audit will encroach on program effectiveness (as distinct from operational effectiveness) and policy issues

- the selection process is also extremely time-consuming because of the need to funnel considerable amounts of information into defining an appropriate topic for investigation.

In our view, and as indicated above, performance audits should be seen as less of a "major event" and more closely linked to the outcome of financial audit work. Performance audit work should be regarded as an ongoing activity - in the same way as financial audit responsibilities. The integration of financial and performance audit responsibilities is addressed in Section 8.

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The selection of matters for detailed compliance work should also flow from financial audit work as well as referrals from Parliament and Ministers (through Parliament). Large compliance assignments, should be undertaken as "special reviews" and managed in an organisational unit separate from ongoing financial and performance work.

3.3 Funding Of Performance Audit Work

Under present arrangements funding for performance audit work is mainly provided through:

- a "levy" on financial audit work
- parliamentary appropriation
- specific "fee for service" arrangements

The levy on financial audit work is in effect a "cross subsidy" from financial audit to performance audit. We regard this arrangement as inconsistent with the Government's objectives of identifying the full cost of service delivery and removing, to the maximum extent possible, cross subsidy arrangements in agencies.

We are of the view that the performance audit function should be fully funded through parliamentary appropriation and/or specific fee for service arrangements. Removal of the levy on financial audit might be expected to see a reduction in the cost to agencies of audit work.

Recommendation

> *The cost of performance audit be met from either:*
> - *Parliamentary Appropriation ; and*
> - *Fee for service arrangements*

3.4 Role Of The Public Accounts Committee

There is no systematic procedure for the Parliament to discuss or comment on the scope or direction of Audit work being undertaken by the Auditor General. In the private sector, and in Local Government, an Auditor advises the Board, through an audit committee, that audit work is necessary and/or appropriate.[21] The Audit firm may undertake the work through its own Audit Division or refer it to a Consulting Division.

With the exception of matters that are specifically referred by Parliament or Government, the Auditor General is acting independently, under the terms of his appointment, in selecting matters for audit and reporting the results to Parliament. However, Parliament is not formally advised that work is to be undertaken or of the resources that will be involved.

In the Commonwealth Parliament, a resolution has been introduced to form an Audit Committee consistent with UK practice. The key elements in the resolution are as follows:

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[21] The Audit Committee may also specifically refer a compliance matter to the Auditor.

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- the Committee to advise the Auditor General of the Committee's audit priorities in respect of Commonwealth bodies

- the Committee to consider the resources of the Audit Office for the purposes of assessing the effectiveness of the Office in undertaking its charter and the adequacy of resource levels to undertake an appropriate program of audit coverage.

The creation of an Audit Committee provides a formal link between the Parliament and the Auditor General. It would provide a mechanism for the Auditor General to obtain specific references from the Parliament and for the Auditor General to inform the Parliament of performance and compliance audit work that is to be undertaken.

Such an arrangement provides a mechanism for the government to seek advice from the Parliament in relation to resourcing of performance and compliance audit work. We would not see, however, such a Committee involved in the "management" of the Appropriation for the Audit Office.

While we see merits in the Audit Committee approach, we are of the view that the same functions can be performed by the Public Accounts Committee. We see the role as one of consultation and discussion rather than direction and oversight.

We also consider that the Public Accounts Committee should take a more active role in commenting on and monitoring the outcome of performance audit work. In some instances the Committee has held follow up hearings - but this is not a regular procedure. We see considerable merit in the Committee taking some "ownership" of reports once they have been tabled in the Parliament.

Recommendation:

> *The Public Accounts Committee adopt the following responsibilities in relation to the Auditor General and the conduct of performance audit*
>
> - *review and discuss the annual and forward performance audit plan with the Auditor General*
>
> - *recommend for Parliamentary approval the resources required to undertake the Audit Plan*
>
> - *review performance audit conclusions and recommendations following tabling in Parliament.*

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3.5 Addressing "Policy" Issues

An expectation of the Public Accounts Committee in 1993 for performance audits to focus more on effectiveness issues has also created difficulties to the extent that performance audit considerations of program effectiveness run a very high risk of touching on policy issues. Section 38B of the *Public Finance and Audit Act* precludes the Auditor-General from commenting on the merits of government policy objectives.

It must be recognised, however, that public sector management takes place in a political environment, with intense interest group activity and stakeholder involvement (participation). Program implementation is subject to many political and pressure group influences concerning the strategies adopted, the way in which resources are allocated, the work processes followed and services delivered. There is in addition, a very high expectation of accountability.

In terms of the public sector management process described in Section 2, the impact of political influences and pressure group activity is represented diagrammatically below.

The Planning, Management and Implementation Process

Policies, Pressure Groups, Stakeholder Interests

| Public Policy | Strategies | Structures | Resource Allocation | Activities | Outputs | Outcomes |

Accountability, Reporting
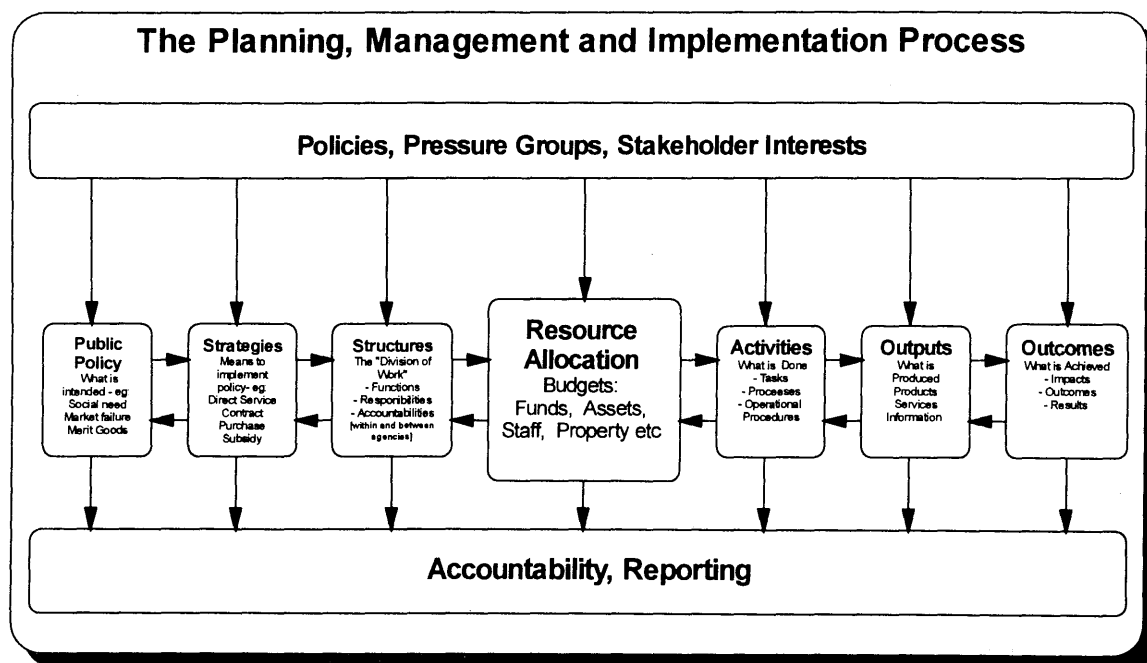
The framework is particularly useful in acknowledging that:

- the tendency, under current arrangements, for

  - governments deciding on policy action, to meet pressure group interests, in relation to program design, organisation structures, service delivery arrangements, etc

  - governments to specify implementation strategies, work processes and procedures in some detail - independently of policy objectives and resource constraints

- interest group activity, stakeholder involvement and institutional constraints relate to *all* aspects of the policy, planning, management, and service delivery process

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- stakeholders are often as much concerned about organisational structures (for example, creation of special interest "offices" within government) as they are about policies and outcomes

- government activity often commences with a strategy or a structure without really clarifying policy goals in relation to a specific need for government intervention

- interest groups often have as much concern about the way work is done (processes) as they do with the policy or outcome of policy.

The Office sought advice from the Crown Solicitor in 1993 to clarify the restriction on commenting on policy issues. The Crown Solicitor advised that a distinction could be made between policy objectives and the means chosen for achieving the objectives. This interpretation acknowledges the reality that the means of implementation (and indeed service delivery) are quite often also determined as matters of government policy. In this respect, an eminent public administration scholar has noted:

> What particular areas politicians interest themselves in, and decide are "crucial" for the moment, will depend on many factors, including their personal preferences and "the dissatisfaction of citizens, multiplied by their strength, modified by their geographical-jurisdictional location and by their persistence and techniques of agitation.
>
> Any particular problem is capable of being pushed upward for resolution by political processes; and even the "normal" level at which decisions of a certain kind are taken is fixed by political considerations.[22]

In 1994 a further legal opinion was obtained from the NSW Solicitor General. That opinion interprets policy to be read as any high level, general decision by a government, including a government agency.[23] We would qualify the suitability of this definition to the extent that:

- the general decision must be made by a Minister;

- there must be documentary evidence of the decision.

An interpretation of policy as a culmination of past practice and incremental change through implementation should not be accepted as evidence of a policy decision or series of decisions. Nor should Ministers and senior officers simply assert that particular directions are matters of policy on the basis of a rationalisation of present day situations and circumstances.

That performance audits should not in any way question or challenge the merits of government policy objectives, where they are demonstrated to exist, is not open to debate. However, we consider that it is acceptable, and appropriate, for the Auditor General to point out the resource implications of those decisions and directives and report where documentary evidence does not exist.

Where policies and directions and objectives are clearly stated by Government and Ministers in relation to program strategies, organisation arrangements, processes and

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[22] Appleby, Paul, *Policy and Administration*, cited in R.N. Spann, *Public Administration in Australia, Government* Printer, Sydney 1960.

[23] This definition is broadly consistent with current usage in the public policy literature. Mark Considine, in *Public Policy: A Critical Approach* (Macmillan, 1994), defines public policy as "an action which employs governmental authority to commit resources in support of a preferred value (p.3). However, policy makers are defined as "those key politicians and bureaucrats who have command of the institutions which must give approval to any decision or program " (p.5).

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products then it is clearly not open to the Auditor General to question the merits of those objectives. However, where policy objectives *have not* been made clear it may be open for the Auditor General to develop audit criteria to address whether the strategies, processes, products and procedures that have been put in place are the most efficient and effective to achieve intended objectives.

In some situations, however, it may be impossible to undertake a performance audit because of the *absence* of clear policy directions and program strategies/objectives. Governments quite often set up organisation structures and allocate resources for particular purposes without any clear statement of commitment to outcomes or results to be achieved. It should, nonetheless, be open for the Auditor General to point this out - but this should not always require the full resource commitment of a direct performance audit review.

In some situations policy initiatives are ambiguous and reflect political purposes. We have doubts about the extent to which the performance audit process is the best vehicle to enhance public accountability in these areas - compared with other means to secure accountability through the processes and procedures of the Parliament itself.[24].

We consider that the most appropriate way to address the issue of policy ambiguity and inconsistency is through the mechanism of attest audit of program performance statements and performance indicators - rather than direct audit.

The framework that has been identified in the early part of this section serves as a useful basis from which to consider the interaction between the planning, organisation and delivery process and the recognition not only of policy goals and objectives but also the policy directives that impact on program performance. These factors should be identified in *Program Performance Statements* that are presented to the Auditor General for attestation. Specific recommendations concerning attest audit are contained elsewhere in this Report.

Recommendation:

> *In reporting on a performance audit work, and without questioning the merits of policy objectives, the Auditor General draw attention to situations where:*
>
> - *there is a lack of clarity, ambiguity or inconsistency in policy goals, objectives and directives*
>
> - *stated policies are not supported by documentation and evidence of the intention of Government and/or Ministers*

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[24] For example, Questions with and without Notice, censure motions, debates on matters of public importance, adjournment debates, etc

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3.6   Conclusion

It is our firm view that the Auditor-General, in taking up responsibilities in the area of performance audit, should focus on matters concerned with the economy, efficiency and effectiveness of *practices, operations and service delivery*. In coming to that view, we have noted, in Section 2, that:

- there are many government agencies involved in the examination of organisational and program effectiveness (although none is involved in the accountability function)

- audit based methodologies[25] are not always suitable for review of programs and organisations

- the tools and techniques of process analysis, workload analysis, and benchmarking are particularly appropriate to operational improvement.

While there might be a traditional view about the limitations of skills and capabilities of financial auditors in undertaking performance audit, new approaches in education and training in the accounting discipline are broadening the scope and horizons of the audit profession.   Moreover, in the process of reviewing the financial performance of an organisation through accounting statements there is an opportunity to develop a multi-disciplinary approach that will report on all relevant aspects of financial and operational performance.

The Audit Office has recently been giving greater emphasis to topics where results could be applied across a range of agencies. This will assist in identifying benchmarks for use in establishing audit criteria and areas of "best practice". Benchmarks can be used by the Audit Office in direct report assignments or as a basis for performance reporting in attest audit work.

We see it as particularly important that further development in the area of performance audit be directed towards the development of improved and/or additional audit criteria, indicators and benchmarks as well as methods and approaches for the attest audit of agency performance reports and statements.

This observation forms the basis for further analysis of the management and conduct of performance audit in the NSW audit office in the remainder of this Report.

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[25]   This refers to methodologies based on the identification, development and application of "audit criteria" as set out in audit manuals and the proposed Accounting Standard.

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4 Management Of Performance Audit In The NSW Audit Office

4.1 Strategic Directions

4.1.1 Goals and Objectives

The NSW Audit Office recently produced the following aims and objectives;

Mission:	To improve public sector performance by providing the best auditing and related services and advice
Vision:	By December 1995, the Audit Office of New South Wales will be recognised as the centre of excellence for the provision of public sector auditing and related services and advice
Goal:	To deliver quality audit projects on time and within budget

The Performance Audit Branch has identified the following goal statement:

GOAL

To deliver quality audit projects on time and within budget

In particular, by December 1995 the Performance Audit Branch intends to have become:

- a producer of relevant, independent, quality audit reports to Parliament, with an annual target of not less than eight reports to be tabled in Parliament

- valued by Parliament as contributing to change and improved public sector performance

- accepted and respected by agency clients

- recognised by fellow members of the Audit Office as making a key contribution to the Office's success

- recognised as a leading figure in the performance audit field.

The goals that have been set are ambitious and represent major challenges for the management and staff of the Performance Audit Branch. The extent to which these goals have been realised will be discussed in Section 7 of this Report (Impact and Outcome).

More recently, the Audit Office has commenced a process to refine objectives in a form that is more amenable to performance assessment. In the Briefing paper provided to the review team, the Office advised that:

> The major issue for our 1995 Branch workshop, and for subsequent discussion with our clients, is how we should measure our own performance in an efficient, effective and impartial way. To this end we sponsored a workshop session at the recent Australasian Senior Audit Executive Conference to seek views from our interstate and overseas colleagues. Client surveys, including surveys of parliamentarians, were being tried in a number of states, although there were concerns as to whether the costs were justified. There were also a variety of views on how far, and who, should follow-up performance audit reports to assess the implementation and impact of audit recommendations.

We are not aware of the outcome of this initiative. It is important to be aware, however, that client surveys, undertaken on the basis of questionnaires, are notoriously unreliable.

for gauging opinion. Face to face interviews and consultations are a more reliable technique for assessing performance and achievement.

Initial proposals in relation to objectives are contained in the Branch Briefing Paper and which were to be discussed at the July Planning Conference, are as follows:

PERFORMANCE AUDIT BRANCH OBJECTIVES (DRAFT)

- to produce reports for Parliament:
  - that are valued by Parliament as contributing to improved public sector performance
  - that are recognised by Parliament as addressing appropriate and significant issues
  - that are generated efficiently and in a timely way
  - that are in a form which best serves Parliament's needs
- to produce audit products for agency clients:
  - that provide an accurate and balanced assessment of current issues
  - that offer constructive and feasible recommendations for improving public sector performance
- to identify potential improvements in performance significantly greater than the cost of the audit
- to be recognised by fellow members of the Audit Office as making a key contribution to the Office's success.

4.1.2 Strategies to achieve Goals

In working towards these Goals the Audit Office advised the Review team in its Briefing Paper that:

> To achieve our goals and the Office's Mission we recognised that neither quantity or quality alone was sufficient. High quality but low quantity would limit our capacity for producing significant, widespread change. High quantity but low quality could not occur, as it would fail our own professional standards and such reports would not be released (so quantity would fall). We knew that we needed both quality and quantity to effect change. We thus set about gearing up so that we could operate accordingly (although lack of external funding has been a limiting factor).

> However, producing quality reports in sufficient quantity should still not be viewed as an end in itself, only as a means to an end. The ultimate result desired is, of course, improvements in the public sector. Though in some cases it may take time for changes to occur and for benefits to flow from changes made. Changes occurring must therefore be studied over time. Given the short life of the Branch this is not possible in all cases. However, even so, the extent of change and improvement already generated within the NSW public sector from our reports can be shown to be significant.

The Branch has produced a document that reports on the outcome of the strategy workshop undertaken in July 1994. Another strategy workshop was held in July 1995. The strategy document contains an environmental appraisal, capability assessment and some statements on vision, strategy and actions. The key issues identified from this material are as follows:

1   Our unstructured 'melting pot' culture is a strength. We need to utilise and market it more effectively.

2   Our current operational resources are satisfactory for the work we perform, but we need more team managers.

3   On a skills level, we currently lack overall 'hands on' experience, the capacity to effectively market ourselves both internally and externally, and an understanding of our clients needs.

4   We are currently 'invisible' both internally and externally, and we need to address this by better promoting ourselves and capitalising on good results.

5   We need to improve our relationship with client management.

6   At the client interface the key issues that must be addressed include professionalism, communication, frankness, feedback, balance, reasonableness.

7   We must produce more quality reports.

8   On a macro level, we will be particularly affected by the definition of 'Special Audit', the attitude of Government to us, and the forthcoming Peer Review to be conducted by Parliament.

This assessment is candid and reflects a realistic and honest appraisal of how the Performance Audit Branch is performing. It is also a fair assessment of what needs to be done to improve performance.

Unfortunately, the strategy document does not contain a clear indication of the way in which the goals of the Branch are to be achieved and how the key issues identified above are to be addressed. Although there is in excess of 60 "Actions Agreed Upon" contained in the strategy document, there is no indication of time frame, order of priority or the resources that will be required.

We have not been provided with any revised material concerning strategies in relation to the newer (draft) statement of objectives.

We would expect a strategy document to clearly identify the "lines of business" and to contain six, and perhaps no more than 10, key strategic initiatives that would be directed towards achievement of Branch goals. Those initiatives would also clearly address the strategic issues identified above.

Recommendation

> *The Performance Audit Branch prepare a Business Plan that more identifies:*
>
> - *Current Mission*
>
> - *Goals and Objectives that are realistic and achievable over the short to medium term*
>
> - *Key business issues*
>
> - *The six or eight strategies to achieve goals and objectives*
>
> - *The resource implications*
>
> - *The performance indicators that will be used to report on achievement*

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4.2 Management And Organisation Structure

Responsibility for the conduct of performance audit in the Audit Office is located within the Performance Audit Branch. The management structure of the Office is set out below:

NSW Audit Office
Senior Management Structure

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                        ┌──────────────────┐
                        │ AUDITOR GENERAL  │
                        └──────────────────┘
                                 │
              ┌──────────────────┼──────────────────┐
              │                  │         ┌──────────────────┐
              │                  │         │     DEPUTY       │
              │                  │         │    AUDITOR       │
              │                  │         │    GENERAL       │
              │                  │         └──────────────────┘
              │                  │         ┌────────┼────────┐
      ┌───────────────┐  ┌───────────────┐ ┌──────────────┐ ┌──────────────┐ ┌──────────────┐
      │   ASSISTANT   │  │   ASSISTANT   │ │  ASSISTANT   │ │  ASSISTANT   │ │  ASSISTANT   │
      │AUDITOR GENERAL│  │AUDITOR GENERAL│ │AUDITOR GENERAL│ │AUDITOR GENERAL│ │AUDITOR GENERAL│
      │(Planning,     │  │(Performance   │ │ (Operations) │ │ (Operations) │ │ (Operations) │
      │ Research      │  │  Audit)       │ │              │ │              │ │              │
      │ & Management) │  │               │ │              │ │              │ │              │
      └───────────────┘  └───────────────┘ └──────────────┘ └──────────────┘ └──────────────┘
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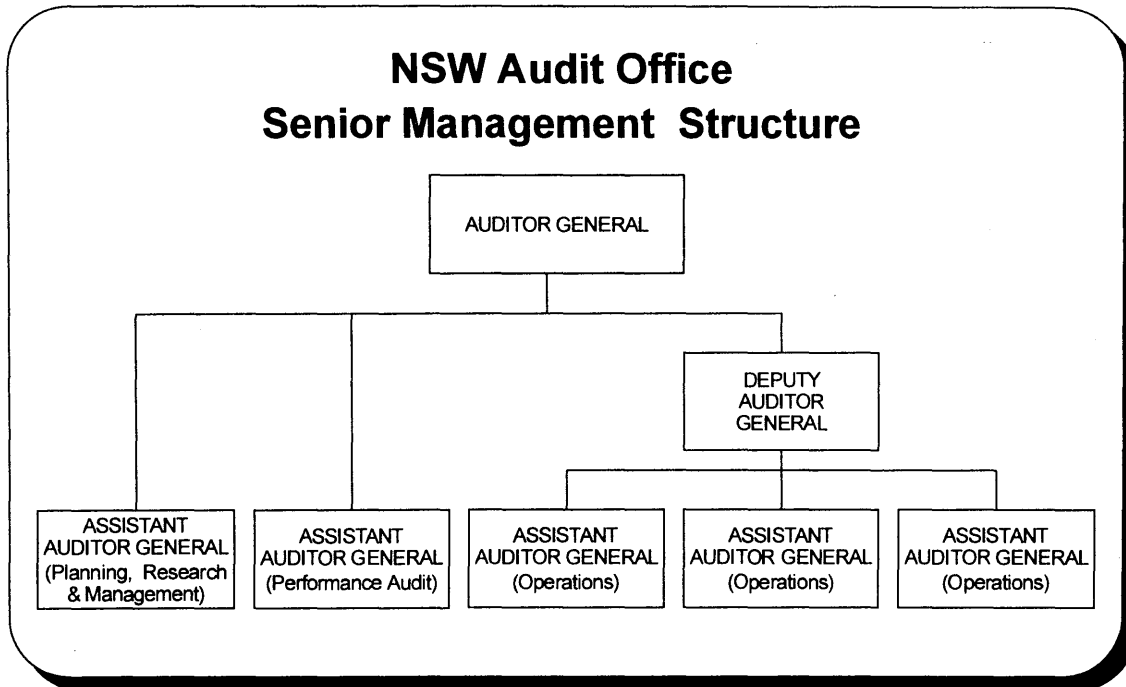
The Assistant Auditor-General, Performance Audit, reports directly to the Auditor-General.

There is little interaction between the financial attest auditors and the performance auditors, other than informal, personal contacts. There have been arrangements in place to encourage financial auditors to:

- advise on possible topics for performance audit arising from their work

- familiarise themselves with performance audit approaches.

But there is no working system in place for financial auditors to approach the Performance Audit Branch with a performance audit assignment arising from problems encountered during financial audit.

Greater interaction - of the kind discussed in Section 3.2.3 - between the different branches within the Audit Office would be desirable, if only to provide a more systematic approach to project selection other than those requested by the NSW Parliament/Government.

4.3 Staffing

4.3.1 Staffing Levels

The current staffing of the Performance Audit branch is 21. The structure, in terms of levels and classifications, is outlined below.

Position	Grade	Number of Staff
Assistant Auditor-General	SES 4	1
Directors	SES 2	2
Principal Auditors	SES 1	2
Senior Performance Audit Managers	5	6
Performance Audit Managers	3	4
Performance Auditors	2	2
Audit Senior	1	1
Trainee Performance Auditor		1
Administrative Assistants		2
		21

The employment profile indicates that there are 15 staff at the manager level or above. With large audit assignments this will have two consequences:

- there will be a very large amount of manager input into assignments - giving rise to very costly outcomes; and/or

- junior staff will be working very hard on a number of assignments.

To draw an analogy with private sector accounting firms, and on the premise that SES positions equate with Partner responsibilities, the partner:staff ratio in the Performance Audit Branch is in the order of 1:3. This compares with a partner:staff ratio of between 1:10 and 1:15 in private sector accounting and consulting firms - depending on the nature of the work.

The high partner:staff ration in the Performance Audit Branch had been put in place to provide for further growth. On the basis of a ration of 1:12, the potential size of the Branch is 60. We understand that the Office does not currently have the financial resources to expand to this level.

4.3.2 Recruitment Policy

The Performance Audit Branch advised that: the selection of performance audit staff has been based on competency criteria. These include abilities to:

- collect, assess and analyse relevant information
- identify and design audits
- develop value adding recommendations and guidelines
- communicate orally and in reports.

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4.3.3 Current Skills Profile

The two Directors joined, what is now known as the Performance Audit Branch, in 1991. The Assistant Auditors General joined the branch late in 1993. In effect, the Performance Audit Branch has only been operating since late 1993. Current staff levels are 21.

The Assistant Auditor-General was recruited from the Australian National Audit Office, the two Directors came from the former Office of Public Management. The two Principal Performance Auditors have a long history in auditing - one came from the UK Audit Commission, while the other has a long career in internal audit in several of the State's Departments.

The remainder of the staff have a variety of backgrounds, although there is a predominance of people with an audit background.

Detailed position descriptions have been developed for the different positions within the Performance Audit Branch. A summary of the qualifications, skills and experience of staff is provided below:

Position	Professional Qualifications.	Specialisation	Prior Employment	Professional Experience
Assistant AG			National Audit Office	
Director PA	FCPA	Financial Auditing	NSW Audit Office	20 years
Director PA	AIAA BBus	Internal Auditing,	OPM	17 years
Principal Auditor PA	MA MCP	Performance Audit	UK Audit Commiss.	20 years
		Internal Auditing	SRA, RTA, Soc.Sec.	23 years
Senior PA Mngr	MBA. Bsc	Policy, Planning	NSW Treasury	7 years
	BEc (Hons)	Economist	Comm. Treasury	12 years
	BIE	Reviews. Internal Audit	PSB & Courts	21 years
	CIPFA - BA MA PhD	Performance Audit	UK Audit Commiss. (secondment)	13 years
PA Manager	MCom. BA	Audit, Teaching	NSW Audit, School Education	16 years
	MA. Bsc	Consulting, Misc	various	10 years
	ACA - BBus	Fin. Investigator/ Auditor	NSW Audit, Duesburys	
Performance Auditor	CPA - BBus	Auditor/Accountant	NSW Audit	8 years
	ACA CPA - BBus	Accountant/ Auditor	NSW Audit, Duesburys, Ernst & Young	9 years
Perf. Auditor Senior	BA/ GDip Admin	Project Officer	ABS, AIHW	9 years
Trainee PA	BFin Admin	N/A		6 years

The profile of skills and qualifications points to a very broad based capacity, with an emphasis on accounting and accounting related disciplines. The inclusion of skills in economics and qualifications in business is also appropriate.

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The Office advised in the Briefing Paper provided to the Review Team that

> Despite still developing our skills and experience base, and our approach, the Branch's expertise was recognised by being asked to develop the performance audit segment of the ASCPA's Audit Module. This is a significant testimonial to the Branch's credentials, and provides considerable recognition for our current stage of development.

4.3.4 Training

At the Branch's initiative, a Training and Development Needs Analysis of all Branch staff was concluded by the Office's Professional Development Unit in February 1995. The most immediate purpose of the analysis was to cross match skill requirements to current skill and knowledge levels, and to focus on the use of courses and seminars to meet identified needs.

The analysis identified a range of skills (or competencies) required of performance audit staff. These skills were put into three categories - core skills, systems skills and specialist skills. The most pressing training and development needs identified were:

- team building, dynamics and management, working in teams
- performance audit methodology - as applied by the Performance Audit Branch
- current management theory and practice as they relate to NSW public sector
- NSW government structure and accountability processes
- performance indicators
- computer skills
- supervision and counselling skills, including individual performance assessment
- project management
- documenting a performance audit
- media skills.

The Branch is currently in the process of establishing a training strategy to meet the requirements identified through a training needs analysis.

Senior management in the branch recognise that training in performance auditing has the highest priority, although it remains unclear what action will be taken to solve this problem in the near future. In-house tailored training courses are the obvious answer, and a number of providers have been approached with a view to providing services.

A training budget has been established, and is $40,000 for 1994-95. Each staff member is allocated a minimum of 10 training or professional development days per year (significantly more at junior levels). This is monitored on a professional development data base.

The Branch's continuing training strategy has six major components:

- Performance Audit Training
- Annual Workshop

- In House Training Courses

- Training Courses from Australian National Audit Office

- Seminars At Branch Meetings

- Exchange of staff with other Audit Offices

Several options for performance audit training have been explored over the last four months. These include the Canberra Institute of Technology, the UK National Audit Office and the Australian National Audit Office. Negotiations are continuing. The Australian National Audit Office has agreed to offer places free of charge on their in-house courses as they become available.

The Performance Audit Branch advised in its briefing paper that:

> In terms of training, two 2-day training programs were run in-house in December 1993 by an international expert, accredited in Canadian performance audit methods, for all Performance Audit Branch staff and selected other staff from within the Office (some 20 people attended this intensive program at a cost of some $14,000). The first course dealt with the fundamentals of comprehensive auditing. The second concerned the "effectiveness reporting" approach advocated by the Canadian Comprehensive Auditing Foundation.
>
> However, such courses are difficult to obtain. Special arrangements were made to run those two courses, but very little is available on the general market. From the time of the recruitment of the bulk of current staff in February/April 1994, emphasis has been placed on providing on-the-job training. An extensive draft version of the Branch's Performance Audit Manual was provided to all staff, and was supported by the Branch's first 3 day workshop (held July 1994) which focused on developing and implementing the Branch's methodology and procedures.

A major current option being pursued is for the Branch to develop a course itself with the assistance of a consultant. Estimates of external costs and Branch resources are being considered. It is anticipated that this action will produce a three day training course on performance auditing to be conducted before the end of 1995.

We consider that much of the difficulty in identifying appropriate training courses and programs in performance audit relates to the "mystique" that has surrounded the conduct of performance audit and exacerbated by attempts to create the subject matter as a separate intellectual and analytic discipline.

It was argued in Section 2 that a separate and identifiable "discipline" of performance audit does not exist. Performance audit draws on a number of disciplines and the methodologies and techniques found in those disciplines are appropriate to performance audit. As indicated in Section 2, these tools and techniques can be acquired on a module basis, and cover topics such as

- benchmarking

- process analysis

- process re-engineering

- financial modelling and appraisal

We have recommended in Section 2.5 that the Audit Office explore the opportunity for Performance Audit Branch staff to become proficient in performance improvement tools

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and techniques developed by the major professional services firms and which are relevant to performance audit work.

4.3.5 Performance Appraisal

A six monthly staff appraisal scheme has recently been introduced throughout the Office to assess individual performance. The approach used by the new scheme specifically seeks to assist in identifying further training and development needs for individuals.

4.3.6 External expertise

Where specialist knowledge is required on particular projects, outside consultants are employed. Audits where consultants have been employed include:

- Aboriginal Land Council: statutory business investments and business enterprises
- Review of Home Fund
- State Bank
- M2
- Children's Services
- Day Surgery
- School Facilities
- RTA 3X3 program.

4.4 Funding

The financial resources available for the conduct of performance audits are derived from three sources:

- an annual appropriation of $500,000

- an allocation of $1m from revenue from audit fees charged for financial audit

- recovery of expenses.

The expenditure pattern of the Branch in 1994-95 (year ended 30 November) is indicated below:

	1994-1995
Wages, salaries, etc	1,454.6
Staff related expenditure	84.0
Building related expenses	92.6
Project related expenses (printing, travel)	85.0
Consultants*	90.0
Computer related expenses	50.0
Office equipment, subscriptions	15.0
Total	1,871.2
* Consultant fees for State Bank are not included	

Departments subjected to a performance audit do not pay for this service, as is the case with financial audits. The Public Accounts Committee is currently reviewing the Performance Audit Branch budget pending the outcome of this review.

4.5 Other Resources

4.5.1 Library and Information

The Branch has taken a great deal of time and effort in bringing together reference and practice material on performance audit. A focus on collection is with State and Provincial governments in North America where there are obvious similarities with the NSW State jurisdiction.

The Branch subscribes to relevant international materials such as that published by the CCAF (Canada), Canadian Evaluation Society, Australasian Evaluation Society.

4.5.2 Property and Assets

The Performance Audit Branch is located in a secure building adjacent to the rest of the Audit Office. There is abundant office space in the building for all staff of the Performance Audit Branch. Each staff member has access to a computer within the Branch.

4.6 Planning And Control Of Performance Audits

Several manuals have been developed internally that outline processes and procedures to follow when carrying out a performance audit. These include:

- a Performance Audit Program for the financial year
- a Performance Audit Manual
- a Project Management Procedures Manual.

In terms of processes and procedures, the branch has put a lot of time and effort into the development of guidelines. The success of these procedures is evident from the more recent working files in the branch where each step of the performance audit process is documented carefully.

4.6.1 Audit Stages

The Audit Office advised the Review Team that Branch policy, as detailed in the Performance Audit Branch Manual, requires that an audit be divided into distinct stages:

1. Planning the Audit	2. Audit Conduct	3. Reporting
Preliminary Study Report	Audit findings	Preliminary Study Report
Audit Plan	Audit Conclusions	Discussion Papers (optional, depending on nature of the audit)
Audit Program	Audit Recommendations	
Audit Procedures	Audit Working Papers	Audit Report for Parliament
		Best Practice Guide (optional, depending on nature of the audit)

The Manual defines responsibility roles for the various phases, which are allocated to personnel within the Performance Audit Branch. These include, for each audit, the roles of project leader; engagement controller; and reviewer.

4.6.2 Project management

Management of an audit involves two key aspects:

- ensuring that individual performance audits achieve their objectives on time and within budget

- building an audit team whose members have a clear understanding of their respective roles and responsibilities.

Audits are assigned to a Performance Audit Engagement Controller (PAEC), an SES officer, and managed on a ministerial portfolio basis.

Following the approval of a topic, the Engagement Controller initiates a Preliminary Study to identify specific matters of potential significance for audit, and to establish basic audit objectives and audit criteria. The Preliminary Study Report sets out proposed budgets in terms of cost and time, and reporting deadlines.

After the completion (and approval by the Assistant Auditor General) of the Preliminary Study Report, the Engagement Controller is responsible for preparing an Audit Plan which is to contain relevant information in regard to audit methodology and management of the audit (staff time, costs, expenses, milestones, deadlines).

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The Engagement Controller is then responsible to ensure that the audit is conducted in accordance with the Plan, and in particular that:

- audit criteria have been addressed

- findings have been identified

- appropriate evidence is gathered to support the conclusions of the audit

- appropriate recommendations are submitted, which also "add value".

The Engagement Controller is to ensure that the audit report contains matters which are significant and that the report is represented concisely, completely, fairly, objectively and in a timely manner.

4.6.3 Reports and Documents

A series of reports are produced during the audit which serve different purposes:

- an initial list of topics is circulated to senior departmental staff in the agency subject to audit

- a brief for the preliminary study, which sets out the topics for investigation and the preliminary objectives for the audit is prepared and widely distributed

- a report on the preliminary study is circulated for comment

- an Audit Plan is agreed which specifies the Terms of Reference for the audit and its scope

- on occasion, a discussion paper is prepared where consultation with external interested parties is considered necessary

- finally, at least two drafts of the final report are prepared for review and discussion.

4.6.4 Audit Criteria

As indicated, the key methodological component of an audit is the identification of audit criteria and assessment of performance against these.

Guidelines for developing the audit criteria are specific and provide useful guidance. The main purpose of the criteria is to translate a high level statement of what the audit will cover, into more easily assessable criteria. Examples of high level criteria include the relevance and appropriateness of the aspect of the program which is being assessed.

Normally the audit criteria established at the Preliminary Study stage are at a very broad level. The process for refining the criteria is discussed with management of the agency during discussions on the Preliminary Study Report. The purpose of this approach is to achieve agreement on criteria as early as possible in the audit cycle.

The Audit Office recognises in the Performance Audit Manual that fundamental disagreement over criteria will be amount to a serious challenge to the success of the audit.

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In particular, if management of an agency does not agree with audit criteria it follows that there will be disagreement with the audit conclusions.

4.6.5 Recent initiatives

In response to various factors (such as the findings of the 1994 audit-practice review; the requirements of the ISO 9001 quality certification project which the Office is undertaking; and also in response to identified needs within the Branch), performance audit project management procedures were recently substantially revised. A new guidance manual was produced concerning project management procedures and took effect from the start of 1995.

The new project management procedures are based around a series of checklists. The Project Leader and the Engagement Controller are required to complete the relevant checklists progressively throughout the audit, for review and sign-off by the Assistant Auditor-General (Performance Audit Branch) at designated monthly review meetings with each audit team. A complete review of the audit's status (time, cost, deadlines) is undertaken at these meetings, as well as a review of progress and findings. Weekly status review meetings are also held by the Engagement Controller with each project team.

To support closer review and control of projects, management information systems for Performance Audit Branch were significantly enhanced late in 1994. Computerised project status information on all aspects of projects is now available in a simple format, which is updated weekly. Information of individual staff productivity rates is also updated on the system weekly.

4.6.6 Future Directions

A review of the new project management procedures has been scheduled to commence shortly after the 1995 Performance Audit Branch workshop.

It is likely that discussion of topics at the workshop will generate suggestions for further improvements in these practices. The workshop session on Quality Assurance Processes, in particular, will lead to the generation of a number of action steps to further refine and bed down the approach. The subsequent review will consolidate experiences to date with the new project management arrangements, and incorporate any proposals from the 1995 workshop.

4.7 Approach To Investigation And Quality Control

4.7.1 Current Practice

Performance Audit in the Office is driven by Auditing Standards (ED 47 & 48), and the Office's view that the "audit reports are no better than the quality of evidence on which the report's findings are based". To this end, the Office has established numerous policies/practices to govern the investigative process to support the conclusions of performance audit reports.

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Policies and practices for the investigation process have been identified within the Performance Audit Manual, in such sections as:

- planning and conducting the audit
- developing conclusions and recommendations
- effective interviewing; and relevant and reliable evidence.

In relation to evidence gathering, the required practices of Performance Audit Branch identify:

- the types of evidence (documentary, physical, oral, analytical)
- the attributes of evidence (relevant, reliable, sufficient, objective, timely)
- the techniques for gathering evidence (interview, analysis, physical observation confirmation)
- strategies for gathering evidence (the case study approach, surveys, questionnaires).

In the initial stages of an audit the objectives, criteria and scope of the audit are identified. In preparing the audit program to meet the audit objectives consideration is given to the means by which the audit objectives will be achieved, including the nature of the evidence to be obtained. Evidence to support conclusions is documented by cross referencing the report's findings with audit evidence.

The Office advised that each major finding of the report is discussed with the client agency to ensure its accuracy and relevance. Findings are also subject to "challenge" within the Performance Audit Branch and by the Auditor-General. All comments made by agencies are taken up or reflected in audit reports.

4.7.2 Recent Initiatives

The Audit Office has chosen to embark upon external third party certification under ISO 9001 for both its financial audit services and performance audit services. No other Audit Office has embarked on this course. The total project for the Office is being led by a Performance Audit Director.

The Performance Audit Branch has translated the clauses of the Standard into an audit environment, dividing the 20 clauses into three groups:

- controls over the auditing process
- controls over the auditing environment
- controls over the quality environment.

Extensive documentation of all quality system elements has been developed as required for certification purposes, and a range of systems/procedures enhancements have been introduced progressively.

4.7.3 Future Directions

The Office advised that work on the ISO quality certification project will continue, and that it will further refine its quality systems. The Office advised in the Briefing Paper that:

> . . . we recognise that true quality assurance requires us to go beyond the requirements of ISO 9001. Compliance with professional standards, and the pursuit of true "excellence" are our goals. As such, we have scheduled Quality Assurance processes as one of the major topics for examination at our 1995 Branch workshop.

The Office has developed a Quality Assurance model for performance auditing. This is regarded as a comprehensive and innovative conceptual approach. It has been used to diagnose current processes and to identify further opportunities for improvement. The Office has also studied approaches to Quality Assurance taken elsewhere (specifically the Australian National Audit Office, NZAO, VicAGO, OAGWA) as part of the strategy to approach Quality Assurance in a comprehensive "best practice" manner.

4.7.4 Comment

We found the Audit Office to have extremely detailed procedures which are designed to guide the performance audit. The driving principles which seem to be embodied in their processes include:

- to be systematic

- to provide an audit trail

- to ensure the briefing, review, and sign off by the Assistant Auditor General at key milestones in the audit

- to support a comprehensive audit by providing prompt questions

- to ensure the transparency of the process for the agency being reviewed

- to foster consultation and briefing of parties with an interest in the audit.

We believe that all these are positive features of the audit process.

We have a small concern, however, that relates to the time required to work through the processes and the impression that processes are as important as the content of the audit. One argument which supports the current arrangements is that the Audit Office is required to maintain extensive and detailed working papers in order to defend their conclusions. This requirement is particularly important in situations where audits may be subject to Parliamentary Review up to two years after the event.

The second concern relates to the need to more clearly define the ambit of the audit and the terms of reference at an earlier stage in the process. The terms of reference for the majority of studies are only finalised after the preliminary study - a full three months into the project.

At face value, a three month preliminary study would appear to be excessive and indicate a major diffusion of effort in attempting to establish the issues to be audited. However, by the nature of performance audit methodology, it is during this "preliminary" stage that

audit criteria are developed confirmed. Subsequent phases of the review involve the application of criteria in developing audit findings and conclusions.

4.8 Branch Output

4.8.1 Performance Audit Reports

Since the inception of Performance Audit Branch in the NSW Audit Office a total of 19 Reports have been completed. These are as follows:

Agency or Issue Examined	Title of Performance Audit Report or Publication	Status
Department of Housing	*Public Housing Construction: Selected Management Matters*	Tabled 5 Dec 1991
Police Service, Department of Corrective Services, Ambulance Service, Fire Brigades and Others	*Training and Development for the State's Disciplined Services: Stream 1 - Training Facilities*	Tabled 24 Sep 1992
Public Servant Housing	*Rental and Management Aspects of Public Servant Housing*	Tabled 28 Sep 1992
Police Service	*Air Travel Arrangements*	Tabled 8 Dec 1992
Public Service	*Fraud Control Strategies*	Tabled 15 June 1993
Home Fund Program	*The Special Audit of the Home Fund Program*	Tabled 17 Sep 1993
State Rail Authority	*Countrylink: A Review of Costs, Fare Levels, Concession Fares and CSO arrangements*	Tabled 13 Dec 1993
Ambulance Service, Fire Brigades	*Training and Development for the State's Disciplined Services: Stream 2 - Skills Maintenance Training*	Tabled 13 Dec 1993
Fraud Control	*Fraud Control: Developing an Effective Strategy (joint publication with the Office of Public Management, Premier's Department)*	Tabled 30 Mar 1994
Aboriginal Land Council	*Statutory Investments and Business Enterprises*	Tabled 31 Aug 1994
Aboriginal Land Claims	*Aboriginal Land Claims*	Tabled 31 Aug 1994
Children's Services	*Preschool and Long Day Care*	Tabled 10 Oct 1994
Roads and Traffic Authority	*Private Participation in the Provision of Public Infrastructure (Accounting Treatments; Sydney Harbour Tunnel; M4 & M5 Tollways)*	Tabled 17 Oct 1994
Sydney Olympics 2000	*Review of Estimates*	Tabled 18 Nov 1994
State Bank	*Special Audit Report: Proposed Sale of the State Bank of New South Wales*	Tabled 13 Jan 1995
Roads and Traffic Authority	*The M2 Motorway*	Tabled 31 Jan 1995
Department of Courts Administration	*Management of the Courts: A Preliminary report*	Tabled 5 Apr 1995
Joint Operations in the Education Sector	*A Review of Establishment, Management and Effectiveness Issues*	Tabled 22 Sep 1995
Department of School Education	*Effective Use of School Facilities*	Tabled 22 Sep 1995
Luna Park Reserve Trust	*Luna Park*	Tabled 12 Oct 1995

A further six assignment reports are currently in the pipeline.

Agency or Issue Examined	Title of Performance Audit Report or Publication	Status
Roads & Traffic Authority	*3x3 Program*	Not yet finalised - draft report stage
Department of Health	*Same Day Admissions*	Not yet finalised - draft report stage
Several Agencies	*Government Advertising*	Not yet finalised - draft report stage
Environment Protection Authority	*EPA: Key Result Areas*	Not yet finalised - draft report stage
Ethnic Affairs Commission	*Administration of Grants*	Final stages of field work
Department of Health	*Medical Specialists: Rights of Private Practice Arrangements*	Still in progress

4.8.2 Report Follow-up

The Branch has adopted a practice of providing follow-up advice and information after report tabling. This is a particularly valuable initiative and draws on the experience gained by Auditors during investigations.

4.8.3 Other Services

The Branch has also extended its product base by providing a value added service to the wider community by having:

- prepared a Performance Audit Module for the CPA programme

- lectured to the local government Auditors' Association on performance audit methodology and approach

- developed best practice guides on 'Internal Audit'

- contributed to the development of mediation guidelines

- developed a 'Fraud Control Manual'

- provided many lectures on fraud control strategies

- contributed a chapter to an RIPAA publication on this subject.

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4.9   Comparison With Other Offices

It is difficult to compare the performance of the Performance Audit Branch to that of other Audit Offices around Australia or overseas for that matter. This is mainly due to differences in mandates, organisational differences and budgets.

It would be desirable for the Audit Offices around Australia to agree on a uniform set of performance indicators to assist one another in a benchmarking exercise of performance auditing. However, it would appear that some lessons can be learned in terms of average costs of a performance report, branch budgets and productivity, and organisational structure.

Comparative information provided by the NSW Audit Office in relation to output, staffing and cost is provided below. This information is of limited value.

	Australian Average	Overseas Average	Total Average	NSW Audit Office
Reports per annum	17.3	24.4	21.2	10
Average Staff per report	2.1	1.9	2	2
Staff per Audit (Average)	3.9	3.2	3.5	4.1
Staff Hours Charged to Audit (Average)	2,547.5	3,447.8	3,047.7	1,819
Duration - Months (Average)	13	12.8	12.9	10.3
Staff Costs - Average	$213,621	$214,128	$213,902	$150,730

On the basis of this information, the performance of the Performance Audit Branch compares very favourably with other offices. However, these indications must be qualified to the extent that we are unaware of :

- the scope, coverage and content of performance audits included in the comparisons

- the methods of charging and cost recovery

- the level and expertise of the staff involved

- the outcomes of each audit in terms of impact and effect

Information on approaches to performance auditing in other states is included in Section 9 of this Report.

5   Efficiency Issues

In this Section of the Report we examine matters concerned with the efficiency of the management and conduct of performance audits. The specific efficiency criteria that are considered appropriate are:

- Cost per unit of output - that is, the cost of completing a Performance Audit Report

- Time utilisation - the amount of time taken to complete a task compared with a standard

- Productivity - the relationship between work output and staff input

- Cycle Time - the elapsed time between the commencement of a Performance Audit Project (selection of the topic) and the completion of the Project (tabling in Parliament)

5.1 Cost Of Reports

Costs per report are recorded and monitored as part of the Branch's management information system. The costs of each audit is now stated in each report. At this stage of development, a "standard" time or cost for audits has not emerged.

The Audit Office provided estimates of the time and cost of undertaking the performance audits that have been tabled and are approaching completion. Information is provided below.

Title of Performance Audit Report or Publication	Estimated Time and Cost $'000
Public Housing Construction: Selected Management Matters	400
Training and Development for the State's Disciplined Services: Stream 1 - Training Facilities	343
Rental and Management Aspects of Public Servant Housing	106
Air Travel Arrangements	62
Fraud Control Strategies	107
The Special Audit of the Home Fund Program	142
Countrylink: A Review of Costs, Fare Levels, Concession Fares and CSO arrangements	100
Training and Development for the State's Disciplined Services: Stream 2 - Skills Maintenance Training	203
Fraud Control: Developing an Effective Strategy (joint publication with the Office of Public Management, Premier's Department)	64
Aboriginal Affairs, Statutory Investments and Business Enterprises	123
Aboriginal Land Claims	57
Preschool and Long Day Care	264
Private Participation in the Provision of Public Infrastructure (Accounting Treatments; Sydney Harbour Tunnel; M4 & M5 Tollways)	159
Sydney Olympics: Review of Estimates	207
Special Audit Report: Proposed Sale of the State Bank of New South Wales	1,190
The M2 Motorway	117
Management of the Courts: A Preliminary report	106
Education Sector: A Review of Establishment, Management and Effectiveness Issues	197
Effective Use of School Facilities	276
Luna Park Reserve Trust	81
Total: Completed Reports	4,146
3x3 Program	224

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Title of Performance Audit Report or Publication	Estimated Time and Cost $'000
Same Day Admissions	278
Government Advertising	110
EPA: Key Result Areas	196
Administration of Grants	39
Medical Specialists: Rights of Private Practice Arrangements	197
Total: reports in Progress	1,044

The average cost of preparing the 20 completed reports has been $218,000. These costs do not include the time and resources of agencies being subject to performance audit review.

On the basis of the comparative information included at the end of section 4, the costs of performance audits undertaken in the NSW Audit Office are relatively lower.

In comparison with alternative approaches and methods for performance review, however, the costs of the performance audits undertaken to date is exceptionally high. Public sector clients are generally reluctant to pay in excess of $100,000 for the costs associated with the performance review reports.

The higher cost of performance audits is a result of:

■ the methodology - an absence of an initial "problem" and terms of reference

■ the process involved in developing audit criteria

■ the requirement for extensive documentation of approach, analysis and findings inherent in the audit methodology.

With the development of a more strategic approach to performance audit topic selection and a continuation of the direction of performance audit work into smaller (shorter) audits, and the development of general audit criteria and benchmarks for use on a government wide basis, the average cost of performance audits is might be expected to decline.

5.2 Time Utilisation

The guidelines issued to performance audit staff involve a time allocation for undertaking a performance audit as follows:

- Preliminary Study   30%
- Fieldwork Phase   35%
- Reporting   35%

The high proportion of time allocated to preliminary study is a feature of the audit based methodology used in performance audit.

Information concerning performance in relation to actual time and budgeted time for a number of projects, at the end of July 1995, is provided below.'

Report	Budget Time (Hours)	Actual Time (Hours)	Difference (Hours)
Sydney Olympic Estimates	2,550	2,508.8	41.2
RTA - Review of M2	810	794.5	15.5
Local Courts & Police - Waiting Time	2,480	1,384.9	1,095.1
RTA - 3x3	2,600	2,722.5	(122.5)
Joint Operations in the Education Sector	1,337.9	2,363.2	(1,025.3)

With the exception of the Local Courts and the Joint Operations assignment, time allocations are within a reasonable proximity of budget. The excess time in the Joint Operations project can be attributed to the complexity of the issues. The commitment of time has been reflected in a very positive reaction from clients to the time spent by the performance auditor and the report.

During the Review, criticisms were made about the amount of time involved in the preliminary study stage. Auditees were under the impression that audit staff were "looking under rocks" to find errors, faults and subject matter for review.

Whilst these criticisms point to a lack of focus in audit approach, they relate, in the main, to earlier performance audit reviews. More recent reviews have been focussed and disciplined in their approach.

It is also in the nature of an audit-based methodology for a large amount of time to be spent in the identification and specification of audit criteria. Once criteria have been identified, and agreed with management, the remaining work of the audit is relatively straightforward.

5.3 Productivity

The Performance Audit Branch advised that productivity has been a major focus for management. We were advised by the Performance Audit Branch Briefing Paper that

> . . . we have strongly focused on putting our effort into work which will lead to output. Performance Audit Branch has also played a leading role within the Office in establishing staff productivity targets and a simple productivity monitoring and reporting system, which provides information available to all Branch staff updated on a weekly basis. The financial audit staff are now implementing the same system for their operations.

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Initiatives designed to maintain productivity include:

- each Director is responsible, as part of their performance agreement, to ensure that productivity rates are being achieved for the staff within their Group

- project management practices have been developed

- each Audit has an approved budget, and timetables are monitored closely with a constant review process to ensure productivity.

The Branch has submitted that staff productivity rates are being achieved, despite staff being heavily involved in a wide range of corporate initiatives and projects which do not count towards their individual productivity score.

The expectation of time charged to audit assignments is as follows:

Position	Annual Standard Hours
Assistant Auditor-General	770
Directors	1,085
Principal Auditors	1,115
Senior Performance Audit Managers	1,225
Performance Audit Managers	1,295
Performance Auditors	1,316
Audit Senior	1,344
Trainee Performance Auditor	1,344
Administrative Assistants	560 - 700

These expectations are broadly in accord with commercial practice.

The performance Audit Branch maintains a time and cost recording system and regular management reports are produced.

5.4 Report "Cycle" Time

A major issue concerning efficiency of the performance audit process is the time taken to complete reports. This was mentioned several times by agencies contacted during the review.

The guidelines for the elapsed time of a performance audit are

- Preliminary Study   1.5-2 months
- Audit/Reporting   2.5-6 months

The actual time recorded for undertaking assignments has been as follows.

Title of Performance Audit Report or Publication	Date Commenced	Date Tabled	Elapsed Time (Months)
Public Housing Construction: Selected Management Matters	Jan 1991	5 Dec 1991	11
Training and Development for the State's Disciplined Services: Stream 1 - Training Facilities	July 1991	24 Sep 1992	15
Rental and Management Aspects of Public Servant Housing	Aug 1991	28 Sep 1992	14
Air Travel Arrangements	Feb 1992	8 Dec 1992	10
Fraud Control Strategies	Aug 1992	15 June 1993	11
The Special Audit of the Home Fund Program	May 1993	17 Sep 1993	5
Countrylink: A Review of Costs, Fare Levels, Concession Fares and CSO arrangements	March 1993	10 Dec 1993	10
Training and Development for the State's Disciplined Services: Stream 2 - Skills Maintenance Training	Feb 1993	13 Dec 1993	11
Fraud Control: Developing an Effective Strategy (joint publication with the Office of Public Management, Premier's Department)	Sept 1993	30 Mar 1994	7
Aboriginal Affairs, Statutory Investments and Business Enterprises	Nov 1992	31 Aug 1994	21
Aboriginal Land Claims	April 1993	31 Aug 1994	17
Preschool and Long Day Care	Oct 1993	10 Oct 1994	12
Private Participation in the Provision of Public Infrastructure (Accounting Treatments; Sydney Harbour Tunnel; M4 & M5 Tollways)		17 Oct 1994	
Sydney Olympics: Review of Estimates	31 Dec 1993	18 Nov 1994	11
Special Audit Report: Proposed Sale of the State Bank of New South Wales		13 Jan 1995	
The M2 Motorway	23 Nov 1994	31 Jan 1995	2
Management of the Courts: A Preliminary report		5 Apr 1995	
Education Sector: Review of Establishment, Management and Effectiveness Issues			
Effective Use of School Facilities	1 Nov 1994	1 Sep 1995	10
3x3 Program	30 May 1994	28 Feb 1995	9
Same Day Admissions	21 Sep 1994	(draft report)	11

The reasons for the long time frame stem from a number of factors. These relate to:

■   resourcing issues - staff are taken away from assignments determined as part of the performance audit program to work on audits requested by Parliament

- the requirement to give agencies 28 days to comment on reports prior to tabling

- time taken for printing

- arranging exit interviews

- working paper requirements

- field staff being available for work on only one performance audit at any particular time.

5.5   Conclusion

We have noted in this and earlier Sections of the Report that the performance audit process is particularly resource intensive.   We acknowledge, of course, that the Performance Audit Branch has been in a learning cycle and constrained by a range of pressures, including those imposed by the Public Accounts Committee view of the Audit mandate and the statutory reporting requirements.   Notwithstanding, the data in Section 4.9 shows the Office is operating at better than average, compared to its past, in a number of areas.

We would expect some further improvement in report cycle time with a clearer delineation between major compliance audit work and performance audit work and the integration of responsibility for performance audit work with the financial audit Branches of the Office.

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6   Effectiveness Issues

We have reviewed a sample of audit reports produced by the Audit Office and have also interviewed the agencies which were the subject of these reports. Our observations on effectiveness are grouped under the headings of:

- quantity

- timeliness

- quality

- client satisfaction

6.1   Report Quantity

The Performance Audit Branch has an objective to table eight performance audit reports this year. Current indications are that the number will be 10.

6.2   Timeliness

Timeliness refers to the extent to which performance audit reports were completed in a time that was relevant to Parliamentary expectations as well as management planning and decision frameworks.

As indicated in section 5, a number of reports have taken a considerable time to complete. The Branch has, however, been called upon by Parliament at very short notice to undertake urgent performance audits (such as the M2 Motorway and the State Bank). On these occasions, under difficult circumstances, the Branch delivered the product within the exceptionally tight deadlines set by Parliament.

6.3   Report Quality

6.3.1   Style And Content

Our assessment of the content of the reports from a peer group perspective are that the quality, style, and insightful comment is decidedly mixed across the range of reports produced to date.

A number of reports demonstrate good practices in relation to:

- extensive use of data to support arguments

- relevance of issues raised

- sound interpretation of data

- alternative hypotheses which are explored in order to provide comparisons and other options for consideration

- good client and stakeholder consultation.

Nearly all reports have suffered from the following limitations:

- a presentational layout which obscures the main focus and terms of reference for the study - this may reflect the process of undertaking the audit itself, where there appears to be a search for "auditable issues"

- a mixture of both highly significant issues which need to be addressed, alongside smaller, operational points

- the criteria for the performance audit topic selection and aims and objectives of the audit are not always explicitly stated

- the underlying analytical framework and methodology are not explicitly stated, thereby giving the impression that there was a limited use of evaluative tools and techniques.

6.3.2 Approaches To Investigation

Criticisms were made by clients that auditors were concentrating on looking for errors, mistakes and matters that would achieve publicity in reporting. Other matters of concern raised by organisations subject to audit were:

- auditors "would not listen" to arguments being put by clients

- auditors were reactive rather than pro-active.

- a perception that auditors see themselves as custodians of the public interest in finding waste, mismanagement and incompetence.

These are matters of perception and reflect anecdotal experience of people involved in the audit process. They are only reported here because of the opportunity for audit staff to give attention to the way in which they communicate in the audit environment.

In a more recent assignment, a client complemented the auditor leading the project on his capacity to work with a group and contribute to the development of improvement strategies.

6.4 Client Satisfaction

The Review team held interviews with nearly all clients that had been subject to audit. It is not appropriate to report in detail all comments made. The Public Accounts Committee held public hearings on 14 September during which Chief Executives and senior managers of a number of agencies made comments on the performance audit function. we do not propose to canvas those comments in this Report.

We feel that some comments, whilst probably accurate in relation to past activities and approaches are either dated or have been addressed in subsequent performance audit assignments. Many of the adverse comments related to compliance work - as distinct from what would be regarded as performance audit assignments. In our view, many of the issues would be resolved by adopting the recommendations in relation to the structure and conduct of performance audit set out in Sections 2 and 3 of this Report.

The auditees' views of the content of the reports were mixed. Negative comments made related to the following concerns:

- the scope of the audit topic was the subject of much debate and remained unclear throughout the audit

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- by dealing with effectiveness issues, the Audit Office was questioning government policy--an area which is said specifically to be excluded by an audit

- the reports did not add value, were too narrow in focus, and written in a negative way

- the audit was too time-consuming and costly for the agency (the agencies' internal auditors were not invited to work alongside performance auditors)

More positive comments were that:

- it provided the agency with a thorough analysis of data which was helpful to it in assessing the impact of its policies

- good questions were raised through the audit which were useful in broadening the agency's views of its service.

6.5 Conclusion

We believe that many of the adverse views about performance arise from:

- an unwillingness on the part of the agencies to be subject to audit

- a confusion in both methodology and approach between performance audit and compliance audit (addressed in Section 3 above)

- inexperience on the part of staff undertaking the audit work.

It is important to emphasise, however, that the reaction of agencies to performance audit work has been much more positive in relation to work undertaken and completed over the last twelve months. This reflects:

- a focus of audit on operational issues

- a style of investigation that is seen as helpful and "working with" agencies that are subject to review

- reports providing results that are regarded as being realistic, informed and contributing to improving performance

- an acceptance of the value of reports containing information on best practice and audit criteria that can be used by management.

We have made recommendations about the desirability of separating responsibility for compliance audit work from performance audit work. As indicated, we are of the view that a perceived separation will contribute to a greater acceptance of performance audit and the development and application of methodologies directed towards performance improvement.

7 Impact And Outcome

In the context of the goals and objectives of performance audit, the ultimate tests of impact and outcome are success in relation to the objectives of:

- improved management practices, work processes and client service

- enhanced public accountability

- implementation of findings and recommendations

- savings identified

- sustainability.

In addition, the views of the agencies on the conduct of the audit, the conclusions, and the report, are important indicators of success. This is not to say that the agencies will always be regarded as correct, as they have the right to disagree with the findings. Nonetheless, an opportunity for them to express their views on the process and outcome will provide important feedback for the Audit Office.

7.1 Contribution To Improved Performance

The Audit Office provided detailed comments outlining its interpretation of the impact and effect of performance audits on improved performance in public sector management.

An important aspect of the review also involved discussion with organisations that had been subject to audit their views about the way in which audits had been conducted and the impact that had been made in relation to improved performance.

The Audit Office comments, together with a summary of client views concerning the audits are reproduced in the table on the following pages. The client comment does not always reflect its comment included in the tabled report.

Title of Performance Audit Report or Publication	Audit Office Comment Provided to Review Team	Summary of Client Comment
Rental and Management Aspects of Public Servant Housing	The Performance Audit Branch has drawn attention to *Memorandum to Ministers No. 94-10* issued by the NSW Premier, which stated: NSW Government policy on employer-provided residential housing and other forms of rental assistance for employees has recently been reviewed in the light of the Auditor-General's special audit report ..... To address these concerns, a new employee housing policy has been developed and is set out in the attached policy guideline ..... The impact of the reports we had produced up to the end of 1992 was canvassed in some depth in Public Accounts Committee Report No. 70, and will not be repeated here. The following reports have been produced since that time.	The Department made clear its disagreement with some of the recommendations and the implementation process recommended. Annual follow-up by the Auditor-General still takes place. Performance Audit recommendations not implemented because of Department's concern/objections to performance audit findings. The Department's objections are documented in the PAC's "Minutes of evidence taken before the public accounts committee inquiry into the review of special auditing functions of the auditor-general's office" - October 1993.
The Special Audit of the Home Fund Program	The performance audit raised a range of very significant matters, which were subsequently considered by a Parliamentary Select Committee and by the Government, finally leading to major action being required to rectify maladministration of the scheme. This included legislative changes.	

Title of Performance Audit Report or Publication	Audit Office Comment Provided to Review Team	Summary of Client Comment
Countrylink: A Review of Costs, Fare Levels, Concession Fares and CSO arrangements	The performance audit raised a series of significant issues concerning the determination and application of fare levels and subsidies. The issue of rail fare levels and subsidies continues to be an issue of topical debate. Countrylink have responded positively to other items which the report also raised, concerning such matters as performance measurement, management systems and accounting systems, and have implemented a number of appropriate reforms	The performance audit alledgedly transgressed into questioning government policy regarding fares. The audit created tensions, and the SRA was unable to redress the report prior to publication. The scope of the audit changed twice, and the last version of the report has still not been received by the SRA. The adequacy of the investigative process was questioned by the client and the outcomes of the audit were already known to client through the separate Mercer Review. Was the audit really value-for-money?
Fraud Control Strategies	Substantial action occurred during 1994 arising from a 1993 performance audit into **Fraud Control** across the NSW public sector. In response to strong demand for assistance in this area, and especially for a new and innovative approach to the whole issue, during 1994 the Performance Audit Branch of the Audit Office developed a strategic model for fraud control as a corollary to the 1993 performance audit. The Branch subsequently undertook the preparation of a major reference work (or Guide) to assist agencies, titled *Fraud Control - Developing an Effective Strategy*. The Guide was officially endorsed by the Office of Public Management, Premier's Department for implementation, who demonstrated their support and appreciation by meeting the costs of its publication and distribution across the NSW public sector. This work has also led to the establishment of a NSW Public Sector Fraud Control Forum, which is active in promoting fraud awareness and education, and provides a means of assisting agencies to implement effective fraud control using our model. The Forum also holds periodic symposiums and produces newsletters.	The Report has attracted widespread endorsement and support within the NSW public sector.

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Title of Performance Audit Report or Publication	Audit Office Comment Provided to Review Team	Summary of Client Comment
Training and Development for the State's Disciplined Services: Stream 1 & 2	The performance audit into identified potential to enhance training effectiveness and methods, which would also generate efficiency gains of up to 50%. Improved net economic benefits from adopting recommended reforms were estimated in the range of $8.5 million to $18.8 million over ten years. During 1994 the Public Accounts Committee specifically inquired into results which had occurred in the Fire Brigades. The Public Accounts Committee reported that: The NSW Fire Brigade has made considerable progress in the improvement upon existing training strategies and procedures. (Report No. 82, p 34) The Committee found the New South Wales Fire Brigade to be both responsive and amenable to the recommendations for improvement suggested by the Auditor-General. (Report No. 82, p 35) The Committee was satisfied that the Brigade was taking action to ensure that the concerns highlighted by the Auditor-General were being both reviewed and rectified and that in the future ongoing reassessment would contribute toward a constantly improving public service. (Report No. 82, p 35)	Partial implementation of the recommendations suggested. The Fire and Ambulance training services did move to Goulburn Police Academy, while the Corrective Services training centre remained at Eastwood. The client acknowledged that Eastwood, due to the PA report, put a hold on expensive renovations, attracted a new Director, and became more service oriented. However, according to the client room for improvement remains.
Aboriginal Affairs Statutory Investments and Business Enterprises	The report raised significant findings concerning overall effectiveness, and financial management of investments. Action to address these matters has been a priority for the Council.	
Aboriginal Affairs: Aboriginal Land Claims	The report has prompted the department (CALM) to further improve the efficiency of its assessment and processing operations.	The performance audit report was seen to lack constructive criticism. Many aspects of the Department's Act were overlooked. Some of the final recommendation were considered inappropriate by the client. Many sections were rewritten by the Department. Peripheral issues were considered. Auditors were perceived to be selective in their choice of stakeholder interviews.
Preschool and Long Day Care	All recommendations were accepted by the three departments involved. The Technical and Further Education Commission has introduced a new fee structure for its long day care centres from 1st February 1995 (which will yield benefits to the State of up to $1 million per annum), and is promoting greater financial delegation to operational centres, as the audit recommended. The Department of Community Services and the Department of School Education are both reviewing their programs in the light of the audit and hope to have revised arrangements in place later in 1995. The former has in fact recently purchased 90 copies of the report from us so that a copy can be given to all operational managers throughout the State to aid in generating change and achieving improvement. This is a very positive indicator of the value and impact of our work. Overall, total benefits to the State from the audit are estimated at over $7 million per annum.	The analysis and recommendations provided a useful basis upon which to build, particularly the weaknesses in the management information system. The audit successfully drew together various difficult concerns about the topic. It reinforced views already held on the subject, and in that sense was not groundbreaking.

Title of Performance Audit Report or Publication	Audit Office Comment Provided to Review Team	Summary of Client Comment
Private Participation in the Provision of Public Infrastructure (Accounting Treatments; Sydney Harbour Tunnel; M4 & M5 Tollways)	The report has had significant impact in terms of raising awareness and debate of significant matters of public interest and financial treatments for such projects. This issue has proven to be a major area of difficulty for governments worldwide, and this report has provided a significant contribution to an ongoing debate upon the issues. In terms of impact, a later project of this sort (the M2 Motorway) was also audited, and it was found that many of the problem areas raised by this report had been handled much better in the next project. This is a clear sign of improvement in public sector management arising from a performance audit report.	The RTA was particularly critical of these reports and argued that no benefit had been achieved.
Sydney Olympics: Review of Estimates	The performance audit made a number of recommendations concerning the preparation and publication of annual estimates of operating and capital costs, the auditing of those estimates and auditing the actual costs of staging the Olympics. The Premier has advised that the Government has adopted all recommendations.	
Special Audit Report: Proposed Sale of the State Bank of New South Wales and the M2 Motorway	The Performance Audit Branch was recently required to respond to two special and urgent requests of Parliament for reports, both of which had to be undertaken in extremely short time frames. The Parlaiment could not proceed with the sale of the bank until the report had been received, and required urgent report on the M2 before enabling legislation could be finalised. Both tasks were completed by the time required (in the case of the latter, just 1 week), and the Branch thus played an important part in Parliament's consideration of major contemporary matters of public interest.	
Management of the Courts: A Preliminary report	The report is only preliminary, and not intended to directly produce change. However, even so this report has succeeded in agreeing a series of improvements which the Department has formally committed itself to achieving in a set time frame, after which a further audit has been set down to be undertaken.	This particular report was limited to a preliminary survey study, and a proper performance audit will be carried out during 1996. The reason is that the Department is currently undergoing a review by a management consulting firm.
Education Sector: Joint Operations		Unclear, while the reports are received in a positive light, many criticisms were made in relation to poor communication and the fact that the report wasn't a joint effort with the internal auditors.

Title of Performance Audit Report or Publication	Audit Office Comment Provided to Review Team	Summary of Client Comment
Effective Use of School Facilities		The Department of School Education overall was very pleased with the operational aspects/processes of the audit. The Department was presented with a choice of three in the selection of the audit topic and had an opportunity to comment on the methodology. A liaison officer was continuously kept informed during the progress of the performance audit. However, the Department does not support all conclusions. For example, formulation of room utilisation in schools has been questioned as being too sensational (i.e. media focussed). Also, the schools' freedom of choice of alternative community use of facilities and charges is fully endorsed by the Department, contradicting the audit report. In future, the Department would like its internal auditors to work alongside the performance auditors.
Same day Admissions	Responses (in writing) from operational managers right throughout the health service to our current audit (presently at draft report stage) have been outstanding. Highly praiseworthy of the audit. The Director-General of the Department of Health has now initiated discussions with us about undertaking a number of further performance audits in his organisation. We are discussing with him ways in which we might put performance auditing in the health sector on a more permanent basis. He is aware that such audits would still be entirely independent, and that the reports would be tabled in Parliament.	The Report was well received. Criticisms were made about the time taken and the lack of innovative analysis and recommendations.

7.2   Contribution To Improved Accountability

One of the purposes of performance audit is to improve public accountability by reporting on instances of poor or inadequate performance in relation to matters of economy, efficiency and effectiveness. As indicated earlier, such an approach can give performance audit a negative approach and develop a compliance orientation.

To the extent that performance audit reports contain details of inefficiencies and ineffective practices, and those reports receive wide publicity, then it might be possible to say that public accountability is enhanced. Whilst not suggesting that these practices should not be corrected, it is questionable whether public accountability is enhanced by forcing managers to, at times, "defend the indefensible" as distinct from getting on with the job of improving performance.

Most managers are aware of areas where performance can be improved. The role of audit should not be to make the task of improvement difficult by drawing attention to weaknesses and attributing blame. It is our view that the focus of performance audit should be on assisting managers, through the mechanism of public reporting, improve performance.

Contributions to improved performance are more likely to come from an approach where auditors trust and work with managers and let *them* report performance. Public

accountability will be enhanced if an auditor provides a level of assurance that the information is appropriate, complete and sufficiently comprehensive to meet the needs of the Parliament.

7.3   Implementation Of Findings And Recommendations

It is difficult to come up with definitive statements about the overall impact and outcome of performance audit work. Impacts may be immediate, in terms of realised savings, changed practices and procedures being implemented, or more long term with implementation occurring over a number of years.

Many agencies commented that the performance audit merely supported what management had intended to do. At the same time, however, this was regarded as useful in that it forced a focus on priorities and implementation.

The Auditor Office has compiled statistics concerning the implementation of recommendations. These are summarised below:

Status	Percentage of Recommendations Made
Accepted and implemented	50
Accepted but not yet implemented	19
Accepted and partyially omplemented	8
Partially accepted	8
Rejected	6
Not considered on policy grounds	5
Not yet tested	4
Total	100

7.4   Savings In Resources

There is a tendency to judge the success of performance audit by the savings that will be generated as a result of implementation of recommendations. While this is an important indicator, it is important to take account of:

- costs of implementation and change

- whether the savings could have been realised through other review mechanisms or management action.

The Auditor General has identified potential economic benefits generated as a result of three performance audit reports totalling $14m annually. The Reports are:

- Training and Development of the State's Disciplined Services: Stream 2 - Skills Maintenance Training

- Children's Services

- Same Day Admissions.

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7.5 Reputation And Sustainability

Perhaps the most important tests of impact relate to the reputation that has developed and the "sustainability" of the function - that is the extent to which the work of the Auditor General in performance audit is regarded as a permanent and ongoing activity. During discussions and consultations there was *no-one* who suggested that the Auditor General should be prevented from undertaking further performance audit work.

Sustainability is also evidenced by requests made by Parliament and agencies for "special audit" work (covering both performance and compliance/regularity audit). Just under half of the special audit work (14 of 31 reviews) have commenced on the basis of requests from Parliament or agencies. These include:

- Sydney 2000 - ongoing review of estimates
- SRA - Internal control
- Attorney general - Statutory Interest account
- Ethnic Affairs Commission - Administration of Grants
- Government Advertising
- RTA - Review of the 3x3 program
- Luna Park
- RTA - the M2 Motorway
- State bank - proposed sale

We consider that the Auditor General will continue to attract work on the basis of the reputation that has been established for independence, objectivity and the quality of the work.

We note, that a reputation has been established under circumstances where a significant proportion of the "special audit" work relates to regularity and compliance audit rather than performance (value for money) audit.

We would not like to see the commitment to performance audit work, initiated by the Auditor General, diminished as a result of a commitment to regularity and compliance issues. We consider that commitment to performance audit can be maintained by achieving a greater integration of performance audit with financial audit functions within the Office - as discussed elsewhere in this report.

8   Future Directions

8.1 Capacity And Capability

It is clear from our review that the quality of performance audit reports and the impact has improved greatly over the last year. Our review of the performance audit function indicates that the Audit Office has developed a strong capability in relation to undertaking audits of operational issues and preparing audit and best practice guides for internal and wider public sector use. The audit of Joint Operations in the Education Sector and the work on Fraud Control stand out as major contributions.

The Audit Office advised in its Briefing Paper that

- There is now proof that we have "done our time" or "earned our spurs", and that as a result we will be in a strong position for the future.

- Ministers have recently taken up with the Auditor-General the prospects of undertaking some major performance audits within their areas of responsibility.

The main areas of strength are in matters concerned with operational aspects of government agencies and preparing audit and best practice guides. We consider that the Audit Office should continue to develop and enhance its reputation and contribution in these areas. In approaching this task, the Audit Office has an opportunity to:

- assist service delivery agencies and work with the central agencies in the development of methods for performance reporting

- identify audit criteria, measures and indicators relevant to particular areas of government activity

- identify areas of "best practice" in both Australia and overseas in relation to specific operational and functional areas

Performance audit of program effectiveness is well covered through the other government mechanisms of program evaluation and policy review. Moreover, we do not consider that the audit criteria methodology used by the Audit Office is appropriate for organisational and program review.

In following a direction focussed on development of best practice and operational performance audit, performance audit will be seen less as a "major event" and become part of the overall accountability and reporting arrangement to Parliament.

Our comments, conclusions and recommendations for future directions on performance audit work are contained in the remainder of this Section.

8.2   Direct Audit

The Audit Office considers that as it now has a demonstrated track record in direct audit, it will be able to liaise at the ministerial and chief executive level with a view to offering significant potential for real benefits in performance audit. Ministers and Chief Executives have requested the Office to carry out specific audit assignments. The Office notes:

> . . . since such audits had been requested it seems likely that the speed and extent of implementation of recommendations made would be greater - thus further enhancing our impact in terms of acting as an agent for change in public sector management.

The Audit Office has demonstrated that it has developed the experience to address complex topics. Its work in the area of management practices and operational and service effectiveness should continue. As the knowledge and skill base of the Office expands, however, there will be the opportunity to move the focus of audit away from the traditional approach which suggests that all information for input into the audit process should come from a single study.

Input into direct audit work should come from:

- general business and analytical review of an agency's operations

- detailed systems audit work previously undertaken

- detailed knowledge and experience from continual involvement in general advice and audit.

In these respects we suggest that the Office should work towards developing an integrated approach to the audit process. The main elements of this approach would be:

- review of financial and accounting systems

- assessment as to whether the financial statements represent fairly the financial position and status of the agency

- consideration of the arrangements in place for detecting fraud and corruption

- consideration of compliance with legal requirements (but not carrying out detailed compliance reviews)

- assessment of the performance of particular services through carrying out a limited number of performance studies each year

- assessment of the effectiveness of overall management arrangements.

There is an inter-relationship between all of these elements of audit. Separate reports might be presented to Parliament on each element with a consolidated report that summarised work carried out and comments on the overall management arrangements.

Recommendation:

> *The Audit Office adopt an integrated approach to audit that combines:*
>
> - *review of financial and accounting systems*
>
> - *assessment and attestation of financial reports*

- *considerations of arrangements to minimise risk*
- *assessment of the overall performance of individual services (on a cyclical basis)*
- *assessment of the effectiveness of management arrangements.*

It is our view that this approach to audit is best undertaken in an integrated management and organisational structure. The Audit Office has a long term strategy for integrating performance audit with financial audit. The process of integration will occur over a longer term on account of the need to:

- establish a common approach

- provide training and support

- create an environment in the Office that supports the integration.

The Audit Office also has a strategy that at least 50 percent of the work of the Audit Office will be directed towards performance audit. As it is unlikely that the Audit Office will receive additional resources to bring the proportion of performance audit work to a level that equates with the current commitment to financial audit, it will be necessary to:

- reallocate resources from financial audit to performance audit within the existing financial audit branches

- transfer resources from the existing Performance Audit Branch to existing (and possibly new) audit branches

Integration will involve a number of key changes and amendments to legislation will be required. These will relate to:

- adopting a more efficient approach to undertaking financial audit work- in order to free up resources for performance audit[26]

- training current financial audit staff in the tools and techniques of performance audit

- recruiting, appointing and promoting staff with skills in accounting combined with education and training in disciplines relevant to performance audit work

- providing for greater industry specialisation through organisation structures that focus on key audit clients

These changes will require careful planning and implementation over an extended period - possibly three to five years. Change will require a strategic approach, a commitment to investment in training and change management. It is nonetheless important that a time horizon be clearly identified by the Auditor General as a basis for managing change.

Recommendation

> *Strategies be put in place that will achieve a full integration of financial and performance audit work with the finance audit branches over a period of three to five years.*

To facilitate integration, and to provide for the development of focus and expertise, we would envisage that the management structure of the Office would be on industry/agency

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[26] Issues in this area have been identified in the separate report on financial audit.

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lines, with multi-disciplinary teams developing and applying expertise in specific areas of public sector activity. An intermediary approach may be to have internal staff secondments within the two branches.

8.3 Development Of Broad Based Audit Criteria

The Audit Office has already adopted a strategy of producing "value-added" products from its performance audits. The idea is, that in addition to normal performance Audit Report to Parliament, the Branch will produce additional material such as a "best practice guide" or a some other form of publication (perhaps akin to a monograph). This would could provide benefit across the entire public sector.

The Audit Office has indicated that it would like to produce "audit guides" for use by both financial auditors and/or the management/internal auditors within agencies arising from particular audit assignments. Work has already commenced on this initiative. This will have the effect of extending the work done on audits across a much larger population. For example, in health, such an audit guide could then be applied at every hospital in NSW.

The best example so far is the work in the area of fraud control, where the work of the Office has been regarded as very successful. The Branch has been very active in promoting its ideas, receiving invitations for numerous speaking engagements over an extended period, and even contributing a chapter in a recent publication of note on the topic.

In the fraud control area the Office claims that is has clearly demonstrated both potential and credentials to act as an agent for substantial change in public sector management.

The success in Fraud control led the Branch to continue seeking avenues to value-add from performance audit projects. The most recent example is a best practice guide for Joint Operations In The Education Sector, developed as a corollary to a performance audit of that issue (both the Report and guide are presently in final draft form).

Experience in the UK also points to the success of this approach to performance audit. The development of thematic studies examining individual activities within particular services is seen to provide a depth of background information to enable auditors of individual agencies to deal confidently with topics with which they might not otherwise be familiar.

As indicated earlier in this Report, we are of the view that the Audit Office should take the initiative and embark on major thematic studies at regular intervals. These studies can also be used as a basis for establishing benchmarks against which the performance of individual agencies can be compared.

It is our view, canvassed elsewhere in this Report, that:

- The future scope of performance audit work be focussed on:
  - assessing economy, efficiency and effectiveness of agency management practices, the use of resources in operational activities and methods of service delivery

- the development of audit criteria, benchmarks, indicators and measures for assessing performance in key operational and functional areas

- assisting agencies in the development of performance reporting methodologies and techniques

8.4 Attest Audit

In New South Wales there is a major opportunity for the Auditor-General to take a pro-active role in the development and implementation of attest audit in relation to performance measures and reports. This will involve working closely with the Parliament (Public Accounts Committee) and the central agencies in developing an approach that is useful for both accountability and performance improvement purposes.

Movement towards attest audit is constrained by the absence of formal procedures for the preparation and presentation to Parliament of performance reports. The Commonwealth formally presents Senate Estimates Committees with Program Performance Statements and Victoria is moving towards inclusion of performance information in Budget Statements.

The quality of performance indicators and measures that are currently available would not enable the Auditor-General to systematically report, or report meaningfully on performance. Part of the difficulty in this area relates to a problem of defining unambiguously what Government agencies actually produce and what they achieve. A great deal of information about government performance is reported in terms of activities and processes.

Nonetheless, and given this limitation, there still remains significant scope for the Auditor-General to develop approaches, in cooperation with the Treasury and other central agencies, for the attest audit of key activities and processes in government agencies. This may involve, for example, the Audit Office advising of standards and criteria in relation to key operations and processes, identifying areas of "best practice" and reporting against benchmarks.

There has been much work to develop acceptable frameworks to underlie such reports. In Canada, experimentation has begun in preparing "management representations" of effectiveness.

Recommendation

The Auditor-General work closely with the Parliament and the Central Agencies in developing a systematic approach for performance reporting in the NSW Budget Sector.

The Auditor General be given responsibility for undertaking attest audits on Performance Statements prepared by agency management and reporting on the accuracy, relevance and reliability of performance indicators.

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8.5 Future Role Of The Performance Audit Branch

With integration of financial and performance audit into the general operational areas of the Audit Office, there would still be a need for a separate organisational unit to:

- develop broad based, government wide audit criteria and best practice guides that could be used to guide in performance and financial audit work

- develop and monitor methodology on performance audit

- undertake large special reviews - in the nature of special projects of a compliance nature.

We consider that work on the development of audit criteria is best undertaken in an area of the office that is not responsible for the implementation of those criteria. At the same time, we consider that the performance audit methodologies have been developed to a stage where they will only require ongoing maintenance and updating.

The work of special reviews and investigations of a compliance nature will be an on going requirement. It is appropriate to maintain a capacity to undertake this work. Staffing resources can be supplemented as appropriate when review activity is particularly intense.

Recommendation

> *The current Performance Audit Branch continue as a separate organisational unit with an ongoing responsibility for:*
>
> - *undertaking broad based, sector wide performance audits with a view to developing audit criteria, benchmarks and best practice for use in performance audit work undertaken in operational areas*
>
> - *developing the Office's methodology for the audit of performance statements*
>
> - *maintenance of performance audit manuals*
>
> - *undertaking performance audit work that does not fit easily within the functional responsibilities of finance-performance audit branches.*

Any surplus staff within the current Performance Audit Branch would be allocated to the current financial audit branches to assist in developing an integrated audit approach and recruiting and training staff in performance audit approaches.

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8.6 Relationship Between Internal And External Performance Audit Work

In discussions with departments, staff from internal audit areas suggested that there be closer cooperation and coordination in the development of internal and external performance audit programs.

We think that progress can be made in this area with the integration of operational and performance audit in the Audit Office and the development of a stronger client focus in all areas of audit activity and interest.

8.7 Report Follow Up

Once an audit report is produced for the Public Accounts Committee and copies given to the agency, there appears to be little follow up.

Recently, procedures for follow up discussions with the agency have been developed. This is an important initiative, as the audited agency is in the best position to action the recommendations of the audit. The Audit Office can play an important catalytic role in this respect.

Additionally, there is an opportunity for the Public Accounts Committee to consider what action or further investigation should be initiated as a consequence of the audit. The Public Accounts Committee is in an ideal position of authority to ensure that the many thousands of dollars of expenditure on such audits lead to demonstrable improvements in public sector administration.

Consistent with practice in the Commonwealth Parliament, the Government should give a commitment to respond to Committee reports within six months.

Recommendation:

> *The Public Accounts Committee have a specific responsibility for review of Audit Office findings and conclusions and making recommendations to Government*
>
> *The Government be required to respond to Public Accounts Committee Reports within a six month time frame*

9 Performance Audit Manadates: Comparisons Among States And New Zealand

9.1 Australian National Audit Office - Commonwealth Government

9.1.1 Mandate/Scope/Terminology

The Audit Act 1901 provides for two types of performance audits - efficiency audits and project performance audits. A performance audit project is basically a special review.

Section 2(4) of the Act defines an efficiency audit as:

(a) an examination of the functions performed by, and the operations carried on by, the body or person for the purpose of forming an opinion concerning the extent to which those operations are being carried on in an economical and efficient manner; and

(b) an examination of the procedures that are followed by the body or person for reviewing operations carried on by the body or person, and an evaluation of the adequacy of those procedures to enable the body or person to assess the extent to which those operations are being carried on in an economical and efficient manner.

Performance audits do not examine the appropriateness or policy effectiveness of a program, ie. the effectiveness of governments in choosing policies and programs that meet society's needs. However, they do examine the outcomes of policy.

9.1.2 Selection Criteria/Reporting Requirements

In its performance audit manual the ANAO states that it "conducts performance audits to provide information and assurance to Parliament and the public about the economy, efficiency and effectiveness of the performance of public sector agencies. The ANAO also seeks to improve public sector performance by producing a report that specifies where improvements can be made and the likely impact of those improvements.

The manual stresses that the performance audit report is not the final outcome. While outcomes should drive the performance audit topic selection and be the focus of the performance audit report, the performance audit report should be the focus for identifying audit outcomes and the medium for communicating those outcomes to Parliament and the auditee.

The commonwealth accountability cycle includes detailed procedures for the implementation of a follow-up package by the ANAO, as well as suggestions for follow-up of audit recommendations by the Auditor-General. In fact, it is a core strategy to carry out follow-up audits on performance audits and monitor and follow up auditee adoption of audit recommendation through Department of Finance reports and auditee liaison.

9.1.3 Methodology

The ANAO has a well developed performance audit methodology since 1986. For each stage in the performance audit process, auditors are encouraged to ask the following four questions;

- what is the impact of the audit?
- what savings will emerge from the audit?

- what value is being added by the audit?

- how can the findings and recommendations of the audit be best communicated?

This is not only to ensure a logical structure and approach to conducting performance audit, but also to ensure that the final report is borne in mind at every stage in the audit process. Concise, understandable and useful audit reports of a consistent quality and structure are the ANAO's primary objective.

9.1.4 Strategic Planning In Performance Audit

The ANAO has developed a detailed strategic plan, which was distributed to all Members and Senators, outlining themes and quantitative targets for the following financial year.

9.2 Victoria

9.2.1 Mandate/Scope/Terminology

Audit Act 1994

> 16.   Performance audit of authorities
>
> (1) Subject to sub-section (7), the Auditor-General may conduct any audit he or she considers necessary to determine whether an authority is achieving its objectives effectively and doing so economically and efficiently and in compliance with all relevant Acts.

The part of the Act that refers to reporting requirements is very similar to that of New South Wales. The major revisions to the Act in 1994 include the provision of an annual program for performance audits within departments to be determined by the Auditor-General in consultation with the Public Accounts and Estimates Committee of the Parliament. The revised legislation also provides for the cost of departmental performance audits to be met from moneys appropriated to the Parliament. The Victorian Auditor-General is also not permitted to question the merits of policy objectives of the Government.

9.2.2 Selection Criteria/Reporting Requirements

Performance audit topics for projects are selected primarily on the basis of risk and materiality, added value, enhancing accountability and identifying scope for cost savings or improved revenue management. Currently the Office has a Performance Audit Project Database that lists a list of potential projects that, at any point in time, do not extend beyond a planning time frame of between 18 months and two years. This is to reinforce the dynamism of the Database and the importance of its continuing relevance to current and emerging circumstances within the public sector in Victoria.

Reporting requirements by the Victorian Auditor-General are very similar to the ones laid down by legislation in NSW, with the exception that the Victorian Audit Act 1994 refers to Performance Auditing, while in NSW the term Special Audit is used. The Victorian Audit Office favours the approach taken by the United Kingdom and the United States of America by preparing a long-term audit report (conclusion) for performance audits for reasons outlined in its audit manual (p 1-8).

Since 1992, the Victorian Minister for Finance has tabled an annual report in the Victorian Parliament detailing action taken by public sector agencies in addressing recommendations contained in Auditor-General's Reports. According to the Victorian Auditor-General's Office, the number of audit issues assessed by the Minister as requiring further action or monitoring by agency management during 1993-94 fell from 76percent to 54percent of identified issues. Also, the number of issues raised by audit which were considered to be fully resolved increased from 24percent to 46percent.

9.2.3 Methodology

Victorian Performance Audit Methodology (VPAM) was introduced in August 1991. Since 1984 the Audit Office of Victoria carried out so-called comprehensive audits and it was based on a model developed by the Canadian Auditor-General. In 1990 the mandate for the Audit Office was widened to undertake value-for-money audits which focussed more on effectiveness, rather than just economy and efficiency as was the case in the eighties. Performance auditing is defined as "an audit relating to any matters concerning the performance of an organisation other than those connected with the fair presentation of financial statements". It differs, according to the Victorian Audit Office, from financial statement auditing as there is:

- some discretion in establishing audit objectives and scope

- in many cases, an absence of a generally accepted body of performance audit criteria

- a different nature and source of audit evidence

- often a requirement for multi-disciplinary knowledge and skills.

9.2.4 Strategic Planning In Performance Audit

Each business group within the Victorian Audit Office has developed business plans. These plans, complement the Corporate Plan, outline available resources, key result areas, strategies and action programs for the following financial year.

The Corporate Plan of the Victorian Audit Office lists three principal tasks to be achieved between 1994-95 and 1996-97;

- continually enhance and effectively apply the Office's performance audit methodology to reflect cost-effective business principles, value added concepts and international developments

- improve the cost-effectiveness and timeliness of the audit reporting phase through enhanced project management

- establish a framework for effective consultations with the Parliament's Pubic Accounts and Estimates Committee for the selection and funding of departmental performance audits.

Under the Audit Act 1994, the Auditor-General is required to consult with the Victorian Public Accounts and Estimates Committee, prior to finalisation of the next financial years program for departmental performance audits.

9.3   Western Australia

9.3.1   Mandate/Scope/Terminology

Financial Administration and Audit At 1985

Power to investigate

80 The Auditor General may at any time -

(a) audit the accounting and financial management information systems of the Treasury or any department or statutory authority to determine their effectiveness in achieving or monitoring programme results;

(b) conduct any investigation that he considers necessary concerning any matter relating to the accounts of the Treasurer, a department or a statutory authority or to public moneys, other moneys or moneys of a statutory authority or to public property or other property and may carry out examinations of the efficiency and effectiveness of departments, statutory authorities or parts of departments or statutory authorities.

In Western Australia the term "performance examination is used" for what is called performance audit in NSW. In Western Australia there is no Public Accounts Committee. That's why the Act refers to the Treasury department, which determines the funding levels of the WA Auditor General's Office.

Another major difference with other States is that there is no requirement for auditees (departments) to comment on a performance audit report's findings and recommendations before publication. Therefore no comments by the auditee are included in the report.

9.3.2   Selection Criteria/Reporting Requirements

A formal scanning and selection process is currently only used within the largest WA department, that of Health. The WA Audit Office also has a contract to analyse the most frequently discussed topics in the press. An additional 300 hours of discussion and research identified 60 topics and this list was subsequently narrowed down to six concept papers and finally to two for preliminary study. Within other agencies professional judgement and "keeping an ear to the ground" approach are used. The Office runs a Lotus Notes database to maintain flexible data base of current/potential topics.

Performance Audit reports are reported to Parliament, both in report format and in a leaflet summary format. Recommendations are not discussed with auditees before hand "for fear of compromising (or appearing to compromise) auditor's independence." An issues paper will have been discussed with the client prior to the preparation of a draft report.

9.3.3   Methodology

The so-called Performance Examination branch within the WA Audit Office undertakes, besides performance audits, also Performance Indicators Attest function on behalf of the Treasury department.

In terms of performance examination, no manual has been developed, other than a few documents that provide guidance for particular part of the performance audit process.

The WA Audit Office prefers not to get involved in any follow-up work regarding performance audit reports, because of changing circumstances and the risk of getting involved in long follow-on studies while resources are very limited. However, the WA Parliament would like the Audit Office to do some follow-up work. Consultants are used in support roles, but do not lead or undertake performance audits independently. Their skills are more technical (eg. child care and health).

9.3.4 Strategic Planning

Currently little strategic planning appears to take place in WA.

9.4   Queensland

9.4.1   Mandate/Scope/Terminology

Financial Administration and Audit Act 1977

Section 80(3) states that "the object of the audit includes determining whether the performance management systems enable the public sector entity to assess whether its objectives are being achieved economically, efficiently and effectively."

The Queensland Audit Office refers to performance auditing as "Performance Management Systems". The above paragraph was only included in the 1993 review of the Act. To date no performance management systems audits have been finalised.

The Act has given the Auditor-General the following discretion

- whether to carry out performance management systems audits or not
- whether to carry out the audit separately, or
- whether to carry out the audits as part of another audit.

In addition section 80(4) of the Act states that in conducting a performance management systems audit, the Auditor-General must have regard to any prescribed requirements relating to the establishment and maintenance of performance management systems that apply to the public sector.

9.4.2   Selection Criteria/Reporting Requirements

The guidelines recently finalised by the Queensland Audit Office list materiality, matters of public interest, size and complexity of operations, known unresolved problems emanating from financial and compliance audits, and concerns of the Public Accounts Committee as factors that may determine performance audit projects.

The Queensland Parliament has allowed the Auditor-General discretion as to what matters warrant reporting to it and has also left the manner of reporting to be determined by the Auditor-General.

9.4.3   Methodology

Earlier this year the Queensland Audit Office completed a brief overview of performance auditing methodology and processes. Five phases have been identified for the proper conduct of performance auditing;

- proper definition (proposal)
- adequately scope (information gathering)
- rigorously planned (objectives)
- professional conduct and
- objective reporting

9.4.4 Strategic Planning In Performance Audit

To date, no strategic planning seems to have taken place for performance auditing.

9.5 Tasmania

9.5.1 Mandate/Scope/Terminology

The Tasmanian legislation governing the performance audit function is the Financial Management and Audit Act 1990.

The Tasmanian Audit Office's mission statement is to provide independent audit assurance to Parliament concerning the financial statements of the Treasurer, Government Departments and public bodies and the economy, efficiency and effectiveness of those entities; operations.

The Corporate Goals in relation to performance auditing state that "reports on performance audits undertaken in accordance with Parliamentary funding before the following July. Completion of performance audits in accordance with aggregate and individual approved time-frames, costs and resource budgets.

9.5.2 Selection Criteria/Reporting Requirements

Like in many of the other States, a variety of sources of information that may lead to the selection of a performance audit topic. Some of the criteria for project selection are;

- potential for operations to be conducted more effectively

- potential for greater economy and efficiency of operations

- materiality

- environment

- past or proposed coverage and

- management systems.

Performance Audit reports are reported in separate report and sometimes part of the No 2 Report on Government Departments and Public Bodies to parliament. Follow-up work is undertaken by writing to a selected number of agencies on a yearly basis.

9.5.3 Methodology

The Tasmanian Audit Office has developed its own performance audit guidelines which have drawn heavily from the ANAO and the Victorian Performance Audit Methodology (VPAM).

9.5.4 Strategic Planning In Performance Audit

To date, no strategic planning seems to have taken place for performance auditing.

Coopers
&Lybrand
Consultants

9.6   Key Issues - Main Similarities/Differences

The role of the Auditors-General differ greatly in Australia when it comes to performance auditing. The primary cause for this difference is the different mandates that the Auditors-General have in the different States and Territories of Australia.

The Federal Auditor-General has the widest mandate in Australia, and therefore the accountability cycle works to its fullest extent possible. The Victorian Auditor-General follows a close second. The Act in Victoria defines very clearly the role of performance auditing in the accountability cycle. Follow-up audits seem to take place from time to time.

The NSW Auditor-General follows next, although the poor definition for performance auditing in the Act seems to lead to multiple interpretations of what constitutes a "special audit". Also the workings of the NSW Public Accounts Committee in the process of accountability cycle needs to be defined clearer in order to smooth the follow-up process in NSW.

Western Australia's problems seems to be the lack of a Public Accounts Committee that can take the results of performance audits further than is currently the case. This vacuum has resulted in performance audit reports that exclude comments from the auditees for fear by the WA Auditor-General to be seen to be compromising his function. Queensland and South Australia seem to do very little performance auditing to date, although the Acts have been recently modified to allow performance audits to take place. The ACT has a policy of letting performance audits to external contractors. The NT has not taken any action to date in relation to performance auditing.

It seems that the development of performance auditing in Australia has largely progressed over time. The best developed accountability cycles are found in the Commonwealth and Victoria, the two institutions that introduced performance audit earliest. As the sophistication of techniques developed, the role of the Auditor-General seems to have widened to include performance auditing as a primary task. Gradually the emphasis has shifted from economy, to efficiency and currently effectiveness. Only in those two institutions is true analysis of the three primary objectives of performance auditing taking place.

In all other States and Territories of Australia the emphasis is still, more or less, on the implementation of performance audit. NSW follows closely but both the Auditor-General and the Public Accounts Committee need to do more to ensure a full implementation of the accountability cycle with regards to performance auditing. Not only needs the Performance Audit mandate to be clarified in many States and Territories, but the role of the Public Accounts Committee in the follow-up process of performance auditing needs to be clearly defined as well. Lessons learned from the Commonwealth and Victoria tells us that this may simply be a matter of time, although the sooner guidelines regarding follow-up are implemented, the better.

Once the Act has been modified and clarified, greater emphasis can be put on the selection and follow-up process of performance auditing, in order to ensure a greater quality and consistency in the reporting of performance audit results. This will lead to a

greater understanding and appreciation of Auditors-General through their role of performance auditing public enterprises and departments.

9.7 Performance Auditing In New Zealand

9.7.1 Mandate/Scope/Terminology

Office of the Controller and Auditor-General

Section 25 of the Public Finance Act 1977 states;

> (3) ... "the Audit Office may whenever it thinks fit, make such examination as it considers necessary in order to ascertain whether, in its opinion, resources of the Crown or a Government agency subject to subsection (1) of this section or a local authority, have been applied effectively and efficiently in a manner that is consistent with the applicable policy of the Government, agency, or local authority, as the case may be."

Again, the key limitation inherent to this section is that the Office cannot question policy. Also, the word performance auditing is not stated explicitly in the Act.

9.7.2 Selection Criteria/Reporting Requirements

The NZ Auditor-General's Office has in place a process of strategic audit planning. These plans have a three-year focus and relate to specific parts of the public sector. The plans flow from the Office's assessment of key risks and interests in each sector and are designed to identify the audit areas and strategies to be adopted by the Office in each sector. It has only been in place for the last two years and is therefore still subject to considerable innovation and development, according to the Office.

A great deal of emphasis is placed on reporting by the NZ Auditor-General. Reporting to Parliament is seen as:

- providing independent assurance as to the performance and accountability of government; and/or

- promoting, where needed, improvements in the standards of performance and accountability in government.

No report will be tabled in Parliament until a formal clearance is obtained and the Auditor-General is satisfied that the Minister(s) is/are fully aware of the thrust of the report. One way of doing this is to offer the Minister a briefing by the Office. Most reports arising from performance audits have been included in the Office's general reports to Parliament.

9.7.3 Methodology

A substantial proportion of the Office's time is directed towards the attestation of performance indicators. This work is regarded as part of its overall performance audit effort. No details are available of NZ audit methodology at this stage. The Office is believed to be conducting performance audits at an advanced level. Currently the Office is revising its performance auditing manual.

9.7.4   Strategic Planning In Performance Audit

The Office has a process of strategic audit planning. These plans have a three year focus and relate to specific parts of the public sector. The plans flow from the Office's assessment of key risks and interests in each sector and are designed to identify the audit areas and strategies to be adopted by the Office in each sector.

Public Accounts Committee

Review of Audit Office of NSW
Management of Human Resources
Conducted by Price Waterhouse
September 1995

TW Williamson
Partner

RA Butler
Director

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1. Executive Summary

The Management of Human Resources (HR) in the Audit Office of New South Wales (AO) is a vital function in the context of the day-to-day management of the AO, and in the support required for the AO to achieve its Corporate Goals. While there are specific individuals occupying specialised human resources management roles, the success or otherwise of the HR function will depend on the skills of all managers in the AO, and their degree of commitment to the effective management of their employees.

There is recognition in the AO of the role within and results provided to the Office at the operational level by skilled and experienced human resources professionals. However, there is yet to be full appreciation as to how HR management expertise may benefit the AO at a strategic level.

The integration of the HR management function with the process of corporate planning in the AO, together with a need to upgrade and enhance current HR procedures and practices, represent the major issues emanating from this review.

These issues are elaborated upon in more detail below under headings which define the management of HR in the AO.

Recruitment and Selection

- Recruitment criteria are a fundamental part of the recruitment process used in the AO. Such criteria should reflect the attributes required in applicants which are relevant to the culture envisioned for the AO.

- The AO, in recent times, has been successful in attracting to it, quality recruits, particularly at graduate level. To maintain or improve this standard, recruitment and selection processes for both graduates and higher level entry employees should be enhanced to ensure quality applicants are selected.

Training and Development

- To be proactive and to better support the achievement of the AO Corporate Goals, it is seen as necessary that the Training and Development (T&D) function establish formalised links into the planning process and with other functions within the AO.

- T&D systems, administration and analysis of the function could be improved to make the function more effective and capable of evaluation.

- HR management and T&D are complementary functions and therefore the links between these areas needs to be strong.

- Currently, far greater emphasis in the T&D function is placed on technical compared with managerial training. Managerial and personal development training are part of the processes needed in an organisation undergoing significant change.

Performance Management

- As the culture of the AO is changing so are the performance management needs of the Office. Accurate and relevant information on the performance of staff is required to effectively manage the practice, and for individual personal development. Appropriate systems needs to be in place to provide this information.

- Management is aware of and is attempting to address the issue of underperforming staff. The aim of current and additional procedures and processes needs to be successful resolution of this issue.

Career Development

- At present, career development is not an active part of the management of HR in the AO. A program of career development jointly managed by line and HR management could greatly assist staff motivation and the process of change in the AO.

- The knowledge and experience of senior staff in the AO has not been applied to provide career guidance for less senior staff in the office. Many benefits could be provided to the AO by the introduction of a formal counselling program, mentoring and moves towards a coaching culture.

- Integration of a number of HR initiatives should be considered in the establishment of a program of career development. In this context, job rotation, transfers and secondments will be an important part of the program.

Corporate Culture

- For a process of cultural change to be successful, it is best practice to closely involve and invite participation from HR professionals.

- To assess progress in the process of cultural change, a program of regular staff surveys would be the ideal monitor and measure.

Remuneration and Benefits

- The Public Sector Management Act limits the amount of flexibility available to the AO in the area of remuneration and benefits. This is an area where the AO must compete on the open market. The Enterprise Agreement, as currently drafted, will address some remuneration and benefits issues, but the AO will still be restricted in its ability to react to the marketplace.

Staffing

- Adequately staffing the AO means knowing the precise requirements of the Office and being able to respond in an appropriate timeframe to meet those requirements. Systems and procedures need to be in place to enable the AO to respond appropriately.

- Turnover, particularly of well performed staff, will prevent the AO being able to achieve its Corporate Goals. Introduction of a Co-ordinated Staff Retention Program should go a long way towards addressing the issue of turnover.

Human Resources Management Capabilities

- Recommendations in this report suggest the need for more resources in the HR function, possibly at a more senior level than current staffing, to implement the required new HR initiatives and to maintain the momentum of change already established.

2. Introduction

2.1 Background

The Public Accounts Committee has engaged Price Waterhouse to provide consulting services and to assist the Committee, and to advise on the Review of the Audit Office of NSW with particular response to the Management of Human Resources.

The Terms of Reference for this engagement are:

* To review the management of human resources within The Audit Office of NSW.

* In the context of that review and without limiting its scope, the following issues are important:-

    (a)   recruitment, training and professional development of staff;
    (b)   promotion and career development;
    (c)   remuneration and work practices;
    (d)   the adequacy and balance of available resources (including skills and competency) to enable The Office to efficiently and effectively achieve its corporate objectives and assist the Auditor-General to efficiently and effectively discharge his statutory responsibilities;
    (e)   the use of contract and/or specialist staff.

2.2 Methodology of Review

The review was carried out in the following stages:

Stage 1:   Review of available documentation dealing with all aspects of the Management of Human Resources in the AO.

Stage 2:   Interviews with senior executives and management in all responsibility centres of the AO. Conduct of "focus group" discussions with employees of the AO.

Stage 3:   Interview with Waite Consulting who completed an assignment for the AO over the past year.

Stage 4:   Preparation of the final report and confirmation of findings and recommendations.

3. Recruitment and Selection

3.1 Recruitment in Perspective

Recruitment is the lifeblood of the AO. Recruitment provides the resources for the AO to perform its statutory responsibility, but it also provides an opportunity whereby, if so desired, change may be gradually implemented, particularly in an environment of approximately 15% turnover per annum. In recent years, it is acknowledged in the AO that recruitment of a limited number of employees from outside the Office and the Public Sector has contributed to the changing culture within the AO.

3.2 The Recruitment Process

In reviewing the recruitment function of the AO, it was important not to lose sight of the fact that the process of recruitment in the AO is strongly driven and directed by the "Recruitment and Employment" guidelines contained in the Public Service of NSW "Personnel Handbook".

The results of adherence to these guidelines are:

- a structured process must be undertaken to fill vacancies as they occur in the AO;

- all vacancies in the AO are required to be advertised, and staff within the AO seeking to improve their grade may make application for any vacancy advertised.

As mentioned, in Section 6 of this report, this is the process by which promotion takes place, i.e., staff may proceed to a position at a high grade level only when a vacancy occurs at that level.

As limited flexibility is available to the AO in terms of the process which must be applied when recruiting staff, it was not appropriate to examine that process in detail or to recommend an alternative process. A constructive approach was to explore how value may be added within the constraints of the prescribed process, and to suggest how optimum results from the process may best be obtained. Recommendations in this area have been derived on this basis, and on the basis that recruitment can be a powerful tool to implement cultural change.

3.3 Changing the Culture

The primary document for driving recruitment in the Public Service of NSW is the Job Description. Much effort in the AO has been dedicated to the production of job descriptions.

Advertisements for vacancies are derived from job descriptions and selection criteria are based on those skills, knowledge, experience and qualifications to which reference is made in the vacancy advertisement. In the structure in the AO where one of the Corporate Goals is "to build an organisational culture that embraces quality as a core value, and promotes commitment to excellence and client service", the appropriate personal attributes associated with building this culture need to be assessed as part of the selection process for each new employee. At this stage, job descriptions have not been updated to incorporate such attributes, and therefore, at present the attributes which support one of the AO's major Corporate Goals are not being assessed as part of the recruitment process.

3.4 Recruitment of Graduates

On a very limited budget, the AO performs very creditably in the area of graduate recruitment.

Features of the recruitment of graduates for the AO are:

- applicants are recruited in a sensitive and professional manner;

- based on a limited review of graduates due to start in early 1996, it appears an above average quality graduate is being attracted to commence employment with the AO;

- it is almost universally recognised, in the AO, that the quality of graduates being brought into the Office over recent years is very good and an improvement in the general standard of new employees compared with prior years.

In this context the efforts of the Administration Manager and Administrative Officer (Staff & Personnel) should not go unrecognised, but the challenge exists to maintain the high standards established in an environment where it is predicted the demand for quality graduates is likely to increase.

Whether or not the situation in the mid to late 80's will be replicated, when almost all accounting graduates leaving university could be assured they would easily find employment, is yet to be determined.

The current process of recruitment of graduates is based on interviews held on campus and, for selected applicants, in the AO's offices. SES staff are involved in the office interview program. These interviews are structured and the majority of questions used are technically oriented. There are no minimum standard quality criteria established for graduate recruits, although a degree of quality control is maintained by using the same staff consistently through the graduate recruitment process.

3.5 Recruitment and Selection of Higher Level Staff

As outlined earlier, recruitment of staff at levels above that of graduate may result in bringing into the AO new staff from outside the AO or it may be a promotion for someone already in the AO. To attract quality candidates from outside of the Public Sector, the AO has successfully used "head hunters" on several occassions, particularly to recruit staff at SES grades.

The process for this recruitment is heavily dependent upon panel interviews, and for staff making application
from within the AO, no reference may be made to their personnel file or prior performance records, but "Work Reports" are prepared on potential promotees by their direct supervisors.

In the review, some disquiet was expressed in relation to this process in terms of:

- applicants within the AO not feeling that they necessarily were judged on their merits, nor that their abilities were fully taken into consideration;

- those in managerial positions feeling that the best candidate had not necessarily been selected for the vacancy, be he/she being an internal or external applicant;

- the time taken to find new staff to replace resignations.

A process for selection which relies substantially on panel interviews can be influenced by factors such as:

- the quality of the interviewing panel, and the style and content of questions posed; and

- the consistency of application of the process in terms of Selection Committee membership.

Additional procedures if implemented, would work towards eliminating any deficiencies which may result from the above factors. In the case of both the Performance Audit Branch (PAB) and the Information Systems Audit Branch (ISAB), it is important to mention that the relevant Assistant Auditor-General (AAG) and Director become directly involved in the recruitment of staff for their branches. This should, and generally does mean, that these factors are not applicable to the PAB and ISAB.

3.6   Selection and Other Human Resources Issues

The current processes for recruitment of staff in the AO:

- are based on concepts of "fairness", with the procedures developed in an attempt to prevent any applicant being disadvantaged; and

- EEO principles are strongly adhered to.

Our review led us to conclude that theoretical fairness was consistently and conscientiously applied. However, in a selection process where only limited time is dedicated by those who form the Selection Committee, and some information i.e., prior performance information, is not available to that Committee, it is almost inevitable that not all selection decisions will be the correct ones.

Incorrect selection decisions can lead to other human resources issues arising, which should not be the case if correct, or at least acceptable decisions are made. Such issues are:

- staff becoming disgruntled because they believe they have been overlooked;

- staff being promoted to a level beyond their competence and possibly, thereby, creating a blockage and an underperforming staff member;

- staff becoming disillusioned about the process of recruitment/promotion or about the competence of those administering the process.

3.7 Recommendations

3.7.1 Appropriate personal attributes associated with building the AO's defined culture to be prominently incorporated into all job descriptions for positions in the AO. Those on Selection Committees to be suitably trained to assess and evaluate these attributes.

3.7.2 Graduate recruitment process to be upgraded and enhanced by the application of more resources and materials e.g., higher quality brochures and information material, more time available to dedicate to career fairs etc., enhanced visits to the AO for interviews. Minimum quality criteria to be established for graduate recruits.

3.7.3 Standards and procedures to be established for Work Reports prepared for Selection Committees. Production of "honest" Work Reports to be a requirement. **[See Section 5 of this report]**

3.7.4 Performance standards to be established in relation to timeliness etc for the recruitment of replacement staff.

3.7.5 Selection Committee members to be carefully screened and selected to ensure they possess the required characteristics to make recruitment decisions.

3.7.6 Continuity of Selection Committee membership to be maintained to achieve some consistency in selection decisions. Also, Selection Committee members to be from the same branch in which the vacancy exists. **[Moves are already in place to implement this recommendation]**

3.7.7 Higher level interviews (by SES staff in the branch where the vacancy exists) to be conducted to confirm Selection Committee decisions.

3.7.8 Selective testing of applicants eg: tests of conceptual reasoning, critical analysis etc. to be used to assist in evaluating how applicants will perform at the level for which they are being recruited.

4. Training and Development

4.1 Business Strategy and Objectives

There is widespread recognition in the AO of the need for the dedication of time and resources to training and development. Generally speaking, the technical training currently provided to support the business objectives of the AO is comparable to that of private sector audit firms, particularly in the early career stages.

An implicit link between the training activities and the business plan of the AO has been made through the development in 1993 of the Structured Training Program, which has been designed to meet the business objectives of the Office. The Professional Development (PD) unit is not guided by any plan which sets out objectives for the unit for the medium and long term.

Whilst, during the course of the review the impression was gained that employees of the AO tend to value the training function and support the activities of the PD unit, the PD unit is used, primarily, as a course provider, rather than as an internal professional development consultant to branches in the AO. However, the Performance Audit Branch, which has a budget for external technical training, does utilise the PD unit for consultation.

Apart from setting and maintaining a budget for training, consideration is not given to any cost/benefit analysis of training activities within the AO. To conduct such an analysis would be difficult currently without an appropriate training administration system being in place.

4.2 Consultation and Identification of Training Needs

To be effective, training and development departments, or as is the case in the AO, the PD unit, need to be in active, regular and meaningful consultation with the users they serve to ensure their courses and other activities are supporting the aims and objectives of these operational departments. Such consultations should be formalised but may be just as effective if informal, and generally that is the mode of consultation used in the AO.

Presently there is regular liaison between the PD and operating units to confirm that training materials are up-to-date and relevant to the business needs. The bulk of the PD unit's activities are centered around the Structured Training Program which was established as a result of a training needs analysis conducted by Marketing Frontiers in October 1993. To supplement this work, the PD unit discusses with management, course content, and feedback is obtained from field staff regarding their needs. Course scheduling is based on past experience and is confirmed after consultation with nominated individuals from each of the branches.

There is limited liaison between the PD unit and the Human Resources (HR) (Administration) function, which results in lack of input to areas of HR management where potentially contribution could be valuable e.g., in recruitment and retention initiatives. On the other hand, the PD unit is not automatically provided with relevant HR information and data, which can impact on the PD unit's ability to plan for new recruits and grade changes within the AO.

Identification of training needs is summarised as follows:

- there has been no further training needs analysis since the work of Marketing Frontiers in October, 1993 mentioned above, other than for the Performance Audit Branch, but a new needs analysis is now underway;

- there are no core courses for the Performance Audit Branch (PAB) and there are limited resources to develop courses specific to the PAB. As a result of this and because the branch has its own training budget, the PAB relies heavily on external course providers;

- the PD unit works predominantly to provide technical courses although it recognises the need for non-technical skills training for supervisors and managers. Branches have also identified personal skills training needs such as presentation and report writing skills for mangers and senior managers to facilitate enhanced client service delivery.

  Management training is presently estimated to be 5% of all training conducted;

- needs have been identified for training in "mentoring" and "coaching" as referred to in Section 6 of this report;

- it is anticipated that the new Performance Management System will identify a number of training needs, particularly at the individual employee level;

- induction training is well regarded, however, it is recognised that there is scope for highlighting the broader context of the AO within the induction training provided.

4.3 Training Design

Defining the most appropriate methods for training delivery is still an "evolving" issue within the AO. Currently the training run is mostly classroom-based. However, a wide mix of training delivery styles are employed by the AO, including workshops, videos, on-line PC tutorials, CBT, audio and on-the-job training. Industry Specialisation Groups also provide a forum to discuss issues pertaining to specific industries and liaise with industry groups in other States regarding current issues, practices and to identify potential training courses.

The PD unit holds scheduled screenings of videos eg updates to accounting standards. For those people who miss the scheduled screening of these, videos are available to be borrowed from the PD unit. It is planned to make more extensive use of videos in the Structured Training Program, and some training materials have self study components eg RBA. Trainees are able to load templates onto their computers and do the exercises in conjunction with participant workbooks. Tutorials for Microsoft Office products are available in modular form on the network and staff are encouraged to access these in the computer training room.

Whilst the PD unit sees value in producing courseware on diskettes (eg A PLUS) using remote learning for those trainees unable to attend scheduled training, they are currently under resourced to do so. Additional resources are provided by a library which is currently being developed by the PD unit, containing relevant technical and non-technical books, videos and audios.

Training courses are designed using field audit and Planning, Research and Management (PRM) staff where available, in conjunction with the PD unit. By using "subject matter experts", the PD unit ensures that the training offered is relevant. Where a training need has been identified, but it is unable to be satisfied internally, AO staff are sent to external training courses/conferences. Leader Skill conducted a program in December 1994 on client service. Coopers & Lybrand held a course on Managing the Audit in June 1995.

4.4 Implementation and Monitoring Effectiveness

All internal trainers at the AO are qualified trainers. They have undergone "Train the Trainer" and "Presentation Skills" training. The mix of technical and non-technical skill in the PD unit allows both these needs to be addressed and to align them to the developing and changing corporate culture of the AO.

Evaluation sheets are completed by trainees and managers at the conclusion of each training program to assess what has been learned. There are informal testing procedures for some courses. In addition, evaluation forms are completed by trainees and their managers within 3 months of any training program. This is of great value to assess what skills have been transferred to day to day work practices. Generally, trainers do not report to managers on the performance of participants on training programs, unless asked to do so.

The PD unit reviews the effectiveness of training on the job only when new recruits come in for further training after the induction session. This feedback also assists the PD unit to predict where management training is required.

4.5 Resources and Management of Training

Apart from the PD unit's staff complement of three (3), the unit requires field staff with expertise in particular areas to provide input to assist in the development and/or assessment of courseware. Also, during peak business periods, as the AO relies on a number of temporary staff, the PD unit has identified a need for resources to assist in adequately training the sudden influx of new employees.

Current systems do not allow the PD unit to assess the cost effectiveness of training initiatives. The PD unit is unable to assess what percentage of the training expenditure is spent on training needs analysis, design of courseware, delivery or evaluation. Acorn codes are used to define the training done by AO staff, and for other record-keeping purposes.

4.6   Recommendations

4.6.1   Best practice organisations have a strong link between their Training Plan and Business Plan. A formally documented link needs to be created between the business plan objectives and training responses. This will enable the PD Unit to be more proactive and ensure that the content of training programs and the methodology used are linked to the business plans of the AO and support the Corporate Goals of the Office. Input from PD unit should be considered at the business planning stage. *[See also Section 10]*

4.6.2   To ensure that the activities of the training function reflect and support the latest practice of other functions (audit methods, technical products etc), formally organised links should be established between the PD unit and other functions within the AO.

4.6.3   The short, medium and long term objectives of the training function to be clearly defined in writing and confirmed as appropriate by the AO leadership. This is to be reviewed and updated on a regular basis.

4.6.4   To ensure that training is only used where it is likely to be cost effective, the AO should give careful consideration to the cost/benefit of all training activities. It is expected that the training module of the recently purchased CHRIS software will facilitate the administration and greater depth of analysis of the training function.

4.6.5   As mentioned elsewhere in this report training is one area that could act as a critical success factor to recruiting and retaining staff. Consideration should be given to including the PD unit in the development of recruitment, career development and retention initiatives.

4.6.6   To ensure that training effort is directed toward priority areas for the AO, is relevant and cost effective, it is vital to conduct training needs analyses on a continuing basis.

4.6.7 Change management efforts derived from the HR function should involve the PD unit to ensure that suitable changes are made to the training program. Similarly, the HR function should have access to all training information, so that they can take the appropriate actions to support and reflect the training.

4.6.8 An increase in managerial personal skills training for managerial staff is recommended in other areas of this report to improve HR management, and will also facilitate the change process taking place in the AO.

4.6.9 Consideration should be given to investment in the resources to develop CBT (Computer Based Training) materials / remote learning facilities for courses that are of particular importance to on-the-job performance. *[Note: Remote learning would marginalise the benefits of trainees meeting with other members of the AO at classroom training sessions, but would still be of more benefit than no training at all.]*

4.6.10 Mechanisms should be enhanced to provide feedback to managers after training courses, and to assess the effectiveness of training on-the-job. Debriefing sessions and client feedback could then form the basis of amendments to current training programs, or could define a need for additional training to improve service delivery to clients.

4.6.11 The PD unit should be adequately resourced and supported by the other branches to design and develop courseware that is current, relevant and aligned to the Corporate Goals of the AO. There should be no barriers to the allocation of field staff to assist the PD unit.

4.6.12 Over time, it is planned that the AO be less reliant during busy periods or temporary staff. Subject to success in this area, resources need to be allocated to the training of temporary staff to a level which does not potentially compromise standards of auditing and related services provided to clients.

4.6.13 As identified by the report of Waite Consulting in April 1995, there is a need to supplement the training records now kept by the ACORN system. At the earliest opportunity, an assessment needs to be made of CHRIS, the software that has been selected for the HR functions within the AO, to determine whether this software will address the needs of the PD unit and where tailoring of this software may be necessary.

5 Performance Management

5.1 Objectives of Performance Management

Performance management is a key plank in the human resources management in any organisation, as it is the means by which the organisation brings together its own goals and those of its staff members. In general terms, performance management systems operate to achieve these objectives:

- to provide the employer with accurate human resources information relating to the productivity and the performance of its employees to facilitate business planning;

- to quantify strengths and weaknesses in the staff of an organisation upon which management decision making may be based;

- to provide employees with objective evaluations of their performance and of their individual levels of skills, abilities and knowledge;

- to enable each employee to manage his/her career and to permit planning for the achievement of personal goals and objectives.

5.2 New Performance Management System

5.2.1 Development and Outputs

Historically, it would seem performance management has not consistently been a high priority in the Management of Human Resources. However, during 1995, a new Performance Management System has been introduced with a view to addressing the above objectives. This new system is objectives driven, in accordance with current Premier's Department policy. Much effort would appear to have been applied to the development of the Performance Management System and a continuing program of training in the use of the system has been put in place to ensure uniformity of implementation and application.

In the AO, branch management requires global information on the levels of performance being achieved by staff within the branch. That is, for example, how many staff in the branch are performing according to expectations, how many above expectations, and general information or knowldge and skills strengths and weaknesses.

Currently, this information is provided anecdotally, by word of mouth or through personal knowledge of individuals, which is insufficient information for appropriate managerial planning and development of staff. How such information is to be provided to branch AAG's, for instance, from the new Performance Management System, is not clear, but it would seem this needs to be an output of the System or some alternative mechanism needs to be in place to produce this management information.

5.2.2 Benchmarks

The new Performance Management System uses benchmarks:

- developed from Position Descriptions for each grade level, Office Policy Circulars, the AO's Corporate Plan and its "Guarantee of Service";

- which are the performance standards for the Performance Management System; and although

- these standards are recorded in various source documents, and are consolidated as part of the process of preparation of Workplans.

It may be problematic, therefore, for those with the responsibility to operate the Performance Management System, to complete Workplans, which are a key element of the System, in the way in which the instructions intend for Workplans to be completed. However, as completed forms using the new System will not be generally available until towards the end of the year, it is not possible to comment on the success or otherwise of the operation of the new System in its first year.

Current best practice in the area of performance management is to express required performance standards in the form of competencies, a methodology:

- based on criteria, developed by analysis of individual jobs and tasks in an organisation;

- which allows personal performance to be measured against the set criteria, which may be grouped under headings such as "Client Service", "Personal Effectiveness", "Staff Development and Management", "Technical Competence" and so on;

- designed to indicate areas of performance where full competence is not achieved, so employees understand the ways in which they need to improve.

Theoretically, using this methodology, it is very unlikely that any employee will be assessed as "fully competent" in all areas for assessment, and, thereby, appropriate training and development needs are also established. Such is also the case for the objective-based methodology used in the AO's new Performance Mangement System.

In the case of the AO, the competency based approach to performance management would permit more emphasis on competencies or attributes relevant to the current Corporate Goals of the Office, than is the case with the "Generic Work Behaviours" evaluation section of the new Performance Management System. Also, evaluation against specified competencies permits clear differentiation of performance, thereby recognising good and very good performers and minimising potential demotivation of the staff which the Office would wish to retain, if such information can be incorporated into promotion decisions.

5.3 "Honesty" in Appraisal

Discussions with management and staff revealed that, in the AO, assessment of employees' performance had not always been carried out with diligence and "honesty".

The dimensions of this lack of honesty are as follows:

- poor or inadequate performance is not identifiable by reference to performance management documentation;
- some of those required to complete performance appraisals question the concept in an environment where such documentation, as discussed by Public Service guidelines in this area, is not used for promotion decisions;
- a culture exists where it is felt to give a subordinate a poor performance report only succeeds in upsetting that employee, and leads to aggravated relationships between staff who need to work together on a regular basis;
- failure to meet required standards of performance, in some cases, is also not documented in the production of "Work Reports", which are a focal point for promotion discussions.

The results of lack of honesty in appraisal can be:

- employees promoted to grade levels where they are unable to satisfy the requirements of the grade; and
- the situation where a number of underperforming staff are spread at various grade levels in the branches.

As referred to in Section 3 of this report, under the promotion system currently operating in the AO, it is not possible for historical performance reports to be referred to as part of the process of making decisions on those to be promoted. This may provide some rationalisation for supervisors not to complete appraisals of performance in a honest way, but such an approach undermines the reputation of the supervisor and can threaten the integrity and credibility of a promotion system based on merit, not to mention the morale and other implications. In the AO, the system does provide for open discussion between service management at the final section style, ?????? and it is hoped that the new Performance Management System may minimise this problem.

It is unusual that a reason for not being honest in completing appraisals, is, apparently, because some supervisors do not wish to "upset" employees who they have working with them and also will continue to be working with them. This is almost universally the situation in workplaces where honest and accurate performance management systems are in place and operating successfully, and therefore, it is impossible to attribute any justification to such an attitude.

5.4 Underperforming Staff

During the recent past, considerable time and resources have been dedicated in an attempt to address the issue of underperforming staff. Staff in this category are variously estimated to be between 5-10% of the total staff complement. Management in the AO fully recognise the scope and implications of this issue and leaders of branches are now required to take responsibility for staff in their branches assessed as having unsatisfactory performance. The new Performance Management System will confirm, to some degree, the extent and degree of any unsatisfactory performance, and the Enterprise Agreement, as drafted, provides a mechanism to deal with underperforming staff.

Some issues associated with underperforming staff are:

- the lack of productivity in times when the AO is "stretched" for resources;

- the morale implications associated with continuing tolerance of underperforming staff;

- underperforming staff at various grades preventing promotions of good quality staff at lower grades; and

- the "example" set for other staff.

5.5 Recommendations

5.5.1 Changes and enhancements to the Performance Management System need to be implemented in such a way so that individual differences in performance may be clearly identifiable, and so that management may evaluate global strengths and weaknesses in an objective and empirical manner.

5.5.2 A program needs to be put in place to develop competency based position descriptions for all levels of staff in the AO. **[Work has already commenced on a competency model/skills matrix for staff in IS Audit (although this does not conform to current Public Service of NSW guidelines), and "Position Profiles" have been developed for attest audit staff, although theses are not competency based].** **[If this recommendation is adopted, there would be significant implications in the area of Training and Development]**

5.5.3 Appropriate performance criteria for all levels of staff need to be developed as the basis for the performance management system. These criteria would be derived from the competencies which constitute the position descriptions. **[Work has commenced on appropriate performance indicators and work standards for staff in the Performance Audit Branch]**

5.5.4 A cultural change program is required to overcome the reluctance to assess staff "honestly". This could be part of any ongoing training and development being provided on performance management. In this context, the completion of "Work Reports" needs to be covered with a view to improving the quality of these reports so that they accurately reflect abilities, skills and knowledge.

5.5.5 Where staff have been promoted to a particular grade level but it is assessed that they are unable to operate at that level, in line with the recent "Action Team" recommendations, an intensive individually based program need to be put in place for each person to attempt to bring these staff to the required level of performance, or to consider other courses of action. An SES person in each branch needs to take ownership for such a program.

5.5.6 In each branch, in conjunction with the program outlined above for those promoted to a level at which they cannot presently operate, a program needs to be in place to address the issue of underperforming staff, who are so, not solely because they have been promoted beyond their level of competence, with a view to completing the required individual action plans within a specified timeframe. Once again, an SES person needs to take ownership of such a program.

5.5.7 Mechanisms need to be considered so that appropriate historical performance information may be incorporated into decisions relating to promotions, and "broadbanding" as envisaged in the Enterprise Agreement may facilitate this to some extent. The aim should be that the best performers are promoted first.

6 Career Development

6.1 Introduction

Career development is a multi-faceted concept which finds expression in organisations in a variety of ways. At the highest level, career development can be the centrepiece of human resources management in an organisation and can encompass the activities of selection, performance management, promotion, training and development, counselling and so on. It is acknowledged that, most employees, particularly those at junior level and while still developing, are likely to benefit from appropriate career guidelines and direction.

On the other hand, career development can be an individually driven activity where, essentially, the employee is responsible for the shape and direction of his/her career and for any initiatives to achieve career objectives.

6.2 Career Planning and Change

The process of career development in the AO is defined by the established organisational structure of the Office and is brought into action by the operation of a number of human resources management functions i.e., personal and professional development, performance management, and promotion and advancement. In the absence of any systematic process of career planning in the AO now, and there are some good reasons why such a process has probably not been developed, career development in the AO is definitely more individually directed than corporately guided. In a time of change, as is presently being undergone is the AO, the importance and significance of career development and planning is emphasised because:

- change is generally disruptive for most employees, because it creates uncertainties which can be diminished if employees are given a clear vision of how the changes will impact upon their own career plans and progression;

- change as defined by the AO's Corporate Plan will have a greater chance of success if all employees are involved in and are made to feel part of the process of change. Such involvement and commitment is guaranteed if employees believe their individual career needs are being addressed;

- as part of the process of change, the identification and development of the "potential" that exists in each employee needs to be understood and directed so that both corporate and personal goals may be achieved. Career development and planning if a formal process, focuses attention on the "potential" which exists in an organisation; and

- intelligent and motivated employees generally have career ambitions, and they need assurance that they will be able to achieve these ambitions within the AO;

- in an environment such as the AO, where there are limitations as to what may be provided to well performed staff in terms of remuneration and promotions, career development provides an alternative to maintain commitment and enthusiasm.

6.3 Organisation Structure and Promotion

The established organisation structure in the AO, referred to above, is defined in the following ways:

- in the main, employees will join the Office after completing tertiary studies and will, over a period of years, progress through grades gradually assuming higher levels of responsibility and authority;

- the structure is outlined to employees at the time of entering the Office and is well publicised, so that all employees are aware of the levels of seniority to which they may aspire;

- promotion from one level of seniority to the next takes place according to laid down NSW Public Service guidelines, and occurs by application when a vacancy exists at the next level.

In other words, employees may, for some time, be in a position to assume responsibility at a higher level and may be assessed to be ready to be promoted to that level, but promotion can only take place when a vacancy exists and if the employee is successful in his/her application. Herein lies two reasons why career planning as a process has not been developed in the AO:

- the timing of promotions, particularly at levels above Audit Senior, can be unpredictable; and

- in the AO and in other areas of the Public Sector, choosing to apply for promotion is an individual decision, and a number of employees choose not to apply for positions of greater responsibility.

On the other hand, career planning in the form of creating new experiences for the individual, could be highly regarded by staff feeling frustrated because they are unable to advance through promotion.

Determining whether or not an employee is ready for promotion will be done through the new Performance Management System, and performance management is discussed in more detail in Section 5 of this report. Appraisals of performance will be discussed with employees by their supervisor when he/she completes the appraisal, and it is intended that discussion will focus mainly on the past and on specific assignments. There is no process in place for performance and general career ideas or concepts to be discussed with a member of senior management, for instance, a member of the SES, although this can, and undoubtedly does, happen on an informal basis.

It should be noted that with the "broadbanding" planned to be introduced when the Enterprise Agreement is finished and agreed, greater flexibility will be available in the AO to make promotions when staff are ready to be promoted.

6.4   The Challenge to Management

In circumstances where employees are talented and are ready for promotion but expectations cannot be fulfilled it is the challenge to management to keep those staff motivated and to ensure that the better performers are retained in the service of the employer. Career development and planning can play a very important role in this context with the emphasis being to develop the individual and to maintain enthusiasm in the role and tasks being performed.

It is the responsibility of management in the AO to be aware that:

- work for some staff can lack sufficient variety to stimulate and to maintain enthusiasm;

- professional development and competence can be enhanced by the careful selection of assignments and the opportunity to work in different areas; and

- managerial resources and time are required to be dedicated to "monitoring" and "coaching" activities.

6.5   Development

6.5.1   Professional Development

Staff in the AO who formed part of the focus groups assembled, spoke highly of the degree to which the AO had satisfied their expectations for professional development. In summary this development takes the form of active support by the AO of its employees in their efforts to obtain their professional qualifications, and this support is supplemented by a structured training program which gradually builds the technical skills of employees appropriate to the grade level at which they are operating.

6.5.2 Personal Development

While professional development/technical training requires standardisation to ensure uniformity of service and to maintain quality standards, personal development needs to be more tailored to the individual. In the AO, less emphasis is placed on personal development, and the comment was passed by some staff that they felt the skills and abilities which they possessed were not being fully utilised. One of the roles of management is to identify talent and potential and to nurture that talent or potential to provide the maximum benefit for the AO, and reward for the individual.

6.6 Recommendations

6.6.1 "Career Development" needs to become a joint responsibility of branch management and human resources management in the AO to assist the process of change in the Office, and to maintain the motivation of good employees the AO wishes to retain. Ownership and responsibility for career development must be assigned and an active program put in place to assist all staff to manage their careers.

6.6.2 Counselling of all staff should be introduced to give staff a formal opportunity to discuss their careers with a senior person in the AO. Training in counselling techniques would be necessary for those given the responsibility for counselling. Set out below is a recommended counselling program.

6.6.2.1

Recommended Counselling Program

A formal program of counselling for all staff in the AO provides the opportunity for frank discussion relating to career and other matters in the AO, and in the case of less experienced employees, they can benefit greatly from the information which may be imparted by their more senior colleagues, to assist them to know what their career goals should be, and how they may best set about trying to achieve those goals.

A counselling program establishes the frequency with which counselling should take place and the appropriate member of senior management who should conduct the counselling for each grade level in the AO. Variations to the recommended program may be necessary in individual branches due to size and structure.

Counselling Program

Grade		Frequency of Counselling	Counsellor
2	Trainee Auditor	Bi-Annually	Once by Manager/Senior Manager. Once by Principal Auditor /Director of Audit /Auditor-General
3/4	Senior Audit Clerk	Bi-Annually	As for "Trainee Auditor"
5/6	Audit Senior	Bi-Annually	As for "Trainee Auditor"
7/8	Auditor	Annually	Principal Auditor Director of Audit
9/10	Manager	Annually	Director of Audit
11/12	Senior Manager	Annually	Assistant Auditor-General

The aim of the Counselling Program is to provide a formal opportunity for employees to discuss career and other issues with a decision maker in the branch, who can not only provide advice based on his/her own experience, but can also provide answers and bring about change as is necessary. Counsellors should be carefully selected to ensure they possess the required personal attributes to make employees feel good about themselves and positive about the AO, particularly those employees whom the AO has identified as wishing to retain.

6.6.3 As part of the career development process, consideration should be given to more regular rotation on jobs according to individual development needs. Also, more inter-branch secondments or transfers (between attest audit and IS audit and performance audit and vice versa as appropriate) should be facilitated. The AO should investigate in detail the opportunities for staff to be seconded to other AO's in other States, New Zealand and overseas countries, as well as secondments to comparably large private chartered accounting firms, clients and other organisations. **[There are currently no inter-branch transfers in place, and there are currently four (4) AO employees on secondment to other Public Sector agencies]**

6.6.4 Those in managerial positions require training and guidance in the subject of career development, with a view to developing a culture where "mentoring" becomes commonplace. Training for all SES Staff and Senior Managers in the coaching and management of staff is envisaged.

7. Corporate Culture

7.1 Culture in the AO

One of the Corporate Goals of the AO clearly defines the culture which is envisaged for the Office. It states: "build an organisational culture that embraces quality as a core value, and promotes commitment to excellence and client service".

Much has been done already in the AO to move the Office towards its desired culture. For example:

- Audit Office Client Surveys
- Client Service Training
- Establishment of Industry Specialisation Groups
- Better Communication, internally and externally
  e.g., Auditor-General's open door policy, "Awareness", branch/group meetings, minutes of BOM and Senior Management meetings in "Grapevine", engagement letters, client service plans, greater consultation with clients
- Better Information Systems i.e., Winstaff, new HR management system
- Introduction of Structured Training Program
- The Benchmark/Matrix Study
- Introduction of a new Performance Management System
- Action Teams to address Corporate Goals issues
- Recruitment of Staff from outside the Public Sector

As a result, a significant process of change has been evident during our review of the AO.

7.2 The Role of Human Resources Professionals

Best practice guidelines indicate the need for close involvement by human resources professionals in a process of cultural change to provide advice and to implement key activities which drive the desired change. A number of the recommendations in this report emphasise the link between the recommendation and the Corporate Goals of the AO, and it is through these links that the human resources management of the AO becomes directly involved in the process of cultural change. Further comments are to be found in Section 10, however, as already apparently recognised in the AO, cultural change will rely heavily on innovation and change in human resources policies, procedures and practices.

7.3 Monitoring Cultural Change

While change can always be evident anecdotally and to those familiar with an organisation, it needs to be measured and assessed on a regular basis to ensure success is being achieved in targeted areas and that change is occurring uniformly across the Office.

Already as part of the "Survey of Audit Office Clients" conducted by Marketing Frontiers, a "mini-survey" of Audit Office employees was conducted, which has revealed valuable information on the process of change, but the primary target of the survey is the clients of the AO, and therefore, this survey does not provide comprehensive information on the process and status of cultural change in the AO.

7.4 Recommendations

7.4.1 Ensure the close involvement and participation of human resources professionals in the process of cultural change in the AO **[See also Section 10.4 of this report]**

7.4.2 Research and implement on a regular basis e.g., once every twelve months, a process of conducting staff surveys, to monitor and to make changes, where necessary, to the process of cultural change.

8. Remuneration and Benefits

8.1 Current Structures and Constraints

Remuneration and benefits in the AO are determined by scales common to other NSW Public Sector departments and agencies. Positions within the AO, below the SES grades, are aligned to the grades in the Crown Employees (Administrative & Clerical Offices - Salaries) Award, which was last amended in November, 1994.

The features of the Award are

- within each Grade of the Award, there are two salary figures, one for the "1st Year of Service" and the other figure for "Thereafter";

- AO Grades normally extend over two Award Grades, e.g., an AO Audit Senior in a Grade 5 or Grade 6 in the Award;

- ranges of salary with Award Grades appear quite narrow, e.g., the Grade 6 range is $38,524.00 pa to $39,652.00 pa, being the "1st Year of Service" and "Thereafter" figures respectively;

8.3 Rewards and Incentives

At present an "Action Team" in the AO has produced a discussion paper on "Performance Rewards and Incentives" which has been circulated to staff for comment. This is a very positive move in the Office to attempt to address some of the constraints referred to above, and is in line with general marketplace initiatives in remuneration of "pay for performance". It is understood also that incentives or rewards in the form of monetary rewards may become part of the Enterprise Agreement, which is still to reach final agreement.

8.4 Overtime

In the AO, there are periods during the year when substantial amounts of overtime are worked by employees. In the attest and IS audit branches this is generally in the period from June to October, while in the performance audit branch this may be at any time according to the deadline of a particular assignment.

It is accepted by employees that, in their chosen career, overtime is part of the professional service they provide, and in most cases, extra hours are worked without payment. Subject to prior managerial approval, payment may be made for overtime, or time off in lieu granted.

While adverse comment was limited, it did appear that there was an issue with overtime because:

• there was inconsistency with the way in which the overtime policies were applied; and

• the good performers were the ones who normally worked the most overtime.

The working of overtime in all organisations can be a contentious issue, and in the AO, where everyone is expected to work a significant amount of overtime during the year, it is vital that extra hours do not become a source of discontent for employees.

8.5 Benchmarking with the "Big 6"

Due to the size of the AO in terms of staff numbers, the quality and complexity of clients and other similarities, an appropriate benchmark for remuneration is the remuneration currently being paid in the "Big 6" chartered accounting firms in Sydney. Set out below is a comparative schedule giving details of current AO remuneration and the average remuneration for the "Big 6" chartered accounting firms in Sydney. Comments are:

- Entry level salaries in the AO compare very favourably with the outside market, and remain that way for the early years of employment with the AO. Salaries set in this way could create an incorrect impression and later could be a source of dissatisfaction and turnover;

- At or about the time of qualification, salaries in the AO begin to be less than the outside market, probably due to increases which are normally paid to staff in the "Big 6" upon successful completion of their professional qualifications. It is acknowledged that is both the public and private sectors, employees are likely to look for other opportunities after they have qualified;

- Attracting suitable quality staff at post qualification and senior levels may be an issue;

- Many of the staff in the AO at Manager and Senior Manager level, due to their length of service, would be receiving superannuation contributions at the level of 15%, and, therefore, for these staff, the difference quoted in the schedule would not be as large.

- In the AO, the same remuneration across grades is applied to the attest, IS and performance audit branches. Outside of the AO, IS auditors are generally remunerated at a premium compared with financial auditors because of market factors, and this may be a barrier to the AO being able to attract suitable quality staff. It is more difficult to make any definite comments in relation to performance auditors as their skills sets are varied at present and they are less easy to compare with the outside market.

Audit Office	Audit Office *	Average "Big 6"	Difference
GRADE	REMUNERATION EFFECTIVE 4 NOVEMBER 1994	REMUNERATION AS AT JANUARY 1995	"BIG 6" / AO
Trainee Auditor			
- Bottom of Range	30950	27050	(14.4%)
- Top of Range	31800	28900	(10.0%)
Senior Audit Clerk			
- Bottom of Range	32700	31250	(4.6%)
- Top of Range	35800	34800	(2.9%)
Audit Senior			
- Bottom of Range	38600	41750	8.2%
- Top of Range	42550	46000	8.1%
Auditor			
- Bottom of Range	43850	46000	4.9%
- Top of Range	48550	52650	8.4%
Manager			
- Bottom of Range	49950	55500	11.1%
- Top of Range	55050	75750	37.6%
Senior Manager ⊕			
- Bottom of Range	69450	80500	15.9%
- Top of Range	78500	92700	18.1%

*   *Includes Annual Leave Loading and 6% Contribution to Superannuation to equate with "Big 6" total remuneration figures. Some long serving AO staff are receiving superannuation contributions at a rate of 15%.*

⊕   *Includes the skills shortage allowance for AO staff at this level*

NOTE

- *Grade levels in the AO and "Big 6" firms do not directly align. The comparative "Big 6" figures are as close a match on positions as possible, not a match on years of experience, which is generally greater in the AO than in the "Big 6" firms at most of the grade levels.*

8.6 Recommendations

8.6.1 Some of the proposals contained with the Enterprise Agreement will address some of the remuneration issues in part. Effort must be applied to bring the Enterprise Agreement into place.

8.6.2 Once the Enterprise Agreement is in place it could be the foundation for any further initiatives to not have the AO within the scope of the Public Sector Management Act.

8.6.3 Although Public Sector requirements or guidelines may ultimately prevent it, further research and action should be taken to determine the extent to which current salary bands could be improved by wider application of specialist/skills shortages allowances and by job re-evaluation according to the recognised methodology.

8.6.4 As remuneration is unlikely by itself to be a means by which staff can be retained in the AO, recognition must be given by AO management to the importance of a co-ordinated program for staff retention. Such a program would require top management support and a recommended program is set out in Section 9 of this report.

8.6.5 Market levels of remuneration need to be regularly monitored and compared to the levels of remuneration in the AO to understand fully current relativities and levels where AO staff are most "at risk". Consideration needs to be given to the fact that IS audit and performance audit staff have different skills sets and expertise and their remuneration should not necessarily be aligned to the attest audit staff.

9 Staffing

9.1 Issues

There are three main issues which may be identified in relation to staffing in the AO. They are:

- whether current staff levels and performance meet the current needs of the Office;

- whether every effort is being expended to ensure the AO retains the staff it wishes to retain; and

- how to provide for the future needs of the Office.

The first and third issues are what could be described as the "traditional" staffing issues of any organisation, but the second issue is particularly germane to the profession of auditing and accounting. It is recognised in the AO as it is in private practice that employees will join, at say, graduate level and gradually as these employees become qualified and more experienced, they will seek other opportunities outside of the AO. In fact, the pyramid structure of the AO almost means this is inevitable.

The challenge in this set of circumstances is the ensure that the Office retains the staff it wishes to retain and hence the emphasis in this section is on the subject of retention.

9.2 Needs

For the attest audit branches, the Benchmark/Matrix study completed in May, 1994 has evaluated the staff needs and the current staffing levels in the branches and the conclusion was reached that the AO had sufficient staff to perform its attest audits. Clearly, a similar exercise needs to be conducted on a regular basis in line with client changes, performance and productivity expectations, and changes to methodology. The Benchmark/Matrix study is described in more detail in the AO review report on "Management of the Audit Function", where it is described "as an excellent and concise review".

The IS audit branch has an approved complement of nineteen (19) staff but at present it is not operating at that level, as the new Director is rebuilding the function and attempting to integrate it more with the attest audit function. The aim is to "upskill" all the attest auditors to have some IS audit competency and to that end, a small number of graduates will join the IS audit branch later in 1995. Highly technical work in IS audit is and will continue to be "contracted out". Staffing in the IS audit branch is covered in more detail in the AO review report on "The Adequacy and Management of Technology".

Staffing needs in the performance audit branch cannot be directly linked to budgeted work the branch will perform because of the unpredictability of assignments which the branch may have to complete. Essentially, the staffing of the performance audit branch is determined by the budget allocated to the branch to conduct its audits.

9.3 Structure and Mix

The Benchmark/Matrix study draws attention to the fact that the AO has an excess of Senior Audit Managers (SAM's) in the attest audit branches and the study recommends suitable measures which may be adopted to address this issue. In the attest audit function, the organisation/staff structure in terms of grades is very similar to the benchmark of a "Big 6" audit practice, with the significant difference that, normally, the rate of progression in the AO is slower than in private sector firms. This results in generally there being a greater level of experience at most of this grade levels in the AO compared to similar grade levels in the "Big 6" firms.

In the AO review report on "The Adequacy and Management of Technology", there is a section entitled "The Appropriateness of the IS Audit Organisation Structure and Staffing", and it is considered that this fully covers the issue of structure and mix for the IS audit branch.

9.4 Skills, Abilities and Knowledge

As mentioned in Section 5 of this report, current systems in the AO which report in any way on the skills, abilities and knowledge of employees in the AO, are not able to produce any summarised information which evaluates the current levels of competence or skills in the organisation. Therefore, in any quantitative sense, it is not possible to pass comment as to whether or not the Auditor-General has at his disposal employees of sufficient skills, abilities and knowledge to enable the Office to efficiently and effectively achieve its

corporate objectives and to assist the Auditor-General to efficiently and effectively discharge his statutory responsibilities.

However, it a qualitative sense, it can be seen, from other comments in this report that more can be done in the AO, than is presently the case, to develop and enhance the skills and abilities of AO employees. Before any initiatives in skills enhancement are commenced, it is important that levels of skills and performance be established, using the recommended competency based methodology. From a human resources management perspective, any changes in the AO to facilitate a better understanding of the effective strength of the staff complement in the AO, must be based on a clear articulation of the needs of the Office in terms of skills, abilities and knowledge, and the introduction of a process whereby staff, individually or as a group, may be measured against these needs.

If the Office wishes to retain its best people, it must be able to clearly identify these individuals.

9.5 Underperforming Staff

Earlier in this report, there is discussion of underperforming staff, most of whom became so classified, because of acknowledged shortcomings in the way in which employees have been promoted in the AO, most notably in the past. The phenomenon of underperforming staff brings to attention the need for minimum standards to be maintained within each grade level in the AO, to eliminate variability in the quality and capability of employees across the grades in the AO. Such variability has come about by the lack of appropriate performance standards, as mentioned above, and is a significant impediment to the management of staff resources required to effectively conduct the work of the AO.

9.6 Temporary Staff

At the time of conducting the review, there were in the vicinity of thirty-five (35) temporary staff in the attest audit branches, or approximately 23% of the overall manpower of the attest audit function. Such reliance on temporary staff places a considerable management burden in the attest audit branches in terms of supervision, quality control, on-the-job training and assignment management. Although it is not possible to measure the effects of having such a relatively large force of temporary staff, it would seem this must impact upon the effectiveness of the work being performed by the attest audit branches, but, this is not something of which the management of the

AO is not aware. The Benchmark/Matrix study provides a number of recommendations in this area, and further comment on managing the "peaks and troughs" of the attest audit function is to be found in the AO review report on "Management of the Audit Function".

9.7 Contract and Specialist Staff

Contract staff are used in the AO for the attest audit branches for the following general reasons:

- the Auditee requests that the audit be done by contract;

- geographically it is more efficient for the audit to be conducted by a local firm;

- shortage of resources in the AO; and

- the need for specialised expertise not available in the AO.

In the IS audit branch, specialists are used where expertise is not available in the AO, and also in the performance audit branch, specialists are used for fundamentally the same reason.

Contractors for the attest audit branches are normally private chartered accounting practices; specialists for IS audit also come from private accounting practices, normally the larger firms; and the performance audit branch uses specialist consulting corporations.

Contractors and specialists are employed for a set period, however, provisions exist to conclude contracts at relatively short notice, if the services of a contractor or specialist are assessed to be unsatisfactory. Generally, in the AO, the view was expressed that current contractors and specialists being used were performing according to expectations.

9.8 Turnover

For the year from 1 July 1994 to 30 June 1995, staff turnover was at the level of 15% per annum in the AO, a slight increase on the previous year. While this rate of turnover may be seen as high for the AO, it compares favourably with private practice and particularly the "Big 6" firms where employees comparable to those of the AO, turnover at approximately 20%

per annum or higher. Raw statistics do not, however, tell the whole story in relation to turnover, as, obviously, it is a qualitative as well as a quantitative issue.

During the 1994/95 year, 62% of those who left the AO were exit interviewed and as a result of those interviews and from other sources of information, the features of staff turnover in the AO are:

- 72% of those who were exit interviewed were leaving the AO to join the private sector, indicating the marketability of AO staff, which appears not to be fully appreciated in some parts of the AO;

- the average length of service of those exit interviewed was 4.25 years, that is staff in whom the AO would have invested in terms of training and development, and who were probably, at a point where they were beginning to "add value" to the Office;

- although it is unable to be quantified, most of those who left the AO were reported to be the good or better performed staff in the Office;

- turnover of female employees becomes greater as they progress through the grades in the AO. At Grades 3 to 5, the male/female ratio is approximately 50%/50%; at Grades 6 to 9, it is approximately 75%/25%; at Grades 10 to 12, it is approximately 95%/5%;

A number of reasons were given by those who were exit interviewed for leaving the AO, with remuneration, lack of job satisfaction, uncertainty about future progression, lack of recognition for good performance and poor management/supervision seeming to be the major cases for resignation. In themselves, these reasons are not unpredictable but they indicate areas of human resources management where potentially improvement in the AO is required.

9.9   Recommendations

9.9.1   The staffing requirement of the AO is not static. As such it is incumbent upon the management of the AO that they have in place procedures and mechanisms to define current and future requirements. The Benchmark/Matrix methodology needs to be applied to this task and needs to be enhanced according to changed or expanded needs. Those in managerial positions need to be able to clearly articulate their staff needs in terms of skills, abilities and knowledge which will vary according to the Office's Corporate Goals.

9.9.2 As mentioned in other parts of this report and in other reports, every effort should be applied to eliminate features of staffing of the AO such as underperforming staff and excessive use of temporary staff, which reduce productivity and distract managerial time and effort.

9.9.3 Turnover and other aspects of human resources management to be addressed by the introduction of a "Co-ordinated Staff Retention Program".

9.9.3.1

Recommended Co-ordinated Staff Retention Program

A key staffing issue is the AO's ability to retain its better staff. The consequences of not doing this are well understood in the AO. Staff retention is therefore a cause for some concern.

By retention is meant keeping in the AO those employees the Office wishes to keep. There is, of course, no single formula for success in this area, just as there is probably no single cause for resignations. Keeping staff requires attention to many factors, eg: career development, recognition, training and development, communication, coaching and mentoring and so on.

It is believed that retention will improve, if the efforts and actions aimed at it are co-ordinated and directed in a systematic manner. It is this co-ordination and direction that is referred to as a **"Co-ordinated Staff Retention Program"**.

Success will depend on identifying and introducing the most appropriate measures, individually desirable in themselves, in a way which shows that they are understood to be and are managed as part of the same whole.

Only the management of the AO is in a position to define the factors that influence the current high turnover. Those shown as examples above give an idea of the breadth of the enquiry that will be needed. The formulation of measures to be taken will also require discussion among the same group.

Once the decision has been taken to adopt a broad-front, pro-active approach to the problem of retention it is recommended that a methodology for a **Co-ordinated Staff Retention Program** along the lines of that described below be considered:

1. *The Goals*

Fix realistic retention targets for a period of, say, three years. Fix the goals by branch and, where possible, by person. In fixing the goals it should be assumed that gradual improvements will be attained during the period contemplated.

2. *The Critical Factors*

After enquiry and discussion identify the factors critically affecting retention. Initially, at least, it may be practical to limit them to four or five (see comments at the end of this section). At this stage it would be constructive to comment that almost all Public Sector agencies face an outside market offering increased remuneration to their staffs.

3. *Measures and Actions*

Decide on the measures and actions to be introduced or taken to address the critical factors identified. Many of these may be improvements or extensions of existing Human Resources procedures or practices, most commonly in the areas of counselling, career development, use of secondments, etc.

4. **Responsibility and Accountability**

Assign responsibility for the actions agreed to specific individuals in branches, making it clear that what is expected of them is a matter of critical concern for the AO generally - and therefore to be assumed in exactly the same way as other duties and responsibilities. At the same time agree a timetable for introduction / implementation with those concerned.

5. **Commitment**

Show, by example, that those who manage the AO are committed to retaining talented people for the Office.

6. **Monitor Results**

Devise means of monitoring the progress of the various actions that have been agreed and ensure that reliable up to date information is regularly provided on staff movements. Consider instituting a procedure through which information on staff losses is reported to all SES staff, as they occur, together with a brief description of the reasons that led to the loss.

7. **Evaluation**

After a reasonable period, say, one year, examine the results of the program in detail. What were its successes and what its failures? Have attitudes changed? Do more employees feel that they are with an employer that wants to keep them?

8. **Adaptation**

Adapt the program to take into account the results of the evaluation carried out.

It is recognised that time would be required to implement a full-scale program based on the methodology suggested. However, this should not deter the AO from embarking on a program which includes all the above steps, but is directed initially at addressing a reduced number of the factors considered critical for staff retention - say, one or two.

These may be added to as experience is gained and time permits. In this way the objective will still be attained of demonstrating that the measures taken or to be taken form and are managed as part of the same whole: a broad-front and pro-active program to address the issue of retention.

10. Human Resources Management Capabilities

10.1 Current Staffing and Responsibilities

At present in the AO, the human resources (HR) management capability (including training and development (T&D)) is provided by the following employees:

- Assistant Auditor-General (Policy, Research and Management)
- Administration Manager
- Manager, Professional Development (PD)
- Administrative Officer (Staff and Personnel)
- EEO Co-ordinator
- Training Officer (Audit)
- Training Officer
- Staff and Recruitment Officer

These employees provide a wide range of HR management and T&D services to the other staff in the AO, and, as part of our review, we concluded that, by and large, these services are efficiently and effectively delivered.

Further observations are:

- the HR and T&D functions are very much task driven, with staff in those areas working within defined boundaries, conducting day-to-day activities to fulfil their assigned responsibilities;

- by definition of their roles and by use of their resources in the AO, neither the HR function nor the T&D function operate at a strategic level to directly support the defined Corporate Goals of the AO.

10.2 The Role of Human Resources Management in the Corporate Plan

The AO's Corporate Plan has been developed so as to achieve the vision of the Office that: "By December 1995, The Audit Office of New South Wales will be recognised as the centre of excellence for the provision of public sector auditing and related services and advice".

Corporate Goals have been established as the cornerstones for achievement of the AO's vision and looking at those Goals in totality, it was decided in the AO that there were a number of priority HR issues requiring attention, which the AO has already addressed or is still in the process of addressing.

Best practice guidelines suggest corporate planning should be undertaken utilising input from support functions such as HR and T&D, and, thereby, the final Corporate Plan will include HR and T&D initiatives which are directly liked to the achievement of the Corporate Goals. To illustrate this, on the following pages is a schedule showing "Corporate Plan Broad Goals", "Human Resources Management Issues". "Human Resources Management Actions/Initiatives/Recommendations".

The effectiveness of the HR and T&D functions may be evaluated by the extent to which these functions are conducting activities derived from the Corporate Goals, as illustrated in the schedule below.

CORPORATE PLAN BROAD GOALS	HUMAN RESOURCES MANAGEMENT ISSUES	HUMAN RESOURCES MANAGEMENT ACTIONS / INITIATIVES / RECOMMENDATIONS
• Be recognised in the market as the public sector auditor of choice	• To improve the quality and level of client service by: - better understanding of client service expectations - improving the motivation of AO staff - promoting and recruiting "client focused" staff	**ACTIONS** • Client service training commenced **INITIATIVES** • Performance rewards and incentives under consideration • Client service standards to be reflected in individual "Work Plans" **RECOMMENDATIONS** • "Client service" attributes to be included in job descriptions and in selection criteria • Selection Committee members to be carefully screened, trained to evaluate criteria . Continuity of membership desirable • Mechanisms to be considered so that historical performance information may be incorporated into promotion decisions

CORPORATE PLAN BROAD GOALS	HUMAN RESOURCES MANAGEMENT ISSUES	HUMAN RESOURCES MANAGEMENT ACTIONS / INITIATIVES / RECOMMENDATIONS
• Implement the best technical products/services and methodologies	• To improve the general and specific expertise and knowledge of AO staff by - ensuring skills levels in the AO staff are sufficiently high to be in a position to implement products/services and methodologies. - providing appropriate training and familiarisation with new products.	**ACTIONS** • Introduction of new Performance Management System • Establishment of Industry Specialisation Groups **INITIATIVES** • "Position Profiles" developed for attest audit staff • Competency model/skills matrix commenced for IS audit staff • Performance indicators and work standards drafted for performance audit staff **RECOMMENDATIONS** • Introduce competency based job descriptions and performance criteria for all grades and across all branches in the AO • Strengthen links between PD and branches to keep abreast of changes • Maintain process of continual needs analysis for training and development to ensure branch needs are being met • Consider further CBT and remote learning initiatives

CORPORATE PLAN BROAD GOALS	HUMAN RESOURCES MANAGEMENT ISSUES	HUMAN RESOURCES MANAGEMENT ACTIONS / INITIATIVES / RECOMMENDATIONS
• Earn sufficient revenue to ensure sustainable self-sufficiency and to underwrite required investment	• To ensure levels of staffing, and of competence and performance in the staff of the AO are at the required levels to produce budgeted results, by - appropriate and regular evaluation of staff, individually and across branches - realistic planning for and evaluation of present and future staff needs - development of plans and initiatives for training and development - innovative management of underperforming staff	**ACTIONS** • Benchmark/Matrix study has established the recommended staffing required for the current workload in the AO • Action Team has developed appropriate strategies to deal with staff with consistent unsatisfactory performances **INITIATIVES** • Branches to become empowered for resourcing and HR management **RECOMMENDATIONS** • Articulate clearly staff needs required to perform the work and to achieve Corporate Goals • Establish appropriate systems and procedures for monitoring of levels of competency and performance, to differentiate individuals and to understand overall skills levels across the AO • Training and development to be linked to the AO's business plans • Short, medium and long term objectives to be established for PD unit • Further development of strategies and initiatives for the management and performance improvement of underperforming and overpromoted staff.

CORPORATE PLAN BROAD GOALS	HUMAN RESOURCES MANAGEMENT ISSUES	HUMAN RESOURCES MANAGEMENT ACTIONS / INITIATIVES / RECOMMENDATIONS
• Attract and retain highest quality staff who are supported by training and development programs and career opportunities	• To ensure HR policies/procedures and practices in the AO are as effective and as competitive as possible in the areas of - Recruitment and Selection - Remuneration and Benefits - Career Development - Training and Development	**ACTIONS** • Good quality graduates recruited over recent years • AO able to attract quality applicants from outside Public Sector for higher level positions • Structured Training Program implemented and operating smoothly • Exit interviews conducted and results communicated to management **RECOMMENDATIONS** • Graduate recruitment process to be upgraded and enhanced by application of more resources and materials. Quality criteria to be established • Higher level interviews by SES staff to be considered to confirm Selection Committee decisions • Selective testing to be considered to supplement current recruitment processes • PD unit to be included in the development of recruitment, career development and retention initiatives • Overall closer links between HR management and PD unit • Career development program to be put in place • A counselling program to be introduced • Job rotation, transfers and secondments to be an important part of the career development program • Consideration to be given to implementation of a co-ordinated program for staff retention • Enterprise Agreement to be finalised and brought into place • AO to monitor closely remuneration and benefits relativities with outside marketplace, and to consider whether any flexibility exists for further skills shortages allowances or job re-evaluation

CORPORATE PLAN BROAD GOALS	HUMAN RESOURCES MANAGEMENT ISSUES	HUMAN RESOURCES MANAGEMENT ACTIONS / INITIATIVES / RECOMMENDATIONS
• Build an organisation culture that embraces quality as a core value, and promotes commitment to excellence and client service	• To create and sustain an environment where the "new" culture is made known and is understood by the AO staff and is regularly reinforced by - appropriate communication of the new culture - integration of the culture into internal HR systems and procedures - specific initiatives to change aspects of the "old" culture in the AO which are deeply entrenched	ACTIONS • Communication of culture through the AO Annual Report, "Grapevine", "open door" policy • Formation of networking groups and regular branch meetings RECOMMENDATIONS • Cultural change program to overcome reluctance to assess the performance of staff "honestly", both in appraisals and Work Reports • Human resources professionals to be closely involved in the process of cultural change • Regular staff surveys to be considered • Managers to become "mentors" and to receive appropriate training in coaching and the management of staff

CORPORATE PLAN BROAD GOALS	HUMAN RESOURCES MANAGEMENT ISSUES	HUMAN RESOURCES MANAGEMENT ACTIONS / INITIATIVES / RECOMMENDATIONS
• Develop internal systems to ensure the effective overall operation of the AO	• Ensure HR management expertise and resources are available in the AO to: - monitor and change, where necessary, current HR procedures and practices required to effectively and efficiently conduct the AO practice; - develop and implement initiatives which support the business plans and Corporate Goals of the AO	**ACTIONS** • HR and PD "Client Service Plans" developed **INITIATIVES** • New CHRIS software purchased **RECOMMENDATIONS** • HR and T&D functions to be involved in planning phases of setting corporate goals and other strategic planning • Additional HR/T&D resources to be considered, possibly at a higher level than current staffing

10.3 HR Management in an Environment of Change

The AO's current Corporate Plan has clearly defined an objective for the AO and to achieve that objective, a process of change is underway. That process has many HR and T&D implications. These implications require skillful HR and T&D management, and, as outlined above, HR and T&D need to be involved at the strategic and planning stages of the change process.

Currently:

- the structure and definition of roles of HR management and T&D does not facilitate the involvement of HR and T&D professionals in the strategic and planning processes operating in the AO;

- appropriate skills sets and other attributes may not be available internally in the AO in the current HR and T&D structure to provide strategic and planning input if required;

- much of the process of change relating to HR has been delegated for implementation via line management in the AO; while line management needs to be actively involved and to "buy into" any process of change, sufficient expertise, understanding and skill may not exist in the line to implement sensitive HR changes;

- the "Corporate Benchmark Monitor" conducted by the consultants, Cullen, Egan & Dell, indicate that the HR management function may be understaffed with its current staff complement. This was also mentioned in the Waite Consulting Report completed in April, 1995.

10.4 Recommendations

10.4.1 Because of the nature of the AO, the achievement of Corporate Goals will be entirely dependent upon the employees. Therefore there needs to be HR and T&D involvement in the planning phases of setting corporate goals and other strategic planning.

10.4.2 Many of the recommendations in this report are considered to be initiatives which will further support the process of change already commenced in the AO. It is felt additional HR and T&D resources will be required in the AO to implement the recommendations made and to maintain momentum for the process already begun.

10.4.3 Subject to an appropriate evaluation of current internal resources, it is recommended that consideration be given to appointment of an HR/T&D Director who would have the skills and experience to implement many of the recommendations of this report and who would be at a sufficiently high level in the AO to participate in the strategic planning and corporate goal setting processes. Such an individual could also "drive" those HR initiatives which have been delegated to line management.

Appendix A

Interviews with Senior Executives and Management

As part of the review, interviews were conducted with the following Senior Executives and Managers in the AO

Tony Harris	Auditor-General
Jim Mitchell	Deputy Auditor-General
Eric Lumley	Assistant Auditor-General
Phil Thomas	Assistant Auditor-General
Tony Whitfield	Assistant Auditor-General
Geoff Oliver	Assistant Auditor-General
Tom Jambrich	Assistant Auditor-General
Phillip Poon	Director
Jack Kheir	Director
John Rosier	Consultant
Geoff Allen	Administration Manager
Angela Lester	Senior Audit Manager / Training
Matthew Campbell	Contract Administrator
Gary Beer	Administrative Officer (Staff & Personnel)
Glenda Sladen	EEO Co-ordinator
Lynda Paju	Training Officer / Audit
Bernabe Sarreal	Training Officer

Appendix B

Focus Group Discussions

As part of the review, two focus group discussions were conducted with representative groups of staff of the AO from different branches and at different grade levels. Also, two former staff members of the AO were interviewed.

Focus Group Discussion 1

Raoul Ray	Senior Audit Manager
Sally Leong	Senior Performance Audit Manager
Peter Kerr	Audit Manager
David Nolan	Audit Manager
Bruce McComb	Information Systems Audit Manager
Andrew Grice	Auditor

Focus Group Discussion 2

Leone King	Performance Auditor
Kelly Koutzas	Audit Senior
Peter Sawaszenko	Audit Senior
Sean Buggy	Senior Audit Clerk
Melissa Myers	Senior Audit Clerk
Rob Josevski	Trainee Auditor
Mark Lombardi	Trainee Auditor

Telephone Interviews
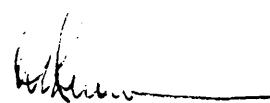
Helen Krinelos	Former Audit Senior resigned July, 1995
Christine Lord	Former Auditor resigned May, 1995

Public Accounts Committee

Review of Audit Office of NSW
Management of the Audit Function
Conducted by Price Waterhouse
September 1995

TW Williamson
Partner

DC Brown
Partner

Table of contents

1 Executive Summary

The overall conclusions to be drawn from the review are that the Audit Office has made great strides in identifying what is best practice and has plans and strategies in place for the future. The key issues, however, revolve around the actual implementation and monitoring of the plans and strategies.

There is an obvious and quite apparent focus on change in the Audit Office and this is being embraced by the majority of staff. It is important that the momentum be maintained in a realistic way so that targets and deadlines become challenging but not unachievable.

The main issues in the course of our review are noted under the following headings:

Effectiveness of organisational and staffing structure

- There is a need to finalise and put in place the new performance reporting system so that branch leaders can manage and control their resources more effectively.

- Determining the optimum staff mixed needs to be considered in the context of a long term staff plan.

- The action plan that was developed from the Waite Consulting review of the support functions of the Audit Office should be reviewed and monitored by the Board of Management on a regular basis.

- Opportunities to transfer and rotate staff between branches and specialisations should be pursued with the aim of developing and enhancing the skills of all staff.

Adequacy and effectiveness of the planning process

- The Benchmark Matrix Study provides useful guidance for projecting future staff needs and should be linked to the staff scheduling and staff allocation systems.

- A longer term plan (5 to 10 years), incorporating an optimal staff pyramid and how to get there, is required. The plan needs to incorporate issues such as expected growth rates in client hours, utilisation rates, staff retention rates, and whether to grow the staff from within or to recruit externally.

- The implementation and monitoring of the staff scheduling system should be a high priority.

Adequacy and effectiveness of systems to measure and control productivity

- The new management reporting systems are now being introduced. The previous reporting systems were inadequate and ineffective in monitoring and controlling performance.

- There is a need for improved communications between audit support services and the audit groups. This includes greater "user" involvement in systems and programming development.

- There is no incentive for staff (including senior personnel) to record all the hours worked on audit assignments. Resource planning can only be effective if all personnel record the necessary hours to complete each audit.

Management culture - effect on performance

- The change culture within the Audit Office is happening and there is momentum.

- The inability to effectively deal with non performing staff is seen as a significant issue within the Audit Office. Their presence can have a negative effect on other talented employees and this needs to be carefully handled.

Relationship with clients and influencing factors

- Clients of the Audit Office have commented favourably on the changes and the focus on improving client relationships. The thrust for continuous improvement in client service should be encouraged and maintained.

- Client satisfaction surveys over the past 3 years and interviews with selected clients show that encouraging changes have occurred. However the perceived improvements in performance have not yet been reflected by improvements in the Client Satisfaction Index.

- The Audit Offices role with the Parliament would be facilitated by the appointment of an audit committee of the Parliament. This would seem to be an appropriate role for the Public Accounts Committee.

Extent of best practices in management

- The Audit Office has a clear understanding of what are best practices in managing an audit business. It has access to the Big 6's ideas, methodologies, and benchmarks. The key issue is implementing and monitoring the use of these practices. In a period of great change as has occurred over the past 3 years, there is a need to reflect on the pace of such change and to ensure that procedures are in place to actually make things happen.

- A variety of consultants have been engaged to review and report on various aspects of Audit Office activities. Where their recommendations have been agreed to by the Audit Office, they need to be actively pursued and monitored.

2 Introduction

2.1 Background

The Public Accounts Committee has engaged Price Waterhouse to provide consulting services and to assist the Committee and to advise on the Review of the Audit Office of NSW with particular response to the Management of the Audit Function.

The Terms of Reference for this engagement are:

- To review the efficiency and effectiveness of the management of the Audit Office of NSW in assisting the Auditor-General to discharge his statutory responsibilities under the Public Finance and Audit Act 1983.

- In the context of that review and without limiting its scope, the following management issues are important:-

  - the effectiveness of the organisational and staffing structure;

  - the adequacy and effectiveness of the planning process;

  - the adequacy and effectiveness of systems to measure and control productivity;

  - the management culture and its effect on performance;

  - the relationship between the Office and its clients (including the Parliament) and any factors influencing that relationship;

  - the extent to which best practice in management (including appropriate benchmarks) have been adopted in the Office.

2.2 Methodology of Review

The review was carried out in the following stages:

Stage 1:   Review of available documentation dealing with all aspects of the management of the Audit Function in the Audit Office.

Stage 2:   Interviews with senior executives and management in all responsibility centres of the Audit Office.

Stage 3:	Interviews with Consultants (Marketing Frontiers and Waite Consulting) who have completed assignments for the Audit Office over the past year.
Stage 4:	Interviews with selected clients of the Audit Office.
Stage 5:	Preparation of the final report and confirmation of findings and recommendations.

3 Effectiveness of organisational and staffing structure

3.1 Branch Structure

Within the Audit Office there is support for the existing structure of 3 attest audit Branches. The major reasons in favour of the current structure relate to the overall size of the office and the importance of staff not feeling they are anonymous members of a big practice group. These "qualitative" issues are seen to outweigh the impact of having 3 separate Branch Administrators and 3 reporting units.

Whilst there are some imbalances of workloads throughout the year within the 3 Branches this is not seen as a major issue. Imbalances require a flexible approach to the sharing of staff resources to cope with peaks and troughs in the Branch workloads.

The Board of Management of the Audit Office (BOM) is well supported by the AAG's. To date the majority of its focus appears to have been on operational rather than strategic issues (90:10). Now that some of the branches have formed their own management groups the BOM can move towards spreading its time more evenly between operational and strategic issues (50:50).

3.2 Accountability for Branches as Self Managed Teams

The process of the 3 Attest Branches, CISB and PAB being accountable for their performance as separate managed teams is still evolving. The management reporting systems that were previously in place were largely inadequate to effectively manage the Branches. New management reporting systems are being implemented to provide the Assistant Auditors General with improved information to manage their Branches.

3.3 Staff mix

What is the optimum staff mix for the Audit Office needs to be considered in the context of a long term resources plan (that goes out 5 to 10 years). The plan needs to incorporate expected growth rates in client hours, utilisation rates, retention rates, plus the optimum staff mix (per the Benchmark Matrix) balanced with the desire to "grow your own" resources (example included as Appendix D). This latter point is influenced by the difficulty of recruiting the required quantity and quality at each staff level. Added to this is the desire to attract good graduates and have them stay and progress through the office to at least the manager ranks.

"To grow your own" could result in the number of graduates and undergraduates being more than as indicated by the Benchmark Matrix at those grades. This situation could be exacerbated by a low retention rate which will mean that more graduates will need to be taken on in year 1 to produce the required senior numbers in year 4.

The 1994 Benchmark Matrix study highlighted some staff mix imbalances notably a surplus at the senior audit manager (SAM) grade. Whilst there are practical problems in resolving differences in the short term, the study has made various recommendations such as the surplus SAMs be allocated as Engagement Managers to certain large audits and other large "average" audits which have higher degrees of complexity attached to them.

Actual staff at May 1994 compared with that indicated by the benchmarking study at that time are shown above.

BENCHMARK AND ACTUAL STAFF NUMBERS
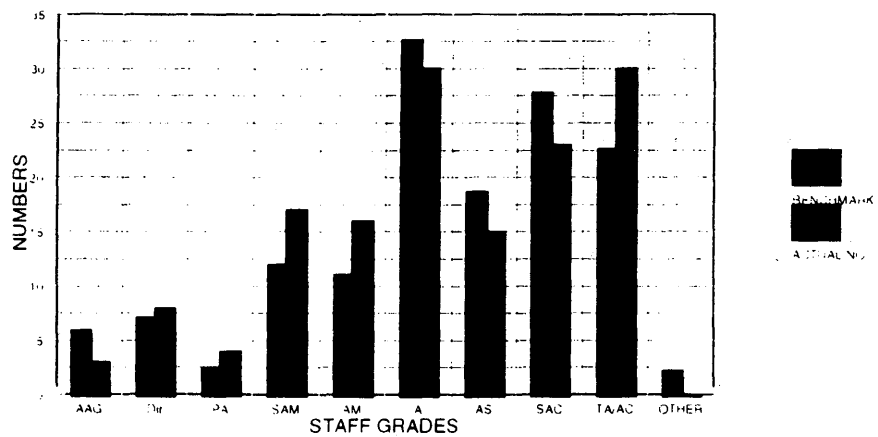
The benchmark itself does not take account of the timing of work. Accordingly the differences above must be considered in the context of the need for the Audit Office to take on a large number of temporary staff (discussed in 4.2.1 below) to help them through the August- September busy period.

3.4   Attest and CIS audit functions

It is acknowledged that there is a shortage in the marketplace of suitably qualified CIS Audit specialists and that it has been appropriate to establish a separate specialist group in the short term. However, consideration should be given to more closely integrating the attest audit and CIS Audit functions in the longer term. This will ultimately enable a more co-ordinated approach to audits and enable a better skills transfer within the audit teams. In the short term the CIS specialists have a key role in helping to develop the CIS skills of attest audit staff.

3.5   Rotation

There are conflicting views on the desirability of rotation/short term transfers from the attest function to the performance audit branch (PAB). There is resistance from PAB because such transfers focus on resolving immediate staffing needs, whereas the PAB is seeking to build up a team of permanent resources. The funding arrangements of PAB and the existing remoteness (different premises and different teams with no integration with attest audit) have also caused some resentment and absence of cohesive teamwork.

There are opportunities for improved staff development and retention, as well as enhanced client service and value adding, in having attest auditors with performance audit skills. The complementary skills of performance auditors and attest auditors need to be maximised.

3.6   Industry specialisation

Industry specialist groups were originally established in 6 areas - Health, Transport, Education, Electricity, Superannuation and Water. More recently Local Government and Law and Order have been added to the list. The infrastructure of the various groups has been established but the level of activity varies between groups. Some are more active than others and the issues can be more volatile.

Each such group needs to be responsible for determining the strategy for investment and training necessary to achieve their targets and increase the skill base of their teams. Whilst it is anticipated that staff (including senior staff) would work on clients covered by a number of different industry focus groups throughout the year, there can be significant benefits for both clients and Audit Office staff from having industry specialists in the audit teams.

3.7 Support functions

In 1995 Waite Consulting carried out a review of the support functions of the Audit Office. The review was carried out to diagnose support service issues including organisation, structure and service delivery. The Consultant's report made various recommendations including:

- A need for improved services from the Finance Unit and in particular a need for a fully computerised general ledger system to supply monthly financials by operating unit.

- The appointment of an experienced executive to concentrate on developing financial services along with all other support services.

- The need for improved HR capabilities to meet the requirements set by Operations, eg a recruitment officer to drive the system to ensure the Audit Office has the people it requires.

- The need for a higher priority in developing the strategy for longer term systems development with such planning carried out in closer co-operation with Operations than was the case in the past. A review of tasks, workloads and skill requirements in Computer Operations was also recommended.

Each of the Consultant's recommendations is being addressed by the Audit Office through an action plan with responsibilities allocated and deadlines agreed. The action plan and timetable have been submitted to the Board of Management for ongoing review.

3.8 Recommendations

3.8.1 The new performance reporting system should be finalised and implemented as a high priority. Timely completion will enable the Branch AAG's to more effectively manage the resources under their control.

3.8.2 The progress of the implementation of the action plan that was developed from the recommendations of the Waite Consulting report should be actively monitored.

3.8.3 There should be a long term staff plan to bring the Office staff profile in line with a determined optimum staff mix. This will entail using and updating the Benchmark Matrix on a regular basis and linking it more closely to the planning and budgeting processes.

3.8.4　A plan should be developed to more closely integrate the attest audit and CIS Audit function in the longer term.

3.8.5　Opportunities to rotate attest and performance audit staff should be further considered. (Refer section 6 of our Review of the Management of Human Resources.) This will enable efficient use of staff resources and will enhance and broaden the skill base of the staff involved.

3.8.6　The leaders of industry specialisation groups should instigate specific action plans involving both staff and clients in developing specialist skills. PRM branch has a key role in identifying appropriate training courses for each of the industry specialisation groups.

4 Adequacy and effectiveness of the planning process

4.1 Benchmark/Matrix study

4.1.1 Background

The following is a brief summary of key aspects of the Benchmark/Matrix study which was completed in 1994 as the first step in the process of the Audit Office acquiring and maintaining the optimum numbers and mix of staff for the attest audit function

Engagement managers prepared a "Baseline Budget" (ie the most efficient and effective mix of resources on an audit) for each individual audit in line with the criteria and parameters set within the matrix. The criteria and parameters comprised:

(a)   Rating individual clients as either Complex, Average or Simple according to criteria provided.

(b)   In line with the above rating, drawing up budgets of estimated hours and the level of staff required for each task or account area in accordance with the guidance in the Matrix.

(c)   According to the assessed complexity of the audit, complying as far as practicable, with the given benchmarks of times to be spent on the audit by each level of staff as a percentage of the total budgeted time. These benchmark percentages were based on perceived best practice in both the public and private sectors.

Engagement managers were asked to disregard the existing staff mix on their audits which may have been influenced by staffing difficulties, including the inability to provide the required staff levels when needed. This provided them with the opportunity of preparing the budget that they considered would result in the most efficient and effective audit.

The benchmark utilisation rates (ie the expected minimum level of chargeable time as a % of total time) for the various levels of staff were determined by reference to perceived best practice in the private sector.

For information purposes we set out below the utilisation rates for Attest and CIS staff in the matrix together with the actual utilisation rates achieved for 1993 and 1994:

Grade	Actual Chargeable Hours/year		Benchmark Chargeable hours/year
	1993	1994	
Assistant Auditor General	888	904	900/950
Director	1,483	1,358	1,250
Principal Auditor	1,377	1,233	1,250
Senior Audit Manager	1,368	1,213	1,300
Audit Manager	1,285	1,226	1,300
Auditor	1,300	1,341	1,350
Audit Senior	1,286	1,242	1,375
Senior Audit Clerk	1,378	1,347	1,375
Trainee Auditor	1,130	1,082	1,200
Overall average	**1,274**	**1,228**	**1,299**
Utilisation rate	**72.8%**	**70.2%**	**74.2%**

The comparison of benchmark versus actual utilisation rates highlights that these benchmark are attainable. It should also be noted that this Benchmark chargeable hours includes an allowance for special projects (eg corporate plans, industry specialisation meeting, professional committee memberships etc) which could account for 2% of the hours.

Appendix A summarises the details of the actual chargeable hours for 1993 and 1994. However, there are a few difficulties when benchmarking the Audit Office target hours with those of the Big 6. The firms generally have a standard 37.5 hour week compared with 35.0 for the Audit Office. There is also the amount of overtime the Big 6 rely on to meet their peak demand which is difficult to compare with the Audit Office because of the extent of non recording of overtime (referred Section 5.4).

During peak periods more than 15% of the hours in the Big 6 audit practices can come from overtime. Over a year overtime accounts for between 8 and 9% of the total chargeable hours.

The Big 6 and the Audit Office have different approaches to overtime. However, most of the overtime hours are not paid as usually about 5 hours a week is expected ("goes with the job") with some accumulated and taken as leave in lieu.

4.1.2 Findings

The initial results of comparing the actual staff numbers against the optimum number according to the Benchmark Matrix seemed to be that the Audit Office had sufficient staff in total to perform their attest audits over a given year. However, this needs to be considered in the light of the peaks in work and the difficulty in spreading work evenly over the year as discussed below.

The Benchmark Matrix Study highlighted that there seemed to be an excess of Senior Audit Managers over the optimum number. The table showing the comparison is attached as Appendix B.

The Benchmark study suggests that the Audit Office should be aiming to eventually align its human resources pyramid with the results of the Benchmark/Matrix exercise through a process of natural attrition and resignations. It further suggests the exercise needs to be performed, say every 3 years, at which stage any variances between actual staff numbers and optimum levels should be addressed.

The following chart depicts the dependence of the Audit Office on the temporary staff from 1991 to 1995(estimated):

Temporary Staff As A % Of Other Staff
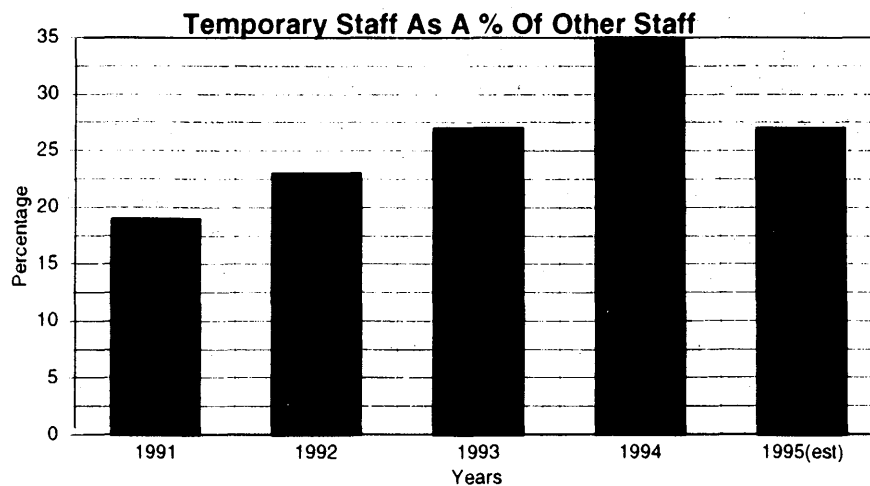
It is obvious from the above chart that the dependence of the Audit Office on temporary staff has been increasing in the last few years. Although there was the expectation of a drop this year as noted in the 1994 accounts of the Audit Office, we understand that the level is now expected to be similar to that in 1994.

The consequences of having such a preponderance of 30 June balance dates will always be that temporary staff are required. However effectively managing these peaks and troughs can result in keeping the number and costs of temporary staff to a minimum. The Audit Office study also contains appropriate recommendations to smooth out staffing peaks and troughs eg:

- Requiring staff to work longer hours in the peak periods.

- Scheduling annual leave and other non chargeable activities in the slack months.

- Allowing staff to accrue overtime in peak periods and take time off in lieu in slack periods.

- Bringing work forward from the peaks and liaising with clients to do this.

- Releasing staff promptly when assignments are completed.

- Considering having a pool of permanent staff at lower levels for attest work during peak periods who can then become involved in performance audits.

Overall the Benchmark/Matrix study is an excellent and concise review of some of the operational issues facing the Audit Office. It needs to be used as one of the management tools for projecting the future staff needs of the Audit Office and in particular it needs to be linked to the staff scheduling and staff allocation systems so that the benefits from determining the appropriate staff mix on audit assignments can be optimised. Other key issues identified in the study are:

- The reasons for departures from benchmarks need to be adequately documented. Compliance with benchmark criteria should be an integral part of the Engagement Controller's review of budgets.

- The Audit Office needs to set and communicate a policy on utilisation rates for attest audit staff. Without it HR planning cannot be effectively carried out.

- The present staff needs for individual audits may need reconsideration to improve efficiency and cost effectiveness

- Suggestions put forward as to how to effectively use the "surplus" Senior Audit Managers, whilst moving towards the optimum level, need to be implemented.

4.2 Winstaff

There is widespread criticism of Winstaff (the staff scheduling system) throughout the Audit Office and the fact that it is not yet fully implemented. Branch leaders and managers recognise the importance of having an accurate staff scheduling system integrated with the budgeting system. The implementation and regular monitoring of the staff scheduling system should be a high priority.

4.3 Job and office budgeting

Individual job budgeting and the history of budgets (ie versus actuals) is considered by Audit Office management to be reasonably reliable. However, the office budgeting process occurs very late and is only finalised in March - 4 months into the year in question.

It is important that job and office budgets be finalised before the commencement of the relevant year so that performance against budget can be monitored on a timely basis. There is also a need for early planning to identify gaps and to look for ways of smoothing out the peak periods of July to November.

Ideally fees and budgets should be agreed with clients before the commencement of the current year's audit.

4.4 Use of Agents and Specialists

Various audit assignments are contracted out to private sector accounting firms but with the Audit Office retaining overall responsibility for those audits.

Selecting which audits are contracted out has been determined by considering, inter alia :

(i)   the geographic locations of clients such as those which are outside the Sydney metropolitan area. It is considered more cost effective to engage local accountancy firms to carry out these audits under the supervision of the Audit Office.

(ii)   the nature of client's business, particularly those in specialist industries. For example, when various hospitals/health schemes became audit clients of the Audit Office, they were contracted out as part of the tendering process.

Contracts put to tender ensure that the audits are competitive from a cost viewpoint. Agents are appointed through a selective public tender process with the performance of individual agents monitored via the Audit Office's review of the agents working papers. The hourly rates charged by agents tend to be extremely competitive and significantly below the average hourly rates of chartered accountancy firms and approximate the hourly rates used by the Audit Office.

4.5 Recommendations

4.5.1 The best practices identified in the Benchmark Matrix noted above should form an integral part of the planning and scheduling process.

4.5.2 The completion and integration of Winstaff with the office management systems should be a high priority.

4.5.3 Consideration should be given to completing the Office Budget before the commencement of the financial year.

4.5.4 A longer term plan for the Audit Office should be developed including consideration of:

- succession planning on key assignments and key responsibilities

- the staff pyramid now and in the future

- whether to build up technical skills in-house or outsource

- contracted out activities.

5 Adequacy and effectiveness of systems to measure and control productivity

5.1 Management reporting systems

The management reporting systems used by the Audit Office have been strongly criticised by Consultants (eg Waite Consulting) and by management.
It is recognised that to service the Audit Office organisationally and by individual business unit, there is a need to significantly improve the financial reporting systems. Previous reporting systems were seen as inadequate and ineffective in monitoring and controlling performance.

The key issue is to provide better information on the critical aspects within each manager's sphere of responsibility (as regards Management of Staff and Management of Audits). At this stage it does not appear appropriate to supply full financial details to all management staff other than for information purposes as they neither control it nor directly influence it.

The main reports which have previously been used for managing performance include:

Profitability   - variances against budget
Productivity   - % chargeable staff time
Work in Progress - % total work performed

The new monthly management reporting system will be based on existing data systems producing better reports for various levels of management. All existing reports will continue to be produced. All reports will be by Board of Management (BOM), Branch AAG, Controller, Group Manager and Engagement Manager.

- Billable Production: The value of billable work during the month will be compared with initial Winstaff estimates and will provide information, on a progressive basis, of the variance from budgeted production for that group of audits.

- Billings: A report will show the value of fees raised each month in respect of the group of audits for which the manager is responsible and will provide some idea as to whether fees are being raised in a timely manner.

- Work Progress: This will show the hours charged each month YTD. Total hours will be compared to the budgeted total for the year, the budgeted YTD and the manager's assessment of the % completed so that it can be determined whether the audits are progressing in a timely fashion.

- Future Work Program: This will show each month what staff requirements are for the rest of the year at each grade of staff and what staff hours are available at each grade for the rest of the year.

- Productivity: This will show each month the percentage of chargeable time for each group.

- Summary Report: This one page report provides an overview of the above reports.

5.2 Communications

Throughout our interviews there was regular reference to the need for better communications between audit support services and the audit groups.

Matters raised included the need for better communications between users and programmers; the need for proper user involvement in testing of Winstaff; and the need for systems programming shortcomings to be resolved.

It was also apparent that support services are not meeting the needs of Performance Audit Branch (PAB). This is exemplified by the PAB rekeying their financial information to produce their own financial management reports. This rekeying of data is clearly inefficient and a waste of resources.

5.3 Controlling Human Resources

The optimum staff mix to be identified as discussed in 3.3 above will take some time to phase in and to fulfill its potential. Projecting the human resources pyramid going forward and comparing it to the perceived needs as defined by the Benchmark Matrix is one of the important tools available to assist in effectively managing the Audit Office.

5.4 Non recording of hours

The non recording of hours worked by staff, including senior personnel, continues to be a problem in managing performance and resources. There are usually two reasons for staff not recording hours worked:

(i)   it may highlight apparent inefficiency or wasted time and staff do not wish to draw attention to it, and

(ii)   staff do not wish to exceed the budget allocated for the work.

Comments were made in the course of interviews that staff are effectively penalised by being required to explain audit overruns. Where they are not being paid for overtime hours worked they can see no incentive to record the full hours worked. This merely contributes to distorting the figures of what resources are really needed in the Audit Office.

5.5 Recommendations

5.5.1   The new management reporting systems that are being implemented will need to be monitored by appropriate management and be linked to the staff scheduling systems of Winstaff.

5.5.2   The development of new systems should involve appropriate communication between users of the systems and programmers. New systems should be tested by users prior to implementation.

5.5.3   Further encouragement should be given to all personnel to record the hours worked so that effective planning of resources can be managed.

6 Management culture - effect on performance

6.1 The change culture

It is clearly apparent that there has been significant change in the Audit Office over the past 3 years. There are differing views on the pace of change but generally we have found them to be very positive both from within the Audit Office and outside. Other findings from our meetings include the following:

- the Audit Office is seen as more open and honest by team members

- the move towards having each branch or business unit as responsible for managing its own resources, recruiting etc is seen as positive

- the recruitment of senior executives from the private sector and from other public offices has assisted in implementing necessary change.

- there remains some resistance to changes in certain quarters. This was described as a "rump" of resistance but is not surprising in view of the rapid changes in leadership and the change in focus. Overt resistance is thought to be in the minority.

- the Administrative support groups which comprise people of long standing in the Audit Office may be more difficult to change. The Waite Consulting report identified areas which appeared under resourced and were not completely satisfying the needs of users eg delivery of financial services; provision of technical advice to Operations.

6.2 Non performing staff

The inability to move on non performers is a significant issue. Their continued presence is seen to demotivate and to give the wrong message to good young staff. The importance of a motivated workforce where performance is rewarded and lack of performance is penalised in an appropriate way cannot be over emphasised.

6.3 Recommendations

6.3.1 The current attitude and momentum towards client service should be encouraged and maintained.

6.3.2 Non performing staff should be actively managed by supervisors setting objectives, regularly monitoring performance and providing regular feedback through a counselling and appraisal process.

7 Relationship with clients and influencing factors

7.1 Client satisfaction survey

Over the past 3 years independent client satisfaction surveys have been carried out for the Audit Office by Marketing Frontiers. The conclusions from the latest report are encouraging in recognising changes which are occurring in relationships with the clients. In particular:

- The real efforts of the Audit Office to improve its service and professionalism have been acknowledged by the marketplace.

- There is no question that the Audit Office has improved its performance in the eyes of Parliamentarians, stakeholders and audit clients.

There are sections of the consultant's report which are consistent with the feedback from our interviews, namely:

- There is a new breed of staff coming through the Audit Office.

- The Audit Office is meeting with clients more frequently, developing relationships and mirroring what the private sector is doing.

- Clients want their auditors to meet their needs with regard to: competency, timeliness, continuity, cost effectiveness, advice, and communication. They also want their auditor to understand their business and the industry in which they operate.

- The public sector enterprise is still unable to attract the best talent because of the disparity in salary and conditions, particularly at some of the higher levels.

- One of the mechanisms that is used in the survey is the "Client Satisfaction Index" which for the latest survey recorded only a modest or slight improvement over the previous result. It is somewhat unusual that the improvements in performance as reflected in comments from Audit Office clients are not being reflected by improvements in the Client Satisfaction Index.

Audit Client Satisfaction Index from 1992 to 1995(as estimated in the 1994 accounts) is shown below:

Audit Client Satisfaction Index
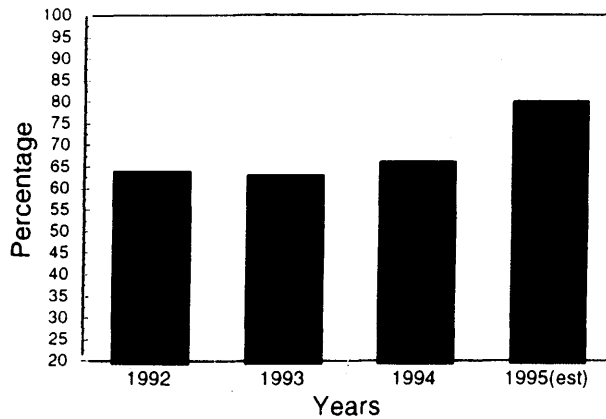
7.2 Auditor of Choice Surveys

The Audit Office recently sought views directly from their clients as to whether they were the public sector auditor of choice. They also sought other feedback on how they could improve their performance. Whilst it is recognised that the responses from clients went straight to the Audit Office and therefore may be argued to lack necessary anonymity and objectivity, the feedback from those clients who responded was nevertheless very favourable and positive. Clients have commented very favourably on the changes in the Audit Office over the past 3-4 years.

Further follow up of this survey is required to determine if the level of "no response" reflects any dissatisfaction with the Audit Office performance.

7.3 Client interviews

In the course of the Peer Review process we selected a very small sample of Audit Office clients to interview. The interviews focused on the following matters:

- The skills and abilities of the Audit Office staff who carry out the audits including:

  Technical skills
  Industry knowledge
  Professionalism
  Commitment
  Level of interest

- The management of the audit including:

  Staff management (supervision, direction etc)
  Assignment management (timeliness of planning, execution of fieldwork, reporting etc)
  Client service

- The changes in the skills and abilities of Audit Office staff and their attitude/motivation in completing the audit.

Whilst the sample was small it was clear that the process of change in the way audits are carried out and the relationship with clients is happening. Clients are commenting favourably on the progress made and whilst there can always be scope for continuous improvement, the results are very encouraging.

Some clients expressed the wish for ongoing constructive dialogue with the Audit Office over difficult or contentious issues without the need for confrontation or threatened qualification. An important part of client service is to work with the client to solve problems and to avoid qualification where possible without compromising, in any way, the independence of the auditor.

It must be recognised that change and the development of strong client relationships cannot occur in a short time frame and that this will continue to be an evolving process.

7.4 Relationship with Parliament

Consistent with normal practice for all clients the Auditor-General has issued an audit engagement letter to Parliament outlining the scope and approach for 1995. We understand that no response has been received by the Auditor-General.

The Auditor-General reports to the Parliament of New South Wales Act. Recognising the need for independence at the Audit Office, the Auditor-General is given special protection in respect to the continuity of appointment. While there is a clear need for independence there is also a need for the Auditor-General to be able to have an effective discussion with a small representative group of the Parliament to provide for:

(a) Confidential briefings of concerns held by the Auditor-General to seek counsel and guidance for future actions.

(b) Confidential briefing to the Auditor-General of concerns expressed by the Audit Office clients to Ministers, and other parliamentarians and/or government employees.

(c) Discussion on planning activities and management direction in the future covering both short, medium and longer term issues.

While all these activities can theoretically occur by reporting to the Parliament, in practice we consider it is impractical due to the size and nature of the Parliament. In both the private and public sector there has recently been a move to mandatory audit committees to enable confidential discussions between the Auditor and the Audit Committee of the Board.

Typically, these discussions work best where there is a continuity of knowledge, a trusted relationship and a commitment to provide the highest standards of corporate governance.

We recommend that the appointment of an audit committee of the Parliament or the extension of the role of the PAC to include this function as an effective means of encouraging communication between the Audit Office and the Parliament (albeit a sub-committee thereof) which could provide support to the Audit Office when that support is required and provide a forum to discuss any potential sensitive matters in a manner most appropriate. The existence of the "Audit Committee" would not preclude the Auditor-General from reporting direct to the Parliament; however, the need for such reporting may be reduced and be made more streamlined and effective.

It would be particularly important for issues likely to create conflicts with sections of the public service or Government Owned Enterprise to be discussed

with the audit committee as the issues are emerging to assist in managing the issue and providing support to the Audit Office.

7.5   Recommendations

7.5.1   The thrust for continuous improvement in client service in the Audit Office should be encouraged and maintained.

7.5.2   Monitoring client service through client satisfaction surveys, and face to face client interviews should be continued.

7.5.3   Consideration be given to the appointment of an audit committee of the Parliament which should endorse the annual corporate plan of the Audit Office in the same way as an Audit Committee does in the private sector. This would seem to be an appropriate role for the Public Accounts Committee. Further, this would provide the Audit Office with a more effective reporting mechanism and a useful sounding board.

8 Extent of best practices in management

8.1 Big 6 methodologies and bench marks

The main drivers that determine a successful audit practice include:

(a) Effective utilisation of staff;
(b) Setting appropriate hourly rates to recover costs and return a profit to the proprietors of the business;
(c) Appropriate job budgeting and fee setting;
(d) Appropriate allocation of staff to client assignments;
(e) Effective billing and collection procedures;
(f) The recruitment, training, counselling and retention of good staff.

The Audit Office has a clear understanding of what are the best practices in managing the attest audit business. It has had access to the Big 6's ideas and methodologies and this has heightened its awareness as to what is best practice. A number of the performance indicators are incorporated in the Audit Office's Annual Report, with reference to both public and private sector bench marks where available. However, the Audit Office does not approach its business with the same profit motive that drives the Big 6. Nor has it the same need to market its services to gain and retain clients.

The pricing for their services is set to recover the estimated annual cost of running the office. An average price per hour is determined by taking the estimated total cost for the year plus a 2% contingency, less direct charges to clients divided by the estimated hours for the year. The rate is approximately $67 per hour and has been around that figure for a number of years. The average rate billing rate for the Big 6 firms would be twice that of Audit Office with the recovered rate at more than $110 per hour.

8.2 Implementation of best practices

The key issue for the Audit Office is to implement and monitor the ongoing use of best practices. The management reporting systems have been inadequate in the past and are currently going through change. It is essential that the AAG's in charge of branches have accurate and reliable information with which to manage their branches.

8.3 Corporate Benchmarking

The Audit Office has continued to participate in the Corporate Benchmark Monitor which compares human resource and other administration data for organisations of similar size and in similar industry groups. The information that is benchmarked includes:

- Proportion of Human Resource staff to total staff
- Training expenditure per employee
- Voluntary turnover
- Hours overtime per week for office staff
- Base salary costs per employee

The results of the latest report (May 1995) concluded that over three benchmark periods, a comparison of the Audit Office results do not indicate a significant deviation from industry averages in the majority of benchmark areas, indicating that the Audit Office compares favourably with its public sector counterparts. There was a specific trend noted that there was a tendency for the Audit Office results to fall below the industry average in terms of the proportion of Human Resource staff and Finance and Administration staff to total staff. In the case of Human Resources, this may have implications in terms of staff retention and/or absences. Appendix C shows a brief summary of the findings.

The figures for staff turnover have improved since the very high attrition rates experienced by the Audit Office in 1989. The graph below shows total staff turnover now increasing to 14.9% in the period to 30 June 1995.

Staff Turnover
Staff Losses as a % of Year End Staff

The figures for the last few years are good compared to the Big 6 firms who experience a turnover rate of around 20% exacerbated by their "up or out"

approach to staff. However, the critical issue when looking at turnover statistics is the nature and quality of the staff leaving. In the twelve months to 30 June 1995, 29 staff left the Audit Office, 19 of which were between Trainee Auditor an Auditor, with an average time of around 4 years with the office.

8.4 Other benchmarking

The Audit Office has also:

- Commenced a project of Quality Accreditation under ISO Quality Standard 9001. This project needs to be followed through, implemented and then monitored on a regular basis. It is intended to engage a consultant to manage the implementation.

- Benchmarked with Audit Offices in other States.

8.5 Support functions

The support functions of the Audit Office have each prepared draft client service plans recognising the need to service their clients (ie the other Audit Office branches). These plans need to be finalised and agreed between the support functions and the users.

8.6 Performance audit reviews

Ernst & Young completed a review of the Performance Audit Branch in January 1995 identifying, inter alia, a need to establish a more systematic, timely strategic planning process; a systematic training program; and a strengthening of operational management of the planning, conduct, reporting and budget control of individual audits.

8.7 Recommendations

8.7.1 Management procedures should include designated responsibility for the implementation of best practice ideas. This requires ongoing accountability for projects such as:

- The financial management system
- Quality accreditation
- Industry specialisation
- Improving office support service

8.7.2 The various recommendations put forward by the various consultants to the Audit Office should continue to be actively pursued and monitored.

Audit Office of NSW

Details of Chargeable Hours by Grade

Grade	No of Staff	1994 Total Chargeable Hours	Average Hours	No of Staff	1993 Total Chargeable Hours	Average Hours
Auditor General	1	252	252	0.7	126	180
Deputy Auditor General	1.2	245	204	1	413	413
Assistant Auditor General	3.7	4,025	1,088	3.7	4,254	1,150
Director of Audit	7.7	10,458	1,358	7.3	10,829	1,483
Principal Auditor	3.6	4,438	1,233	3.6	4,956	1,377
Total	17.2	19,418		16.3	20,578	
AVERAGE FOR PARTNERS			**1,129**			**1,262**
Senior Audit Manager	14.9	18,074	1,213	15.9	21,756	1,368
Audit manager	20.1	24,633	1,226	20.2	25,949	1,285
Auditor	32	42,917	1,341	28.1	36,519	1,300
Audit Senior	16.4	20,363	1,242	16.4	21,084	1,286
Project Officer Grade 5	1.9	2,898	1,525	2	2,786	1,393
Senior Audit Clerk	19	25,263	1,330	19.1	26,299	1,377
Trainee Auditor	13.6	15,302	1,125	16.4	18,683	1,139
Clerk Grade 1-2	4.3	4,410	1,026	11.6	13,258	1,143
Clerk general scale	3.7	3,654	988	2.1	2,079	990
Systems Review Officer	1.9	1,652	869	1.7	2,177	1,281
Manager, DP audit	1	1,225	1,225	1	945	945
Information Systems Clerk	3.1	3,297	1,064	0	0	0
Information Systems Audit Manager	0.4	301	301	0	0	0
Systems Examiner	1	1,428	1,428	1	1,239	1,239
Total for All Grades	150.5	184,835		151.8	193,352	
OVERALL AVERAGE			**1,228**			**1,274**

Schedule of Attest Audit Staffing Requirements

	AAG	Dir	PA	SAM	AM	A	AS	SAC	TA/AC	Other	Total Hours
Complex Audits	4581	3698	3146	15649	1848	23254	10659	14846	11824	1097	90601
Average Audits	896	4499	-	-	11801	18606	10850	19133	10748	1777	78309
Simple Audits	48	721	-	-	787	2301	4263	4205	4490	15	16830
Total Annual Hours	5525	8918	3146	15649	14436	44161	25772	38184	27062	2889	185740
Available Chargeable Person Hours per annum (b) Chargeable Hrs as % of 215 days	925 63%	1250 86%	1250 86%	1300 90%	1300 90%	1350 90%	1375 91%	1375 91%	1200 80%	1350 (Averaged) 90%	
Optimum Number of Staff Required (b)	5.9	7.1	2.5	12.0	11.1	32.7	18.7	27.8	22.6	2.2	142.6
Actual number of Staff at May 1994	3.0	8.0	4.0	17.0	16.0	30.0	15.0	23.0	30.0		147.0
Variance	(2.9)	0.9	1.5	5.0	4.9	(2.7)	(2.7)	(4.8)	7.4	(2.2)	4.4

	May 1994			November 1995			May 1995		
	Size	Public Sector	AO	Size	Public Sector	AO	Size	Public Sector	AO
Proportion of HR staff to total % (excluding payroll)	2.20	1.50	1.00	1.70	1.50	1.02	1.20	1.50	0.97
Proportion of Finance & Administration to total %	16.00	6.70	1.02	9.00	6.40	1.00	5.60	6.00	1.46
Involuntary turnover	13.90	2.30	4.12	4.60	2.80	4.10	4.20	2.80	2.44
Hours overtime per week office staff	0.60	0.70	0.047	1.30	0.90	0.05	1.10	1.70	0.124

	Below Lower Quartile			Above Upper Quartile		
Outside the Normal 'Quartile' Distribution	May-94	Nov-94	May-95	May-94	Nov-94	May-95
Proportion of HR staff to total% (excluding payroll)	x		x			
Proportion of finance & Administration to total	x	x	x			
Involuntary turnover					x	
Hours overtime per week office staff	x	x	x			

STAFF PYRAMID MODEL VARIABLES

10-Nov-95

Base Year: | 1995 | **Office:** | Audit Of | **Group** | Audit

Grade Name	Years in Grade	1995 Staff	Schedule Rates	Salaries p. person	Retentio Rates 1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Partner e	-	17	$67	$135,000	80%	80%	80%	80%	80%	80%	80%	80%	80%	80%
SAM	3.0	17	$67	$78,000	80%	80%	80%	80%	80%	80%	80%	80%	80%	80%
AM	3.0	16	$67	$55,000	80%	80%	80%	80%	80%	80%	80%	80%	80%	80%
A	1.0	30	$67	$48,000	80%	80%	80%	80%	80%	80%	80%	80%	80%	80%
AS	1.0	15	$67	$42,000	75%	75%	75%	75%	75%	75%	75%	75%	75%	75%
SAC	1.0	23	$67	$37,000	72%	72%	72%	72%	72%	72%	72%	72%	72%	72%
TA/AC	1.0	30	$67	$33,000	75%	75%	75%	75%	75%	75%	75%	75%	75%	75%
Other	1.0				80%	80%	80%	80%	80%	80%	80%	80%	80%	80%
Other	1.0				80%	80%	80%	80%	80%	80%	80%	80%	80%	80%
Other	1.0				80%	80%	80%	80%	80%	80%	80%	80%	80%	80%
Grade	1.0													
Grade	1.0													
Grade														
Admin/Support		6	$67	$40,000	65%	65%	65%	65%	65%	65%	65%	65%	65%	65%

Percentage of Graduates that make Partner Equiv	13.3%	13.3%	13.3%	13.3%	13.3%	13.3%	13.3%	13.3%	13.3%	13.3%

Grade	Chargeable Hours per person 1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Partner equiv	900	900	900	900	900	900	900	900	900	900
SAM	1,300	1,250	1,250	1,250	1,250	1,250	1,250	1,250	1,250	1,250
AM	1,250	1,250	1,250	1,250	1,250	1,250	1,250	1,250	1,250	1,250
A	1,200	1,300	1,300	1,300	1,300	1,300	1,300	1,300	1,300	1,300
AS	1,225	1,300	1,300	1,300	1,300	1,300	1,300	1,300	1,300	1,300
SAC	1,350	1,350	1,350	1,350	1,350	1,350	1,350	1,350	1,350	1,350
TA/AC	1,250	1,375	1,375	1,375	1,375	1,375	1,375	1,375	1,375	1,375
Other	1,375	1,375	1,375	1,375	1,375	1,375	1,375	1,375	1,375	1,375
Other	1,100	1,200	1,200	1,200	1,200	1,200	1,200	1,200	1,200	1,200
Other	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
Grade										
Grade										
Grade										
Admin/Support	750	750	750	750	750	750	750	750	750	750

Total	186,074	186,849	193,553	194,757	193,249	191,396	189,533	187,886	186,519	185,416

GROUP P&L **Office:** Audit Office NSW   **Group:** Audit   10-Nov-95

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Schedule Value	10,970	9,532	9,489	9,428	9,290	9,156	9,029	8,918	8,827	8,753
Under-Recoveries	548	477	474	471	464	458	451	446	441	438
Net Revenue	10,421	9,056	9,014	8,956	8,825	8,698	8,578	8,473	8,385	8,315
Salaries	7,900	7,115	7,038	6,906	6,690	6,479	6,290	6,132	6,004	5,903
Occupancy	1,575	1,575	1,575	1,575	1,575	1,575	1,575	1,575	1,575	1,575
Other Costs	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000
Contrib incl Ptnr Salary	(2,054)	(2,634)	(2,598)	(2,525)	(2,440)	(2,356)	(2,287)	(2,234)	(2,194)	(2,162)
Partner Salaries	2,174	1,807	1,573	1,386	1,237	1,117	1,022	945	884	835
Contribution	120	(828)	(1,025)	(1,139)	(1,203)	(1,238)	(1,266)	(1,289)	(1,310)	(1,327)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Group Recovery Rate	0.95	0.95	0.95	0.95	0.95	0.95	0.95	0.95	0.95	0.95

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Partner:Staff Ratio	8.7	10.4	12.4	14.2	15.9	17.5	19.0	20.4	21.6	22.8

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Contribution per Partner	7	(62)	(88)	(111)	(131)	(150)	(167)	(184)	(200)	(215)

Contribution by Grade   ($'000)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Partner equiv	(2,018)	(1,701)	(1,470)	(1,295)	(1,162)	(1,057)	(974)	(907)	(853)	(810)
SAM	(496)	(679)	(785)	(899)	(967)	(984)	(975)	(956)	(937)	(921)
AM	(33)	(65)	(51)	(47)	(45)	(45)	(47)	(51)	(55)	(59)
A	41	97	85	63	52	51	51	50	48	47
AS	127	188	171	143	147	153	154	153	150	147
SAC	495	304	255	281	307	317	316	313	309	305
TA/AC	464	296	382	451	475	477	473	467	462	457
Other	(106)	(379)	(484)	(520)	(536)	(547)	(555)	(563)	(569)	(574)
Other	(402)	(574)	(591)	(597)	(606)	(616)	(625)	(633)	(640)	(646)
Other										
Grade										
Grade										
Grade										
Admin/Support	(127)	(121)	(110)	(105)	(104)	(104)	(105)	(106)	(107)	(108)
	(2,054)	(2,634)	(2,598)	(2,525)	(2,440)	(2,356)	(2,287)	(2,234)	(2,194)	(2,162)

Office: Audit Office NSW						Group: Audit			

AVERAGE PARTNER / STAFF NUMBERS

10-Nov-95

T O T A L	156	152	156	157	155	153	151	150	148	147
	1995	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**
Partner equiv	16	13	12	10	9	8	8	7	7	6
SAM	17	21	24	28	30	30	29	28	27	26
AM	19	25	27	24	20	17	15	15	15	15
A	20	13	10	8	7	7	7	7	7	8
AS	13	14	12	10	11	11	12	12	12	12
SAC	22	14	11	13	14	15	15	15	15	15
TA/AC	23	11	14	16	17	17	18	18	18	18
Other	4	14	18	20	20	20	20	20	20	20
Other	15	21	22	23	23	23	23	23	23	23
Other										
Grade										
Grade										
Grade										
Admin/Support	7	6	6	6	5	5	5	5	5	5

RECRUITMENT

	1995	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**
Partner Equiv										
SAM										
AM										
A										
AS	1	1	1	1	1	1	1	1	1	1
SAC	2	2	2	2	2	2	2	2	2	2
TA/AC	2	2	2	2	2	2	2	2	2	2
Other	2	2	2	2	2	2	2	2	2	2
Other	25	25	25	25	25	25	25	25	25	25
Other										
Grade										
Grade										
Grade										
Admin/Support	2	2	2	2	2	2	2	2	2	2
Total	34	34	34	34	34	34	34	34	34	34

NET TRANSFERS IN/(OUT)

	1995	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**
Partner equiv										
SAM										
AM										
A										
AS										
SAC										
TA/AC										
Other										
Other										
Other										
Grade										
Grade										
Grade										
Admin/Support										

REPORT TO THE

PUBLIC ACCOUNTS COMMITTEE

OF THE

NEW SOUTH WALES PARLIAMENT

'REVIEW OF THE AUDIT OFFICE OF NSW'

Prepared by

Professor John J. Glynn

18 August 1995

CONTENTS

REPORT TO THE PUBLIC ACCOUNTS COMMITTEE OF THE NEW SOUTH WALES PARLIAMENT

'REVIEW OF THE AUDIT OFFICE OF NSW

BACKGROUND

My engagement was to assist the PAC in its review of the Audit Office of NSW with particular reference to the conduct of Performance Audits. The letter of engagement set out the following terms of reference:

"To review the efficiency and effectiveness of the management and conduct of performance undertaken by the Audit Office of NSW.

In the context of that review and without limiting its scope, attention should be given to:

(a) the criteria for the selection of performance audits;

(b) the effectiveness of the planning and control of the performance audits;

(c) the criteria against which the efficiency and effectiveness of the performance audits conducted by The Office are measured;

(d) the adequacy of the investigative process to support the conclusions arising from the performance audit and the appropriateness of quality control procedures;

(e) compliance with statutory requirements for the conduct and reporting of performance audits and the extent to which applicable professional

standards and practices are complied with;

(f) the skills and competency of staff undertaking performance audits;

(g) the productivity of the Performance Audit Branch;

(h) the extent to which performance audits have been agents for change in public sector management."

In undertaking this review I took a consumer focus addressing the value of the performance audit function to Parliament, through the PAC, as well as from the auditee/client viewpoint. This approach also entailed consideration of the overall 'value-added' to be achieved from an efficient and effective audit office, including the benefit that ought to be derived from other parts of The Office being involved with some elements of performance audit work.

The review was undertaken with the strong belief that whilst there is a need for a strong independent audit office, The Office as a whole must demonstrate the value of that need in terms of the quality of the reports and associated advice that it provides to both the Parliament and its clients. I was also mindful of the PAC report No. 70 which was published in 1993. The (then) Chairman's forward states, in part:

> *"The Committee believes that the Auditor-General should carry out special audits which specifically address the question of effectiveness as a primary audit objective."*

During the period of this appointment, 7-18 August 1995, I had the opportunity to meet with the Auditor-General, members of his staff, members of the PAC and a small cross-section of clients (auditees). All were very willing to assist me in my enquiries. I should also like to thank the secretariat of the PAC for the first-class support that they provided.

SUMMARY

During the last couple of years the NSW Audit Office has attempted to build up its performance audit expertise and has undertaken a series of challenging performance audits. Despite some useful work the utility value of many of their reports, as a force for change and improvement in the management of State public services, has been limited. One reason for this is that The Office's interpretation of their mandate, reinforced by a previous PAC report was that all such investigations should 'specifically address the question of effectiveness' and that such investigations should do so 'at length'.

Urgent attention should be given to providing the Auditor-General with a clear and workable audit mandate so that, as appropriate, the Auditor-General may choose to examine matters of economy, efficiency and effectiveness. Such investigations need not always be 'at length' but should be relevant to the perceived utility value to be obtained from the investigation. In framing this legislation the PAC, in discussion with the Auditor-General, should agree and be clear upon the nature of effectiveness review. Views vary on this, but most audit mandates do permit an Auditor-General to specifically comment upon the effectiveness of government programmes (are programme objectives being met) but in so doing expressly prohibit the Auditor-General from questioning, or indeed, commenting upon the merits of policy objectives. Some audit mandates restrict the Auditor-General to reviewing what might be termed managerial effectiveness, the extent to which the management of a project, programme or policy is effective in producing functional outputs.

There may be a fine line to be drawn between what might be termed policy review and a performance audit that comments upon policy effectiveness but

it is a line that does need to be determined and agreed upon by the PAC and the Auditor-General. Such an agreed statement should be published and made available to all audit clients.

Notwithstanding problems associated with the legislative framework this investigation determined that greater attention should have been given to the planning and control of those investigations carried out to date. Where indeed these audits themselves value for money? A great deal of effort would appear to have been expended in, often times, an unfocused way. This was certainly the perception of some clients. Some staff in the performance audit division accepted this and some recognised a need for them to be more client focused.

It has also to be recognised that the planning of performance audits is important and that a number of requests have been made to The Office on an ad-hoc basis directly by the Parliament or Ministers. This makes the adoption of a strategic and systematic programme of performance audits difficult to achieve.

Little attention, to date, has been given to integrating performance audit into other branches within The Office. Tensions exist between staff in the performance audit branch and those in other branches. Again this is recognised by a number of people and management have a responsibility to address this issue so as to achieve the maximum effect from scarce resources.

The Auditor-General should be more accountable to the Parliament, through the PAC, for the work that he undertakes. With respect to performance audits, he should seek agreement as to the assignments that he wishes to undertake and, in so doing, provide the PAC with a note of the potential outcomes expected from such investigations and their associated cost.

RECOMMENDATIONS

Recommendation 1

I recommend that the PAC give consideration to a redraft of the performance audit legislation to remove any ambiguity as to what the performance audit mandate of the Auditor-General ought to be.

Recommendation 2

The Audit Office should urgently review and agree with PAC the basis by which performance audit topics are selected.

Recommendation 3

The PAC should consider taking on the responsibility for oversighting the resources appropriated to the Audit Office so as to make more accountable the resources applied by the Auditor-General, particularly with respect to performance audits. If the PAC feels this is not their responsibility they might care to consider how this important oversight responsibility be undertaken.

Recommendation 4

The PAC might wish to consider whether clients should be billed for performance audits in similar fashion to the billing for their attest/regulatory audit. This would impose a market test and discipline on

the value of this audit effort.

Recommendation 5

The performance audit branch should, as a matter of urgency, develop or adopt a practice guide so as to standardise the quality of performance audit reporting.

Recommendation 6

The Audit Office should develop a strategic plan to best maximise the value that clients might receive from performance audits.

Recommendation 7

The Audit Office should address how it might better create a cross-fertilisation of effort between staff in the performance audit branch and the other branches of The Office. In addition this cross-fertilisation should also embrace a closer working relationship with those private sector audit firms who do sub-contract work on behalf of the Auditor-General.

Recommendation 8

PAC might consider extending the Auditor-General's mandate to undertake performance audits of local government, health and other areas which are in receipt of government funding but which are currently outside of his audit mandate.

Recommendation 9

The PAC should invite the Auditor-General to consider how his attest/regularity auditors might become more involved with aspects of performance auditing and should advise the Committee of any operational difficulties associated with such a move.

Recommendation 10

The Auditor-General should include in future client surveys questions that specifically ask for responses on the value and quality of performance audit reports.

Recommendation 11

I recommend that the PAC closely monitor the types of performance audits undertaken by the Audit Office and that the Auditor-General provide the PAC with brief details of the scope of each investigation, the anticipated outcomes and estimated (total) cost.

Recommendation 12

I recommend that only the PAC should approve the performance audits undertaken by the Auditor-General. If the Executive feels that they wish the Audit Office to undertake such investigations then such requests should properly be channelled through the PAC for consideration.

Recommendation 13

The Auditor-General should instigate a series of iniatives to remove the perceived barriers between the various branches of The Office so as to instill in all staff a sense of corporate identity, shared vision and goals.

Recommendation 14

The Auditor-General should prepare a plan for the PAC outlining the required competencies for all grades of staff involved in performance auditing and the associated training and development programme to ensure that such competencies are achieved and maintained.

PERFORMANCE AUDIT

An Overview

External audit , in its various forms, is essentially an ex-post process that is superimposed on an accountability relationship that involves at least two parties, the one who allocates responsibility and the one who undertakes to discharge that responsibility. Traditionally public sector audit dealt with financial accountability and fiscal regularity. Concern that public services should also provide value for money led to many countries expanding the traditional audit function into the area of performance auditing. Some commentators have seen this development as either a reaffirmation of a hitherto implied responsibility, seldom acted upon, or as a natural extension of the traditional audit role. Others have viewed this development as an altogether new direction of work that requires new skills and specialisms that the auditor does not necessarily posses. Indeed it has been contended that performance audit cannot be regarded as an audit in the traditional sense because of the subjective nature of measuring and commenting upon programme efficiency and effectiveness. This latter criticism tends mainly to relate to those audit offices which have undertaken 'substantive' investigations which have included, explicitly or (more often) implicitly, the review of government policy because the reports produced are more judgemental.

There is some variability in the way countries have adopted performance audit legislation, even amongst those countries aligned with the Westminster model of government. In the UK and Canada, the auditor-general is an officer of Parliament and the Parliament itself addresses issues of staffing and finance. In the UK, for example, the role of resource provision is undertaken

by a separate Parliamentary committee, the Public Accounts Commission. By making the office of the Auditor-General responsible directly to Parliament all potentiality for the control or manipulation of this important office, directly or indirectly, is removed and the Audit Office is more directly accountable for its work.

In New Zealand and the UK auditors are permitted to specifically comment on all aspects of value for money provided by government programmes (are programme objectives being achieved) but not to question the merits of policy objectives. In Canada and (the Commonwealth of) Australia the audit mandates are more restrictive with respect to effectiveness. In Canada the Auditor-General is required to report to Parliament when 'money has been expended without due regard to economy or efficiency, or satisfactory procedures have not been established to measure and report the effectiveness of programmes'. In Australia amendments, in 1979, to the Audit Act 1901 permit the Auditor-General to undertake efficiency audits. Efficiency to also embrace the notion of 'administrative effectiveness'.

The Australian situation is, at the time of writing, under review. It seems likely that the JCPA does not wish to make the Australian Auditor-General an officer of the Parliament though it (rather than a separate committee) would like responsibility for approving the funding of the AAO. Although the desire of this committee is to see this office as an independent statutory provision its independence will, at least in principle, be impaired as the de facto position will remain that the Executive can still have some influence over the funding of this office.

At the state level within Australia audit mandates vary but two States have mandates that compare very favourably to those adopted in other countries,

excepting the issue relative to whether the Auditor-General ought to be an officer of the Parliament. The West Australian Financial Administration and Audit Act 1985 is noteworthy in that it provides for explicit and broad efficiency and effectiveness audit powers as well as requiring the Auditor-General to express an opinion on performance indicators reported by agencies. Performance indicators that are required to 'be related to specific organisational objectives and developed in conjunction with the corporate plan of the department or statutory authority' (WA Treasury Instruction T.1904). In Victoria the Audit Act 1994 states that ' the Auditor-General may conduct any audit he or she considers necessary to determine whether an authority is achieving its objectives effectively and doing so economically and efficiently and in compliance with all relevant Acts' (Section 16.1).

In all four of the countries cited above their respective PACs are in no doubt that a strong audit office is essential for good government. This said, it should also be stated that, at the same time, these PACs have, on occasions, been critical of some of the performance audit work undertaken by their respective audit offices. Periodic reviews of the mandate of individual Auditors General and the functioning of their offices have sought to more closely define the value and direction of effort that respective Parliaments, Executives and clients might expect. In reporting directly to Parliament (through) the PAC, an Auditor-General, under his/her performance audit mandate, should (as a minimum) provide the legislature with information and advice on:

> the accuracy, reliability and completeness of information provided for determining policy objectives and deciding on the means of pursuing them

the clarity with which policy objectives have been defined and communicated to those responsible for implementing them

the appropriateness and consistency of lower level operational aims, targets and priorities

the management information systems and other arrangements for monitoring results and achievement against objectives, and taking any necessary action

and (depending on the legislation) possibly

an assessment of the economy, efficiency and effectiveness with which objectives are being pursued and achieved, including unforseen side effects

significant evidence about economy, efficiency and effectiveness in the implementation of policy objectives which would not otherwise be reported to parliament.

(Adapted from an internal document of the UK NAO,n.d.)

This list is not too different to that offered in the Australian Statement of Auditing Practice (AUP) 33 except that this statement does recommend that an auditor should report on "the extent to which programmes, operations or activities of an entity have been effective" (para.5.c). AUP 33 is helpful is stressing that a performance audit does not necessarily have to address all the three 'E's. It states:

". . . a performance audit is defined as an independent systematic examination of all or part of an entity's programmes, operations or activities to assess economy and/or efficiency and/or effectiveness." (para.5)

In summary, therefore, most performance audit mandates provide that an Auditor-General may, in addition to their statutory audit responsibilities, undertake (via discretionary powers) examinations of the economy, efficiency and effectiveness of expenditure and use of resources by bodies where he/she is appointed auditor or has rights of access, either under statute or by agreement. These 'examinations' are more colloquially termed Performance Audits. Mandates do vary with respect to the degree to which effectiveness is examined. Such mandates do not tend to prescribe the nature of the performance audit reports produced but much internal effort is given over to determining, in consultation with the PAC and others, the types of reports (e.g. long and/or short form) and the style of report(s). Auditors-General, having attained a performance audit mandate, have tended to spend some time and effort on managing the cultural change involved both internally within his/her office and externally (by the PAC, audit clients and the public at large).

Whilst principally reporting to Parliament it has also not to be forgotten that these reports need to be structured in a format that makes them also useful to audit clients and others. Indeed audit clients may well receive supplemental information/guidance outside of the main report to the PAC so that the attention of the PAC is mainly directed to substantive issues. Whilst not all Auditors General are officers of Parliament their overwhelming majority view is that they ought to be, so that they are truly accountable to the Parliament both in terms of their funding and the quality and value of the reports that

they produce. Accountability varies between whether this is solely a Lower House relationship or whether this is a relationship with an expanded joint House Committee.

PERFORMANCE AUDIT IN NSW

The Audit Mandate

The performance audit mandate of the Auditor-General of NSW is provided by Schedule 1, Section 38B of the Public Finance and Audit (Auditor-General) Amendment Act 1991. This section is headed Special audit and provides that:

(1) 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.

(2) A special audit is separate from, and does not effect, any other audit required or authorised by or under this Act or authorised by or under any other act.

The Auditor-General is specifically prohibited from questioning the merits of Government policy objectives (Section 38D). Some effort is made to define in the legislation what are deemed to be policy objectives. Illustrative advice is offered (again in Section 38D) but this is not inclusive.

An explanatory note to the Amendment Act unhelpfully states that item (1) enables the Auditor-General to carry out a special audit of the activities of an authority to determine whether it is carrying out its activities effectively, economically and efficiently. This interpretation has caused some internal difficulties within the Audit Office and their current approach to 'special'

audits has seemed to have been a cause concern to auditees and the PAC. As written, the Audit Office have taken this explanatory note to indicate that all such audits must address issues of effectiveness and that they are restricted from, for example, undertaking performance reviews that might only concentrate on issues of economy and efficiency. This view was reinforced by PAC report No. 70 which states (inter alia):

> *"The Committee believes that the Auditor-General should carry out special audits that specifically address the question of effectiveness as a primary audit objective."*

and

> *"Although it has been put to the Committee that the section 38B(1) might be too draconian in requiring each of these elements to be considered at length and might be more prescriptive than the Committee originally intended, the Committee nevertheless feels that it is important to pursue the goal of a special audit incorporating each of these elements and notes that the Auditor-General's Office has yet to produce one."*

The explicit use of the term special audit is cause for a number of concerns. Operationally, the Audit Office consider these audits as performance audits, using the generically accepted terminology for such audits (INTOSAI, OECD, AARF etc.). Indeed the terms of my own appointment referred to performance audit rather than special audit. The issues that have arisen over this use of the word 'special' are many and include both internal and external perceptions.

Internally within the office staff at various levels expressed concern at the appropriateness of the term 'special'. Indeed it did appear that this term and the (Section 38B(2)) notion that such audits be separate from and do not effect any other audit had created problems and tensions within The Office. Some performance audit staff had a view that they ought to be seen as a distinctive and separate unit. Others felt that it would be useful if there was more liaison with the other divisions but, at the same time, expressed concern at the narrow attest focus adopted by their colleagues making this (currently) impossible. Staff in other branches appear to have a mixed view as to the value of the performance branch. Views offered included an opinion that there were instances when client liaison and working arrangements had been impaired by the operational style adopted by their performance audit colleagues.

There is one final point arising from the drafting of the current legislation. Item (1) states that the Audit General may carry out an audit to determine whether an authority is carrying out its <u>activities effectively</u>. As written, this would appear to indicate that an effectiveness review is more to do with what might be termed 'administrative effectiveness'. That is an audit that should focus on an authority's capacity to monitor and review itself and translate resources to outputs. Key questions arising in such an audit include: are programme objectives and intended outputs clearly specified? Have satisfactory means been established to , monitor and report on the effectiveness of programmes? What use is made of data? Is it collated, used for decision-making purposes and reported upon? Such an audit would not normally comment on the nature and direct relevance of the effectiveness performance measures and indicators produced, but does consider the management and reporting of activities. If this is the intention of the Act then current performance audit practice and reporting goes beyond this

interpretation. If the PAC consider that reviews of administrative effectiveness are too narrow a concept of an effectiveness review then they ought to consider how the legislation be more appropriately phrased to allow the Auditor-General to investigate and report upon the outcomes and (possibly) the impacts of individual programmes.

Recommendation 1

I recommend that the PAC give consideration to a redraft of the performance audit legislation to remove any ambiguity as to what the performance audit mandate of the Auditor-General ought to be.

General Observations

From the fieldwork and desk research undertaken a number of issues arose which need attention. The four more important of these that the PAC should be aware of are:

Preliminary Audits

These have been undertaken at times by the performance audit branch to determine whether or not a performance audit should be undertaken and, if so, what topic(s) are to be investigated. Such preliminary audits can take a number of months and have been justified by some staff as a necessary means of gaining an understanding of how an agency operates. Externally some clients have perceived this as an expensive exercise akin to 'turning stones' in an endeavour to find negative issues to investigate.

Both operationally and, from a client perspective, this presents a picture of uninformed auditors, at considerable expense, learning on the job. This raises issues about topic selection by this branch and the utilisation of scarce resources. Clients (auditees) are not billed for performance audits. If they were one could imagine their reaction to being initially billed for ,say, a three month preliminary audit followed by a second bill for the performance audit itself. Overall costs of performance audits were quoted to be, broadly, in the range of $100,000 to $250,000. It was also reported that, of the $1.5 million allocated for performance audit reviews, $1.38 million represented staffing costs. If this information is correct then it would be useful to know what the full cost (including office and other support costs) of such audits really are.

Clearly costs are often shared across agencies and benefits vary between agencies. These costs and benefits should be published more widely as part of the formal audit reporting process. At present this information is only included in summary totals in the Auditor-General's annual report.

Recommendation 2

The Audit Office should urgently review and agree with PAC the basis by which performance audit topics are selected.

Recommendation 3

The PAC should consider taking on the responsibility for oversighting the resources appropriated to the Audit Office so as to make more accountable the resources applied by the Auditor-General, particularly with respect to performance audits. If the PAC feels this is not their responsibility they might care to consider how this important oversight

responsibility be undertaken.

Recommendation 4

The PAC might wish to consider whether clients should be billed for performance audits in similar fashion to the billing for their attest/regulatory audit. This would impose a market test and discipline on the value of this audit effort.

Performance Audit Reports

The reporting style and format of performance audits leaves a lot to be desired. Having read a number of reports one is struck, in a number of instances, by the confrontational style of writing and the verbosity taken to make particular points. Enquires led to general agreement internally at all levels that urgent attention was required to address this issue. Even on basic issues of 'house-style' it was reported that often weeks were spent in packaging reports according to the individual style of the various reviewers as reports progressed through The Office.

Recommendation 5

The performance audit branch should, as a matter of urgency, develop or adopt a practice guide so as to standardise the quality of performance audit reporting.

Lack of a Client Focus

Whilst it is undisputed that the Audit Office (primarily) report to Parliament, through the PAC. It seemed of little concern to some members of the performance audit branch that they ought not to forget that there is a client dimension to their work. Auditees unless treated as clients can feel alienated to their auditor and are obviously less receptive to adopting advice emanating from performance audit investigations. Performance audit is not always about 'whistle blowing' it is also about ensuring the efficient and effective management of public services. There was belated recognition of this need by some members of the Audit Office.(An issue, in fact, that is not solely related to the performance audit division). More 'value added' could be obtained if the performance audit function gave more attention to the dissemination of their findings to clients, their colleagues in the other audit branches and to those private sector auditors who undertake some of the regularity audits on a sub-contract basis. For example, clients might receive 'best practice guides' and the attest/regularity auditors, both internal and external, might undertake some review/implementational work in relation to specified elements arising out of the more substantive performance audit reviews. This approach would, in part, ensure that greater benefit was obtained from the initial investigation.

On a slightly aside issue, but one that has been raised during the course of my enquiries, I would not favour the privatisation of either the regularity audit function or the performance audit function. But this does not mean that there should not be private sector audit involvement in both of these areas. Audit independence and issues of quality control are best preserved if such appointments continue to be made by the Auditor-General.

Recommendation 6

The Audit Office should develop a strategic plan to best maximise the value that clients might receive from performance audits.

Recommendation 7

The Audit Office should address how it might better create a cross-fertilisation of effort between staff in the performance audit branch and the other branches of The Office. In addition this cross-fertilisation should also embrace a closer working relationship with those private sector audit firms who do sub-contract work on behalf of the Auditor-General.

Local Government Performance Audit Reviews

Given the increasing responsibility undertaken at the local government level for the management of Commonwealth and State funded programmes, it would seem more than necessary that the Auditor-General be given powers to undertake performance audits at the local government level. Again, as stressed above, the full benefit of such investigations would benefit from a close working relationship with the external attest/regularity auditors directly appointed by individual local authorities. This applies to other areas of government, including health, where such authorities are not accountable directly to Parliament and where Ministers can only exercise indirect control through conditional grants.

Recommendation 8

PAC might consider extending the Auditor-General's mandate to undertake performance audits of local government, health and other areas which are in receipt of government funding but which are currently outside of his audit mandate.

REDIRECTING THE PERFORMANCE AUDIT EFFORT

From what has been said earlier, and arising from the nature of the enquiries undertaken, it would appear that the performance audit branch needs to re-appraise how best it should focus its activities. As previously indicated, this would be easier to facilitate if the legislation was revised.

It was indicated that little or no training had been undertaken, despite efforts to secure suitable training. Efforts had included seeking assistance from universities, but they had showed little interest, and a possible joint venture with the AAO and the Victorian Audit Office had not, in the end, materialised. Current thinking is that, at a minimum, the performance audit branch might utilise some of the training units offered to the staff in the attest/regularity divisions. Such units (apparently) to include topics such as the preparation of working papers. Many of the staff in the performance audit division have only been in position for less than two years but one might have thought that when they joined, or shortly thereafter, there ought to have been in place some centrally agreed parameters as to how these individuals were to operate and what standards they were to apply with respect to office practice, base audit skills and particular specialist skills relevant to performance audit. Some two years after this mandate was undertaken these issues are only now being recognised as base issues that require immediate attention.

It would be useful to have information on staff turnover within this branch as one auditor remarked that by the end of one investigation the three assistants assigned to the audit had left and were not replaced on the team, thereby necessitating this auditor to handle all the report drafting, review and (and

apparently) considerable redrafting. When questioned as to why these individuals had left the view was offered that they had realised that they were not suited to this type of audit work. This incident raised a number of potential concerns. Their superior, the person interviewed, was undoubtably talented, having had previous related experience, but was themself still on a learning curve as far as developing into a performance auditor. This auditor was also endeavouring to understand the nature of the client's business. How then was this auditor able to provide leadership to junior staff who clearly needed to operate in a learning environment? On what basis were these relatively junior staff recruited and, back to training, what was their induction programme when they joined the branch?

Views varied as to the utility of the attest/regularity audit staff in assisting with elements of performance audit investigations. The Auditor-General offered the view that these staff 'were (either) just not interested' or inappropriately skilled because of their narrow mind-set on financial statement analysis. Staff in the performance audit branch also took the view that many of their attest/regularity colleagues were too narrowly orientated to attest issues and unable to address or recognise some relatively fundamental issues with respect to best financial management practice and some broader, but related, management issues; for example, economic life-cycles of assets, stock management, tendering etc.

Time precluded further enquiry into whether there was some 'dead wood' that needed to be removed from the attest/regularity audit branches and /or why there was a failure within The Office to recognise how both groups of auditors might pool their scarce resources to maximum effect. Certainly I was aware that a number of key positions within the attest/regularity audit branches had been filled in recent years with staff recruited from the major private sector

audit firms and would have imagined that their training and experience would have been such that they could assist the staff in the performance audit division in their efforts to develop performance audit expertise throughout The Office.

The attest/regularity audit staff should, in principle, be able to identify and assist with certain topics for a performance audit review. Even if such topics focus mainly on issues of economy and efficiency this is nonetheless an important means of ensuring the PAC and clients that managers manage and are held accountable for the resources that they use.

It would seem key to the development of the performance audit within The Office that the skill/competency base of the attest/regularity audit should be broadened out so that they can address broader issues of financial management. The Auditor-General also offered the view that attempts on his part to address this issue had been frustrated by Treasury's view that the attest/regularity audit function remain in isolation to the performance audit activity of The Office. This cannot be regarded as a sensible approach to modern government auditing which takes a much more business oriented focus.

Recommendation 9

The PAC should invite the Auditor-General to consider how his attest/regularity auditors might become more involved with aspects of performance auditing and should advise the Committee of any operational difficulties associated with such a move.

Client feedback varied as to the value that could be attributed to particular performance audit investigations. One client felt pleased to have been consulted by the Audit Office as to what topics might be undertaken (this

accorded with the view of The Office) but felt that during the course of two investigations the scope of the audits had unnecessarily widened and were hence of less value than they might otherwise had been. There were some differences of opinion as to whether the client, at appropriate levels, was kept in touch with the progress of these two audits. Similar views were expressed by other clients. Clients also seemed to doubt whether some of these reports had much utility value. The performance audit division generally believed that, with one notable exception, they enjoyed good working relationships with clients. A small sample of three client groups, covering approximately one-third of reports published or at the clearing stage, were not so convinced that the relationship was as positive as it might be.

Recommendation 10

The Auditor-General should include in future client surveys questions that specifically ask for responses on the value and quality of performance audit reports.

Within a very short period of time the performance audit branch have undertaken a range of challenging investigations to mixed effect and impact. The Office view was that this was unavoidable given the expectations of the PAC. It would be more usual for an audit office embarking on an expanded mandate that includes performance audit to, in the vernacular, 'pick winners'. In order for The Office to better develop their methodology and for clients and the PAC to perceive the value of the performance audit function it would be useful if they undertook a more varied selection of investigations that, on occasions and contrary to previous advice issued by the PAC, did not necessarily have an over-emphasis on issues of effectiveness. It is certainly true that programmes can be efficient but not effective. It is also true that

while some programmes might be effective we need to consider at what price. With scarce resources it is important to address the efficiency and quality of services provided.

Recommendation 11

I recommend that the PAC closely monitor the types of performance audits undertaken by the Audit Office and that the Auditor-General provide the PAC with brief details of the scope of each investigation, the anticipated outcomes and estimated (total) cost.

On a related matter it was noted that during the course of this investigation, the Minister for Transport requested the Auditor-General to undertake a 'special' audit and this the Auditor-General seems happy to do. I believe that such arrangements (including those covered by S.45 of the Act) compromise the independence of the Auditor-General and that he should not undertake such direct requests form the Executive. Indeed, as noted earlier, much of the performance audit activity undertaken by The Office has come directly from the Parliament and Ministers rather than as a result of a strategic plan developed within The Office.

Recommendation 12

I recommend that only the PAC should approve the performance audits undertaken by the Auditor-General. If the Executive feels that they wish the Audit Office to undertake such investigations then such requests should properly be channelled through the PAC for consideration.

CORPORATISM WITHIN THE NSW AUDIT OFFICE

Throughout the course of my enquiries I was struck by the overall lack of 'corporatism' within the Audit Office. Staff moral was an issue. Instances were reported of the negative impact in the attest/regularatory branches caused by the apparent arrogance of some of their colleagues in the performance audit branch. Claims were made that offers of co-operation and the suggestion of topics were knocked back in a dismissive way. Equally, staff in the performance audit branch had a perception that their colleagues in the other branches were too narrowly focused on issues of financial compliance. Client feedback certainly saw The Office as operating as effectively two separate and unrelated and uncoordinated halves. The client perception was that performance auditors were 'green' and often lacking in any real understanding of their business.

One would not wish to belabour the issue of corporatism but staff at varying levels and from all branches agreed that this was an issue that required some urgent attention. It is important for all staff to feel part of the one efficient and effective organisation. This is also necessary if The Office is to more fully develop its performance audit work. In the medium to long term it is to be hoped that a large proportion of performance audit work is more integrated into the other divisions. This is needed so as to maximise scarce resources. This is not to say that the performance audit branch should cease to exist as a separate entity but simply to question its future role as The Office seeks to expand its performance audit activity.

Recommendation 13

The Auditor-General should instigate a series of iniatives to remove the perceived barriers between the various branches of The Office so as to instill in all staff a sense of corporate identity, shared vision and goals.

TRAINING & DEVELOPMENT

Key to improving the development of performance auditing throughout The Office and to developing particular skills and competencies in the performance audit branch is the issue of training and development. This weakness has been a consistent theme in earlier sections of this report, being a common theme that was raised when interviewing staff at all levels.

The Office should develop as a matter of urgency a training and development strategy that provides for general and specific competencies relevant to performance auditing. This strategy to cover the needs of all staff be they in the performance audit branch or other branches of The Office.

Whilst it is appreciated that some of this training may be in scarce supply, The Office might wish to consider whether some elements might be more easily covered by adopting best practice developed by other audit agencies in the public and private sectors, as appropriate.

Recommendation 14

The Auditor-General should prepare a plan for the PAC outlining the required competencies for all grades of staff involved in performance auditing and the associated training and development programme to ensure that such competencies are achieved and maintained.

THE PAC & THE AUDITOR-GENERAL

The PAC have a critical role to play in ensuring the independence and accountability of the Auditor-General and his Office. Clearly some of the current problems associated with performance auditing emanate from the way the legislation is drafted and interpreted. It is also clear that there is not much oversight of the performance audit activity by the Committee. Senior staff of The Office certainly felt that it would be beneficial to have a closer dialogue with the PAC as the agent of Parliament. The PAC needs to address how best the Auditor-General be resourced and held accountable for providing not only themselves, but also clients, with reports that add value to the ongoing quest for the efficient and effective management of public services.

It may be that the PAC see themselves taking on a more pro-active role in certain areas or it may be that they consider that certain aspects of the resourcing and accountability of the Audit Office are best handled by others. In the absence of an accountability framework for this Office it seems that the PAC has little option but, in the first instance, to address these issues themselves.

It is impossible for the Audit Office to function effectively without a clear legislative charter and a clear accountability framework. This is essential for good government and accepted by most other Westminster-style Parliaments.