

Mr Jonathan O'Dea
Chairman
Public Accounts Committee
Parliament House, Macquarie Street
SYDNEY NSW 2000

11 September 2013

Dear Mr O'Dea

Auditing Services

I am writing to clarify why I believe it is necessary for my Office to undertake the majority of NSW universities' audits in order to produce an overview report to Parliament that meets both the requirements of my mandate and the expectations of stakeholders.

Summary of my position

If my office does not perform the majority of university audits, it will be difficult to:

- achieve the same degree of oversight of the risks and issues facing the NSW university sector
- prepare a meaningful issues based report for Parliament. It is through the conduct of NSW university financial audits that my staff become aware and have a shared understanding of sector wide issues worthy of reporting to Parliament
- ensure consistent quality of audit processes, reporting and value.

If universities are allowed to appoint their own auditors, and I am charged with oversighting the audits and reporting outcomes to the Parliament, I would be required to perform additional reviews of the audit work performed to verify the accuracy, robustness and quality of the outcomes and matters to be reported to the Parliament.

I would need to ensure additional audit work is performed to cover those areas required by my mandate, which are not in the normal scope of a private sector financial audit – see the Mandate of the Auditor General section. These additional layers of oversight and review would burden university management and increase the overall costs of the audit and reporting functions. If each university has a different auditor, it is probable the depth and breadth of shared knowledge of the sector would diminish and the risk of inconsistent auditing practices would increase.

Mandate of the Auditor-General

For independence reasons, the *Public Finance and Audit Act 1983* charges me with the responsibility of performing the universities' audits and reporting matters of significance to Parliament.

Section 27B (5) of the Act requires me, in the exercise of my functions, to have regard to whether there has been any wastage of public resources, or any lack of probity or financial prudence in the management or application of public resources.

Section 31 (1) of the Act requires me to communicate with the Treasurer upon all matters which I believe are sufficiently significant to be brought to the Treasurer's attention.

Section 43 (2) of the Act requires me to report to the Minister, Treasurer and those charged with governance of an agency as to the result of my audit and as to such irregularities or other matters that in my judgment call for special notice.

Comparison with private sector audit firms

Considering the above, it is clear that my mandate and responsibility goes beyond that of a financial attest audit performed by a private sector audit firm. My Office must audit all agencies within the public sector irrespective of size, complexity, risk or location.

Universities are public institutions, which control significant public sector assets and receive substantial taxpayer funding to enable them to operate. My independence and mandate provides a unique mechanism to hold the universities accountable for their use of these public resources. In planning my audits I am generally more risk adverse than a private sector audit firm. Given my responsibility to Parliament and the wider public, my view of materiality is different to a private sector audit firm and I set the scope of my work accordingly.

In comparison, to maximize profitability, private sector firms target particular sectors or clients, and seek to do the minimum audit work required to provide an audit opinion on the financial statements, while seeking to increase revenues by offering other services. It is my practice to recover the cost of the audit from the agency concerned. If the actual cost is less than the estimated fee, I reduce the final invoice to reflect the cost of service delivered.

To achieve the necessary level of independence, the legislation does not allow public sector agencies to choose their own auditors. As a consequence, my strategy for auditing the university sector must ensure the required degree of independence is maintained.

My Office's expertise gained from auditing the sector and my independence allows me the flexibility to report on any matter I think fit, without fear of losing the audit engagement, particularly where my findings may be adverse and/or critical of management. In past university audits, I have identified many issues around the governance and business undertakings of universities and their controlled entities. Some of the issues I have reported in recent years include:

- insufficient funding arrangements for superannuation liabilities totalling \$4.7 billion at 31 December 2012
- increasing reliance on Australian Government grants, which make up nearly half of universities' revenues
- some universities not achieving certain financial performance benchmarks set by the Australian Government
- business cases not being prepared to support major financial decisions and capital projects
- the lack of total asset management plans
- insufficient resources being allocated to risk management and internal audit
- delays and cost overruns on major capital projects
- inadequate corporate governance frameworks for controlled entities and complex business arrangements
- significant amounts of backlog maintenance
- financial and reputational risk from business arrangements both locally and overseas
- issues that require me to qualify my audit opinions on controlled entities of universities.

Contacting out audit services

Generally, I do not contract out audit services in strategic industry sectors in which I must maintain and develop expertise, industry knowledge, awareness and understanding of the issues facing that industry.

My current strategy is to contract out about 10 per cent of my Office's audits to:

- facilitate the benchmarking of its work against the private sector to ensure it provides comparatively cost-effective and efficient audit services
- improve audit processes through knowledge transfer and the adoption of innovative ideas
- benefit from access to different skills and specialist knowledge.

Current arrangements already allow me to tender out university audits. I have recently contracted a private sector audit firm to provide audit for one university. My assessment of this trial has confirmed this is an appropriate model and I am in the process of contracting out the audit of this university for a further three years. The outsourcing of one university audit allows me to maintain the required level of independence and benchmark service quality and cost, while enabling me to gain a deep understanding of the issues across the sector. It is also consistent with my practice of outsourcing approximately 10 per cent of my audit work.

NSW universities operate in a highly specialised industry sector with a changing risk profile. My Office has developed significant and unique expertise in auditing this sector and continues to identify many significant risks. I must maintain this expertise to effectively fulfill my mandate and report key issues to Parliament.

Generally, it is my experience that when I contract out financial audits to private sector contract audit agents, there is a significant decrease in the number of issues identified for reporting to management, those charged with governance of the agency, and the Parliament. This concerns me, particularly as this was again my experience with the recent exercise in contracting out a university audit.

Benchmarking our audit services

One of the terms of reference of the Public Accounts Committee's inquiry into the efficiency and effectiveness of the Audit Office of NSW was:

Whether the Audit Office of NSW Provides Value for Money Financial Audit Services, In Comparison With the Services and Fees of Similar Organisations

I provided a detailed response on this topic in my submission dated 9 May 2013. For the reasons noted above, the most comparable organisations to benchmark my Office's services against are other Australian State and Territory Audit Offices. In summary, I advised:

- our external survey and benchmarking results confirm the Audit Office is providing value for money financial audit services.
- our external survey results show those charged with governance of agencies value our services highly.
- our financial audit services cost less than the average of the other State and Territory Audit Offices.

I benchmark my Office's audit fees against private sector firms I contract in to provide audit services. Whilst I don't believe benchmarking against private sector firms is as comparable as benchmarking against other State and Territory Audit Offices, my Office's fees are competitive with those charged by private sector providers.

Direction of local government auditing

Local governments in NSW currently chose their own auditors. There is a provision in the Local Government Act whereby my Office can be appointed as the auditor where another auditor is not appointed. However, this has never occurred.

In an April 2013 report titled "Future Directions of Local Government", the Independent Local Government Review Panel noted that the current audit arrangements for local government have failed. The report noted:

Another issue raised by TCorp is the desirability of a more consistent approach to auditing of annual financial statements and collection of data on asset maintenance and infrastructure backlogs. Whilst it has no doubt that auditors undertake their tasks in a professional manner, the Panel is concerned that the current system whereby councils individually tender for audit services creates a tendency to minimise the amount of work involved, and hence the cost. This means that the potential for auditors to contribute to improving financial management and fiscal responsibility can be restricted.

The Panel has concluded that NSW should follow the example of Queensland and Victoria in placing local government audits under the oversight of the Auditor-General. ...The Auditor-General would also prepare an annual overview report to Parliament, providing an independent assessment of the financial health of the local government system.

If you have any queries, please call me on (02) 9275 7107.

Yours sincerely



A T Whitfield
Acting Auditor-General