

PROCEEDINGS BEFORE

PUBLIC ACCOUNTS COMMITTEE

INQUIRY INTO AUDIT COMMITTEES

At Sydney

Wednesday, 27 October 2004

The Committee met at 9.00 a.m.

PRESENT

Mr M. J. Brown (Chair)

Ms G. Berejiklian
Mr P. E. McLeay
Mr G. R. Torbay
Mr J. H. Turner
Mr S. J. R. Whan

RICHARD ANTHONY POWIS, Chief Executive Officer, Integral Energy, P.O. Box 6366, Blacktown, New South Wales, affirmed and examined:

CHAIR: I have been advised that you have been issued with a copy of this Committee's terms of reference and the relevant Standing Orders in relation to examination of witnesses, is that correct?

Mr POWIS: Yes.

CHAIR: We have received a submission in the form of a questionnaire from you. Is it your desire to have that included as part of your formal evidence?

Mr POWIS: Yes.

CHAIR: Would you like to make an opening statement in this matter?

Mr POWIS: The lessons I have learnt at Integral, and when I was company secretary at TransGrid, are that it is important that the board review its performance on a regular basis. That is the first thing. The second thing is that it is very hard to prescribe what is the right and wrong review process. We have had people who have come in to facilitate reviews. We have equally done it in-house and we have done it on a one-to-one basis. Out of the three methods that I have seen in a review process, the best one that I thought has worked is when the board has sat down collectively and in an open way tried to work it through, but it requires the CEO, like myself, to be open to comments, criticism, et cetera, and equally the board to be responsive to that process. I think in the interests of modern management openness and transparency is fundamental. When you get into the audit part of the process, the final part of the audit is the final check and the board has to ensure that there are processes in place. Again, that needs to be tackled in a way that enables an organisation to culturally move ahead in business systems and processes. I actually think that the workings of the board and the workings of the Audit Committee are fundamental to keeping a check and balance on the business and moving forward.

CHAIR: Maybe you could tell us a little about the mechanics as to how the Audit Committee works, such as who is on it, how often do they meet, what interaction do they have with the board?

Mr POWIS: The Audit Committee currently consists of all but one of the board members and I am an invitee to the Audit Committee, because obviously it is about what I do as a manager of the company. Why are there so many of the board on it? They see it as a fundamental part of running the business and it is also amalgamated with the risk assessment, so it is the board and the risk. It meets roughly on a quarterly basis. It can meet more often if it has to sign off accounts and things like that. The way the audit process works in our organisation is this: I have an internal audit group of about - I forget the numbers because they flow, but say four or five. We also have a component outsourced, which is currently to PWC. Having an internal capacity means you have familiarity with your systems, but equally it has got capacity to do things at a moment's notice if something arises, also investigations and things like that. They have a program going out for a year. It is actually a three year rolling program. They would commence their review, we would then have an executive Audit Committee meeting which would be two to three weeks prior to the board Audit Committee. We would review the audits of the various components, for instance there could be on billing, trading, asset management, depots, payroll, all those areas that have been identified as risk. We go through the audit findings at the executive meeting to ensure that we have been dealing with the issues in a critical way. They then get replicated straight up to the board. So the board does not get to see a summary, they get to see the whole report of the executive, and there is a series of them. There are also minutes of the previous meeting and they are then considered. The workings of the board also consider on a yearly basis the budget, the audit plan for the future year and, if there has been any disconnect e.g., we may have had an inquiry that was necessary that took resources which meant the plan was compromised. We then have to ensure that the plan is not compromised moving forward, because as a check you need to ensure you have covered your risk areas in a methodical way.

CHAIR: You mention that most of the Audit Committee are board members. Would it be correct to take it from that evidence that you choose the make-up of the Audit Committee on their role in the organisation, not necessarily the qualifications they have?

Mr POWIS: We originally had two committees. We had an Audit Committee, which was at board level, and we had a risk committee. The risk committee was to identify what they thought were the risks in the organisation and it was separate. All the committees of the organisation at board level, we have a retail risk which meets monthly because retail is such a risk element, we had a risk committee, we had an audit committee and we had a remuneration committee. We made a call as part of our review process that we would actually bring the risk and audit together. As a consequence of bringing those two together, we ended up with all but one of the board on that Committee, because the people who were passionate about risk and the people who were passionate about audit did not want to lose sight of the hard work they had been doing. The organisation has been in repair mode from about four or five years ago when it had a few problems. So we have done a fair bit of work to get into space so everyone has a degree of ownership moving forward.

The composition of it: We have two people with insurance backgrounds, so they are risk managers; we have an ex-Premier/Treasurer on the board, who has definitely got a public focus; we have somebody who was the Vice Chancellor of the University of Western Sydney, who has enough issues on her plate and is using it as a way of learning and experiencing how this is managed in a different environment; and we have also the Labour Council representative, who does take an interest in the organisation as well. I view it as a positive thing rather than a negative.

Mr McLEAY: How many are there on your board?

Mr POWIS: We have Mike McLeod, the chairman, deputy chair is Terry Downing, we have John Fahey, Jan Reid, Paul Sinclair and Emma Stein. Emma Stein has just joined us.

Mr McLEAY: And what about Janice Reid?

Mr POWIS: Jan Reid, yes. Until about March this year the head of the Audit Committee was the deputy chair, which was Terry Downing. When we did our assessment we thought it was good to have rotation and as a consequence we had John Fahey to be the chair.

CHAIR: How transparent does the Audit Committee regard the external reporting process to be and could that be beefed up and made more robust?

Mr POWIS: I will answer it this way, I think when you are in a SOC environment, State Owned Corporation, your reporting is actually quite extensive in the annual report, in reports up to the Minister, under your SCI process, you have got licence conditions off to IPART. I do not think you could dream how many reports that I actually have going off to various parties. I think you can put any reporting arrangements in place. It comes down to how the board functions and how the CEO manages his role, and the thing I have learnt is the role of the CEO cannot be underestimated, but the final thing is it has to be a genuine management process. You can manage audit in several ways. I have seen in organisations where you can get an audit report which says you have got a risk, you have got this issue, this is what you should do, and management could easily say we are going to set in place a training process, we are going to do an information process or we are going to look into it or we are going to review it. They are code for you are not going to do anything. Management has to go the next step and say we have the issue and we genuinely believe that that is a risk that has to be merit managed, et cetera. So funnily enough, you can have a reporting system which says we are putting in a training system and you can train and nothing else happens. So it is about the genuineness of the process more than the reporting of the process if you know what I mean.

I do not know how you overcome that, because the thing about governance that is being proposed these days is about transparency, but if someone is genuinely trying to subvert the system, they will do it. I am not saying I am, but I am just saying you have got to look at some key mechanisms of making sure the board has personalities that are complementary and are challenging. I

think one thing you should be looking at is that an organisation can get too comfortable in itself, so board membership should be considered in a rotation sense, and that ensures that a cozy environment does not occur, it ensures that there is some challenging going on. So I think the board should have that change process, and it is not every year, but I think after every period of time you can move one director from one organisation to another organisation, so they stay as a director but they could actually move around.

Mr WHAN: I was just going to come back to the make-up of your audit committee. You are on the committee ex officio, you said. Have you got any other people outside of the committee, for instance, representatives of the Auditor General's Office?

Mr POWIS: No, the Auditor General's Office comes once a year and sits down to go through their findings with the board. Prior to that, the head of the audit committee sits down with the Auditor General people and goes through the report in private without me there. They could have our audit people there, but without me there. That is to ensure that they are hearing the truth and are listening to the issues. We have moved to another layer at the last board audit committee where we have actually said that once a year I will be excused from the meeting and anybody of management will be excused from the meeting and the board will have a free and open discussion with the audit group in my organisation. That is to ensure that I am not applying pressure, and that is a fair way. So the two things that do occur is the Audit Office, and it only happens once a year, and they go through their findings in a very straightforward way.

Mr McLEAY: You said in your statement that Audit Office representatives are invited to committee meetings when financial statements are presented for review to discuss issues arising. Would it be of benefit if the Audit Office was, as your external auditor, invited to your audit committee meetings more regularly?

Mr POWIS: When they come and talk about financials they actually talk about, for instance, examples they found in personnel files, that personnel files are sometimes not complete. They have also found issues sometimes with billing systems and they actually go through those as part of the audit letter and say this is what we found, because they have access to all the internal audit reports and they also do their own random checks, so they not only do the financials, which is about provisions, accruals and things like that, but they also go into things that they potentially see as issues. Now I would have to say in our case they have been diminishing, but notwithstanding that opportunity exists there all the time. An advantage for them coming along? I will discuss it with the board.

Mr WHAN: An advantage for you in them coming along really.

Mr POWIS: What happens is that, in the audit process, my internal auditors are doing their work all year. The Audit Office come along and they keep in contact with the internal auditors throughout the year. It comes to a crescendo around the end of the financial where they ask for all the copies of the internal audit reports. They actually ensure the auditors. My head of audit is actually from the Audit Office, so she is very familiar with the process, and it comes to a crescendo around the account period, so having a roving one - I mean I tend to think they rove through the place from time to time but, to be blunt, they don't come to the audit meeting. Whether there is a benefit in them coming and highlighting something else I will take on board.

CHAIR: Do you use their best practice guides and, if so, are they obvious?

Mr POWIS: I think the best practice guides are headed in the right direction. Every organisation is at a different part of its cycle. Integral came out of a period where we had substantial issues about four years ago and had a lot of things to deal with. We made a very big effort to go into compliance auditing in the first part. We have now moved to a match of compliance and process auditing. Eventually we have to get to process auditing. We are in an evolution. If I had a best practice organisation, I would be in process auditing now, but we are in transition as an organisation. The way to relate to that is that four years ago - and I know it is safety and it may seem strange - we had a frequency rate of 14 in the organisation and we had had it for decades. We are now down to

about seven to eight, which means we are half way to getting it down to zero.

Mr McLEAY: What is a frequency rate?

Mr POWIS: It is roughly how many accidents and the severity of the accidents that you have in an organisation. For utilities, the average used to be nine and it is now down to about seven. In essence, it means that within a month we used to have about four serious accidents - not life threatening, but serious accidents - and we are now down to two per month. Our aim is obviously to get it to zero, but the reason I use that as an example is that accidents are about discipline, both management and individuals, about how you approach things, so if you are in an organisation in transition, to get best practice, you want to get to zero, so we are half way. That is why I am saying that we have a mixture of compliance and process auditing going on. Best practice is the final end stage, but you have to get to that final end stage in a very holistic sense as an organisation.

CHAIR: You were talking about different organisations being in different cycles of their existence. Do you know whether your audit committee discusses their work internally in your organisation with other similar organisations?

Mr POWIS: No. They go off to courses and I think there is one in the next month or so that a couple of them are going off to. That would be the extent of it. They would not sit down with another audit committee. They have not sat down with another audit committee. They may have had individual talks themselves, but that is about it. The chair is also the CEO of an organisation, so he is familiar with his own; John Fahey obviously has his own reference point; Jan Reid has her own audit committee, so they have their own reference points. They actually think that our process is one of the more robust that they have seen.

(The witness withdrew)

(Short adjournment)

NEIL CRAIG SHEPHERD, Director General, Department of Community Services, 4-6 Cavill Avenue, Ashfield, affirmed and examined:

CHAIR: I am advised that you have been issued with a copy of the Committee's terms of reference and a copy of the relevant Standing Orders that relate to the examination of witnesses. Is that correct?

Dr SHEPHERD: Correct.

CHAIR: We have received a submission in the form of a questionnaire from your organisation. Is it your desire to have that part of your formal evidence?

Dr SHEPHERD: Yes.

CHAIR: Would you care to make an opening statement?

Dr SHEPHERD: I do not think that is necessary. My understanding is that you have a series of questions you wish to ask me on the basis of the response to that questionnaire.

CHAIR: May I ask a general question: How does the role of the audit committee assist corporate governance within the Department of Community Services?

Dr SHEPHERD: It is the formal structure for a focus on the audit function within the organisation. As you would appreciate, within a high pressure environment there is a tendency to deal with the short-term and crisis issues that exist in any large organisation and what the audit committee does is to provide almost time out to consider the longer term and strategic issues and the risk issues that face the organisation. You get a broad range of views that are brought to bear on the audit program and on consideration of the reports. We have more externals on our audit committee, either as committee members or as observers, than we have internals. That includes two members from the external auditor and the Audit Office. It is also a forum for discussion of the respective needs of internal audit and external audit in that what it does is enable the external auditors to be satisfied that the internal audit program will address a substantial part of their requirement. It also provides a mechanism for ensuring that the audit recommendations are implemented because there is a formal reporting against audit findings and a formal follow-up system through the executive. It also provides a forum for considering the quality of the advice that the contracted internal auditors, Ernst and Young, actually provide to me and it does provide a check, particularly from the perspective of the externals, on the quality of the risk profile that we develop for the department. So they are the basic things that it does.

Mr McLEAY: How often does it meet?

Dr SHEPHERD: Every two months would be my guess - yes, more frequently than quarterly, it would be every two months.

Mr McLEAY: I note that you have taken a decision to have two independents. How were they selected?

Dr SHEPHERD: They were selected by going to the various agencies who basically hold auditors, if you like, so the chartered accountants group, the audit professional bodies and so on, getting advice from them and then selecting by an open process.

Mr McLEAY: Which was?

Dr SHEPHERD: My recollection is that we either went to expressions of interest or tender, but I will have to come back to you on that. Certainly it was an open process.

Mr McLEAY: Why two?

Dr SHEPHERD: No particular reason. I think that if you only get one you get one kind of expertise and you can be pretty narrow in what you pick up. Given the size of the audit committee, I think that two gives you a better spread of skills. If you look at the two who are on the current audit committee, they come from very different backgrounds and they do provide a spectrum of external advice that you would not get from a single person.

Mr McLEAY: Having those two people there, is the benefit that they are independent or is it that you sought someone with specific skill sets, for example, legal or accounting?

Dr SHEPHERD: There are a number of benefits. Obviously the fact that they are independent is important in its own right. The second thing is that, in my view, they need to bring a wide range of auditing skills into the process, particularly as we have selected them, they have both government and non-government audit experience and commercial experience and government experience, so we have a wide range of expertise in those two independents other than the fact that they are independent.

CHAIR: Would it assist you further if one of those independents or another independent actually chaired the committee?

Dr SHEPHERD: I do not think so, and I am happy to explain that at length because I understand it was an issue of interest to you. If you look at the structure of inner budget sector agencies versus private sector public companies there are some substantial differences. In the case of an inner budget sector agency, the director general has the sole responsibility to the Minister for the department and under section 11 of the Public Finance and Audit Act it is the director general who is responsible for the internal control mechanisms.

If you look at the function of internal audit as being two-fold, the first is to satisfy me, since I am the accountable person to the Minister, that I have the systems and controls in place to manage the agency effectively and to meet the accountabilities that I have to administer and, secondly, to do audit work of a sufficient breadth and to a sufficient standard to satisfy the external auditor that they do not need to do a total audit for the agency. So they are the two things that I think internal audit does. If we focus on the first one of those, which is the advice to me about the controls, then I would argue that it is logical that I should chair the committee since I have the greatest interest in the outcome from the committee and, if it does not work, I am the loser since I am the one who has the accountability for the performance of the agency to the Minister. The other thing is that no independent that you bring in will have sufficient knowledge of the complex business that the Department of Community Services is engaged in to really chair that committee effectively and to know when something is not likely to be right. One of the skills you get as a director general is that you get a pretty good nose for what is or is not right sitting underneath you. I think the fundamental difference is that if you had a board, either as a private sector company or as a public sector enterprise with a board, and some of those are inner budget sector agencies, like the Environment Protection Authority, then you can get a member of the board to chair the committee. The member of the board should have a substantial knowledge of the workings of the agency and it is not like just almost buying an independent off the street who is an auditor sole rather than someone who has a much broader range of experience.

My view is that, in an inner budget sector agency with no board, the director general ought to chair the committee if he has a sufficient interest in the audit function.

CHAIR: Are you aware that the Auditor General recommended that directors general did not chair audit committees?

Dr SHEPHERD: Yes, I am aware of that, but I hold a different view and I think my accountabilities are quite clear, they are set out in the statute, and that is why I choose to chair it.

Mr McLEAY: Do you know of any other agencies that have audit committees with CEOs or directors general chairing them?

Dr SHEPHERD: I know of the ones I have worked in and I have chaired the audit committee in each of them, and I have been a CEO in the system now for some 14 or 15 years. I am not aware specifically of what other CEOs choose to do. I would be very interested if there were CEOs who actually attended the audit committee when it was chaired by an independent, like a true independent, and they were inner budget sector agencies.

Mr McLEAY: We have heard other evidence of that happening. What about your predecessor? I know your committee has been going for ten years now.

Dr SHEPHERD: She has certainly attended the Audit Committee. I have no idea whether she was the chair or otherwise. I can find out, if that is useful for you.

Mr WHAN: With the deliberations of the Audit Committee and reporting, what goes on there, what happens to the outcomes of your Audit Committee or your reports? Who sees them? Is it relatively open or is it restricted to being reported in the annual report and staff get to see what the outcomes are?

Dr SHEPHERD: In order I guess. The stuff that is in the annual report is who is on the Audit Committee, the audit program and those sorts of things. The individual audit reports do not get published in the annual report, for the simple reason that if you look at the volume of the internal audit reports they are quite substantial. But what we do have in place is a rigorous follow-up system in the agency around the audit reports and that operates at a number of different levels. When a draft audit report is received, it is circulated to the areas that are the subject of the audit. They get an opportunity to comment on that and their comments are taken into account by the internal auditors. The report is then brought to the full Audit Committee and it is discussed in the full Audit Committee with the relevant management person present, if that is required in order to discuss the issues further. We then will have a response from the agency to the Audit Committee that says what we are prepared to adopt, what we are not prepared to adopt and the reasons for that. We then keep a schedule of outstanding issues for things that have not been implemented, because they were due to be done over successive years or whatever, and that schedule is followed up by the manager of internal audit and the relevant executive director, who is the executive director governance in this case, and then the Audit Committee considers that schedule at each of its meetings.

We have been in the process over the last two or three Audit Committees of trying to tidy up the backlog of recommendations on the schedule that are no longer relevant. We also have a formal process in place. If we are not going to continue with a recommendation that was made that was agreed previously. If it is sitting on the schedule as an incomplete action, and there become good reasons in the agency for no longer pursuing that, so something might have changed or whatever, then it has to come to me for sign-off. It must come to the Director General for authority to disengage from that recommendation, and then that is reported back to the Audit Committee. So there is a pretty solid follow-up system for internal audit recommendations.

CHAIR: On the internal Audit Committee, I note your response to question 9, looking at the qualifications of members of the Audit Committee. Do I take it from that answer that besides the independent people that you put on there who have very obvious expertise as were do you choose the members of that committee on their role within the organisation as opposed to their having good qualifications in audit?

Dr SHEPHERD: The answer to question 9 that we provided was really based on the fact that this is a non-issue for the Department of Community Services. It is not a statement of principle about what you would do under different circumstances. If you look at the people on our Audit Committee, the two externals were obviously chosen for particular expertise, the two independents. The internals are chosen for their relevance to the audit function. So you have got the executive director governance sits on the committee and so on. I can give you a list of those people. The other externals are there as observers, and they are the two members of the Audit Office, who are obviously auditors, and the relevant partner from Ernst & Young, because we outsource our internal audit, and the manager of the audit function. So there are a substantial number of people around the table who

have audit qualifications, as well as people who have a strong and direct interest in the particular management functions that would be associated either with the particular audit or with audits in general.

We have only got one internal auditor as such, and that is the person who manages the internal audit function and he is qualified and holds the relevant practice and requirements to be an internal auditor. If we had not outsourced it to Ernst & Young, and with that large number of externals on the committee, if you had a different model in which DOCS employed all of its own auditors, then I think you would try to have on the Audit Committee the qualifications and so on of the people engaged in the external audit. The fact is that Ernst & Young have more than enough people capable of doing an audit and we do not really need to inquiry behind the face of that company, except that we do have in our contract the capacity, if they put a different person on a particular audit, to examine the qualifications of that person and to accept or reject, which is what we do.

Ms BEREJIKLIAN: Could you please explain to us the scope of the risk management and compliance strategies that the Audit Committee undertakes? Do you regard those functions as a key part of the Audit Committee's role or do you have separate parts of the department which deal with those?

Dr SHEPHERD: My view is that risk management is a primary function of the agency and not the Audit Committee, but I will expand on that. Theoretically, I am responsible for risk management within the organisation because I am accountable for risk, as I said previously, but in reality the executive collectively is responsible for setting up the risk profile and dealing with risk management across the spectrum of the things that we do. The Audit Committee's role in risk management, as far as I am concerned, is to examine the process that we have undertaken to develop the risk profile, to advise on the content of the risk profile, which is what they have just done at the last Audit Committee meeting, and then to monitor the implementation of any strategies that are associated with the risk profile. I think they are really the respective roles of the two parts of the function, and they get the full risk profile and they do follow it up.

Ms BEREJIKLIAN: What about compliance? Is compliance part of the Audit Committee activity or do you have a separate area for compliance?

Dr SHEPHERD: In what sense?

Ms BEREJIKLIAN: In a sense of adhering to your department's guidelines in relation to the legislation or statute.

Dr SHEPHERD: The Audit Committee signs off on the audit program, again which is something which we did at the last Audit Committee meeting, and the audit program is divided up into a number of different areas, one of which is routine compliance, with the sorts of things that you describe, and we allocate a certain proportion of the time available for internal audit to that function. The Audit Committee will receive all of the reports in relation to the compliance function and will also do all of the monitoring of the implementation of the recommendations, as I outlined earlier. So they do have a role in that sense in overseeing the compliance function. Obviously, I have got an interest in compliance, because clearly I need to comply, but the external auditors also have a very strong interest in compliance. So you get two strands of compliance auditing, one of which is really closely supervised by the committee and the other which is supervised by the Audit Office, the external audit.

Ms BEREJIKLIAN: Does your Audit Committee accept targets for measurables within the organisation?

Dr SHEPHERD: No.

Ms BEREJIKLIAN: Which body would manage that?

Dr SHEPHERD: That is a multi-faceted one.

Ms BEREJIKLIAN: For example, the DOCS help line?

Dr SHEPHERD: The operating standards there are set by the organisation after consideration of a broad range of things associated with call centres and similar organisations around the world, and so you set the benchmarks and the standards according to that and then you monitor that very closely. The Audit Committee would not normally get involved in monitoring the help line statistics. The Minister gets involved in monitoring the help line statistics, which I would have thought is how it should operate.

Ms BEREJIKLIAN: But hypothetically, if the statistics were outside the bounds of the targets set, for example, would that be brought to the attention of the Audit Committee or would that be dealt with outside of the scope of the Audit Committee?

Dr SHEPHERD: There are a couple of ways that that could come onto the agenda. The Audit Committee members are at liberty to raise anything in Audit Committee meetings that are relevant to the functions of the organisation. If they had a strong view about something connected with the help line because of something they had come across or something they had seen in the annual report, what we would normally do would be to discuss that at the time the audit program was being developed for the year and then to put an audit in place to do it. In the case of the help line, it is being done by an external performance audit from the Audit Office, which is what I requested to have done, because I thought it was important to have an external body do that particular audit.

For other things, normally the Audit Committee does not generally rove over the department. There are a number of watchdog bodies that sit over the Department of Community Services that get interested in these things. You would just be adding another group to the oversight. I think really the Audit Committee's function is to look at what we do internally, to determine what the audit plan is and then to make sure that audit plan is followed through. If there were an oddball thing came up that the Audit Committee felt very strongly about, we do have a few reserve days of audit sitting in the audit plan. You always keep a few up your sleeve in case something that happens that you think you need to pursue.

CHAIR: In response to your answer to question 11, where you say you understood that the Audit Office fees were fixed, is that your understanding as written?

Dr SHEPHERD: Theoretically, the fees are not fixed in the sense of a prescribed fee, and I accept that, but in practical terms they are not readily negotiable by the agency and there are reasons for that. DOCS is not in the business of external audit, and the only way that we could assess the appropriateness of proposed audit fees would be by either getting hold of an industry benchmark or going to the market for quotes. There is no other way of determining what is reasonable. I am not aware of any industry benchmark that would apply, which is published anyway, that would show an appropriate external audit fee for an agency like a department with our level of staffing and so on. In the number of offices that we have we are quite different to other agencies. We have 87 community service centres. The other point is that the Audit Office has a monopoly on our external audit. So it is not as if I can go anywhere and get realistic quotes from other players. If I go to the market for quotes for an external audit, no-one is going to quote because they know that there is a statutory monopoly sitting there in the Audit Office. So in realistic terms, I am not in a position to argue with the Auditor-General about the fees. I could say they are too high or too low but if he comes back to me I have got nothing to debate. My view is that theoretically they are not fixed but in practice they are and I have to accept that.

CHAIR: Do you think that the rigour of your internal audit assists your external auditor in keeping fees low?

Dr SHEPHERD: That is a complex question in a sense because you would need to know exactly what the relative hourly rates were. It may be cheaper if the external auditor's rates were lower than Ernst and Young's to have a much bigger program of external audit, but the problem with

that is that I cannot direct the external audit and really, if the purpose of this exercise is to give me maximum satisfaction about the system that I have in place in order to keep this department on the rails and to meet my responsibilities to the Minister, then it is pretty important that I can direct where that audit goes. I think the only thing that is important in there is that the external auditor is sitting at the table at the same time as the program is developed, so the external auditor has an opportunity to say, okay, I would actually be interested in you doing more internal audit on this particular area, which in fact is one of the things that happened at the last audit committee meeting.

Mr McLEAY: Going back to the external auditor, aside from pricing, would you see the rest of the process as reasonably transparent?

Dr SHEPHERD: I think it is transparent. I think they put their issues on the table at the audit committee. The first item at every audit committee meeting, once you have got rid of the minutes and all that sort of stuff, is in fact the external audit update. They bring any issues of concern either in terms of their current audit or things that have not been followed up or things that they are not happy with from the implementation schedule that I mentioned earlier, and they come back to us with a management letter, which you are aware of. They are prepared to take our issues into account. I am happy to say that, whilst I have had skirmishes, as you would be aware, with the Auditor General from time to time, as you do with any oversighting agency, their process is pretty good and I think they do it in a fair and transparent manner. I have no complaints.

Mr McLEAY: Have you found their best practice guidelines useful?

Dr SHEPHERD: I have not looked at them recently, but I certainly did when we were setting up the audit committee, or resetting, a couple of years ago. Yes, they were useful. I don't agree with all of them as I have indicated, but we take the ones that, after reasonable consideration, we think are reasonable.

Mr McLEAY: Whilst they have done a broad review of independents, they recommend that directors general not chair the committee. Since you made that decision, have they ever voiced a concern about it?

Dr SHEPHERD: Not to my knowledge, or I don't remember it. They may have raised it, but it is not an ongoing issue that is raised at every audit committee meeting and would not make much sense if it was.

CHAIR: Do you get involved with other internal audit committees of different agencies, whether intra or interstate, to discuss how they are managing their internal audits?

Dr SHEPHERD: There have been a number of informal approaches, if you like, from other directors general about how we run our audit committee and I have had discussions with a couple of them in recent weeks. Obviously, as a director of Business Link Pty Limited, we are in the process of setting up an internal audit committee there which will be quite different to the one that we run in the Department of Community Services because there you will not have the director general of the agency, if you like, actually chairing the committee, it will be a board member who chairs the committee, which is entirely appropriate, and probably the chair of the board in that case, although that is not finally determined.

(The witness withdrew)

(The Committee adjourned at 10.05 a.m.)