

**INQUIRY INTO BUDGET PROCESS FOR INDEPENDENT
OVERSIGHT BODIES AND THE PARLIAMENT OF NEW
SOUTH WALES**

Organisation: Auditor-General of New South Wales
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Mr David Shoebridge MLC
Chair
Public Accountability Committee
Parliament House
Macquarie Street
SYDNEY NSW 2000

16 October 2020

Dear Mr Shoebridge

**Submission to inquiry into the budget process for independent oversight
bodies and the Parliament of New South Wales**

Thank you for the opportunity to make a submission to the Public Accountability Committee's inquiry into the budget process for independent oversight bodies and the Parliament of New South Wales. I trust my submission will assist the Committee in the conduct of its inquiry.

Yours sincerely

Margaret Crawford
Auditor-General for New South Wales

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Executive summary

The Audit Office of New South Wales (the Audit Office) holds a privileged position as one of a small number of independent agencies that supports accountability and provides assurance that is integral to our system of government. The role of the Auditor-General in New South Wales has a proud history stretching back to 1824. Its core purpose, to scrutinise and hold government to account, has not wavered in all this time.

Being a largely self-funded organisation, the Audit Office has consistently operated within its means; planning and managing with the resources that are available to it. The Audit Office has historically planned its performance audit program to fit its funding envelope, which has sometimes resulted in audit requests made by members of parliament and the public being declined or deferred.

As a result of being largely self-funded, the Audit Office has been mostly distant from the budget bid process that underpins the annual NSW State Budget. Only in recent times has the Audit Office sought additional funding to deliver its performance audit program.

While the Audit Office has largely operated without direct involvement from the Executive Government, the current cluster arrangements, the imposition of efficiency savings, and expenditure control limits have the potential to threaten the independence of the Auditor-General and the Audit Office.

As outlined in this submission, the International Organization of Supreme Audit Institutions (INTOSAI) international standard for protecting the independence of an audit institution, known as the *"Mexico Declaration on SAI Independence"*¹, supports the notion of a legislative committee having some oversight of the resource needs of the Audit Office. It also supports the notion that the Auditor-General should have financial and managerial/administrative autonomy and the availability of appropriate human, material and monetary resources in fulfilling the audit mandate.

Overview of the Audit Office of New South Wales

Vision and purpose

The Audit Office conducts audits for the Auditor-General for New South Wales. The Audit Office's purpose is *"To help parliament hold government accountable for its use of public resources"* while its vision is to generate *"insights that inform and challenge government to improve outcomes for citizens"*.

Legislative mandate

The Audit Office is a statutory authority, established under the *Public Finance and Audit Act 1983*. The Audit Office conducts financial and performance audits, principally under the *Public Finance and Audit Act 1983* and the *Local Government Act 1993*.

Financial audits provide an independent opinion on NSW government entities', universities' and councils' financial statements. They identify whether their financial statements comply with accounting standards and relevant laws, regulations and government directions.

Performance audits review whether public money is spent efficiently, effectively, economically and in accordance with the law.

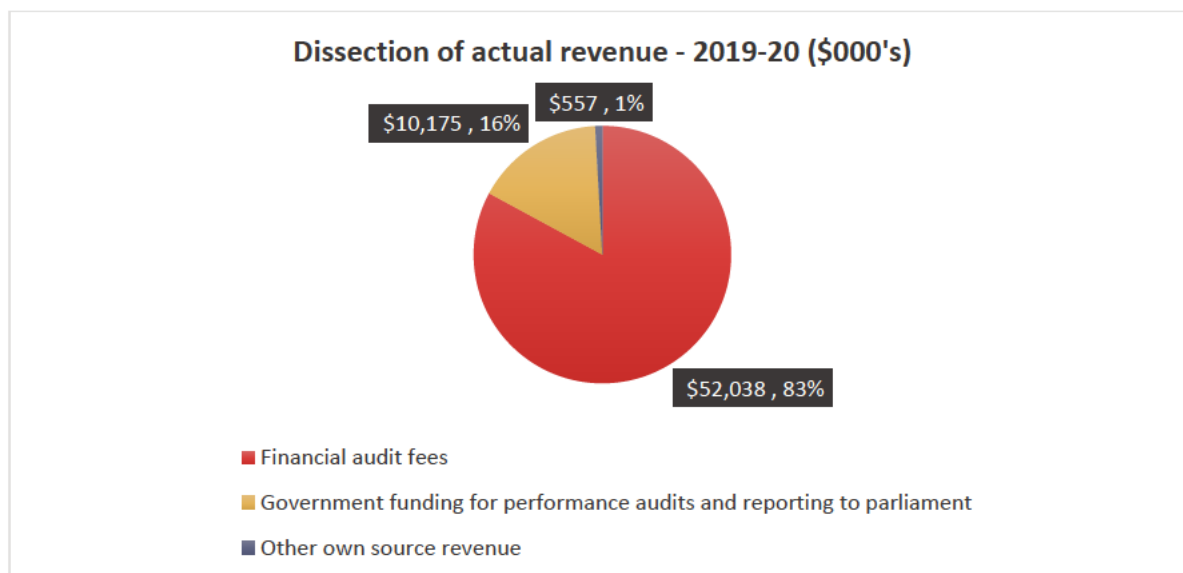
The Auditor-General can also be requested by the Treasurer, a minister or both Houses of Parliament to perform other audit or audit-related services. These can include audits of agencies' compliance with specific legislation, directions and regulations.

¹ See https://www.intosai.org/fileadmin/downloads/documents/open_access/INT_P_1_u_P_10/INTOSAI-P-10_en.pdf

How the Audit Office is funded and its sustainability

Source of funding

The Audit Office is largely self-funded. Most of the Audit Office's revenue comes from charging auditees the cost of conducting their financial audit. The Audit Office also receives a government contribution to cover the cost of carrying out performance audits and the cost of reporting to parliament the results of its financial audits. The breakdown of the Audit Office's 2019-20 actual revenue is shown in the chart below.

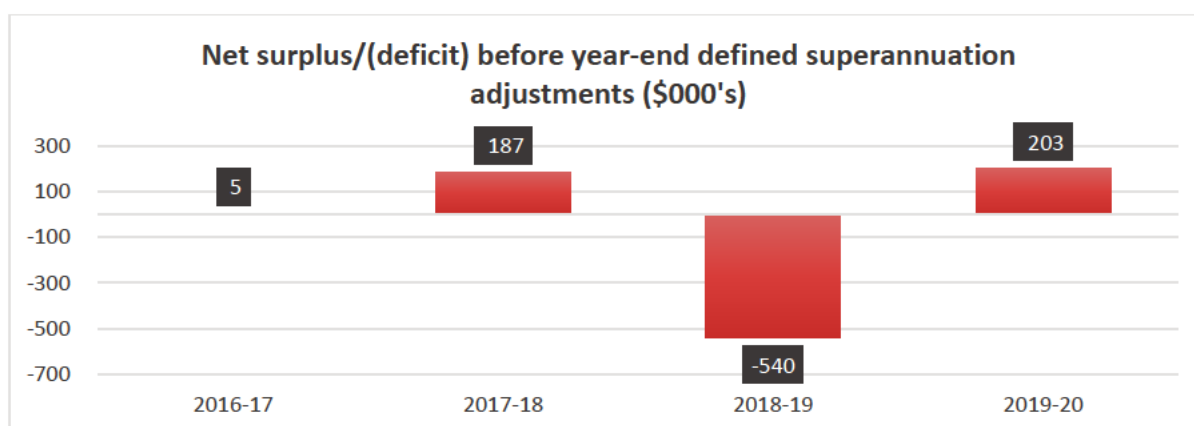


In 2019-20, the Audit Office generated \$52.0 million, or 83 per cent of its total revenue from charging auditees the cost of conducting their financial audit. Sections 43(3), 45(3) and 45I(3) of the *Public Finance and Audit Act 1983* and section 422(3) of the *Local Government Act 1993* provide the authoritative source for charging auditees the cost of these audits.

The Audit Office's other main source of revenue is the government contribution towards performance audits and reporting the results of financial audits to parliament. In 2019-20, this contribution from the government was \$10.2 million, or 16 per cent of the Audit Office's total revenue.

The Audit Office's financial objective

The Audit Office operates on a cost recovery basis and seeks to break even over the medium term of four years. The Audit Office's financial performance over the last four years is summarised in the chart below. These results are before the year end actuarial adjustments for defined superannuation liabilities, which are outside the Audit Office's control.



In some years, the Audit Office has recorded a surplus, while in others it has operated at a loss. This fluctuation is caused by factors such as the deferral of expenditure, capital investment and other one-off transactions. Despite some years of surpluses and other years of deficits, the Audit Office has kept to its objective of breaking even over the medium term, including in more recent years where the Audit Office has absorbed the cost of standing up the local government mandate and related transitional costs.

The objective of breaking even is becoming harder with the need for the Audit Office to make significant investment in new ways of working, such as data analytics, and at the same time limit fee increases to auditees. The long-term nature of capital investments means this investment does not translate to immediate efficiency gains, but they are important to ensuring the Audit Office's capability remains relevant.

How the State Budget process has applied to the Audit Office

Recent budget bids by the Audit Office

Being largely self-funded, the Audit Office has not been extensively exposed to the budget bid process for additional funding that underpins the preparation of the NSW State Budget. Only more recently, as part of the 2020-21 State Budget process, did the Audit Office submit a 'Parameter and Technical Adjustment' (PTA) seeking additional funding to cover the increased cost of delivering the performance audit mandate. The PTA was submitted directly to NSW Treasury.

The last time the Audit Office received a budget enhancement to its government contribution was in 2016-17. This was for two to three additional performance audits in recognition of the Auditor-General's appointment as the auditor of local councils in New South Wales.

In addition to the recent request for additional government funding for the performance audit program, each year the Audit Office has sought budget adjustments relating to the timing of when it expects to incur expenditure, changes between what is classified as capital and operating expenditure, and changes to the Audit Office's audit fee revenue because of changes to the auditee base. Historically, the Audit Office's budget and expenditure control limits have been done in consultation with NSW Treasury staff. Information on these adjustments were shared with DPC given the Audit Office is placed within the DPC cluster.

Application of efficiency savings to the Audit Office

In 2016-17, 2017-18 and 2018-19, the Audit Office was exempted from the government's efficiency savings. It is understood that this exemption was granted because the Audit Office is largely self-funded. However, in 2019-20, DPC advised that the efficiency savings announced as part of the 2019-20 State Budget would apply to the Audit Office.

The reason for this change was not communicated to the Audit Office, nor was the Audit Office consulted in determining the amount allocated to it. In September 2019, the Audit Office advised DPC that it disagreed with how the saving had been calculated. DPC allocated efficiency savings of \$483,000 to the Audit Office in 2020-21, increasing to \$740,000 in 2028-29.

At the time of preparing this submission, the matters of applying efficiency dividends to the Audit Office and the quantum remain unresolved. The Audit Office has not processed a budget adjustment in NSW Treasury's Prime system to reflect the allocation of efficiency savings over the forward estimates and planning years.

Whilst the Audit Office has been exempted from the government's efficiency savings in past years, it has nevertheless imposed its own internal savings to minimise price increases to auditees while also remaining financially sustainable.

The importance of having an independent Auditor-General and Audit Office

The Auditor-General and the Audit Office play an important role in helping the Parliament of New South Wales hold the NSW Government to account for its use of public resources. The Auditor-General and the Audit Office can only be objective and effective if they are independent from the audited entity and are protected from outside influence. Any perceived or actual compromise of independence can have a detrimental impact on the parliament's and/or the public's trust in the effectiveness of the Auditor-General and the Audit Office. Protecting the reputation of the Auditor-General and Audit Office is vital.

INTOSAI Mexico Declaration on SAI Independence

The International Organization of Supreme Audit Institutions (INTOSAI) has issued an international standard which outlines the framework for protecting the independence of an audit institution. It is known as the *"Mexico Declaration on SAI Independence"*² and it recognises that audit institutions should have the functional and organisational independence required to carry out their mandate. It is a standard the Audit Office advocates for and supports the underlying principles.

The eight principles within the *Mexico Declaration on SAI Independence* are:

Principle 1	The existence of an appropriate and effective constitutional/statutory/legal framework and of de facto application provisions of this framework.
Principle 2	The independence of SAI heads and members (of collegial institutions), including security of tenure and legal immunity in the normal discharge of their duties.
Principle 3	A sufficiently broad mandate and full discretion, in the discharge of SAI functions.
Principle 4	Unrestricted access to information.
Principle 5	The right and obligation to report on their work.
Principle 6	The freedom to decide the content and timing of audit reports and to publish and disseminate them.
Principle 7	The existence of effective follow-up mechanisms on SAI recommendations.
Principle 8	Financial and managerial/administrative autonomy and the availability of appropriate human, material, and monetary resources.

A self-assessment against the eight principles is at Attachment A. Given its relevance to the Public Accountability Committee's inquiry, an analysis against the details within principle 8 follows.

Principle 8 - Financial and managerial/administrative autonomy and the availability of appropriate human, material, and monetary resources

SAIs should have available necessary and reasonable human, material, and monetary resources — the Executive should not control or direct the access to these resources. SAIs manage their own budget and allocate it appropriately

The Auditor-General has the discretion to determine how to use available resources, but within the confines of the NSW Government financial management framework. This includes having to comply with Treasurer's directions and expenditure control limits (including any efficiency savings) imposed through the annual budget process, unless they conflict with the Audit Office's statutory functions.

² See https://www.intosai.org/fileadmin/downloads/documents/open_access/INT_P_1_u_P_10/INTOSAI-P-10_en.pdf

Unlike other integrity agencies in the DPC cluster, the Audit Office operates outside of the Consolidated Fund. The Audit Office operates within the government's Special Deposit Account. The Audit Office does not receive an annual appropriation and therefore is not subject to the annual Appropriation Act.

The Treasurer has established a working account within the Special Deposits Account, which enables the Auditor-General to manage the Audit Office's funding in accordance with the terms of the working account. This includes complying with all applicable requirements in the *Government Sector Finance Act 2018* and regulations. This means the Auditor-General retains ultimate accountability for the Audit Office's expenditure. However, the Treasurer retains the authority to close the working account at their discretion.

Despite operating outside the Consolidated Fund, it is expected the Audit Office operate within agreed expenditure control limits and in a way that complies with directions issued by the Treasurer. The expenditure control limits include how much can be spent on employee related costs (enforced through the labour expense cap), how much can be spent on capital purchases (enforced through the capital expenditure authorisation limit) and the overall spend (enforced through the net cost of services limit).

The *Government Finance Sector Act 2018* does provide the Auditor-General with the ability to not comply with directions issued by the Treasurer if it impinges on their statutory role. In such cases, the reason(s) for non-compliance must be given to the Treasurer or Minister who gave the direction as soon as practicable after it is decided to not comply. The reason(s) for non-compliance must also be published in the Audit Office's annual report.

The Legislature or one of its commissions is responsible for ensuring that SAs have the proper resources to fulfil their mandate

There is no legislative committee that is responsible for ensuring the Audit Office has the proper resources to fulfil its mandate. Presently, the Public Accounts Committee's functions are limited to examining the opinion or any report of the Auditor-General transmitted with the consolidated financial statements and general government sector financial statements, and any other report laid before the Legislative Assembly by the Auditor-General.

SAs have the right of direct appeal to the Legislature if the resources provided are insufficient to allow them to fulfil their mandate

The Audit Office does not have a formal direct appeal to the Parliament of New South Wales if the resources provided are considered insufficient.

Independence threats caused by not having financial and managerial/administrative autonomy

The INTOSAI principle of the Auditor-General having complete financial and managerial/administrative autonomy is important in managing perceived and actual threats to independence. Under the current NSW Government financial management framework, the Audit Office and Auditor-General is, at times, faced with independence threats because NSW Treasury operate the State budget process at a cluster level, including the allocation of efficiency savings. Under this approach, there is a general expectation that agency budget pressures are managed within the cluster. It is also the responsibility of the principal department to allocate whole of government efficiency savings to agencies within its cluster.

Independence of Auditors General

The Australian Council of Auditors General (ACAG) recently issued a report on the independence of Auditors General across Australia and New Zealand³. The report surveyed each jurisdiction's legislative framework to determine the extent of each Auditors General independence according to the INTOSAI principles. This is the third time ACAG has commissioned such as a report, with the first released in 2009.

³ See <https://www.acag.org.au/files/Final%20Report%20on%20Independence%20of%20Auditors%20General.pdf>

The report concluded the Auditor-General for New South Wales continues to score lower on overall independence relative to many other jurisdictions, including New Zealand, Victoria, Queensland, Western Australia, Tasmania and the Australian Capital Territory. The report concluded the *“independence safeguards continue to be less well developed in New South Wales”*. Some of the reasons for this include: not having standalone audit legislation; not having the independence of the Auditor-General explicitly mandated; and not having a mandate that is as broad as other jurisdictions.

In terms of the INTOSAI principle around financial and managerial/administrative autonomy, the ACAG report found there is a wide variation in financial and managerial/administrative autonomy across audit offices. Relative to other jurisdictions, the Auditor-General for New South Wales scores well in terms of autonomy in appointing staff and running the Audit Office. This is because staff are employed outside the public service and the Auditor-General has control of, and is the accountable authority for, the Audit Office. But the area where the Audit Office does not score well is around financial independence.

The ACAG report found that models, such as the one in New Zealand, where Parliament decides the level of funding for the Auditor-General, provides stronger protection than a model whereby the Auditor-General's budget is determined by the Executive.

How the Auditor-General and Audit Office remain accountable

Quadrennial review by the Public Accounts Committee

At least once every four years, the Public Accounts Committee conducts a review of the Auditor-General and Audit Office's activities in accordance with section 48A of the *Public Finance and Audit Act 1983*. The review examines the auditing practices and standards of the Auditor-General and determines whether the Auditor-General is complying with those practices and standards in carrying out their functions. The most recent review was conducted in 2017.

The statutory review by the Public Accounts Committee is an important and effective mechanism in the Audit Office demonstrating its accountability as a prudent manager of financial resources. It also provides structured oversight by Parliament of the performance and financial management of the Audit Office.

The 2017 quadrennial review of the Audit Office⁴ found the Audit Office had sound processes and controls in place, and that the Office was engaged in several strategic initiatives aimed at driving its future direction. However, the review did make four specific strategic recommendations which the reviewer concluded *“are important [in ensuring] that the Audit Office continues to meet its objectives of remaining effective in delivering its mandate and providing value for money to Parliament and the public”*. The four strategic recommendations, listed below, remain unactioned.

1. Follow the dollar – the review acknowledged that the Auditor-General does not have the authority to directly examine performance outcomes from services delivered by the private sector and Non-Government Organisations (NGOs). This limits the ability of the Auditor-General to ensure that public money is being spent in an accountable manner.
2. Assurance over performance-based outcomes – the review recognised that increasingly government agencies are reporting performance-based outcomes in their annual reports and there would be benefits in this information being subject to independent assurance. Some form of assurance would ensure the information is useful, reliable and accurate.
3. Review of the State Budget – the review highlighted that given the importance of the State Budget and, to be consistent with other jurisdictions, there is value in the Auditor-General's mandate being updated to include an annual review of the State Budget.
4. Local council mandate - the review recognised there would be a greater level of investment in the initial years of auditing the sector to improve accountability and financial compliance. It recommended additional funding during the transition period to help the Audit Office effectively stand up the new mandate without having to reallocate resources from other critical strategic initiatives.

⁴ See

<https://www.parliament.nsw.gov.au/ladocs/inquiries/2474/Quadrennial%20Review%20of%20the%20Audit%20Office%202017.pdf>

Attachment A – Self-assessment against the INTOSAI Mexico Declaration on SAI Independence principles

Principle	Self-assessment
Principle 1 - The existence of an appropriate and effective constitutional/statutory/legal framework and of de facto application provisions of this framework.	Largely exists - the role of the Auditor-General and the Audit Office is governed by the <i>Public Finance and Audit Act 1983</i> and the <i>Local Government Act 1983</i> . Unlike other jurisdictions, the Auditor-General is not identified as an 'independent officer of the Parliament'.
Principle 2 - The independence of SAI heads and members (of collegial institutions), including security of tenure and legal immunity in the normal discharge of their duties.	Largely exists - the appointment, re-appointment, employment, removal and retirement of the Auditor-General is governed by provisions in the <i>Public Finance and Audit Act 1983</i> . The Auditor-General is appointed by the Governor for a fixed non-renewable term of eight years.
Principle 3 - A sufficiently broad mandate and full discretion, in the discharge of SAI functions.	<p>Partly exists - The Auditor-General has the mandate to audit the use of public monies, financial reporting, and the economy, efficiency, and effectiveness of government entities or operations. The Auditor-General is also free from direction or interference from the Parliament and the Government in the:</p> <ul style="list-style-type: none"> • selection of matters for audit • planning, programming, conducting, reporting and following up audits • organising and management of the Audit Office. <p>The Auditor-General does not have the mandate to audit non-public sector organisations that provide public services for the government (follow the dollar mandate), and nor does it have the mandate to systematically audit agencies' performance-based outcomes. Some of the other audit offices in Australia do have this mandate.</p>
Principle 4 - Unrestricted access to information.	<p>Largely exists - The Auditor-General and the Audit Office has the power to obtain all necessary documents under section 36 of the <i>Public Finance and Audit Act 1983</i> and section 423 of the <i>Local Government Act 1993</i>, except for:</p> <ul style="list-style-type: none"> • documents that are classified as 'cabinet in confidence' • documents that are subject to legal professional privilege. <p>The Auditor-General can request access to documents that are classified as 'cabinet in confidence' via a formal request to DPC.</p>

Principle	Self-assessment
Principle 5 - The right and obligation to report on their work.	Exists - The Auditor-General has reporting mechanisms (including rights and obligations) under the <i>Public Finance and Audit Act 1983</i> and the <i>Local Government Act 1993</i> .
Principle 6 - The freedom to decide the content and timing of audit reports and to publish and disseminate them.	Exists - The Auditor-General is free to decide the content of audit reports; having the ability to make observations and recommendations after considering the views of the auditee. The Auditor-General also decides on the timing of audit reports.
Principle 7 - The existence of effective follow-up mechanisms on SAI recommendations.	Exists - The Audit Office follows up on recommendations through several ways, including management letters to auditees, and follow up of performance audits and reports to parliament on the results of financial audits. The Public Accounts Committee also reviews the Auditor-General's reports and conducts follow up reviews to ensure agencies have appropriately responded to the Auditor-General's recommendations.
Principle 8 - Financial and managerial/administrative autonomy and the availability of appropriate human, material, and monetary resources.	Partly exists – see submission for more detail.