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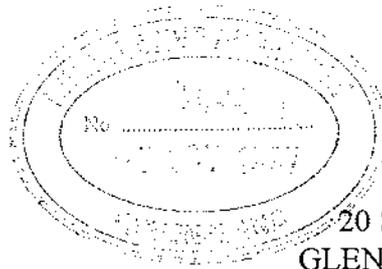
REPORT OF THE STRATEGIC REVIEW OF THE QUEENSLAND AUDIT OFFICE

PURSUANT TO S72 OF THE *FINANCIAL ADMINISTRATION AND AUDIT ACT 1977*

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25 August 1997

The Honorable Rob Borbidge MLA
Premier
PO Box 185
Albert Street
BRISBANE QLD 4002

Dear Premier

Herewith is my Report on the Strategic Review of the Queensland Audit Office. It contains your comments on the Report that I sought in accordance with Section 72 (9) of the Financial Administration and Audit Act 1977.

I appreciated the opportunity to conduct the Review which I found both challenging and rewarding. I hope the Report is seen as making a positive contribution to the public sector accountability process which is the cornerstone of good government both in Australia and elsewhere.

It is regretted that my commitments in South Australia resulted in what must appear to be a lengthy time to complete the task. However I can assure you that the actual time spent on the Review was considerably less than the overall lapsed time.

I also would wish to express my thanks to Mr John Sosso and Dr Harold Thornton for the excellent administrative arrangements they made available to me, which made the task much easier than it might otherwise have been. I also wish to acknowledge the willingness of the Auditor-General (Mr Barrie Rollason) in making his Executive Officer (Mr Michael Morris) available to me during the Review and for the willing co-operation of the staff of the QAO. In particular Michael was a considerable source of advice and assistance and his prompt and pleasant manner in dealing with requests for information was much appreciated.

Yours sincerely

T.A. Sheridan
QAO Strategic Review

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EXECUTIVE SUMMARY

Key Points

- **The independence of the Auditor-General is fundamental to the Westminster System of government.**
- **The Queensland Auditor-General, through the QAO, conducts a sound public sector audit practice.**
- **The operation and the image of the QAO has improved significantly over the past 5 years.**
- **The independence of the Auditor-General is at risk through a restricted mandate and the resourcing process.**
- **The Corporate organisation and culture needs improvement.**
- **The Corporate Vision and Reporting to Parliament needs to be widened.**

Office of Auditor-General *(Chapter 1)*

- Disclosure and accountability to the Parliament is the cornerstone of the Westminster System of government.
- The independent Office of Auditor-General is fundamental to that System
- **History clearly shows that any action which weakens the independent accountability process is fraught with danger.**
- One only has to turn to relatively recent events in both South Australia and Victoria, where decisions, seen by some as well intentioned at the time, saw the Auditor-General bypassed as the external auditor of the State Bank in each of those States.
- As a consequence and more significantly, the independent accountability process to the Parliament also was bypassed.
- The community of both South Australia and Victoria paid a very high price.

Queensland Audit Office

Past 5 years

(Chapter 2)

- Legislative, management and operational changes implemented over the past 5 years have significantly enhanced the efficiency, economy and effectiveness of the QAO
- The Auditor-General and his staff are entitled to credit for those changes.
- It would be unfortunate if issues arising from this Strategic Review were seen to diminish in any way the importance of what has been achieved.
- **Those issues should be seen as no more than the next logical step in a program of continuing management improvement in the QAO**

Strategic Review

Independence

(Chapter 4)

- A wide legislative mandate and adequate resourcing are two of the important elements in the functional independence of an Auditor-General.
- In the Queensland context there is cause for concern with respect to each of those elements. Present legislation is (and in the case of resourcing could at least be seen to be) restricting the Auditor-General's independence, with consequent effect on accountability to the Parliament.

Mandate

- There is now general acceptance that the focus of public sector auditing should be extended to incorporate reviews of economy, efficiency and operational effectiveness with respect to an auditee's operations (the performance audit).
- That extended mandate has been introduced to many overseas audit jurisdictions and in all Australian audit jurisdictions, with the exception of Queensland and the Northern Territory.
- In the case of Queensland the extended mandate has been restricted to an audit of performance management systems.
- To restrict the Auditor-General's role in this area and for Parliament to rely solely on an entity's own assessment of its performance overlooks 2 important factors:-
 - (a) **an independent assurance that adequate systems are in place**, to assess whether an entity's objectives are being achieved economically, efficiently and effectively **is no guarantee, by itself, that actual performance measures up to that criteria.**

- (b) **an assurance on actual performance by an entity through its responsible Minister to the Parliament leaves open to question the impartiality of that assurance.** It is stressed that the integrity of the persons providing that assurance is not questioned, but rather the recognition of an understandable degree of self-interest that can exist in the nature of the reporting framework.
- Bicameral Parliaments within Australia and overseas have accepted the need for the extended mandate. That extended mandate is no less important in an unicameral Parliament.
- **To stand apart from the mainstream and restrict the Auditor-General's mandate and Parliament's right to that level of independent information and advice, runs the real risk of the Parliament and the community, including the business community, losing confidence not only in the accountability process, but ultimately in the Executive Government also.**
- Performance audit, properly managed, has the proven potential to deliver significant benefits. There is evidence to show that it makes a significant contribution to effective public sector management and to effective resource use.
- It can (and must) do so without transgressing the area of government policy objectives.
- **This review strongly supports the extension of the Auditor-General's mandate to incorporate a complete program of performance audit.**
- **This Review recommends that:-**
 - (a) the Financial Administration and Audit Act 1977 be amended to permit the Auditor-General to examine and report on the economy, efficiency and effectiveness of the operations of any public sector entity for which the Auditor-General is the auditor;
 - (b) the Auditor-General exercise his/her discretion as to the degree of emphasis to be given to economy, efficiency and operational effectiveness in the conduct of a particular performance audit;
 - (c) the conduct of any performance audit be reported in accordance with Division 3 of Part 6 of the Financial Administration and Audit Act 1977;
 - (d) there be close consultation between the Auditor-General, the Public Accounts Committee and the Public Service Commissioner on public sector management issues.

Resources

- The question of resources for Auditors-General both within Australia and elsewhere has been the subject of debate for many years.
- Central to the debate is the notion that it is not appropriate for an auditee of the Auditor-General (Treasury Department) to recommend to Government the funds to be appropriated to the Auditor-General for the discharge of his/her responsibilities.

- Implicit in all concerns expressed on this issue is recognition of situations which inevitably arise, where resource requirements seen by the Auditor-General as essential to meet his/her statutory responsibilities, are being determined by an auditee (Treasury Department; Treasurer) at a time when the auditee may not feel comfortable with an Auditor-General's audit findings.
- The fact that the auditee may be unable to meet the Auditor-General's requirements, may not in itself be sufficient to placate the perception.
- The Commonwealth Parliament has moved to resolve this issue, with legislation now before it that requires the Joint Committee of Public Accounts to review the annual budget of the Australian National Audit Office (ANAO) and recommend the level of resource requirements for the ANAO.
- That approach has much to commend it. It would remove the perception that the Auditor-General's independence and mandate is at risk. It would add also to the Auditor-General's own accountability to the Parliament.
- **This Review believes it is essential for the question of the Queensland Auditor-General's independence in this matter to be put beyond doubt.**
- **This Review recommends that:-**
 - (a) the Financial Administration and Audit Act 1977 be amended to require:-
 - (i) the Auditor-General to submit the estimates of revenue and expenditure for the QAO to the Public Accounts Committee each financial year;
 - (ii) the Public Accounts Committee to review with the Auditor-General the performance of the QAO for the current year and the resource requirements for the year in prospect;
 - (iii) the Public Accounts Committee, on behalf of the Parliament, recommend to the Government the level of resources to be made available to the QAO for the year in prospect, taking into account Government requirements for budgetary constraint.
 - (b) the appropriation for the QAO be a "one-line" appropriation, or alternatively the Auditor-General be given freedom to transfer funds between individual lines within that appropriation, provided the total appropriation for the QAO is not exceeded and/or there is no additional carry-over commitment to the next financial year.

Corporate Management (Chapter 5)

Organisation

- While there is a need to review some management levels within the existing structure, this Review recognises that the incoming Auditor-General (presumably to be appointed within the next few months) may also have a view on organisational matters.

- **This Review believes it would be prudent, at this late stage, to defer action on any organisational change (including those currently in train) so as to ensure that the incoming Auditor-General's view is not pre-empted.**
- The size of the Corporate (Support) Services Branch relative to the size of the QAO seems high. Current initiatives of the QAO to improve the efficiency of processes in that Branch should be supported.
- If the QAO is to maintain a high standard of public sector auditing, then it needs a more flexible classification structure in order to recognise achievement and provide appropriate career prospects.

Planning & Control

- The QAO has adequate procedures in place to plan and control all audits for which the Auditor-General is responsible.
- Some aspects of the process need to be addressed.

Human Resources

- The QAO devotes considerable effort to the recruitment, training, professional development and general well being of its people.
- It has a well qualified, skilled and professional workforce.
- Staff of the QAO are well equipped to perform in management and other appropriate operating roles in the public sector generally.

Delegation

- The Auditor-General has no power of delegation under the Corporations Law.
- Most of the 172 audits for which he is the signing officer are small company audits.
- The First Corporate Law Simplification Act 1995 may provide opportunity for the Auditor-General to delegate those small company audits.
- Alternatively the Auditor-General might consider having some of his staff meet the requirements of and become accredited as company auditors under the Corporations Law.
- Delegation of these small company audits would allow for more effective use of the Auditor-General's time.
- The Auditor-General should explore these opportunities.

Culture

- Staff of the QAO are well qualified, skilled and professional and are dedicated to their work. They are proud of the QAO and what it stands for.
- Notwithstanding that strong and positive attitude the attention of this Review was drawn consistently to 2 matters which seemed to be of concern to staff:-
 - (a) the frustration experienced in the settling of reports and management letters which seem to involve a time consuming and iterative process.
 - (b) the fear of making a mistake or of not been able to stay within the planned time for an audit.
- Fear of making a mistake can lead to over-auditing and an inefficient use of resources.
- **Management needs to urgently address and resolve these concerns.**

Financial and Compliance Audit *(Chapter 6)*

- The Auditor-General, through the QAO conducts a sound public sector audit practice.
- Audits conducted by private contractors for the Auditor-General meet the standards of the QAO.
- The QAO maintains satisfactory control over audits conducted by private contractors.
- The QAO exercises an appropriate level of quality control over all audits.
- Some aspects of the auditing process have been raised with the QAO. They do not detract from the above overall conclusions.

Reporting to Parliament *(Chapter 7)*

- Reports to Parliament by the Auditor-General essentially surround the disclosure of deficiencies in financial, accounting and compliance matters, or in the adequacy and appropriateness of systems to enable management to measure its performance.
- This Review believes that an Auditor-General with his/her wide charter, is in an excellent position to provide an informative and balanced overview on a range of public sector management issues - not just accounting and financial issues.
- This wider reporting role would contribute to public sector management and administration generally and be a useful source of information and advice to the Parliament.
- **This review recommends that the QAO adopt a wider reporting role.**

Information Technology (Chapter 8)

- Information Technology is fundamental to the conduct of an efficient and effective audit practice.
- The need to keep pace with developments in information technology cannot be over-emphasised.
- This Review strongly supports the initiatives being undertaken by the QAO in this important area.

Relationship with Other Bodies (Chapter 9)

- There is a strong relationship between the Public Accounts Committee and the Auditor-General and the staff of the QAO.
- The QAO also has a good professional relationship with the internal audit of public sector entities.

Vision (Chapter 10)

- The vision of the QAO is embodied in 3 corporate goals.
- Those goals focus on auditing and the development of QAO staff to their full potential.
- Those goals have considerable merit and have been instrumental in the significant improvement in the operation and image of the QAO over the past 5 years.
- There is now a general business and professional view that the audit focus, both within the private and public sector needs to be widened, to look beyond an auditee's business to the industry in which the auditee is operating and to potential risks (environmental, health, legal, financial etc) that might impact on the auditee's business.
- The Auditor-General, with his/her wide public sector charter and management experience has a unique opportunity to make a valuable contribution to public sector management and administration. It would also enhance further the image of the QAO.
- **This Review recommends that the QAO adopt a further goal** *"to ensure that we use our best endeavours to contribute to improved public sector management and administration."*



T.A. Sheridan
QAO Strategic Review

19 July 1997

MATTERS OF SIGNIFICANCE

- Section 72(9) of the Financial Administration and Audit Act 1977, requires the person conducting a Strategic Review of the QAO, to give the Minister and the Auditor-General written advice of any matter which the person regards as significant and seek their comment.
- As this is the first Strategic Review conducted under the Act (as amended), I considered it appropriate to provide a complete copy of the Report to both the Premier and the Auditor-General for comment.
- Their comments are included in this Report as Appendix G.
- In general terms the Auditor-General is positive about many aspects of the Report, although he has questioned a number of points regarding the management and operation of the QAO.
- On the other hand the Premier's comments have been confined largely to that part of the Report relating to the independence of the Auditor-General (Chapter 4). While those comments give qualified support to the issues raised in that Chapter, it is important to note that:-
 - (a) regarding resources it is perception that is central to the Review's proposal. It is the PAC's recommendation of the QAO's resources (rather than the PAC receiving the draft estimates of the QAO) that is relevant to overcoming the perception.
 - (b) while regrettably public disagreement has occurred over a few performance audits, there have been many other performance audits undertaken where no such disagreements have occurred.

In these latter cases, both Governments and Auditors-General have been able to draw a distinction between government mandated policy (where an Auditor-General has no power of review) and government operational policy.

This Review remains of the opinion **that the public interest is best served by adopting a positive approach to performance audit and recognising that in most cases that policy distinction can be made** - and in those isolated cases where it may be "blurred" a conservative approach must be taken.

While consultation with the PAC should be encouraged (particularly in cases of "blurred" policy distinction), to limit performance audit to those instances where agreement is reached with the PAC, or to referrals from the PAC, is still to restrict the Auditor-General's mandate and independence.

- As to the comments of the Auditor-General, clarification of 2 matters may help to better understand the thrust of this Report. Those matters are:-

First, the question of the independence of the Auditor-General which this Review has stressed is of fundamental importance in the Westminster System of government.

One element of that independence, the personal independence of an Auditor-General, draws its strength from legislative protection and from the incumbent's own integrity - **and the independence of the Queensland Auditor-General is well served on both counts.**

It is therefore somewhat surprising that the Auditor-General is troubled by the desirability of close consultation with the Office of Public Service (recommendation suggests Public Service Commissioner) other than in its capacity as an auditee of the Auditor-General; he goes on to say that the Auditor-General must stand apart from central agencies in order to maintain objectivity (page 3).

Close consultation should not be misconstrued as direction. **To isolate oneself from the knowledge and experience of others is to tread a narrow path of restricted vision.**

Second, the notion that management and operating improvements suggested in this Report are in conflict with positive comments in the Report about those same functions is hard to understand. The Report stresses (Executive Summary and elsewhere) that issues raised in the Report should be seen as the next logical step in a program of continuing management improvement in the QAO. It would therefore be regrettable if those suggestions were seen as criticism.

• Having said that there also are a few more specific matters which require a brief response.

- (a) to state (page 2) that I have a perception that the *“QAO is driven by some demonic fear of making a mistake”* is a significant over-reaction to the Report and it is indeed a nonsense. The concern is at the low end of the scale and the need for urgent attention is to ‘nip it in the bud’ before it becomes entrenched in the culture.

It goes without saying that an Audit Office must be diligent and professional in its work and reporting and there is nothing wrong in staff giving freely of their time provided they feel comfortable in recording it.

- (b) comments on Corporate Vision and Reporting to Parliament (page 3) seem to imply that the Auditor-General has an exception reporting role on audit matters (including where the financial management of a public sector entity is found wanting), but has no role (unless perhaps specifically requested) as an independent source of information and advice to the Parliament.

The wider role as an **independent source** of information and advice has become increasingly important for Parliaments in recent times given the increasing complexity of government financial arrangements and arrangements for service delivery; and the Parliament’s capacity to assess the multitude of matters that come before it.

Parliament should not have to wait for accrual based accounting and Whole of Government Reporting to obtain a distinction between capital and recurrent expenditure on Consolidated Fund. It can also be provided under cash based accounting.

While current legislation does not specifically identify an information and advice role for the Auditor-General it also does not preclude it.

- (c) as to the review of the QAO’s resources by the Public Accounts Committee (page 4), the question of review again seems to be confused with direction. It is relevant to note that the Commonwealth Auditor-General (Mr Pat Barrett) does not appear to have the same apprehension about the Joint Committee of Public Accounts reviewing and recommending resources of the ANAO. (see Page 60 Guarding the Independence of The Auditor-General 1996).

- (d) on the question of Corporate Management (page 5):-
- (i) it is noted that the size of Corporate Support Services is now projected at 29 and may reduce further, which would bring it close, in relative terms, to the South Australian Audit Office. In comparing the QAO with that Audit Office it is relevant to note the somewhat unique position of the QAO, where 241 of its 580 audits involve no more than 50 hours of audit time (see Appendix A);
 - (ii) again to suggest that the Report infers that *“QAO’s Staff Appraisal System has largely one purpose in mind and that is to serve as a means of determining promotion”*, is to misconstrue its meaning. The words in the Report *“continue to ensure”* should be sufficient to negate that suggestion.
- (e) regarding Financial and Compliance Audit (page 8) the important issue is not the one incident in a relatively small sample, but:-
- (i) the fact that stakeholders and those contracting business with an entity could claim to feel misled (with its potential for attendant consequences) if an inserted erratum became detached from the entity’s Report and they were left with the impression that a clear certificate had been given.
 - (ii) the professionalism of the QAO. While the Act does not place specific responsibility on the Auditor-General on this matter, nevertheless public perception may hold a different view.

In relation to the standards for qualified audit certificates, both Ernst & Young and I have acknowledged the rights of the Auditor-General to carry out and report on his audits in the way he sees fit, in accordance with the wide ranging powers and responsibilities set out in the Financial Administration and Audit Act.

This Review certainly does not suggest that all audit certificates issued by the Auditor-General must comply with Auditing Standards. However, departures from Auditing Standards should be rare and should be accompanied by adequate file notes to document the reasons for such departures. Ernst & Young could see no justification for departures from Auditing Standards in the two cases referred to in their report.

- After careful consideration of all comments and given that evidence provided to this Review was consistent from a wide range of staff, I see no reason to change the views expressed in the Report.
- I believe that the incoming Auditor-General will, quite properly, form his/her own opinion on these matters, which I accept.



T.A. Sheridan
QAO Strategic Review

21 August 1997

CHAPTER 1

OFFICE OF AUDITOR-GENERAL

ACCOUNTABILITY TO PARLIAMENT

ACCOUNTABILITY TO PARLIAMENT

- Recent events in Australia have increased public interest in and concern for the processes by which governments are accountable to the people for their actions. That interest is driven by a public which has become increasingly aware of and concerned about government activity and is demanding to be reassured that:-
 - (a) monies they provide to governments by way of taxes, charges and fees are being collected and spent in accordance with the law and applied to the purposes for which they have been provided.
 - (b) the relationship between the taxes, charges and fees paid, and the community services provided, represents value for money.
 - (c) those charged with the responsibility for implementing and managing government policies and programs do so with integrity and propriety.
- It is not a new demand. It was first voiced in England centuries ago and gave birth to the Westminster System, which is the basis of government in Australia today.
- Disclosure and accountability to the Parliament is the cornerstone of the Westminster System of government. It brings an added discipline to the management and administration of the Executive Government.
- Fundamental to that System are three bodies:-
 - (a) the **Parliament** (representing the community/shareholders)
 - (b) the **Executive Government** (the Cabinet/Board of Directors)
 - (c) the **Office of Auditor-General** (the External Auditor) - an office totally independent of the Executive Government, with a responsibility to report to the Parliament on the stewardship (integrity, propriety, economy, efficiency and operational effectiveness) of the Executive Government and other entities nominated by Parliament in law.
- Those three bodies are the statutory links in the management and financial accountability chain of the Westminster System.
- The independence and mandate of the Office of Auditor-General is fundamental to that accountability process. Any diminution of that independence and mandate (whether real or perceived) will lead ultimately to a loss of confidence by the Parliament and the community, including the business community, not only in the accountability process, but also in the Executive Government.
- Under the Westminster System the Office of Auditor-General has an exclusive role as the Parliament's and the community's (shareholder's) external auditor. That exclusive role recognises three important principles:-
 - (a) the need for an impartial source of advice to be available to the Parliament to assist the Parliament in holding the Executive Government of the day responsible for its actions.

- (b) the need for that advice to be a single source of advice which not only relates to individual government entities, but also provides the Parliament with a coordinated overview of the Executive Government's operations as a whole.
- (c) the need for that advice to be factual, forthright and balanced and to be (and to be seen to be) unfettered by the external auditor's involvement in any other capacity with the Executive Government.

- Those three principles are the foundation of the Office of Auditor-General and of Parliament's right to an independent source of advice and information to enable it, in the public interest, to hold an Executive Government to account.
- It is acknowledged of course that Parliament has access to a wide variety of advice and information, including from its own Parliamentary Committees, Ministers, Chief Executives of government agencies, non-government parties, the media and the public generally.
- In reality, the bulk of information regarding the operation and business of government agencies is provided by the agencies, through their responsible Ministers. To question the impartiality and objectivity of advice and information provided through that framework, is not to question the integrity of the persons providing the information and advice, but merely to recognise a degree of self-interest that can exist in the nature of that organisational framework itself.
- Outside that framework, is the independent advice and information of the Office of Auditor-General which underpins the accountability process of the Westminster System.
- Contestability

At a time when the advantages of a competitive environment are being seen as an obvious means of achieving greater levels of economy, efficiency and effectiveness in the public sector generally, it is understandable that the exclusive role of the Office of Auditor-General would be subject to question.

- That question, the subject of debate over many years, has gained momentum in recent times. A view is now being put forward in another State, that the audit of government entities should be the responsibility of a public sector audit office, separate from the Auditor-General's Office, operating as a government business enterprise on fully commercial terms under a Board of Management.
- Taken at face value, that approach, in bypassing the Office of Auditor-General and leaving the Auditor-General as an independent officer of the Parliament without direct auditing capacity, has serious implications for the effectiveness of the accountability process and Parliament's ability to hold the Executive Government responsible for its actions. The most serious of those implications are:-
 - (a) economic considerations could inhibit the scope of the audit and weaken (and be seen to weaken) the quality of accountability to the Parliament.
 - (b) with the public sector audit office as an arm of the Executive Government there would no longer be an independent and impartial single and coordinated source of reporting and advice to the Parliament and an effective overview of the Executive Government's

operations as a whole would be diminished.

- (c) the independence and impartiality of the agency's external auditor would be seen to be impaired unless the external auditor (or his/her firm) relinquished any other involvement with the Executive Government and its entities.
 - (d) unlike the exclusive mandate of the Office of Auditor-General, contestability, by its very nature, introduces a perception (if not a reality) that reporting and advice to the Parliament may be less rigorous and forthright than under the exclusive mandate.
 - (e) the Auditor-General would not have an independent body of resources available to follow through on matters perceived by him/her to be important in the protection of the public interest.
- It also needs to be recognised that the traditional straight forward system of accountability to the Parliament has changed. Society has become a much more complex and demanding cultural body and as a consequence governments generally have been forced to look to more innovative ways to meet the economic and social needs demanded by that Society.
 - In many cases those innovative ways have involved government entities entering into business arrangements that are removed from direct parliamentary scrutiny, despite the fact that public funds are involved, or that a contingent liability rests with the Government either explicitly or implicitly through guarantees or indemnities that have been given. The Corporations Law and the constitution of Ministers of the Crown as bodies corporate, provides the legal status for development of these business arrangements, as does specific legislation, such as the Government Owned Corporations Act.
 - In those cases the appointment of the Auditor-General as the external auditor is essential if the independent accountability link to the Parliament is to be preserved .
 - The importance of the independence and mandate of the Office of Auditor-General in the accountability process, and the community's confidence in that process and in the Executive Government cannot be stressed too strongly. The necessity for that mandate to extend to all areas where public monies are at risk (either directly or indirectly) and the government has a controlling interest, also cannot be over emphasised.
 - The W.A. Inc Royal Commission, 1992, gave emphasis to this view in its report which stated:

"The Office of the Auditor-General provides a critical link in the accountability chain between the public sector, and the Parliament and the community. It alone subjects the practical conduct and operations of the public sector as a whole to regular, independent investigation and review. This function must be fully guaranteed and its discharge facilitated. The Auditor-General is the Parliament's principal informant on the performance of the administration system. The Parliament therefore has a special responsibility to ensure both that the independence and the effective resourcing of the Auditor-General are secured and that its own investigation procedures (particularly through Committees) are such that it fully utilises the information about government supplied to it in the Auditor-General's reports. The commission's recommendations have this responsibility particularly in mind (3.10/T)."

- And on the question of mandate, the Victorian Commission of Audit in its 1993 Report had this to say:-

“The Auditor-General should be responsible, on behalf of the Parliament, for the financial and performance audits of all public sector entities (recommendation 6.20).”

and further

“The external audit, on behalf of the Parliament, of whole of government and all public sector agencies GPFR’s, including state owned enterprises, and companies and joint ventures in which the Government has a controlling interest, should be the responsibility of the Auditor-General (recommendation 6.22).”

Prognosis

- Any economic gain (yet to be demonstrated) that might be obtained by introducing contestability to public sector audits, needs to be carefully balanced against a proven accountability process which has well served the Parliament and the community over the years.
- History clearly shows that any action which weakens the independent accountability process is fraught with danger.
- One only has to turn to relatively recent events in both South Australia and Victoria, where decisions, seen by some as well intentioned at the time, saw the Auditor-General bypassed as the external auditor of the State Bank in each of those States.
- As a consequence and more significantly, the independent accountability process to the Parliament also was bypassed.
- The community of both South Australia and Victoria paid a very high price.

Contracting

- The current strategic review of the Queensland Audit Office recognises the fundamental principles of the Westminster System, in particular the independence of the Office of Auditor-General and the exclusivity of the Auditor-General’s mandate with respect to all Government entities.
- The review also recognises the present practice of Auditors-General to contract out some of their audit work. This in itself can introduce a level of contestability to the audit process. While it is essential for an Auditor-General to maintain a strong core of audit staff, continuation of the present practice is desirable provided always that the Auditor-General:
 - (a) appoints the contract auditor;
 - (b) sets and controls the scope and quality of the audit; and
 - (c) signs off on the audit and reports to the Parliament

CHAPTER 2

QUEENSLAND AUDIT OFFICE (‘QAO’)

THE PAST 5 YEARS

PAST FIVE YEARS

- The Queensland Audit Office (previously the Department of the Auditor-General) has undergone significant change in the past 5 years. It is therefore important that the outcome of any current review is balanced against the background of that change.
- The catalysts for that change were:-
 - (a) the Fitzgerald Inquiry, whose initial terms of reference were widened considerably to cover public sector administration and accountability to the Queensland Parliament. The Department of the Auditor-General was a small but important part of that inquiry;
 - (b) a subsequent review by the Electoral and Administrative Review Commission (EARC) which was one of many to flow from the Fitzgerald Inquiry. This particular review concentrated on public sector auditing in Queensland. EARC issued its report on this matter in September 1991.
- The EARC review was wide ranging and was subject to an extensive post review consultative process which resulted in modification of some of EARC's recommendations. Those recommendations addressed legislative, management and operational issues.
- Implementation of the legislative changes, which involved the Financial Administration and Audit Act 1977, the Government Owned Corporations Act 1993 and the Local Government Act 1993, strengthened the role of the Auditor-General and the disclosure and accountability processes to the Queensland Parliament. The most significant of those legislative changes were:-
 - (a) confirmation of the independence of the Office of Auditor-General by precluding any person from directing the Auditor-General in the exercise of his/her powers in relation to audit, or in the priority given to audit matters;
 - (b) extension of the Auditor-General's mandate to include responsibility for the audit of all public sector entities;
 - (c) removal of the strict secrecy provisions embodied in the previous legislation to allow the Auditor-General to disclose information to a range of bodies including Parliamentary Committees, Criminal Justice Commission etc.;
 - (d) provision for an internal audit function in all departments and at the discretion of the appropriate Minister, in all statutory bodies; and
 - (e) confirmation of the Auditor-General as an independent statutory officer and the establishment of a Queensland Audit Office to replace the Department of the Auditor-General.
- A major modification to EARC's recommendations concerned the proposal to widen the Auditor-General's mandate to include the conduct of performance audits. The legislation now in place restricts the Auditor-General's role to the audit of performance management systems. This matter is taken up later in Chapter 4 of this Report.

- In addition to the legislative change was the need to revitalise an organisation which had an entrenched tradition and culture spanning more than 100 years, staffed by employees who were fundamentally conservative and were not encouraged to embrace change.
- On the initiative of the Acting Auditor-General, the QAO took control of its own destiny. It undertook, with the assistance of an external consultant, a comprehensive review of its corporate vision and structure, its management and operating policies and procedures and its professional image.
- The outcome of that review has resulted in a number of changes over the past 3 years, the most significant being:-
 - (a) removal of a number of senior management positions and the consolidation of the field audit function and the corporate (support) services function into 2 discrete organisational units;
 - (b) adoption of a formal staff recruitment and promotion policy based on merit, which represented a substantial departure from the traditional public service seniority based promotions, where staff did not have to contest positions;
 - (c) the departure of staff who were unable to secure positions in the new and more compact organisational structure;
 - (d) adoption of a set of corporate goals and a quality management framework, which gives emphasis to the performance of high quality, cost effective audits, a reporting process that is fair, relevant and timely and a management culture that empowers staff to do their work and develop to their full potential;
 - (e) adoption of a proven international audit methodology which has significantly improved the discipline, documentation and overall quality of public sector auditing;
 - (f) improvement of quality control procedures over the conduct of all public sector audits; and
 - (g) increased use of contract audit staff by the Auditor-General.
- The combination of these legislative, management and operational changes has significantly enhanced the efficiency, economy and effectiveness of the QAO. It has allowed an additional audit workload to be undertaken, with a minimal increase in resources.
- During the course of this Strategic Review discussions were held with a number of QAO auditees both within the Brisbane metropolitan area and in regional Queensland. (see Appendix D).
- It was clear from those discussions that the auditees also recognised the significant improvement in the approach and the capability of the QAO. They referred to:-
 - (a) the professionalism of the audit staff, in their approach to the audit and their good understanding of the auditee's business. They were seen as helpful and provided advice which added value to the audit;

(b) a good professional relationship which allowed audit issues to be discussed fully and frankly with management and generally resolved before the issue of a management letter; and

(c) the ease of accessibility to the Auditor-General and his staff.

- There were some relatively minor negative reactions, in the main, concerning the treatment of some accounting issues where the local situation did not always sit comfortably with the wider view required by the public sector and/or the professional standards.
- The Auditor-General and his staff are entitled to credit for this change. It would not have been an easy task.
- **In that context it would be unfortunate indeed if issues arising from this Strategic Review were seen to diminish in any way the importance of what has been achieved.**
- **Those issues should be seen as no more than the next logical step in a program of continuing management improvement in the QAO.**

CHAPTER 3

STRATEGIC REVIEW (QAO)

TERMS OF REFERENCE

TERMS OF REFERENCE

- To review and report to the Premier and the Auditor-General on the existing and any future strategic plans, structure, goals, operational conduct, policies and management of the QAO, with particular reference to:-
 - whether they are appropriate to the audit mandate, Parliamentary oversight, the needs of public sector agencies and emerging public sector organisational structures;
 - their effectiveness, and in particular the effectiveness of the auditing standards issued by the Auditor-General, in fulfilling the audit mandate within the contemporary accountability requirements of Queensland's system of government;
 - the operational efficiency of QAO methodologies and the relative efficiency of in-house and contract audit service provision;
 - the standards of service provided to Parliament, auditees and executive government; and
 - whether the audit mandate requires amendment or enhancement to enable the QAO to meet the needs of the Parliament, the Queensland public sector and the people of the State into the next century.
- The review is to examine the totality of the QAO and may also examine its external links with internal audit units of agencies, with auditees and with clients.
- The review is to have regard to the provisions of Section 72 of the *Financial Administration and Audit Act 1977*.
- This Strategic Review is the first undertaken under the new legislation introduced in 1993.

CHAPTER 4

STRATEGIC REVIEW (QAO)

INDEPENDENCE

MANDATE;

RESOURCES

INDEPENDENCE

- Independence of an Auditor-General is a fundamental precept of the Westminster System. It is critical to the disclosure and accountability process of that System and to the Parliament's oversight of the operations of the Executive Government and public sector entities generally.
- The importance of that independence cannot be over-emphasised. It has been stressed in reports of a Royal Commission, Commissions of Inquiry and by a range of other professional and responsible persons who have been called upon to review the role of Auditors-General.
- Any action, real or perceived, which diminishes (or is seen to diminish) that independence will lead ultimately to a loss of confidence by the Parliament and the community, including the business community, not only in the accountability process, but also in the Executive Government.
- The Commonwealth Joint Committee of Public Accounts recently sought a wide range of views regarding the independence of an Auditor-General and its October 1996 report "Guarding the Independence of the Auditor-General" had this to say:-

"Drawing on this diversity of views, the Committee considers that the principal elements of functional independence for the Auditor-General are:-

- *personal independence in relation to appointment and tenure;*
- *a wide legislative mandate empowering the Auditor-General to audit the complete spectrum of Commonwealth functions;*
- *audit independence, including freedom to determine the audit programme, and to decide the nature and scope of audits to be considered;*
- *unrestricted access to information in performance of the audit function together with the right to report any findings to Parliament; and*
- *adequate resourcing to fulfil audit functions effectively."*
- In the Queensland context, the Financial Administration and Audit Act 1977 protects the Auditor-General's independence with respect to personal independence (Sections 50-52, 57[3]), audit independence (Sections 49, 65) and access to information (Sections 85-87, 90).
- As to a wide legislative mandate and resourcing there is cause for concern. Present legislation is (and in the case of resourcing could at least be seen to be) restricting the Auditor-General's independence, with consequent effect on independent accountability to the Parliament.
- The remainder of this Chapter examines these two issues.

Mandate

- In its 1991 Report, EARC recommended that the Auditor-General should have authority to undertake performance audits into all public sector entities, but should not as a general rule, undertake evaluation of programmes that would require the Auditor-General to examine the appropriateness of strategic programme goals.
- This recommendation was rejected by the Government of the day on the grounds that:-
“responsibility for establishing standards of performance, for determining who is responsible for achieving those standards and for reporting the results rests squarely with the managers of public sector entities. The Auditor-General’s role is to audit and report on the existence and adequacy of performance management systems and practice.”
- In the event the Financial Administration and Audit Act 1977 was amended in 1993, to provide only for the audit of **performance management systems** by the Auditor-General (Section 80).

Need For Extended Mandate

- Traditionally public sector audit has focussed on financial accountability, propriety and probity (the financial and compliance audit).
- More recently, it has been accepted generally that the focus should be extended to incorporate reviews of economy, efficiency and operational effectiveness with respect to an auditee’s operations (the performance audit).
- That extended mandate has been introduced to many overseas audit jurisdictions and in all Australian audit jurisdictions with the exception of Queensland and the Northern Territory. In the case of Queensland and the Northern Territory the extended mandate has been restricted to an audit of performance management systems.
- This Review notes the reasons advanced for restricting the Auditor-General’s role to the audit of performance management systems. This Review strongly supports the view that it is clearly the responsibility of the management of any entity to ensure that the management practices and performance of the entity are efficient, economic and effective.
- However to restrict the Auditor-General’s role in this area and for Parliament to rely solely on an entity’s own assessment of its performance, overlooks two important factors:-
 - (a) **an independent assurance that adequate systems are in place** to assess whether an entity’s objectives are being achieved economically, efficiently and effectively **is no guarantee, by itself, that actual performance measures up to that criteria;** and
 - (b) **an assurance on actual performance by an entity through its responsible Minister to the Parliament, leaves open to question the impartiality of that assurance.** In making this point it is again stressed that the integrity of the persons providing that assurance is not questioned, but rather the recognition of an understandable degree of self-interest that can exist in the nature of the reporting framework itself.

- In essence, that restriction denies Parliament and the community a level of independent advice and information to which it is entitled.
- **Like any shareholder representative, Parliament** not only needs to be independently assured that resources provided by the community (the shareholders) have been properly accounted for and that management has acted with propriety and probity; it also **needs to be independently assured that those resources have been utilised economically, efficiently and effectively.**
- Bicameral Parliaments within Australia and overseas have accepted the need for their Auditors-General to have an extended audit mandate that examines economy, efficiency and operational effectiveness.
- That extended role is no less important in a unicameral Parliament.
- **Indeed to stand apart from the mainstream and restrict the Auditor-General's mandate and Parliament's right to that level of independent information and advice, runs the real risk of the Parliament and the community, including the business community, losing confidence not only in the accountability process but ultimately in the Executive Government also.**
- It is also the experience of the Reviewer, both in practice and through observation of results in a number of audit jurisdictions, that properly managed, performance audit can make a significant contribution to effective public sector management and administration and to effective resource use.
- It can do so without transgressing the area of government policy objectives.
- Indeed it is universally accepted and is a fundamental principle of the accountability process that Auditors-General:-
 - (a) **have no mandate** to review and report on the appropriateness (or otherwise) of government policy objectives; but
 - (b) **do have a mandate** to review and report on the economy, efficiency and effectiveness of the implementation and delivery of government policy objectives.

Management of Performance Audit

- An extended audit mandate to embrace performance audit represents quite a change for both Auditors-General and their staff; and for auditees.
- It needs to be managed carefully and sensitively and its purpose needs to be clearly understood by all parties involved in the process.
- It is understandable that some people may have a negative view about performance audit. Most people feel uneasy about the prospect of having their performance reviewed, particularly by an independent "outsider" with wide reporting powers, who may be seen as a "whistle-blower."

- It should be stressed at the outset, that performance audit is not about whistle-blowing. Nor is it about “looking for a scalp to nail to the wall.” If that is seen as its purpose it will not succeed.
- **Performance audit has a much more important and positive dimension - the improvement of public sector performance, that is to say working with auditee management to enhance economic, efficient and effective management and operating performance in the public sector.**
- **In this form performance audit has a proven potential to provide real and significant benefits to the community.**
- The conduct of performance audit should not be seen as the sole province of an elite audit group, nor should it be shrouded in an “aura of mystery” to give it a special status. It is no more or less important than financial and compliance auditing to the overall public sector audit and accountability process.
- Performance audit should be seen as a logical extension of the financial and compliance audit. Given the depth of knowledge and understanding of an auditee’s business and operation gained from the normal financial and compliance audit, and the external auditor’s ability to relate to knowledge gained from the operations of other auditees, it is highly likely that appropriate and productive performance audits will be identified during that audit process.
- Performance audits need to be disciplined and well managed. Elements that contribute to the conduct of an efficient and effective performance audit include:-
 - (a) adequate definition of the performance audit and what it is expected to achieve;
 - (b) the resources required to undertake the audit, including the necessity to “contract in” any specialist resource;
 - (c) the duration of the audit - as a general rule an audit that extends over a lengthy period (say longer than 3 months) may tend to lose its focus and become overtaken by events; and
 - (d) the involvement of auditee management at least at the definition stage. The positive role that auditee management can play should not be overlooked, as they may well see the Auditor-General’s involvement as an opportunity to resolve a situation that they do not have the resources to address.
- An approach to performance audits based initially on small manageable audits from which effective results can be achieved has much to commend it. It would allow the QAO to gain confidence in this type of audit; it also would allow the wider public sector to become used to and confident in the process.
- In that context it would be surprising, if in an organisation of the size and complexity of the Queensland public sector, there were not many opportunities for performance audits directed, in the first instance, towards processes and procedures (economy and efficiency) which would realise significant tangible benefits for the community.

- It has certainly been the case in other audit jurisdictions.
- It provides a sound basis of confidence and experience for progression to audits of operational efficiency, economy and effectiveness.
- Finally, the role of the Public Accounts Committee and the Office of Public Service in public sector management should not be overlooked. Much can be gained from continuing consultation between the QAO and those bodies.

Funding Performance Audits

- Authority to conduct performance audits raises the question as to whether the QAO should charge a fee for those audits.
- The view that an auditee should pay for a performance audit could be justified on the grounds that:-
 - (a) the auditee may benefit from savings generated by the performance audit;
 - (b) if the auditee's performance was such that a performance audit needed to be undertaken, then the auditee should pay for the audit irrespective of whether or not savings were generated.
- While the "user pays" principle has considerable merit, practical experience suggests that performance audits are not always accepted as fitting neatly into those two categories.
- In those situations the audit process could be frustrated (or in the extreme thwarted) by protracted negotiation between the Auditor-General and the auditee, in determining responsibility for funding.
- To ensure that the focus remains where it should (on the audit) it is essential that the source of funds for performance audits be established prior to the commencement of the audit year.
- This Review supports an appropriation from Consolidated Fund as the best means of meeting this need.
- **In this context it is perhaps relevant to note that EARC recommended that there be no charge to auditees for a performance audit.**
- That is not to say that Treasury, with the cooperation of the Auditor-General, should not seek to recover to Consolidated Fund, the costs of a performance audit from an auditee in appropriate instances (e.g. where it can be demonstrated that savings have clearly been achieved).
- An alternative method of funding performance audits, by loading the financial and compliance audit fee for all auditees is not recommended by this Review, as its appropriateness is subject to question on several grounds, including equity and cross subsidy.

This Review strongly supports the extension of the Auditor-General's mandate to incorporate a complete program of performance audit. It has the proven potential to deliver significant benefits.

This Review recommends that:-

- (a) the Financial Administration and Audit Act 1977 be amended to permit the Auditor-General to examine and report on the economy, efficiency and effectiveness of the operations of any public sector entity for which the Auditor-General is the auditor;
- (b) the Auditor-General exercise his/her discretion as to the degree of emphasis to be given to economy, efficiency and effectiveness in the conduct of a particular performance audit under this Act;
- (c) the conduct of any performance audit be reported in accordance with Division 3 of Part 6 of the Financial Administration and Audit Act 1977; and
- (d) there be close consultation between the Auditor-General, the Public Accounts Committee and the Public Service Commissioner on public sector management issues.

Resources

- The question of resources for Auditors-General, both in Australia and elsewhere has been the subject of debate for many years. While some Australian Auditors-General retain their audit fees and use those fees, together with an allocation of funds from Consolidated Fund to fulfil their statutory responsibilities, others (as is the case in Queensland) are totally reliant on an allocation of funds from Consolidated Fund.
- Central to the debate is the notion that it is not appropriate for an auditee of the Auditor-General (Treasury Department) to recommend to Government the funds to be appropriated to the Auditor-General for the discharge of his/her statutory responsibilities. It is claimed that the process can (and can be seen to) affect the independence and mandate of the Auditor-General.
- That claim is true. However the view that an Auditor-General's Office cannot expect to be immune from accepting its fair share of general public sector budgetary constraint is equally true - and the Queensland Auditor-General recognises and accepts that view.
- In the context of the QAO two particular issues arise:-
 - (a) the specific requirements under the Financial Administration and Audit Act 1977 that the Auditor-General must give the estimates of receipts and expenditure for the QAO for each financial year to the Treasurer; and **the Treasurer must consult with the Parliamentary Committee in developing the proposed budget of the QAO** for each financial year (Section 68); and
 - (b) the current nature of the QAO appropriation, which necessitates the Auditor-General seeking the approval of the Treasurer for the transfer of funds from special allocations to the base appropriation, even though the total appropriation for the QAO will not be exceeded.
- Regarding (b) and by way of example, the Auditor-General is unable to transfer funds from contract audit fees to staff salaries, even though the Auditor-General believes that there is justification for QAO staff to perform certain audits which may have been performed previously by an approved contract auditor and funds are available to do so.
- It is relevant to note the words in Section 68(3) "in developing the proposed budget of the Audit Office" which could be seen to imply to those not familiar with the process, that the Treasurer, rather than the Auditor-General has that responsibility.
- Implicit in all concerns expressed on this issue is recognition of situations which inevitably arise, where resource requirements seen by an Auditor-General as essential to meeting his/her statutory obligations to the Parliament are being determined by an auditee (Treasury Department: Treasurer) at a time when the auditee may not feel comfortable with an Auditor-General's audit findings. **The fact that the auditee may not be able to meet the Auditor-General's requirements, may not in itself be sufficient to placate the perception.**
- The Commonwealth Parliament has moved to resolve this issue. Legislation now before the Commonwealth Parliament requires the Joint Committee of Public Accounts to review the annual budget of the Australian National Audit Office (A.N.A.O.) and to recommend to the Commonwealth Government the level of the A.N.A.O.'s resource requirements.

- That approach has considerable merit, in that:-
 - (a) it removes the perception that the Auditor-General's independence and mandate is at risk;
 - (b) it would add to the Auditor-General's own accountability to the Parliament, through a review process that would require the Auditor-General to report to the Public Accounts Committee on performance for the current year (against the work program previously submitted for that year) and provide a works program for the year in prospect, which could specify, for example:-
 - for financial and compliance audits the total hours proposed for each auditee (compared to the previous year)
 - for performance audits, the purpose of the audit, an estimate of the elapsed time for the audit and the resources required to conduct it, and the anticipated benefit to be gained from the audit;
- The review process needs to recognise the operational flexibility provided to the Auditor-General in terms of Section 49 of the Financial Administration and Audit Act 1977. However any significant change to the submitted current year's works program would need to be justified by the Auditor-General to the Public Accounts Committee in the subsequent performance review of that year.
- **This Review believes it is essential for the question of the Auditor-General's independence in this matter to be put beyond doubt.**
- **This Review recommends that:-**
 - (a) the Financial Administration and Audit Act 1977 be amended to require:
 - the Auditor-General to submit the estimates of revenue and expenditure for the QAO to the Public Accounts Committee for each financial year;
 - the Public Accounts Committee review with the Auditor-General the performance of the QAO for the current year and the resource requirements for the year in prospect.
 - the Public Accounts Committee, on behalf of the Parliament, recommend to the Government the level of resources to be made available to the QAO for the year in prospect, taking into account Government requirements for budgetary constraint.
 - (b) the appropriation for the QAO be a "one-line" appropriation, or alternatively the Auditor-General be given the freedom to transfer funds between the individual lines within that appropriation, provided the total appropriation is not exceeded; and/or there is no additional carry-over commitment to the next financial year.

CHAPTER 5

STRATEGIC REVIEW (QAO)

CORPORATE MANAGEMENT

ORGANISATION;

PLANNING AND CONTROL;

HUMAN RESOURCE MANAGEMENT;

DELEGATION;

MANAGEMENT CULTURE

CORPORATE MANAGEMENT

- A sound organisation structure and culture is important to the effective and efficient operation of the corporate management of any organisation. Fundamental to that structure and culture are:-
 - (a) a compact structure with lines of responsibility that are direct and represent clearly and unambiguously the operations of the organisation and maximises the use of the organisation's available resources.
 - (b) a management environment which provides for the development of its people and encourages individual as well as corporate pride and achievement.
- The QAO is the organisational unit which assists the Auditor-General in meeting his/her statutory responsibilities to the Parliament. It is constituted under the Financial Administration and Audit Act 1977 and the legislation recognises the Auditor-General's sole control over the management of the unit.
- The QAO is a relatively straight forward organisation. The complexity of its operation comes from the level and range of accounting, financial and management knowledge and skills it needs to apply to a wide variety of diverse organisations.
- While the QAO is a statutory office responsible for public sector auditing, in essence it is not dissimilar to the audit practice of a major accounting firm.
- In addition to a sound structure and culture, other factors essential to an efficient and effective audit practice are:-
 - (a) realistic planning of the annual audit program;
 - (b) appropriate allocation of staff to the individual audit assignments within the annual audit program;
 - (c) effective control over the individual audit assignments;
 - (d) establishment of appropriate charge-out rates to recover all costs and provide an acceptable rate of return;
 - (e) management and administrative processes and procedures that are effective and are time and cost efficient; and
 - (f) policies for recruitment, training, counselling and retention of good staff.
- The remainder of this chapter considers the organisation, planning and control, human resource management and culture of the QAO against that general background.

Organisation

- While based in Brisbane, over 50% of the auditees of the QAO are located outside the Brisbane metropolitan area. They stretch from Coolangatta to the Torres Strait, to Mount Isa in the West and to Birdsville in the South West.
- Currently the Auditor-General is the appointed external auditor of 580 public sector entities including 150 local government bodies. Those audits range in size and complexity from major government departments (such as Education; Health) to financial bodies (such as the Queensland Investment Corporation) business entities (such as the South East Queensland Electricity Corporation) to the Brisbane City Council and a large number of small audits, including water boards and river improvement trusts.
- An analysis of the QAO audit workload (Appendix A) shows that:-
 - (a) those 580 audits involve approximately 157,000 hours of direct audit time;
 - (b) 308 of those audits (approximately 39,000 direct audit hours) are contracted out by the Auditor-General to approved contract auditors; and
 - (c) 41% of those 580 audits involve 50 hours or less of direct audit time.
- The QAO had an actual staff complement of 154 as at May 1997. Its Revenue and Expenditure budgets for 1996-97 are about \$14 million and \$16 million respectively.

Structure

- The QAO has a relatively simple structure. It has one major function (audit) with a group of services to support that function (see Appendix B).
- There are 5 financial and compliance audit groups each responsible to an Executive Director. The 5 Executive Directors along with the Executive Director (Performance Audit) and the Manager, Information Systems are each responsible to the Deputy Auditor-General.
- The financial and compliance audit workload is allocated between those 5 groups principally on the basis of like audits (e.g. education: local government). While that allocation method presents some management difficulties in the nature of peak work loads (involving staff moving between groups to meet the peak work loads), an alternative method based on allocating end of year financial work more evenly between groups to even out the peak loads has not been adopted because of inefficiencies it would create in terms of audit co-ordination and to a consistent reporting process.
- As to the Corporate (Support) Services Branch, the structure involving 2 Directors (including one new position) each reporting to the Assistant Auditor-General is in the process of being implemented following an internal review of the Branch by the QAO.
- The review, which began in July 1996, has reduced staff numbers from 34 to 31.
- While the general structure and the workload allocation process are appropriate there are some features of it which seem to warrant consideration:-

1. the management levels within the structure
2. the size of the Corporate (Support) Services Branch relative to the size of the QAO
3. the classification structure that makes it difficult to recognise achievement.

Management Levels

- The review of the Corporate (Support) Services Branch commenced in July 1996 at the instigation of the Auditor-General, following the Government's expressed wish to ensure that resources across the whole budget sector were being well directed to front-line service delivery.
- That review has now been completed and has:-
 - (a) identified a reduction from 34 to 31 in the overall staffing of the Branch
 - (b) resulted in the establishment of 2 new positions in the Branch; one a Director, Resource Management (a new position) and one a Director, Technical Services and Development (a reclassification of an existing position). Both positions report to the Assistant Auditor-General (see Appendix B).
- While the review was specific to the Corporate (Support) Services Branch, consideration also needs to be given to some other matters that could impact on the availability of resources for front-line delivery service:-
 - (a) the role of the Assistant Auditor-General in the new organisation structure which has seen the span of direct management control reduced from 4 positions to 2. It is noted also that the present classification levels preclude the Assistant Auditor-General from sharing the financial and compliance workload of the Deputy Auditor-General, whose workload may increase under an expanded program of performance audits.
 - (b) the relationship between the 2 Director positions in the Corporate (Support) Services Branch and the positions of Audit Manager and whether any adjustments to the classification level of Audit Manager will be required.
 - (c) the present complement of 7 Executive Secretaries at the second and third levels of management which seems high and perhaps the opportunity for sharing needs to be explored.
- In addition to those considerations the question of the need for a layer of management between the Executive Directors (Financial and Compliance Audit) and the Auditor-General arose from evidence consistently put to this Review that in practice, more often than not, the Executive Directors report directly to the Auditor-General.
- The need for that layer of management of course, depends largely on an Auditor-General's own style of management.

- **It depends on whether an Auditor-General sees his/her role solely as an audit one; or sees a wider public sector role in properly and in a balanced way, contributing to an awareness of issues which may need to be addressed in the interests of improved public sector management and administration. An Auditor-General's wide public sector audit focus provides a sound basis for this wider role.**
- Should the Auditor-General not wish to adopt that wider role then it is difficult to see how the layer of management can be justified.
- **On the other hand and as discussed later in this report, this Review believes that the wider role is a legitimate and important one for an Auditor-General to undertake. It adds value to the audit process.**
- **If that role is adopted then the layer of management can be justified.**
- In raising these issues this Review is mindful that on organisational matters the incoming Auditor-General (presumably to be appointed within the next few months) may have a view which differs from the views expressed in this report.
- Indeed he/she may also have a view which differs from the organisational structure that is currently in the process of being implemented and may see the diversion to the field audit function of savings generated from the review of the Corporate (Support) Services Branch as a more effective use of the limited resources of the QAO, rather than their use (either partly or fully) in the Corporate (Support) Services Branch.
- **This Review believes it would be prudent at this late stage to defer action on all of these organisational issues, including those currently in train, so as to ensure that the incoming Auditor-General's position is not pre-empted in any way.**

Corporate (Support) Services

- The size of this Branch (31) relative to the size of the QAO (154) seems high. It represents 20% of the total workforce.
- The size of the function again depends on the management style and needs of individual Auditors-General. Comparison with other State Audit Offices does not provide any conclusive view, although the South Australian Auditor-General's Department seems to have a smaller function, relative to the QAO, particularly when allowance is made for persons attached to the function under the National Training Wage Traineeship Scheme.
- While the QAO has taken positive steps to improve efficiency in this Branch (and the establishment of a Service Centre is a recent example), a number of the Branch's activities still involve manual processes and procedures that in some cases are still driven by expectations reflecting traditional public service practices, rather than present circumstances. In addition the centralised activities of the Branch need to operate more flexibly if it is to efficiently support field staff in what is essentially a "decentralised" QAO operation.
- The extension of computerisation to audit records and working papers, to library services and to reference material essential to the conduct of field audits would provide field staff with on-line access to that information. It would provide the flexibility needed and not only improve the efficiency of field audit operations, **it would also reduce the workload**

(particularly inquiries) of the Corporate (Support) Services Branch.

- It is understood that the QAO now has these matters under consideration and they will be progressed as soon as resources become available to do so.
- It is understood also that:-
 - (a) a new financial management system has been implemented in July 1997 to provide better management information and eliminate a number of manual processes inherent in the previous computerised system.
 - (b) the QAO is currently assessing the adequacy of its Human Resource Management System (HRMS) and its Resource Management Information System (QAOMIS). The need for compatibility between each of those systems and the Financial Management System is important, as is the need for the direct input of time sheet information by individual staff to replace the present time consuming process undertaken by Executive Secretaries.
- Efficiencies flowing from all these initiatives should impact favourably on the resource needs of the Corporate (Support) Services Branch.
- **Support should be given to their prompt progress.**
- *Classification Structure*
- A motivated workforce is fundamental to the effective and efficient operation of an organisation.
- Recognition of achievement is one of a number of important factors in the maintenance of a motivated workforce. It can be expressed in either a material or non-material way.
- In the QAO as in any public sector budget funded organisation, recognition of achievement in a material way is difficult to deliver. It depends on the traditional public service practice of a position becoming available at a higher level in the classification structure or the payment of a higher duty allowance.
- Recent history shows, that apart from one financial year (1993-94) movement of staff in the QAO has been relatively limited and confined largely to the junior level of the classification structure. It mainly relates to graduate staff with one or two years experience, who perceive a long waiting period for advancement within the QAO and see more immediate access to attractive salaries in other public sector agencies (in internal audit particularly), or in the private sector.
- The QAO accepts that it has a role in training people for the wider public sector. However the Office needs to realise a reasonable return from its own training efforts.
- Auditing at its lowest level can be a routine, repetitive and time consuming process. While no doubt a few isolated practitioners feel comfortable with that process it is an image from a bygone era.

- Modern auditing is a much more demanding process. It requires people with a high level of accounting, financial and management knowledge and skills, a perceptive and analytical approach which can identify issues of significance and properly manage risk; and the application of that knowledge, skill and approach to the audit of a diverse range of organisations that vary in both complexity and size. It demands the application of high professional and ethical standards.
- In short the quality of an audit depends on the quality of the people assigned to the audit - and the QAO seems to have people that meet this standard.
- In that context the QAO needs the flexibility to recognise its achievers in a material way.
- Two methods (and there maybe others) of achieving the flexibility needed are:-
 - (a) promoting an “achiever”, together with his/her substantive position up the classification structure; reverting the position back to its original level in the structure when the person vacates the position;
 - (b) developing a classification structure that gives more emphasis to relative differences between audits and/or groups of audits (e.g. complexity, sensitivity). For example at the moment all audit managers are on the same classification level; as is the case with audit supervisors and audit seniors.
- The effective use of these methods requires:-
 - (a) a firm management approach. Recognition must be based on demonstrated achievement over time - not just long and loyal service
 - (b) in the case of the classification structure [(b) above], a framework which is more flexible than the present public sector framework.
- Regarding that framework, this Review notes that EARC’s recommendation that the QAO be a separate statutory office was rejected by the Government of the day on the grounds that it “would detract from employee’s career paths and inhibit movement into and out of the organisation” (Queensland Government response to EARC report - November 1992).
- This review finds that view difficult to accept. It is hard to imagine that the Auditor-General would set salaries at a level that would “price his staff” out of the employment market and indeed the overall employee situation in the QAO should be no different in this respect to the position in any other statutory body in Queensland.
- **This Review recommends that the Auditor-General be given flexibility in determining the appropriate remuneration for his/her staff.**

Planning and Control

- Like the rest of the public sector, the QAO is operating in a period of tight budgetary constraint. It is understood that this situation is unlikely to change in the immediate future.
- Important to a successful audit practice are planning procedures to ensure that resources are utilised in the most efficient and effective way and that there is sufficient quality audit coverage to enable a proper opinion to be passed on the financial statements; and that appropriate systems are in place to monitor and control performance.
- In a time of budgetary constraint these planning procedures and control systems take on added importance.
- The QAO has planning procedures and control systems in place. While adequate for those purposes it seems to this Review that some aspects of the process could be improved.

Planning

- Briefly the planning procedure involves:-
 - (a) a presentation to the Auditor-General and the Deputy Auditor-General, by each Executive Director on the audit work undertaken on their portfolio of audits in the recent audit year and proposed for the year in prospect;
 - (b) the Auditor-General determining with the Deputy Auditor-General and the Executive Directors the overall audit thrust and focus for the year in prospect; and
 - (c) the Executive Directors with their Audit Managers and field staff reviewing and revising the audit effort for their audit portfolios given the thrust and focus determined by the Auditor-General.
- This Review believes that 2 aspects of the process involved in the planning procedure warrant attention:-

1. Timing

- It is noted that the annual resource plan of the QAO, which gives rise to the overall audit plan, is not finalised for most audits until late November/early December, even though the QAO audit year commences on 1 November.
- The main reason for the delay seems to be that the planning process cannot commence until October, as audit staff are fully committed between July and September on end of year financial statements and assisting in the preparation of the Auditor-General's report to the Parliament.

- While staff are employed on audit work during the planning process, concern was expressed that the final stage of the planning process (the review with Audit Managers and field staff) becomes rushed, with insufficient time to objectively examine how audit times might be realistically reduced in order to meet budget reductions. In some instances additional time was required eventually to complete the audit, with the additional time not recorded against the audit in order to stay within the planned time.
- Given the nature of the workload of the QAO and the availability of resources, there is no ideal time for planning work to be undertaken. Commonsense suggests that it needs to be undertaken at a time when results from the current audit year are becoming known - and given a planned program of interim audits those results tend to emerge toward the end of the financial year or in some cases following finalisation of the financial statements.
- To be effective the planning process needs to allow sufficient time to critically review times for the major and medium size audits and be finalised early in the audit year.
- **The QAO needs to address this matter.**

2. *Audit Review*

- Two aspects of this process warrant consideration:-

First, discussion with a range of audit staff indicated that not all additional time spent on an audit is recorded against the audit, despite repeated instructions from the Auditor-General to record all time. The review of the conduct of financial and compliance audits by Ernst & Young as part of this Review (Chapter 6) arrived independently at the same conclusion.

The extent of non recording of time is difficult to assess and may not be significant in the overall QAO Audit program.

However from the point of view of an individual audit it provides an incomplete base for making a proper and realistic assessment of audit work for that audit.

It could have implications for the quality of the audit in the future. It has implications also for the recovery of costs through the audit fee.

Second, auditing is about taking a properly assessed and calculated risk. It is not practical to audit in detail every aspect of an auditee's operation.

Within most major audits there are audit activities that do not require the same level of audit attention each year. The audit of those activities can be undertaken on a cyclical basis provided there has been no significant change in the process or in the management of the process since the last audit.

Again discussion with audit staff suggested a rather tentative approach to the cyclical approach. The report on financial and compliance audit by Ernst & Young reinforces this view.

- **While senior management approve audit strategies, greater attention may need to be given to the cyclical approach included as part of those strategies.**

Control

1. Systems

- The QAO is currently reviewing the systems it has in place to monitor and control its financial operations and also its audit and support service operations.
- The review is timely given that:-
 - (a) the existing systems seem to involve a substantial amount of manual input.
 - (b) in the case of the system to monitor and control audit operations (QAO MIS), staff are highly critical of the usefulness of many reports provided by the system. This may be a reflection of initial training in the use of the system, rather than a shortcoming in the system itself.
- **This Review strongly supports the review being undertaken by the QAO which is aimed to overcome these problems.**

2. Charging

- The QAO charges an audit fee for all financial and compliance audits that it undertakes. The fee is based on direct audit time spent on the audit and aims to recover all QAO costs applicable to the audit.
- It could be argued that charging public sector entities for the audit (particularly those that rely solely on an allocation of funds from Consolidated Fund) is merely transferring funds from “one pocket to another” and creating unnecessary administrative work.
- While there is some substance in that argument, it nevertheless overlooks two important points:-
 1. the need to allocate responsibility for costs to the point where they are incurred, not only so that they will be taken into account in any fees and charges those entities may need to make, but also for accountability.
 2. it places responsibility on:-
 - (a) entities to have their financial statements properly and adequately prepared and presented for audit; and adequate and proper systems in place to control their operations.
 - (b) the QAO to ensure that it conducts its audits in an efficient and effective manner.

Human Resource Management

- The most important and major asset of the QAO is its people.
- In recognition of this, the QAO devotes considerable effort to the recruitment, training, professional development and general well being of its people. As a consequence it has a well qualified, skilled and professional workforce.

Recruitment

- The QAO maintains an active presence on the campuses of all universities and colleges. Its presence is focussed on what the QAO does and what the QAO has to offer a graduate in terms of job satisfaction and in his/her professional development.
- The QAO presence is seen by graduates as professional and of high quality.
- As a consequence the QAO has attracted well credentialed graduates to its ranks.

Training

- The QAO has a suite of training programs aimed at developing the audit and management skills of its staff, as well as providing an understanding of the public sector structure and its environment. The programs are practical and are conducted generally in-house, with outside support where appropriate.
- These formal training programs are supplemented by “on the job” training and also by a range of “easy to read” policy and procedural documents and guidelines which are freely available to all staff.
- The training programs are generally well received by all staff.

Professional Development

- Staff are encouraged to maintain their professional development and participate in courses conducted by the professional accounting bodies.
- Encouragement is given also for staff to attend appropriate courses and/or seminars.
- The QAO has a well developed performance appraisal system for all staff, which includes the review of selected audits undertaken by audit staff. While the system seems to be working well, management needs to continue to ensure, through proper counselling and supervision of the system, that the appraisal system is seen by staff as being in the interests of their professional development, rather than a means of determining promotion.

Promotion

- As mentioned earlier in this Report, promotion is based on merit.
- In summary this Review would make the following points:-
 - (a) despite the pressure on resources, every effort should continue to be made to maintain the present commitment of the QAO to the recruitment, training and professional development of its staff;

- (b) auditing is no longer a bookkeeping function. Audit staff are now well qualified and involved in the audit of complex financial and management arrangements. They are exposed to and gain a wide experience of a variety of public sector operations. As a result audit staff are well equipped to perform in management and other appropriate operating roles within the public sector generally.

Delegation

- At the time of this Review the Auditor-General was responsible for the audit of 580 public sector entities.
- 75% of those audits involve 200 hours or less of direct audit time. For over 40%, the direct audit time is 50 hours or less.
- The Auditor-General, in accordance with Section 66(1) of the Financial Administration and Audit Act 1977, has delegated authority for the audit certification of 408 of those audits, to the Deputy Auditor-General (12), Directors of Audit (195) and approved contract auditors (201).
- Audit certificates for the remaining 172 audits are signed by the Auditor-General. While those audits include major and/or sensitive audits the majority represent small company audits.
- Involvement of the Auditor-General in those small company audits does not seem to be an effective use of an Auditor-General's time. For many of the audits minimal transactions are involved.
- While the Auditor-General has delegated authority for other small audits (e.g. water boards) he has been unable to do so in the case of company audits, as the Corporations Law gives no power of delegation to the Auditor-General.
- There has now been a change in this situation.
- In December 1995, the First Corporate Law Simplification Act 1995 came into effect. In essence it amends the Corporations Law and provides no obligation for proprietary companies, meeting the criteria of "small," to prepare General Purpose Financial Statements and to have those statements audited and certified, unless specifically requested to do so by shareholders.
- Most, if not all, of the companies referred to above would fall within the definition of the category of "small".
- In an instruction to QAO staff on 17 April 1996, the Auditor-General conveyed his decision that those companies continue to prepare General Purpose Financial Statements and that the statements be audited, in order to provide the necessary accountability to Parliament.
- Without questioning that decision, it nevertheless seems to this Review that the Auditor-General may have an opportunity to delegate those audits. He may be able:-
 - (a) subject to legal advice, to rely now on his powers under the Financial Administration and Audit Act 1977 given that the audit of those companies is no longer a requirement under the Corporations Law.
 - (b) to have some of his staff (e.g. Audit Managers) meet the requirements of and become accredited as company auditors under the Corporations Law.
- Delegation of audit certification for these small company audits would allow for more effective use of the Auditor-General's time.
- **It is suggested that the Auditor-General explore these opportunities.**

Management Culture

- The management culture of any organisation is important to the morale of that organisation.
- Morale is an important ingredient in the motivation of people and in the efficient and effective operation of the organisation.
- The staff of the QAO are well qualified, skilled and professional and dedicated to their work. They are proud of the QAO and what it stands for.
- Notwithstanding that strong and positive attitude the attention of this Review was consistently drawn to 2 matters which seemed to be of concern to staff:-
 - (a) the frustration experienced in the settling of reports and management letters which seemed to involve a time consuming and iterative process;
 - (b) the fear of making a mistake or of not been able to stay within the planned time for an audit.
- Regarding (a), if that situation reflects poor report and letter writing skills then perhaps more attention needs to be given to that aspect of staff development in the training programs of the QAO in order to ensure the quality of the end product.
- As to (b) the fear of making a mistake may stem from the recollection of criticism of the previous Department of the Auditor-General by the Fitzgerald Inquiry, which is still live in the minds of many staff today. It may also have its roots in the knowledge and perception of the style of a previous autocratic management.
- Whatever the cause it is essential for the QAO not to continue to “look over its shoulder at the past.”
- While this Review does not promote a “laissez-faire” approach to auditing, it nevertheless points out that auditing is a risk based profession and on occasions judgements based on risk will err. The important issue is to ensure that those judgements are based on sound logic known at the time and that steps are taken to correct the process rather than just look to apportion blame.
- **If fear of making a mistake is allowed to become a consideration in auditing, then it will inevitably lead to over-auditing and an inefficient use of resources.**
- **Management needs to urgently address and resolve these concerns.**

CHAPTER 6

STRATEGIC REVIEW (QAO)

FINANCIAL AND COMPLIANCE AUDIT

FINANCIAL AND COMPLIANCE AUDIT

- The Auditor-General is responsible for the financial and compliance audit of 580 public sector entities (Appendix A). The conduct of those audits fall into 2 categories:-
 - (a) audits conducted by QAO staff for the Auditor-General
 - (b) audits conducted under contract for the Auditor-General
- All major audits and audits where a qualification is being considered are subject to a pre-certification review. An internal Peer Review System is also in place and operating, which critically examines the quality of audit work, for a selected number of audits each year. The peer reviewer is from outside the Group responsible for the audits.

Audits Conducted by QAO Staff

- Of the 272 audits conducted by QAO staff, 49 involved direct audit time in excess of 500 hours. The majority of audits involved direct audit time of 100 hours or less.
- Review of these audits was structured to encompass at least one audit from each of the 5 financial and compliance audit groups, to cover a mix of audits that represented a range of departments and statutory bodies and to include financial and commercial entities as well as traditional public sector entities.
- Within that structure 10 audits were selected for review, each of which involved direct audit time of approximately 500 hours or more.
- The review of these audits was undertaken for the Reviewer by the Brisbane Office of Ernst & Young. Their report is included as Appendix F to this Report.
- In summary the Ernst & Young report confirms that:-
 - (a) the methodologies, practices and procedures, including quality control procedures adopted by the Auditor-General and his staff are appropriate to discharge their responsibilities effectively;
 - (b) while it is not possible to form an opinion on the efficiency of probity audit matters as the scope, extent and nature of those audits is a matter of judgement exercised at the time by the Auditor-General, the audit practices adopted by the QAO, on the whole, appear to be efficient and are subject to appropriate levels of management control;
 - (c) audit plans and working papers were adequate to support the evidence and opinions of the Auditor-General, although there were some instances where the standard of working paper documentation could be improved.
 - (d) the QAO standards are appropriate to the Auditor-General's audit mandate. They are based on jointly published auditing standards issued by the Australian Society of Certified Practising Accountants and the Institute of Chartered Accountants in Australia, supplemented by additional documents specific to the QAO, such as its code of conduct and quality assurance standards.

- While not detracting from those overall conclusions in any way, the Ernst & Young report did identify areas where it considered that the audit approach adopted could have been improved and procedures could have been strengthened. They can be broadly classified into 3 categories:-
 - (a) control over the issue of audit certificates;
 - (b) standards for qualified audit certificates;
 - (c) consistency in the application of materiality.
- Regarding (a) and (b), both matters relate to professional standards rather than any deficiency in the conduct of the audit. While there is no legal obligation for an Auditor-General to ensure that public sector entities include his/her certificate as part of their published financial statements, it would nevertheless seem prudent to do so in those instances where a qualified certificate is given. It would seem to be important at least for all medium sized auditees and where financial statements are required to be lodged with the Australian Securities Commission.
- As to (c), it is difficult in an organisation of the size of the QAO to gain absolute consistency where individual judgements are exercised. Continued guidance, training and supervision needs to be exercised to improve performance in this important area.

Audits Conducted Under Contract

- These audits mainly comprise local government bodies and small public sector entities, such as water boards. They are essentially located in regional Queensland.
- Of the 308 audits conducted under contract, only 5 involved direct audit time in excess of 500 hours. The majority of audits (78%) involved direct audit time of 200 hours or less.
- Review of these audits was structured to encompass a mix of audits that covered local government, other public sector entities including a small financial entity.
- Within that structure 10 audits were selected for review.
- This review was undertaken by the Reviewer. The object of the review was to establish:-
 - (a) the criteria for appointment as a contract auditor
 - (b) the extent of control exercised by the QAO over the scope, performance and quality of the audit.

Criteria for Appointment

- The QAO maintains a register of contract auditors. To be included on the register a person must:-
 - (a) be a member of the Australian Society of Certified Practising Accountants or the Institute of Chartered Accountants in Australia

- (b) satisfy the Auditor-General on his/her audit experience and competency.
- Each person included in the register is provided with a QAO handbook titled “Guidelines for Contract Auditors”. It is a detailed document and sets minimum standards, as well as guidelines, for audit planning, audit working papers, reporting requirements and audit certificates.
- Contract auditors are engaged for a defined period, generally 3 years. They sign an engagement contract for each audit appointment.

Control of Audits

- The level of control exercised by the QAO over these audits is considered satisfactory given the number and size of the audits involved and the wide area over which they are located. In summary the QAO:-
 - (a) requires the contract auditors to submit a detailed plan of the scope of the audit, together with his/her proposed audit fee for each audit year;
 - (b) reviews the adequacy of the scope of the audit plan, together with the reasonableness of the proposed audit fee;
 - (c) obtains the approval of the Auditor-General to the agreed audit plan and the audit fee;
 - (d) requires the contract auditor on completion of the audit to provide to the QAO a detailed certificate regarding work performed, any issues arising from the audit and time spent on the audit;
 - (e) verifies the certificate of work performed against the audit plan for both completeness and reasonableness. If not satisfied, the QAO calls in the audit working papers, which has led to the cancellation (or non-renewal) of contracts in some instances;
 - (f) as part of a planned annual program, calls in and verifies for completeness and quality the working papers of a selected number of contract audits each year.
- While progress payments are made against the approved audit fee, final payment is not made until the QAO has verified and is satisfied with the completeness and reasonableness of the audit.

CHAPTER 7

STRATEGIC REVIEW (QAO)

REPORTING TO PARLIAMENT

REPORTING TO PARLIAMENT

- The Auditor-General's statutory reporting responsibilities to the Parliament are set down in Sections 97 to 102 of the Financial Administration and Audit Act 1977.
- Those responsibilities are onerous and extensive. In brief they range from:-
 - (a) confirmation of the integrity and completeness of the Treasurer's Annual Statement to the Parliament and its conformity with the Public Accounts; to
 - (b) an assurance that the accounts of each public sector entity and the statements relating to those accounts have been audited; and providing an opinion on those statements; to
 - (c) reporting any deficiencies in the proper control, safeguard and accounting of public monies; and any inadequacy in the financial performance of a public sector entity, which in the opinion of the Auditor-General is of sufficient significance to report to the Parliament.
- The Auditor-General has issued 4 reports for the financial year 1995-96. Three reports were issued on financial and compliance audits performed for 1995-96 and the fourth related to the audit of performance management systems.
- The first and the major report, on financial and compliance audits for 1995-96, related to the Public Accounts and the accounts of public sector entities. The report provided:-
 - (a) the required certificate with respect to the Public Accounts and a Statement of Unforeseen Expenditure to be appropriated for 1995-96;
 - (b) a statement on the status of the audit and the provision of the required audit certificate for departments and statutory bodies;
 - (c) a summary of audit findings for each department and statutory body, which essentially related to accounting issues; together with a follow-up report on the status of previously raised audit issues;
 - (d) a summary of the outcome of special project audits conducted by the QAO for 1995-96, relating largely to compliance with Public Finance Standards, Public Sector Management Commission instructions and the appropriateness of policies and procedures in relation to software copyright and computer virus management.
 - (e) a summary of progress on public sector wide issues such as, accrual accounting, information security and establishment of asset records; as well as disclosure of defalcations, deficiencies and irregularities which came to the attention of the Auditor-General.
- That report (as was the case with the other reports) was well presented and easy to read and understand, with emphasis on the disclosure of deficiencies in financial and accounting matters essentially in individual public sector entities.
- Overall those reports raised issues important to the economy, efficiency and integrity of those entities and to the adequacy and appropriateness of their systems to enable management of those entities to measure their performance.

- **Without wishing to detract from that emphasis in any way, this Review nevertheless believes that an Auditor-General with his/her wide charter, is in an excellent position to provide an informative and balanced overview on a range of public sector management issues - not just accounting and financial issues.**
- This wider reporting role would contribute to public sector management and administration generally and be a useful source of information and advice to the Parliament.
- While not wishing to be prescriptive, the following general examples may help to illustrate what this Review has in mind.

First, the Treasurer's financial statement is arguably the most important financial document to come before a Parliament. It would seem to justify more than the statutory one page compliance assurance.

It seems to this Review that Parliament could be assisted in its consideration of that document by having, for example an independent, factual and balanced analysis of that document from the Auditor-General, who has a detailed understanding of and access to the Public Accounts.

That analysis might include a statement (similar to a source and application of funds statement) showing the components of revenue and expenditure which reconcile to the surplus or deficit position on the Government's Operating Account, with similar statements for the Government's Capital Account and for the Consolidated Fund as a whole.

Second, in the understandable search for greater economy and efficiency in the public sector, issues are now arising which have the potential to significantly change the way in which public sector services are delivered. That change can bring with it considerable risk unless the implications of the change are clearly understood and managed.

The Auditor-General has a contribution to make in this area. It can be done in a balanced way without compromising his/her independence.

Recent reports of the South Australian Auditor-General (Audit Overview) provide practical evidence of what can be done.

- **This Review recommends the adoption of a wider reporting role.**
- **It can make a valuable contribution to effective public sector management and administration. It would add to the image of the QAO.**

CHAPTER 8

STRATEGIC REVIEW (QAO)

INFORMATION TECHNOLOGY

INFORMATION TECHNOLOGY

- Information Technology is fundamental to the conduct of an efficient and effective audit practice.
- It is no less important in the QAO, where major audits conducted by that Office involve public sector entities with large and complex computer systems.
- The QAO has a centrally located, small size computing facility, which is used for payroll and account processing and for the operation of its management information systems. This “central bureau” has the capability to be directly accessed by field audit staff.
- A Computer Services Unit within the Corporate (Support) Services Branch maintains those operating systems and provides support to the Field Audit and Corporate (Support) Services Branches.
- The QAO has recently progressed 2 actions to improve the efficiency of its audit operations and its corporate management operations overall. Those actions involve:-
 - (a) provision of lap top computers for all field staff;
 - (b) a review of its management information systems.
- These initiatives are long overdue. In the case of lap top computers the delay in providing this important tool has been subject to the availability of funds. As to the review of management systems the need for this action has been referred to earlier in this Report (Chapter 5).
- There now appears to be 2 further matters to resolve to complete the overall Information Technology strategy for the QAO. They are:-
 1. The transfer of audit work files and other related audit records to files which can be directly accessed by field staff.
 2. The transfer of reference material relevant to the performance of field audit work to similiar files.
- Both these matters seem to be a logical next step given that the availability of computers to all field staff now provides them with the capacity to access files at the central facility.
- It is seen by the QAO as an essential development for an organisation whose staff are located outside the central office.
- **This Review strongly supports the initiatives being undertaken by the QAO in this area. The importance of Information Technology to the audit function and the need to keep pace with developments can not be over emphasised.**

CHAPTER 9

STRATEGIC REVIEW (QAO)

RELATIONSHIP WITH OTHER BODIES

RELATIONSHIP WITH OTHER BODIES

Public Accounts Committee

- While an Auditor-General has wide powers of investigation and reporting, he/she has no authority over management to ensure that his/her findings and recommendations are actioned.
- An Auditor-General is dependent upon a strong and effective Public Accounts Committee to follow up issues raised in his/her report to the Parliament. It is essential to the accountability process, particularly in those instances where the Government or its agency may be reluctant to address an audit issue.
- This Review notes a strong relationship between the Public Accounts Committee and the Auditor-General and the QAO. Evidence points to a number of issues raised by the Auditor-General which have been followed up by the Committee and to regular meetings which occur between the Committee and the Auditor-General.
- This relationship will be strengthened further if the recommendation that the Committee review the resource requirements of the QAO is adopted (Chapter 4).

Internal Audit

- The Financial Administration and Audit Act 1977 provides for the establishment of an internal audit function in all departments and at the discretion of the appropriate Minister, in all statutory bodies.
- It is important for the QAO to work closely with internal audit to ensure that:-
 - (a) there is no duplication of audit activity; and
 - (b) there is a complete audit coverage; and
 - (c) the work of internal audit can be relied upon by the external auditor in forming an opinion on the financial statements of the auditee.
- Audit plans and working papers of the QAO recognise the work of internal audit.
- Discussions held during this Review with a number of auditees (Appendix D) confirmed a strong relationship between their internal audit branches and the QAO.

CHAPTER 10

STRATEGIC REVIEW (QAO)

VISION

VISION

- The vision of the QAO is embodied in 3 corporate goals. Those goals are:-
 - 1 *“to perform high quality, cost effective audits and to provide quality value added advice and assistance.*
 - 2 *to ensure that our reporting is fair, relevant, timely and of high quality.*
 - 3 *to ensure that our people are empowered to do their work and developed to their full potential.”*
- The QAO is meeting those goals. Audits are conducted in a professional and effective manner, reporting is balanced and relevant and the Office provides appropriate programs and opportunities for the development of its staff.
- As to “value adding,” auditees interviewed during the course of this Review expressed their appreciation of the service provided to them by the QAO on a range of matters, including the interpretation of accounting standards; the interpretation of Treasury and other central agency instructions; in advice on systems development, accrual accounting and asset valuations.
- **While achievement of those goals has enhanced the professionalism and effectiveness of the QAO, the focus of their vision is on audit and financial and accounting matters.**
- Earlier in this report (Chapter 7) reference was made to issues now emerging which have the potential to change significantly the way in which public sector services are delivered. It also refers to the risks that change can bring if the implications of the change are not clearly understood and managed.
- There is also the general business and professional view that the present audit focus, both within the private and public sectors needs to be widened.
- That view is being driven by the complexities and demands of a contemporary society. While an understanding of the business itself will still continue to be necessary, an auditor will need to widen his/her focus and look beyond, to an understanding of the industry in which the business is operating, and where necessary create an awareness of any potential risks, including environmental, health, legal, financial etc risks. It will emphasise further the need for management and analytical skills for the audit.
- It will be seen by stakeholders as an essential part of the audit service, providing further protection for the business.
- The Auditor-General’s role in both of these matters is an important one and provides the opportunity to make a valuable contribution to public sector management and administration. It should enhance further the image of the QAO.
- **This Review recommends that the QAO:-**
 - 1 **adopt as a further specific goal “to ensure that we use our best endeavours to contribute to improved public sector management and administration.”**
 - 2 **expand goal 3 to place greater emphasis on leadership, management and analytical skills in the recruitment and development of its people.**

APPENDICES

QUEENSLAND AUDIT OFFICE
WORKLOAD
(Financial Compliance Audits)

AUDIT HOURS	TOTAL MANDATE			UNDERTAKEN BY QAO			UNDERTAKEN BY APPROVED CONTRACT AUDITORS		
	PUBLIC SECTOR	LOCAL GOVERNMENT	TOTAL	PUBLIC SECTOR	LOCAL GOVERNMENT	TOTAL	PUBLIC SECTOR	LOCAL GOVERNMENT	TOTAL
0-25	170	9	179	80	0	80	90	9	99
26-50	55	7	62	42	0	42	13	7	20
51-100	52	16	68	39	1	40	13	15	28
101-200	67	59	126	27	6	33	40	53	93
201-300	22	29	51	7	3	10	15	26	41
301-500	20	20	40	17	1	18	3	19	22
501-1000	13	7	20	12	3	15	1	4	5
1001-2000	19	2	21	19	2	21	0	0	0
2001-3000	5	0	5	5	0	5	0	0	0
3001-4000	3	0	3	3	0	3	0	0	0
4001-5000	1	0	1	1	0	1	0	0	0
5000 and over	3	1	4	3	1	4	0	0	0
Total	430	150	580	255	17	272	175	133	308

Direct Audit Hours

157,000

118,000

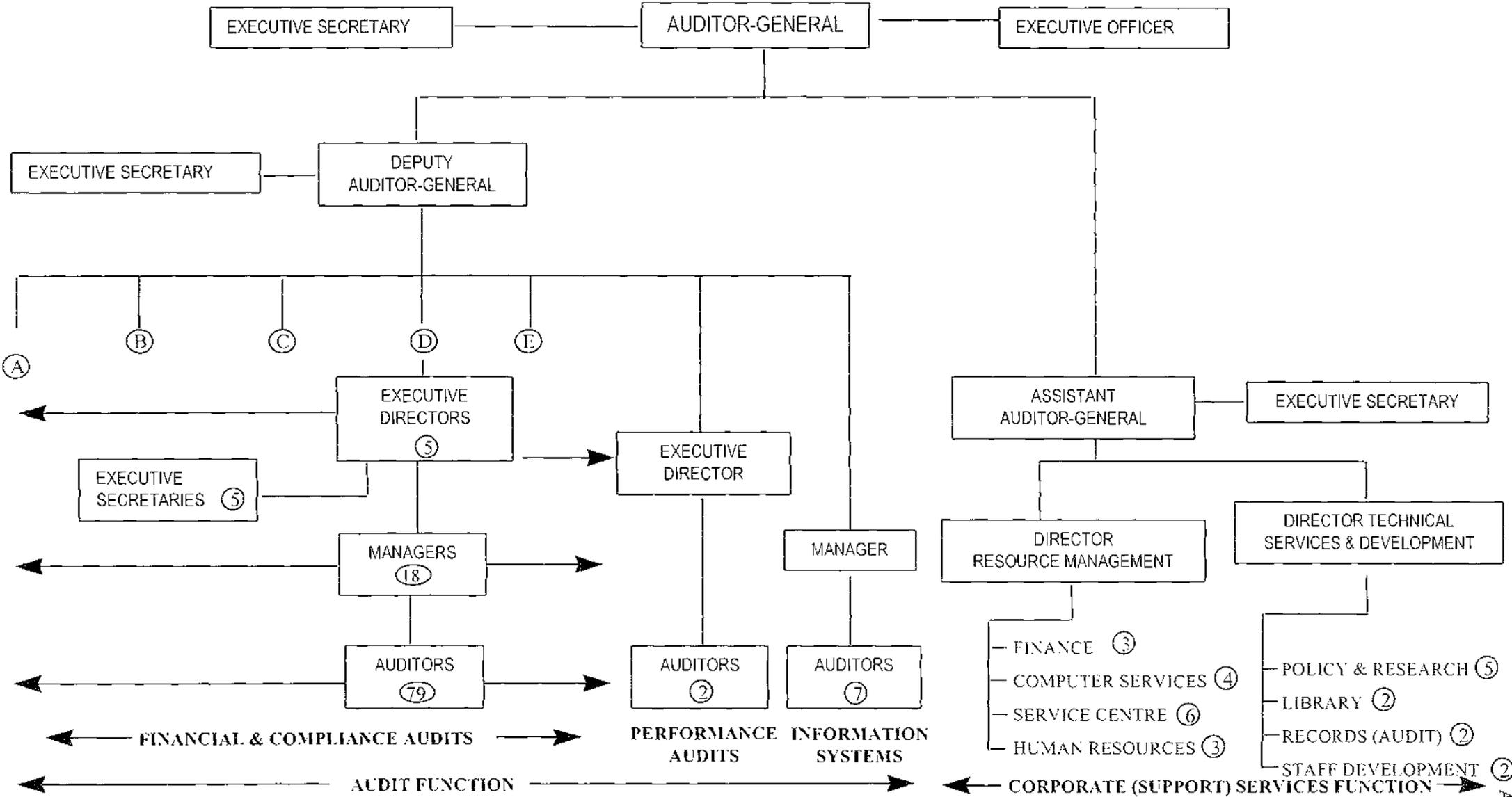
39,000

AUDIT CERTIFICATE
(Signing Officer)*

Audit Hours	Auditor-General	Deputy Auditor-General	Executive Directors	Approved Contract Auditor	Total
0-25	56	2	40	81	179
26-50	29	2	24	7	62
51-100	29	1	25	13	68
101-200	18	2	54	52	126
201-300	4		20	27	51
301-500	7		16	17	40
501-1000	4	2	10	4	20
1001-2000	13	2	6		21
2001-3000	4	1			5
3001-4000	3				3
4001-5000	1				1
5000 and over	4				4
	172	12	195	201	580

* the Auditor-General signs all qualified audit certificates

QUEENSLAND AUDIT OFFICE ORGANISATION AND STAFF
as at May 1997



Ⓐ to Ⓔ represents the 5 Financial and Compliance Audit Groups
 ○ represents number of staff
 Note: the chart is not an accurate representation of relative salary levels

TOTAL ACTUAL STAFF = 154

QUEENSLAND AUDIT OFFICE

INTERVIEWS

New Graduates	2
Auditors	4
Audit Seniors	3
Audit Supervisors	4
Audit Managers	4
Information Systems Staff	2
Executive Directors	5
Corporate (Support) Service Managers	3
Assistant Auditor-General	
Deputy Auditor-General	
Auditor-General	

QUEENSLAND AUDIT OFFICE

AUDITEE INTERVIEWS

- CAPRICORNIA ELECTRICITY CORPORATION
- CENTRAL QUEENSLAND UNIVERSITY
- ROCKHAMPTON CITY COUNCIL
- TOWNSVILLE CITY COUNCIL
- NORTH QUEENSLAND ELECTRICITY CORPORATION
- JAMES COOK UNIVERSITY
- FAR NORTH QUEENSLAND ELECTRICITY CORPORATION
- CAIRNS PORT AUTHORITY
- CAIRNS CITY COUNCIL
- QUEENSLAND RAIL
- QUEENSLAND INVESTMENT CORPORATION
- TRANSPORT DEPARTMENT
- EDUCATION DEPARTMENT
- BRISBANE CITY COUNCIL
- HEALTH DEPARTMENT
- QUEENSLAND TREASURY
- OFFICE OF THE PUBLIC SERVICE

In each case the interviews were with the Chairman (or equivalent) and/or Chief Executive (or equivalent) and in some cases the Manager (or equivalent) of the Internal Audit Branch.

THE REVIEWER AUTHORITY AND PROFILE

- On 23 January 1997, the Governor in Council appointed Mr T.A. Sheridan, under Section 72 of the Financial Administration and Audit Act 1977, to conduct the inaugural independent Strategic Review of the Queensland Audit Office.
- The Terms of Reference for the Review are set out in chapter 3 of this Report.
- Mr Sheridan was the South Australian Auditor-General for a period of 7 years from 1983.
- Prior to taking up that appointment, Mr Sheridan had considerable experience in accounting, information technology and financial and general management in the South Australian public sector, including 10 years as Assistant Under Treasurer and Deputy Under Treasurer in the South Australian Treasury Department.
- He also held Senior Management positions in the Department of Marine and Harbours, Engineering and Water Supply Department and the Woods and Forests Department.
- Following his retirement in 1990 he took up a number of appointments including Deputy Chairman of the Council of the Institute of Medical and Veterinary Science and Deputy Chairman of Medvet Sciences Pty Ltd. Prior to their recent sale he was Chairman of Festival City Broadcasters Ltd and a Director of Austrust Ltd, including Chairman of the Audit Committee.
- Mr Sheridan is also retained as an Executive Consultant for Ernst & Young (Adelaide Office) an international firm of chartered accountants and also a member of the Board of Advice for the Aon Alexander & Alexander Group, international insurance brokers.
- He has also conducted reviews of the Australian National Audit Office (1990) and the New South Wales Audit Office (1995).
- Mr Sheridan is a Fellow of the Australian Society of Certified Practising Accountants.

- Mr Sheridan made known to the Queensland Department of Premier and Cabinet his involvement as Executive Consultant to the Adelaide Office of Ernst & Young, prior to the Department appointing the Brisbane Office of Ernst & Young to undertake the review of the financial and compliance audit component (Chapter 6) of this Review.

**Queensland Audit
Office**

Review of Performance
of Selected Audit
Engagements

July 1997

QUEENSLAND AUDIT OFFICE
REVIEW OF PERFORMANCE OF SELECTED AUDIT
ENGAGEMENTS

JULY 1997

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APPENDICES

- A. Auditees selected for review

1. EXECUTIVE SUMMARY

The Queensland Audit Office (“QAO”) is a large auditing practice, employing approximately 110 professional audit staff. It exists to support the Auditor-General in the discharge of his responsibilities, which are set out in the Financial Administration and Audit Act 1977 (“the Act”).

The overall objective of our review was to examine the effectiveness and efficiencies of the methodologies, practices and procedures of the QAO in carrying out its audit responsibilities. This review forms part of a strategic review of the Queensland Audit Office being carried out by Mr Tom Sheridan under section 72 of the Act.

During the course of our review we inspected workpapers in respect of ten auditees, held interviews with over 20 QAO staff, including executive directors and managers, and have inspected the Auditing Standards and Manuals maintained by the QAO to support their practices.

Summary of Findings

Based on the results of the work carried out under the terms of this engagement we are satisfied that the methodologies, practices and procedures, including quality control procedures, adopted by the Auditor-General and the staff of the QAO are appropriate to discharge their responsibilities effectively.

The audit plans and work papers were adequate to support the opinions given, although there were some instances where the standard of workpaper documentation could be improved . Further details of these matters are set out in section 5 of this report.

The scope of public sector audit work carried out in respect of individual audit engagements is subject to a number of qualitative considerations which, under the powers vested in the Auditor-General under the Act, are subject to his direction only. Those considerations generally relate to matters of probity and propriety and are required to be undertaken in the public interest to ensure the integrity of public sector management and administration.

They are additional to the financial audit and can have a significant impact on the scope, extent and nature of testing carried out by the QAO and can be influenced by factors which come to the Auditor-General's attention from a variety of sources.

As reliance must be placed on the Auditor-General's judgement it is not possible for us to form a view on the extent of testing necessary to address these matters.

Subject to that qualification the audit practices adopted by the QAO in performing audits generally appear to be efficient and are subject to appropriate levels of management controls and quality assurance.

This report, by necessity, records the findings of our review on an exception basis. As would be expected in carrying out a review of audit engagements of this magnitude our review did identify a number of areas where we considered that the audit approach adopted could have been more efficient, as well as some areas where we considered that procedures could have been strengthened. These matters should not detract from the otherwise high standards achieved by the QAO.

In particular we identified a number of areas where further efficiencies could be obtained from the more comprehensive use of technology in carrying out, and in documenting, the audit. Again, specific examples of these areas are set out in section 5 of this report. The QAO has advised us that this issue has been under consideration but, due to budgetary constraints, limited progress has been possible to date. These matters are to be reviewed during the current financial year.

The key issues of significance arising from our review which we believe require attention are:

- control over issue of audit certificates
- standards for qualified audit certificates
- consistency in application of materiality

These issues are summarised below:

Control over issue of audit certificates

Many of the Departments, other public sector entities and statutory bodies audited by the Auditor-General or his delegates prepare printed annual reports for distribution to stakeholders or other interested parties. These annual reports include the Auditor-General's audit certificate.

At present the Auditor-General's practice is to attach his signed certificate to an original set of accounts prior to the printing process, and to stamp each page of the financial statements. The QAO's audit procedures do not appear to require it to extend its audit procedures to the final report issued to stakeholders.

In one instance the Auditor-General had issued a qualified audit opinion on the financial statements of a Statutory Body. The Statutory Body in this case is an unlisted public company with external shareholders. When the financial statements were incorporated into the Statutory Body's annual report the qualification paragraph from the Auditor-General's certificate was omitted, apparently through printer error. We have been advised that this was detected by the auditee before the annual reports were issued to shareholders and was corrected by the inclusion of a loose insert which incorporated the qualified audit certificate.

It appears that the Auditor-General did not become aware of this until some considerable time after the annual reports were despatched to members. The copy of the Statutory Body's annual report held in the QAO's library did not contain the insert.

The annual reports produced by Public Sector entities and Statutory Bodies are used for a variety of purposes. The Auditor-General's audit certificate is likely to be referred to or relied upon by many users in assessing the reliability of the financial information.

We believe that the QAO's audit procedures should be extended to include a final review of the printed annual reports prepared by the auditee, at least for those auditees where a qualified audit certificate has been issued. This review should ensure that the Auditor-General's audit certificate has been included correctly, and that the financial statements are consistent with those to which the Auditor-General attached his original audit certificate. The Auditor-General has indicated that he considers this to be impractical. We, however, regard it as an important procedure to preserve confidence in annual reports which have been subjected to audit by the QAO.

Standards for qualified audit certificates

Australian Auditing Standards issued by the professional accounting bodies in Australia require that, where an auditor expresses a qualified opinion, the audit certificate shall include a section headed "qualification" which includes a clear description of the reasons for and effects of the qualification. On two occasions in the sample of audit certificates which we examined, the Auditor-General had departed from Australian Auditing Standards in the presentation of his audit certificate.

The QAO Auditing Standards state that the QAO will comply with Auditing Standards, although we acknowledge that the Auditor General retains the right to exercise discretion in the application of these standards. Where he believes that such discretion is required, however, we believe that any departure from the Australian Auditing Standards should be supported by full documentation setting out his justification for the departure.

An audit certificate issued by the Auditor-General in respect of one Department contained a qualification in respect of the Department's keeping of accounts. The qualification was included as part of the opinion paragraph and would only be evident if the certificate was read carefully. There was no separate qualification paragraph to draw the reader's attention to this matter, and neither any quantification of the effects of the matter giving rise to the qualification, nor any explanation why the effects were incapable of being measured reliably.

We found the wording used by the Auditor-General confusing. We were advised by the executive director responsible for this audit that the qualification referred to the presentation of the financial statements as well as the keeping of accounts. This was not clear from reading the certificate itself. The standards set out in Australian Auditing Standards issued by the professional accounting bodies are designed to avoid such confusion.

In its response to us on this matter the QAO has commented that “this was not a qualification in the conventional sense”, and has referred to the Auditor-General’s duty to “determine what approach in accordance with the law is appropriate given the circumstances of the case to achieve the desired accountability outcome”.

We also noted another qualified audit certificate where the qualification was included as a separate paragraph under the heading “audit opinion”. Australian Auditing Standards require the paragraph to be headed “qualification”, with the opinion paragraph being headed “qualified audit opinion”. On this occasion the wording of the audit certificate also appeared to be inconsistent with QAO standards.

Australian Auditing Standards are issued jointly by the Institute of Chartered Accountants in Australia and the Australian Society of CPAs. They are developed as a result of an extensive process of consultation, and are specifically drafted to be applicable to both public and private sector audits.

Whilst we acknowledge the Auditor-General’s rights to conduct his audits in whatever way he determines appropriate, we do not consider his departure from Australian Auditing Standards in relation to the form and content of qualified audit certificates to be either appropriate or necessary under the circumstances.

Consistency in application of materiality

We understand that the issue of materiality has no role to play in some aspects of the QAO's work, and particularly in the context of probity and propriety considerations. However, we noted a considerable degree of inconsistency in the interpretation of the QAO's policies in respect of setting levels of materiality in respect of audit engagements. Whilst we accept that materiality will always be a matter of professional judgment to be exercised in the context of each engagement, the level of inconsistency in both the bases being adopted to assess materiality levels, and the use of materiality in the audit process itself appears to be such that inefficiencies may occur.

It appears that QAO staff require further guidance, training and supervision to ensure the appropriate application of materiality standards across all audit engagements.

The QAO has commented that considerations for professional judgment are "vastly different between the public and private sectors" and that a "simplistic mathematical calculation of materiality threshold will not suffice". Whilst we acknowledge these important considerations, we believe there is scope for improvement in the application of materiality in the audits examined by us.

2. OBJECTIVES AND SCOPE

Mr Tom Sheridan has been appointed by the Governor in Council to carry out a strategic review of the Queensland Audit Office in accordance with Section 72(1) of the Act.

We have been contracted by the State of Queensland through the Department of the Premier and Cabinet to assist in this strategic review.

The objectives and scope of our engagement were agreed in a contract dated 4 March 1997, and are summarised below.

2.1 Objectives

The objectives of our engagement were to examine and report on the adequacy and appropriateness of the application of the methodologies, practices and procedures of the QAO to a range of specific audits, and the extent to which audit opinions issued by the QAO comply with applicable professional and operational auditing standards and practices and are:-

- (a) supported by adequate plans and workpapers
- (b) supported by appropriate audit evidence
- (c) supported by appropriate control procedures
- (d) reported in accordance with the statutory responsibilities of the Auditor-General.

In addition, we were requested to give attention to the following matters:-

- (a) the effectiveness and efficiency of the planning and co-ordination of the financial and compliance audits, having particular regard to internal audit of client agencies and the Information Systems Audit Branch of the QAO;
- (b) the appropriateness of the level and mix of testing between substantive, compliance and analytical review;

- (c) the appropriateness of communication with audit clients, including engagement letters and management letters;
- (d) the appropriateness of the QAO's use of technology in the management and conduct of the audit process;
- (e) the extent to which the Auditor-General adds, or can add, value to the financial and compliance audit process.

2.2 Scope

Our review was carried out by reference to the audit work carried out in respect of the 1996 financial years of auditees. In most cases this meant that we reviewed selected workpapers in respect of the 30 June 1996 audit of each auditee, although in one case the auditee's financial year ended on 31 August 1996, and for another the financial year ended on 31 December 1995.

We were instructed to carry out our review procedures on 10 auditees selected by Mr Tom Sheridan. One auditee selected for review was replaced following identification of a potential conflict of interest.

We understand that the final selection for the auditees to be reviewed was structured so as to ensure that our review covered each of the QAO's executive directors and a selection of audit managers. The sample did not include any audits of less than approximately 500 hours duration.

A complete listing of the auditees selected for review is attached as Appendix A.

2.3 Approach

Our planning for this review included a general review of the Act, the QAO's Auditing Manuals, QAO Auditing Standards, Code of Professional Conduct and Quality Assurance Standard.

The general steps followed in conducting our review of each audit engagement were:

1. Obtain general background information about the audit and auditee through completion of engagement profile sheets by QAO audit team.

2. Interviews with the executive director and manager responsible for each audit engagement to obtain further information about the scope, planning and conduct of the audit and any special circumstances.
3. Review of financial statements, audit report file, planning and control files, IS audit files, selected permanent files and selected working paper files for each engagement. The extent of our review of these files was limited to that which we considered necessary to obtain sufficient information . In respect of the larger audits a sampling approach was adopted and we did not review every working paper file.
4. Interviews with each audit manager to discuss issues arising from our reviews.
5. Interviews with the Deputy Auditor-General, and the Executive Officer to the Auditor-General, together with audit directors, managers, and staff as considered appropriate to review the issues raised in our draft report and consider the QAO's response to those issues.

In addition, interviews were held with Mr John Adams, Manager, Information Systems Audit group, Mr Tony Skippington, Manager, Policy and Research, and Mr Paul Shipperley, Audit Manager.

2.4 Personnel

In accordance with our contract, our review was carried out entirely by the following personnel:

Name	Position
Tim Eddy	Partner
Ian Rodin	Principal
Philip Burgess	Manager, Information Systems Audit

2.5 Disclaimer of Responsibility

The extent of our review of audit working papers was limited to that which we considered necessary to obtain sufficient information in order to form a conclusion on the objectives set out above. We have not carried out detailed reviews of each audit working paper file and accordingly do not make any representations about specific audit issues other than those which came to light as a result of our review.

Neither the specific procedures carried out as described above, nor any statement made in this report should be interpreted as implying our concurrence with the audit opinions expressed by the Auditor-General or his delegates on specific audit engagements. This report has been prepared expressly for the purpose set out above and should not be relied upon for any other purpose whatsoever.

The contents of the report are confidential. The report is intended to form part of Mr Sheridan's report to the Minister and the Auditor-General under Section 72(1) of the Act and is not to be used for any other purpose. The report must not be copied or shown to any other party without our express permission in writing.

2.6 Acknowledgments

We would like to formally acknowledge the assistance given to us by the QAO in the conduct of these reviews.

3. BACKGROUND - QAO RESPONSIBILITIES

Any review of the work carried out by the Auditor-General and the QAO must be considered in the context of the responsibilities and powers of the Auditor-General under the Act. These are considered briefly below by way of background information to assist in the interpretation of our findings. The scope of our engagement did not include any reference to the responsibilities and powers of the Auditor-General.

The Act gives the Auditor-General extremely wide powers to control and direct the QAO and the manner in which audits are carried out. Under Section 49(1) the Auditor-General is not subject to direction by any person about the way in which his powers in relation to audit are exercised, or the priority to be given to audit matters.

The Auditor-General must be appointed as auditor of every public sector entity (with the exception of the QAO itself).

The Act sets out some general responsibilities for the Auditor-General in respect of the audit of financial statements of Departments, Statutory Bodies and other public sector entities. These are essentially to report on whether:

- (a) he has received all the information and explanations he required; and
- (b) in his opinion,
 - (i) the prescribed requirements in respect of the establishment and keeping of accounts have been complied with in all material respects;
 - (ii) the statements have been drawn up to present a true and fair view of the financial position and the transactions for the year.

There are variations to these broad responsibilities depending upon the form of the entity being audited, and other legislation which may be relevant in some circumstances, such as the Corporations Law.

In relation to the audit of the public accounts the Auditor-General's responsibilities are extended to include issues such as the control and safeguarding of public moneys, safeguards to prevent fraud, and allocation of moneys to appropriate funds.

The legislation specifically allows the Auditor-General a free reign on how to conduct the audits, suggesting in Section 79(2) that he may have regard to recognised standards and practices.

4. AUDIT STANDARDS AND METHODOLOGY

QAO Standards

The Act requires the Auditor-General to prepare a report to Parliament setting out, amongst other matters, the general standards he applies or proposes to apply in the conduct of audits, and the extent to which such standards are in accordance with auditing standards issued by relevant professional bodies. Where significant changes are made to these standards he is required to prepare a further report setting out the nature of the change and the extent to which the changed standards are in accordance with auditing standards issued by the relevant professional bodies.

Where these general standards are not applied on any occasion of significance the Auditor-General must refer to this fact in his report to Parliament on the conduct of that audit.

To meet these obligations the Auditor-General produces a document entitled “QAO Auditing Standards”. This document was last updated on 1 July 1996 when significant changes were made to ensure the QAO Standards were consistent with the Australian Auditing Standards issued by the professional accounting bodies, which had undergone considerable change.

The QAO Standards are based on the jointly published auditing standards issued by the Australian Society of Certified Practising Accountants and the Institute of Chartered Accountants in Australia, supplemented by additional documents specific to the QAO such as its code of conduct and quality assurance standard.

The QAO Standards include all Australian Auditing Standards with the exception of two which are specifically excluded (AUS 806 “performance auditing” and AUS 808 “Planning performance audits”, which are replaced by the QAO’s own “guidelines for the conduct of audits of performance management systems”).

All Auditing Standards released subsequent to those listed in the QAO Auditing Standards apply automatically unless specifically excluded by direction of the Auditor-General.

Audit Methodology

All financial and regularity audits carried out by the QAO are conducted using a risk-based methodology known as QFAA (Quality Financial Audit Approach). This methodology, which was introduced in 1993-94, was based on the audit methodology of one of the major private sector accounting firms. .

The methodology is partially automated in that audit programs can be derived automatically through the input of data regarding risks and controls.

The methodology is regarded as a broad framework for the conduct of attest audits but is intended to be applied with flexibility. The methodology is supported by audit manuals which provide guidance on the application of the methodology.

The methodology is subject to review by an Audit Methodology Committee, which meets regularly and provides suggestions for improvements to the methodology or the manner in which it is applied. Further modifications to the methodology are generated through the annual peer review program. We understand that, in 1997/98, the QAO intends to conduct a review of developments in audit methodologies since the implementation of QFAA, including a review of developments in audit automation.

The findings from our review indicated that, subject to the matters referred to in more detail in section 5 below, QAO standards and the methodology and procedures set out in the QAO Auditing Manuals had been followed on the engagements inspected by us.

5. SUMMARY OF FINDINGS

We set out below a summary of the findings from our reviews of the various engagement files.

5.1 Adequacy of plans and workpapers

Considerable resources are committed to the planning stages of the audit. On average, for the 10 engagements reviewed, planning accounted for approximately 22% of the actual hours recorded on the engagement, with a range from 15% to 30% for the 10 engagements. The average appears a reasonable level of commitment to planning, although the range is broader than might be expected.

We found that audit planning was generally well documented, and there was adequate evidence on file of review of the audit plans by managers, executive directors and, in many cases, the Auditor-General himself.

Audit workpapers were generally adequate to support the opinions being given by the Auditor-General. There were some exceptions to this, and we have discussed these under “appropriateness of audit evidence” in 5.2 below.

Workpapers are generally prepared manually, and we believe significant efficiencies could be obtained by increasing the use of technology to support workpaper preparation. This is discussed in more detail in 5.9 below. We understand that the QAO has until recently been constrained in this regard by a lack of available funding for the purchase of necessary hardware, but it is planning to review this aspect of its work shortly.

The following matters arose from our reviews:

Time control and budgeting

Planning is a very significant component of the total hours spent on an audit engagement. In one audit, planning time accounted for 30% of the total engagement hours. In seven of the ten budgets and time summaries we inspected, planning was addressed only in total. It is therefore very difficult to assess whether the number of hours being spent on planning is appropriate and whether time is spent efficiently. In three engagements planning time had been considered in more detail, but in two of these audits no detailed budget numbers had been input in the time recording system.

The planning process can easily be dissected into a number of component activities. Budgets for planning, and any other activity accounting for a significant proportion of the total time, should be analysed in more detail to provide greater accountability.

Timing of planning

Planning is not always being completed and reviewed on a timely basis. In two audits, whilst the detailed planning fieldwork had been carried out in either February/March or April/May respectively, the audit strategy memoranda were only signed by the executive director on 26 June and 1 July respectively. In both of these cases the planning work was carried out largely by an audit supervisor and there appears to have been little time recorded by either the manager or the executive director until June. The QAO Auditing Manual is not prescriptive about the involvement of audit managers in the planning stages of the audit prior to the review of the Audit Strategy memorandum. We understand that the delegation of these tasks is at the discretion of the relevant Executive Director. Whilst we acknowledge that the audit supervisor in these engagements had eleven years' experience, we would have expected that, where a manager has been assigned to an engagement, he would at least be involved in initial strategy planning meetings. There was no evidence of this in the time recording systems.

In another engagement the planning did not commence until June. In this case we understand the auditee had experienced difficulties in the implementation of a new accounting system and planning was therefore deliberately deferred until the position with regard to the new system was clearer.

Late planning may increase the risk of inefficiencies in the audit process and can lead to difficulties in obtaining relevant data for testing purposes, particularly where Computer Assisted Audit Techniques (“CAATS”) are being used. In one of the audits where planning had been signed at a late stage the audit strategy documented in the Audit Strategy Memorandum in relation to Information Systems Audit was inconsistent with the conclusions set out in a memorandum from the Information Systems Audit Manager dated prior to the date of the audit strategy memorandum. This appears to have arisen as a result of the planning fieldwork having been carried out at an earlier date. The documented strategy was subsequently amended to take into account the issues raised by ISA.

Changes to audit strategy

The audit strategy followed in the conduct of the audit frequently differed from that agreed in the Audit Strategy memorandum. This is to be expected as circumstances change and audit plans must be flexible to accommodate this.

However, in some cases the rationale for the deviation from the agreed strategies had not been documented on file.

In one case the number of branch visits was extended, with the effect of increasing the hours spent on the audit by 179 hours. There were no explanations in the working papers to account for the reasons for the increased audit effort. We were advised that the additional visits were carried out at the direction of the Auditor-General as it was planned to carry out performance audit procedures at these additional locations and it was decided to carry out additional financial audit procedures at these locations in conjunction with the performance audits. We have been advised by the QAO that the total audit budget for this auditee was reduced by 900 hours to compensate for the amount of time spent on the performance audits. However, the amount of time spent on

financial audits at the branches exceeded the original budget by 179 hours. The executive director for this audit considered that the performance audits had been of considerable value to the auditee.

5.2 **Appropriateness of audit evidence to support opinions**

Generally, the documented audit evidence appeared adequate to support the audit opinions issued by the Auditor-General. Standards of documentation of significant audit issues, however, varied considerably. Whilst most audits had comprehensive documentation to support the consideration of significant issues in some cases we were unable to identify adequate audit procedures in some significant areas.

Documentation of significant issues

In some cases we noted that the audit workpapers did not include appropriate documentation of significant issues arising during the audit to indicate the nature of the issues, what audit procedures were carried out, and how any such issues arising were resolved.

The QAO auditing manual clearly sets out the required procedures in respect of documentation of matters of significance arising during the audit. It requires all such matters to be recorded by the preparation of "Matters for Directors Attention" ("MDA"), regardless of whether the audit manager is satisfied that the matter has been satisfactorily resolved.

The completion of MDAs was inconsistent amongst the audits reviewed. In some audits there appeared to be a comprehensive record of significant matters which had arisen. In others, however, there was little or no documentation to indicate what work had been carried out in respect of particular material issues, and how the auditor had formed this judgment

This included an audit where a qualified audit certificate was issued, yet the issues which gave rise to the qualification were not recorded on an MDA, the current year audit work papers did not include any documentation regarding the QAO's considerations of the issues giving rise to the qualification, and the QAO's procedures in respect of obtaining an independent preissuance review for qualified audit certificates was not followed. The decision not to conduct a preissuance review was made by the Auditor-General and was supported by a recommendation from the Deputy

Auditor-General on the basis that the “position unchanged from previous year”. The note from the Deputy Auditor-General was dated 1 August 1996. We understand that the final audit fieldwork did not commence until 23 September 1996. The auditee in this case was an unlisted public company, reporting under the Corporations Law, and with external shareholders.

The QAO has explained that the issues giving rise to this qualification had arisen in the 1994 financial year and that circumstances had not changed since then. Documentation from the auditee in relation to the issues was inspected on the QAO’s 1994 audit workpapers but had not been carried forward or referred to in the 1996 workpapers. The Auditor-General has asserted that the “substantiation [for this qualification] lies with me”. This is not an appropriate level of documentation under any professional auditing standards.

We have not attempted to assess whether or not the Auditor-General’s qualification of these financial statements was appropriate but note that there was no documentation to provide evidence that the QAO had reassessed the continued appropriateness of the qualification.

In another audit a number of significant audit issues were identified during our review. Whilst the QAO states that it has addressed each of these issues during its audit, no documentation was available to support this assertion. We would normally expect these issues to be documented in the audit workpapers. The issues arising were:

- the value of the auditee’s investment in a controlled entity was written down by a significant amount. Whilst the workpapers included a photocopy of a memorandum prepared by the auditee there were no notes or comments on the file documenting audit procedures carried out to satisfy the auditor in relation to the appropriateness of the write-down, or the resulting carrying value of the investment in the accounts.
- the opening retained earnings of a controlled entity which was being consolidated for the first time were recorded in the consolidated accounts as an adjustment to opening consolidated retained earnings. This is an unusual accounting treatment which can only be applied in conditions specified in the relevant Accounting Standard. There were no workpapers on file to indicate whether this, and other issues relating to the consolidation

such as the treatment of minority interests, had been given any consideration by the auditors.

- the financial statements certified by the Auditor-General were consolidated and did not include any accounts in respect of the holding entity itself. We have been advised by the QAO that no separate accounts are required under the Public Finance Standards, and that the auditee did not require a report on the holding entity which is itself a business unit of a department. We could see no evidence of these considerations on the QAO files.

We have not considered these issues in detail and so have not formed an opinion on whether the treatment adopted by the auditee was appropriate or not. However, we would expect to find clear documentation of the auditor's considerations in relation to these issues.

In another audit, complex accounting issues in relation to accounting for unrealised losses on foreign exchange futures contracts had been raised by the auditee for consideration by the internal auditor. There was no evidence on file that the QAO had independently satisfied itself that the treatment proposed was appropriate and that the treatment adopted by the auditee in the financial statements was consistent with the advice received. In the same audit the documentation of audit work in relation to inventory was confused and difficult to follow.

Changes to audit strategy

We identified two engagements where audit strategies had been changed at a late stage. In both cases the change in strategy resulted in less audit work being carried out. In both cases, however, the original strategies only appear to have been challenged as a result of external factors. This may indicate that there is scope to adopt more efficient strategies in other engagements, or in other areas of the same engagements.

In one engagement the agreed strategy set out in the audit strategy memorandum included the use of audit software to substantively audit a particular application. For a number of reasons the audit software was not run. Instead of carrying out alternative testing the manager rationalised that no further testing should be carried out. This change of strategy was documented in a MDA and

approved by the executive director in August 1996. We do not have sufficient knowledge of the auditee's operations to make a judgment on whether the audit procedures followed were adequate in the circumstances. However, if they were adequate despite the fact that the planned testing had not been carried out, it would be appropriate to question the effectiveness of the original planning process.

A similar situation arose in another audit, where the audit strategy was amended at a late stage. The initial planning had been based upon a preliminary assessment of IT controls being strong and accordingly the planning had included compliance testing of IT controls. When the ISA report was completed it concluded that general controls could not be relied upon.

The audit strategy was amended and this was documented on a MDA. The strategy adopted resulted in very little further audit work being carried out, even though the compliance testing had not been carried out. Again, we are not in a position to conclude on the appropriateness of the revised audit strategy.

5.3 **Appropriateness of control procedures**

The QAO auditing manual has a separate section on supervision and review. This includes a comprehensive policy on the extent of review required.

In all audits examined there was adequate evidence that workpapers had been subject to review at the various levels expected.

There was evidence on most files of consultation with the Auditor-General throughout the audit. This is regarded as a strong control, allowing the Auditor-General to obtain a thorough knowledge of any audit issues on a timely basis, and to contribute to the audit process directly.

Overall we were satisfied with the level of control exercised by QAO. However, whilst not critical to the control of the particular audits undertaken, we did find instances where audit staff members appeared not to have a clear understanding of the real purpose for which particular audit tests were undertaken.

5.4 **Adequacy of reporting in accordance with statutory responsibilities**

The Auditor-General's formal reporting responsibilities are set out in the Act and include, inter alia:

- reports to Parliament in respect of each audit conducted
- audit certificates attached to the financial statements.

In each audit examined in our review the Auditor-General had complied with his reporting responsibilities under the Act. However, two significant issues arose in respect of qualified audit certificates issued by the Auditor-General.

Control over issue of audit certificates

Many of the Departments, other public sector entities and statutory bodies audited by the Auditor-General or his delegates prepare printed annual reports for distribution to stakeholders or other interested parties. These annual reports include the Auditor-General's audit certificate.

At present the Auditor-General's practice is to attach his signed certificate to an original set of accounts prior to the printing process and to attach a stamp to each page of the financial statements. The QAO's audit procedures do not appear to require them to extend their audit procedures to the final report issued to stakeholders.

In one instance the Auditor-General had issued a qualified audit opinion on the financial statements of a Statutory Body. However, when the financial statements were incorporated into the Statutory Body's annual report the qualification paragraph from the Auditor-General's certificate was omitted. We have been advised that this was detected by the auditee before the annual reports were issued to shareholders and was corrected by the inclusion of a loose insert page which incorporated the qualified audit certificate.

It appears that the Auditor-General did not become aware of this omission until some considerable time after the annual reports were despatched to members. The copy of the Statutory Body's annual report held in the QAO's library did not contain the insert.

The annual reports produced by Public Sector entities and Statutory Bodies are used for a variety of purposes. The Auditor-General's audit certificate is likely to be relied upon by many users in assessing the reliability of the financial information.

We believe that the QAO's audit procedures should be extended to include a final review of the annual reports prepared by the auditee, at least for every audit certificate which is qualified. This review would ensure that the Auditor-General's audit certificate has been included correctly, and that the financial statements are consistent with those to which the Auditor-General attached his original audit certificate. The Auditor-General has indicated that he considers this to be

impractical. We, however, regard it as an important procedure to preserve confidence in annual reports which have been subjected to audit by the QAO.

Standards for qualified audit certificates

Auditing Standards issued by the professional accounting bodies in Australia require that, where an auditor expresses a qualified opinion, the audit certificate shall include a section headed “qualification” which includes a clear description of the reasons for and effects of the qualification. On two occasions in the sample of audit certificates which we examined, the Auditor-General had departed from Australian Auditing Standards in the presentation of his audit certificate.

The QAO Auditing Standards state that the QAO will comply with Australian Auditing Standards, although the Auditor-General retains the right to exercise discretion in the application of these Standards. Where he believes that such discretion is required, however, we believe that any departure from the Australian Auditing Standards should be supported by full documentation setting out his justification for the departure.

An audit certificate issued by the Auditor-General for one Department contained a qualification in respect of the Department’s keeping of accounts. The qualification was included as part of the opinion paragraph and would only be evident if the certificate was read carefully. There was no separate qualification paragraph to draw the reader’s attention to this matter, and neither a quantification of the effects of the matter giving rise to the qualification, nor any explanation why the effects were incapable of being measured reliably.

We found the wording used by the Auditor-General confusing. We were advised by the executive director responsible for this audit that the qualification referred both to the presentation of the financial statements as well as the keeping of accounts. This was not clear from reading the certificate itself. The standards set out in Australian Auditing Standards issued by the professional accounting bodies are designed to avoid such confusion.

The executive director responsible for this audit explained that the intention had been to issue a ‘soft’ qualification as the auditee had disclosed the lack of compliance in the financial statements.

However no attempt had been made to quantify the financial effect of the non-compliance. Accordingly a user of the financial statements would have no basis for assessing the impact.

In another case:

- The audit report stated that the audit had been conducted in accordance with “QAO Auditing Standards”. The auditee was reporting under the Corporations Law. *QAO Auditing Standards (7.2.2)* require that the audit certificate should indicate that the audit has been conducted in accordance with *Australian Auditing Standards* when the Corporations Law applies.
- The qualification was not included in a separate paragraph headed “qualification”, and the audit opinion was not headed “qualified audit opinion”, as would be required under Australian Auditing Standards.
- the qualification was in respect of an “ongoing inherent uncertainty” in relation to the Directors’ valuation of certain assets. The audit certificate was issued on 8 November 1996. Australian Auditing Standard AUS 702 was amended in October 1995 with an operative date for audit certificates issued on or after 1 January 1997. However, earlier adoption of this Standard was “encouraged”. Had the Auditor-General chosen to adopt this Standard early in the case of this auditee, it is quite possible that a qualification could have been unnecessary.

Auditing Standards are issued jointly by the Institute of Chartered Accountants in Australia and the Australian Society of Certified Public Accountants. They are developed as a result of an extensive process of consultation, and are specifically drafted to be applicable to both public and private sector audits.

Whilst we acknowledge the Auditor-General’s rights to conduct his audits in whatever way he determines appropriate, we do not consider his departure from Australian Auditing Standards in relation to the form and content of qualified audit certificates to be either appropriate or necessary under the circumstances. In any circumstances where he deems such departures to be appropriate the audit workpapers should be supported by adequate documentation to explain the reasons for the departure.

5.5 Information Systems Audit branch

The QAO's audit policies require general audit staff to liaise with information systems auditors in all audits where the auditee has computer-based systems. In general this involvement should take place initially at the planning stage of the audit. The information systems auditor is required to sign off on the audit strategy memorandum.

During the course of our reviews we examined the ISA files in respect of each audit to assess the effectiveness of the ISA function and the appropriateness of their level of involvement in each audit. We also held extensive discussions with the ISA manager.

Each audit examined had involvement from ISA, although the extent of that involvement varied significantly from audit to audit. This ranged from less than 1% of total audit time, to more than 7%. In one audit ISA actually accounted for over 22% of total hours, however, this included work carried out on bureau applications which was relied upon by other external auditees. The average level of ISA involvement (excluding the bureau applications) was 5.1% of total audit time.

In one case there was insufficient documentation on file to corroborate a conclusion that general controls were poor and could not be relied upon. We were advised that this was because testing was carried out very late in the financial year and, although the controls reviewed were adequate at the time of review, the prior year's assessment had shown that there were deficiencies and these had not been corrected until late in the financial year. As the controls had not operated throughout the audit period it was felt that they could not be relied upon.

The rationale for this decision was not documented on file, and there was no evidence that the conclusion had been challenged by the general audit staff.

There generally appeared to be little evidence of challenging of ISA's findings by general auditors to ascertain whether alternative controls exist, or whether controls could have been relied upon for a portion of the period. Overall, however, we concluded that the involvement of ISA was at an appropriate level.

5.6 **Reliance on Internal Audit**

Each of the 10 auditees reviewed had an internal audit function. In each case the QAO had completed an evaluation of the internal audit unit in accordance with the QAO Auditing Manual.

The QAO concluded that it could rely on internal audit work in 9 of the 10 audits examined. In three cases, however, it was unable to reduce its testing as a result of internal audit work carried out. In two of these audits this was due to resourcing problems within the internal audit function, and in the other case because internal audit had not carried out any relevant work in the areas subject to external audit. In each of the audits where the QAO concluded that reliance could be placed on internal audit procedures, there was evidence on file of liaison with internal audit and of the assessment of their work.

In the remaining audit the QAO concluded it was unable to rely on internal audit as the internal auditors had become heavily involved in the preparation of the entity's accounts and were therefore considered not to be independent.

5.7 **Appropriateness of level and mix of testing**

The level and mix of testing appropriate to a particular audit will always be a matter of judgment to be exercised by a responsible, experienced auditor. It will be influenced by a number of factors, including the assessment of control risk, the extent of assurance obtained from alternative procedures, the level of materiality, and the characteristics of the population being tested.

The QAO auditing manuals contain extensive guidance on determining sample sizes. This guidance has been supplemented from time to time by circulars issued by the Auditor-General to all audit staff, the latest of which was dated 21 June 1995.

Our reviews of audit files, however, indicated significant inconsistencies in the determination of sample sizes.

This appears to be linked with the approaches adopted to the determination of materiality, which varied significantly from audit to audit. Again, the issue of materiality has been the subject of circulars issued by the Auditor-General.

The assessment of materiality has both quantitative and qualitative considerations. In the context of the QAO the major consideration appears to be in relation to the Auditor-General's concerns regarding probity and propriety in public sector entities. We understand that the issue of materiality has no role to play in some aspects of the QAO's audit work, and particularly in the context of these probity and propriety considerations. This is well documented in manuals and circulars, and the Auditor-General's direct involvement in this aspect of the audit work is evident from his comments and input to audit plans. However, whilst the Auditor-General's concerns are well known, there appears to be no consistent approach adopted to satisfy these objectives. As a result each auditor appears to make judgments regarding the extent of additional testing that may be required to satisfy the Auditor-General's requirements for assurance in these areas. As the additional work carried out specifically to satisfy these assertions is not separately identified in the testing plans, it is often difficult to isolate which testing relates to purely financial statement assertions, and which relates to the additional assertions of probity and propriety. This may lead to an unquantifiable element of "overauditing".

At present it is not possible to separately identify the number of hours spent on each audit satisfying the financial statements assertions as opposed to probity and propriety assertions. The planning is also carried out in total. We believe this leads to an element of confusion amongst the audit staff as to the purpose of the tests they are carrying out. This may be avoided if the testing designed to satisfy the probity and propriety accountabilities were planned and budgeted for separately. Regardless of this, however, we recognise that auditors would need to be very aware of these separate objectives whilst performing their financial audits.

The basis for establishing materiality levels for planning purposes varies considerably from audit to audit. However, in many cases there appears to be no clear link between materiality and the extent of audit testing.

We noted a number of examples of inconsistencies in the use of materiality and in establishing sample sizes for testing. These included:

- Recording of minor errors on score sheets. Examples included amounts of less than \$1,500 in respect of an auditee with annual expenditure in excess of \$1bn, and \$14,000 in a Department with annual expenditure exceeding \$2.7bn. Requiring audit staff to record errors of such small magnitude is likely to create a culture where less experienced staff believe that their audit testing should be designed to detect errors which are clearly immaterial and may lead to overauditing.
- In testing expenditure in another audit, a sample size of over 190 items was tested in interim testing, with further samples of approximately 39 items carried out at the final audit. The size of the sample tested in this audit appeared significantly larger than samples used in compliance testing on other audits.
- In one audit materiality levels had been set at a higher level for balance sheet accounts than for income and expenditure accounts. Other than in the assessment of balance sheet classification we believe this approach to materiality is conceptually flawed since errors detected in the balance sheet may impact on the income and expenditure account, and if the balance sheet has been audited to a higher materiality level, the desired level of assurance in the income and expenditure account may not be obtained.
- In another audit the auditee had conducted fixed asset counts at each of its locations. The auditee has over 100 locations. The QAO strategy relied upon this key control. Instead of testing a sample of locations to ensure that asset count certificates had been obtained, the QAO staff listed and checked that certificates had been obtained from all locations.

5.8 Appropriateness of communication with auditees

The formal communication requirements in respect of each audit are set out clearly in the QAO Auditing Manual . These include:

- *engagement letters*, which outline the auditor's responsibilities and summarise audit protocol;
- *management letters*, which record weaknesses and deficiencies detected during the audit, together with recommendations for improvements;
- *referral letters*, which summarise the results of the audit, including items which require a response from the auditee.

In the audits examined during our review each of these audit requirements had been complied with adequately with the exception of one audit where no engagement letter had been sent. In this case we understand that the QAO decided not to issue an engagement letter due to changes taking place within the Department being audited, and that these issues had been raised with the auditee and advised to the Legislative Assembly.

We noted that the communication with auditees appeared to be very formal. For example, engagement letters appear to be used largely as a method of communicating statutory responsibilities. We believe that there are opportunities to expand these letters to include more detail regarding shared expectations from both the auditor, and the auditee. This may include, for example, an outline of expectations in respect of information to be made available for audit purposes, summaries of significant issues expected to arise and agreed plans for their resolution, expectations of levels of assistance from internal audit, and timing of audit visits.

5.9 Use of technology

The use of technology within the audits carried out by the QAO is relevant in three areas:

- the use of Computer Assisted Audit Techniques (“CAATS”) and other automated analytical audit tools to enhance audit efficiencies;
- the use of automated workpapers and basic technology to improve audit efficiencies; and
- in providing technical support to auditors.

CAATS and other audit software

CAATS are used extensively on audits at an appropriate level. CAATS can either be developed and run by ISA staff following instruction from general audit staff, or in some circumstances, can now be developed and run by general audit staff using IDEA audit software. This software was being piloted during the 1996 audits and was used in a number of the audits reviewed by us.

The major uses of the audit software in the audits we reviewed were for the extraction of audit samples, including identification of large or unusual items in populations being tested.

Automation of audit workpapers

The QAO’s audit workpapers are currently largely manual. The use of word-processing and spreadsheeting software in the preparation of audit workpapers was not extensive, and was inconsistent from audit to audit, although there was evidence of extensive use of word processing capabilities on two audits.

Significant opportunities exist to improve efficiencies through the more consistent and effective use of these skills as an integral part of the audit process.

Specific examples of areas where use of technology would improve efficiency include:

- audit strategy matrices; these are prepared for each significant account being audited, and summarise the levels of risk and audit approach to be adopted to satisfy all the various audit assertions. By their nature these matrices are likely to be similar from year to year and should only require updating for changes in the auditee's operations or controls, or agreed changes in audit strategy. There are often a large number of matrices required to cover all the significant accounts and audit assertions. In many cases these matrices were handwritten. In one smaller audit examined, 33 matrices were prepared, each of them handwritten. Use of word processing in preparation of these matrices would save considerable time in updating for future years.
- management comment fact sheets ("MCFs") are prepared to record weaknesses and deficiencies noted as a result of audit testing. These are subsequently used to prepare management letters and, along with Matters for Director's Attention ("MDA") sheets are used in drafting audit and referral reports. In the audits reviewed as part of this examination there were often large numbers of MCF sheets. In most cases these sheets were handwritten. As a result, when these comments were incorporated in the management letter or referral report, they would have to be rewritten. Had these been drafted using word-processing documents, the time taken to incorporate them in subsequent documents would have been significantly reduced.
- we also noted some examples where software was used, but was not adequately capitalised on in the audit process. In one case CAATs had been used to extract a sample of approximately 160 expenditure items for audit testing. Instead of using the CAAT listing to record the results of audit testing on each item sampled, the auditor wrote a manual workpaper listing each of the 160 items selected for testing.

Full automation of audit workpapers could increase efficiency further, and offers a number of other advantages such as convenience, and savings in storage space requirements. However, the successful introduction of automated workpapers at the QAO would require a significant investment in both training and technology.

The QAO has commented that its ability to capitalise on these opportunities has, until recently, been limited by the lack of funding available for the purchase of the necessary computer hardware. However, we understand that this has now been addressed.

We understand that the QAO intends to carry out a review of automated audit workpaper products in the next financial year.

Technical Support

The QAO's auditing methodology is supported by comprehensive audit manuals, which are issued to all staff. These are further supported by regular "A-G Circulars" which are issued by the Auditor-General to provide additional guidance in new and developing areas.

The QAO Auditing Manuals were issued in March 1994, when the QFAA methodology was introduced and have not been updated since, other than through A-G circulars.

Induction training is provided to new auditors to familiarise them with the methodology, and we understand that copies of past A-G circulars are available for inspection in the QAO library.

Since the A-G circulars are not accountable documents it is difficult to establish whether all staff, including new recruits, are in possession of a comprehensive manual containing current policy. Updates to policy manuals should therefore take place through regular manual updates rather than through A-G circulars.

The automation of these manuals and circulars should be considered. It would allow easy access for auditors on site at auditees' premises and would facilitate regular updating of the manuals. We understand that the QAO Audit Methodology Committee has established a project for 1997/98 to review the methodology in the context of current developments in the auditing profession, and that this will include an assessment of automated workpapers.

5.10 Adding value

The role of the Auditor-General and the QAO in public sector auditing is stated in the QAO Audit Standards in terms of providing assurance in respect of financial reporting, making appropriate recommendations concerning improvements to public sector accountability generally, and monitoring and reporting on accountabilities in respect of probity and propriety matters.

The growing pressures for greater efficiencies and “value-adding” have been recognised by the Auditor-General and have been addressed in an AG Circular to all audit staff. The Auditor-General, in this circular, envisages three areas in which the QAO can add value by assuring:

- the community that the Government is a good helmsman;
- the Government that the relevant public sector entity is providing the appropriate goods and services at competitive prices and according to a specified quality standard; and
- a public sector entity that contractors are providing the goods and services at specified prices and in terms of quality standards.

The current focus of the QAO is on providing value through providing assurance on compliance with relevant legislation, and in maintaining an appropriate level of internal controls. It seeks to deliver this through its various reports, including management letters.

With the current moves towards commercialisation and corporatisation in the public sector, we believe the needs of both Parliament and of the auditees are changing. Whilst the QAO clearly has a role in monitoring the actions of accountable officers in complying with their accountabilities under the Act, the primary responsibility for compliance rests, as always with the accountable officer.

We believe that the QAO can play a significant role in this. This appears to have been recognised by the QAO in the circular referred to above, where the Auditor-General states that Executive Directors are to “ examine ways of removing themselves from involvement in detail to allow for more time for strategic considerations relating to their audits.”

5.11

Other matters arising

Staff Continuity

A number of the audits examined showed a lack of staff continuity. With the exception of the executive directors and managers, most staff had no more than one year’s previous experience on the audits examined. We understand that the QAO have attempted to resource engagements such that at least 2 staff, including the executive director, have prior experience of the auditee.

While difficulties with resource availability is recognised, lack of continuity can lead to inefficiencies in carrying out the audit work, particularly in respect of familiarisation time. This is often not recorded, or not separately identified, but in those audits where it was separately identified, it was significant.

On two audits, lack of staff continuity had apparently resulted in significant levels of testing being carried out by the managers. In these cases the total manager time represented 30% and 28% of the total audit time. This is an inefficient use of manager time, and can lead to quality assurance difficulties if their work is not adequately reviewed.

Executive Directors - Time charged to engagements

In 7 of the 10 engagements examined the amount of time recorded to the engagement by the executive director was 2% or less of the total hours. In three of the audits, the total hours recorded by the director was less than ten hours, with the lowest being just two hours.

It is not clear why the hours recorded by the executive directors are so low, but would seem to indicate that directors are either not recording all the time which they spend on audit engagements, or are not getting sufficiently involved on audits.

Allocation of time costs to engagements

In addition to the comments noted above, there were a number of indications that staff do not record all the hours they spend on individual engagements. This appears to be a result of budget pressures.

Appendix 1

Auditees Selected for Review

Auditee	Audit Hours <i>(1995/96)</i>
Suncorp	7210
Treasury Department	4184
University of Queensland	1933
CITEC	560
Go Print	494
Department of Health (Central Office)	1133
Grainco	1145
Department of Training and Industrial Relations	4368
Cairns Port Authority	800
Department of Education	3487

MATTERS OF SIGNIFICANCE

[pursuant to Section 72(9) of the Act]

COMMENTS OF:-

PREMIER

AUDITOR-GENERAL

NOTE:

Where reference is made in these comments to a page number in the Report, please increment any reference to page numbers 8 and above by 3 (i.e, for page 41 now read page 44)



PREMIER OF QUEENSLAND

Executive Building • 100 George Street, • Brisbane, Q. 4000 • Telephone: (07) 3224 4500 • Facsimile: (07) 3221 1496

18 AUG 1997

Mr T A Sheridan
Unit 4C, Saltram Towers
20 South Esplanade
GLENELG SA 5045

Dear Mr Sheridan

I refer to the Report on the Strategic Review of the Queensland Audit Office (QAO) you forwarded to me on 17 July 1997. Under the provisions of the *Financial Administration and Audit Act 1977* ('FA&A Act'), you have invited me to comment on the Report prior to its publication.

The Queensland Government remains committed to the independence of the Auditor-General in determining QAO priorities and operations. I do not therefore intend to comment upon your findings and recommendations in relation to the internal operations and management of the QAO, other than to note with satisfaction the positive findings with respect to the direction the QAO has taken over the five years since the Electoral and Administrative Review Commission ('EARC') and Parliamentary Committee for Electoral and Administrative Review ('PCEAR') reports on Public Sector Auditing. I understand you have given the Auditor-General opportunity to respond directly on your Report and doubtless he will have something to say on these matters.

I note your comments linking public perceptions of the independence of the Auditor-General to recommended changes to the audit mandate and to budgetary arrangements. I agree with you that the scope of the audit mandate and adequate resourcing are pivotal to maintenance of public trust in the independence of the Auditor-General and the QAO from interference by executive government.

Dealing with resourcing issues first, I believe it should be noted that the QAO budget has increased by \$4.37M, or 36 percent, since 1994-95. This significant increase in resources under the present Government has, moreover, taken place in a context of fiscal austerity faced by most public sector agencies. It is also worthy of note that the level of carryovers experienced by the QAO since 1994-95 suggest that the organisation has not fully utilised the resources with which it has been provided. Carryovers in 1994-95 were \$0.595M, in 1995-96 \$0.342M, and in 1996-97 \$0.509M. It is clear, then, that if any suggestion were to be made that executive government in Queensland has in any way attempted to force the QAO to heel through control of resources, such a proposition cannot be sustained.

I also note that s68(3) of the FA&A Act provides for consultation between the Treasurer and the Parliamentary Public Accounts Committee ('PAC') in the development of the QAO budget each year. The only difference between existing provisions and your recommended approach (as contained in the *Auditor-General Bill 1996* (Cth) at present before the Commonwealth Parliament) would be that the PAC would be required to be given a copy of the draft estimates for the QAO prior to finalisation. Whilst there may be some benefit to be gained from the suggested reforms, I do draw to your attention Report No. 38 of the Parliamentary Criminal Justice Committee (PCJC), 'Report on the Accountability of the CJC and the PCJC'. In that Report, the PCJC commented favourably on s68(3) of the FA&A Act and in fact has recommended that the *Criminal Justice Act 1989* be amended to reflect the current construction of s68(3) of the FA&A Act.

I turn now to the matter of the audit mandate. The Report makes an explicit link between perceptions of independence and a capacity for the Auditor-General to carry out a full program of performance auditing, alongside the existing program of financial and compliance auditing. I note in this context the EARC and PCEAR recommendations of 1991-1992 and the subsequent extension of the audit mandate to include 'performance management systems'. I also note the development of the QAO's performance management system auditing capacity in response to this extended mandate.

The Queensland Government in general believes that the greatest potential threat to the perceived independence of the Auditor-General lies in the development of conflict between the Auditor-General and executive government over matters of policy. There is real danger that efficiency auditing exercises may overstep the mark in terms of criticism not only of management, but of government policy itself. Where this has happened in other jurisdictions, executive government - which quite properly maintains a monopoly on policy determination - has responded with consequent public disagreement with auditors-general. It seems on the available evidence that the development of conflict along these lines is structural and systemic rather than being tied to the partisan politics of particular governments. It is in the interest of the Queensland polity and of the Auditor-General that such conflict be avoided.

That said, your Report certainly makes out a case for the audit mandate to include some provision for performance auditing. The Parliament and taxpayers of Queensland have a right to know that resources are both properly and appropriately expended. The key to judicious development of a performance auditing capacity seems to me to lie in the relationship between the Auditor-General and the PAC, about which your Report also comments.

Recent changes to the Public Finance Standards issued under the FA&A Act place a great deal more responsibility than previously on agency chief executives in terms of reporting performance and performance management to Parliament. In his existing financial and compliance auditing and performance management systems auditing mandates, the Auditor-General now has adequate capacity to detect weaknesses and areas of inefficiency. The PAC through its own resources may also become aware of efficiency concerns in particular agencies. There may be case for equipping the

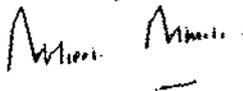
PAC with authority to refer agencies or programs to the Auditor-General for report on efficiency audit.

Lastly, your Report makes a number of findings and recommendations about the relationship between the Auditor-General and Parliament, and about the role of the Auditor-General in enhancing public sector management generally. In general, I believe that the existing legislative framework provides an adequate basis for the development of the Auditor-General's reporting relationship with Parliament. Any deficiencies identifiable in existing practice may be sourced to Parliament and the Auditor-General rather than the legislative structure.

Regarding the Auditor-General's role in enhancing public sector management, I agree that the Auditor-General is well placed strategically and in terms of professional resources to play a leading role. There are, however, arms of executive government which are significant players on this stage - notably the Office of the Public Service and the Treasury Department. Your Report states that the Auditor-General should consult with the Commissioner of the Office of the Public Service (as well as the PAC) on public sector management issues. While the Government would welcome development of such a relationship as optimising resources in scrutiny of management, there may well be some perception issues which will need to be addressed before any formal steps are taken in this direction.

I take this opportunity to thank you on behalf of the Queensland Government for the work you have put into this inaugural Strategic Review.

Yours sincerely

Handwritten signature of Rob Borbidge in black ink, consisting of a stylized 'R' followed by 'Borbidge'.

Rob Borbidge
Premier



QUEENSLAND AUDIT OFFICE

Your ref:

Our ref: 00-2510

5 August 1997

Mr T A Sheridan
QAO Strategic Review
20 South Esplanade
GLENELG SA 5045

Dear Mr Sheridan

I refer to your letter of 17 July 1997 in which you ask for comment on your report on the Strategic Review of QAO which you were appointed by the Governor-in-Council to perform in terms of s.72 of the *Financial Administration and Audit Act 1977*.

The report has been carefully studied both by myself and the Deputy Auditor-General as well as other members of QAO's Executive Management Group and it is out of that process the following observations are offered.

It is pleasing to note the overall positive tick you have given to the outcome of the considerable effort which all at QAO have put in over the past five years to give effect to needed and some long overdue reforms highlighted by the Electoral and Administrative Review Commission (EARC) in its Report on Public Sector Auditing in Queensland which was released in September 1991.

To my mind the success flowing from the journey of reform is well captured in the following statements from your report, and I quote -

"QAO devotes considerable effort to the recruitment, training, professional development and general well being of its people. As a consequence it has a well-qualified, skilled and professional workforce".

"The Auditor-General, through the QAO conducts a sound public sector audit practice".

"...auditees...recognised the significant improvement in the approach and capability of the QAO" and "the ease of accessibility to the Auditor-General and his staff".

In relation to the range of issues arising from the Review about which you have given coverage in your report, the comment that they **"should be seen as no more than the next logical step in a program of continuing management improvement in the QAO"**, is noted.

QAO acknowledges through its Corporate Plan a commitment to continuous improvement and professionalism and where fitting and within its capacity to do so will consider action as appropriate in relation to your suggestions. That said, I feel obliged to raise a number of concerns QAO has with some of your conclusions and recommendations concerning aspects of our operations, the imbalance, at times, of your reporting of issues and other inaccuracies.

My comments largely follow the sequential order of your report as requested.

1. EXECUTIVE SUMMARY

1.1 Key Point - Dot 5 (Page 1)

Given the positive comments which you have made about the professional approach and attitude of QAO staff and the pride they have in what QAO stands for, I am somewhat perplexed about the strength of your statement which reads **“The Corporate organisation and culture needs improvement”**.

When one links that statement to the body of the report from which it is drawn (page 41, Chapter 5), I would question whether the matters which seem to be at the heart of your comment warrant such a strong emphasis. The remark at the foot of page 41 that **“Management needs to urgently address and resolve these concerns”** seems to overstate the real situation and I shall explain why. There are two issues which appear to bring you to your conclusion. The **first** issue which colours your comment relates to the settling of reports and management letters.

Taking the matter of report writing in its widest sense, the documents which emanate from the Office of Auditor-General must conform to a high standard of accuracy of content and balance and observe good literacy conventions. I know of no Audit Office which can achieve these aims (and they all have them) in any free-flowing, one-write manner.

You have acknowledged on page 47 (Chapter 7) of your report that the current Reports of the Auditor-General to the Legislative Assembly are well presented, easy to read and understand. In noting that as a compliment to all at QAO who have played a substantial part in achieving such a recognised high standard, it is difficult to come to terms with your quite categorical conclusion referred to above and the urgency of resolution you attach to it.

I am the first to admit that formal writing befitting an Audit Office can be time-consuming. On the other hand sloppiness can damage image and credibility.

In common with most employers today, QAO suffers from a much debated phenomenon of modern education which has seen a reduction in literacy skills. QAO is mindful of this and has attempted to overcome the problem through report writing courses and one-to-one counselling.

The **second** issue which colours your comment relates to your perception that QAO is driven by some demonic fear of making a mistake. That is nonsense. Certainly, an Audit Office should not be paranoid about “making mistakes” but no Audit Office can afford to be slack or careless in its work and reporting. There is a fine balance to be achieved in all of that but the point you fail to acknowledge is your own comment which is that the staff are skilled, professional and dedicated to their work. It is their professionalism which causes them to avoid “a mistake” not any overlording by senior management.

Neither is there any culture of fear existing within QAO rooted in any past enquiry or review as you seem to imply. There is certainly a recognition of the past and what can be learned from those events. To dismiss history too lightly is foolish.

With any professional person, attention to detail will vary and I see nothing wrong with that. The fact that one officer may give more attention to a piece of work than perhaps another, does not, in my view, give justification for an automatic conclusion that e.g. overauditing occurs or could occur. The issue of personal pride cannot be ignored. In any event, QAO’s Risk Based Audit Methodology serves to stifle any excessive overauditing should that emerge. In QAO, staff do give freely of their time and I would suggest that is the mark of any professional. It is not something to be concerned about provided the general well-being of staff is not overlooked which, I note, you have recognised as a positive in QAO’s case.

1.2 Key Point - Dot 6 (Page 1)

This dot point states **“The Corporate Vision and Reporting to Parliament needs to be widened”** (Chapter 7, Pages 47-48).

Again your choice of words is bemusing as it suggests something lacking in my understanding of the reporting role of the Auditor-General as currently enshrined in the Financial Administration and Audit Act. In Chapter 7 you have acknowledged the benefit to the Parliament of the Reports now submitted. I might add that the recommendations of EARC in relation to reporting have been recognised and mostly implemented by me as considered appropriate.

As to whether the Auditor-General should be required to provide a treatise on or summary of the State's finances in his/her report to the Parliament is something for the Parliament to determine and I might add, fund.

In Queensland and elsewhere in modern times, an approach has been adopted to public reporting and accountability as reflected in the *Financial Administration and Audit Act 1977*. This approach places clear responsibility for financial reporting with management (the Financial Administration and Audit Act explains the mechanisms). The Auditor-General has been given wide discretion by the Act about the matters requiring reporting to the Legislative Assembly but has no specific role to play in financial reporting. In other words, the model of exception reporting for the Auditor-General was introduced.

These particular reporting responsibilities of both management and the Auditor-General were fully enshrined in the Financial Administration and Audit Act with the 1985 amendments. The new distinctive and respective financial reporting responsibilities were seen as placing the onus where it properly belonged (on management) leaving the Auditor-General to fulfil the external audit role. There is nothing preventing the Auditor-General reporting to the Parliament upon the financial management of a public sector entity where that management was found to be wanting.

As this State and most others are progressively requiring their public sector entities to adopt accrual-based accounting and reporting principles with Whole of Government Reporting on the horizon, the concerns you seem to have about current cash based reporting practices should largely be overcome. The distinction between capital and recurrent expenditure will become apparent. It is the intention for all of these statements which are based upon Australian Accounting Standards 29 and 31 to be audited and certified by the Auditor-General and conveyed by the Treasurer and Accountable Officers to the Parliament. Indeed, AAS 29 has application for 1996-97. Under normal circumstances I do not see a need for any further financial reporting or commentary by the Auditor-General additional to that now called for in the *Financial Administration and Audit Act 1977*.

2. INDEPENDENCE (CHAPTER 4)

In this Chapter there are three matters which I wish to address.

There is firstly the recommendation that **“there be close consultation between the Auditor-General, the Public Accounts Committee (PAC) and the Public Service Commissioner on public sector management issues”**. In part, the recommendation troubles me.

I recognise the right of the Public Accounts Committee through the *Parliamentary Committees Act 1995* to refer issues within its area of responsibility to the Auditor-General for consideration however I do not accept the desirability of **“close consultation”** with the Office of the Public Service other than in its capacity as an auditee of the Auditor-General.

What concerns me with your suggestion involving the Public Service Commissioner is the possibility for compromise of the Auditor-General's independence. The Office of the Public Service and the Commissioner are part of the Premier's Department and in their management review roles mostly take their remits from the Premier who has responsibilities in this regard under Division 1 of Part 4 of the *Public Service Act 1996*. The Auditor-General must stand apart from central agencies in order to maintain objectivity.

Secondly, in regard to the suggestion under **Resources** calling for a form of accountability to the PAC by the Auditor-General about a past year's work in conjunction with the next year's budget considerations, I do not favour the idea as it could be most unproductive largely for the reason you yourself give on page 27 of the report where the statement is made "**The review process (by PAC) needs to recognise the operational flexibility provided to the Auditor-General in terms of s.49 of the *Financial Administration and Audit Act 1977***". Experience has shown that in any audit year the Auditor-General has to adjust audit priorities to enable mandated work to be completed on time and as well cope with a range of unplanned enquiries and investigations. This calls for judgements to be made by the Auditor-General as to the use of resources which are rightly his by law to make.

I have yet to learn of any Public Accounts Committee which contemplated a role for itself in directing or monitoring the Auditor-General's work plan. Indeed at biennial conferences of Australasian Public Accounts Committees there have been clear expressions of contrary views. As well, Public Accounts Committees have clearly stated that they do not wish to be captives of Auditors-General. Your proposal has shades of an Audit Committee model and that I oppose. Independence for an Auditor-General from the Parliament is equally as important as it is from the Executive Government.

As for the manner in which you suggest the Auditor-General's budget should be considered and determined, I would be more inclined to press for a greater commitment to a working of the current provisions of s.68(3) of the *Financial Administration and Audit Act*.

While there are some recognised limitations associated with the current and indeed past arrangements for allocating funding for the Auditor-General's purposes, they have usually produced outcomes acceptable to the Auditor-General and have recognised the substance of your statement "**that an Auditor-General's Office cannot expect to be immune from accepting its fair share of general public sector budgetary constraint...**".

Thirdly, on the matter of the expanded performance audit mandate which you recommend, that is an issue for the Government to determine and I make no comment about it other than to say that QAO has worked hard to set the scene for the type of audits the Parliament envisages in terms of s.80 of the Act, i.e. audits of performance management systems.

In 1995, QAO published a booklet titled "Guidelines for the Conduct of Audits of Performance Management Systems" and earlier in my First Report to the Parliament on audits performed for 1993-94 (21 November 1994) I appended a statement outlining how I envisaged these audits being conducted, managed and reported upon in terms of Queensland law.

For 1995-96, I tabled the first discrete report on "Performance Management Systems Audits" conducted relative to that year although matters of a performance nature were previously included in the principal annual reports of the Auditor-General to the Legislative Assembly.

Early this year, a small separate unit was established headed by an Executive Director to concentrate on performance management systems issues but in association with the five principal audit Groups. Much is being achieved and I believe the incremental approach adopted by QAO over the past few years reflects the advice given to the Auditor-General by EARC.

3. CORPORATE MANAGEMENT (CHAPTER 5)

3.1 Organisational Change

The process of organisational change which QAO embarked upon nearly 5 years ago was founded upon a professional Change Management Strategy (acquired externally) which was clearly enunciated to all staff both then and since. All structural reorganisation over time involving the abolishing and establishing of relative positions etc., has observed the protocols of that framework. There are no just reasons to halt any process now in train. It will continue.

In relation to the relative size of QAO's Corporate Support Services, I draw your attention to our projected number (29) for 1997-98. That number has already been achieved and may reduce further as the full effects of the new financial and human resource management systems materialise. In any event, I do not now consider the level of staff in Corporate Support as excessive as at least six staff are fully involved on technical investigatory work and compilation of six reports to the Parliament in any one year. Additionally, technical support involves policy and procedural memoranda, maintenance of QAO's range of audit and administrative manuals and professional development and training. All of this work performed by a relative few is critical to the ongoing effectiveness of the public sector auditing program.

Benchmarking QAO's level of Corporate Support Services against that of other Audit Offices provides a reasonable basis of comparison and it shows, in relative terms, that QAO is not overstaffed in that area of administration. To use the South Australian Audit Office as a benchmark is misleading as it has a staff complement of 106 (QAO - 172), a budget of \$8 million (QAO - \$16 million) and audits numbering approximately 241 (QAO - 580).

Again, it is not correct, in my view, to relate the number of QAO's corporate services staff to the number of permanent staff at any point in time as you have chosen to do. QAO's financial resourcing is based upon a staff complement of 174 and any reduction in permanent numbers for a variety of reasons (secondments, maternity leave, etc.) must be overcome through contracting-in of labour which has to be serviced, albeit differently from the permanent workforce. Based upon QAO's staff complement, the ratio of corporate services staff to the whole is in the order of 17 per cent and is within the benchmark of 20 per cent previously recognised by Treasury as acceptable. Detailed information on QAO's Corporate Services goals, planned performance for 1997-98 and compared with estimated actuals for 1996-97, was included in the 1997-98 Ministerial Program Statements which were endorsed by the Premier and form part of the year's Parliamentary Budget Papers. The information was accepted by the relevant Estimates Committee during my appearance before it on 10 June 1997.

3.2 Benchmarking QAO's Performance

At page 29 of your report you recite eight factors which you regard as essential to achieving an efficient and effective audit practice and as you point out you have used those factors as a means of benchmarking QAO's performance. The use of the phrase "**effective audit practice**" suggests to me that you are modelling QAO on the private sector and in that regard I have much concern about the substance of factor (d) "**establishment of appropriate charge-out rates to recover all costs and provide an acceptable rate of return**".

The particular offending words are "**acceptable rate of return**" which suggests that you are promoting some expectation that a public sector audit office should return a profit/surplus on its year's activities. That idea runs totally against Parliament's intention for the Office of Auditor-General in this State and elsewhere I would suggest, and certainly offends your own objection to the model being promoted in another State where a commercially focussed arrangement for the audit role is being contemplated but vigorously opposed by a whole range of parties including the Australasian Council of Auditors-General (report Page 10). Such an approach would, in my view, be contrary to enhancing the independence and freedom of action by the Auditor-General espoused by EARC and which the Financial Administration and Audit Act has so ably enshrined.

In your report you express some support for the current Commonwealth proposals as to how funding for the Auditor-General in that jurisdiction is to be determined. Those proposals give some role to the PAC. I feel you have failed to recognise under that model that audit fees are not intended to be charged for "departmental" and other budget funded agency audits which is contrary to Queensland's practice. I would suggest it is for the reason of "no fees" that a stronger oversighting role is proposed for the Commonwealth PAC. In Queensland, QAO's performance is substantially judged in terms of the criteria mentioned on page 37 of your report.

3.3 Classification Structure

Under the heading of **Classification Structure** (Page 33), reference is made to the need for a motivated workforce and recognition of achievement which you suggest can be handled in either a material or non-material way. I have no quarrel with the point of view so expressed but it seems to me that you overly emphasise the "material" aspect of recognition.

QAO resides within the Public Service and is bound in its salary structure by the Public Service Award-State subject to proper evaluations of established positions according to approved criteria. While the salaries at some levels may be lower than those of their private sector counterparts, this is not so at the more junior level as you seem to imply. The public service scale is mostly superior at that level. Your proposition that QAO's staff exit rate at the lower end of the establishment is brought about by staff seeking access to more attractive salaries is not wholly borne out by the evidence collected by QAO through its exit interviewing process in which I participate.

The reasons given for leaving QAO are many and varied and have a lot to do with the attitude of young people today who are conditioned to exploring a range of jobs in their search for wider skills. One cannot argue greatly against the benefit likely to accrue to them as a result of those ambitions. In some cases, departure has resulted from an officer's personal assessment that they were unsuited to the auditing environment.

QAO's average turnover rate of 13 per cent is well below that of most Australian audit jurisdictions. As you have said in your report (page 38), QAO has no difficulty in recruiting well credentialed officers and this suggests that the issue of salary is not necessarily an inhibiting factor as terms of employment are explicitly conveyed, for example, at University Campus presentations and in QAO's promotional literature.

In relation to higher staffing levels and staff development, every practical effort is made to support external secondments as a means of grooming and growing staff. The present system of audit allocations within QAO recognises differing work values based upon audit complexity and therefore provides challenge and stimulation. The new *Public Service Act 1996* (effective 1 December 1996) gives a Chief Executive Officer (Auditor-General in QAO's case) much more autonomy and flexibility in determining the number and classification levels of employees within the organisation. I have acted to exercise those powers.

3.4 Planning Process

Your understanding of QAO's Yearly Audit Planning process (Page 35), is not correct and your report gives a misleading picture.

For example, for the 1996-97 audit year, the Deputy Auditor-General issued memoranda in September 1996 to all Executive Directors - Audit and Audit Managers outlining the Planning Process.

Essentially this recognised QAO's commitment to a well structured planning process, based on sound rationale through the application of QAO's approved risk-based audit methodology.

The objectives of QAO's planning process are two-fold -

- to determine the resources required to achieve desirable audit coverage to enable input as appropriate to the Treasury budget process; and
- to produce a work program that can be achieved within anticipated available resources.

Anticipated resourcing requirements are progressively injected into QAOMIS (audit management information system) prior to 31 October. There is no impediment to the process for the reasons you suggest. Mostly, feedback from myself and the Deputy Auditor-General is finalised on the resource projections shortly after 31 October resulting in the production of an approved overall QAO resource model for the ensuing audit year.

Detailed audit strategies may result in changes to original budgets and these strategies are progressively prepared over the ensuing months for approval by the Executive Directors - Audit and in some cases only after further presentation to myself and the Deputy Auditor-General.

The process I have outlined does not suggest one that is "rushed" as you infer. Sufficient time is allowed for audit staff to prepare realistic budgets and amend those budgets after discussion as outlined previously.

I see no need for QAO to address the planning issue for the reasons you promote.

Under the heading of **Audit Review** (Page 37), you suggest that QAO gives only tentative recognition to the cyclical approach to auditing and you state that Ernst & Young reinforced your view.

QAO does not recognise the cyclical approach to auditing as having any validity in the application of a modern-day audit methodology. That approach phased out with Systems Based Auditing some years ago.

The principles of QAO's Quality Financial Audit Approach (QFAA) do not recognise that certain aspects of an entity's financial operations can be excluded from audit examination/analysis simply on the basis that coverage may have been provided during the course of a prior audit period. Rather, the methodology in guiding the development of the audit strategy requires an annual determination to be made aimed at identifying areas of risk and materiality and to respond by directing audit activity to those areas as appropriate. The foundation of QAO's audit planning lies in the evaluation of audit's cumulative knowledge of the public sector entity, including its operations and the environment in which it operates, the accounting and management information systems and internal control structure upon which management places reliance. The Audit Strategy document is dynamic in its nature and is reassessed at key stages of its execution and amended subject to approval.

3.4 Staff Performance

In the segment on Professional Development under **Human Resource Management** (page 38), you infer that QAO's Staff Appraisal System has largely one purpose in mind and that is to serve as a means of determining promotion. The facts are that under the existing and former scheme entered into with staff, a guarantee was given by management that under no circumstances can any officer's appraisal material be accessed by a selection committee unless authorised by the officer concerned. This guarantee has been rigorously observed. Your inference is without foundation.

4. FINANCIAL AND COMPLIANCE AUDIT (CHAPTER 6)

4.1 Overall Observation

The observations of Ernst & Young in respect of their contract to review files, etc., associated with a range of audits performed by QAO during 1995-96 as selected by you and in terms of your direction, are noted.

It is gratifying to learn that Ernst & Young confirmed that QAO's audit methodologies, practices and procedures including quality control procedures are regarded as appropriate to discharge the mandate of the Auditor-General.

I recognise that audit efficiencies may be attainable through automation of audit and other manuals including automated workpapers and these issues are scheduled for examination during 1997-98. Any substantial progress in this regard could not be made until the point had been reached where every auditor had personal computer power. That position has only just been achieved within the last two months.

4.2 Audit Certificates

In their report, Ernst & Young make much of two issues which you have classified as -

- (a) control over the issue of audit certificates; and
- (b) standards for qualified audit certificates.

You claim that both issues relate to professional standards; presumably you mean professional Auditing Standards.

I do not consider that point (a) has any relevance to auditing standards. There is nothing in the auditing standards which requires an auditor to supervise the printing of an entity's annual report including the audited and certified financial statements.

Under the *Financial Administration and Audit Act 1977*, a public sector entity is obliged to forward its annual financial statements to the Auditor-General for audit and once certified by the Auditor-General those statements must be returned to the entity for inclusion in the Annual Report for submission to the appropriate Minister and tabling in the Legislative Assembly. The degree of responsibility, for example, which the Parliament places on the entity (and not the Auditor-General) relative to publication, can be found in s.46(f)(9) of the Financial Administration and Audit Act which reads "**All copies of the financial statements so published shall be true copies of the statements certified**".

While in the private sector the practice may be observed whereby the auditor does check the "printers proof" of the financial statements and audit certificate, there are considerable logistical difficulties attaching to the observance of that approach in the public sector where the audit mandate embraces nearly 600 entities scattered throughout the length and breadth of Queensland. It would be impossible to effectively perform the task suggested by Ernst & Young within the tight publishing timeliness contained in the Financial Administration and Audit Act even if this were only confined to qualified opinions.

It seems to me that Ernst & Young's recommendation is driven by one incident where a statutory body in its first printing of the audit opinion omitted the qualified audit reference. The body immediately remedied the situation by inserting an "erratum" in the Annual Report. I was satisfied that there was no deliberate intent on the entity's part and I might add that in our experience such occurrences have been extremely rare. On this basis, there are no compelling reasons to require the Auditor-General to oversight an entity's printing and publishing processes. Indeed, I would suggest that the Parliament has recognised the logistical difficulties involved by placing responsibility where it should appropriately lie (with management).

On the matter of standards of audit certificates, the Parliament gives clear direction to the Auditor-General in relation to their content. This can affect their form as the certificates to financial statements are required to state whether all necessary information and explanations have been received, and whether in the Auditor-General's opinion the prescribed requirements in relation to the keeping of the accounts have been materially complied with and that the statements have been drawn up in accordance with the prescribed accounting standards.

In all of that there are three key matters to consider and they are -

- (a) It is the Auditor-General's opinion that is called for.
- (b) It is the prescribed requirements which the Auditor-General must recognise and these embrace a wide range of law but particularly the Financial Administration and Audit Act and its subordinate law.
- (c) It is the prescribed accounting standards which the Auditor-General must recognise and these are the Australian Accounting Standards, etc., as edicted for application to public sector entities under the Financial Administration and Audit Act.

In performing the audits necessary to give the audit opinions required by the Parliament, the Auditor-General is granted considerable latitude. In essence, while the Parliament leads the Auditor-General to a recognition of contemporary Auditing Standards, it does not limit the Auditor-General to such standards in conducting an audit and in reporting upon the audit.

Therefore, on that basis, the way in which the Auditor-General may wish to draw attention in the audit certificate to an issue falling within (b) and (c) above is solely for the Auditor-General to determine. In most cases, the standardised form of audit report (or a version of it) recommended by the Australian Auditing Standards is adopted but where a different approach is taken (the subject of Ernst & Young's concerns), I believe that is solely a matter for the Auditor-General by law to determine for reasons believed to be appropriate to the particular circumstances.

In addition, my Reports to Parliament clearly outline all qualified audit certifications given during the course of a year.

Ernst & Young, in my view, failed to sufficiently appreciate the personal responsibilities of the Auditor-General under the Financial Administration and Audit Act and the personal nature of any action flowing from those actions which may not always accord with the private sector's interpretation of the professional auditing standards.

5. ACKNOWLEDGMENT

I note from your letter of 17 July 1997 the intention to include my comments in your final report.

Yours faithfully



B M ROLLASON
Auditor-General