ASSURANCE AUDITING IN A CHANGING AGPS ENVIRONMENT

Pat Barrett, AO
Auditor-General

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1. Introduction

This Paper is a companion to that presented to performance audit students at the University of Canberra, titled “Performance Auditing in a Changing APS Environment”\(^1\). I consider it is timely to also review the important role assurance auditing undertaken by the Australian National Audit Office (ANAO) plays in improving public sector accountability. Assurance auditing is largely seen in a financial statements reporting context but is not confined to that context, as our Business Support Process Audits show and, indeed, as do varying elements of our performance audits.

Since it was established in 1901, the ANAO has been the independent auditor of the Australian Government Public Sector (AGPS). The \textit{Audit Act 1901} was the fourth piece of legislation passed by the Australian Parliament, and was described by the then Treasurer, Sir George Turner, as legislation that the “…legislature needed to enact in order that the work of the Government may be properly carried on”\(^2\). Our role in providing the Parliament with assurance over its accounts is no less important today than it was when the office was first established. To many, despite the growth in performance auditing, this is still regarded as the ANAO’s key role.

**A Changing Accounting Environment**

AGPS entities used cash accounting until the mid 1980s when Government Business Enterprises began to use accrual accounting for reporting purposes. Other AGPS entities followed suit from the mid 1990s. The budget framework under cash accounting was very prescriptive, allowing agencies little-to-no financial flexibility. Budget-funded agencies often received appropriations for a specific project in a specific location. As well, very detailed cash accounting disclosures were required to report on actual expenditure for each element of funding.

A number of reforms to the AGPS took place from the mid to late 1990s to promote more of a performance culture. The result of these reforms has been to encourage flexible management of resources to achieve desired outcomes and deliver identified outputs. The reforms were also aimed at providing suitable delegation of responsibilities within strengthened governance arrangements. The reforms included those listed in Table 1 below.

In April 1997, the Government decided to implement an accrual-based outcomes and outputs framework for managing the resources in the public sector. The first accrual budget was in 1999-2000. The accrual budgeting reforms more directly aligned the budget process with the annual reporting framework. The new accrual-based outcomes and outputs framework is a key component in creating a more competitive, efficient and effective public sector.

The policy objective was to provide a better framework for deciding and managing what should be produced and at what price, assessing how well it is produced and how it contributes to the government’s planned outcomes.
Table 1 – Recent Significant Financial Reforms for the AGPS

<table>
<thead>
<tr>
<th>Introduction of accrual accounting for agencies and Whole-of-Government:</th>
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<tbody>
<tr>
<td>• accrual budgeting;</td>
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<tr>
<td>• budgeting and reporting by outcomes and outputs (not detailed programs);</td>
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<tr>
<td>• output pricing reviews;</td>
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<tr>
<td>• principles of sound fiscal management for the Government through the <em>Charter of Budget Honesty Act</em>;</td>
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<tr>
<td>• government service charters;</td>
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<tr>
<td>• performance improvement cycles; and</td>
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<td>• competitive pricing policies.</td>
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<table>
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<th>Refinement of:</th>
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<tr>
<td>• broad reaching mandate for the ANAO through the <em>Auditor-General Act</em>; and</td>
</tr>
<tr>
<td>• accountability and corporate governance through the introduction of the <em>Financial Management and Accountability Act 1997</em> and the <em>Commonwealth Authorities and Companies Act 1997</em> by:</td>
</tr>
<tr>
<td>- sharpening accountabilities for chief executives and boards, involving devolving responsibility to agency heads or boards of directors;</td>
</tr>
<tr>
<td>- highlighting standards of ethical behaviour and probity; and</td>
</tr>
<tr>
<td>- aligning financial and accountability arrangements for Government Business Enterprises with those for the private sector.</td>
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The financial framework for the AGPS has by no means become stagnant after experiencing considerable change in the latter part of the 1990s. There are also a number of changes involving accounting issues that are currently impacting upon the AGPS, including:

- adoption of Australian equivalents to International Financial Reporting Standards (IFRS);
- convergence of Australian Generally Accepted Accounting Practices (GAAP) and Government Finance Statistics (GFS);
- increasingly compressed financial reporting timetables for the AGPS; and
- convergence of Australian Auditing Standards with International Standards on Auditing.

As shown in Figure 1, the effects of these changes have broad-reaching impacts upon AGPS entities and the ANAO. These reform programs are largely running concurrently, and identify some broadly overlapping issues for resolution. As such, each reform program will impact upon agencies in generally the same timeframe. Consequently, matters arising from their impacts will require almost simultaneous resolution involving many of the same people, thus exacerbating their effects.

While by no means less important than previous AGPS reforms, the more recent reforms are, in the main “…evolution, not revolution”, in that they are incrementally improving the accounting and budgeting framework in place. However, there is no doubt that the AGPS is still coming to grips with the accrual accounting environment, both from a systems and management viewpoint.
The AGPS itself is constantly changing and evolving to meet growing public expectations. To keep pace with these expectations, the Government has introduced a range of initiatives through both legislative and policy reforms. Adding to the impact of these reforms, there are a number of contemporary issues that are relevant to the Australian Government’s governance arrangements and external reporting processes. Many of these issues also pose challenges for the ANAO with respect to Assurance Auditing. These include:

- restoration and maintenance of the public’s confidence in the accounting profession;
- accountability and performance measurement in arrangements involving Joined-Up Government (at all levels) and/or arrangements involving both public and private sector entities working together to provide public services;
- managing the accrual budgeting and financial management framework in the public sector; and
- reporting of broader corporate social responsibilities.

These challenges will be outlined later in this Paper, including a discussion as to how the ANAO is dealing with them.
2. Our Environment

It is useful to outline the environment in which the Auditor-General and the ANAO operate in order to provide some perspective on the approach being taken in assurance auditing. The intention is that this provides for a better appreciation of that approach as part of the ANAO’s performance of its audit function.

**Role**

The Auditor-General, with the assistance of the ANAO, provides an independent review of the performance and accountability of the public sector in its use of public resources. Through the delivery of an integrated range of high quality audit products that are timely, cost effective, and consistent with public sector values and ethics, the ANAO aims to meet the needs and expectations of the Parliament, the Executive, and audit clients, and to add value to public sector performance and accountability. As with other public sector organisations, the ANAO expects to be judged both by its results and the manner in which it achieves those results.

The ANAO provides independent assurance to the Parliament, the Executive, Boards, Chief Executive Officers (CEOs) and the general public on the financial statements and financial administration of AGPS entities. The ANAO also aims to improve public sector administration and accountability by adding value through an effective program of performance, including Business Support Process audits and related products, for example, Better Practice Guides (BPGs). A growing element of the ANAO’s value-adding activities is the communication of the ANAO’s activities and their outcomes, through representation at a range of Parliamentary committees and agency audit committees, and through interaction with the Boards of government authorities and companies. The ANAO also seeks opportunities to contribute to the development of the accountability framework, including better practice and standards in public sector accounting and auditing, and through professional and other audit bodies in Australia and overseas.

**Legislation**

The *Auditor-General Act 1997* (the Act) is a robust piece of legislation founded on the important notion of audit independence. The Act establishes the Auditor-General as an ‘independent officer of the Parliament’ – a title that symbolises the Auditor-General’s independence and unique relationship with the Parliament. Consequently, while the ANAO is part of the changing auditing landscape currently challenging both public and private sector auditors, it is also set apart from it due to its statutory independence. This is one of the ANAO’s major strengths that enhances its reputation, credibility and effectiveness.

The Act outlines the mandate and powers of the Auditor-General and the functions of the ANAO as the external auditor of AGPS entities. Specifically, Part 4 of the Act governs the activities undertaken by the ANAO. These activities are described in some detail later in this paper.
**Mandate**

The Auditor-General has a broad mandate, currently enshrined in the *Auditor-General Act 1997*, to audit the financial statements of all Australian Government entities and, subject to some qualifications, for example in relation to Government Business Enterprises, to undertake performance audits of those entities. A particular challenge in public sector auditing is the increasing tension about the role of national audit offices, and observing the boundaries between government policy and its implementation. The Auditor-General’s performance audit mandate stops short of review of Government policy decisions. The scope of a performance audit may, however, incorporate the audit of information leading to policy decisions, an assessment of whether policy objectives have been met, and an assessment of the results of policy implementation both within the administering agency and, externally, through other involved bodies. But essentially, the audits are about administrative processes, including the implementation of policy.

**Contribution to the Parliament**

The Parliament is the ANAO’s primary client. The ANAO’s interaction with both individual parliamentarians and parliamentary committees, provides the opportunity to ensure that financial and performance audit products and services are tailored to Parliament’s needs. The most important interaction is with the Joint Committee of Public Accounts and Audit (JCPAA) and its review of our reports, resourcing and appointments, which is explained in more detail later. The ANAO’s relationship with the Parliament is crucial to its ability to maintain the quality and relevance of the ANAO’s audit products. It is the Parliament, through the JCPAA and its recommendations, that makes the ultimate decision on the ANAO’s resources. This is important for signalling the independence of the Auditor-General by, for example, removing the issue of fee dependence between auditor and auditee in the Australian Government Public Sector.6 This is clearly a different relationship to that experienced in the private sector. Nevertheless, all ANAO products are fully costed as an important part of its accountability to Parliament. This is also important for benchmarking our audit services.

**Independence**

Corresponding with overall public sector changes, the role of the Auditor-General and the place of auditing in democratic governance have also changed. While the accountability imperative remains constant, the role of the ANAO has evolved to take account of, and respond positively to, the ongoing public sector reform agenda. In today’s environment, the ANAO’s role includes providing independent assurance on the overall performance, as well as on the accountability, of the public sector in delivering the Government’s programs and services and effectively implementing a wide range of public sector reforms. The importance of the independence of the Auditor-General in this respect cannot be overstated. As the public and private sectors converge; as the business environment becomes inherently riskier; and as concerns for public accountability heighten; it is vital that Auditors-General have all the professional and functional freedom required to fulfil, fearlessly and independently, the role demanded of them.

The independence of the Auditor-General is a key feature of our democratic system of government. Three elements are crucial to reinforcing the independence of the Office:
the powerful *Auditor-General Act 1997*; direct financial appropriation as part of the Budget process; and the ability of the Auditor-General to develop and set professional auditing standards for his/her Office. In practice, the latter are largely those set by the Australian Auditing and Assurance Standards Board (AuASB), which are now being converged with the international standards on auditing issued by the International Auditing and Assurance Standards Board (IAASB). The ANAO takes an active role in commenting on the development of, and changes to, these standards.

The way in which the ANAO performs its functions further reinforces its independent status. The ANAO operates in an advisory capacity, rather than participating directly in decision-making by public sector managers. While ANAO officers are encouraged to ‘stand in the managers’ shoes’ in order to understand the complexities of the particular business environments under review, it is for the managers themselves to decide whether or not they will act on ANAO or other advice with reference to their particular risks and opportunities. This is one essential difference between management consultancies and the public sector audit approach. The ANAO’s ‘observer status’, as public sector auditors, reduces the risk of conflict of interest issues arising in the course of its work. However, that does not absolve the ANAO from any responsibility to the Parliament for its views and actions.

A particular issue exposed in various reviews of corporate governance has been that of audit independence, which is at the heart of an effective governance framework. The debate over audit independence is not new, although it has attained an increased profile in the wake of the recent corporate difficulties and collapses in Australia and internationally. Audit bodies, and the accounting profession worldwide, have been actively engaged in clarifying and reinforcing independence for many years. This is illustrated by the international study undertaken on behalf of the International Federation of Accountants (IFAC) last year, aimed at restoring credibility and confidence in the profession.7

While the ANAO takes a professional interest in this ongoing debate, it is also set apart from it by virtue of its statutory and functional independence. Nevertheless, there is also an operational imperative, with the ANAO outsourcing a proportion of its audit work to private sector accounting firms. As well, with the increasing use of such firms by the public sector for internal audit, the ANAO often uses their work, with some retesting, in coming to an audit opinion on organisations’ control environments and financial statements. In the latter respect, the ANAO has to be satisfied that the work has been done consistently with the independence requirements of the auditing and assurance standards.

The principles of audit independence in Australia are detailed in the Professional Statement F1, entitled ‘Professional Independence’8, released by CPA Australia and The Institute of Chartered Accountants in Australia (ICAA) in 2002. Compliance with the Professional Statement F1 by CPA and ICAA members has been mandatory since 31 December 2003. Under F1, independence is defined as:

(a) *Independence* of mind—the state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgement, allowing an individual to act with integrity, and exercise objectivity and professional scepticism; and

(b) *Independence* in appearance—the avoidance of facts and circumstances that are so significant a reasonable and informed third party, having
knowledge of all relevant information, including any safeguards applied, would reasonably conclude a firm’s, or a member of the firm’s, integrity, objectivity or professional scepticism had been compromised.

The concept of auditor independence in Australia is further strengthened by the provisions of Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) (CLERP 9) Bill 2003 which incorporates the following measures designed to enhance auditor independence:

- the role of the Financial Reporting Council (FRC) will be expanded to cover oversight of the audit standard setting process and monitoring and advising on auditor independence;
- auditors will be required to meet a general standard of independence and make an annual declaration that they have maintained their independence;
- disclosure will be required of certain matters in relation to all non-audit services;
- restrictions on certain employment and financial relationships will be introduced and/or enhanced;
- auditors will be required to rotate after five years (and up to seven years where Australian Securities and Investments Commission (ASIC) relief has been granted);
- auditors will be required to attend company Annual General Meetings (AGMs); and
- ASIC will be given a power to impose conditions on auditors’ registration.

The Bill was passed by the Parliament on 25 June, and will apply from the latter of 1 July 2004 or the day after the Bill receives Royal Assent. The roles that auditor independence and CLERP 9 play in restoring the public’s confidence in the accounting profession are discussed in more detail later in this paper.

Client focus

It is vital that the ANAO continues to be an active participant in the public sector’s negotiation of the changing AGPS environment. While, in the past, the ANAO’s prime focus may have been on ensuring compliance with legislation, including parliamentary appropriations, this has now been subsumed as part of a broader approach to assist agencies in improving public sector administration. To be successful, this approach requires considerable cooperation between the ANAO and the agencies and other bodies with which it deals. This means that our relationship management strategies are given particular prominence, with links being constantly formed and strengthened, particularly with our major clients. The ANAO does this through a range of activities including assistance to parliamentary and agency audit committees, liaison with state/territory and international counterparts, through forums such as the International Organisation of Supreme Audit Institutions (INTOSAI) and the Australasian Council of Auditors-General (ACAG), and ongoing interaction with the accounting profession, particularly through the major accounting bodies.

Such is the strategic importance of meeting clients’ needs, it comprises the first of the ANAO’s four key results areas on its balanced scorecard. The objective is to satisfy the
needs and expectations of the Parliament, the Executive Government, and audit clients in relation to performance assurance and accountability. The ANAO aims to do this by enhancing our dialogue and relationship with all members of Parliament and Parliamentary committees—particularly the Joint Committee of Public Accounts and Audit (JCPAA)—so that they are fully informed about the ANAO’s activities. As well, this should better place us to provide them with timely and constructive assistance, including secondment of ANAO staff to assist parliamentary committees in reviewing matters relevant to our audit reports. The ANAO also strives to build on its product and professional relationships with the Executive Government and each of its audit clients, so that it can continue to meet their audit related needs and contribute to public sector reform in our particular areas of knowledge and expertise, without undermining our independence.

It is important that the ANAO works cooperatively with agencies to gain genuine acceptance and implementation of its recommendations. We need to do so if the ANAO is to be effective, add value, and maintain its credibility as an agent of change. The ANAO’s preferred approach is to encourage agencies to take necessary remedial action and to make improvements, by acknowledging and reinforcing any action taken by them in the course of our audits. ANAO officers endeavour to meet formally and informally with agency senior management throughout the year. In particular, the ANAO promotes their interest and involvement at the start of each audit and in planning processes, to facilitate progress and completion of the audit, as well as commitment to its findings and recommendations. Finally, the ANAO aims to meet its clients’ needs by periodically reviewing the relevance and mix of its products and services, striving for innovative approaches, and continually improving the quality and effectiveness of its products and services. The above initiatives are aimed at securing the engagement and commitment of all stakeholders to the ANAO’s work and its reports.

The ANAO also builds regular and ongoing liaison with its stakeholders into its annual planning process. The most important aspect of this, in terms of setting strategy for the Office over successive financial years, is the development of the ANAO’s annual audit work program (AWP).

A particularly important facet of the ANAO’s ongoing work with stakeholders is the relationships that have developed with the audit committees of individual agencies. Financial legislation introduced in January 1998 required all Australian Government bodies to establish an audit committee. The ANAO sees its relationship with audit committees as one of partnership. Senior ANAO staff routinely observe and participate in meetings of these committees. Through this mechanism, the ANAO seeks to: develop its linkages with overall agency review processes; co-ordinate the ANAO’s AWP with the range of ongoing internal agency review activities; and strengthen the effectiveness and credibility of audit committees in the eyes of both internal and external stakeholders.

Finally, senior executives at the ANAO have a requirement for Parliamentary liaison built into their individual performance agreements. The ANAO’s ultimate aim is to be accessible to Parliament and the AGPS, to enhance the reach and significance of its work, and to maintain its relevance and credibility through the acceptance, and implementation, of its audit findings and recommendations. Our particular emphases are on remedial action as necessary, better practice, and achievement of required results, while reflecting public service values and ethics.
ANAO Accountability

Annual report

The ANAO’s annual report is the most public and comprehensive mechanism for demonstrating its accountability to the Parliament. The ANAO aims to include an analysis of achievements to date, as well as perceived challenges for the future. In this way, the ANAO provides Parliament with a comprehensive overview of its performance over the preceding financial year and an indication of areas of priority and commitment for the future.

The annual report includes an assessment of the Office’s achievements against its annual balanced scorecard. The scorecard incorporates the ANAO performance indicators set out in its Portfolio Budget Statements.

Each year, the ANAO’s annual report also includes results of quality assurance processes including peer reviews and benchmarking activities. It also includes commentary on the key strategic issues targeted by the ANAO for the next 12 months. This commentary, together with the publication of the results of the ANAO’s audits in its activity reports, allows the ANAO to contribute to contemporary debate on a broad range of issues facing the AGPS. Importantly, the commentary also provides a focus for ongoing discussion with the Parliament (notably the JCPAA), in setting appropriate strategies for the future. We regard such initiatives as being essential for Parliamentary assurance.

Client surveys

Another important performance management and assessment mechanism is a survey of agencies and entities conducted separately from the Office. After each performance audit is tabled, feedback on the audit process is sought independently from the senior entity manager responsible for the audited program by means of a questionnaire and interview. An independent consultant performs this evaluation. The results of the most recent survey were positive, with key indices at their highest levels since the survey was commenced in 1997–98. Agency managers continued to support the ANAO’s efforts to move to a more ‘value adding’ approach. They also referred to the value of ANAO reports and recommendations in providing assurance, and in obtaining leverage to facilitate particular organisational strategies and activities. This survey is one of the most direct and credible ways that the ANAO has to test that its ongoing commitment to relationship management with entities is achieving required results.

In addition, as well as the regular contact that the ANAO has with the JCPAA and other Parliamentary committees, the ANAO conducts face-to-face surveys of parliamentarians. These surveys are conducted every two years to help ensure, for example, that the ANAO is ‘hitting the mark’ in terms of its product mix. They also provide greater assurance that the ANAO will continue to be able to respond to the challenges of the future, and that it has a shared understanding of appropriate standards of accountability to lead and/or guide agencies in this important respect into the future. This imperative is a priority, reflected in related criticism by the Senate Committee on Finance and Public Administration of the AGPS in recent years.
Other External scrutiny

In addition to the aforementioned review and quality assurance procedures, the ANAO is subject to several layers of other external scrutiny, including those applying to all other AGPS agencies and entities. The most important of these are:

- the JCPAA, in reviewing all the ANAO’s reports to Parliament, as well as its annual budget; and
- the Independent Auditor of the ANAO, who carries out both the audit of the ANAO’s financial statements and selected performance audits.

The JCPAA is a statutory committee with members from both houses of Parliament, and has particular responsibilities for the ANAO. The JCPAA considers the operations and performance of the ANAO; reports to the Parliament about the Auditor-General’s functions and powers; and makes recommendations to the Parliament on the annual budget for the Office. The Committee reviews all ANAO reports and examines a selection at quarterly public hearings. The JCPAA may also conduct more broadly-based inquiries into matters arising from an audit.

ANA0’s Auditing Standards

Section 24 of the Auditor-General Act 1997 requires the Auditor-General to set auditing standards to be complied with by auditors performing:

- the audit of the [Whole-of-Government Consolidated] annual financial statements prepared by the Finance Minister in relation to the Commonwealth;
- financial statements audits of Commonwealth agencies, authorities, companies and their subsidiaries;
- performance audits of Commonwealth agencies, authorities, companies and their subsidiaries, including general performance audits; and
- financial statements and performance audits of the Australian National Audit Office.

The Auditor-General sets these Standards, referred to as the ANAO Auditing Standards. They express the minimum standard of audit work expected of auditors conducting audits on behalf of the Auditor-General. The standards are largely based on those of the Australian Auditing and Assurance Standard Board, as indicated earlier.

APS 1.1 Conformity with Auditing Standards requires members of CPA Australia and the ICAA to undertake audits in compliance with Australian Auditing Standards. A significant portion of the ANAO’s financial statement audit staff are members of either, or both, organisations. To require compliance with these standards by other staff, the Auditor-General has adopted as the Statement of Conformity with ANAO Auditing Standards, the Statement APS 1.1 with references to “members” in APS 1.1 being read as references to “auditors to whom the ANAO Auditing Standards apply”.

The content of these standards is very important in demonstrating how the ANAO undertakes its audits, as they outline the requirements to be met by our audit teams. The following section of this paper outlines in some detail the requirements in relation to assessing risks, and the implications of these assessments for the financial statement audit processes.
Ensuring adequate audit coverage is essential in meeting the objective of any financial statement audit. That objective is to “enable the auditor to express an opinion whether the financial report is prepared, in all material respects, in accordance with an identified financial framework”.11

This section provides a brief overview of the ANAO’s financial statements audit process, including how a risk-based approach is applied to ensure audit effort is focussed on areas of greater risk.

**Overview of the Phases of a Financial Statement Audit**

The ANAO financial statement audit process is conducted in four phases:

- planning;
- interim;
- hard close; and
- final.

These phases are explained below.

**Planning**

Planning is perhaps the most critical phase of the financial statements audit process. It allows audit teams to gain knowledge about the entity, which is then used to update the entity’s business profile. This knowledge includes such elements as changes to business activities, management structure, accounting procedures and control environments. Well developed planning enables a strategic audit approach to be developed, identifying the key risks faced by the entity, as well as areas where more detailed audit examination will be required.

**Interim**

The interim audit phase assesses and tests those systems and processes used to generate financial statement information. The results of these tests are then evaluated to determine whether the entity’s financial system can be relied upon to generate relevant and reliable information for financial statement purposes. An assessment is also made as to whether the planned audit strategy and procedures require amendment.

The ability of an audit team to rely on the entity’s controls to prevent, or detect and correct material errors reduces the amount of substantive testing required to verify the year-end balances. In times of compressing reporting timetables, these types of efficiencies are of growing importance to ANAO financial statement audit teams. However, they must also provide considerable assurance for the organisation’s management and confidence in their decision-making.
**Hard Close**

Hard close procedures are performed when a client is able to prepare a full set of financial statements prior to the year-end balance date. Testing at hard close includes:

- ‘top up’ testing of controls to ensure they continued to operate efficiently as intended for the entire reporting period;
- analytical procedures (including year-end balance predictions);
- additional process analysis; and
- substantive testing aimed at verifying financial statement amounts.

Performing a hard close benefits both the client and the ANAO in a number of ways. A hard close may identify certain areas of concern, leaving the client with enough time to rectify the situation prior to year-end, where time to do so is at a premium due to the tight reporting timetable. The ANAO benefits by being able to reduce the amount of work required at year-end, with some of the work having already been completed, and so easing the peak workload with benefits to all concerned. The importance of hard close procedures is set to increase, with Commonwealth financial reporting timeframes set to compress even further next year.

Performing a hard close is one step towards ‘real time auditing’. Such an approach assists agencies more expeditiously and is of “… increasing value to our audit clients.”

**Final**

The final audit phase is designed to substantiate the information contained within the financial statements with accounting records and supporting documentation. Auditors also ensure that accounting policies are appropriately and consistently applied in the preparation of financial statements, and that disclosure is in accordance with the relevant reporting and legislative frameworks. (for example, Australian Accounting Standards and the Finance Minister’s Orders) This phase is completed within very tight reporting deadlines. Gaining efficiencies from work performed earlier during the interim and hard close phases is crucial in reducing the workload at this ‘peak’ period, with benefits to all concerned.

**Risk-based Methodology**

The ANAO uses a risk-based approach for all its financial statement audits. This approach is consistent with the current Australian Auditing Standards, which require audit effort to be focussed on those items in the financial statements with the highest risk of material misstatement. As such, assessed risks ‘drive’ the audit. Auditors use a structured approach to identifying risks and perform detailed risk analysis procedures to determine the level of risk associated with a particular item or area. Consequently, the level of audit effort required to gain assurance for a particular aspect of the client’s financial statements increases with the relevant assessed risks.

In undertaking such an approach, auditors need to gain a good understanding of the entity’s core business functions, organisational structure, and key business processes. The ANAO’s methodology also emphasises the importance of developing strong client
relationships, and gaining synergies through effective teamwork. This risk-based approach is applied throughout all phases of the audit cycle and allows the ANAO to consistently provide efficient, high quality audits to Parliament.

In applying the principles of a risk-based methodology, the ANAO performs risk assessments for each client to ascertain where audit efforts should be focussed. These assessments should help determine the level of assurance required for each item/component group, thereby identifying those items in the financial statements requiring greater scrutiny.

There are several different types of risks considered by auditors when conducting a financial statement audit. The specific risk assessments made during the planning process include assessments of:

- materiality to identify financial statement items which are material by size or by nature\(^\text{13}\);
- business risks facing the agency;
- the three components of audit risk, that is, inherent risk, control risk and detection risk; and
- the risk of fraud.

As part of the ANAO’s integrated approach to auditing, the knowledge about risks identified during the planning stage is shared between financial statement auditors, performance auditors, and ANAO staff working on Business Support Process audits, to ensure appropriate and adequate coverage through at least one of the ANAO’s audit products.

When planning the financial statement audit, the team is seeking the most efficient and effective approach to cover off the risks identified, and provide assurance that the financial statements are free from material misstatements. Auditors need to ensure audit risk (essentially the risk of an incorrect audit opinion) is restricted to an acceptably low level.

**Assessment of Materiality**

As previously discussed, the objective of an audit of a financial report is to “enable the auditor to express an opinions [as to] whether the financial report is prepared, in all material respects, in accordance with an identified financial framework”.\(^\text{14}\) (Emphasis added). Information is defined as material if:

…its omission, non-disclosure or misstatement has the potential to adversely effect decisions about the allocation of scarce resources made by the users of the financial report or the discharge of accountability by management or the governing body of the entity.\(^\text{15}\)

Items can be either material by size or material by nature. An item is material by size if the balance of that item is greater than a pre-determined base amount. For example, it is ANAO Policy that items greater than 1 per cent of total revenues or expenses are material by size. An item that is material by nature is considered to have a significant
or sensitive impact. An example of this would be act of grace payments and auditor’s remuneration, as well as executive remuneration.16

The ANAO performs a preliminary materiality assessment during the planning stage of an audit. This helps determine the nature, timing and extent of audit procedures that will need to be undertaken to provide sufficient audit coverage. Following planning, the audit team will implement a range of procedures designed to detect material errors. Materiality is again considered when evaluating the overall effect of misstatements noted during the audit, to ensure they are not material in aggregate.

**Business Risk**

Anything that has the potential to adversely affect a client in the future is considered a business risk. Business risks relate directly to the nature of the client’s business operations and, as such, auditors require a thorough understanding of the business in order to identify these types of risks. The following examples are just some of the many factors that can impact upon business risk:

- market volatility;
- legislative changes;
- interest rates;
- general economic conditions;
- Budget allocations; and
- exchange rates17.

There are numerous steps involved in identifying a client’s business risks. Firstly, the ANAO must develop a clear understanding of the client’s business operations. The audit team then assesses the client for areas of vulnerability and identifies what control mechanisms are in place to counter such weaknesses. Lastly, consideration is given to the effectiveness of these business process controls and whether they can be tested and relied upon, thereby reducing the audit effort required.

**Audit Risk**

Audit risk is ‘the risk that the auditor gives an inappropriate audit opinion when the financial report is materially misstated’.18 Audit risk is comprised of three separate components: inherent risk; control risk; and detection risk. Auditors are required to make an assessment of audit risk and develop audit procedures designed to ensure that audit risk is reduced to an acceptably low level.19

**Inherent Risk**

Inherent Risk is the susceptibility of a class of transactions or an account balance to material misstatement, assuming that no related controls are in existence.20 Auditors are required to use professional judgement and assess inherent risk at both the financial reporting level and the account balance/transaction level.21

Assessing inherent risk at the financial report level requires an understanding of the culture and structure of the client. This assessment provides an insight into the
importance placed upon compliance with the control put in place. Factors to consider as part of this assessment include:

- the integrity of management;
- management experience and knowledge and changes in management during the period, for example, the inexperience of management may affect the preparation of the financial report of the entity;
- unusual pressures on management, for example, circumstances that might predispose management to misstate the financial report, such as the industry experiencing a large number of business failures or an entity that lacks sufficient capital to continue operations;
- the nature of the entity's business, for example the potential for technological obsolescence of its products and services, the complexity of its capital structure, the significance of related parties and the number of locations and geographical spread of its production facilities; and
- factors affecting the industry in which the entity operates, for example economic and competitive conditions as identified by financial trends and ratios, and changes in technology, consumer demand and accounting practices common to the industry\textsuperscript{22}.

Assessments of inherent risk at the account balance or class of transaction level, provide audit teams with an understanding of the nature and complexity of the financial statement items being audited. This assessment indicates to the team where material errors are most likely to occur. Factors that may influence inherent risk at the account balance/transaction level include:

- financial report accounts likely to be susceptible to misstatement, for example accounts which required adjustment in the prior period or which involve a high degree of estimation;
- the complexity of underlying transactions and other events which might require using the work of an expert;
- the degree of judgement involved in determining account balances;
- susceptibility of assets to loss or misappropriation, for example assets which are highly desirable and movable such as cash;
- the completion of unusual and complex transactions, particularly at or near period end; and
- transactions not subject to ordinary processing\textsuperscript{23}.

The more susceptible a balance is to material misstatement, the higher the assessment of inherent risk.

\textit{Control Risk}

Control Risk is the risk that material misstatements that could occur in an account balances or class of transactions, will not be prevented, or detected, in a timely manner by the entity’s internal controls.\textsuperscript{24} ANAO audit teams make a preliminary assessment
of a client’s control risk during planning.

Australian Auditing Standard AUS 402 *Risk Assessments and Internal Controls* requires the auditor to obtain an understanding of the internal control structure. AUS 104 *Glossary of Terms* describes ‘internal control structure’ as follows:

The dynamic, integrated processes, effected by the governing body, management and all other staff, that are designed to provide reasonable assurance regarding the achievement of the following general objectives:

(a) effectiveness, efficiency and economy of operations;
(b) reliability of management and financial reporting; and
(c) compliance with applicable laws and regulations and internal policies25.

The internal control structure is comprised of the control environment, the information systems and control procedures. The following excerpt provides an overview of the importance of the internal control structure.

**Table 2 – The Importance of the Entity’s Internal Control Structure**26

<table>
<thead>
<tr>
<th>It is management’s responsibility to maintain an adequate control structure. An effective internal control structure assists management in ensuring that, as far as practicable, the conduct of business is orderly and efficient, including:</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) irregularities being prevented, or detected and corrected should they occur;</td>
</tr>
<tr>
<td>(b) assets being safeguarded from unauthorised use or disposition; and</td>
</tr>
<tr>
<td>(c) financial records and other relevant databases completely and accurately reflecting the entire operational activities of the entity and permitting the timely preparation of financial information.</td>
</tr>
</tbody>
</table>

By gaining this understanding, audit teams can best identify and design appropriate audit procedures. Depending on the information gathered from the documentation of the organisation (that is, gaining an understanding of the control structure), a decision whether the controls identified should be evaluated, as part of the audit process, can be made.

Auditors also need to be mindful of the inherent limitations of internal control structures, listed as follows:

- management's usual requirement that the cost of an internal control does not exceed the expected benefits to be derived;
- most control procedures tend to be directed at routine transactions rather than non-routine transactions;
- the potential for human error due to carelessness, distraction, mistakes of judgment and the misunderstanding of instructions;
• the possibility of circumvention of control procedures through the collusion of a member of management or an employee with parties outside, or inside, the entity;

• the possibility that a person responsible for exercising an internal control could abuse that responsibility, for example a member of management overriding an internal control; and

• the possibility that procedures may become inadequate due to changes in conditions; and compliance with procedures may deteriorate.27

The more robust and reliable the controls in place are, the lower the assessment of control risk. Control risk should be assumed to be high, unless there are factors which indicate it should be assessed as lower than ‘high’.

Once this assessment has been made, the audit team determines whether relying upon controls is an appropriate and efficient approach to take during the audit; and plans the audit accordingly.

Any significant matters noted during this assessment are raised with the client’s management, as appropriate, and on a timely basis. What constitutes a ‘significant issue’ is a matter for professional judgment.

This approach is very different to the requirements of auditors in the United States who, by virtue of section 404 of the Sarbanes-Oxley Act of 2002, are required to provide a separate report on the effectiveness of the client’s internal control structures and procedures. The introduction of this requirement is said to assist to bridge the expectation gap between “what an auditor’s report was perceived to encompass and what it actually delivered”28. In addition, an auditor’s opinion of the effectiveness of controls could be said to give the users of financial reports a means of assessing the effectiveness of the entity’s management, as outlined below.

[Research has found] that investors, analysts and financial managers believe quality of management essential to developing a full understanding of risk and opportunity in a company. Because internal control is a significant management responsibility, added reporting on this critical management process provides a new window into the overall quality of management.29

For the present, at least, the Australian standard setters are yet to venture down this particular path. There is scope to do so, though, with the international convergence of Australian Auditing Standards with International Standards on Auditing, issued by the International Auditing and Assurance Standards Board, and through any influence being exerted on the latter by the United States standards. A significant number of Australian corporations are being directly, and indirectly, impacted by the Sarbanes-Oxley legislation, particularly those with international connections. The ANAO’s review of exposure drafts, recently issued, shows a generally more prescriptive approach taken with respect to the requirements of auditors.

Should the entity’s internal controls be assessed as robust, the team may then choose to rely upon controls in place. This approach reduces the level of substantive test procedures required to verify year-end balances, but should only be taken where it is efficient to do so. This means that consideration should be made of the potential time
and efforts required to gain assurance that the controls are operating effectively, versus the potential time and efforts saved from performing fewer substantive procedures.

Detection Risk

Detection Risk is the risk that an auditor’s substantive procedures will not detect a material misstatement. This is the one component of audit risk that can be managed by the auditor. The auditor’s assessment of control and inherent risk directly influences the nature, timing, and extent of substantive testing needed to reduce detection risk (and audit risk) to an acceptably low level.

Detection risk is inversely related to both inherent risk and control risk. The higher inherent and control risk are, the lower detection risk, and vice versa. This is illustrated in Table 3 as follows.

**Table 3 – Assessment of Detection Risk**

<table>
<thead>
<tr>
<th>Auditor’s Assessment of Inherent Risk is:</th>
<th>High</th>
<th>Medium</th>
<th>Low</th>
</tr>
</thead>
<tbody>
<tr>
<td>High</td>
<td>Low</td>
<td>Low</td>
<td>Medium</td>
</tr>
<tr>
<td>Medium</td>
<td>Low</td>
<td>Medium</td>
<td>High</td>
</tr>
<tr>
<td>Low</td>
<td>Medium</td>
<td>High</td>
<td>High</td>
</tr>
</tbody>
</table>

Acceptable Level of Detection Risk

The lower the assessment of detection risk, the more substantive procedures are required to gain sufficient appropriate audit assurance for this item. It is important to note that an assessment of detection risk as ‘high’ is also an acceptable outcome. This indicates that the audit team is able to place a greater reliance on the client’s controls to prevent, or detect and correct, material errors, rather than detecting such errors through substantive procedures alone.

Assessing the Risk of Fraud

Financial statement auditors are required to consider the risk of fraud and error during the audit of the client’s financial statements. Australian Auditing Standard AUS 210 *The Auditor’s Responsibility to Consider Fraud and Error in an Audit of a Financial Report* provides both guidance and requirements for considering the risk of fraud. The main requirements of this standard include:

- during the planning stage, discussion amongst the audit team and with the entity’s management about the susceptibility of the entity to material misstatements resulting from fraud and error;
- consideration of the risk of fraud when assessing inherent risk and control risk, including consideration of whether fraud risk factors are present, as outlined in the Appendix to the Standard;
- should fraud risk factors be present, specific procedures should be included in the test program to reduce the risk of misstatements from fraud and error to an acceptably low level;
• consideration of misstatements noted during the audit may be indicative of fraud;
• the audit team should obtain written representations from management about the disclosure of all facts relating to any fraud or possible fraud; and
• emphasis of the importance of the auditor’s use of professional scepticism whilst planning and executing the audit.

Interestingly, AUS 210 also makes a distinction between different types of fraud – employee fraud and management fraud. Employee fraud relates to misstatements resulting from misappropriation of assets, including theft, embezzlement or causing the entity to make payments for goods and services not received. Management fraud relates to misstatements from fraudulent reporting, arising from intentional misstatements, or omissions of amounts, or disclosures, to deceive financial report users.

Gaining an understanding of the culture at the client, and assessing inherent risk at a financial reporting level, assists teams to make assessments of the risk of fraud, including identification of any perceived motivation to commit fraud and a perceived opportunity to do so.

The auditing profession is driven by requirements in both the Australian Auditing Standard AUS 710 Communicating with Management on Matters Raised from an Audit and legal precedence in relation to reporting issues to the client. This standard requires issues of significance noted by the auditor at any time during an audit to be reported to an appropriate level of management on a timely basis. More specifically in relation to fraud, in his judgment for the Pacific Acceptance case, Justice Moffat ruled that it is an auditor’s duty to report all suspected fraud to management, even if the financial effect of the fraud is not material to the financial statements. To not report the fraud would be negligent. AUS 210 also reinforces the importance of reporting misstatements resulting from fraud and error to an appropriate level of management in a timely manner.

The requirements in the current standards are similar to those in the proposed revisions, as part of the convergence with International Standards on Auditing. In late 2003, the ANAO’s views were included as part of ACAG’s response to Exposure Draft ED 84 The Auditor’s Responsibility to Consider Fraud in an Audit of a Financial Report. In the ACAG response, acknowledgement was made that the proposed changes to the standard would raise the requirements regarding the auditor’s responsibilities to consider fraud in an audit of a financial report. While agreement and support was expressed of the changes made to this standard, comments were also expressed that the proposed standard is more prescriptive than the current standard. The ANAO notes that the revised standard has now been issued for application in financial reporting periods starting on, or after, 15 December 2004. The Australian Auditing and Assurance Standards Board encourages early adoption of the revised standard. The ANAO is already taking steps to ensure adoption of this standard for the 2004-2005 financial statement audits.
Other Key Aspects of the ANAO’s Methodology

Business Process Model

As previously outlined, the risk-based methodology adopted by the ANAO will not function effectively unless auditors are able to gain a thorough understanding of their client’s key business processes. A business process is essentially what each individual AGPS entity does, and is often linked to legislation administered by the entity, such as the provision of unemployment benefits by Centrelink, or the Department of Health and Ageing subsidising aged care facilities.

The ANAO’s financial statement audit process is designed to identify a client’s business processes. Audit teams then focus their audit efforts on those business processes that are both significant in relation to the financial statements and critical to the client’s operations. For example, all relevant information regarding client business processes should be appropriately documented, controls tested for reliability, and any areas of weakness, reported to the client for rectification.

Client Relationships and Effective Teamwork

Underpinning the entire ANAO audit methodology is the emphasis placed on teamwork and client relationships. Without these two elements, the efficiency and effectiveness of an audit would be significantly reduced. Therefore, the ANAO has proactive measures in place to foster cohesive working relationships.

The importance of client relationships is reinforced by its specific inclusion in the ANAO’s Key Result Areas, as published in our Corporate Plan:

We will deliver our services by focusing our efforts on the key result areas of: meeting our clients’ needs with quality products and services, using highly performing people, and with good business management.

Specifically, in relation to external client relationships, the ANAO has published in its 2003-2004 Business Plan, the following objective and strategies.

Table 4 – Extract from the ANAO’s 2003-2004 Business Plan

<table>
<thead>
<tr>
<th>MEETING OUR CLIENTS’ NEEDS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Our objective:</strong> To identify and address the needs and expectations of the Parliament, the Executive Government and our audit clients in the areas of performance, assurance and accountability.</td>
</tr>
<tr>
<td><strong>Our strategies:</strong> We will do this by:</td>
</tr>
<tr>
<td>• maintaining our independence and the reputation of the ANAO by our actions, including reports, and the judgments we make;</td>
</tr>
<tr>
<td>• enhancing our dialogue with all members of the Parliament, particularly members of the JCPAA and other Parliamentary Committees, so that they are well informed about our activities;</td>
</tr>
<tr>
<td>• improved dialogue will enable us to provide members with timely and constructive assistance in addressing their parliamentary role;</td>
</tr>
<tr>
<td>• building on our productive and professional relationships with the Executive Government and each of our audit clients so we can continue to identify and address their needs, particularly for better performance, and keep them well informed about our work; and</td>
</tr>
</tbody>
</table>


35

36
• periodically reviewing the relevance, mix and delivery of our products and services; striving for innovative approaches and improving the quality and effectiveness of our products and services, including by incorporating developments in accounting and auditing frameworks.

**OUR KEY PERFORMANCE INDICATORS ARE:**

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Target</th>
</tr>
</thead>
<tbody>
<tr>
<td>Parliament acknowledges the value of the ANAO contribution</td>
<td>90% value role of ANAO</td>
</tr>
<tr>
<td>The JCPAA’s satisfaction with the overall quality, timeliness and coverage of our products and services is at an acceptable level</td>
<td>High level of satisfaction</td>
</tr>
<tr>
<td>Public sector entities acknowledge the value added by ANAO products and services</td>
<td>90% value role of ANAO</td>
</tr>
</tbody>
</table>

**Our key initiatives in 2003-2004 are:**

• develop a communications strategy which assists the ANAO to maximise opportunities for interaction with all our stakeholders, particularly Parliamentarians and agencies;

• assist the Parliament and our audit clients to manage the impact of the adoption of international accounting standards and the harmonisation of Government Financial Statistics (GFS) with Generally Accepted Accounting Principles (GAAP); and

• keeping abreast of, and implementing, changing auditing standards reflecting international best practice in relation to triple bottom line auditing.

**Key ongoing activities:**

• the preparation of a comprehensive annual audit work program which details, by portfolio, the audits in progress and lists potential audit topics from which performance audits and other products will be selected during the year;

• the presentation of a comprehensive financial statement Audit Strategy Document to portfolio agencies and to the audit committees of all major entities;

• conduct a range of well targeted activities designed to enhance our relationship with Parliamentary Committees, Parliamentarians, Audit Committees and senior management;

• conduct periodic surveys of audit clients to obtain independent and structured feedback on our financial statement and performance audit work; and

• the secondment of ANAO staff for personal development where the opportunity arises.

The ANAO’s review of performance against the key performance indicators, as published in our Annual Reports, shows that we are meeting, and even exceeding, our targets in this area.

From an internal perspective, effective teamwork is strongly encouraged to build synergies within audit teams. The ability for ANAO staff to work and contribute effectively in a team environment is so critical to the ANAO’s operations that it has been included amongst the six aspects of the ANAO’s Organisational Capabilities Framework. This framework is based on the skills and knowledge identified by the ANAO as being critical to ongoing work efficiency, effectiveness and professional growth. Capabilities are expressions of what constitutes successful performance and appropriate behaviour in the ANAO and the impact on our work, and are linked to the ANAO’s Core Values and ANAO Work Level Standards. The Organisational Capabilities Framework is referred to in ANAO selection criteria and performance evaluation.
Table 5 – Extract from the ANAO’s 2003-2004 Learning and Development Calendar

<table>
<thead>
<tr>
<th>ANAO Capability</th>
<th>Direct Impact Upon Work</th>
</tr>
</thead>
<tbody>
<tr>
<td>Achieves Results</td>
<td>Timeliness, cost and quality of outputs</td>
</tr>
<tr>
<td>Shapes Strategic Thinking (EL &amp; SES only)</td>
<td>Influence on ANAO and corporate contribution</td>
</tr>
<tr>
<td><strong>Cultivates Strong Working Relationships</strong></td>
<td><strong>People management and teamwork</strong></td>
</tr>
<tr>
<td>Exemplifies Personal Drive and Integrity</td>
<td>Initiative, professionalism and accountability</td>
</tr>
<tr>
<td>Communicates with Influence</td>
<td>Client focus and management of client relationship</td>
</tr>
<tr>
<td>Applies Technical Proficiency</td>
<td>Job knowledge, sharing information</td>
</tr>
</tbody>
</table>

**Adopting an Integrated Audit Approach**

The ANAO’s range of products aims to provide assurance that the risks facing the AGPS, and the management of its finances and programs, are being adequately addressed through an integrated audit approach. The ongoing challenge for the ANAO is to strike the right balance of audit activity across the public service to fulfil the ANAO’s statutory obligations, while meeting the particular needs of Parliament and individual agencies. The key to this outcome is understanding the Parliament’s priorities and the business/functional imperatives of agencies that are creating a need for audit examination.

The ANAO is committed to delivering high quality audit products. The integrated audit approach applied by the ANAO is designed to address any expectation gaps in ANAO coverage. First, at the broader level across the public sector, the ANAO needs to ensure that its product mix and coverage are tailored to the environment in which it operates and to the accountability needs of the Parliament. As the AGPS environment changes, so do the associated accountability arrangements. The ANAO’s audit product mix also needs to reflect Parliamentary concerns about compliance issues where there are perceived gaps appearing, as well as inadequacies being reflected in public administration.

The Parliament wants general assurance that the public service is working well. Further, Parliament wants to know how public administration can be improved. The ANAO seeks to provide such assurance on the state of the AGPS and to contribute to improvements in the AGPS through the provision of a range of quality audit products. Those products are based on a thorough audit planning process, designed to address emerging issues in the AGPS, and to provide sufficient coverage of activities.

The second layer of the integrated audit approach occurs at the agency level where the ANAO aims to ensure that its audit services assist public sector entities to improve their performance and accountability, as well as to better manage their functions and/or business.

The ANAO is committed to an integrated auditing framework that draws on the strengths of both the assurance and performance audit sides of its business. The approach capitalises on intelligence gathered in each field and allows the ANAO to target areas for audit activity that add most value to overall public administration.
Range of audit products

The Auditor-General’s mandate extends to 25738 public sector bodies, including Australian Government agencies, authorities, companies and their subsidiaries. These audit clients include Budget-dependent agencies involved in the delivery of core public services, and commercially oriented entities such as Government Business Entities (GBEs). The Auditor-General Act 1997 provides the authority to undertake financial audits, performance audits, and to provide other information support services, including the development of BPGs. Performance audits of wholly owned GBEs may only be undertaken at the request of the responsible Minister, the Finance Minister or the JCPAA.

The ANAO aims to provide well-targeted products and services that provide both assurance and value for money. The ANAO also attempts to provide an audit product continuum as a strategic approach to better governance. The ANAO fills the gaps between high-level performance audits and traditional financial statement audits with BPGs and BSP audits covering a range of issues challenging the AGPS. The range of products currently produced by the ANAO includes the following major activities, starting with performance audits that need to be put in the context of our overall audit effort.

Performance audits

The aim of a performance audit is to examine and report to the Parliament on the economy, efficiency and effectiveness of the operations of the administration of the Australian Government and to recommend ways in which these may be improved. Such audits are best described as an independent, objective and systematic examination of the operations of a body for the purposes of forming an opinion on whether:

- the operations have been managed in an economical, efficient and effective manner;
- internal procedures for promoting and monitoring economy, efficiency and effectiveness are adequate; and
- improvements might be made to management practices (including procedures for promoting and monitoring performance).

Performance audits are conducted in all ministerial portfolios with the main concentration being directed to portfolios with significant Government outlays or revenues. Performance audit reports, including Business Support Process audit reports, are tabled in the Parliament (61 in 2002-03, and 57 in 2003-04). All recent performance audit reports are placed on the ANAO’s homepage at http://www.anao.gov.au, and are also summarised in the ANAO’s series of six-monthly activity reports.39 They are also listed progressively in each performance audit completed.

Performance audits often involve assessments of governance, probity and the quality of management in individual agencies. While the auditor’s professional opinion in these cases is derived from compliance with rigorous standards, and therefore provides a high level of assurance, the audit does not provide complete assurance as to the entities’ operations. This ‘expectation gap’ is a complex issue that challenges the profession as much as it challenges our immediate range of stakeholders. Different perceptions and requirements inevitably arise which need to be addressed.
In 2002–03, the average time taken to complete a performance audit was 11 months, with a range from 5.2 to 15.5 months. The average cost was $310 000 with a range from $112 000 to $631 000. The important point is that we fully cost all our products, which is included in each report, as noted earlier.

**Business Support Process audits**

General performance audits include what we call BSP audits. Assurance is provided to a greater extent through the conduct of BSP audits that examine business processes which support the delivery of outputs by public sector agencies. The focus of BSP audit reports is essentially the efficiency and effectiveness of the accountability, control, and compliance mechanisms and systems operating within public sector agencies. The audits are generally conducted in a number of agencies, with findings reported in generic terms to Parliament and on an individual basis to client agencies. Output from these may also include BPGs. BSP audits replaced what we described as financial control and administration audits, and assurance and assessment control audits, previously undertaken by the ANAO.

**Cross-agency audits**

The ANAO has sought to maximise its efforts and the value added to public sector administration through an increased focus on cross-agency audits. These audits are designed to provide an analysis of performance across the public sector. They are conducted on agencies where there are shared objectives, shared service delivery or, simply, a sharing of common issues. These audits are important as agencies increasingly find new methods to deal with shared issues, and form alliances and partnerships, including with the private sector, to deliver government services. This approach is also becoming more important with the greater use of a ‘whole-of-government’ approach to public administration.

Cross-agency audits are conducted where aspects of performance management or control arrangements across the AGPS are to be reviewed by the ANAO as a performance audit. Issues can be identified for cross-agency coverage in the course of a financial statement audit, where that issue is identified as likely to apply to a number of agencies across the AGPS. The ANAO considers that the ability to leverage off experience and knowledge gained from these multi-agency audits provides a significant return for the audit effort involved. Topics covered, or planned to be covered, via cross-agency audits in the current Audit Work Program include annual performance reports, intellectual property, special accounts, performance management, fraud, workforce planning, outsourcing of legal services, and Internet service delivery.

**Assurance auditing**

Financial statement audits express an opinion on whether financial statements of Australian Government entities have been prepared in accordance with the Government’s reporting framework and give a true and fair view (in accordance with applicable Accounting Standards and other mandatory professional reporting requirements) of the financial position of each entity as at year end, and the results of the entities’ operations and the entities’ cash flows. In 2002–03, the ANAO conducted assurance audits of 257 entities.
In addition to the audit opinion on the financial statement, the ANAO provides each client with a report that deals with the results of the financial statement audit process. A report is also provided to the responsible Minister. The ANAO also provides two cross-entity assurance reports each year to Parliament. The first details the results of an assessment of the control structure of major entities, while the second provides a summary commentary on the results of all financial statement audits undertaken in the 12-month audit cycle ending in October of each year.

Information Technology (IT) Audit

For many years, the ANAO has invested in the use of technology to provide more efficient and effective audit products to the Parliament. The ANAO’s IT Audit section exists to provide an integrated audit support service to all business units within the ANAO, with responsibility for management and delivery of both performance and assurance audit activities. The ANAO’s long-standing practices of integration of information technology specialists into its audit teams, reflects comments made in late 2000 by the then United States Public Oversight Board.

In its report, the Public Oversight Board also noted that integration of IT specialists with auditors should include “…assessing the risks of erroneous information affecting a financial statement, the adequacy of controls, and the tests designed for operating effectiveness”. This mirrors the overriding objectives for the IT Audit section, which are to provide independent IT assurance through the identification and assessment of risks presented by the adoption, and use, of new and emerging technologies within AGPS entities.

Specifically, the IT Audit section provides the following services:

- technical consultancy and advice on IT risks, controls and emerging issues;
- review and assessment of client corporate and business IT systems, processes and procedures; and
- technical audits over networks, operating platforms and database management systems; and the use of computer-aided audit techniques to interrogate and analyse data.

The results of these services include a number of value-adding recommendations for the individual clients. These are aggregated, with other recommendations relating to internal controls, and tabled in Parliament as part of the ANAO’s annual ‘Controls Report’ to provide the Parliament with an overview of the strength and weaknesses in its IT environments. The report for 2003-04 is currently being prepared for tabling in Parliament.

Better Practice Guides

The Auditor-General Act 1997 (Section 23) gives the authority for the Auditor-General to provide information to public sector bodies. This has facilitated the development of a program of Better Practice Guides (BPGs) (as well as client seminars) designed to assist public sector agencies in improving their performance. BPGs aim to improve public administration by ensuring that better practices employed in some organisations are promulgated to the whole of the AGPS. The ANAO is in a unique position to compare operations across the public sector, and sometimes with the private sector,
allowing it to add value to a wide range of stakeholders. This is important as agencies increasingly develop individual approaches to deal with common issues, often a matter of virtually re-inventing the wheel. In some cases, they were employing the same consultants to provide the same, or similar, advice.

The program for BPGs is based on the ANAO’s understanding of the emerging issues impacting on the performance of the public sector. BPGs may be produced in conjunction with a performance audit or, alternatively, a BPG might be prepared as a result of a perceived need to provide guidance material in a particular area of public administration. The development of BPGs may involve examining practices in the public and private sectors, in Australia or overseas. BPGs have recently been produced on topics such as the management of scientific research and development projects, governance in the AGPS, GST administration, management of Parliamentary workflow, managing learning and development in the AGPS, internal budgeting, administration of grants, and the development of policy advice.

BPGs are important outputs in the achievement of the ANAO’s outcome of ‘Improvement in Public Administration’. BPGs add value by bringing together lessons learnt across the public sector and have been well received by program managers looking to learn from the experiences of others. BPGs also provide a very valuable source of audit criteria for future audits, which is their justification from an audit viewpoint. That is not to say that they need to be undertaken by the ANAO. However, BPGs can be often completed at a relatively small marginal additional cost to that of the audit.

BPGs and similar publications are becoming increasingly important source documents for managers operating in an environment of devolved authority and responsibility. These documents are of particular value to small agencies that find it difficult to develop and maintain in-house expertise on the wide range of public sector management issues, and which have tended to rely heavily on detailed legislative and policy frameworks and guidance from central agencies. The ANAO has often worked with other agencies in the production of some BPGs, including the recent guides developed on Goods and Service Tax (GST) Administration, compiled with the Australian Taxation Office, and on annual performance reporting prepared in association with the Department of Finance and Administration.

Information services

The ANAO also provides information services, including assistance to Parliament, national and international representation, and client seminars. Assistance to Parliament includes the provision of submissions to Parliamentary committee inquiries and reviews and briefings on audit reports tabled in Parliament.

ANAO staff also organise and participate in conferences, seminars and workshops to share expertise and disseminate better practice and lessons learnt from the auditing activity. A growing element of this role is communicating the ANAO’s activities and outcomes through representational activities with a wide range of stakeholders and contracts, including Parliamentary committees, boards of government authorities and companies, as well as professional organisations.

The ANAO also produces a quarterly magazine, *Opinions*, published to provide audit clients with details of recently completed performance audits and BPGs. It also lists
audits scheduled for completion in the near future and information on developments in financial reporting and disclosure. These are important complementary initiatives as part of our overall audit approach, to meet our assurance and performance objectives.

Comment

The success of the ANAO’s integrated approach to auditing providing assurance to the Parliament, is shown by the ANAO’s positive results against its key performance indicators over time, in particular, parliamentarians’ satisfaction with the ANAO and its products.
4. Issues Impacting on Assurance Audit

There are a number of contemporary issues that are currently impacting upon the ANAO, in its role as the independent auditor for the Australian Government’s financial statements. These issues include:

- adoption of Australian equivalents to International Financial Reporting Standards;
- convergence of Australian generally accepted accounting practices and Government Finance Statistics;
- increasingly compressed reporting timetables for the AGPS; and

This section of the Paper will discuss each of these issues, and how the ANAO is addressing them.

**Adopting Australian Equivalents to International Financial Reporting Standards**

As well as changing governance requirements, adoption of Australian equivalents to International Financial Reporting Standards (IFRS) will bring about a number of changes for all Australian entities, including those in the public sector.

The impact of these new standards will differ from entity to entity, depending on their specific business and financial statements. It is difficult to identify ‘global’ issues that will affect all public sector entities. Each entity will need to individually review the changes that will arise, and assess how these changes will impact upon them.

From a public sector perspective, the introduction of these new standards does not only represent harmonisation with the standards issued by the International Accounting Standards Board (IASB). It also represents harmonisation with the relevant requirements of the International Public Sector Accounting Standards (IPSAS), issued by the Public Sector Committee of IFAC⁴⁵.

An added complexity for all entities applying Australian equivalents to IFRS will be determining whether or not they meet the definition of a not-for-profit entity. The term ‘not-for-profit entity’ is defined in the pending standards as follows:

A not-for-profit entity is an entity whose principal objective is not the generation of profit. A not-for-profit entity can be a single entity or a group of entities comprising the parent entity and each of the entities that it controls⁴⁶.

Those that meet the definition of a ‘not-for-profit’ entity will need to be aware not only of the changes that the new standards bring to all Australian entities, but also where the new standards have specific requirements, or exclusions, for not-for-profit entities.
Applying that definition, it is reasonable to assume that the Australian Government’s Whole-of-Government Consolidated Financial Statements will be prepared on the basis that the Australian Government is a not-for-profit entity.

An issue arises, though, when considering the appropriate classification of each entity comprising the AGPS. While the majority of these entities do not have a principal objective relating to the generation of profit, there are those within the Australian Government that do, Telstra or Australia Post, for example. These entities, and others with a profit motive within the AGPS, may be required to keep two sets of accounts. One set will comply with the ‘for-profit’ requirements of the pending standards, which will be for publication as that entity’s financial statements. The other set will be compliant with the ‘not-for-profit’ requirements and exclusions contained in the pending standards. This second set of financial data would be required by the Department of Finance and Administration for the purposes of consolidation into the Australian Government’s Consolidated Financial Statements.

Further complications arise for those applying current Australian Accounting Standards AAS 29 Financial Reporting by Government Departments and AAS 31 Financial Reporting by Governments. Both of these standards are earmarked for retention after the adoption of IFRS. Of concern is that each of these standards contains mandatory ‘black letter’ requirements that effectively state that, to the extent that there are different requirements from another standards, these standards prevail. The inclusion of such words may affect the ability of government departments and governments to fully apply the new standards, particularly in relation to matters discussed in these standards. The list of matters affected is quite extensive, and includes:

- recognition, measurement, revaluation and depreciation of assets, including infrastructure, heritage and community assets;
- recognition of liabilities;
- agreements equally proportionately unperformed;
- recognition of revenues and expenses, including parliamentary appropriations, taxes, transfer payments, contributions such as grants, and revenues and expenses arising from administrative restructuring;
- contributions by owners and distributions to owners; and
- disclosures of financial and non-financial information.

The ANAO has been in contact with the Australian Accounting Standards Board (AASB) to ascertain the likely impact of this wording. Our interest is focusing upon whether, with the inclusion of the above words in AAS 29 and AAS 31, public sector agencies and governments will be in a position to be able to fully comply with Australian equivalents to IFRS.

This awkward situation may be alleviated by amendments to AAS 29 and AAS 31 to remove the requirements for these standards to prevail where there are differences with other standards. Such amendments have already been foreshadowed in the exposure draft for the amendment of AAS 27 Financial Reporting for Local Governments. The proposed amendments in this exposure draft do not contain such wording, instead making the following statements:
To the extent that local governments are subject to financial reporting requirements set out in legislation or other authority that differ from the requirements of this Standard or other Standards, the foregoing requirements would apply in addition to (not instead of) the requirements of this Standard or other Standards. Where those requirements conflict with the requirements of this Standard or other Standards, or where information needed to satisfy those foregoing requirements would detract from effective communication of the information reported in the general purpose financial report in accordance with Standards, such information must not be included in the local government’s general purpose financial report. ⁴⁹

Notwithstanding that there are still some significant issues to be resolved, a key implementation issue is to ensure that there is an appropriate plan in place for applying the new standards. This plan should include:

- a structured methodology for identifying which issues will impact the organisation and how they will be resolved (although at this late stage, this aspect of the plan would be expected to have already been substantially completed); and

- a communication strategy for ensuring the entity’s progress is being regularly reported to the Audit Committee, and to those staff within the organisation who need to be aware of operational implications of the changes required.

An important aspect to be considered in the agency’s implementation plan is the requirement for international standards to be applied in a retrospective manner. This is a requirement of the pending standard AASB 1 First Time Adoption of Australian Equivalents to International Financial Reporting Standards.

This standard requires entities to prepare two sets of financial statements for the balance date before the first internationally compliant statements are published. One set needs to be compliant with current Australian accounting standards for publication, as normal. The second set needs to be compliant with the Australian equivalents to IFRS and will not be published immediately. These statements will, instead, form the comparative data for the following year’s financial statements. Table 6 outlines the deadlines imposed by AASB 1 First Time Adoption of Australian Equivalents to International Financial Reporting Standards.

Table 6 - Deadlines for transitioning to the Australian equivalents to IFRS. ⁵⁰

<table>
<thead>
<tr>
<th>Balance Dates</th>
<th>Key Dates and Events</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Prepare opening balance sheet</td>
<td>Start collecting comparative data</td>
</tr>
<tr>
<td>31 Dec</td>
<td>31 Dec 03</td>
<td>1 Jan 04</td>
</tr>
<tr>
<td>30 June</td>
<td>30 June 04</td>
<td>1 July 04</td>
</tr>
</tbody>
</table>

Interim and annual financial reports published on or after 30 June 2004 will be the first to disclose the impact of the transition to new standards. Australian Accounting Standard AASB 1047 Disclosing the Impacts of Adopting Australian Equivalents to
International Financial Reporting Standards requires narrative disclosure in the 2003-2004 financial report as to:

- how the transition to Australian equivalents to IFRS is being managed; and
- key expected differences in accounting policies arising from the adoption of the Australian equivalents to IFRS.

In 2004-2005, entities will disclose any known or reliably estimable information about the impacts on the financial report, had it been prepared using the Australian equivalents to IFRS.

There is a lot of work for a number of entities in the foreseeable future in relation to adopting the Australian equivalents to IFRS. Of particular importance to the process of transitioning to the new standards is the communication strategy used. This strategy needs to include keeping all interested parties informed about the entity’s progress against its implementation plan, including an entity’s Audit Committee.

Another key stakeholder is the ANAO, in its capacity as the entity’s external auditors. The ANAO will need to know when the entity will have its opening balance sheet and comparative data relating to 2004-2005 prepared to an auditable quality. This will assist with scheduling the audit of this information to suit both the entity’s IFRS project plan and the ANAO’s operational priorities.

The ANAO recently conducted a survey of IFRS readiness of 25 large Australian Government agencies. This survey showed that the Australian Government’s progress towards implementation of these new standards varies widely across such agencies.

While it was pleasing to see all 25 agencies were aware of the deadlines for the implementation of Australian equivalents of IFRS, there were some concerning results. These included:

- 13 of 25 agencies surveyed did not have an IFRS or equivalent project team or Steering Team that incorporates functions across finance, operations, IT, strategy and client relations; and
- 10 of 25 agencies surveyed did not have a staff training strategy in place.

As our clients’ independent auditors, the ANAO is seen as a source of advice during this time of change. While this is an excellent opportunity to add value to our clients, we also need to be aware of the boundaries of this role and ensure we do not compromise our independence.

As well as publishing our annual *AMODEL Illustrative Accounts* and quarterly newsletter *Opinions*, the ANAO is presenting client seminars to give some of the information required to assist agencies through this period of change.

Technical sessions are presented regularly to ANAO staff to ensure they have a thorough understanding of the changes the new standards will bring. These sessions will be supplemented by the publication of an IFRS reference guide, which outlines the proposed changes to the standards and the impact of these changes. This reference guide is accessible by the ANAO’s clients from the ANAO’s web site.
Convergence of Australian Generally Accepted Accounting Principles and Government Finance Statistics

Another change to accounting requirements will come from the convergence of Australian Generally Accepted Accounting Principles (GAAP) and Government Financial Statistics (GFS).

Background

The AASB and the Public Sector Accounting Standards Board, through a detailed process that includes extensive consultation with the accounting profession, jointly develop Australian Accounting Standards. These standards form part of the framework for general purpose financial reporting, which is undertaken for the objective of “…provision of information to users that is useful for making and evaluating decisions about the allocation of scarce resources”.51

The GFS reporting framework is a sophisticated statistical system, which is consistent with international statistical standards52 and the guidance published by the International Monetary Fund in the form of the Government Statistics Manual. The GFS reporting framework is designed to provide comprehensive statistical information and assessments to support economic analysis of the public sector. The GFS framework, information and data analysis thereon, reflect the needs of fiscal analysts and other technical users interested in the analysis of government operations.

In addition to conceptual inconsistencies, there are a number of technical differences between GFS and Australian GAAP relating to timing and so-called permanent differences, which lead to dissimilar net results and/or balance sheets. The Federal Budget includes information on both bases. This has caused some confusion in the Federal Parliament, and lack of clarity in relation to comparisons with financial reporting.

In 2002-2003, the Financial Reporting Council set the following broad strategic direction for the AASB in relation to the GAAP/GFS convergence project53:

With regard to public sector reporting, the Board should pursue as an urgent priority the harmonisation of Government Finance Statistics (GFS) and Generally Accepted Accounting Principles (GAAP) reporting. The objective should be to achieve an Australian accounting standard for a single set of Government reports which are auditable, comparable between jurisdictions, and in which the outcome statements are directly comparable with the relevant budget statements.

Progress to Date

The AASB has an ambitious timetable to harmonise Australian GAAP and GFS, with an exposure draft scheduled for release in March 2005 for application of the new standard in 2005-200654.

To achieve this timetable, the AASB has levered off work completed by the HOTARAC55 GFS/GAAP Convergence Working Group. A Project Advisory Panel (PAP) has been established by the AASB, and is reviewing the papers written by this group.
To date, two consultation papers have been released for the PAP’s review, covering a range of issues, including:

- the objectives of GAAP and GFS and the scope for convergence;
- the status of General Government Sector (GGS) reporting (including whether the GGS is a reporting entity and, if so, whether it should be exempted from fully consolidating its investments in controlled non-GGS entities);
- the measurement of GGS investments in controlled non-GGS entities;
- the content, format and presentation of converged financial statements (including contemplating a statement of financial performance and fiscal impact);
- the treatment of a range of specific technical accounting differences between GAAP and GFS (including inventories, constructive obligations and tax effect accounting);
- the implications for public sector accounting standards of the different features of the public sector compared with the private sector; and
- the calculation and disclosure of GFS analytical balances.

The comments made by the PAP members in relation to the working group’s papers, and any other relevant issues identified, will be considered by the AASB when writing the Exposure Draft scheduled for issuance in March 2005.

Some of the technical differences identified rely upon the adoption of international standards, as their treatments align GAAP with GFS. This means the timing of convergence between GAAP and GFS will be, in part, reliant on the timing of adoption of international standards.

The timing of Australia’s implementation of the new standards has recently come into question. Rumours of deferral of the January 2005 implementation deadline were quashed at the FRC’s April meeting. At this meeting on 23 April, the FRC heard an update from members on their consultations with stakeholders, following their in-principle agreement on 31 March 2004 to proceed with the current Australian timetable for adoption of IFRS from 1 January 2005. Stakeholders appeared broadly supportive of the decision, provided the AASB would be able to meet its work program deadline by 30 June 2004. The AASB Chairman, Professor David Boymal, confirmed that the international accounting standards, released on 31 March 2004 by the International Accounting Standards Board (IASB), met the AASB’s requirements and that the AASB will be able to make available on its website the corresponding versions of Australian standards by 30 June 2004.

The process of converging Australian GAAP and GFS also, in part, relies upon the early adoption of the solutions identified by the IASB Reporting Comprehensive Income Project. This is a problematic approach, as the IASB has delayed the progress of this particular project until after the completion of its IASB 2005 Project, and has not currently scheduled a completion date.

Another challenging aspect of the project to converge Australian GAAP with GFS is the timing of the application of the new standard, which may coincide with public sector entities’ implementation of IFRS. This will, of course, depend on the exact timing of the application of a new standard to converge GFS and GAAP, and when
adoption of international standards will be achieved. There is considerable work for the implementation of IFRS and for the implementation of changes arising from the convergence of Australian GAAP and GFS.

The project to converge Australian GAAP with GFS has got to the point where truly fundamental conceptual issues are being identified for resolution. The fundamental issues for resolution relate to whether the:

- GGS is a reporting entity; and
- GFS analytical balances should be presented on the face of the financial statements and, if so, whether they should be calculated on a converged accounting basis or a ‘pure’ GFS basis\textsuperscript{58}.

These matters bring up all kinds of questions, including:

- if the GGS is not a reporting entity, where do the boundaries really lie?;
- if GGS is a reporting entity, should it be exempt from full consolidation?;
- to what extent should Australian GAAP concept of control be compromised? and
- will the reports produced under a converged GAAP/GFS standard present financial information that is sufficiently user-friendly?

Looking Ahead

To realistically move forward, the above listed issues need to resolved. Pragmatically, the project is getting to the point where some significant decisions need to be made. For example, are we prepared to be inconsistent with Australian GAAP to converge with GFS, or do the GFS principles need to accommodate convergence with Australian GAAP?

The AASB’s preliminary view to date, as reflected in the Consultation Papers (Nos 1 and 2), is for the following possible solution:

- to be based on sector neutral standards, and retain GAAP for definitions, and criteria for recognition and measurement;
- to consider presentational issues, including non-disclosure of GFS differences that are not harmonised; and
- to be addressed in consultation with PAP in relation to whether there are compelling reasons for departure from GAAP.

Should these projects have coinciding implementation timetables, there will be a need for public sector agencies to carefully factor this into implementation plans and communication strategies used. The impact is likely to be valuable across organisations.

From the point of view of the AGPS independent auditor, the potential to converge Australian GAAP and GFS brings about both benefits and challenges to our interested clients – being the Parliament, the Government and the AGPS entities. From the Parliament’s and the Government’s perspectives, this project will provide greater clarification of the financial information provided. From the agencies’ perspectives, it may lead to different financial information to be collected and/or disclosed. In this
respect, the project to converge Australian GAAP with GFS may have a similar impact on agencies as the project to adopt Australian equivalents to IFRS – i.e. agencies will need to perform individual assessments of the magnitude of the changes on their organisation and put appropriate plans in place to make the required changes before the time deadline for the latter standards.

**Increasingly Compressed Reporting Timetable for AGPS**

A further complication for public sector entities for adoption of Australian equivalents to IFRS and converging GFS and GAAP is that they will run concurrently with initiatives to further tighten the Australian Government Public Sector's financial reporting timetable.

The *Charter of Budget Honesty Act 1998* requires Australian Government entities to provide financial information within tight timetables to the Department of Finance and Administration. This facilitates the preparation of the Consolidated Financial Statements and Final Budget Outcome Report each year. In accordance with the *Charter of Budget Honesty Act 1998*, the Final Budget Outcome Report needs to prepared for public release “no later than 3 months after the end of the financial year.”

In 2002, these deadlines were further tightened after the publication of *Estimates Memorandum 2002/13 Budget Estimates and Framework Review – Recommendations*. This was endorsed by a Cabinet decision.

Amongst others, the Department’s goal is to provide the Parliament with the Final Budget Outcome Report within 45 days of the end of the financial year. To achieve this goal, the Department is proposing to incrementally tighten the reporting timetable for Australian Public Sector entities, as summarised in Table 7.

**Table 7 – Summary of Current and Future Financial Reporting Timetables**

<table>
<thead>
<tr>
<th>Financial year ending</th>
<th>Audit clearance required from ANAO of financial information of larger entities</th>
<th>Final Budget Outcome Report provided to Parliament</th>
</tr>
</thead>
<tbody>
<tr>
<td>30 June 2004</td>
<td>30 July 2004</td>
<td>20 August 2004</td>
</tr>
<tr>
<td>30 June 2005</td>
<td>20 July 2005</td>
<td>14 August 2005</td>
</tr>
</tbody>
</table>

The challenges with this tightening timetable lie with both agencies and the ANAO, to ensure that the required information is made available to the Department of Finance and Administration when required, without a reduction in the quality of that information.

This additional requirement impacts upon the workload, pressures and resources of agencies and of the ANAO. The ANAO has already put strategies in place to facilitate audit clearance of financial information within tightening reporting timetables, without diminishing the quality of the audit work performed.

A key strategy, which the ANAO is endeavouring to implement, is to shift audit efforts away from the peak period, that is, after the end of the financial year. We do this by completing an additional phase in our audits, called a ‘hard close’, as outlined earlier in this paper.
During an efficient hard close, significant efforts are placed upon auditing the balances as at that date. Then after year-end, assurance on the year-end balances is gained via review of the movements between the date of the hard close and the client’s balance date. This can be achieved by using techniques such as analytical procedures and review of journals.

The effectiveness of these strategies does, however, rely upon effective communication between agencies and their external auditors, and the provision of auditable financial information in accordance with agreed timetables.

**Converging Australian Auditing Standards with International Standards on Auditing**

The Auditing and Assurance Standards Board (AuASB) has a long-standing policy of convergence and harmonisation with International Standards on Auditing. The AuASB uses international standards as the basis for its corresponding Australian standards.

It is the policy of the AuASB to aim to ensure that, moving forward, compliance with Australian Auditing Standards will also constitute compliance with international Standards on Auditing. It is anticipated that this goal should be met by the start of 2005, through ongoing revisions of both international and Australian standards.

The AuASB has recently undertaken a comparison of the “black-letter” requirements of International Standards on Auditing (ISAs) and Australian Auditing Standards (AUSs) to determine the extent and nature of any differences. This review identified 35 differences between the current ISAs and AUSs, including instances where:

- there was no similar or matching AUS “black-letter” wording for ISA “black-letter” wording;
- a difference in approach had been adopted in the drafting of the AUS and the ISA;
- AUS “black-letter” wording appeared to require a lesser requirement than the corresponding ISA “black-letter” wording; and
- ISA “black-letter” wording was covered by equivalent AUS “grey-letter” wording.

In Australia, the AuASB and International Auditing and Assurance Standards Board generally issue an exposure draft of a proposed auditing and assurance standard concurrently for consideration by interested parties. It is expected that an exposure draft will be issued to address each difference noted.

The ANAO has been reviewing, and will continue to review and respond to, exposure drafts as they are issued. Greater emphasis is placed upon those exposure drafts that will impact the public sector. The ANAO will respond to these exposure drafts either in its own right or as part of a collaborative response through ACAG.

The ANAO’s initial reviews of the proposed standards indicate that the proposed new standards are more prescriptive than the current Australian standards. These changes may result in additional work for Australian auditors to ensure full compliance with the new standards.
As discussed earlier in this paper, the requirements of the Australian Auditing Standards are still some way short of the requirements of the highly prescriptive Sarbanes-Oxley Act of 2002 in the United States. As previously stated, this is particularly true of the differences between requirements of Australian and American auditors vis-à-vis the entity’s internal control structure.

The ANAO is reviewing exposure drafts of proposed auditing standards as they are released, to make comments upon the proposed content and identify potential changes to ANAO’s policies. While it is expected that application of the revised standards will not be required until the 2005-2006 financial year, the AuASB encourages their early adoption. Work is also underway within the ANAO to ensure that our staff are appropriately trained with respect to the application of the revised auditing standards during their audits of financial information relating to the 2004-2005 financial year. To complement this training an Auditing Reference Guide, a companion to the IFRS Reference Guide referred to earlier, is currently being developed.

To date, the ANAO’s review of the proposed standards has also shown that the proposed standards contain elements that are more prescriptive than current requirements in Australian Auditing Standards. An example can be found in the proposed revision of the International Standard on Auditing ISA 240 *The Auditor’s Responsibility to Consider Fraud in an Audit of Financial Statements*. The proposed standard has an overall prescriptive approach, which reduces the auditor’s ability to exercise his, or her, professional judgment. This is particularly apparent where the same procedures are mandated regardless of the assessed risk of fraud in relation to improper revenue recognition or management override of controls.

Such an approach does not totally override the current risk-based approach required by the Australian Auditing Standards. Rather, it codifies how to evaluate the risks identified.

The next phase in the harmonisation process is the development of ANAO auditing policy to ensure compliance with any new standards as they are introduced. Our Research and Development Branch will identify any changes required to the ANAO’s current policies; draft the required amendments; and seek my approval.

As the AuASB issues exposure drafts, the ANAO will be in a position to anticipate the actual changes the new standard will require to both the techniques used by ANAO staff, and the policy applied by the Office as a whole.

Significant training is planned for ANAO staff to ensure they are familiar with changes and new requirements as a result of the AuASB’s harmonisation approach. The format and delivery of this training will depend on the magnitude of changes made to the existing AUSs.

In any case, these changes to the standards increase the professional requirements of auditors. Such changes may have a significant impact upon the ANAO, as the Australian Government’s financial reporting timetable continues to compress.
5. Particular Challenges Being Addressed by the Auditing Profession and the ANAO

In addition to the current reforms taking place, there are other broad challenges for the auditing profession and the ANAO with respect to assurance auditing. These include:

- restoration and maintenance of the public’s confidence in the accounting profession;
- accountability and performance measurement in arrangements involving Joined-Up government (at all levels) and/or arrangements involving both public and private sector entities working together to provide public services;
- managing the accrual budgeting and financial management framework in the public sector; and
- reporting of broader corporate social responsibilities.

This section of the Paper broadly outlines these challenges and their apparent/likely impact on the public sector.

Restoration and Maintenance of Public Confidence in the Accounting Profession

There are a number of factors that are contributing to greater expectations being placed upon both agencies and their auditors. These include:

- an increased focus upon corporate governance;
- the influence of CLERP 9 legislation; and
- the convergence of Australian Auditing Standards with International Standards on Auditing.

An underlying rationale for these, and other, initiatives is to restore the public’s confidence in the accounting profession. This profession has suffered significant undermining in the level of confidence and trust the public holds in its work, by virtue of a number of major corporate collapses both in Australia and internationally. The former SEC Chairman, Arthur Levitt Jr, recently explained just how essential the public’s trust and confidence is to the accounting profession, as follows:

The accounting profession is a profession like no other, and, in my mind, one of the most noble in our marketplace. …With that precious franchise come some unique pressures and challenges. In most businesses the watchword is “The customer is always right.” Accountants, however, are charged with telling the customer when he’s wrong. What other profession has that responsibility? What other profession is enshrined in our nation’s securities laws to serve no interest but the public’s? What other profession so directly holds the keys to public confidence – the lifeblood of our markets.

I can think of none other but the accounting profession61.

In October 2002, IFAC commissioned a Task Force on Rebuilding Public Confidence in Financial Reporting to “…provide an international perspective on the causes of the
loss of credibility in financial reporting and corporate disclosure and to recommend courses of action to restore credibility\(^{62}\).

In the report issued in July 2003, the task force made the following recommendations:

- effective corporate ethics need to be in place and actively monitored;
- corporate management must place greater emphasis on the effectiveness of financial management and controls. In addition, incentives to misstate financial information need to be reduced;
- boards of directors need to improve their oversight of management;
- the threats to auditor independence need to be given greater attention in corporate governance processes and by auditors themselves. This includes greater control over auditor provision of non-audit services.
- audit effectiveness needs to be raised, primarily through increased attention to quality control processes;
- codes of conduct need to be put in place and their compliance monitored for other participants in the financial reporting process, such as financial analysts, credit rating agencies, legal advisers, and investment banks; and
- audit standards and regulations, accounting and reporting practices need to be strengthened. The standard of regulation of issuers also needs to be raised\(^{63}\).

Most of these recommendations have already been incorporated in changes, or proposed changes, to requirements for companies subject to the *Corporations Act 2001*, as well as for Australian accountants and auditors.

Interestingly, over recent times, the Parliament has also indicated some concerns and disquiet with agencies in these areas. This has been demonstrated by inquiries by the Senate Finance and Public Administration Committee and the Joint Committee of Public Accounts and Audit, and requests for the Auditor-General to examine specific aspects of public administration.

Of particular interest was the JCPAA’s Report 388 “Review of the Accrual Budget Documentation”, issued in June 2002. The terms of reference state that the Committee would “…inquire into the effectiveness of, and options for enhancing the format and content of, the current budget documentation including the Portfolio Budget Statements, Annual Report and the Portfolio Additional Estimates, for the purposes of Parliamentary scrutiny”\(^{64}\). The long-standing importance of these documents to public sector accountability was reinforced by the following introductory comments:

In March 2000, the Committee commented in its *Report 374* that it had noted some concern among members of Parliament concerning the impact of the new budget format on their ability to scrutinise proposed government expenditure\(^{65}\). This report’s overall conclusion was that the framework in place was sound and was going through a period of refinement. The content and recommendations in the report indicated an overall need for the Parliament to be presented with appropriately aggregated information, which was consistent over time and between agencies.
This report also contained the recommendation that the Auditor-General’s mandate be extended to include auditing the Final Budget Outcome (FBO) report. The main reason stated for this proposal was to add credibility by an independent review of this important information. The ANAO’s response to this proposed increase to its mandate was that it “would be in a position to audit this information if requested”\(^{66}\).

In its response to this report, the Government disagreed with the notion of having the FBO audited. It noted that the *Charter of Budget Honesty Act* requires the FBO to be published by 30 September and “the introduction of a complete audit process would compromise this legislative requirement”\(^{67}\). The Government’s response did, however, note that the recent Budget Estimates and Framework Review\(^ {68}\) included a Cabinet-endorsed recommendation for tighter reporting timetables (as discussed earlier in this Paper), which may allow for the potential audit of the FBO report to be reconsidered in the future.

*Increased Focus on Corporate Governance*

Corporate governance in Australia has been predominately self-regulated, as compared to the more prescriptive approach taken by the United States. The latter approach has become even more regulated since the introduction of the *Sarbanes-Oxley Act of 2002*. However, due to several high-profile corporate failures\(^ {69}\), new legislation has recently been passed to further strengthen the Australian framework. This will be discussed in greater depth later in this Paper.

Ensuring there is an appropriate governance structure in place, in both policies and in practice, will aid entities to survive and thrive in the Australian Public Service’s culture that strongly emphasises performance and accountability.

Over the years, the ANAO has published a number of Better Practice Guides addressing the topic of corporate governance, including our most recent offering in July 2003, *Public Sector Governance – Volumes 1 & 2*\(^ {70}\). This document was produced to assist public sector organisations meet the current pressures, and expectations, of their governance framework, processes and practices.

The overall increased emphasis on the importance of having a good corporate governance structure in place has an impact upon financial statement audits undertaken by the ANAO. As discussed earlier, auditors are required by Australian Auditing Standards\(^ {71}\) to “…obtain an understanding of the internal control structure sufficient to plan the audit and develop an effective audit approach.”\(^ {72}\) Assessing the auditee’s internal control structure is defined as:

> The dynamic, integrated processes, effected by the governing body, management and all other staff, that are designed to provide reasonable assurance regarding the achievement of the following general objectives:

(a) effectiveness, efficiency and economy of operations;

(b) reliability of management and financial reporting; and

(c) compliance with applicable laws and regulations and internal policies. (Emphasis added).\(^ {73}\)
With increasing focus on corporate governance comes fewer deficiencies in the internal control structures noted by audit teams, and a greater ability for audit teams to rely upon controls put in place during an audit.

**Audit independence**

A central aspect of corporate governance is auditor independence. As discussed earlier, this is a very important ‘tool’ in the external auditor’s ‘toolbox’, as it is the key aspect of the credibility of the auditing function. The “…perceived independence of auditors is vital to the maintenance in the auditing profession”\(^{54}\).

Audit independence has been broadly discussed due to a number of high-profile corporate failures, in terms of the duration for which an auditor should be involved with auditing a specific client, and other services that auditors should (and should not) be able to perform concurrently with audit services. Changes to requirements for auditors are taking place in both Australia and internationally. In the United States, the *Sarbanes-Oxley Act* “…attempts to create a more independent environment for auditors to make their contribution to the corporate reporting supply chain”\(^{55}\). The components of this legislation pertaining to auditor independence are intended to “…remind all parties of their responsibilities to protect and safeguard the interests of investors”\(^{56}\).

In Australia, the changes to requirements of auditors are addressed by revisions made to:

- the Auditing and Assurance Standards Board’s Guidance Note *Auditor Independence and Other Services*;
- the revised Professional Statement F1 *Professional Independence*, which was issued jointly by CPA Australia and the Institute of Chartered Accountants in Australia as part of the Australian accounting profession’s Code of Professional Conduct; and
- the recent legislative amendments through the Corporate Law Economic Reform Program.

The ANAO takes a professional interest in this ongoing debate. As outlined earlier, though, it is set apart from this debate by virtue of its statutory and functional independence, afforded to it by the *Auditor-General Act 1997*.

**Influence of CLERP 9**

Since 1997, Australia has been embarking upon a Corporate Law Economic Reform Program (CLERP). The following extract provides an overview of this program:

> The Corporate Law Economic Reform Program (CLERP) is a comprehensive initiative to improve Australia’s business and company regulation as part of the Coalition Government’s drive to promote business, economic development and employment. CLERP was announced by the Treasurer in March 1997 and is aimed at reforming key areas of corporate and business regulation.\(^{77}\)

The ninth instalment in this program, *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003* (referred to as CLERP 9) was
introduced to the Australian Parliament for consideration in December 2003. The Bill was passed by both houses of the Parliament on 25 June 2004.

CLERP 9 is designed to enhance audit regulation and the general corporate disclosure framework. The legislation introduces a number of significant policy changes, as listed in Table 8 as follows:

**Table 8 – Significant Changes Included in CLERP 9**

- legal backing for auditing standards;
- rotation of auditors of listed companies after five years;
- Chief Executive Officers and Chief Financial Officers required to sign off on the financial statements, stating they are in accordance with the *Corporations Act 2001* and accounting standards, and present a true and fair view;
- the establishment of a Financial Reporting Panel to resolve disputes between Australian Securities and Investments Commission (ASIC) and companies concerning the company’s accounting treatment in its financial report;
- additional licensing obligations to supplement the general duty to provide financial services ‘efficiently, honestly and fairly’ to manage conflicts of interest;
- additional powers for ASIC to issue infringement notices (of up to $100,000) in relation to contraventions of the continuous disclosure regime;
- ASIC may apply to courts for extension of up to 15 years on the current five year automatic disqualification of directors for contraventions of the *Corporations Act 2001*;
- closer alignment of the exemptions from disclosure regimes that apply to sophisticated investors and wholesale clients with respect to fundraising, and financial services and markets; and
- a number of measures designed to promote transparency and accountability in relation to the remuneration of directors and company management.

While Australia still retains a self-regulated approach to corporate governance, CLERP 9 does represent a step towards greater prescription for the Australian accounting and auditing professions. The following excerpt from the recent House of Representatives’ Hansard in relation to the Senate’s amendments to the CLERP 9 Bill indicates that the government is keen to retain a principles based approach, rather than pursue an overall prescriptive route:

> The government is taking what we would regard as a principles based approach. The alternative, which has been adopted in some other parts of the world—most particularly the United States—is a much more prescriptive black-letter law approach which seeks to micromanage the decisions being made across the corporate sector. Our approach has been more to adopt broad principles and seek to have them upheld.

Australian Government companies, which are bound by the *Corporations Act 2001*, will need to apply the legislative changes arising from CLERP 9. It would be better practice for other Australian Government agencies to also apply the principles of this legislation. From late 2003, for example, the ANAO began adopting the then proposed changes relating to rotation of auditors, and has reviewed the CLERP 9 legislation to
identify other policy implications. The increased awareness of maintaining the independence and the proposed changes to CLERP 9 are already impacting upon the ANAO when it contracts out financial statement audit work to accounting firms.

The revised Professional Statement F1 *Professional Independence* requires members of the Australian accounting profession to avoid undertaking work that impedes actual or perceived independence. Examples of where a financial or commercial relationship which could be presumed to impair independence include:

- internal audit services;
- taxation advice;
- actuarial services;
- accounting policy advice;
- services relating to the setting up and/or maintenance of significant accounting records and systems;
- the preparation of accounts and records or financial statements of the entity; and
- any other services related to fundamental aspects of the entity's business and/or strategic planning, including Information Technology.

By virtue of the Australian accounting profession’s *Code of Professional Conduct*, private sector accounting firms are prevented from providing external audit services and other services.

CLERP 9 provides Australian auditing standards with the force of law. This has the effect of increasing the risk associated with performing the external audit function, as there is a risk of litigation should breaches of Australian auditing standards be found to have occurred.

The combined impact on the ANAO, of the amendments to the Australian accounting profession’s *Code of Professional Conduct* and the amendments arising from CLERP 9, is moderate. This relates to the extent that providing other services is becoming a more attractive and lucrative alternative for private sector accounting firms than the higher risk associated with the external audit function.

This situation limits the ANAO’s choices for contracting out external audit work to appropriately qualified and experienced private sector accounting firms. We are increasingly confronting ‘conflict of interest’ situations.

Other impacts of the policy changes in CLERP 9 upon the ANAO include the following:

- Currently, the Auditor-General is not able to delegate responsibility for signing an opinion for a company. The Bill will amend the Corporations Legislation allowing the Auditor-General to delegate this responsibility.
- As a result of the ANAO’s earlier consideration of proposed CLERP 9, we have amended the policy in relation to rotation of Signing Officers from five to seven years to a period of five years.
• There may be a change in perception regarding career prospects for auditors that may result in increased difficulties to attract suitably qualified staff.

• The Auditor-General and his/her delegates as registered company auditors may have to lodge annual statements with ASIC detailing information prescribed in regulation, for example, nature and complexity of work undertaken.

• The Auditor-General and delegates are required to comply with standards made by the AuASB when conducting audits of financial reports prepared under the Corporations Act.

• The ANAO will now need to consider its policies, methodology or training in relation to:
  − the authority to sign Audit Opinions;
  − annual Returns to ASIC;
  − complying with Auditing Standards when auditing Companies;
  − the wording of Commonwealth Authority and Company Audit Opinions;
  − attendance and answering questions at Annual General Meetings;
  − notifying ASIC within seven days of attempts to influence, coerce, manipulate or mislead the auditor;
  − staff movement from ANAO to Commonwealth Authorities and Companies; and
  − reviewing additional information included to provide a true and fair view in the directors report.

**Accountability and Performance Measurement in a Changing AGPS Environment**

An additional challenge for the AGPS is that of various types of arrangements being entered into by agencies to deliver services in a changing AGPS environment. It is important to consider also how these arrangements impact upon performance measurement and ultimate accountability.

The arrangements discussed further in this Paper relate to:

• Joined-Up or Collaborative Government;
• Private Financing Initiatives; and
• Outsourcing.

**Joined-Up or Collaborative Government**

The terms ‘Joined-Up or Collaborative Government’ and ‘Connecting Government’ can be used to describe the AGPS working in a Whole-of-Government way. In this respect, the AGPS is trying to address the challenge to find new and better ways to work together to deliver results.
In this context ‘Whole of Government’ can be defined as follows:

…public service agencies working across portfolio boundaries to achieve a shared goal and an integrated government response to particular issues. Approaches can be formal and informal. They can focus on policy development, program management and service delivery\(^{81}\).

Major challenges for public administration such as “ensuring security, building a strong economy, coping with demographic change and crafting social policy” – necessarily require the active participation of a range of central and line agencies.\(^{82}\)

Joined-Up Government includes, but is not limited to, relationships between departments, other government agencies and external entities, to deliver, or assist in the delivery of, outcomes and outputs. The changing approaches to public administration which have sought to join-up, both between agencies and with entities outside of government, have sharpened our awareness, particularly of the practicality of shared responsibility and accountability and the associated corporate governance issues that have been occurring through an increased focus on accountability and performance\(^{83}\).

There are numerous arrangements in the Australian Government, for the delivery of services. An example of Joined-Up Government in practice, includes the work of a number of agencies\(^{84}\) to deliver the Australian Government’s environment and sustainability policies, as highlighted in a Ministerial Statement relating to the 2004-2005 Budget\(^{85}\). While individual agency heads are accountable under the *Financial Management and Accountability Act 1997* and the *Commonwealth Authorities and Companies Act 1997* governance arrangements will, to some extent, be found in the agency which delivers the services on behalf of the ‘accountable’ agency.

While there are numerous benefits of these joined-up arrangements, they also raise questions relating to governance and accountability requirements. There are also some practical issues that need to be resolved for such arrangements to be fully effective. For example, performance measures between entities need to be closer aligned to allow improved analysis and program evaluation. Similarly, there is incompatibility between financial management information systems (FMIS) between agencies. This significantly reduces the effectiveness of program management because of the difficulty of exchanging financial and performance information.

To overcome these problems, a ‘Whole-of-Government’ approach must be taken. For example, the Department of Finance and Administration could develop a standard template for the operation of a FMIS. This would allow transfer of data between agencies with very different businesses requirements, while facilitating uniform information sharing and encouraging shared performance measurement regimes to be put in place.

Where joined-up arrangements exist, clarity with regard to the outcomes, outputs, performance, responsibilities and accountability is required, if they are to be successful. Memorandums of understanding, contracts and Business Partnership agreements are examples of formal arrangements between entities that endeavour to clarify such matters. In addition, where joined-up arrangements exist, the ANAO is required to determine and assess the adequacy of the accountability mechanisms in the separate entities included in the joined-up arrangement. *Australian Auditing Standard AUS 404*
Private Financing Initiatives

Private Financing Initiatives (PFIs) are a form of procurement where private sector capital is used to fund a public asset that would have otherwise been funded using public monies. This approach is beneficial when procuring major assets and infrastructure, as the public sector directly benefits from the private sector’s specialist expertise and innovation. Another benefit is the public sector’s ability to re-allocate risks to those better able to manage them. This arrangement is also referred to as public-private partnerships in the public sector literature and is increasingly common parlance when referring to PFI arrangements. Further, such a model allows for the public sector to take advantage of innovations and initiatives from the private sector, while also transferring more responsibility to the private sector for providing community infrastructure. Such an approach can lead to a better outcome for the users, who at the end of the day still pay, for example, for the construction of the infrastructure. However, they do not have their taxation dollars ‘tied up’ in projects that can be provided by the private sector.

While the Australian Government has yet to undertake a major procurement using private financing, many Australian examples can be found at the State and local Government levels. For example, in October 2003, the Roads and Traffic Authority in New South Wales selected the Lane Cove Tunnel Consortium as the preferred consortium to design, build, maintain and operate the Lane Cove road tunnel. When constructed, this 3.6km tunnel will ease some traffic flows in Sydney, including bypassing up to 26 sets of traffic lights, by linking the Gore Hill Freeway with the M2. This will reduce the time take to travel from the city to Sydney’s northwest. The tunnel is estimated to cost $815 million, which is to be funded privately and recouped via tolls for vehicles using the tunnel.

Outsourcing

Outsourcing non-core public sector functions to the private sector can lead to more efficient and cost effective services. Other stated benefits include:

- increased flexibility in service delivery;
- greater focus on outputs and outcomes rather than inputs;
- the freeing-up of public sector management to focus on higher priority or ‘core’ activities;
- encouraging suppliers to provide more innovative solutions; and
- cost savings in providing services.

Of course, the notion of ‘core’ functions can, and does, change. However, governments are generally not inclined to define what is ‘core’. Rather, they progressively redefine the coverage of those functions by outsourcing and privatisation.

An example of successful outsourcing can be found from within the ANAO itself. For many years, the ANAO has tendered out the audits of Government Business Enterprises and of a number of other AGPS commercial bodies. The ANAO retains an oversight...
role of these audits and issues the audit opinions, while benefiting from the expertise and knowledge of the international accounting/audit firms that complete the bulk of the work.

The Australian Government’s experience with outsourcing to date is that it needs to be a well-managed process to ensure it is suitably transparent to protect public accountability. This simple, yet important, message was conveyed in both the ANAO Audit Report on the Australia Government’s experiences when outsourcing the information technology function\(^9\), and the subsequent JCPAA inquiry into the issues raised by that report\(^9\).

**Competitive Tendering and Contracting**

Competitive tendering and contracting is a means of testing whether the current arrangements are providing the most economical and efficient approach to delivering public sector goods and services. In a competitive tendering and contracting process, bids are submitted for provision of the output, from both internal and external sources. These bids are then compared against criteria to identify the best approach to delivering the outputs.

An example of the competitive tendering and contracting process can also be found within the ANAO. When evaluating and selecting financial audit methodology software, the ANAO considered the software that could be sourced from other audit offices and private sector audit firms. As well, if developing our own software in-house, we also needed to consider obtaining best value for money. The tenders were evaluated against our criteria for the software to determine which option would provide the best approach for the ANAO. In this instance, the best approach identified was to source our financial audit methodology software from a major private sector audit firm.

No matter which approach is taken to engage the private sector in the delivery of public sector services, the main issues public servants need to be actively aware of are unchanged, such as:

- ensuring appropriate transparency, accountability and sound governance arrangements are in place; and
- that Australian citizens and taxpayers should receive public services that are of a high quality, and which also provide value for money.

Appropriate contractual and performance monitoring and review processes and costing information are required to address these requirements. This requires forethought and planning when entering into such arrangements, to ensure that the Australian public’s resources are being used as best they can be to achieve the desired outcomes and deliver the required outputs. Agreed methods of measuring success, using accounting information, key performance indicators, balanced scorecards and the like, are important elements in addressing these requirements. The adoption of sector neutral international standards (those that apply equally to the public, private and not-for-profit sectors) would assist this process, by providing a broadly consistent accounting and reporting framework for both the public and private sectors.

These requirements also led to interesting questions of how the blurring of the boundaries between sectors impacts on governance and accountability requirements.
For example, where private sector entities are engaged through public/private partnerships or competitive tendering:

- who is ultimately responsible for the delivery of the public sector services?
- who is accountable for the quality of the services being provided?
- who is accountable for the costs associated with providing the services? and
- is it the public sector agency that engaged the private sector entities, the private sector entities themselves, or both?

Currently, the Government and the Parliament consider that the public sector entity has ultimate accountability for the provision of the public sector services, even where private sector entities are involved. This leads to questions as to whether the public sector should be responsible for the actions of external parties, particularly where the former is not directly involved. For many, the public sector’s responsibility lies in the contract management process. But can contracts adequately capture the accountability requirements of the public sector? The answer seems to be ‘only in a limited manner’.

**Managing the Accrual Budgeting and Financial Management Frameworks in the Public Sector**

The AGPS financial management reforms commenced in the mid 1990s when the public sector, as a whole, moved from using cash accounting to accrual accounting. In the late 1990s, a further series of legislative changes, reforms and initiatives was introduced.

These developments brought about a significant shift in budgeting ideology from a prescriptive, process based regime to a more flexible and principles based approach. The new framework was based on devolution of authority to public servants who are best placed to make informed decisions about achievement of desired outputs and outcomes. Under these new arrangements, the AGPS is encouraged to:

- flexibly manage resources to achieve desired outcomes and deliver desired outputs; and
- provide suitable delegation of responsibilities and governance arrangements with the overall goal of cultivating a performance and accountability culture within the AGPS.

The current framework is succinctly described as follows:\textsuperscript{92}:

**Table 9 – Components of the Framework\textsuperscript{93}**

<table>
<thead>
<tr>
<th>Description</th>
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<tr>
<td>All Commonwealth agencies operate on the basis of an outcomes and outputs framework that was introduced by the Government in 1999-2000. The Government delivers benefits to the Australian community (outcomes) primarily through administered items and agencies’ goods and services (outputs) which are delivered against specific performance benchmarks or targets (indicators). The framework operates in the following way:</td>
</tr>
<tr>
<td>- the Government specifies, via outcome statements, the outcomes it is seeking to achieve in given areas;</td>
</tr>
<tr>
<td>- these outcomes are specified in terms of the impact government is aiming to have on</td>
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</tbody>
</table>
some aspect of society, for example, Defence;

- Parliament appropriates funds, on an accrual basis, to allow the government to achieve these outcomes through administered items and departmental outputs;
- items such as grants, transfers and benefit payments are administered on the government’s behalf by agencies, with a view to maximising their contribution to specified outcomes;
- agencies specify the nature and full accrual price of their outputs and manage them to maximise their contribution to the achievement of the Government’s desired outcomes;
- performance indicators are developed to allow for scrutiny of effectiveness (i.e. the impact of the outputs and administered terms on outcomes) and efficiency (especially in terms of the application of administered items and the price, quality and quantity of outputs); and
- agencies discuss in their annual reports their performance against their performance indicators.

This section of the Paper discusses some of the financial management matters being addressed by the ANAO in its role as the Australian Government’s external financial statement auditor.

**Balance Sheet Disclosure and Management in the Public Sector**

The most topical issue surrounding ‘balance sheet management’ in the Australian Government public sector, is that of ensuring the capacity to meet capital requirements and liabilities when they fall due. This is of particular importance to the Chairs and/or Directors of the Boards of Commonwealth authorities and companies, who are required by the current Finance Minister’s Orders (FMOs) to include with their financial report a statement of “whether or not, in their opinion, there are, when the statement is made, reasonable grounds to believe the entity will be able to pay its debts as and when they fall due”. The Chairs and/or Directors of the Boards of Commonwealth companies have similar requirements imposed upon them by the Corporations Act 2001.

Such statements are not required in relation to financial institutions which apply Australian Accounting Standard AAS 32 Specific Disclosures by Financial Institutions or agencies that are covered by the Financial Management and Accountability Act 1997.

Current Australian Government policy is to fully fund agencies’ operating expenses. For example, the Government currently provides appropriation funding for depreciation and amortisation expenses incurred as non-current assets are consumed over a period of time. Appropriation funding is provided for these expenses to ensure that the agency can maintain its operating capacity by replacing assets it consumes, from funding that matches this consumption over time. Similarly, employee entitlements are fully funded in each year to ensure that agencies have the capacity to meet those liabilities when they fall due.

The debate is not about ‘the policy’ to fund all expenses in the year they are incurred, as the policy itself has many merits, not the least of which is the elimination of intergenerational inequities. Intergenerational inequities may occur if, for example, funding was not provided for depreciation. In this circumstance, agencies may
consume, or even totally run down, assets currently held with the expectation of future
generations of taxpayers providing resources to be used to replace these assets.

Avoidance of intergenerational inequities is not only government policy but required by
the *Charter of Budget Honesty Act 1998*. This Act requires the Government to apply
the principles of sound fiscal management, including ensuring that “…its policy
decisions have regard to their financial effects on future generations”\(^96\). Furthermore,
the Government is required to “manage financial risks faced by the Commonwealth
prudently…”\(^97\). These risks are defined to include the following \(^98\).

(a) risks arising from excessive net debt; and

(b) commercial risks arising for ownership of public trading enterprises and
public financial enterprises;

(c) risks arising from erosion of the tax base; and

(d) **risks arising from the management of assets and liabilities.** (Emphasis added)

This is further reinforced by the requirement for the Government to publicly release and
table intergenerational reports every five years\(^99\). The content of this report includes
information for the assessment of the “…long term sustainability of current
Government policies over the 40 years following the release of the report, including by
taking account of the financial implications of demographic change”\(^100\). The
Government publicly released and tabled an intergenerational report as part of the

The matter of concern is about the inevitable diversion of funds, intended for capital
replacement and funds required to meet liabilities when they fall due, to other purposes.
Any diversion of these funds to other purposes has the effect of circumventing the
Government's intentions, resulting in the need to appropriate duplicate funding some
time in the future.

To ensure compliance with government policy, there must be stricter entity controls
around balance sheet management. This is primarily the responsibility of those
mentioned earlier, who are directly concerned with the financial and business integrity
of their entities.

**Classification and Accountability of Administered and Departmental Items**

**Background**

The distinction between Administered and Departmental items appears, on the face of
it, to be reasonably straightforward. Australian Accounting Standard AAS 29
*Financial Reporting by Government Departments* requires disclosure of administered
items separate to other financial information about the department. The standard notes
that, while the department does not control administered items, disclosure of
information about them is required in the general purpose financial reports because
“…that information may be relevant to performance assessments, including
assessments of accountability”\(^101\). In this context, the concept of control relates to the
department’s capacity to benefit from the assets, etc in the pursuit of its own objectives.

For the purposes of AAS 29, financial statement items recognised in the general
purpose financial reports of government departments are only those that the department
controls. Such items are termed ‘departmental’ items. These are distinguished from tax revenues, user charges, fines and fees, and transfer of funds to eligible beneficiaries (for example, social security payments), which are carried out by the department on behalf of the Government. This latter group is termed ‘administered’ items. The following extract from AAS 29 (see Table 10) helps to clarify the difference between departmental and administered items.

Table 10 – Explanation of administered items as per AAS 29

(T)he responsibilities of a government department may encompass the levying or collection of taxes, fines and fees, the provision of goods and services at a charge to recipients, and transfer of funds to eligible beneficiaries. These activities may give rise to revenues and expenses which are not attributable to the government department. This occurs, for example, where the government department is unable to use for its own purposes the proceeds from user charges, taxes, fees and fines it collects without further authorisation, or where the transfer of funds to eligible beneficiaries does not involve a reduction in the assets recognised in the government department’s statement of financial position. In addition, the government department may manage government assets in the capacity as an agent and may incur liabilities which, for example, while involving the Consolidated Revenue Fund or other Fund will not involve a sacrifice of the assets that the government departmental controls as at the reporting date. These administered revenues, expenses, assets and liabilities are not recognised in the government department’s operating statement or statement of financial position.

Schedule 1 of the current FMOs defines Departmental items and Administered items as follows:

“ ‘Departmental items’ cover those assets, liabilities, revenues and expenses over which the entity has control that are applied to the production of the entity’s own outputs.

‘Administered items’ are assets, liabilities, revenues and expenses that the entity does not control and which are subject to highly prescribed rules or conditions established by legislation, or Australian Government Policy in order to achieve Australian Government outcomes.”

There are a number of examples where, however, the appropriate classification of these items is not clear. In these instances, significant judgement and knowledge of the relevant functions and of the entity itself need to be applied to ascertain the appropriate classification for related financial statement items. Such circumstances lead to questions as to:

- how an item should be initially classified and consequently reported in the entity’s financial statements; or
- whether an item should be re-classified.

The latter point is an issue of importance for transparency and consistency, as there are instances of transactions being classified and reported differently in the preceding, current and future years. Inconsistent reporting causes concern for agencies, especially in times where the importance of balance sheet management is being emphasised. It is difficult to envisage how a Chief Executive could be expected to effectively manage his/her balance sheet where items are appearing, and disappearing from it, on the basis of the latter’s classification as administered or departmental.
The key criteria for determining if something should be classified as a ‘departmental item’ is whether the agency has control (in an accounting sense) over the item. The current FMOs provide the following guidance for establishing whether an agency controls an item (see Table 11).

**Table 11 – Decision points for determining classification of an item**

<table>
<thead>
<tr>
<th>Control over expenses, assets and revenues normally exists, for accounting purposes, where the entity has significant discretion as to how resources are applied in terms of the majority of the following decision points:</th>
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<tbody>
<tr>
<td>(a) purpose – the entity determines the purpose to which an asset is applied or the reason for which expenses are incurred;</td>
</tr>
<tr>
<td>(b) conditions – the entity sets conditions or boundaries on use of the asset or determines whether an amount should be paid (e.g. specifies performance standards);</td>
</tr>
<tr>
<td>(c) beneficiary – the entity determines who has use of its resources and for what purposes;</td>
</tr>
<tr>
<td>(d) timing – the entity is able to determine when to replace or deploy an asset, incur an expense or raise a payment; and</td>
</tr>
<tr>
<td>(e) amount – the entity may negotiate with suppliers on the value to be exchanged (e.g. the cost of the assets or fees for its use).</td>
</tr>
</tbody>
</table>

Where significant discretion does not exist in respect to all of these above decision points, the item is likely to be administered.

**Consistency of Classifications**

The following excerpt from the FMOs shows that there is also a requirement that amounts are reported in ex-post financial statements in the same manner as they are funded:

…where an amount is explicitly described by an Act (including an annual appropriation Act) as being ‘departmental’ or ‘administered’, it will be classified, for the purposes of accrual reporting of the entity, as described in the Act.

If the appropriation does not align to the standard’s requirements for administered items (or vice versa), there is a disconnect between the legal form (appropriation by the Parliament in Budget papers) and the substance (assessment of control under accounting framework). Ideally, this should always be one and the same. For instance, the notion of control in the accounting standards emphasises a substance test. This is based on whether, in reality, the department exercises significant influence (control) over the critical management decisions and whether the department can utilise the funding to obtain its own objectives. Such matters should, ideally, align with whether or not the entity is managing the function on behalf of the Government, and which is “…related to activities governed by eligibility rules and conditions established by the government or Parliament such as grants, subsidies and benefit payments.”

There is an apparent issue for resolution when changes of classification occur from one year to the next when little has seemingly changed in the management of the functions. If we take, as a given, that the previous classifications were correct, the only apparent justifications for reclassification would come from fundamental changes to either the operations or funding source relating to the items.
Assuming relative stability within the management of government programs, this suggests that the appropriation of funding by the Parliament is an important but difficult consideration in the assessment of where control lies in substance.

These matters are also of particular interest to the ANAO as the audit opinions, issued to our audit clients, attest to the financial statements:

- being prepared in accordance with Finance Minister’s Orders; and
- give a true and fair view, in accordance with applicable Accounting Standards and other mandatory professional reporting requirements in Australia and the Finance Minister’s Orders.

As such, the need for resolution not only relates to the need for consistency of classification from year to year, but also to situations where there is a potential conflict between the legal requirement to account for these items in a specific way and the relevant accounting rules. Concerns and debate may arise where the accounting rules and/or legal requirements can be interpreted other than in the manner intended.

The intention behind the requirement in AAS 29 *Financial Reporting by Government Departments* to separate Administered and Departmental items, is to ensure that transactions such as transfer payments and taxation revenue, which the Department did not control, were still disclosed in the accounts.

It is emphasised that the nature of these items are transfer payments and taxation revenues, which the Department could not use to achieve its own objectives.

*Appropriate Level of Accountability for Administered Items*

There are two issues of concern with respect to accountability for administered items – transparency of disclosure and ultimate responsibility.

The current FMOs require much less disclosure of administered items as compared to the requirements for departmental items. While significant details are required of departmental financial information, the administered financial information is relegated to disclosure in schedules only, which are not as disaggregated as Departmental items.

A common timing for changing classification of an item is as part of the Budget process, where the current FMOs require amounts explicitly described in an Act as ‘departmental’ or ‘administered’ to be classified in the same manner for the purposes of reporting. If a trend develops whereby, through the appropriation process, there is a consistent change in classification from departmental to administered, less information will be available, resulting in a further reduction in accountability and transparency.

The second, more important, issue is that of ultimate responsibility.

The financial framework requires that an agency’s Chief Executive is accountable and responsible for his or her resources. The degree of his or her responsibility relates to the extent to which they are able to control and make decisions about the items in question.

For instance, for departmental items, the Chief Executive is responsible for both the efficient use of funding and the effective achievement of outputs as he/she is in a position to make decisions relating to those resources. For administered items, the
Chief Executive is responsible for the efficient administration of the Government’s funds, but is not held responsible for the effective achievement of the outcome/s to which they relate. This situation arises as the Chief Executive is not in a position to make decisions about the administered funds as the agency is charged with performing these functions on behalf of the Government. It is the Government that ultimately makes decisions about these funds, not the Chief Executive/s of the agency, or agencies charged with administering these functions.

The distinction between when a Chief Executive is, and is not, held accountable for the effective use of funds is important when considering proposals to re-classify an item from departmental to administered, or vice versa.

**Reporting of Broader Corporate Social Responsibilities**

**Increasing Preparation and Verification of Triple Bottom Line Reports in the Public Sector**

Recently, CPA Australia’s Audit and Assurance Centre of Excellence published a database on their web site of over 160 companies worldwide that prepare Triple Bottom Line (TBL) reports accompanying their financial reports. This database provides information about these reports, including a listing of those providing TBL audit services. The database is designed to support research undertaken by RMIT University's school of Accounting and Law that “…aims to provide a better understanding of how TBL principles are being applied within organisations in Australia and around the world”.

This commitment to TBL by CPA Australia, and, indeed, also by the Institute of Chartered Accountants in Australia, shows the increasing importance of this type of reporting as a way of Chief Executives discharging their accountability.

There are many definitions and explanations of what TBL is, and what it stands for. Mark Sullivan, the Secretary of the Department of Family and Community Services (FaCS), defines TBL and its uses as follows:

TBL focuses on reporting and making decisions explicitly taking into consideration information on economic, environmental and social performance. As such TBL can be seen as both an internal management tool as well as an external reporting framework.

While TBL reporting is not new to the private sector, which has been reporting using TBL for well over a decade, it is a more recent concept for the public sector. In 2003, FaCS prepared the first ever verified TBL in the Australian Government public sector. This year, FaCS will again prepare a TBL for verification by the ANAO. As well, the Department of Environment and Heritage will prepare its first TBL report for 2003-2004.

The ACT Government is also looking to implement TBL in its jurisdiction. It is, however, looking to implement TBL budgeting rather than TBL ‘ex-post’ reporting. The provision of TBL budgeted information is expected to stress the importance and interdependence of economic, social and environment well-being, and provide a better context of informed decision-making about the allocation of resources.
The importance of considering the broader impacts of decisions made is becoming more prevalent in the private sector at a time where shareholders are looking to, and questioning, TBL reports to gain an understanding of the company’s broader impact. While shareholders were previously only presumed to be interested in receiving a return on their investment, they are now increasingly assessing if they are investing in ‘clear conscience’, and even demanding change where they feel a company is not adequately performing in a financial, social and environmental sense. To illustrate, the following question was posed recently in The Canberra Times – “what is the point of having much more money if the air is polluted and crime rages?”

During a speech at the launch of the FaCS TBL report, I spoke of the ANAO’s initial reservations about providing a verification statement for FaCS’ first attempt at producing a TBL report. These reservations stemmed from concerns that a large number of qualifications may have detracted from the importance that such progressive reporting in the public sector demonstrates.

Even now, there are still no approved standards in existence for preparing or verifying TBL Reports. In verifying the FaCS TBL report, the ANAO used Standards Australia’s draft standard General Guidelines on the Verification, Validation and Assurance of Environmental and Sustainability Reports (DR 03422). A recent study in the United Kingdom indicated that there is a clear need for integrating corporate social responsibility into the ISO management systems. Such an approach would lead to a more standardised global approach to this type of reporting covering key elements such as:

- compliance with all rules and regulations of the jurisdiction in question and relevant international norms pertaining to the environmental, consumer, fair labour standards, human rights, and health and safety protection, as agreed upon through a meaningful stakeholder engagement process;
- processes for meaningful stakeholder engagement;
- development, implementation and communication of corporate responsibility and corporate ethics policies, including those pertaining to anti-bribery and corruption;
- training for socially responsible governance;
- relations with communities, philanthropy, outreach and involvement; and
- measurement and regular reporting to the full range of stakeholders and the general public.

While there are a number of benefits of TBL reporting, consideration should also be given to the costs of such reporting for the organisation. While there has been no academic research on the cost of TBL reporting, the cost of not reporting may be higher “in terms of reputational risk, negative image of brands and so on”.

**Recent Developments in the UK regarding Corporate Social Responsibility Reporting**

There have been significant developments in the United Kingdom (UK) in relation to both Corporate Social Responsibility (CSR) reporting and its subset, Operating and Financial Review (OFR) reporting.
As with TBLs, CSR reporting is a broader approach to corporate reporting, taking into consideration the entity’s broader impact upon its local community, and the global community at large. Gordon Brown, the Chancellor of the Exchequer, recently described the importance of CSR as follows:

Today, our corporate social responsibility goes far beyond the old philanthropy of the past – donating money to good causes at the end of the financial year – and is instead an all year round responsibility that companies accept for the environment around them, for the best working practices, for their engagement in their local communities and for their recognition that brand names depend not only on quality, price and uniqueness but on how, cumulatively, they interact with company’s workforce, community and environment. Now we need to move towards a challenging measure of corporate responsibility, where we judge results not just by the input but by its outcomes: the difference we make to the world in which we live, and the contribution we make to poverty reduction.118

Research undertaken in early 2004 showed that, of the FTSE 100119 companies:

- 70 currently include CSR information in the front ‘review’ section of their annual reports;
- 49 currently include CSR information in the directors’ report; and
- 25 currently include CSR information in both the front ‘review’ section and the director’s report120.

This initiative arose from the Company Law Review, which was later endorsed by the UK Government in its “Modernising Company Law” White Paper in July 2002. This latter paper included the following three broad proposals to improve corporate governance:

- a statement of directors’ duties;
- improved transparency and accountability, with improvements to the quality, timeliness and accessibility of information available for shareholders and others; and
- more effective machinery for enabling and encouraging shareholders to exercise effective and responsible control121.

In mid 2003, the UK Government announced companies listed on the London Stock Exchange would be required to prepare and publish a statutory OFR in their annual report for financial years beginning on or after 1 January 2005. In May 2004, the UK Department of Transport and Industry’s OFR Working Group published both a consultative document and related practical guidance for preparing OFRs122 for which the consultative period ends in early August 2004.

**Proposed Requirements**

The objective of an OFR is not to duplicate CSR reporting, and is outlined as follows:

…to provide a discussion and analysis of the performance of the business and the main trends and factors underlying the results and financial position and likely to affect performance in the future so as to enable users to assess the strategies adopted by the business and the potential for successfully achieving them123.
The specific proposed requirements of an OFR are as follows:

An operating and financial review shall be a balanced and comprehensive analysis of:

(a) the development and performance of the business of the company and its subsidiary undertakings during the financial year;

(b) the position of the company and its subsidiary undertakings at the end of the year;

(c) the main trends and factors underlying the development, performance and position of the business of the company and its subsidiary undertakings during the financial year; and

(d) the main trends and factors which are likely to affect their future development, performance and position;

prepared so as to enable the members of the company to assess the strategies adopted by the company and its subsidiary undertakings and the potential for those strategies to succeed.\textsuperscript{124}

The proposed UK requirements include the need for an audit of the OFR. This independent review is critical as it provides stakeholders assurance that the OFR has been prepared in a careful and balanced manner. The review is an audit of the process used to prepare the report, rather than of the content of the report itself. To this end, the auditor is attesting to:

- the propriety of the directors’ process for preparing the OFR, i.e. how they have satisfied themselves that adequate, supportable information was considered in making their decisions as to inclusion of information; and how they have satisfied themselves that there is an adequate, supportable basis for statements made, whether factual or judgemental;

- consistency of the information in the OFR with the auditor’s knowledge from the audit of the accounts (including consistency with the financial accounts themselves); and

- compliance with any applicable standard\textsuperscript{125}.

As such, users of these reports should have a greater confidence in the review and gain the intended benefits, including that of more informed decision-making, from the provision of this improved information. And that conclusion applies more broadly to issues of assurance that Parliaments, Governments and the general public are seeking to have resolved, particularly by organisational management and endorsed by auditors. That is why this discussion has been included in this Occasional Paper as an indication of the matters that may have to be considered in the future as part of an entity’s assurance framework. Entity managers should at least be considering the likely impacts of any such requirements on their organisations.
6. Concluding Remarks

The important role undertaken by the ANAO of providing assurance over the Australian Government’s financial reports has not diminished over time. Nor have the challenges facing the ANAO. In the current environment, there are a number of matters to be addressed both operationally and strategically by the Office in order for it to continue to deliver high quality financial auditing services for the Australian Government.

In addressing these issues, the ANAO needs to be mindful of its unique mandated position of being the AGPS independent auditor and ensure it safeguards this independence with appropriate vigour. This is not to say the ANAO cannot be of assistance to its client agencies in this turbulent period of financial change. The ANAO has successfully assisted clients through publication of *AMODEL Illustrative Accounts*, provision of client seminars and accounting advice over many years. The Office will need to ensure, however, that while it is necessary to assist its clients, a professional distance also needs to be maintained so as to ensure our actual and/or perceived independence is maintained at a time when the independence of auditors has frequently come into question.

The ANAO’s risk-based methodology should continue to serve the Office well. It is a structured approach for identifying risks and addressing them in the context of an integrated audit approach between the number of audit products the ANAO provides to the Parliament. The risks identified as part of this process may require audit teams to ask the ‘hard questions’ of our clients. However, this again reinforces the importance of the Office’s unique mandated independence, ensuring that the Office can complete its work without ‘fear or favour’.

As the complexity of the risks identified by our audit teams increases, it also reflects the complexities of the environment within which our client agencies are operating. Questions of accountability for public money managed by agencies, and related corporate governance and financial management issues, for example, will continue to provide complex issues for ANAO staff and their client agencies to address for some time to come. These issues are also central to the JCPAA’s interests and responsibilities. While we have the Committee’s support for our assurance work, it is important that we keep it fully informed and confident in the quality of our audit products.

The public’s expectations of the Government to carry out its work in a proper manner are increasing. To this end, innovations such as TBL reporting and budgeting, or extending the ANAO’s mandate to include auditing the Final Budget Outcome, may go some way to meet these expectations.

More immediately, the impact of issues such as adoption of Australia’s equivalents to IFRS and the potential for convergence of Australian accounting principles and the economic principles of GFS will bring their own matters for consideration and resolution. The AGPS leading role in the timely provision of the Final Budget Outcome to the Parliament, puts increasing demands upon the resources and the approach of the ANAO for financial statement auditing. The ANAO, working with its client agencies, is doing its part to meet tighter reporting deadlines, and importantly doing so without diminishing the value of the assurance provided to the Parliament.
As the AGPS financial framework continues to evolve and new challenges continue to appear, the ANAO will continue to step up and successfully meet the challenges it faces both immediately and in the longer term. In this respect, the ANAO should meet Sir George Turner’s expectation of the important role played by both the Auditor-General and the Office to ensure the work of the Government and the Parliament is carried out in a proper manner.
### 7. Abbreviations

AASB | Australian Accounting Standards Board
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ACAG | Australasian Council of Auditors-General
AGM | Annual General Meeting
AGPS | Australian Government Public Sector
ANAO | Australian National Audit Office
ASIC | Australian Securities and Investments Commission
AuASB | Auditing and Assurance Standards Board
AUS | Australian Auditing Standard
AWP | Audit Work Program
BPG | Better Practise Guide
BSP | Business Support Process
CEO | Chief Executive Officer
CLERP | Corporate Law Economic Reform Program
CLERP 9 | *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) (CLERP 9) Bill 2003*
CSR | Corporate Social Responsibility
FaCS | The Department of Family and Community Services
FBO | Final Budget Outcome
FMIS | Financial Management Information System
FMO | Finance Minister’s Orders
FRC | Financial Reporting Council
GAAP | Generally Accepted Accounting Practises
GBE | Government Business Enterprise
GFS | Government Finance Statistics
GGS | General Government Sector
GST | Goods and Services Tax
HOTARAC | Heads of Treasuries Accounting and Reporting Advisory Committee
IASB | International Accounting Standards Board
ICAA | Institute of Chartered Accountants in Australia
IFAC | International Federation of Accountants
IFRS | International Financial Reporting Standards
INTOSAI | International Organisation of Supreme Audit Institutions
IPSAS | International Public Sector Accounting Standards
ISA | International Standards on Auditing
IT | Information Technology
JCPAA | Joint Committee of Public Accounts and Audit
OFR | Operating and Financial Review
PAP | Project Advisory Committee
PFI | Private Financing Initiatives
TBL | Triple Bottom Line
UK | United Kingdom
US | United States of America
8. Notes and References

1 P Barrett, 2004 ‘Performance Auditing in a Changing APS Environment’, an address for students participating in the University of Canberra’s Graduate Certificate in Performance Auditing, Canberra, 1 April.


3 ANAO internal assessment, May 2004.


5 ANAO internal assessment, May 2004.

6 All agency audits are charged on a notional basis reflecting the full cost of understanding, and reporting on, each individual audit. While audit fees are charged for all audits of statutory authorities and government companies, these fee receipts are paid directly to consolidated revenue. The ANAO’s costs are directly funded by Parliamentary appropriation.


8 Institute of Chartered Accountants in Australia and CPA Australia, 2002. Professional Statement F1–Professional Independence, pp.2–3. While Professional Statement F1 reflects Australian conditions, it is based on the standard agreed in November 2001 by representatives of the 120 nations that comprise the International Federation of Accountants (IFAC).

9 The reforms outlined in the CLERP (Audit Reform and Corporate Disclosure) Bill 2003 aim to enhance auditor independence, achieve better disclosure outcomes and improve enforcement arrangements for corporate misbehaviour, while fostering innovation and wealth creation. The Bill was introduced in the House of Representatives on 4 December 2003 and passed on 16 February 2004. It was introduced to the Senate on 1 March 2004 and passed on 25 June 2004.


13 Bearing in mind that Australian Auditing Standards require assurance that the financial statements are free from material error, not absolute assurance that there are no errors.


17 A more detailed list of items to consider is included in the Appendix to Australian Auditing Standard AUS 304 Knowledge of the Business.
18 CPA Australia Members’ Handbook 2002, AUS 402 Risk Assessments and Internal Controls, para. 03.

19 ibid., para. 02.

20 ibid., para. 09.

21 ibid., para. 13.

22 ibid., para. 14.

23 ibid., para. 14.

24 ibid., para. 06.


26 ibid., Appendix 1.

27 ibid., para. 25.


29 Ibid, p 43.

30 ibid., para. 06.

31 ibid., Appendix 1


33 Paragraph .02 of AUS 710 Communicating with Management on Matters Arising from an Audit states “the auditor should communicate significant matters relating to the audit, or identified as a result of the audit procedures performed, to an appropriate level of management on a timely basis”.

34 Pacific Acceptance Corp Ltd v Forsyth (1970) 92 WN (NSW).


37 Internal document


39 See, for example, ANAO Audit Report No. 28 2003–04, ‘Audit Activity Report: July to December 2003’, Canberra, 12 February


44 ANAO 2004, Annual Performance Reporting, Better Practice Guide, Canberra, April


46 Paragraph Aus6.1 Pending Australian Accounting Standard AASB 102 Inventories

47 The exact words used in each accounting standard are as follows:

- AAS 29 Financial Reporting by Government Departments paragraph 4.1:
  “... To the extent that the requirements of this Standard differ from the requirements of other applicable Australian Accounting Standards, the requirements of this Standard must be applied.”

- AAS 31 Financial Reporting by Governments paragraph 6.1:
  “... Subject to paragraph 6.2, the general purpose financial report of a government must be prepared in accordance with other Australian Accounting Standards, except to the extent that the requirements of this Standard differ from the requirements of other Standards, in which case the requirements of this Standard prevail.”

48 Available at www.aasb.com.au

49 ED 125 Financial Reporting by Local Governments, para. 6.2.

50 ANAO internal assessment, May 2004.


52 System of National Accounts SNA93.


55 Heads of Treasuries Accounting and Reporting Advisory Committee


57 The minutes of the FRC’s April meeting are available at www.frc.gov.au (accessed May 2004)


59 Charter of Budget Honesty Act 1998 (Cth), s. 18(1).


65 Ibid, p 3.

66 Ibid, p 81.

67 Australia, Senate 2003, Debates, 13 May, p10580.

68 Completed in October 2002.

69 HIH Insurance Ltd, One.Tel Ltd, Harris Scarfe Pty Ltd, United Medical Protection Ltd and Ansett Ltd

70 Available from www.anao.gov.au

71 Specifically Australian Auditing Standard AUS 402 Risk Assessments and Internal Controls, soon to be superseded by the revised AUS 402 Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatements


76 Ibid, p 22.


79 Australia, House of Representatives 2004, Debates, 23 June, p 30500.

80 Issued jointly by CPA Australia and the Institute of Chartered Accountants in Australia as part of the Australian accounting profession’s Code of Professional Conduct.


82 ibid., p. V.


84 Including the Departments of the Environment and Heritage; Agriculture, Fisheries and Forestry; Education, Science and Training; Industry, Tourism and Resources; Transport and Regional Services;
Defence; Foreign Affairs and Trade; Family and Community Services; the Treasury and Attorney General’s Department.


87 Sponsored by Thiess Pty Limited, John Holland Pty Limited, Transfield Holdings Pty Limited and ABN AMRO.


94 Part (c) of Clause 1C.2 of the Financial Management and Accountability (Financial Statements for reporting periods ending on or after 30 June 2004) Orders

95 The Financial Management and Accountability Act 1997 applies to agencies. This term is defined in Section 5 of the Act to include Departments of State, Parliamentary Departments and prescribed agencies per the list in Schedule 1 of the Financial Management and Accountability Regulations 1997.

96 Charter of Budget Honesty Act 1998 (Cth), s. 5(1)(e).

97 Ibid. s. 5(1)(a).

98 Ibid. s. 5(2).

99 Ibid. s. 20.

100 Ibid. s. 21.


102 Ibid., paras 12.9.2 and 12.9.3.

103 Parts (a) and (b) of Clause 2B.4 of the Financial Management and Accountability (Financial Statements for reporting periods ending on or after 30 June 2004) Orders

104 Ibid, clause 2B.1.2.
68


109 Royal Melbourne Institute of Technology University, trading as RMIT University


111 ‘ACT plan to change reporting practices’, The Canberra Times, 5 May 2004.


116 Ibid.

117 Ibid.


119 The FTSE 100 is an index containing the largest 100 companies (by market capitalisation) listed on the London Stock Exchange, and is reviewed and updated quarterly.


125 Ibid, p29.