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**Developments in Government
Accounting and Auditing in
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Pat Barrett
Auditor-General for Australia



DEVELOPMENTS IN GOVERNMENT ACCOUNTING AND AUDITING IN AUSTRALIA

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**Presented by Mr Pat Barrett, AO
Auditor-General for Australia**

1. Introduction

I appreciate the invitation to present a Paper to this International Conference about Government accounting and auditing in Australia. In my role as Commonwealth Auditor-General, I will be canvassing a number of issues that are of particular interest for, and impact on, the Federal public sector, although these issues have similar implications for other sectors of the economy as well. This Paper is structured as follows:

- a short background of financial reform and auditing in the Australian Public Service (APS);
- public/private sector convergence;
- harmonisation of accounting and auditing standards;
- focus on corporate governance; and
- relevant legislative changes;

followed by some concluding remarks.

Winston Churchill is quoted as saying “the pessimist sees difficulty in every opportunity. The optimist sees the opportunity in every difficulty.”¹ The Australian Public Service (APS) has recently experienced a number of opportunities through reforms to our accounting, budgeting and governance frameworks and systems. These reforms are an on-going process, and continue as governments look for greater responsiveness and cost effectiveness, such as increasing private sector involvement in service delivery.

While not all these reforms have been simple - on occasions, posing some policy and administrative difficulties - the optimists amongst us also see the opportunities that are being created. These opportunities include:

- a greater focus on the better use of resources, budgeting and accounting;

- promotion of greater understanding, transparency and ownership of financial information;
- using financial information to make more informed decisions; and
- cultivation of a culture of accountability and performance based on sound values and ethical conduct.

In recent years, there has been an increasing recognition of the importance of integrating these elements within a sound corporate governance framework for more effective public administration, sharing most of the same principles and approaches used in the private sector.

2. Short Background on Financial Reform and Auditing in the Australian Public Service (APS)

The APS has been at the forefront of developments in budgeting, accounting and corporate governance in the public sector for many years. Before considering the future directions for the APS, it is important to also consider how we have arrived at our current position.

Current Financial Reporting and Budgeting Issues

The APS financial reforms gathered momentum through the 1990s when the public sector, as a whole, moved from cash to accrual accounting. This was a significant development, not just for accounting systems and financial reporting, but also for the way in which resources were being managed and accounted for. As well, in the latter part of that decade, the current government introduced a series of related principles-based legislative changes, budgetary reforms and reporting initiatives. Importantly, the resulting framework continued the devolution of authority from central to line agencies making the Chief Executive Officer responsible for the ethical, efficient and effective use of an agency's resources.

The current framework has been succinctly described as follows²:

Components of the framework

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:

- the Government specifies, via outcome statements, the outcomes it is seeking to achieve in given areas;
- these outcomes are specified in terms of the impact government is aiming to have on some aspect of society, eg. 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.

Some of the major initiatives introduced in the late 1990s included:

- accrual budgeting;
- budgeting and reporting by outcomes and outputs;
- principles of financial management reflected in the *Financial Management and Accountability (FMA) Act 1997* and the *Commonwealth Authorities and Companies (CAC) Act 1997*;
- principles of sound fiscal management for Government through the *Charter of Budget Honesty Act 1998*;
- broad reaching mandate for the Auditor-General and the Australian National Audit Office (ANAO) through the *Auditor-General Act 1997*;
- performance improvement cycles; and
- competitive pricing policies.

An overall goal of these initiatives is to cultivate a performance and accountability culture within the APS. They were also introduced to reinforce the need for the Federal Government to better use its resources and treat its citizens as clients or customers to improve their satisfaction with service delivery. One method of achieving this outcome was to require consideration as to whether the public sector is best placed to deliver the desired outputs (and outcomes), or whether the private sector could more economically and efficiently provide the same service. These decisions, of course, could not be made without appropriate analysis of costs, prices, and any savings involved. Obtaining a credible public sector 'comparator' depended, in large part, on accrual based systems and an understanding of commercially based financial analysis, including derivation of comparable costs and prices.

By the public sector engaging the private sector's expertise, largely through outsourcing relationships involving competitive tendering and contracting, there has been a degree of integration, and recognition of common approaches, between the two sectors. As I will discuss later, these developments have raised questions about suitable governance arrangements, in particular about accountability and transparency.

Notwithstanding successes to date with the current framework, there have been questions within the Parliament as to whether there should not be a greater focus on cash expenditures and whether there has been sufficient control of cash in the budget context. Our experiences to date have also served to reinforce the importance of effectively managing cash. It has become apparent that the Parliament requires detailed cash information to supplement the current accrual reporting regime for greater assurance. Recent experience with accrual budgeting and accrual accounting has proved the importance and value of accrual information in relation to longer term strategic planning, particularly in relation to capital and debt management and identifying inter-generational inequities.

While meeting the Parliament's information needs is important to the APS, raising Parliamentarians' awareness and understanding of the benefits of accrual information for long term strategic planning and fiscal management should also become a priority. This would lead to not only a greater appreciation of the information provided, but also promote more extensive use of accrual information during the decision-making and review processes. However, consistent with all Commonwealth transactions, it is necessary to consider the 'appropriateness' of expenditure, as opposed to its 'accounting' treatment, for the efficient, effective and ethical use of resources (Section 44 of the FMA Act).

Lessons from our experience with the financial framework, and seeking to continuously improve our financial performance, are now reflected in legislation. For example, the *Charter of Budget Honesty Act 1998* requires periodical reviews of the Budget Estimates Framework to:

- assess its accuracy, responsiveness and effectiveness in meeting the needs of the Government; and
- identify areas where further refinements may be made, for the purposes of continuous improvement.

This legislation is regarded as an important discipline on the budgetary framework and promotes greater confidence in the Output-Outcome information provided, as well as in the estimation processes and budget outcomes.

A recent review³ provided 22 recommendations for refinement of the accounting/budgetary framework, all of which were endorsed by the Government. Some of the particularly interesting recommendations included the following:

- progressively tighter reporting timeframes to facilitate eventual reporting of Final Budget Outcome within 45 days of end of financial year (currently 90 days);

- detailed financial information at a program level, including monthly cash and accrual reports; and
- additional cash information to supplement accrual budget and actual information.

Implementing these recommendations is an important part of the financial management challenges facing the APS.

Auditing in the Public Sector

The ANAO provides independent assurance on the financial statements and financial administration of Commonwealth public sector entities to the Parliament, the Executive, Boards, Chief Executive Officers (CEOs) and the public. While, to many, this is the essence of public sector auditing, we also aim to improve public sector administration and accountability by adding value through an effective program of performance audits and related products, including Better Practice Guides (BPGs).

The communication of our outputs and their outcomes through representation at a range of Parliamentary Committees, agency audit committees and Boards of government authorities and companies, is also a growing element of our value adding activities. Additionally, the ANAO seeks opportunities to contribute to the development of the accountability framework, including better practices and standards (as well as harmonisation) in public sector accounting and auditing. Involvement and communication are important drivers, supported by an intensive, and extensive, audit work program.

The ANAO is committed to providing an integrated auditing framework with the objective of delivering high quality audit products that maintain and improve the high standards and professionalism of our audits and related services. These are the means to contribute to better governance.

Like all public sector agencies negotiating the challenges of the changing governance environment, the ANAO has strengthened its own business practices to respond to new demands and directions - the ANAO has responded both at the strategic and tactical levels. On the strategic level, we have given specific attention to relationship management that demonstrates integrity and transparency, as well as to well-targeted products and services that provide assurance and value for money. At the tactical level, we have focussed on ensuring that our work continuously improves as we demonstrate accountability to Parliament, in terms of our legislative responsibilities, and for our overall results to all our stakeholders.

As part of its commitment to transparency, we make the ANAO's annual audit work program available on our website – www.anao.gov.au. While there is little discretion about the approximately 300 financial statement audits conducted each year, the audit topics for the more than 60 performance and other audit products⁴ conducted each year are generally selected on two grounds:

- the capacity of an audit to add the greatest value in terms of improved accountability, economy, efficiency and administrative effectiveness; and

- the desire to ensure appropriate coverage of entity operations within available audit resources over a reasonable period of time.

As public sector bodies do not operate in isolation from the wider community, a quite wide range of issues can impact on the sector as a whole as well on individual agencies. The ANAO recognises this and, accordingly, continually monitors the broader environment so that important issues can be identified and taken into account in the development of its annual audit work program. As well, with our direct involvement with entities in audit activity, and through regular liaison with entity management, including through audit committee activities, the ANAO is able to identify, and take into account, specific entity issues.

The themes, including the challenges that confront the public sector, continually change, reflecting a range of developments in the broader economic and social environment. However, corporate governance, at least in recent years, has become an enduring audit theme. Annual themes are identified as a basis for selecting topics to ensure that the audit program is targeted appropriately to add value to (improve the performance of) public administration. An important part of this planning process is the early engagement of relevant stakeholders, including agency heads, and the Parliament, through the JCPAA, to ensure that the work program is optimally targeted.

Assurance auditing

Financial statement audits express an opinion on whether financial statements of Commonwealth 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 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 now provides two cross-entity assurance reports each year to Parliament. The first details the results of an assessment of the control structure of major entities⁵ 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.⁶

Performance auditing

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 Commonwealth and to recommend ways in which these may be improved*'.⁷ And 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. The performance audit reports are tabled in the Parliament (63 in the 2002-03 financial year) and all recent performance audit reports are also placed on the ANAO's homepage at <http://www.anao.gov.au>, and summarised in the ANAO's series of six-monthly activity reports.⁸

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, it 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 stakeholders. In considering whether performance audits should be legislatively enforced in the private sector, KPMG ⁹ recently noted that there would first need to be reform to the liability requirements under which auditors in Australia operate (ie. either joint and several liability or unlimited liability).

Audit product continuum

In practice, the audit environment is more complicated than simply requiring performance and assurance audits. The ANAO attempts to provide an audit product continuum as a strategic approach to better governance. We fill the gaps between high-level performance audits and traditional financial statement audits with Better Practice Guides, financial reporting for agencies and statutory authorities, and Business Support Process Audit reports covering a range of issues challenging the APS. Our reports are treated as authoritative. Our annual audit of the Consolidated Financial Statements and our assessment of agency control structures, for example, provide a unique overview as to the ongoing financial performance of over 200 Commonwealth entities.

For the ANAO, a key issue is getting the balance right between control and innovation.¹⁰ The aim is to get the 'right mix' of products and services to enhance governance. In setting its agenda for the future, the ANAO relies on intelligence garnered through the review and analysis of Commonwealth entities as well as ongoing feedback and guidance from the Parliament and other audit clients as to the areas they see as adding most value to public administration.

In addition, I would also like to reiterate the point that, under the *Auditor-General Act 1997*, I am required to set auditing standards with which individuals performing Auditor-General functions must comply. This gives the ANAO the flexibility to set its own agenda and to develop appropriate auditing tools for the contemporary environment. In setting the standards, I acknowledge the commonality of professional requirements between private and public sector auditors and, as such, the ANAO auditing standards are formulated with regard to the auditing standards issued by the Auditing and Assurance Standards Board of the Australian Accounting Research Foundation. Consistency with international standards, including the International Organization of Supreme Audit Institutions (INTOSAI) Auditing Standards, and those of the International Auditing and Assurance Standards Board of the International Federation of Accountants is also a consideration.

Cross portfolio audits

Recent years have seen an increase in the number of ‘across the board’ issues and cross-portfolio audits undertaken that compare experiences in a range of agencies and entities. For example, the ANAO has recently undertaken cross portfolio analysis of, among other things, compliance with the 2001 Senate Order on commercial-in-confidence considerations in relation to listing of departmental and agency contracts valued at \$100,000 or more on the internet.¹¹ Other recent cross-portfolio audits include absence management in the APS¹², the management of Commonwealth guarantees, warranties, indemnities and letters of comfort¹³; energy efficiency in Commonwealth agencies’ operations¹⁴; and the payment of accounts and Goods and Services Tax administration by small Commonwealth organisations¹⁵.

Our ability to compare operations across the public sector, and sometimes with the private sector, as well as our statutory independence, are significant strengths and add value to a wide range of stakeholders. This approach is becoming more important with the greater use of a ‘whole of Government’ approach to public administration. The notion is to tailor public services to the individual recipient in a ‘seamless’ manner. Major issues of governance arise, as I will discuss later.

In terms of benchmarking services across agencies, our products currently comprise functional reviews of the major corporate support areas. The overall results of these reviews are published generically and tabled in the Parliament. At the audit client level, a customised report is provided to all entities participating in the benchmarking study. Our most recent benchmarking studies have covered the following areas: people management in public sector agencies¹⁶ the internal audit function¹⁷; the finance function¹⁸; and managing people for business outcomes¹⁹. Finally, as well as benchmarking and analysing public sector performance, we compare our own performance to that of our peers in Australia and internationally.

Future Challenges

The Accounting Framework

A particular challenge facing Australia relates to its conceptual framework for accounting. The Australian accounting conceptual framework includes a statement that “general purpose financial reports shall be presented on a timely basis and in a manner which satisfies the concepts of comparability and understandability”.²⁰ Producing understandable and comparable financial information, particularly for the Parliament and the general public, are two of the greatest challenges currently facing the APS.

Under the previous cash accounting and budgeting regimes, the Parliament was provided with very detailed reporting of budget estimates and actual amounts spent, disaggregated to an individual item level. Higher-level accrual information has been provided at the outcome and output level since the introduction of accrual budgeting. However, there have been concerns expressed about the comparability of this information between agencies, within and across program outputs and outcomes, and, particularly, over time. Individual Parliamentarians and Parliamentary Committees have expressed reservations about the lack of consistent financial information for identified programs over time.

Need for greater understanding of accrual information as an input to decision-making

During the earlier period of cash-based accounting and budgeting, very detailed cash reporting made it possible to determine the budgeted and actual expenditure made on a specific program, or sub-program, or even individual item level. This level of disaggregation is no longer produced, as data is now presented in accordance with each agency's outcome and output structure.

In June 2002, the Joint Committee of Public Accounts and Audit (JCPAA) launched an inquiry into the effectiveness of accrual budget documentation for the purposes of Parliamentary scrutiny²¹. During this inquiry, the JCPAA noted the importance of disclosing output information at an appropriate level of disaggregation to support transparency and accountability. The Committee expressed concern at an apparent diminution in the level of detail relating to programs in the Budget Papers.

The Committee also noted that the extent to which agencies were able to disclose more disaggregated financial data related to the sophistication of their financial management information and costing systems. The Committee recognised the costs involved with establishing and maintaining these systems, and the considerable benefits of providing more disaggregated output information to support transparency and accountability. The Committee strongly encouraged the Department of Finance and Administration (Finance) to identify examples of better practice and make them available to the Parliament, agencies and the general public.

As I indicated earlier, while providing the Parliament with the additional information they are seeking as a major stakeholder is important, so too is the 'educative' process to explain the value and benefits of the information that is currently being provided. Indeed, individual agencies have offered Senate Estimates Committees detailed presentations to explain their budget figures and trends over time, outside Committee hearings, as a recognition of the latter's importance.

Ensuring consistent data is produced within and between agencies and over time

During its June 2002 inquiry²², the JCPAA noted that, while 'continuity of information is essential to support transparency and accountability...' ²³, comparisons were not always possible over time due to a number of changes and refinements to agencies' outcomes and outputs structures.

The Committee concluded that agencies should try to achieve consistency in information provided to the Parliament, both within and between budgetary cycles, taking into account the need for continuous improvement as agencies become more familiar with the framework.

Reviewing trends was further hampered by a break in historical data in 1999-2000 due to the transition from the cash to the accrual budget framework. The Department of Finance and Administration noted it was examining means of overcoming this gap in information.

Auditing in the Public Interest

In summary, our strategic approach allows us to target areas of most interest and value to the Parliament, the Government and the Australian Public Service (APS). We

remain responsive to the needs of a changing public sector and endeavour to ensure that better practice and lessons learned in individual agencies both in Australia and overseas are disseminated across the APS. For many years, we also responded to the implementation of New Public Management (NPM) with a series of products focussing on the challenges and opportunities inherent in the NPM approach. Audits in recent years have covered, among other things, outsourcing, asset sales, contract management and networked service delivery. However, among other factors, a loss of corporate knowledge has required a greater focus on the control environment, including systems, record-keeping and adherence to legislative requirements.

It is my aim to ensure that ANAO audits continue to encourage improvements in the APS. As technology changes, as services change, and new ways of delivering services are introduced, including a much greater focus on risk management, so our auditing methodologies and practices will need to adapt for example, to provide continuous reporting. What will not change is our commitment to improving public sector performance and accountability. As with the private sector,²⁴ these requirements will extend to the notion of corporate sustainability under so-called triple bottom line (TBL) reporting. The ANAO has had its first experience of independent verification of a TBL Report by the Department of Family and Community Services recently.²⁵ The then Minister noted that TBL reporting is recognised by the Australian Government 'as a useful way for organisations to demonstrate their contribution to Australia's wellbeing and prosperity.'²⁶

As the auditor for the Commonwealth, the ANAO will continue to play our part in contributing to broader debates over accounting and governance. In addition, we will continue to assist agencies in dealing with the challenges facing them. This is important so that Parliament can obtain maximum value from agencies' financial statements, as well as be assured as to the effectiveness of agencies' governance and accountability arrangements.

3. Public/Private Sector Convergence

The foregoing future challenges in financial management for the APS need to be considered in conjunction with other significant changes, including that of the blurring of the boundaries between the public and private sectors. The latter has come about largely as a result of sharing of approaches between the sectors through competitive tendering and contracting and, increasingly, through so-called Public/Private Partnering which relates mainly to financing arrangements.

Public/Private Sector Partnering

Public/Private Partnering usually involves government engaging the private sector in public service delivery, either as a supplier or provider. Such partnering includes some (or all) of the following²⁷:

- delivery of services normally provided by government;
- creation of assets through private sector financing and ownership control;
- government support through contribution of land and/or capital works; and
- risk sharing (allocation).

While there are many types of Public/Private Partnering, I will concentrate on Private Financing Initiatives and outsourcing, because of their financial implications.

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 is referred to as public-private partnerships in the public sector literature and in increasingly common parlance when referring to PFI arrangements.

Further, such a model allows for the public sector to take advantage of any relevant innovations and initiatives available from the private sector, while also transferring greater 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 have to pay 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 and are therefore available for other government priorities.

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 Consortium²⁸ 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 north-west. The tunnel is estimated to cost \$815million, which is to be funded privately and recouped via tolls for vehicles using the tunnel²⁹.

Outsourcing

Outsourcing non-core public sector functions to the private sector can lead to more efficient and cost effective services. Other benefits include³⁰:

- increased flexibility in service delivery;
- greater focus on outputs and outcomes rather than inputs;
- the freeing 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 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 a number of other Commonwealth commercial bodies. The ANAO retains an oversight role in these audits and issues the audit opinions, whilst benefiting from the expertise and knowledge of the international accounting/audit firms who 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 function³¹, and the subsequent JCPAA inquiry into the issues raised by this report³².

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. 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 or, if developing our own software in-house, how we could attain 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 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 remain, such as:

- ensuring appropriate transparency, accountability and sound governance arrangements are in place; and
- the Australian citizens and taxpayers should receive public services that are of a high quality, 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 when entering into such arrangements, to ensure that the Australian public's resources are being used as best they can to achieve the desired outcomes and deliver the desired 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) should assist this process, by ensuring 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 relates to 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? 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, such as whether the public sector should be ultimately responsible for the actions of external parties, particularly where the former is not directly involved. For many, the public sector's responsibility lies just in the contract management process.

But can contracts adequately capture the accountability requirements of the public sector itself, for example, by being subject to administrative law and Freedom of Information legislation, as well as public service values and code of conduct? There would be some reservations that they can fully do so, at least given the current notions of accountability. This is borne out in our experiences with so-called 'relational contracts' which demand considerable trust, confidence and flexibility of the parties involved³³.

Nevertheless, I should also observe that the APS has markedly improved its contract management involvement with clearer articulation of objectives and deliverables, including appropriate performance measures and more transparent reporting. The ANAO has now produced a series of reports on departmental transparency of contracts in response to a Senate Order, the latest of which was tabled on 26 February.³⁴ These are part of our cross-portfolio performance audits to which I referred earlier.

4. Harmonisation of Accounting and Auditing Standards

The convergence of the public and private sectors may be assisted by Australia's commitment to adopt International Financial Reporting Standards from January 2005. This commitment may further blur the distinction between the public and private sectors as they will be largely using the same accounting principles and rules. However, it is still not clear as to the extent that international public sector accounting standards (under the control of the Public Sector Committee of the International Federation of Accountants - IFAC) will converge with those of the International Accounting Standards Board. Furthermore, the financial reports will be more internationally comparable, being both prepared and audited using harmonised standards.

Adopting International Financial Reporting Standards

In July 2002, the Financial Reporting Council (FRC) gave the Australian Accounting Standards Board (AASB) a strategic direction for Australia to adopt International Financial Reporting Standards (IFRSs) for reporting periods starting on, or after, 1 January 2005.

The reasons for adoption of IFRSs are explained in the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003* (generally referred to as CLERP 9). This is the ninth paper in a series of Government proposals to amend Australia's corporate law. For the private sector, entities will be able to list on more than one stock exchange around the world and only prepare one set of financial statements. Additionally, the cost of capital will be positively influenced due to the need to prepare only one set of accounts. Australia will be more open to the world investment markets. Other benefits envisaged by the AASB include facilitating more meaningful comparisons of the financial performance and financial position of Australian and foreign public sector reporting entities; and improving the quality of financial reporting in Australia to international best practice. However, an ongoing issue is also to clearly articulate some concept of measurement.

As in Europe,³⁵ there are reservations being expressed in Australia about harmonisation with, for example, requests being made to the AASB to allow an 'alternative treatment' for Australian Companies³⁶. However, the Regulator (Australian Securities and Investments Commission) plans to take a tough stance on non-compliance. There is also some uncertainty between the AASB and the Regulator as to who is responsible for interpreting accounting standards³⁷. This is clearly of interest to both the private and public sectors.

It is proposed by the AASB that the new standards will be sector neutral, (i.e. the standards will be equally applicable to all sectors) although further disclosure requirements may be added for the public sector. Newberry³⁸ questions the concept of sector neutrality and the virtues of applying private sector-like practices in the public sector. Newberry argues the public and private sectors have vastly different accountability, governance, reporting goals, and operating motives. For the reasons given in this Paper, such differences are diminishing but, as a result, the essential differences are becoming more apparent.

Whether true sector neutrality exists within the International Accounting Standards Board's (IASB's) conceptual framework has also come into question. In their updated plan for adopting IASB standards, the AASB have noted "...it's necessary to adopt the IASB Framework when adopting IASB standards because the standards are based on that Framework."³⁹ Jones and Wolnizer question whether the IASB's conceptual framework will be "...equally applicable to the public sector and the private not-for-profit sector [as] currently, the IASB framework provides no guidance for public sector and not-for-profit entities. "⁴⁰

Despite the on-going debate, rapidly approaching deadlines mean Australia will be held to the AASB's notion of sector neutral reporting standards.

Jones and Wolnizer also note concerns about Australia adopting the IASB's conceptual framework, posing the following questions for clarification and discussion⁴¹:

1. If the IASB's conceptual framework replaces the Australian conceptual framework, will it be of sufficient quality, scope and depth to provide adequate guidance for the standard setting process and serve the needs of users?

2. If the IASB's conceptual framework is adopted, what will be the IASB's future program for the development of the conceptual framework, particularly on issues such as the reporting entity concept and accounting measurement?
3. Can the IASB realistically develop a workable conceptual framework that will be acceptable on a global level?
4. What will be the impediments and obstacles to the development of such a framework?
5. Will the conceptual framework continue to serve the same standard setting objectives and priorities that it has traditionally performed in Australia?

The timing of the deadlines to implement IFRSs in Australia mean that such questions need to be answered sooner rather than later. Many would agree that it would be better to have a sector neutral conceptual framework that allowed for any differences relating, say, to small to medium size enterprises, not-for-profit organisations and the public sector to be covered within that framework. However, there would also be agreement with an observation by Professor Murray Wells that:

*A conceptual framework that does no more than articulate a set of arbitrarily or politically motivated rules cannot and will not serve the legitimate interests of the stakeholders of business and Government enterprises.*⁴²

The implementation timetable for IFRSs in Australia became clearer when the Australian Accounting Standards Board issued AASB 1 *First Time Adoption of Australian International Financial Reporting Pronouncements* in December 2003. This standard outlines the transitional arrangements for IFRSs, including that of retrospective application. This requirement shifts implementation deadlines to be significantly earlier than initially thought. For example, an entity with a 30 June balance date (the most common date for the public sector) has to prepare an internationally compliant opening balance sheet as at 1 July 2004 to adjust opening retained earnings. This balance sheet is prepared, but not published, in readiness for recording accounting transactions for the 2004-2005 financial year. In effect, there are two sets of financial statements to be prepared for the 2004-2005 financial year. One set should be compliant with current Australian accounting standards for publication; the second set should be IFRS-compliant to form the comparatives for the 2005-2006 financial statements.

Changes that both sectors need to be aware of are those that require:

- recognition or de-recognition of assets or liabilities;
- new recognition criteria of revenues and expenses;
- different data to be collected in calendar 2004, financial year 2004-2005 and onwards;
- changes to systems; and
- changes in the information to be disclosed.

A broader issue to be considered is the impact of changes to accounting standards upon key performance indicators and other measures of success for outcomes and outputs – an issue of relevance when cultivating a culture of performance and accountability. For example, changes to measurement may impact upon the calculation of a range of measures, such as key performance indicators and budgeted information. This may limit the comparability of information over time, due to the need to not only understand the accounting information being presented, but also the ways in which it has changed due to adoption of international standards. In a climate of assessing performance using accounting information, there is a danger that misleading analyses may be made without such knowledge and understanding.

Convergence between Australian generally accepted accounting principles with Government Finance Statistics

An issue that will impact all Commonwealth public sector entities is the actual timing of harmonisation with International Standards. The AASB has an ambitious timetable to converge Australian generally accepted accounting principles (GAAP) and Government Finance Statistics (GFS)⁴³, with an exposure draft scheduled for release in June 2004 for application of the new standard in 2005-2006. The outcome of this project is to create 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.”⁴⁴

Consequently, any changes to be taken in response to this new standard may coincide with preparations being made for the implementation of harmonised accounting standards for reporting periods starting on or after 1 January 2005. This will accentuate the implementation complexity, not just in determining the implications for an organisation and for its financial reporting, but also for any systems changes that need to be made to reflect the impact of the new standards framework.

A recent Budget Estimates and Framework Review⁴⁵, undertaken by the Department of Finance and Administration, recommended further work to harmonise Australian GAAP with GFS. The review proposed that harmonisation would be achieved by developing an accounting standard to harmonise the two frameworks.

A catalyst for this recommendation was the confusion the current reporting processes creates. The *Financial Management and Accountability (FMA) Act 1997* and the *Charter of Budget Honesty Act 1998* require production of the Commonwealth's Consolidated Financial Statements. The *FMA Act* requires annual financial statements to be produced using Australian GAAP. The *Charter of Budget Honesty Act* requires the Final Budget Outcome report is prepared using the GFS framework by 30 September each year. These reports provide users with different information. Despite explanations and reconciliations between the reports, one question is ‘which report provides the correct surplus or deficit figure?’ There is no answer to this question as each framework serves different purposes, although, nominally, they should be the same, as would be apparent in the private sector.

The GFS reporting framework is a sophisticated statistical system, consistent with international statistical standards⁴⁶ and guidance published by the International Monetary Fund. This framework provides comprehensive statistical information and assessments for economic analysis of the public sector, and reflects the needs of fiscal analysts and other users interested in such analysis. This approach contrasts with

Australian GAAP, which aims to provide users with sufficient information to evaluate the entity's financial performance and position, and its utilisation of resources.

In addition to conceptual inconsistencies, there are a number of technical differences between GFS and Australian GAAP relating to timing and permanent differences⁴⁷, which lead to dissimilar net results and/or balance sheet presentation and outcomes.

Despite all of the efforts being expended on this project, the question remains as to whether a harmonised framework can lead to better information and a better result? Australian GAAP and GFS currently give different information to different audiences for different purposes. To harmonise these two incompatible frameworks might lead to compromises being made which undermine the quality of the very information being sought. One issue of concern raised is whether General Government Sector reporting will remain credible, transparent, understandable and comparable⁴⁸. Nevertheless, there are distinct advantages of transparency and understanding if successful harmonisation can be achieved.

The AASB has an ambitious timetable to harmonise Australian GAAP and GFS, with an exposure draft scheduled for release in June 2004 for application of the new standard in 2005-2006. The Board has recently finalised its preliminary views on a range of issues relating to harmonisation of Australia GAAP and GFS. This includes adoption of GAAP definitions, recognition and measurement principles "...with note disclosure where necessary to satisfy GFS requirements where they differ from GAAP requirements." ⁴⁹

The ANAO presented client seminars in November/December 2003, and will present additional seminars in April/May 2004, to assist our clients identify where their significant changes lie. However, the onus will be on each entity to ensure that they are suitably informed such that they can identify which changes to standards will impact upon them. Agency management, and in particular the Chief Finance Officer, will also need to ensure that the Audit Committee is kept informed of the agency's progress towards IFRS compliance.

Harmonising with International Standards on Auditing

Concurrent to the adoption of International Accounting Standards, Australia has also made an undertaking to adopt International Standards on Auditing by January 2005. Adoption of International Standards on Auditing is a high priority for the Australian Auditing and Assurance Standards Board (AuASB). Similar to the rationale for a single set of world wide accounting standards, having a single set of high quality auditing standards world wide brings many efficiencies and benefits, including:

- giving users confidence of standardised audit practices in relation to financial statements, regardless of their jurisdiction; and
- enhancing the reputation and credibility of the auditing profession, as well as helping to restore public confidence in it.⁵⁰

The International Standards on Auditing, that national standards are being harmonised with, are produced by the International Auditing and Assurance Standards Board of the International Federation of Accountants. Arrangements have been made for that Board to liaise with the International Organisation of Supreme Audit Institutions

(INTOSAI) to reflect public sector requirements. This interaction, combined with the interest and involvement by Auditors-General, is intended to help ensure that public sector auditors' needs are met, and that there are appropriate sector neutral internationally harmonised accounting and auditing standards in place.

The importance of this latter point is reiterated by INTOSAI, through its Auditing Standards Committee, having established a working party to consider alignment between the INTOSAI standards and those of the IAASB.⁵¹ The ANAO is a member of that committee. The working party has already recognised the need for transitional arrangements to accommodate the different standards, experiences, mandates and operations of the more than 180 country members of INTOSAI.

The International Standards on Auditing, like the current Australian auditing standards, allow for greater use of the auditor's judgement. This contrasts with the current approach in the United States, which includes the creation of the Public Company Accounting Oversight Board (PCAOB) as regulator and upholder of the *Sarbanes-Oxley Act* requirements and American auditing standards. The *Sarbanes-Oxley Act* directs the PCAOB to "...establish auditing and attestation standards, quality control standards and ethics standards ..."⁵². Concerns have been expressed that, going alone and setting their own auditing standards, the United States approach is likely to reduce the benefits from global standardisation that I outlined earlier.

In Australia, there is debate about the legal status of auditing standards. While accounting standards have the legal backing of the *Corporations Act 2001*, currently the auditing standards do not. CLERP 9 seeks to redress this issue by giving auditing standards legislative backing. This has raised concerns about the practicality of requiring legislative adherence where there is often an exercise of professional judgement.

The ANAO is taking a proactive approach to the harmonisation of International Standards on Auditing. Where relevant, the ANAO is commenting on both International and Australian exposure drafts in relation to the general principles, and more specifically on the applicability of those principles in the Australian Public Sector context. In addition, the ANAO has begun to take steps to ensure that the audits completed will comply with any new standards as they are introduced. Adoption of such standards is my prerogative under the Auditor-General Act 1997.

Most recently, the AuASB has released the following auditing standards for application for periods commencing on, or after, 15 December 2004. The new and revised Australian auditing standards were released as part of the AuASB's project to harmonise with International Standards on Auditing, and are based on the corresponding International Standards on Auditing issued by the International Federation of Accountants (IFAC) late last year. The new Australian auditing standards include:

- AUS 202 Objectives and General Principles Governing an Audit of a Financial Report (revised);
- AUS 402 Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatements (revised);
- AUS 406 The Auditor's Procedures In Response to Assessed Risks (new); and

- AUS 502 Audit Evidence (revised).

These standards should enable auditors to more clearly focus upon areas of greater risk of potential material misstatement in a financial report. The AuASB anticipates that these new standards “will improve the linkage between assessed risks and audit procedures, resulting in better quality audits.”⁵³

5. Focus on Corporate Governance

In addition to harmonisation of standards, another significant change for the Australian accounting and auditing professions is the increasing focus on corporate governance. The issue of governance particularly rose in prominence in Australia, as in other parts of the world, following a number of recent international and domestic corporate collapses.

Implementing sound principles with better practice

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*’⁵⁴. This document was produced to assist public sector organisations to meet the current pressures, and expectations, of their governance framework, processes and practices. I make the point that it is not prescriptive and has no legislative status. Governance arrangements must be tailored to individual agency circumstances, based on a risk management approach that considers potential benefits and costs associated with activities that contribute to meeting specified objectives⁵⁵. It is not a one size fits all situation, as many have noted.

In the recent guide, the ANAO primarily used the group of principles first articulated by the Nolan Committee of the UK in 1995⁵⁶, which have stood the test of time. They are as follows⁵⁷:

Principles of public sector governance

- **accountability**: where public sector organisations and the individuals within them are responsible for their decisions and actions, and where they are subject to external scrutiny;
- **transparency**, or openness: is required to ensure that stakeholders have confidence in the decisions and actions of public sector organisations and the individuals within them;
- **integrity**: is based on honesty, objectivity, and high standards of propriety and probity in the stewardship of public funds and resources;
- **stewardship**: reflects the fact that public officials exercise their powers on behalf of the nation, and that the resources they use are held in trust and are not privately owned;
- **leadership**: is one of the more crucial principles. It sets the tone at the top of the organisation, and is absolutely critical to achieving an organisation-wide

commitment to good governance; and

- **efficiency:** is about the best use of resources to achieve the goals of the organisation, and is also about being able to prove that the organisation has indeed made the best use of public resources.

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

Leadership, ethics and culture

As with other commentators, I constantly emphasise the importance of leaders (Chief Executive Officers and Boards) to set the 'tone at the top' of organisations to positively influence good governance. While rules, systems and structures are certainly important, they are the vehicles by which crucial values and behaviours are applied.⁵⁸ Good governance is primarily a function of the behaviours and values of the organisation's leaders and is a manifestation of the overall culture of the organisation. In particular, it is important that leaders demonstrate an active commitment to the principles of good public sector governance, and vital that staff adopt good governance practices through their own behaviour and performance.

Establishing effective communication—both internally and externally—is therefore a primary function of leadership. It is through clear and consistent communication of the values and objectives of the organisation to staff, management and external stakeholders that an agency's leadership most effectively supports good governance outcomes and contributes to stakeholder confidence in the organisation.

It is also through consistent communication and personal actions that leaders support ethical behaviour in the organisation, thus influencing the culture necessary to support the objectives and strategic directions of the organisation and achieve the required results efficiently, effectively and ethically.

Risk management and the control environment

The ANAO recognises that risk management is an integral component of good governance that underpins the organisation's approaches to achieving both performance and conformance objectives.

Risk management involves the identification, analysis, treatment, monitoring and communicating of risks. In the public sector, risks are generally taken to represent threats rather than opportunities. That is, risks are identified as events that may prevent the achievement of business objectives much more frequently than events that may provide the opportunity to achieve additional benefits. Organisations in the public sector need to more frequently and comprehensively consider beneficial risks, as this would assist them to become less risk averse, and thereby enable them to more fully embrace the performance aspects of their conformance and performance objectives.

The ultimate responsibility for an organisation's risk management sits with the head of that organisation. But all managers and staff have a responsibility to manage risk.

Effective risk management requires a risk assessment culture, which supports a holistic approach to the identification and management of risk throughout an organisation. This means that risk management should be seamlessly integrated into the day-to-day business of an organisation as well as being part of its higher-level strategy and planning processes.

This concept of risk management is particularly important as the nature and significance of risks change in the public sector as the role of the public sector itself changes. The lack of suitable risk management practices generally features in examples of poor administration that are highlighted in our audit reports from time to time. An example of such changes is the greater involvement of the private sector in delivering public sector services and notions of risk sharing, as noted earlier.

Importantly, an integrated risk management system develops the control environment and control activities, which provide reasonable assurance that the organisation will achieve its objectives with an acceptable degree of residual risk. Taking this approach to risk management can ultimately mean that all major decisions are considered in terms of sound risk management principles. For public officials, there is also a need to understand, and deal effectively with, the notion of insurable risk.

In the ANAO's experience, it is difficult to over-emphasise the importance of integrating an organisation's approach to control with its overall risk management strategy in order to determine and prioritise the agency functions and activities that need to be controlled. Both require similar disciplines and an emphasis on a systematic approach involving identification, analysis, assessment, treatment and monitoring of risks. Control activities to mitigate risk need to be well designed and implemented and relevant information regularly collected and communicated throughout the organisation.

Management also needs to establish ongoing monitoring of performance to ensure that objectives are being achieved and that control activities are operating effectively. The results should be regularly reported to the Board/CEO for information and any guidance or direction, including considering whether controls are effective and if not, how they should be adjusted. An audit committee should have particular interests in these issues which should also regularly feature on their meeting agendas.

The key to developing an effective control framework lies in achieving the right balance so that the control environment is not unnecessarily restrictive nor unduly encouraging to risk adverse behaviour and, indeed, aims to promote sound risk management.

The control structure must provide a linkage between the agency's strategic objectives and the functions and tasks undertaken to achieve those objectives. A good governance model will include a control and reporting regime which is geared to the achievement of the organisation's objectives and which adds value by focusing control efforts largely on the 'big picture' and not simply on particular processes.

Finally, it must be kept in mind that control is basically a process, a means to an end, and not an end in itself. It impacts on the whole agency; it is the responsibility of everyone in the agency; and is effected by staff at all levels, not just by management. Effective control is neither accidental nor incidental. It is fundamental to accountability and performance. Indeed, it has been suggested that boards should

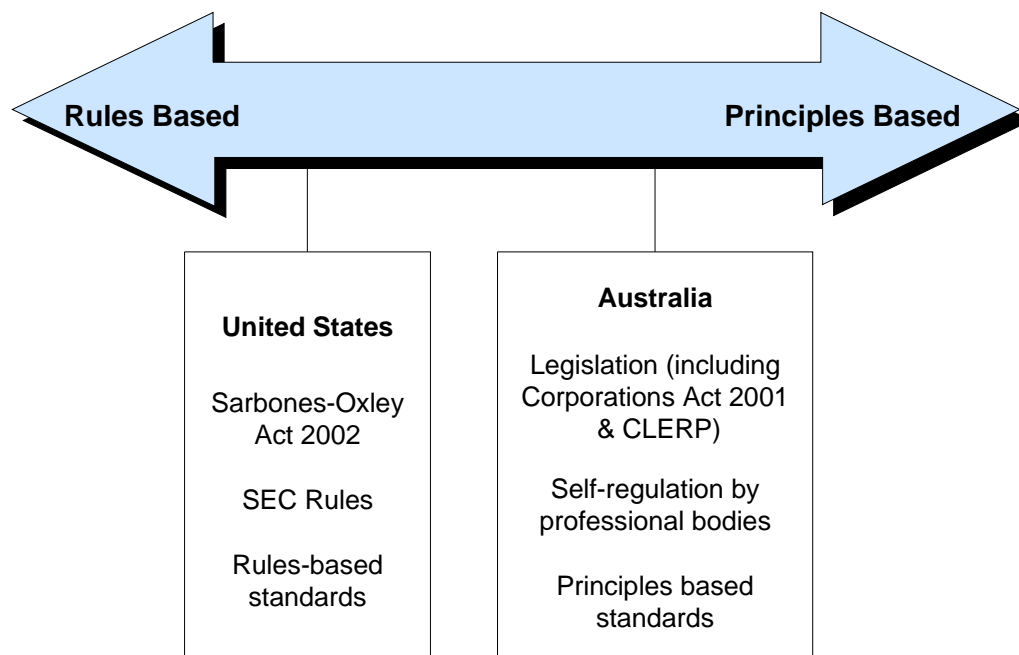
formally accept their responsibility for reviewing the effectiveness of internal control.⁵⁹

6. Legislative Changes

The United States reacted to a number of corporate collapses by introducing the *Sarbanes-Oxley Act 2002*, as noted earlier. This Act is of a highly prescriptive nature, where regulatory bodies seek compliance by ‘wielding a big stick’. This approach is not unlike the saying that ‘the beatings will continue until morale improves’⁶⁰.

Australia, also effected by both international and domestic corporate collapses, has taken a different approach; a mixed approach. It utilises both the powers of regulatory bodies and the ability of professional bodies to make a valuable contribution to their self-regulation, which is changing.

The rules based, highly prescriptive approach taken by the United States contrasts to that used in Australia, as diagrammatically illustrated below. This is not to say that Australia’s approach to regulation is purely based upon principles. There are aspects of the Australian regulatory regime that are prescriptive, which are reflected in the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003*. However, in comparison to the United States, Australia is placed more towards the principles-based ‘end’ of the continuum.



Corporate Law Economic Reform Program

Since 1997, Australia has been embarking upon a Corporate Law Economic Reform Program (CLERP), as noted earlier. 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.⁶¹

The ninth instalment in this program, *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003* (generally referred to as CLERP 9, as noted earlier) was introduced to the Australian Parliament for consideration in December 2003. This bill was designed to enhance audit regulation and general corporate disclosure framework, and introduces a number of significant policy changes, as listed below.

Significant Changes Proposed by 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.

There are indications of the need for a strong policy position for regulation of government bodies to be consistent with that of commercial bodies. While there has been no official announcement that this will occur, this was inferred in the second reading speech for the *Commonwealth Authorities and Companies (CAC) Act 1997* made by the then Minister for Finance. In this speech it was indicated that the *CAC Act 1997* would be maintained in ways that, as far as practical, would keep it in harmony with comparable provisions of the *Corporations Act 2001*. This could be an indication of changes resulting from CLERP 9 being the basis of possible changes to

be applied to the *Auditor-General Act 1997*, the *CAC Act 1997* and the *Financial Management and Accountability Act 1997* some time in the future.

Auditor Independence

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, we are often dependent on their work in coming to an audit opinion on organisations' control environments and financial statements.

The independence of the Commonwealth 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 standards for his/her Office. In practice, the latter are largely those set by the Australian Auditing and Assurance Standards Board (AuASB).

The Statement of Auditing Standards (AUS 1) requires an auditor not only to be independent, but also to appear to be independent. For the purpose of this Statement:

- (a) actual independence is the achievement of actual freedom from bias, personal interest, prior commitment to an interest, or susceptibility to undue influence or pressure; and*
- (b) perceived independence is the belief of financial report users that actual independence has been achieved.⁶²*

While AUS1 provides guidance to auditors when considering independence, the recently released Professional Statement F1, entitled 'Professional Independence'⁶³ addresses the principles of independence with support for its application by the CLERP 9 proposals. Compliance with the new Professional Statement F1 has been required since 1 January 2003. The ANAO supports the Ramsay Report⁶⁴ recommendation that the auditor should make an annual declaration, addressed to the board of directors, that the auditor has maintained his/her independence in accordance with the Corporations Act 2001 and the rules of the professional accounting bodies. I should note that, pursuant to that Act, the Auditor-General is a registered company auditor.

The issues relating to independence are difficult and are still to be resolved, particularly in the light of the recent report on HIH (Australia's Enron)⁶⁵ (which, inter alia, reinforced independence of auditors) and the Government's intended legislative proposals following the CLERP 9 discussions, referred to earlier. The need for active ongoing discussion is clear. The Government has indicated it will consider recommendations in the CLERP 9 legislation which is expected to be introduced to Parliament in the forthcoming Spring Sittings.⁶⁶ As the United States Panel on Audit Effectiveness noted in its review of the current audit model:

'Independence is fundamental to the reliability of auditors' reports. Those reports would not be credible, and investors and creditors would have little confidence in them, if audits were not independent in both fact and appearance. To be credible, an auditor's opinion must be based on an objective and disinterested assessment of whether the financial statements are presented fairly in conformity with generally accepted accounting principles'.⁶⁷

There is growing pressure for the exclusion of audit firms from other activities (non-audit services) within the same organisations. For some years, there has been general acceptance of the desirability of those firms not being engaged both as internal and external auditor. The Government indicated that it will amend the law to require mandatory disclosure in a company's annual report of fees paid for the categories of non-audit services provided. As well, there will be a requirement for a statement in the annual report as to whether the audit committee is satisfied that the provision of non-audit services is compatible with auditor independence. Such amendments will impact on both the public and private sectors.

In my view, the questions about possible conflicts of interest, audit partner rotation and selection of auditors are central to the roles and responsibilities of audit committees as part of the corporate governance framework. One challenge is, therefore, how to strengthen those roles to enhance their effectiveness and credibility in the eyes of both internal and external stakeholders. However, I note that an ASIC survey of auditor independence found that 'it was not normal for the level of non-audit services to be given consideration by the board or the audit committee'⁶⁸. In fact, usually the Chief Financial Officer was the primary person responsible for engaging the external auditor in these roles.

The recent series of high profile Australian corporate collapses has also renewed attention to the issue of the particular roles and responsibilities of both private and public sector auditors in the Australian context. Citizens are more aware of governance issues than ever before. Of particular recent interest has been the focus on personal accountability of directors and senior executives whose performance bonuses may be inversely proportional to trends in share prices and company profits. The public expects that auditors will alert shareholders or other stakeholders to the fundamental soundness (or otherwise) of business entities. It should also be noted, however, that the mere fact that auditors are independent will not save companies from collapse or agencies from the impacts of poor management. A similar sentiment was expressed quite succinctly in a legal update on corporate governance:

It is clear that the most rigorous and independent audit will not save a company with poor management and business practices from insolvency.⁶⁹

This view was also endorsed by the then Chairman of the Australian Securities and Investments Commission who noted that, when it comes to a company's compliance and accounting standard, '*the final buck stops with the board*' rather than with company auditors.⁷⁰ Auditors do, however, have a very important role to play in terms of providing advice that draws on their broad range of experiences, which may range across the public and private sectors. Any concern and/or suggestions should be conveyed in the audit management letter and/or discussed directly with the board of directors, who actually appoint the auditors in the private sector. One issue is

whether, how, and to what extent, should the contents of such a letter be conveyed to other stakeholders.

However, I cannot overstate the fact that the ANAO operates in an advisory capacity, rather than participating directly in decision-making by public sector managers. While I urge my officers 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. Our ‘observer status’ as public sector auditors reduces the risk of conflict of interest issues arising in the course of our work. Nevertheless, that does not absolve us from any responsibility to the Parliament for our views and actions.

These options for enhancing the independence of auditors could be pursued under the current co-regulatory model or through other forms of statutory, or non-statutory regulation. However, the ANAO stressed that these are matters for decision by the government and the profession co-operatively, given the level of interdependence between both parties in current arrangements.⁷¹ A similar observation could be made about a number of related issues, some of which have not been discussed here, such as proportionate liability (agreement reached by Federal and State Governments, announced on 4 April 2003) and professional indemnity insurance. These are important risk management issues for both the public and private sectors.⁷²

Finally, as a matter of interest, ASIC recently announced a timetable for releasing policy proposal papers and other guidelines for implementing CLERP 9. Prior to 1 July 2004, ASIC aims to release the following policy proposals and final policy statements on:

- auditor registration;
- when ASIC might use its powers to adapt requirements in the CLERP 9 Bill that relate to audit and financial reporting. This policy will also discuss how the Bill affects existing ASIC policy on audit and financial reporting;
- when ASIC might use its powers to adapt requirements in the CLERP 9 Bill that relate to disclosure. This policy will also discuss how the Bill affects existing ASIC disclosure policies;
- what insurance requirements should apply for companies that provide audit services (authorized audit companies). A final policy statement on this topic will be issued after 1 July;
- conflicts of interest. We have already issued policy proposals on the proposed obligation for licensees to have adequate arrangements to manage conflicts of interest. We plan to issue a final policy statement before 1 July (noting that this new obligation will not commence until January 2005); and
- a guide on ASIC’s processes regarding the proposed power to issue infringement notices for breaches of the continuous disclosure regime.⁷³

7. Concluding Remarks

Whilst the APS has experienced a number of changes, this Paper has endeavoured to highlight that there are also several issues still to be considered and solutions to be implemented. These changes, in the areas of accounting, budgeting and governance, have far reaching impacts upon the day-to-day operations of Commonwealth entities and the ANAO, as their independent auditor.

There is a lot of work ahead for the APS to fulfill the accounting and budgetary requirements and goals that have been put to it by the Government, Parliament and national and international professional accounting, auditing and standards bodies. There are exposure drafts to be reviewed and commented on, and treatment issues to be resolved. Each entity needs to ensure that it can implement the changes required within the increasingly tightening time deadlines at Federal Government level.

Somewhere amongst all of the detailed issues to be considered and worked through over the immediate future, it would be ideal to steal a moment to take Churchill's advice and consider the opportunities that can be taken from our efforts to add real value to public administration on behalf of all citizens. It is likely that these will increasingly occur in tandem with private sector participation that will reflect real notions of partnering using common accounting, budgeting and auditing concepts, practices and procedures. However, what all participants will do well to bear in mind is the importance of 'politics' in the public sector environment, with all its complexity and uncertainty. Nevertheless, that is what makes public administration so interesting and demanding.

Notes and References

¹ http://www.wisdomquotes.com/cat_opportunity.html

² Joint Committee of Public Accounts and Audit, *Report 388 Review of the Accrual Budget Documentation*, Canberra, June 2002, pp. 2-3.

³ Estimates Memorandum 2003/19 - Budget Estimates And Framework Review - Proposals For Additional Resourcing For Review Implementation

⁴ In 2002-03, the ANAO published 63 audit reports and 5 Better Practice Guides. (performance audits products), and 8 information services products (including BPGs and benchmarking material. This is in addition to the issue of 290 financial statement audit opinions.

⁵ ANAO 2003, *Control Structures as part of the Audits of the Financial Statements of Major Commonwealth Entities for the year ending 30 June 2003*, Report No. 61, Canberra, 30 June.

⁶ See, for example, ANAO 2001, *Audits of the Financial Statements of Commonwealth Entities for the Period Ended 30 June 2002*, Report No. 25, Canberra, 23 December.

⁷ The Auditor-General Bill 1996.

⁸ See, for example, ANAO 2003, *'Audit Activity Report: January to June 2003'* Report No. 2, Canberra, 13 August

⁹ KPMG, 2002. *Review of Independent Auditing by Registered Company Auditors*. Submission to the JCPAA Review of Independent Auditing by Registered Company Auditors, 16 August.

¹⁰ It should be observed that risk management can minimise the uncertainty surrounding innovation, by requiring the assessment of a range of options in terms of the likely opportunities for improved service delivery and program outcomes, and what needs to be done to manage the risks associated with each option. See, for example, Northern Ireland Audit Office 2002 *Investing in Partnership: Government Grants to Voluntary and Community Bodies*, Belfast, 16 May.

¹¹ ANAO 2003, *The Senate Order for Departmental and Agency Contracts (Spring 2002 Compliance)*, Report No. 32, Canberra, 5 March.

¹² ANAO 2003, *Absence Management in the Australian Public Service*, Report No. 52, Canberra, 20 June

¹³ ANAO 2003, *Management of Commonwealth Guarantees, Warranties, Indemnities and Letters of Comfort*, Report No. 27, Canberra, 30 January.

¹⁴ ANAO 2002, *Energy Efficiency in Commonwealth Operations – Follow up Audit*, Report No. 24, Canberra, 20 December.

¹⁵ ANAO 2002, *Payment of Accounts and Goods and Services Tax Administration by Small Commonwealth Organisations*, Report No. 22, Canberra, 12 December.

¹⁶ ANAO 2003, *Managing People for Business Outcomes, Year Two* Report No. 50, Canberra, 18 June

¹⁷ ANAO 2002, *Benchmarking the Internal Audit Function Follow-on Report*, Report No. 13, Canberra, 23 October.

¹⁸ ANAO 2002, *Benchmarking the Finance Function Follow-on Report*, Report No. 62, Canberra, 26 June.

¹⁹ ANAO 2002, *Managing People for Business Outcomes*, Report No. 61, Canberra, 25 June.

²⁰ Statement of Accounting Concepts SAC 3 “Qualitative Characteristics of Financial Information” para 49.

²¹ For further details, please refer to Joint Committee of Public Accounts and Audit, *Report 388*, op-cit.

²² Ibid.

²³ Ibid, p.21.

²⁴ Scaife, Wendy Dr 2003. *The corporate social investment/social reporting groundswell. Keeping Good Companies.* Journal of Chartered Secretaries Australia Ltd. Vol 55 No 11. December. pp.664-668. See also: Petty, John 2003. *Triple Bottom Line Reporting – Revolutionising Organisational Decision Making in the Public Sector.* National Public Sector Convention, Perth W.A. 19-21 November.

²⁵ Department of Family and Community Services 2003. *Triple Bottom Line Report – Our commitment to social, environmental and economic performance.* Commonwealth of Australia. Canberra. 26 September

²⁶ Ibid. Minister's Statement p.i.

²⁷ Barrett, Pat 2003, '*Outsourcing and Partnerships in the Public Sector – Driving a Generic Brand Approach*', a paper presented at the CPA National Public Sector Convention, held in Perth, 20 November, p. 21.

²⁸ Sponsored by Thiess Pty Limited, John Holland Pty Limited, Transfield Holdings Pty Limited and ABN AMRO.

²⁹ For more information, please refer to information published by the New South Wales Roads and Traffic Authority at <http://www.rta.nsw.gov.au/constructionmaintenance/majorconstructionprojectssydney/lanecovetunnel/index.html>

³⁰ Barrett, Pat 2003, '*Outsourcing and Partnerships in the Public Sector – Driving a Generic Brand Approach*', p. 25, op-cit.

³¹ ANAO 2000, *Implementation of Whole-of-Government Information Technology Outsourcing Initiative*, Canberra, September.

³² Humphry R 2000, *Review of the Whole of Government Information Technology Outsourcing Initiative*, Public Hearing, Canberra, 17 May

³³ An interesting illustration of a 'relational contract' is contained in ANAO 2000 *Construction of the National Museum of Australia and Australian Institute of Aboriginal and Torres Strait Islander Studies*. Report No 34, Canberra, 16 March.

³⁴ ANAO 2004. *Senate Order for Departmental and Agency Contracts (Financial Year 2002-2003 Compliance)*. Report No. 31, Canberra. 26 February.

³⁵ Senior, Antonia 2004. *EU Defers Accounting Standards.* The Australian, 4 February, p.23

³⁶ Walters, Kath and Andrews, Bruce 2004. *Standards fightback Accounting.* Business Review Weekly, 12 February, p.36.

³⁷ Walters, Kath 2004. *ASIC warns recalcitrants Accounting.* Ibid. p.38

³⁸ Newberry, S 2003, "*Forum: Change in the Public Sector "Sector Neutrality" and NPM incentives': their use in eroding the public sector*" *Australian Accounting Review* Volume 13 Number 2 2003, CPA Australia, Melbourne.

³⁹ "AASB's plans for adopting IASB standards by 2005", last updated 17 February 2004, page 4, available from www.aasb.com.au.

⁴⁰ Jones, Stewart and Wolnizer, Peter W 2003, *Harmonisation and the Conceptual Framework: An International Perspective*, Abacus Vol 39 No 3, pp 379-380.

⁴¹ Ibid, p 377.

⁴² Wells, Murray 2003. *Forum: The Accounting Conceptual Framework*, ABACUS Vol 39 No 3 p.278

⁴³ For further details, refer to the AASB's plans for convergence in their document 'GAAP/GFS Convergence: Implementing the FRC Strategic Direction' available from www.aasb.com.au.

⁴⁴ *GAAP/GFS Convergence: Implementing the FRC Strategic Direction*, published at www.aasb.com.au, amended 18 December 2003.

⁴⁵ Department of Finance and Administration 2003. *Estimates Memorandum 2003/19 - Budget Estimates And Framework Review - Proposals For Additional Resourcing For Review Implementation*

⁴⁶ System of National Accounts SNA93

⁴⁷ The following explanation of timing differences and permanent differences is provided in the AASB's GFS/GAAP Convergence plan, available from www.aasb.com.au:

"Timing differences relate to those items that affect the GFS and GAAP operating results in different periods. For example, defence weapons platforms are treated as expenses in the year of acquisition under GFS but are not recognised as expenses until later years (through depreciation or impairment) under GAAP. Permanent differences relate to those items that affect only one of the GFS or GAAP operating results. For example, dividends paid are treated as an expense under GFS but are treated as a distribution to owners under GAAP (and therefore will not affect the GAAP operating result in the current or future years)."

⁴⁸ Response from CPA Australia to Australian Accounting Standards Board in relation to GAAP/GFS Convergence Project Advisory Panel, dated 30 January 2004, available at http://www.cpaaustralia.com.au/01_information_centre/13_ext_report/1_13_0_11_news.asp

⁴⁹ AASB Action Alert number 22 October 2003.

⁵⁰ Barrett, Pat 2003, *'The Provision of Audit Services to the Public Sector: Establishing Sound Corporate Governance and Auditing Practices'*, a paper presented at the 2nd Annual New Directions in Australian Auditing & Accounting Standards Conference, held 19 May.

⁵¹ <http://www.intosai.org>

⁵² Excerpt from Public Company Accounting Oversight Board's web site at www.pcaobus.org

⁵³ AuASB 2004, *'New Audit Risk Standards issued by the AuASB'* media release 9 February, p. 1.

⁵⁴ Available from www.anao.gov.au

⁵⁵ ANAO 2003. *Public Sector Governance – Volumes 1&2 Better Practice Guide, July, and ANAO 1997. Applying Principles and Practice of Corporate Governance to Budget Funded Agencies*. Canberra, ANAO 1999 *Principles and Better Practices – Corporate Governance in Commonwealth Authorities and Companies*, Canberra, May.

⁵⁶ Nolan Committee of the UK, 1995. *First Report of the Committee on Standards in Public Life*, London

⁵⁷ Barrett, Pat 2003, *'Better Practice Public Sector Governance'*, a paper presented to the National Institute of Governance in Canberra, 21 August, p. 7.

⁵⁸ See: Donald J. Johnston (Secretary-General of the Organisation for Economic Cooperation and Development), 2002, *'Better values for better governance'*, OECD Observer, 18 October; and Jeffrey A. Sonnenfeld 2002, *'What makes great boards?'*, Harvard Business Review, September.

⁵⁹ Groom Michael (President of the Institute of Chartered Accountants of England and Wales) 2002. *Corporate Governance – The Role of Financial Reporting and Auditing in Good Corporate Governance*. IOSCO Conference, 25 May, p. 5.

⁶⁰ Origin unknown

⁶¹ The Treasury, *Corporate Law Economic Reforms Program Policy Reforms*, May 1998, found at <http://www.treasury.gov.au/contentitem.asp?pageId=&ContentID=264>.

⁶² Extracted from CPA Australia Members' Handbook, December, 2001. issue AUP32.

⁶³ Institute of Chartered Accountants in Australia and CPA Australia, 2002. *Professional Statement F.1 – Professional Independence*. pp. 2-3

⁶⁴ Ramsay, Ian 2001. *Independence of Australian Company Auditors, Review of Current Australian Requirements and Proposals for Reform*, Commonwealth of Australia, October.

⁶⁵ Owen, The Hon Justice Neville, 2003, '*The Failure of HIH Insurance*' The Report of the HIH Royal Commission Parts I , II and III, April.

⁶⁶ Commonwealth Treasurer, 2003, *Report of the HIH Royal Commission*. Press Release, Canberra. 16 April, p. 2.

⁶⁷ United States Panel on Audit Effectiveness 2000, *Report and Recommendations*, Public Oversight Board, Stamford Connecticut, p. 109.

⁶⁸ Australian Securities & Investments Commission 2002. *ASIC announces findings of auditor independence survey*. Media Release 02/13. 16 January, p.3.

⁶⁹ Blake Dawson Waldron 2002, *Corporate Governance Update: Audit Independence*, March 2002.

⁷⁰ Quoted in *Auditors could be whistleblowers, ASIC chairman proposes*, Committee Bulletin Vol. 13 no. 3, February 2002, 16-28, p. 3.

⁷¹ New York Stock Exchange Corporate Accountability and Listing Standards Committee, 2002. *Report*. New York, 6 June, p.26. The Committee, among other matters, also proposed that listed companies must have an audit committee comprised solely of independent directors; the chair of the committee must have accounting or financial management experience; and audit committees must have sole responsibility for hiring and firing the company's independent auditors, and for approving any significant non-audit work by the auditors. p.21

⁷² See, for example, the Institute of Chartered Accountants in Australia 2003, *PI Insurance crisis forces ICAA to lower its mandatory requirements*, Media Release, Sydney. 20 February.

⁷³ Australian Securities and Investments Commission (ASIC) 2004. *Proposed ASIC CLERP 9 Policy Papers Timetable*. Media and Information Release 04-029. Sydney, Thursday 5 February. Found at http://www.asic.gov.au/asic/asic_pub.nsf/byheadline/04-029+Proposed+ASIC+CLER