

Address to University of Canberra
Students participating in Graduate
Certificate in Performance Auditing

**Performance Auditing in a
Changing APS Environment**

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Performance Auditing in a Changing APS Environment

1. Introduction

I appreciate the opportunity to talk with you this morning on the important role of performance auditing in improving public sector administration and accountability. This role is becoming more important in the context of a public service that is expected to achieve better performance, using fewer resources, while providing higher quality services to the Australian community. While these elements would seem to reflect the requirements of a more 'responsive' public service, the latter also needs to be seen to be more pro-active in its approach. That also applies to our auditing processes, where we should aim to be more forward looking and strategic in our thinking.

The value of performance auditing is becoming more widely recognised across both the public and private sectors, with a growth in performance auditing services offered by private sector consulting firms and the expansion into the performance audit arena by agencies' internal audit functions. Perhaps, not surprisingly, there now appears to be some interest being shown by the corporate world under pressure to be more responsive and more public in its performance reporting. If this trend is to continue, courses like this one will become more important in providing a solid foundation of expertise on which agencies, and others, can rely.

A broader range of skills and abilities is increasingly important for performance auditors, as the environment in which we operate becomes more complex. The evolution of the public sector, under successive internal reforms and external pressures, is presenting challenges to agencies, and their auditors. While a number of these challenges stem from fundamental changes to the legislative framework for public sector governance in the late nineties, they continue to have a profound effect on the way in which agencies operate today. New challenges are ever present, notably those that relate to the adoption of new technology and the growing convergence of the public and private sectors, particularly under the effects of globalisation which do not seem to be diminishing despite recent suggestions otherwise and some public displays of nationalism as a counter reaction.

The ANAO is responding to these challenges on many fronts. We recognise that we are part of, and contribute to, the public service environment. It is critically important that we understand the nature and operations of the public sector and how we can work collaboratively to improve public administration. To this end, we have implemented a range of initiatives to ensure that we possess a well-developed understanding of the key issues facing the public sector as well as important concerns of the Parliament. We are also committed to continually reviewing and improving our business management, which supports the effective and efficient delivery of our suite of audit products.

I would like to start by discussing my role and that of my Office to provide some perspective to the approach being taken in performance auditing. This is important in order to be able to appreciate better that approach as part of our audit function or business.

2. The Australian National Audit Office

Role

The office of the Auditor-General of the Commonwealth of Australia dates back to the beginning of Federation, being created by the Commonwealth Parliament in 1901. However, our experience in performance auditing could be said to be less than one-quarter of that period. The Auditor-General, through the ANAO, provides an independent review of the performance and accountability of Commonwealth 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 Commonwealth public sector 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, agency audit committees and 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* 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 a 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 Commonwealth public sector 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 same entities. A particular challenge in public sector auditing is the increasing tension over the role of national audit offices and the boundaries between government policy and its implementation. The Commonwealth 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, on other involved bodies.

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 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 that makes the ultimate decision on the ANAO's resources. This is important for signalling the independence of the Auditor-General by removing the issue of fee dependence between auditor and auditee in the Commonwealth public sector.¹ 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.

Independence

Corresponding with public sector changes, the role of the Auditor-General and the place of auditing in democratic government 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 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 auditing standards for his/her Office. In practice, the latter are largely those set by the Australian Auditing and Assurance Standards Board (AASB), which are now being converged with the International Auditing and Assurance Standards. 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.²

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 is often dependent on their work in coming to an audit opinion on organisations' control environments and financial statements. In the latter respect, the ANAO has to be satisfied as to the quality of the work done under the requirements of the auditing and assurance standards.

The principles of audit independence in Australia are detailed in the Professional Statement F1, entitled 'Professional Independence'³, 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 2003⁴ 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.

Client focus

It is vital that the ANAO continues to be an active participant in the public sector's negotiation of the changing Australian Public Service (APS) 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 well 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.

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 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.

In addition to the contact referred to above, 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). I will outline this in more detail later. However, I would like to stress here the extensive discussion that takes place with agencies and the Parliament, notably with the JCPAA.

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 targets for Parliamentary liaison built into their individual performance agreements. The ANAO's ultimate aim is to be accessible to Parliament and the APS 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 our 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. The annual scorecard is explained in further detail later in this paper in relation to our performance.

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 every six months in the activity reports, allows the ANAO to contribute to contemporary debate on a broad range of issues facing the APS. Importantly, the commentary also provides a focus for ongoing discussion with the Parliament (notably the JCPAA), in setting appropriate strategies for the future.

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 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 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 periodically to help ensure 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 guide agencies into the future.

Other External scrutiny

In addition to the afore-mentioned review, and quality assurance procedures discussed later in this paper, the ANAO is subject to several layers of other external scrutiny, including those applying to all other APS 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. The role of the Independent Auditor is explained later in this paper.

3. Performance audit coverage considerations

Managing stakeholder expectations

Increased interest in accountability considerations

The public has high expectations of government and the public service with its demands for effective, efficient and economical levels of service. Public sector managers are responding to the demands of their particular operating environments by streamlining and adapting traditional methods of providing services, such as taking advantage of alliances that bring together the public and private sectors in partnering type relationships.

Under the current reforms, the public sector is subject to increased levels of scrutiny of its performance and effectiveness. A culture of ongoing performance assessment is

important in maintaining Parliamentary and public confidence. The ANAO has a key role in reviewing and reporting on public sector performance. Performance assessment in the APS covers a range of measures, both quantitative and qualitative. Agencies have to be accountable, for example, for the implementation of the Government's requirements with respect to public sector reforms and for meeting legislative, community service and international obligations; for equity in service delivery; and for high standards of ethical behaviour.

It is important for the ANAO to know as much as possible about the public sector environment and the functions and/or business of public sector agencies and bodies. Positive and open relationships with the various stakeholders assist the ANAO in keeping itself informed of matters impacting public sector agencies. New ways of delivering public services, increasingly involving the private sector, have marked implications for accountability. The ANAO needs to both understand and contribute to the changing governance environment. Through its understanding of the public sector business environment, the ANAO can contribute pro-actively to change and enhance its audit performance.

The ANAO regularly reviews its audit planning process and the relevance and audit effectiveness of the mix of its products and services. For its products to remain credible and relevant, the ANAO needs to demonstrate that it is meeting the challenges of the changing public sector environment and, within its capacity, is contributing pro-actively to the implementation of the Government's reform agenda.

The challenge to the ANAO is to strategically position itself so that it can adequately respond to emerging issues in the APS. The ANAO strives to tailor its products to meet the needs of clients and to continue to be relevant by identifying opportunities for improvement and providing value added services. Changes in the APS environment in recent years have necessitated a more strategic, risk-based approach to audit activity. The ANAO recognises the importance of being an active participant in the process of change and the need to target products that span the accountability continuum from providing basic assurance and assessment of performance through to better practice and benchmarking guides.

Focus on APS improvement

The ANAO aims to add value to public sector performance. It therefore follows that it is important for the ANAO to suggest improvements to public administration. This advisory role is timely and useful for a public sector challenged by diverse governance issues. An important focus in the conduct of all performance audits is the identification of better practice and the provision of recommendations aimed at improving efficiency and administrative effectiveness in the APS. The ANAO formulates recommendations to assist agencies in the achievement of better outputs and outcomes and to promote improved performance by the public sector. This also requires agreement with, and commitment by, agencies to the implementation of those recommendations.

While the ANAO endeavours to construct recommendations that will be accepted by agencies, occasions may arise where a difference of opinion is held.⁵ Such tensions can also involve the Auditor-General's status as an Officer of Parliament rather than being an Officer of the Government. Nevertheless, our effectiveness is largely related to the extent to which our recommendations are accepted and fully implemented. In this respect, we are also attentive to any statements by individual Ministers about action being taken by portfolio agencies on performance audit and other audit

recommendations. Some Ministers are quite assiduous in this respect despite there not being a requirement to do so, as it was in the past.

The impact of performance audits can be assessed by the ANAO through the conduct of follow-up audits. Follow-up audits assess the implementation of recommendations made in an earlier audit and determine whether implementation, or alternate action to address issues leading to the recommendations, have provided suitable improvements. Follow-up audits are included in the annual AWP. Audit Committees can also be a useful source of follow-up action, particularly if such action is a regular item on the Committee's meeting agenda.

The impact can also be assessed via a series of audits on a common theme or program activity. One such series covers privatisation in the APS. A key outcome from the ANAO's privatisation audits has been the identification of opportunities for significant improvement in the tendering process and the management of contracts with external advisers to the sale or procurement activities. The ANAO has had a real impact on the way trade sales have been conducted. For example, a program to privatise 22 Federal airports was completed in December 2003. The sales involved the granting of leases over each of the airport sites, which remain Australian Government-owned. The airports privatisation program involved sales in three major tranches with aggregate sale proceeds of \$8.5 billion. The three major tranches have been subject to audit by the ANAO.

An aspect of the ANAO's approach to auditing the second tranche sale was to examine action taken in response to recommendations made in the audit report on the first tranche sale. The ANAO found that all eleven recommendations in the 1998 report were implemented by agencies, even though not all had been fully agreed to by the agency responsible for the sales. The improved processes resulting from implementation of these recommendations supported an effective overall outcome for the second tranche. This outcome was also due to the greater understanding of the accountability requirements by private sector contractors who not only addressed audit comments, but also initiated related discussions with the auditors concerned.

The third major sale reviewed by the ANAO was of Sydney (Kingsford Smith) Airport. The audit concluded that the sale process was effectively managed and that a sound governance framework contributed to an effective overall outcome from the sales process. The ANAO considered that the framework included an effective committee and working group structure, a detailed risk management plan and continuous improvement mechanisms designed to address previous audit findings and recommendations.⁶ From these audits, the ANAO has identified a number of relevant principles and sound administrative practice to guide future major tendering processes.

Audit product continuum

Adopting an integrated audit approach

The ANAO's range of products aims to provide assurance that the risks facing the APS 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. Key to this 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 APS environment changes, so do the associated accountability arrangements. In performance audit, the balance between the effort applied to administrative effectiveness issues and efficiency concerns needs to be adequately considered. 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 things can be improved. The ANAO seeks to provide such assurance on the state of the APS and to contribute to improvements in the APS 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 APS 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. In developing an audit strategy for a particular agency, the ANAO looks at the perceived relative strengths and weaknesses of the entity in terms of its performance and accountability, taking into account any complementary internal or external reviews, investigations and evaluations, in order to determine an appropriate audit program for the organisation.

The ANAO is committed to an integrated auditing framework that draws on the strengths of both the financial (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 some 300 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 services, and commercially oriented entities such as Government Business Entities (GBEs). The *Auditor-General Act 1997* provides the authority to undertake 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 Business Support Process (BSP) audits covering a range of issues challenging the APS. 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 are tabled in the Parliament (47 in the 2002-03 financial year, with 35 tabled in the year to date). 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.⁸ 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 individual report.

➤ **Business Support Process audits**

General performance audits include what we call Business Support Process (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 audits 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 APS 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 APS. 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 AWP 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 entities⁹ 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.¹⁰

➤ **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 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 APS. 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 APS, GST administration, management of Parliamentary workflow, managing learning and development in the APS, internal budgeting, administration of grants, and the development of policy advice.

BPGs are very 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.

BPGs and similar publications are becoming increasingly important source documents for managers operating in an environment of devolved authority and responsibility. These documents are especially of 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 who 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 guide developed on Goods and Service Tax (GST) Administration, compiled with the Australian Taxation Office¹¹ and the soon to be released guide on annual performance reporting prepared in association with the Department of Finance and Administration.¹²

➤ **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 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, 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.

Planning and selection of audit products

Audit Work Program process

While there is little discretion about the financial statement audits conducted each year, the audit topics for the more than 60 performance and other audit products conducted each year are generally selected on the following 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 agency and entity operations within available audit resources over a reasonable period of time.

The ANAO continually monitors the broader environment so that important issues can be identified and taken into account in the development of its annual AWP. In

addition, the ANAO's direct involvement with agencies in audit activity, and regular liaison with agency management, including through audit committee activities, allows it to identify, and take into account, specific agency issues in the annual planning process.

The ANAO assesses business risks that are likely to impact on the APS. These risks are also taken into account in identifying the key areas of focus in developing the annual AWP. In addition to business risks, audit activity is planned with regard to financial materiality,¹³ program significance, likely audit impact, visibility of the program, and the extent of recent review activity of the program.

An analysis of materiality assists the ANAO in setting its strategic audit approach from one year to the next. The ANAO takes a risk-based approach across the 'whole-of-government'. In planning and prioritising its performance audit coverage the ANAO also considers the need to respond to emerging issues of interest to the Parliament and to provide Parliament with assurance, over time, of the performance of public sector agencies. To achieve this objective the ANAO also undertakes audits of less material aspects of agency activities. The ANAO aims for at least some audit presence across the whole public sector within a reasonable timeframe. Importantly, the ANAO endeavours to provide coverage of activities performed by portfolios over a five to seven year cycle.

The concept of risk management is fundamental to the ANAO's auditing activities. Professional accounting standards require the ANAO to identify and assess the risks that exist in agencies being audited. The ANAO performs assessment and prioritisation of the risks of various programs, to ensure that resources are applied to the areas of greatest risk and to the audit of those programs that are likely to provide the greatest returns in terms of improved accountability, economy, efficiency and administrative effectiveness. At the same time, the ANAO has in place a number of internal risk management structures which ensure that it is not exposed to unnecessary risks internally. This includes the increasing expenditure on legal advice as a means of containing risk exposure in a more litigious environment.

The ANAO consults with the JCPAA on the Parliament's audit priorities. This consultation is a strategic-level process that the ANAO uses to assist it in developing its AWP. The views of the JCPAA and other parliamentary committees and public sector entities are sought when the AWP is being planned, and suggestions from individual members and senators are also welcomed. The ANAO receives, on occasions, requests from Ministers, Parliament, and Parliamentary committees to undertake particular audits. Examples include the Australian Defence Force Recruiting contract¹⁴ and the administration of staff employed under the *Members of Parliament (Staff) Act 1984*.¹⁵

The AWP is presented to audit committees and senior management of public sector entities to foreshadow the areas of audit interest. The program provides a basis for discussion of significant audit and other related issues facing the entity. The AWP provides details of audits currently in progress and potential audits for the financial year for each Ministerial Portfolio/Agency. The final audit program is determined by the Auditor-General, having regard to requests from Members of Parliament and Parliamentary committees to review new topics and priority tasks that may arise during the year. The AWP is available on the ANAO website.

The ANAO has identified performance audit themes that underpin the preparation of the AWP. Annual themes are identified as a basis for selecting topics to ensure that the audit program is targeted appropriately to provide adequate assurance as well as to

improve the performance of public administration. For the current year these include: human resource management including workforce planning; financial management and reporting; performance management and measurement; procurement and contract management; application of information technology and other resources; and, service delivery. In addition, sound corporate governance, at least in recent years, has become an enduring audit theme. Performance audits may also be conducted on matters where there has been considerable public interest, for example the recent audit of the supervision of superannuation entities by the Australian Prudential Regulation Authority (APRA).¹⁶

In addition to APS wide issues, factors affecting the performance audit coverage in individual agencies include:

- ❑ the structure of governance and accountability in the agency;
- ❑ the extent of public/private interface in service delivery;
- ❑ the involvement of private sector contractors and the extent to which they are subject to Commonwealth legislation, including the Public Service Act, Freedom of Information Act, and the financial management legislation and associated required levels of accountability; and
- ❑ extent of recent audit coverage, including internal and other external reviews of agency operations.

Taking account of evaluation activity

Evaluation activity being undertaken in relation to an agency is also considered in the selection and planning of the ANAO's performance audits. While there is currently no central evaluation function in the APS, nor a requirement for agencies to report progress against recommendations made in ANAO audit reports, evaluation activity occurs at the agency level, even if somewhat variable across agencies.

In a recent audit of annual performance reporting by agencies, the ANAO found that most agencies undertook a range of evaluations.¹⁷ However, it was found that the results of these evaluations were frequently not discussed in agencies' annual reports. Therefore, evaluations were not being used to support performance reporting in the annual report by providing information on quality and effectiveness that was otherwise not available. The audit covered five APS agencies. To assist agencies to develop their annual reporting performance information frameworks and analysis, the ANAO has jointly prepared, with the Department of Finance and Administration (Finance), a BPG on this subject, as noted earlier¹⁸.

A Cabinet Implementation Unit has recently been established in the Department of Prime Minister and Cabinet. It is intended that the Unit will work with agencies to ensure timely and effective implementation of government decisions. The Unit will identify policy proposals that should include an implementation plan; examine systemic issues that determine the effectiveness of implementation; and identify and support best practice in project management and program implementation. The Unit will monitor and report to government on the timeliness and effectiveness of the delivery of key programs and services, but will not evaluate program outcomes against policy objectives. The Unit will complement existing review activity, including that by the ANAO, which will remain completely independent.

Implementation of audit recommendations

Until 1999, there was a requirement for Portfolio Ministers to submit periodic reports to the Minister for Finance and Administration on action taken on matters raised by the Auditor-General in audit reports. As part of this process, Finance undertook an assessment of the adequacy of these actions. The Prime Minister devolved this responsibility to agency heads in 1999. There is now no formal requirement for the progress of implementation of ANAO recommendations to be reported in Parliament. Nevertheless, as noted earlier, some Ministers do provide such reports to the JCPAA and the ANAO on a regular basis. Moreover, these matters may now be addressed directly through audit committees and the JCPAA.

The ANAO works closely with the various audit committees of public sector organisations to monitor the implementation of its recommendations. However, the most effective action is the JCPAA's quarterly public hearings on selected audit reports and any JCPAA inquiry conducted as a result of these reports. The ANAO also conducts its own follow-up audits to monitor the implementation of recommendations, as well as to report on any other emerging issues that may be of interest to Parliament. To ensure that the Parliament and agencies consider that the ANAO's audit activity adds value to public sector administration, it is important that the ANAO's recommendations are both accepted and implemented.

The JCPAA has, however, identified weaknesses in agency management of the implementation of ANAO audit recommendations. In a recent report of the JCPAA, the Committee found that there were serious deficiencies in the use of Defence's Audit Recommendations Management System (ARMS). It reported that many of Defence's actions in response to both JCPAA and ANAO recommendations, managed through this system, were being marked off by Defence personnel as complete simply because the due date for action had been reached, potentially compromising the veracity of Defence's advice concerning its progress in implementing recommendations that it had agreed with.²¹

Developing Guidance with Audit Counterparts

Developing Relationships

The ANAO's active participation in professional networks, both in Australia and overseas, make it well placed to provide a degree of leadership and guidance into the future. The ANAO works closely with colleagues in Australia and overseas to ensure that its work is well targeted and draws on examples of better practice. Globalisation produces new challenges as well as new opportunities. The ANAO is committed to working closely with its national and international colleagues to ensure that its products and services are relevant and that it has the right mix of assurance, compliance, accountability and performance products at any point in time and over time.

The ANAO maintains strong relationships with public sector peer groups in Australia and overseas and with the various professional accounting and auditing bodies. The ANAO has close links with several national and international auditing organisations through which it assists with the development of auditing standards, professional practices and exchanges of experience. The ANAO also works closely with major accounting firms and professional accounting bodies to set and maintain professional and ethical standards internally. Outsourcing of selected activities and the contracting-in of specialist expertise to assist on particular audits have also provided the ANAO with opportunities to extend and develop its knowledge and skill base.

The ANAO has been active in using the collective international experiences of audit offices to benchmark our performance and to compare the performance of Australian agencies against that of overseas bodies. The ANAO works with both the United Kingdom (UK) and the New Zealand audit offices on peer reviews, and exchanges staff with other national audit bodies to build expertise and knowledge of better auditing practices globally. Engaging with both the public and the private sectors internationally is an integral part of the ANAO's knowledge management strategy.

On a national level, the ANAO participates in the Australasian Council of Auditors-General (ACAG), attending regular meetings and facilitating an exchange of information between Auditors-General in the States and Territories of Australia and Fiji, New Zealand, Hong Kong (in the past) and Papua New Guinea. The objective of the Council is to promote and foster public sector auditing in the Australasian region through an exchange of experiences, ideas, training and development and mutual cooperation.

The ANAO is a member of a number of international institutions. INTOSAI was created to promote the exchange of ideas and experiences between supreme audit institutions around the world. Over 170 Auditors-General, or their equivalent, are currently members. INTOSAI operates through the conduct of triennial congresses, publication of an 'International Journal of Government Auditing', establishment of committees and working groups to study and report on various issues of interest to members, and through the work of the INTOSAI Development Initiative to provide information exchange and training for both practitioners and those who train them. INTOSAI is managed through the congresses and annual governing board meetings.

The Asian Organisation of Supreme Audit Institutions (ASOSAI) represents 32 Asian audit institutions and is a regional grouping of INTOSAI. The objectives of ASOSAI include promoting understanding and cooperation through the exchange of ideas and experiences, providing facilities for training and continuing education and serving as a centre for regional audit development. ASOSAI is managed by the members through an annual governing board meeting and a triennial conference. The ANAO actively participates in each conference. Importantly, we participate fully in the regular performance audit training arrangements and preparation of related research papers.

Developing performance audit guidance

Australia lead a research team of six representatives of ASOSAI members, who developed a draft of performance auditing guidelines early in this decade. The draft guidelines were circulated to ASOSAI members for review and comment. All comments were taken into account in developing a final draft of the guidelines, which were approved by the ASOSAI Governing Board at the 8th ASOSAI Assembly in Thailand in October 2000²². These guidelines provide a framework for managing and conducting performance audits. They are not a detailed instruction manual and do not replace the need for audit management and staff to use their professional judgement to ensure the delivery of a quality audit product. They were an important source of later guidance provided by INTOSAI's Auditing Standards Committees.²³

4. Issues Impacting on Performance audit

Public sector reforms

The APS has been under increasing pressure in recent years to achieve a better performing public service with less costly, better focussed and higher quality services. The public sector reforms have placed an emphasis on:

- ❑ ensuring a greater APS orientation towards outcomes, rather than just on administrative process;
- ❑ continuous improvement to achieve better performance in an environment of devolved authority and increased management flexibility; and
- ❑ improved service delivery through the contestability of services, and where appropriate, outsourcing of functions.

Outcomes focus

In the past, a tendency in the public sector to focus primarily on ensuring conformance with legal and procedural requirements encouraged a risk-averse approach. Increasingly, the current focus is on performance and program outcomes. The implementation of a sound risk management approach as part of effective corporate governance has been instrumental in changing the culture of the public sector to be more outcome, rather than input, focussed. Strengthening the internal framework of agencies allows management attention to be directed to the core business of the agency, reflected in its outputs and outcomes.

The move to accrual budgeting and management, and the adoption of a greater focus on agency outputs and outcomes, have underlined the importance of sound performance management and reporting within the public sector. The performance, particularly relating to effectiveness, of the APS is now subject to increased levels of scrutiny. Performance information, assessment and reporting are critical tools for monitoring, reviewing and improving performance.

The focus on outcomes has also heightened the importance placed on rigorous performance information systems capable of quantitatively and qualitatively measuring or assessing results and demonstrating achievement. Under the accrual budgeting framework, agencies are required to define inputs, outputs and outcomes. Under the legislative framework, agencies are also required to demonstrate the efficient, effective and ethical use of resources.

The ANAO reviews performance information as a matter of course in most performance audits. This includes review of the appropriateness and comprehensiveness of the relevant performance measures. The benefits of cost effective performance information include the capacity to better manage risks, to adjust programs to meet changing client needs, and to demonstrate to the Parliament that Commonwealth resources are being used efficiently and effectively.

Agencies require a range of performance information for internal program management purposes and external reporting, particularly for accountability purposes. Key performance indicators used for external reporting and accountability purposes should assist management to drive their business towards achieving expected outcomes. Monitoring performance information to determine that appropriate progress is being made towards delivering outputs and achieving outcomes should be fully integrated with routine business management operations. Performance information is a valuable management tool. Therefore, Portfolio Budget Statement (PBS) performance details, accountability-related information included in annual reports, and general management performance information are, and must be, part of the same integrated framework for management and accountability.

It is clear that sound performance information is essential to the achievement of statutory accountability requirements defined by the Parliament. A number of ANAO performance audits have found substantial shortcomings in performance information

available on many important public sector functions. In response to such audit findings, the ANAO was requested by both the JCPAA and the Senate Finance and Public Administration Committee some years ago to consider the quality of performance information in audits undertaken. In the light of the special interest of these committees in performance information, the ANAO conducted a performance audit with the objectives of assessing the appropriateness of performance information made available by agencies in a selection of PBSs and annual reports; and agency arrangements to identify and collect this information.²⁴

The subsequent audit report²⁵ concluded that, overall, performance information in the PBSs should be improved to enable agencies to establish and demonstrate the links between outcomes, outputs and performance indicators. The report noted that while agencies had placed considerable emphasis on developing useful performance information, this element remained a priority given the importance of using performance information for target setting, performance measurement and for accountability purposes. The report also concluded that the observed inadequacies would make it difficult for the Parliament and other stakeholders to assess agency performance with reasonable assurance. This was because the PBS performance information did not always include targets, or the targets that were provided were often vague and/or ambiguous.

The ANAO released a BPG on performance information in PBSs in May 2002 in response to the Senate Finance and Public Administration Legislation Committee's request to develop a guide to provide assistance to agencies in their development of performance information.²⁶ It builds on an earlier guide developed by the ANAO.²⁷ I referred earlier to our latest BPG on performance information provided in annual reports.²⁸

Decentralisation and devolution of authority

The public service legislative framework has changed with the intention of allowing managers increased flexibility to respond to the particular dynamics of their business environments. Greater flexibility in management, and corresponding increases in personal accountability, have become central features of the current administrative arrangements. For example, personal responsibility has been delegated to the heads of agencies. This approach reflects the private sector management model. It also creates new opportunities and risks that require effective and appropriate corporate governance frameworks if the public interest is to be protected without stifling the benefits offered by the new flexibilities.

Public sector reform has involved the steady devolution of responsibility and authority away from central agencies such as the Treasury, Departments of Finance and Administration and Employment and Workplace Relations as well as the Public Service Commission. Line agencies now have greater autonomy in their decision-making as well as greater flexibility in how they manage their business. New financial management legislation enacted in January 1998, replacing the *Audit Act 1901*, illustrates how significantly the management framework has changed. Voluminous and detailed rules and prescription were largely replaced by principles-based legislation that clearly places the responsibility for the efficient, effective and ethical management of public sector organisations in the hands of chief executives and directors of boards.

Greater responsibility and flexibility in decision-making requires a focus on accountability arrangements to ensure decisions are appropriate, soundly-based and

transparent. To provide such assurance, public sector entities need to have robust corporate governance arrangements and financial management and other control structures in place.

The ANAO looks to be proactive in providing ongoing advice and support to agencies in establishing and maintaining a sound corporate governance framework. The ANAO seeks to do this through producing a range of relevant audit products, maintaining a relationship with agencies, and through contributions to conferences, professional bodies and tertiary institutions. In a devolved environment, the ANAO is well placed to contribute to improving public administration through its audit program.

Improved service delivery

The Australian Government has identified the greater involvement of the private sector in public service delivery as core policy. Increased contestability of services, outsourcing, privatisation and commercialisation have all become features of modern public administration. These approaches present different accountability risks that require appropriate agency responses to achieve the goals of improved efficiency and effectiveness while maintaining proper standards of accountability. The convergence of the public and private sectors has introduced new opportunities, but also some significant risk management issues for public sector administration. While the public sector accountability regime should not stifle innovation or other management activity, it is important that appropriate mechanisms are in place to ensure the ethical and accountable use of resources as well as achievement of required results.

Both the nature and the scale of public sector involvement with the private sector continues to change. The nature has changed by adapting, or adopting, private sector methods and techniques, and through the direct private sector provision of some public services. The scale has changed through opening up to competition areas previously reserved to government, such as telecommunications, public sector entities contracting private sector suppliers of goods and services in areas such as employment services and information technology, and through transferring some \$70 billion in Commonwealth assets or business to private sector owners. In aggregate, these changes are often described as the privatisation or commercialisation of the public sector.

The introduction of the notion of contestable service delivery has led to the outsourcing of a growing proportion of public sector activity. Not only is the private sector providing more goods and services to the public sector, it is also delivering an increasing range of public services direct to the public. The public sector is shifting from being a provider of services to a purchasing role. This has been accompanied by a growing 'commercialisation' of public sector organisations in both their structures and ways in which they operate.

The provision of government services by the private sector is one of the most significant issues in contemporary public sector administration. It represents a major challenge for both agency managers and the ANAO to establish an appropriate balance between achieving cost effective outcomes and demonstrating accountability for the manner in which public sector resources are used. The fundamental differences between the two sectors have to be considered. Transparency, equity of treatment and probity in the use of public resources, including the application of public service values and codes of conduct must be considered. Public sector agencies still have very different legal and accountability requirements. These agencies have their primary accountability to the Executive and the Parliament. Private sector companies,

however, have as their primary responsibility the provision of shareholder value. Any Board that delivers such value is most unlikely to experience difficulties in being re-elected by shareholders.

Improved economy and efficiency cannot be pursued at the expense of accountability. The increasing participation of the private sector in service delivery and decision-making raises challenges for the ANAO in terms of the boundaries of its mandate. To date there have been no examples where an audit has not been possible. It is important for the ANAO to actively consider the complexities facing the changing public service environment and how they may be addressed effectively in its audit planning and conduct.

Outsourcing has been a key feature of the changing public sector environment and has raised important questions of accountability. Objectives of outsourcing have included 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 activities; encouraging suppliers to provide innovative solutions; and cost savings in providing services. There have been some successes, for example, the outsourcing of human resource management functions in Finance was assessed as positive for the agency's core business, and the agency won a worldwide outsourcing achievement award.²⁹ In addition, a recent audit of the management of Commonwealth national parks found significant benefits both in terms of savings to the Australian Government and in increased employment opportunities in some rural and remote communities.³⁰

Outsourcing also brings risks. Audit experience indicates that an agency pursuing outsourcing of services should develop a robust analysis of business requirements prior to going to the market. The experience of the ANAO has been that a poorly managed outsourcing approach can result in higher costs, wasted resources, impaired performance and considerable public concern. An important issue is whether there is sufficient transparency in the arrangements to satisfy the Parliament's concerns about accountability both for the use of public resources and the results being achieved.

The ANAO's audit of the initial implementation of IT outsourcing across the public sector found that benefits realised by agencies were variable and that costs were well in excess of the amounts budgeted.³¹ Deficiencies were identified in risk and transition management and the ongoing management of the outsourced business arrangement.³² The ANAO identified that savings and other benefits do not flow automatically from outsourcing. The outsourcing process, like any other element of the business function, must be well managed to produce required outputs and outcomes and must be suitably transparent to protect public accountability.

Market-testing of services, competitive tendering and contracting out can, and has, separated policy development from service delivery with some unfortunate, unintended consequences, such as with the Federal Government's Information Technology (IT) Initiative. Agencies need to consider effective corporate governance frameworks and workforce-planning practices to ensure that the attendant risks are well managed and that the public interest is protected into the future.

The ANAO has an important role to play in terms of leading and guiding agencies through the accountability issues presented by private sector involvement. Lessons learnt in relation to outsourcing and contract management are already significant, as reflected in a number of our BPGs. The convergence of the private and public sectors will continue to introduce new levels of complexity and risk to public sector agencies.

Joined-up Government

Traditionally, the public sector has performed its business in a fragmented way, with discrete agencies having monopoly responsibility for particular areas of interest. The Prime Minister observed recently that a particular challenge for the future of the APS is:

the capacity of departments to successfully interact with each other in pursuit of whole of government goals and more broadly, for the entire Service to work in partnership with other bureaucracies, with business and with community groups as resources and responsibility are devolved closer to where problems or opportunities exist.³³

The APS is moving towards a more collaborative or whole-of-government approach. This has led to an increasing complexity of relationships to deliver services traditionally provided by individual organisations, including:

- ❑ Australian Government agencies undertaking activities with other Australian Government agencies;
- ❑ cross-government co-operation—such as Australian Government agencies undertaking activities with State and/or local government agencies; and
- ❑ public/private arrangements, including contestability and contracting out and government as a shareholder.

The increasing number of whole-of-government, collaborative, or ‘joined-up’ government projects developed to implement the Government’s policies, places additional demands on the capacity of agencies to maintain an appropriate level of corporate governance. ‘Joined-up’ government inevitably involves at least dual accountability of participants both for their individual organisations and for the ‘joined-up’ arrangements. Robust governance arrangements are required to facilitate the management and successful acquittal of those accountability obligations. In particular, in situations where a number of agencies contribute to an outcome, sufficient information should be collected and reported for the overall effectiveness of a program to be determined.

Many agencies in Australia, like their counterparts overseas, have reviewed, or are currently reviewing, the way they do business to take advantage of opportunities for networked or ‘joined-up’ service delivery with other public sector agencies. Canada has experimented with networked partnership arrangements to good effect. The UK has indicated that ‘joined-up’ government is central to its modernising government initiative. Examples of ‘joined-up’ government or extensive interaction with other agencies in the APS include:

- ❑ Centrelink—provides delivery services for the Department of Family and Community Services (FaCS) and fifteen other Australian Government agencies plus all State Housing Authorities;
- ❑ Department of Employment and Workplace Relations—provides information and assistance to small business by acting as lead agency across the Australian Government, State Governments and the private sector;
- ❑ AusIndustry (within the Department of Industry, Tourism and Resources)—coordination agency responsible for delivering the Government’s Business Information Service Program which interacts with all three levels of government; and

- ❑ Department of Health and Ageing—promotes, develops and funds health and aged care services through partnerships involving the Australian Government and State Governments.

Arrangements between public sector agencies, such as these, tend to be quasi-contractual, based on ‘relational’, rather than ‘legal’, agreements. The trend toward ‘networked’ or cross-agency approaches is one that is likely to continue as agencies take advantage of the opportunities offered by more responsive service delivery mechanisms.

It is important for the ANAO to ensure that arrangements are clearly articulated, including:

- ❑ the objectives of the arrangement, including desired outcomes, and timeframes for achievement;
- ❑ the roles and responsibilities of the parties involved, including their capacity to contribute, and accountability of positions on governing boards or committees;
- ❑ the details of the activity, including specifications of services or projects to be undertaken and performance targets and measures to be met;
- ❑ resources to be applied by the parties and related budgetary issues;
- ❑ the approach to identifying and sharing the risks and opportunities involved;
- ❑ agreed modes of review and evaluation; and
- ❑ agreed dispute resolution arrangements.

An example of the need for cross-agency governance arrangements was highlighted in the ANAO performance audit of the Federation Fund Programme.³⁴ That audit found that no Australian Government department had the responsibility for monitoring the collective performance of Federation Fund projects against the programme’s objectives. Consequently, up to the time of the audit, very little performance information on the achievement of the programme’s overall objectives had been collected or reported to the Parliament. The audit noted that, where more than one portfolio is responsible for delivering the Government’s programme objectives, the concept of whole-of-government performance reporting through, for example, the identification of a ‘lead agency’ is an area of potential improvement in Australian Government reporting and accountability.

In some instances, the concept of ‘one-stop shops’ has been extended beyond the Australian Government to include other levels of government and the community sector. For example, the Natural Heritage Trust (NHT) was founded on a one-stop shop approach involving State/Territory agencies, local government and non-government bodies. The ANAO examined some of the challenges of this approach in its audit of the NHT, a two billion dollar program administered jointly by two Australian Government departments and involving State/Territory agencies, local government, non-government organisations and community groups in program delivery.³⁵

As public sector services change, and new ways of delivering services are introduced, the ANAO’s auditing methodologies and practices will need to adapt for example, to provide continuous reporting and greater focus on risk management strategies adopted by agencies, as well as accountability and performance structures and measures across the organisations involved.

In cases where both State and Australian governments are responsible for the delivery of service through ‘joined-up’ government arrangements, Australian/State government Auditors-General may need to consider taking some form of joint responsibility for providing assurance to the various legislatures.

Information management

Access to information

Agency accountability to the Parliament and the public

Public access to reliable information is necessary for government accountability. Such access is supported in each Australian jurisdiction by ‘Freedom of Information’ (FOI) legislation. A separate, but related issue, is the accountability of governments and agencies to the Parliament. In all circumstances, agencies remain responsible for ensuring that the government’s objectives are delivered in a cost-effective manner. In part, this is what is regarded as being ‘responsive’.

However, as a result of increased private sector involvement, through contractual arrangements, in activities traditionally undertaken by the public sector, it is arguable that the flow of public information available to assess performance and satisfy accountability requirements has, on the whole, been reduced. This situation has arisen where performance data is held exclusively by the private sector or through claims of commercial confidentiality that seek to limit or exclude data in agency hands from wider public or parliamentary scrutiny.

Commercial confidentiality

The issue of commercial-in-confidence has been the subject of considerable parliamentary debate and comment in many constituencies. With the greater involvement of the private sector, concerns have been expressed about commercial considerations, particularly in maintaining competitive advantage. FOI legislation provides for documents to be exempt from disclosure where they would reveal, inter alia, trade secrets and other information having a commercial value that would be, or could reasonably be expected to be, destroyed or diminished if the information were disclosed.³⁶

Equally, however, concerns have also been expressed about the extent to which commercial interests have been protected at the expense of eroding transparency and accountability.

One of the difficulties in addressing commercial confidentiality issues is that of precisely defining just what is being covered. While there is a broad understanding of the kinds of information contractors might regard as commercially confidential, the question remains how to ensure adequate accountability for the use of public funds while accommodating any justifiable ‘confidentiality’ concerns.

Ability to report information

Reflecting the increasing involvement of private sector entities in public sector activities, performance audits undertaken by ANAO have increasingly involved the commercial and reputation interests of a number of private sector parties, as well as individuals. This has increased the complexity of undertaking such audits.

A number of issues have arisen in recent audits that impact on the manner in which the ANAO presents its findings in its reports, including:

- procedural fairness and natural justice issues;

- ❑ copyright claims on comments provided on draft audit reports which sought to restrict the capacity of the ANAO to reflect those comments in the final audit report; and
- ❑ legal issues of defamation which have also arisen on a number of occasions and which can result in the use of language that may be counter to the ANAO's goal of straightforward and simple explanations in its reports.

One important element supporting the Auditor-General's ability to report without fear or favour, is the application of Parliamentary privilege to performance and financial statement audit reports tabled in the Parliament. This privilege can operate to protect the Auditor-General and ANAO staff from being held liable for statements contained in audit reports. This, in turn, allows the Auditor-General to report freely, openly and responsibly on matters examined in the course of audits. Recently, however, there has been some concern as to whether draft reports and working papers leading to official public reports are similarly covered by Parliamentary privilege.

Legal advice to the ANAO suggests that, until a court decides to the contrary, it is proper for the Auditor-General to proceed on the basis that Parliamentary privilege does apply to draft reports and working papers. The JCPAA accepted this approach. However, the JCPAA considered that the Privileges Committees of both the Senate and the House of Representatives should examine this complex issue to provide greater clarity.

While the ANAO is sensitive to private sector concerns about commercial reputations, the Parliament expects full public accountability, particularly on issues of fair and ethical conduct and protection of the public interest. Conflicts of private and public interest are not new but their resolution in performance audit reports is a challenge for all parties without a genuine shared understanding of what constitutes public accountability. In my view, this is a matter of obtaining clear guidance from the Government and Parliament in a changing public sector environment so that the various parties can exercise 'informed judgement'.

Records Management

Records are an indispensable element of transparency, and thus of accountability, both within the organisation and externally. Records are consulted as proof of activity by senior managers, auditors, members of the public or by anyone inquiring into a decision, a process or the actions and/or performance of an organisation or of an individual. As such, effective records management is important for sound administrative process as well as contributing to required outcomes or results. With the move to greater outsourcing to the private sector, there is increasing concern about the public sector's ability to preserve those records that are needed to support, and report on, the delivery of programs and services, and to meet their accountability, as well as archival, obligations.

In this connexion, higher standards of accountability are expected in the public sector than is usual in the private sector. Recognising this, Parliament has passed legislation relevant to records management that applies to all Australian Government agencies, such as the *Archives Act 1983*, the *Freedom of Information (FOI) Act 1982* and the *Privacy Act 1988*. These Acts deal with the overarching issues of maintenance, archiving and destruction of records, access to records by the public, and confidentiality of records. Also of relevance, particularly from a management viewpoint, are the related obligations under the *Public Service Act 1999*, the *Financial*

Management and Accountability (FMA) Act 1997 and the Commonwealth Authorities and Companies (CAC) Act 1997.

The FMA Act requires that Chief Executives manage the affairs of their agencies in a way that promotes proper use (that is, efficient, effective and ethical use) of the Commonwealth resources for which the Chief Executive is responsible. A Chief Executive must ensure that the accounts and records of the agency are kept as required by the Finance Minister's Orders. Record-keeping is also covered by the CAC Act, which requires a Commonwealth authority to keep accounting records that properly record and explain its transactions and financial position. These records have to be kept in a manner that enables the preparation of financial statements which, in turn, allows those statements to be audited appropriately and effectively.

In addition to legislative requirements, there are several other significant reasons for emphasising the importance of record-keeping in the public sector. Up-to-date, accessible, relevant and accurate records can ensure that decisions made by an agency are consistent and based on accurate information; are cost-effective; engender a sense of ownership of decisions throughout the agency; and place the agency in a considerably better position to justify to the Parliament and to the public any decisions made. I again stress that it is often not just outputs and outcomes that are of concern to the Parliament and the public, but also the *processes* of decision-making and the *reasons* for decisions. Such transparency is achieved by ensuring that the decision-making process, and the reasons for decisions, are adequately documented by agencies. This is also essential to facilitate the management task.

Transparency, through record-keeping, is an agency's first line of defence against accusations of bias, unfair treatment and other negative public perceptions. It also promotes confidence in the integrity of the APS and provides assurance to stakeholders that the APS is making decisions in the 'public interest', particularly where procurement is concerned, as well as meeting any requirements for fairness, equity, privacy and freedom of information.

Countering the loss of corporate knowledge is another area that can be greatly assisted by a sound record-keeping culture. Corporate knowledge is largely the wealth of information and experience that is stored on paper, electronically or mentally by the individuals concerned. Of course, it is accepted that such knowledge is only useful when something is actually done with it.

Loss of corporate knowledge has been a significant issue for the public sector in recent years where, due to the trend towards high turnover and increasing mobility of staff, in part the result of outsourcing activity and privatisation of public sector organisations and activities, there has been an enormous drain on the retained knowledge of the APS through the departure of many experienced individuals. The creation and maintenance of suitable records can alleviate this problem to some extent, particularly in relation to decision-making, as part of a robust knowledge management system. However, it requires considerable personal and organisational discipline.

Apart from mitigating the loss of corporate knowledge, record-keeping can assist the internal functioning of agencies by improving performance. Records of performance information are important in allowing an agency to monitor its performance and benchmark itself against other organisations, to ensure that performance is at optimum level. As well, fraud is less likely in a sound record-keeping environment that supports timely and accurate recording of data, with sufficient separation of duties and constant monitoring and review.

There is general acceptance that there is a cost associated with good record-keeping. In the main, the investment in record-keeping is a risk management judgement that should be made on the basis of a systematic risk assessment with sound identification and prioritisation of both internal and external risks. This involves careful examination of what outcomes are really being required and, therefore, what record-keeping practices are necessary to achieve those outcomes. Any approach should also meet legislative requirements for record-keeping. In short, records should be fit for their purpose. This is particularly important in any outsourcing situation where such records are being wholly or partially maintained by the private sector.

The increasing trend towards electronic communication and record-keeping techniques poses significant challenges in terms of auditors' traditional evidentiary standards. The ANAO is already confronting situations in which traditional forms of documentary evidence are not available. For example, in a recent performance audit of the Health Group IT outsourcing tender process, ANAO's capacity to examine the management of the probity aspects of that tender was limited by deficiencies in the contemporaneous records made.³⁷ In a number of areas, the recollection of individuals was the *only means* of establishing important elements of the sequence of events.³⁸

Transacting business in the electronic environment, whether acting as an individual agency, in partnership with the private sector, or other government agencies, also raises the issue of appropriate record-keeping, and particularly the provision and maintenance of electronic records. The use of email in decision-making is often not supported by record-keeping protocols able to withstand independent scrutiny, despite adequate guidance being provided by National Archives.

The Impact of Technology

Information (including communications) technology is revolutionising the way the public sector operates. It has improved the ability of public organisations to communicate, to share critical information, and to organise political and public service processes in a more efficient and effective way. Effective management of information assets is becoming a significant element of the growing proportion of government Intellectual Property, which has to be protected and preserved.³⁹

Information technology has also enhanced productivity by providing new, more responsive and efficient ways of delivering public services and providing information to citizens. It provides a potentially useful vehicle to deliver better quality products to the public more quickly, cost effectively and conveniently. The result could be programs designed primarily around the needs of the community, rather than just largely reflecting the organisational structure of the public sector. This is likely to require the redesign of current governance systems both within, and across, agencies.

Advances in technology have offered new opportunities to harness the benefits of convergence and alliance-making both between, and across, public and private organisations. As noted earlier, the UK's 'joined up' government strategy recognises that planning for improved electronic service delivery offers the opportunity to break down departmental boundaries and alter the 'silo-based' delivery modes traditionally associated with government departments and agencies acting independently.

In Australia, the e-government strategy—'Government Online'—has similar aims. The program is administered by the National Office for the Information Economy (NOIE) and recognises that:

Getting Government Online is a natural and important step in the development of government and community interaction The

*Government must develop more and better services online—integrated services that break down the barriers of government structure and jurisdiction, and services that meet the real needs of individuals and businesses.*⁴⁰

The delivery of services via the Internet also introduces new risks and exposures that can result in a legal liability for government. Well-designed security and privacy policies can minimise such risks and liabilities, while informing agencies' clients of important aspects of the standard of service they can expect to receive. The benefits associated with a radical re-thinking of the structures and manner in which government services are delivered could be considerable. The important message is that there are commensurate risks with the adoption of new technologies, and the resulting reconfiguration of administrative structures and approaches, that have to be managed well within a robust control environment which is central to sound corporate governance.

Rapid advances in technology offer both opportunities and challenges in the converging business environment. A number of these challenges relate to vulnerabilities resulting from the connectivity and interdependence made possible through information technology. The proliferation of computer viruses and hackers seeking to manipulate critical computer systems poses serious risks to government agencies, and in the private domain. The threat will only grow in the future. Such issues also raise questions about adequate business continuity arrangements, particularly in light of the security environment following the September 11 disaster in New York and the recent terrorist attacks in Spain. Unless appropriately controlled, computerised operations can also offer numerous opportunities for committing fraud, unauthorised tampering with data and/or disrupting vital operations leading to disruption of, and ineffective, service delivery.

The risks involved also raise issues associated with the privacy and confidentiality of records which, as noted, are of considerable concern to the Parliament. In addition, there are accountability issues for agencies, and consequent evidentiary issues for their auditors, when traditional forms of record-keeping are overtaken by the outputs of new technology, as discussed previously.

As dependence on information technology grows and new high risk areas emerge, public sector agencies need to adopt modern practices to correct underlying management problems that impede effective system development and operations even where these are outsourced. Effectively managing these risks will, in many cases, have a major impact on achieving business objectives. Robust corporate governance processes that are pervasive throughout an organisation will both help to identify and deal with such problems. This is an area where the public sector needs to be particularly pro-active and strategic in its approach.

Public sector governance

Sector convergence, and other external trends, including the impact of new technologies, have added a new level of complexity to traditional accountability frameworks. This has reinforced the importance of implementing robust and responsive corporate governance approaches.

While the achievement of value for money outcomes is well established as a public sector priority, the opportunities offered by new service delivery arrangements, and more flexible funding initiatives, including the use of private financing, produce additional challenges for accountability and, consequently, for governance. In recent

years there has been an emergence of tailored administrative approaches defined, and largely determined, by individual agency CEOs. This would have been expected from the devolution of authority from the central agencies as a key element of public sector reform. While individual approaches may be an appropriate response to the changing business environment, the ANAO is committed to ensuring that, whatever strategies or approaches are adopted, agencies are giving effect to the Parliament's intentions while managing their identified risks in an appropriate and responsible manner.

Recent corporate collapses, both here and overseas, have led to the governance, including audit, environment being reconfigured for both the public and the private sectors. The ANAO is adjusting its own approach at the same time as it is responding to agencies' needs for greater guidance in an increasingly complex environment. The ANAO's approach is built on key governance principles, outlined later in this part of the Paper. The ANAO adheres to these principles as it aims to determine the 'right mix' of audit products to provide adequate assurance and improve administration, which also assists it to provide guidance to agencies in dealing with their own challenges.

Fundamentally, good governance arrangements are essential for an organisation to be able to demonstrate to stakeholders that it can be trusted to do what it is established to do. Such arrangements assist stakeholders to have confidence that APS organisations not only have the competence and expertise required, but that they have also established robust administrative arrangements that enable them to do so efficiently, effectively and ethically.

Good governance generally focuses on two main requirements of organisations:

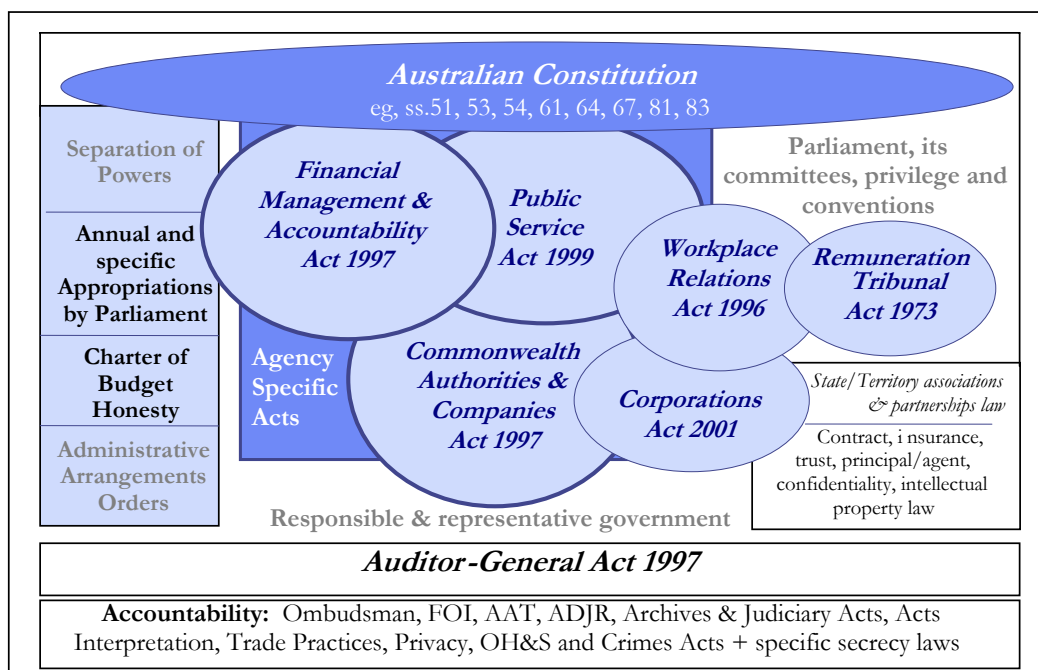
- ❑ **performance**, whereby the organisation uses its governance arrangements to contribute to its overall performance and the delivery of its goods, services or programs; and
- ❑ **conformance**, whereby the organisation uses its governance arrangements to ensure it meets the requirements of the law, regulations, published standards and community expectations of probity, accountability and openness.

Organisations need to achieve both sets of objectives, and not simply attempt to trade one off against the other. Using an integrated risk management framework will help develop an effective control environment and provide reasonable assurance that the organisation will achieve both objectives, within an acceptable degree of risk, both insurable and non-insurable. That is not to say that those who govern may not give more of an emphasis to one requirement over another at particular points in time.

Legal and policy framework

The Commonwealth public sector has an extensive legal and regulative framework that organisations must comply with (see Figure 1), and a great many government policies that they must conform to and implement.

Figure 1: Legal elements affecting governance in the Commonwealth



Source: Department of Finance & Administration.

The major classes of organisation, and their major relevant legislation, are:

- ❑ Departments of State—these are part of the Crown and all subject to the FMA Act and the *Public Service Act 1999* (PS Act);
- ❑ Statutory Agencies—these are established by an enabling Act, are subject to the PS Act and may or may not be subject to the FMA Act;
- ❑ Commonwealth Authorities—these are established by an enabling Act, are subject to the CAC Act and may also be subject to the PS Act;
- ❑ Commonwealth companies—are subject to the *Corporations Act 2001* but generally not subject to the PS Act; and
- ❑ Government Business Enterprises (GBEs)—these are generally established under the *Corporations Act 2001* and are subject to the CAC Act.

These organisations, generally, must also comply with the other Acts outlined in Figure 1. Furthermore, all laws and actions of the Commonwealth must be in accord with the relevant provisions of the Constitution.

In addition to such legislation, Australian Government entities are subject to a variety of regulations and policies impacting on governance, such as the budget outcomes and outputs reporting regime, the growing emphasis on risk management, and the need for effective coordination of ‘whole-of-government’ and inter-agency issues, as previously discussed.

Principles of public sector governance

There is increasing evidence that behaviours consistent with good governance sustain improvements in organisational performance.⁴³ This requires the application of

effective governance principles by management and staff within each organisation to implement the designated governance frameworks, controls and guidelines.

The ANAO, in its recently released BPG⁴⁴, used the group of principles first articulated by the Nolan Committee of the UK in 1995.⁴⁶ They are:

- ❑ **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.

The application of these principles, within an appropriate public sector governance framework tailored to the characteristics of each entity, will assist public sector entities to conform with all relevant legislation and policies, and moreover, perform strongly against their specified objectives and required results.

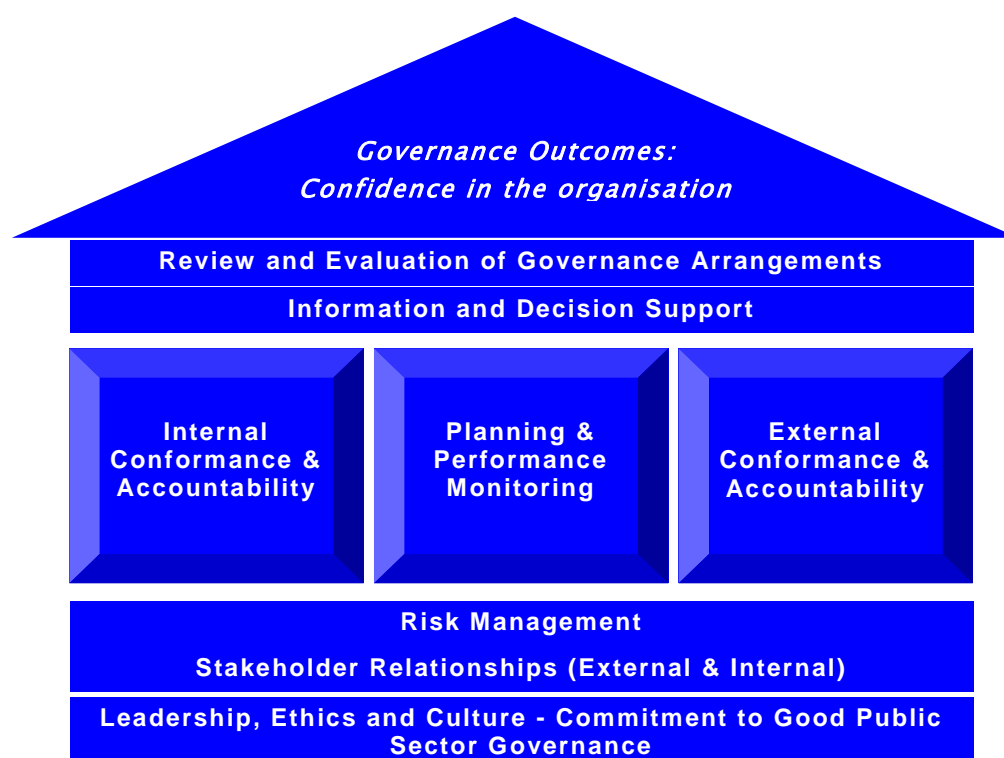
Public sector governance framework, processes and practices

The legislative requirements outlined in Figure 1, together with requirements for high organisational performance, demand that public sector entities' establish and operate an extensive, but integrated system of governance.

To illustrate the key, generally accepted, organisational and process elements of good public sector governance, the ANAO's BPG adapted a model developed by the Queensland Department of Transport—'The House of Governance' (Figure 2). This is a broad-based model that recognises the elements of good public sector governance need to be applied within government frameworks that may differ considerably according to the size, complexity, structure and legislative background of the organisations concerned.

The model emphasises the progression from the foundation of leadership, ethical conduct and a culture that is committed to achieving good public sector governance, through good stakeholder management and development of a risk management culture, to the performance and conformance windows. On top of that, information and decision support, and review and evaluation of governance arrangements, impact heavily on the ability of the public sector organisation to achieve desired governance outcomes—relating to both conformance and performance.

Figure 2: The House of Public Sector Governance



Source: ANAO, *Better Practice Guide on Public Sector Governance*. Adapted from a model developed by the Queensland Department of Transport in its *Corporate Governance Framework for Queensland Transport and Main Roads: Final Report*, July 2001.

However, what many agencies seem to lack is a credible way to integrate those elements into a unified, mutually reinforcing complete structure. This involves a consistent, strategic approach to governance so that good governance practice is successfully integrated with, and supports, the way Australian Government entities do business.⁴⁷ Good governance should not only be found at the corporate level, it should also be apparent to all staff and evident in their behaviour and attitudes in the workplace at all levels of the organisation.

Recent initiatives to improve governance in both the public and private sectors

In response to the corporate governance failures in recent major corporate collapses, a number of high-profile efforts to improve corporate governance in Australia occurred in 2003. These included the Australian Stock Exchange (ASX) Corporate Governance Council's *Principles of Good Corporate Governance* released in March 2003⁴⁸, the HIH Royal Commission report in May 2003 and Standards Australia release of a new standard—AS 8000-2003 on *Good Governance Principles*⁴⁹ in July 2003. The Senate passed two bills to amend the *Corporations Act 2001*. The *Corporate Law Economic Reform Program (Audit Reform & Corporate Disclosure) Bill 2003*⁵⁰ was introduced into Parliament on 4 December 2003 and John Uhrig completed his review into corporate governance of statutory and office holders.⁵¹ Also, as noted earlier, the ANAO published its BPG on 'Public Sector Governance' in July 2003.

Overseas, there has been the recent release (12 January 2004) of the *Review of the OECD Principles of Corporate Governance—Invitation to Comment* and the OECD's *Survey of Corporate Governance Developments in OECD Countries* (9 December

2003) as part of an assessment of OECD Principles of Corporate Governance requested by Ministers in 2002. With the increased questioning of, and emphasis on, good corporate behaviour and performance, we are likely to see a continuance of such interest both nationally and internationally.

5. Particular Challenges Being Addressed by ANAO

The ANAO looks to be proactive in providing on-going advice and support to agencies in establishing and maintaining a sound corporate governance framework. A significant challenge for the ANAO is ensuring the Australian Government's interests are protected and accountability is maintained for the expenditure of public funds in an environment where significant aspects of the delivery of public sector outcomes involve complex, long-term arrangements with the private sector. The Parliament looks to the ANAO for assurance that the APS is working well and to contribute to ongoing improvement in the APS.

There is an inevitable element of repetition between this and the preceding part of the Paper as many of the challenges being addressed by the ANAO arise out of the issues impacting on performance audits. While an effort has been made to minimise any repetition, some is necessary for completeness and understanding of the challenges. As well, it is always a problem when identifying particular areas of interest as, inevitably, people think of others that are of on-going significance such as fraud, security and human resource, or people, oriented management issues. In a number of ways, those are covered by the particular challenges discussed.

Improving public sector governance

The ANAO has long recognised that governance practices often strongly influence the performance and accountability of APS agencies. The ANAO is in a key position to add value to the APS through the dissemination of better practices as part of its audit program. Specifically, the ANAO has provided a series of BPGs on public sector governance.

The first such guide was released in 1997 and promoted governance principles and better practices in budget-funded agencies.⁵² A complementary guide was released in 1999, examining governance in Commonwealth authorities and companies.⁵³ The third and latest guide⁵⁴ was released on 25 July 2003. It discusses better practice governance for all types of APS organisations.

The new guide is different in nature to the previous two, which were structured to address specific purposes. The first guide dealt with the application of governance in public sector agencies and, in particular, made the case for the establishment of executive boards for agencies. It predated the FMA Act and the CAC Act. The ANAO issued the second guide as a discussion paper in 1999, which was designed to assist members of the boards and senior managers of CAC Act bodies to evaluate their governance frameworks and make them more effective.

With the publication of the third, and current, guide the scope has widened again. In essence, it provides more practical guidance. While the latest guide incorporates recent legislative changes and reflects current concerns, the previous two guides remain useful, as the practices and principles they endorse continue to provide the foundations of better practice public sector governance.

The ANAO has produced these guides on public sector governance to provide some clarity for organisations that may be audited, but also because there have been few alternative sources of better practice information on governance focussed on the

public sector. While there has been quite a rapid increase in documented guidance on 'corporate governance', especially by professional bodies, such as the Australian Institute of Company Directors and the Institute of Chartered Secretaries (Australia), and by legal firms, these remain mainly directed towards private sector needs and requirements.

The ANAO is participating in an Australian Research Council linkage grants project with the University of Canberra and other organisations, to examine governance on a multi-disciplinary basis, with the aim of producing an integrated cross-government governance framework. The ANAO will continue to provide guidance on public sector governance in the future on major emerging governance issues.

Auditing public sector governance

In addition to its work in promoting better practice public sector governance through the production of BPGs, the ANAO also conducts performance audits focusing on a wide range of governance issues. The better practice principles established in the ANAO's guides have provided the foundation for these audits. In turn, the audits contribute to the ANAO's knowledge bank that is used to inform the ongoing development of its better practice series and discussion with other interested organisations, such as the professional accounting bodies.

Most recently, the ANAO has completed an audit that focused on the governance arrangements of the National Health and Medical Research Council (Council).⁵⁵ The audit involved a review of a range of issues, including: administrative arrangements; accountability structures; legislative obligations; planning, monitoring and reporting of performance; and administrative systems. The audit concluded that the legislative framework and resulting administrative arrangements under which the Council operates did not facilitate sound administration. In addition, the audit found that the framework necessitated administrative arrangements that were cumbersome and included multiple lines of accountability, as well as unclear roles and responsibilities. The ANAO also acknowledged the complexity of the Council's operating environment and the efforts of the Council over recent years to improve its governance arrangements. The audit made six recommendations, all of which were agreed, some in principle.

The ANAO has also conducted governance audits of the Australian Electoral Commission⁵⁶ and the Australian Broadcasting Commission.⁵⁷ Both audits identified areas for improvement in the agencies' governance frameworks, with a number of recommendations aimed at strengthening these frameworks.

Financing arrangements

A particular risk for auditors in the changing environment with increased involvement of the private sector in the delivery of public sector services, is the considerably increased complexity of financial arrangements involving the private sector. The ANAO must ensure it is in a position to fully understand the transactions being undertaken by agencies in order to review the arrangements on a value for money basis, and to assess the appropriate accounting for the transaction taking account of risk attribution that is planned and/or likely to result.

The ANAO's approach to the conduct of audits involving private sector participation is to focus on the essential management principles that should always underpin efficient and effective management in the public sector legislative framework for financial accountability. Regardless of the method of procurement, the consideration of value for money, performance measurement and effectiveness of outcomes remain

the focus of audit activity. The procurement process should provide a transparent assessment of value for money including a comparison of the selected arrangement against other possible approaches and/or providers, and consideration of the capabilities, commercial viability and proposed risk allocation in relation to those involved.

Effective resourcing of performance audits reviewing financing arrangements with the private sector requires the involvement of experienced performance auditors who understand both the commercial nature of the transactions and public accountability requirements of the public service. Where required, the ANAO engages appropriately qualified professionals to provide specific technical advice, outside the expertise of ANAO officers, for such audits.

Private financing

Private sector investment in public sector areas such as infrastructure, property, defence and information technology is increasingly encouraged. Private sector financing has been explored in a number of countries in response to fiscal pressures, where it is often hard to find dedicated funding for large projects out of annual budgets.

The UK has made considerable use of private financing in the delivery of public services. The National Audit Office (NAO) has published twenty-four reports on Private Financing Initiative (PFI) projects. The key lessons learned from those audits, in terms of value for money, are that:

- ❑ the price must be in line with that prevailing in the market;
- ❑ the contract must provide a suitable framework for delivering the service or goods specified; and
- ❑ the cost of the privately financed option (taking into account risk) should be no more than that of a publicly funded alternative.

The experience in the UK has been that, while authorities have high expectations at the outset of PFI projects for their success in delivering value for money in public services, the achievement of that value for money is not guaranteed. A 2001 report by the NAO highlighted this issue, noting that:

Authorities need to ensure that the value for money anticipated at the time of contract letting is delivered in practice. To do so requires careful project management and a close attention to managing the relationship with contractors. Authorities also need to consult with users about their level of satisfaction with the services being provided.⁵⁸

In Australia, most private sector financing has occurred at the State Government level. In particular, Victoria and New South Wales (NSW) have used private financing arrangements for road and associated infrastructure projects. State audit offices have noted difficulties in establishing clear financial benefits from the private financing approach. While at the national level there has been increasing interest in PFIs, to date there has been limited actual use of such arrangements with the private sector. Finance has established a specialist Private Financing Unit to assist agencies in determining appropriate projects for such treatment.

The Department of Defence (Defence) is committed to examining the merits of using private financing in the delivery of Defence services, including capital equipment, facilities, logistical support and IT programs.⁵⁹

The benefit of private sector financing lies potentially in cost savings and/or the transfer (or allocation) of risk. However, the evaluation of the costs and benefits of private financing are not straightforward. In part, this is because the government can usually borrow funds at a lower rate than most private organisations. Also, while the private sector is generally considered to be better placed to manage the particular risks involved, there is always the concern that risk will ultimately remain with the public sector. The ANAO is mindful that agencies are not able to transfer accountability to a private sector entity, irrespective of the procurement method used.

Private sector financing poses significant challenges in terms of accountability. Of particular interest to the ANAO in reviewing such arrangements will be the cost/benefit evaluation, the basis used for risk allocation, and right of access to information held by the private sector. The net benefits may involve intangible benefits that may not be easily verified by audit. The risks need to be managed in a transparent way that enables full disclosure of the probity arrangements in place. Public accountability and transparency issues for such arrangements arise from the risk transfer or allocation between the two sectors, particularly where they involve ownership of public assets and very long-term service delivery contracts.⁶⁰ The potential liabilities accruing to the Government can be substantial and issues of corporate governance surrounding such arrangements will be the subject of future ANAO audit interest.

The Commonwealth Policy Principles for the use of private financing identify the analysis and treatment of risk as being critical to the value for money determination.⁶¹ The greater the risk carried by the public sector agency, the less likely that value for money will be provided by the use of private financing as opposed to traditional direct procurement. The Principles identify transparency and accountability, together with value for money, as the three core principles for assessing whether private financing should be the preferred procurement method.

As noted earlier, in Australia most private financing initiatives have occurred at the State Government level. However, ANAO has observed lessons learnt from the increasing involvement at the Federal level of the private sector in services traditionally delivered by the public sector that can be expected to also have considerable relevance to the implementation of private financing arrangements. The ANAO will also draw on material produced by the UK NAO in any audit it performs of such arrangements.

Executing a private financing arrangement is generally a major project, typically involving substantial use of financial, legal and other private sector advisers. This is similar to the experience with the privatisation process in Australia. Considerable emphasis needs to be placed on contract management and balancing commercial interests with the overlaying public accountability required of the public service. The use of advisers needs to be effectively managed by agencies in order to ensure there is appropriate accountability for their selection, performance and payment. One of the key outcomes from the ANAO's privatisation audits has been the identification of opportunities for significant improvement to the process of tendering and managing these advisory contracts, the adoption of which has led to improved overall value for money and project management quality in subsequent sales. The emphasis has been

on identifying better practice to add value to public administration as a major audit objective.

Leasing

Finance leases are incompatible with the Australian Government's desire to reduce debt levels, and will not generally reflect the preferred risk allocation basis the Government is aiming to achieve through involving private sector participation in public infrastructure. Agencies, therefore, look to structuring lease arrangements with the private sector to conform to the requirements of an operating lease. Under an operating lease, annual lease payments are recognised as an expense.

A focus of ANAO interest in audits of long-term lease arrangements entered into between the public and private sectors, has been the classification of those leases and the treatment of the transaction in the agencies accounts. Following the Australian Accounting Standard on Leases (AAS 17), ANAO review involves identifying the economic substance of the lease, namely the allocation of risks under the terms and conditions of the lease, and performing the presumptive tests prescribed in AAS17. The ANAO considers the risks presented by the leases from a 'whole-of-government' perspective over the term of the lease.

Following a performance audit of the outsourcing of information technology infrastructure in the Australian Taxation Office (ATO),⁶² the financial statements of the ATO were qualified by the ANAO. The ANAO considered that a number of substantial ownership risks, including residual value risk on early termination or expiry of the lease, had passed to the ATO requiring that the lease be classified as a finance lease as opposed to the ATO's classification as an operating lease. Classification issues have also arisen in the review of Australian Government properties sold with long-term leaseback arrangements to the Government.

Contractual arrangements

Accountability requirements and the need to achieve cost-effective outcomes through contractual arrangements with the private sector can be facilitated by:

- ❑ emphasising project and contract management skills for public sector managers;
- ❑ basing commercial relationships on sound tendering and administrative processes and an enforceable contract; and
- ❑ ensuring that public accountability is not eroded through contracting-out that reduces external scrutiny by the Parliament or the ANAO.

While it is premature to discuss the details of the likely impact of the Government Procurement chapter of the recently concluded negotiations on a free trade agreement with the United States, its implementation may well have considerable implications for the interface between business and government. Public tendering would be the normal mode of procurement with very strict controls on the use of selective tendering or other restricted procurement strategies. Importantly, unsuccessful tenderers would have a right to judicial review of procurement decisions in the Courts. A recent Coors Chambers Westgarth briefing note suggested that there would be 'process prescriptions far more extensive and onerous than have applied in the Commonwealth for over 20 years'.⁶³ The note also suggested that there would be a substantial expansion in the scope for legal challenge to government procurement decisions.

The ANAO has a significant role in ensuring that public accountability is not eroded, by default, through contractual arrangements with the private sector. While public

sector agencies must ensure that they have a sound understanding of the commercial nature of any contract, private sector entities entering into commercial relationships with the Australian Government should also recognise that there are overlaying public accountability issues that need to be addressed.

A particular issue requiring increased attention as the public sector becomes more 'privatised' is contract management. Successful management of the contract is contingent on both a sound contractual base and an effective working relationship. In recent years, the ANAO has considered, and reported on, a range of contract management experiences, some of which have been positive, but others less so, generally reflecting the variability in commercial experience and skills in the public service.⁶⁴ The audits conducted by the ANAO have clearly highlighted that, fundamental to the successful delivery of services through a contract with the private sector, is the establishment of contractual terms reflecting a mutual understanding of all parties to the contract and a common understanding of required standards of service. It is important that the private sector participants also understand the public sector environment, particularly how the governance arrangements operate.

Contract terms and conditions

ANAO audits of contract management have flagged the need for care in negotiating, drafting, and amending major contracts. The ANAO has observed that clear identification and articulation of contract requirements at the outset can save considerable time, cost and effort later in contract management.

The ANAO's audits have also clearly illustrated the value of contracts that reflect the understanding of all parties to the contract, and which constitute the entire agreement between the parties. Otherwise, the documentary trail supporting the authority for the payment of Commonwealth money, contractual performance requirements, and incentives and sanctions may not be apparent, leading to a degree of uncertainty. Not surprisingly, this is a matter of concern to the Parliament, which has been very supportive of initiatives being taken to improve records management.

Values and ethics are a very important part of Australian Government administration. The FMA Act requires Chief Executive Officers to promote the efficient, effective and ethical use of Commonwealth resources for which the Chief Executives are responsible. The PS Act sets out values and the APS Code of Conduct for Commonwealth employees. However, in contractual arrangements, it is often very difficult to enforce conditions relating to values and ethics on private service providers. Interestingly, some Australian Government contracts are now including clauses that seek to apply the relevant sections of the PS Act to private sector employees. There needs to be a shared understanding of what is acceptable behaviour in a public sector context and appropriate corporate governance arrangements to provide confidence that the former will be achieved.

The challenge of contract management is to maintain accountability and transparency throughout the process, and to achieve cost efficiencies and value for money outcomes. Contracts should protect the interests of the Australian Government and foster a partnership between the public and private sectors. However, the boundaries have to be clear to ensure that a request for a service or product does not result in either, or both, of the parties simply resorting to the contract to settle differences, particularly in relation to attitudinal and behavioural issues.

Agency contracting expertise

A common theme in reports examining contractual arrangements and procurement issues relates to the deficiency of project and contract management skills amongst agency decision-makers. This is a significant concern given that some such projects involve substantial resources and inherent complexities. One problem has been the lack of commercial, negotiation and risk management skills in the public sector but, equally, there has been a problem in ensuring that the private sector at least understands the public sector environment and its attendant demands, as noted above.

It is essential that agencies ensure their staff have the capability and capacities to manage contracts effectively if they are to achieve the results required. It is not just commercial skills in relation to contracting that are important. There is still a high premium on knowledge and understanding of the functions/business that are being managed. Put simply, an agency has to be in a position to know what it wants from the contract, what it is actually getting under the contract, and whether the contract is meeting the business needs of the agency. If the contract is not delivering required results, the success of the agency, and its very reason for being, are put at risk.

ANAO reports in this area have flagged a need for care at all stages of the contract management process and, in particular, in relation to assessing value for money. Agencies need to have the skills to make a credible value for money assessment of services provided by the private sector.

Contract Management

Contract management covers the whole process from the initial release of tenders through to ongoing contract performance monitoring and review, including any transition arrangements. It is crucial that the process of awarding contracts ensures open and effective competition, as well as achieving value for money outcomes. The processes involved must be adequately documented, to ensure that the selection of particular contractors is able to meet parliamentary, and other, scrutiny.

Competent contract management is a key means of control over outputs and their contribution to outcomes. In this context, public sector managers and auditors need to be aware of the risks that might arise from contract management arrangements with private sector participants. In many cases, this will require close involvement and open exchanges with those participants to identify clearly those risks and their treatment, including a decision as to who is actually responsible for dealing with them.

To improve contract management in the Australian Public Service, the ANAO issued a *Better Practice Guide on Contract Management*, which has received international recognition and is being used by a number of audit offices overseas. The guide emphasises the importance of dealing with risk in contracts. It also emphasises the need to develop and maintain a relationship with the contractor that supports the objectives of both parties and focuses on the agreed results to be achieved, while not ignoring the requirements for parliamentary accountability. For accountability measures to be effective, it is critical that agencies closely examine the nature and level of information to be supplied under the contract and have the authority to access contractors' records and premises, as necessary, to monitor adequately the performance of the contract.

The ability of Defence to manage major acquisition projects to meet major capability requirements on time, and within budget, has been the focus of ANAO and JCPAA

consideration for some time. Defence spends some \$3 billion a year progressing more than 250 major projects that have an approved value of some \$50 billion. Defence expects to spend \$2.4 billion in 2003-2004 on its top 20 projects, which have an approved value of \$22 billion.

The Senate has requested that the Auditor-General produce an annual report to the Parliament on progress made in major Defence projects, including analysis of performance and emerging trends, to enable the Parliament to have high visibility of all current and pending major projects. The annual report sought would be expected to detail cost, time and technical performance for each project, and is similar to that produced by the NAO on the UK Defence's top acquisition projects. The request resulted from the Senate's consideration of recommendations of a Senate Committee report on materiel acquisition and management in Defence.⁶⁵ The report would address Parliament's need for firm information about progress on Defence's major projects. Past ANAO reports have drawn attention to Defence's inadequate reporting on projects in its annual reports. The ANAO is currently seeking additional funding to resource this new annual audit review activity.

Contract Performance

Although the public sector may contract out service delivery, this does not equate to contracting out the entire responsibility for the delivery of the service or program. It is each agency's responsibility to ensure that the government's objectives are delivered in a cost-effective manner. Agencies need to ensure that qualitative and quantitative performance standards are clearly specified in the contract, including appropriate arrangements for monitoring and reviewing contractors' performance.

Contracts must clearly specify contract deliverables and the level of service required under the contract. The contract should clearly define respective responsibilities of the parties and set out the mechanisms for monitoring performance, incentives and penalties. Agencies should ensure that contract performance standards are in line with their broader service delivery responsibilities, including undertakings set out in Client Service Charters or other corporate documents. Agencies should also ensure that information systems have been put in place to generate the necessary information to allow performance under the contract to be assessed.

There should not be any equivocation about required performance nor about the obligations of both parties. Contract management is as much, or more, about achieving the desired outcome as it is about meeting particular accountability requirements, accepting that the latter are particularly important in the public sector. Any transition arrangements, including requirements on the existing contractor, should be clearly specified to ensure minimum disruption and cost to the business and to its efficiency and effectiveness.

Risk management

Managing the risks associated with the increased involvement of the private sector in the delivery of government services, particularly through contractual arrangements, has required the development and/or enhancement of a range of commercial, negotiation, project and contract management skills across the public sector.

There is a particular risk that the private sector service provider may have greater information and knowledge about the task than the Australian Government. If they are not to be disadvantaged by this situation, public service contract managers need a level of market knowledge and technical skills that are at the same level, or above,

those prevailing among the private sector service providers. This requires effort and commitment that does not simply come from involvement with contracts, particularly on an ad hoc basis which is often the experience of a number of public sector managers.

Risks to be addressed by agencies include external risks such as legal issues, policy changes, contractor business failure, and internal risks such as lack of appropriate skills/knowledge to effectively award and manage contracts, management of poor performance, and management information system failures. These risks need to be analysed prior to the commencement of the contractual relationship as well as during the life of the contract.

By using a sound risk management approach to support contract management, corporate governance is enhanced. Consequently, there is a greater assurance the risks are being managed effectively. The ANAO also has to be cognisant of the potential risks that might arise from contractual arrangements with the private sector. For example:

- ❑ short-term flexibility may be compromised by unforeseen ‘downstream’ costs or liabilities;
- ❑ there may be a tendency for agencies to bear a disproportionate share of the risks;
- ❑ contracts may not fully reflect the parties understanding of their commitments;
- ❑ modelling and projection of costs, risks and returns may have been inadequate; and
- ❑ transparency and accountability factors may not have been adequately considered in the drafting of the contract.

There are also legal risks in terms of determining who is liable for service level deficiencies—these questions bear on the robustness and completeness of the contract arrangements. Because outcomes can be difficult to specify (and indeed may even be the combined product of more than one agency) it can be difficult to specify the circumstances in which ‘non-performance’ has occurred, in order to press for successful contractor performance, given these complex linkages and, moreover, to specify enforceable responses. There may be a need to consider ‘relationship-type’ contracts with their emphasis on confidence, trust and genuine partnership arrangements. More about that later.

As private sector involvement becomes more common in the public sector and increasingly complex contractual arrangements are entered into, risk profiles of agencies need to be continually reviewed. Performance measurement, performance monitoring and fraud control are examples of areas for management focus and audit review. In relation to fraud control, given the rapid rate of change in the APS and the increasing involvement of the private sector, it is important that fraud plans keep pace with the resultant changes in agencies’ risk profiles. A recent cross agency audit of fraud control arrangements in the APS found that there had been an increase in the number of agencies with established fraud control arrangements that were consistent with required guidelines, compared with the findings in an earlier audit conducted in 1999. However, it was considered that there were still a number of agencies that needed to undertake risk assessments on a regular basis to keep abreast of current trends and the changing nature of fraud.⁶⁶

Contract Working Relationship

Successful management of a contract is often dependent on the business relationship established between the contracting parties. It is recognised that effective performance of contractual obligations is generally maximised where a cooperative and trusting relationship exists between the parties. However, agencies should also be mindful that such relationships are founded on a business relationship in which the parties do not necessarily have common objectives. It is important that the ongoing business relationship between the public sector and the privatised business is adequately defined by a legally enforceable agreement. However, it is a question of achieving a suitable balance between ensuring strict contract compliance and working with providers in a partnership context to achieve the required result. According to the OECD:

*A good contract is one that strikes, at a level which will be robust over time, a balance between specification and trust which is appropriate to the risks of non-performance but does not impose unnecessary transaction costs or inhibit the capacity or motivation of the agency to contribute anonymously and creatively to the enterprise in question.*⁶⁷

The Australian Government has committed to pursuing the benefits of partnership approaches both between, and among, the public and private sectors. A range of approaches from the application of elements of private sector management models, to partnerships, through to fully outsourced arrangements, has reconfigured the contemporary governance landscape. The key challenge for agencies is to ensure that, in taking advantage of the various opportunities of the new environment, they do not lose sight of their ultimate accountability to the Parliament, and beyond the Parliament to the Australian public. For partnering arrangements to be successful, both parties need to be fully aware of what each other is bringing to the partnership, their respective responsibilities and performance requirements, accompanied by regular monitoring and review, to ensure that all aspects are adequately covered.

Relational contracts

A relatively new method of public sector contracting is project alliancing. A project alliance is an agreement between the project owner and the contractor(s) who undertake to work cooperatively, on the basis of sharing the risks and rewards of the project. This approach depends importantly on skilful management of the particular risks involved, as well as on trust and confidence between the participants.

Although project alliancing is a business relationship, the aim is to achieve agreed commercial outcomes based on the principles of good faith and trust. As such it offers potential benefits over traditional contracting, but also raises new and different risks that have to be managed. In particular, determining the appropriate balance between maintaining real cooperation and achieving the results required, and protecting the Australian Government's financial interests are essential. Project alliancing is a contracting methodology worth consideration by agencies involved in major construction projects—particularly high profile, prestige Australian Government projects.⁶⁸

The first use of such arrangements by the Australian Government was for the construction of the National Museum of Australia and the Australian Institute of Aboriginal and Torres Strait Islander Studies. The Government decided to pursue a project alliancing strategy to achieve time, cost and quality objectives in the construction of both facilities. The ANAO examined aspects of that project in an audit

undertaken in 1999-2000⁶⁹, which was completed prior to completion of the construction phase of the project. The ANAO concluded that, with respect to that project, appropriate financial incentives were in place to encourage 'best for project' behaviour from the relevant agency and the commercial alliance partners to achieve the cost, time and quality requirements of the project.⁷⁰ However, the ANAO also noted aspects of project alliancing that agencies undertaking such projects would need to consider in relation to effective risk management and accountability.

While such projects are based on the parties working cooperatively to achieve agreed outcomes, the underlying goals of both parties remain as they do in any construction contract. The client wants an outcome that at least meets stated cost, time and quality parameters. Construction organisations want to meet, or exceed, their normal project expectations commensurate with the nature and extent of their involvement. What happens if the alliance's goals and the goals of the alliance members become difficult to reconcile due to, say, a significant cost overrun trend? This was the very problem encountered on the museum project. Although the Department had no legal obligation to do so, it varied the cost gain share provisions to the benefit of the commercial alliance partners. The Department justified its decision, in part, by saying that the great pressure on the need to achieve savings was deflecting the Alliance from striving towards an outstanding result, thus acting to the detriment of the project. Underwriting part of the final cost overrun would help to drive the right behaviours for achieving overall outstanding results. Nevertheless, time, quality and cost targets were eventually met.

This issue illustrates the difficulty, as indicated earlier, within the alliance agreement of determining the appropriate balance between maintaining the collaborative imperatives of the alliance and protecting the Commonwealth's financial interests. Careful management and judgement on the part of those responsible for managing the Commonwealth's interests are required. Whatever decisions are made in this regard, the decision and its reasons should be open, transparent and documented and be subject to Parliamentary or independent scrutiny if necessary—as was the case with the Museum project. This example also highlights the need for careful consideration to be given to the potential for any variations to the contractual arrangements to alter the original value for money determination. This is central to the accountability expectations of the Parliament.

The ANAO has not reviewed any further examples of alliance contracting entered into. The challenge to the ANAO in reviewing such arrangements is ensuring transparency of the decisions taken during the business relationship. Also, ensuring risks have been managed throughout the alliance to protect the interests of the Australian Government is a matter of audit interest.

Access clauses

Accountability can be impaired where the involvement of private sector parties in the delivery of public sector outcomes reduces openness and transparency in public administration. The current trend provides a challenge, not only for agencies' accountability, but also for auditors' ability to access relevant records.

In the interest of securing access to premises and records, the ANAO has been encouraging the inclusion in contracts of model access clauses. These clauses give the agency and the Auditor-General access to contractors' premises and the right to inspect and copy documentation and records directly related to the contract.

While the need for the external auditor to have access to the premises of third party service providers is likely to be required in very few situations, where necessary, it would contribute to an audit being undertaken in an efficient and cooperative manner. As well, such access is important for both management performance and accountability. Any access required for an external auditor is unlikely to exceed that required for sound management. Therefore, audit and management's interests in access are most likely to coincide. In reality, audit requirements may well be satisfied if it can be demonstrated that management has undertaken appropriate checks.

The inclusion of access provisions within agency contracts to enable performance and financial auditing is particularly important in maintaining the thread of accountability with government agencies' growing reliance on partnering with the private sector and on contractors' quality assurance systems. In some cases, such accountability is necessary in relation to government assets, including records, located on private sector premises.

Commercial confidentiality and privacy issues

In May 2001, ANAO completed a performance audit of the use of confidential provisions in contract with commercial providers.⁷¹ The ANAO worked cooperatively with several agencies to distil their experience into a sound framework for wider application across the Australian public/private sector interface. The ANAO reported several weaknesses in agencies' handling of confidentiality provisions in contracts:

- ❑ a lack of rigorous consideration during the development of contracts of which information should be confidential;
- ❑ the failure of the confidentiality provisions in contracts to specify which information in the contract is confidential; and
- ❑ uncertainty among officers working with contracts as to which information should properly be classified as confidential.⁷²

The ANAO developed criteria for use in determining whether contractual provisions should be treated as confidential.⁷³ These criteria are designed to assist agencies to make a decision on the inherent quality of the information *before* the information is accepted or handed over— that is, rather than focusing on the circumstances surrounding the provision of the information.

The audit also provided examples of what would not be considered confidential⁷⁴ and examples of what would be considered confidential.⁷⁵ A report of the Senate Finance and Public Administration References Committee on Australian Government contracts⁷⁶ strongly supported agencies' immediate use of the set of criteria developed by the ANAO for determining whether a sound basis exists for deeming information in contracts confidential. The ANAO audit report also made three recommendations directed at increasing the level of openness of government contracts.

The issue of commercial confidentiality and its impact on open and accountable administration has been subject to increasing Parliamentary scrutiny over recent years. In June 2001, the Senate made an Order that required Ministers to table letters of advice that all agencies, which they administered, had placed on the Internet lists of contracts of \$100,000 or more by the tenth day of the Spring and Autumn sittings of Parliament. The list was to indicate, among other things, whether the contracts contained any confidentiality provisions and a statement of the reasons for the confidentiality. The Government subsequently agreed that agencies would comply with the spirit of the Senate Order. The Government advised that information

regarding individual contracts would not be provided where disclosure would be contrary to the public interest, legislative requirements or undertakings given.⁷⁷

The Senate Order requested the Auditor-General to undertake twice-yearly examinations of agency contracts required to be listed on the Internet and report as to whether there had been any inappropriate use of confidentiality provisions. The Auditor-General agreed to that request and, to date, five audit reports have been tabled.⁷⁸

Another important aspect of performance accountability in the delivery of public services by the private sector is the question of privacy. All Australian Government agencies are subject to the *Privacy Act 1998*, which contains a number of Information Privacy Principles (IPPs) that provide for the security and storage of personal information. The IPPs state that if a record is to be given to a service provider, the record-keeper (i.e. the agency) must do everything reasonably within its power to prevent unauthorised use or disclosure of information contained in the record.

A particular conundrum is being confronted in 'joined-up', collaborative, or whole of government approaches to public administration between privacy considerations on the one hand, and efficiency (including cost) of obtaining, particularly personal, information on the other. The Senate has taken a particular interest in the notion of 'data sharing' or 'data matching' and the notion of personal privacy. The Privacy Commissioner has published extensive guidance which should be regularly consulted in this respect. The Commissioner, Malcolm Crompton, recently spoke on this issue at the National Institute of Governance in the University of Canberra.⁷⁹

Technology and its impact on accountability

Technology issues

The ANAO is tackling the challenges arising from the use of technology by Australian Government agencies in the delivery of programs and services in a number of ways. The ANAO is addressing agencies' need for practical and informative guidance through the production of technology-focused BPGs. The ANAO is also including technology related audits in its AWP. The findings and recommendations arising from these audits are widely applicable throughout the public sector.

Over recent years, the ANAO has released BPGs relating to Internet service delivery⁸⁰ and business continuity management.⁸¹ The ANAO has subsequently undertaken audits against key principles outlined in these guides. In particular, the important area of Internet service delivery has received considerable attention.

An audit of Internet security was undertaken in 2000–01⁸². While audit fieldwork preceded the release of the BPG, it was undertaken in conjunction with the development of the guide. This audit concluded that the level of Internet security for the majority of websites reviewed by the audit was insufficient, given the threat environment and vulnerabilities identified within those sites. The ANAO made seven recommendations, all of which have general application to all agencies. This audit also provides a useful example of an approach that the ANAO is increasingly using in complex, technology related audits. That is, to engage specialists to assist ANAO auditors address specific criteria within the audit. On this occasion, the ANAO conducted the audit with the assistance of the Defence Signals Directorate (DSD) to contribute technical knowledge and to test the security of selected Internet sites.

In February this year, the ANAO tabled the second of its Internet-related audits⁸³ based on criteria established in the BPG. This audit focused on better practice

principles established in the guide under Part 5: *Monitoring and Evaluating Internet-Delivered Government Programs and Services*. This audit also capitalised on external expertise, in cooperation with a consultancy firm with specific expertise in monitoring and evaluation engaged to manage and conduct the audit. The audit concluded that audited agencies did not have specific agency-level policies, including clear responsibilities for both the monitoring and evaluation of websites, portals and Internet-delivered services. The ANAO made five recommendations which were virtually all agreed.

A third audit, focussing on the efficiency and effectiveness of Internet-delivered services, has commenced with fieldwork currently being undertaken. The ANAO also recently tabled an audit that focused on the Department of Family and Community Services (FaCS) management of Internet portals.⁸⁴ Again, there were lessons to be learnt from observed deficiencies.

The important area of business continuity management has been subject to a recent audit by the ANAO.⁸⁵ As outlined earlier, in an environment where the proliferation of computer viruses and hackers seeking to manipulate critical computer systems poses serious risks to government agencies, effective business continuity management is becoming increasingly important for the public sector. While the audit, which focused on the effectiveness of Centrelink's business continuity management and/or associated risk management procedures and plans, found good performance and inherent strengths in Centrelink's practices, it also identified a number of continuity risks. For example, it found that Centrelink had not adequately addressed risks associated with simultaneous catastrophic events to its data centres and off-site backup storage facility. Again, this finding drew attention to a significant issue which had wider ramifications for the public sector.

Records management

In 2001–02, the ANAO commenced a series of audits of record-keeping in Australian Government agencies. The focus on record-keeping was as a result of:

- ❑ significant changes to public sector management that have affected record-keeping in the Australian Government including: downsizing, restructuring and outsourcing;
- ❑ the standard of record-keeping has been a recurring issue in ANAO audits in Australian Government agencies;
- ❑ rapid advances and significant developments in information and communications technology, particularly in the area of electronic transactions, and significant growth in the pace of change to electronic business processes; and
- ❑ concerns raised by both the Australian Law Reform Commission⁸⁶ and the Commonwealth Ombudsman⁸⁷ over the standard of record-keeping in the Commonwealth.⁸⁸

As part of this series, the ANAO recently completed a Business Support Processes (BSP) audit of record-keeping in large Commonwealth organisations.⁸⁹ The audit assessed whether record-keeping policies, systems and procedures were in accordance with relevant Government policies, legislation, accepted standards and record-keeping principles, and applicable organisational controls. As well, it identified examples of sound and better practices in organisations' record-keeping frameworks.

The ANAO concluded that the audited organisations met Government policies, legislation, accepted standards and principles to varying degrees. Although all

organisations had taken active steps to improve their record-keeping frameworks and practices, their record-keeping policies, systems and procedures were at different stages of development. Further, it was concluded that there was a significant risk of the non-capture and unauthorised disposal of records due to a number of identified factors.

In addition to audits that focus specifically on record-keeping, the ANAO has also reviewed the soundness of agency record-keeping through a number of its performance audits. Recent audits have identified problems with agency record-keeping, including non-compliance with Chief Executives' Instructions and some aspects of the *Archives Act 1983*. The ANAO will continue to monitor the quality of record-keeping across the public sector through its performance audit program and BSP program to encourage further improvement in this important area of administration.

Electronic records

As noted earlier, the use of email provides opportunities for more responsive business management, but also creates some significant challenges both for agencies and auditors. Other professions, including the legal profession, where the discovery process is being impacted, are also facing these challenges. Security agencies are also involved. For example, the DSD provides advice on all matters relating to communications security and computer security. Their assistance has been invaluable to the ANAO.

The ANAO has been incorporating reviews of electronic records in its auditing methodology for some time now. For example, in the absence of an adequate suite of supporting hard copy documents, the ANAO reconstructed and analysed the email record to establish the decision-making trail in its investigation of the probity and effectiveness of the decision to include Magnetic Resonance Imaging (MRI) machines⁹⁰ that were 'on order' in the 1998 budget.

The MRI audit, along with other audits currently being undertaken by the ANAO, has highlighted a number of important issues relating to accessing electronic records, particularly email, to establish a decision-making trail. These issues include the following:

- ❑ Storage—access to historical emails is generally gained via agency 'back-up' files, with agency 'back-up' procedures heavily influencing the methodology used by auditors to access records and, consequently, the cost of conducting audits. For example, where an agency 'backs-up' its electronic records monthly, any record that is created and deleted within a particular month may not be stored on 'back-up' files. Accessing these deleted records is more complex and more costly.
- ❑ Cost—the cost of auditing electronic records is significantly higher than a more traditional audit of hard copy records, as it often requires the engagement of experts to undertake more technical aspects of record recovery, analysis and presentation. Accessing electronic records also requires considerable effort on the part of audit teams to identify and communicate search parameters (i.e. time period, sender/receiver, key words) on which the electronic record search will be conducted.
- ❑ Technical Capability—an audit of electronic records generally requires specialist expertise, as noted above, and 'tools' to recover records, 'clean' records (i.e. remove duplicated records), and present the records in a form that facilitates analysis by auditors.

- ❑ Security—the engagement of individuals or firms to undertake record recovery activities on behalf of the ANAO has raised security and confidentiality concerns for some auditees.
- ❑ Privacy—email is used for both business and, to a limited extent, personal purposes in most agencies. As a consequence, privacy concerns are inevitably raised when audit access is sought. It should, however, be noted by agency management that government policy states that electronic records—including emails—sent or received in the course of business transactions are Commonwealth records, subject to the *Archives Act 1983*. As a consequence these records must be retained for as long as they are needed for Government and community requirements. Further, the *Auditor-General Act 1997* provides the Auditor-General or an authorised official with wide-ranging powers, including full and free access to premises and documents, including emails.
- ❑ Permanence—emails can be quickly and easily deleted and, depending on the configuration for an individual’s email software settings, some emails may never be stored in the first place.

Increasingly, technology will shape the way in which auditors perform their functions. It is, therefore, critical that auditors understand how best to interrogate electronic systems and have appropriate auditing standards and training to equip them in this rapidly changing environment.

Dealing with legal issues

The increasing complexity of business conducted by the APS is necessitating a greater involvement of the legal profession. Complex acquisition arrangements, contractual relationships with private sector service providers, and the use of external consultants in business processes increasingly require legal input to ensure that the interests of the Commonwealth are protected in the arrangements being entered into. The success of contractual arrangements with the private sector is often dependent on a sound understanding of the requirements of both parties to a contract, and the terms and conditions of the contractual arrangements.

The ANAO review of agency performance also often requires the engagement of legal services. In the conduct of performance audits, the ANAO will seek to identify legal advice and opinions obtained by agencies to support action taken. In the absence of such advice, or where the focus of interest by the ANAO differs, legal advice is obtained as part of the audit process. A challenge for the ANAO is not to become involved in debating conflicting legal advice. Often underpinning an alternative legal position is a different focus in the advice being sought. The JCPAA has also indicated that it does not want to adjudicate in the alternate legal positions presented by the ANAO and agencies.

A recent audit of the management of an extension option for a significant commercial contract managed by the Department of Health and Ageing involved two instances where legal advice received by the agency conflicted with legal advice obtained by the ANAO. The ANAO noted the differences in the legal opinions in the report.⁹¹

Legal issues may also arise in the presentation of information in performance audit reports. The ANAO review of public sector performance often requires review of private sector participation impacting on that performance. Increasingly, draft audit reports are referred for legal advice on the parties the Auditor-General should consider providing whole or part of the proposed report to, in order to satisfy the requirements of the Auditor-General Act and the rules of procedural fairness. This

legal clearance process ensures that parties identifiable in a proposed audit report have been provided an opportunity to comment on the observations or opinions being presented by the ANAO to meet natural justice imperatives.

In a recent audit, the ANAO took legal advice on issues raised by an agency relating to the inclusion of information in a discussion paper developed prior to the proposed audit report. Section 37 of the *Auditor-General Act 1997* provides that the Auditor-General must not include particular information in a public report if he is of the opinion that disclosure would be contrary to the public interest for reasons set out in the Act. In preparing the final audit report, ANAO had regard to both the legal advice it had received and the various comments provided by the agency. While not necessarily accepting the specific claims raised by the agency under section 37 of the Act, the Auditor-General considered that the report no longer contained any material that warranted his consideration under section 37 of the Act and that the exclusion of such material did not impact on the conclusions reached in the report.⁹²

Managing the ANAO's Business

Like all public sector agencies negotiating the challenges of the changing public sector 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.

At the strategic level, the ANAO has 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. Tactically, the ANAO has focussed on ensuring that its work continuously improves as it demonstrates accountability to Parliament, in terms of legislative responsibilities, and for overall results to *all* stakeholders.

Since 1 July 2003, following a recommendation by the JCPAA⁹³ and agreement with the recommendation by the Australian Government pending legislation implementing that recommendation, agency comments on a proposed report have been published in the final report. As well, a summary of agency comments is included in the brochure accompanying each audit report.

The decision by the JCPAA to recommend the inclusion of agency comments in full was made to promote the effective management, by both audited agencies and the ANAO, of the 28-day comment period to ensure that requests for extensions of time remain the exception. Past experience has shown that, while the ANAO recognises that agencies can have practical problems in relation to the coordination of responses, increasingly, delays in receiving responses have added not inconsiderably to the costs of many audits. This has also made it more likely that an audit report's planned tabling schedule will be delayed with consequent disruption to the overall audit program impacting adversely on both the ANAO, and directly affected agencies and other organisations involved in our audit program.

There has also been greater involvement of Ministers and their staff in performance auditing in recent years which is welcome. However, in some cases this has extended the timeframe for completion of our audits, and added to audit costs as well as to delays in other audits. It is important for the audit program and its effective management, as well as the ANAO's performance, that the statutory period for agency comment on our final reports is met, other than in exceptional circumstances.

Accessibility of the ANAO's work

As the complexity of the subject matter of the ANAO's work increases, it is becoming more important for the Office to improve the way in which it presents its analysis and findings. In addressing this issue, the ANAO is increasingly using diagrams and images to support the communication of its findings. There is also an increased focus on the use of simple language to convey complex arguments. The ANAO has also recently engaged the services of an editor to assist in the preparation of its audit products, which currently exceed 60 products per year.

To assist stakeholders to gain a rapid understanding of key elements of its audits, all ANAO performance audit reports are accompanied by a brochure, which includes the summary, key findings and overall conclusion of the audit.

Summary information on recently completed performance audits and BPGs; and developments in financial reporting and disclosure are also included in the ANAO's quarterly magazine, 'Opinions'. It also lists those audits scheduled for completion in the near future. 'Opinions' is distributed to all Australian Government Chief Executives and Chief Financial Officers, State audit offices and industry groups. It is also provided to participants attending ANAO client seminars, which aim to provide ANAO clients with information addressing developments in financial reporting.

The ANAO also makes extensive use of the Internet to distribute information to stakeholders and the general public. As noted earlier in this paper, all performance audit reports and the AWP are available from the ANAO's website.

Developing the ANAO's Audit Work Program

The ANAO undertakes an on-going, resource intensive planning approach to ensure that its outputs are effectively integrated for maximum impact, and continue to meet the needs of the Parliament, the Government and public sector entities.

The AWP is developed taking into account the APS environment, business risks likely to impact on the APS during the period under review and, over recent years, a number of factors that have significantly affected the APS environment, including: requirements for a more responsive, contestable public service; greater collaboration between agencies, stakeholders, and levels of Government; and an increased focus on sound governance.

The ANAO's ability to identify key public sector themes and risks is enhanced by its organisational structure, which is aligned to the Australian Government's portfolio structure. This enables ANAO senior executives to develop a thorough understanding of the portfolio for which they are responsible. It also facilitates the development of effective working relationships with key agency personnel. This approach is supported by agencies, with comments received through the ANAO's Public Entity Survey indicating that a key success factor in successful audit implementation was auditors with previous agency auditing experience.

Audit resourcing, skills maintenance and development

It is particularly important that the ANAO ensures that it has the relevant expertise required to undertake audits in emerging areas. It is important that ANAO officers auditing complex agency operations have the specialist skills and experience to provide assurance in these complex areas. This means striking a balance between building and maintaining specialist skills in-house, and building effective alliances and partnerships with specialists in relevant industries.

The ANAO has an integrated learning and development program which recognises the importance of high performing individuals and teams to deliver high quality audit products and services. This requires the acquisition of skills and capabilities, commitment to continuous improvement, innovation, learning and knowledge sharing. This is done through targeted learning and development that is set out in the ANAO Learning and Development Framework and Professional Development Calendar. The Personal Development Scheme, and individual professional development opportunities compliment the framework and calendar.

The ANAO encourages the continual development of its staff through a range of tailored activities including: a staff seminar series with guest speakers from the public and private sectors; secondments to Australian Government agencies and the JCPAA; and exchange placements with public sector auditing bodies in New Zealand, Canada and the United States.

While the ANAO is committed to improving its skill base to meet contemporary auditing needs, in some cases it may be necessary to 'buy in' expertise. This is particularly the case in highly technical areas. In entering such arrangements with private sector firms, the ANAO ensures that audit independence issues are addressed.

ANAO performance management

ANAO balanced scorecard

The ANAO has developed, and will continue to update, a scorecard for communicating and understanding how it is performing. The scorecard, which forms an integral part of the ANAO's Business Plan, is aligned with four Key Result Areas and gives information to support a focus on current and future efforts. Performance measures relate to three Output groups: performance audit services, information support services and assurance audit services. These link back to the ANAO's two Outcomes: improvement in public administration and assurance. The scorecard includes both quantitative and qualitative measures and is intended to provide interested parties with an understanding of the link between the ANAO's products and their resulting impacts. It is then possible for stakeholders to assess how cost-effectively the ANAO is delivering its products and to what extent the ANAO is achieving its agreed outcomes. This provides the Parliament with assurance that the ANAO has the appropriate processes in place to produce reliable, and useful, reports.

The ANAO's performance against the scorecard is set out in its annual report. In addition, the operational plans for each work group contain a set of specific performance targets and initiatives for that group. You may be interested in a recent article that compares performance measurement in audit institutions in Australia, Canada, New Zealand and the United States.⁹⁷

A measure of the impact of performance audit services is the potential financial benefits that could be realised from implementation of audit report recommendations. While it is not always easy to cost the value of recommendations, the ANAO's target for financial benefits continued to be 'at least twice the cost of conducting performance audits'.

In 2002–03, the estimated potential annual recurring financial benefit from all performance audits agreed with agencies ranged between \$79 million and \$117 million, depending on the level of improved performance achieved.

Review by JCPAA

As noted earlier, the JCPAA reviews all audit reports and conducts public hearings and inquiries into selected audit reports. The JCPAA's primary purpose in reviewing audit reports is to assess whether audited agencies have responded appropriately to the Auditor-General's findings. The ANAO gives evidence at these hearings and inquiries and assists the JCPAA in its review work. The most recent JCPAA report on its reviews of ANAO audit reports (JCPAA Report 396) covers 11 audit reports tabled in the first three quarters of 2002–03.

- The JCPAA is currently undertaking the following inquiries in response to ANAO audit reports: management and integrity of electronic information in the Australian Government; and aviation security arrangements in Australia.

Quality assurance and peer reviews

The ANAO conducts a quality assurance review of selected audits to evaluate the extent to which ANAO performance audits are completed in accordance with ANAO Auditing Standards, incorporating the Australian Auditing Standards. The review of audits tabled in 2001–02 found that those examined complied with these standards. The review of 2002–03 performance audit reports is currently being finalised.

In 2002–03, a two-person team from the Office of the Auditor-General New Zealand conducted a peer review of two ANAO performance audits tabled in 2002. The review found that the audits examined were of a high standard, with a number of good practices observed. Some suggestions for improvement were also made. In 2004, the ANAO will conduct a similar review of selected New Zealand audit reports. Peer reviews are an important means of exchanging better practice between audit offices.

External and internal audit scrutiny

Section 41 of the *Auditor-General Act 1997* establishes the position of the ANAO Independent Auditor who undertakes the audit of the ANAO's financial statements and selected performance audits of the ANAO. The Act requires the Independent Auditor to have regard to the audit priorities of the Parliament, as determined by the JCPAA, in the conduct of performance audits. Currently, the ANAO's Independent Auditor is Michael Coleman, partner of KPMG who has been appointed until May 2005.

Performance audits conducted by the Independent Auditor range from planning and resource allocation processes⁹⁸, audit management processes⁹⁹, and contract management arrangements.¹⁰⁰

The ANAO's Internal Audit function is responsible to the Auditor-General, through the ANAO Audit Committee, for providing an assurance concerning ANAO systems and processes directed at attaining better practices and assisting in meeting the objectives specified in the ANAO's Corporate Plan. The Committee has an independent Chair and a clear Charter.

6. Concluding remarks

The auditing environment, in both public and private sectors, is continually changing and evolving. As a consequence, the auditing profession must ensure that it is able to respond positively to such an environment at a time when its credibility is under challenge.

This responsiveness is dependent on a well-developed understanding of the challenges confronting our audit clients. The challenges facing the public sector are significant and include: greater orientation towards outcomes (results); new and varied service delivery arrangements; and the requirement for better performance in an environment of devolved authority and increased management flexibility. In furthering our understanding of the challenges facing our audit clients, we have implemented a broad range of initiatives including: the provision of assistance to Parliamentary committees; the involvement of agencies and entities in the audit planning processes; seeking feedback from the Parliament and agencies on our AWP; and ANAO involvement in agency audit committees.

There are undoubtedly different challenges associated with the greater involvement of the private sector in public sector activities, particularly as service deliverers, and even more so in any partnering-type relationships. Mutual understanding of the public sector and commercial imperatives is a necessity. A genuine appreciation of the risks involved and a practical view about who is best placed to manage particular risks and allocating them accordingly are particular challenges. Issues of privacy, security, equity of treatment, administrative law, openness, scrutiny by the Parliament, competing objectives, differing performance measures, values, codes of conduct and culture as well as value for money requirements have to be sensibly addressed. Not surprisingly, Parliament and its Committees are concerned about accountability aspects and therefore look to audit to provide a significant degree of assurance in that respect.

Whole of government approaches to the delivery of program outputs and outcomes, not just between different Commonwealth agencies, but also across levels of government raise a number of governance issues which impact on both the nature and delivery of audit services. For example, do audits have to be much more comprehensive and resource intensive. Do we need to be more active in pursuing joint audits with other constituencies or some other means of cooperation and shared reporting arrangements. Such considerations have important implications for the manner in which we conduct our audit business. An added complication is the extent to which information communications and technology is used both as a driver and facilitator of collaborative effort and interaction with clients/citizens, basically because different approaches, risks and skills are involved.

Our response to these demands is markedly determined by our ability to deliver high quality, targeted audit products that support the achievement of our objectives to improve public administration and provide a high level of assurance to the Parliament. Consequently we are continually striving to improve the products that we deliver and the way in which we deliver them. We contribute significant resources to the development of our work program to ensure that it provides appropriate coverage and targets the accountability for performance required by the Government and the Parliament. We also regularly assess the efficiency and effectiveness of our business management to ensure that we are able to respond to new demands and directions. In this particular respect, the review by the JCPAA of our annual budget is very important and underpins the independence of the Office.

Audit independence is the key to our effectiveness. As well, the professional requirements, skills and our code of conduct are an important complement to the legislative and other imperatives we are subject to as part of the public sector. We are integral to the profession across all sectors of the economy, not divorced from it. We share most of the principles and practices, increasingly so with the greater convergence of the public and private sectors and the application of sector neutral

accounting and auditing standards. However, up till recently, only the public sector conducted performance auditing. We have seen the JCPAA recommend that the private sector consider adopting performance auditing as part of greater transparency and accountability.¹⁰¹ Comments have been made in the media along similar lines supported by some in the profession. A test may be when the CLERP 9 legislation is passed and attention is drawn to its implementation.

We have come a long way since D.R. Steele Craik (Auditor-General) signed the first 'official' efficiency audit on 16 April 1980. Interestingly, it was commenced prior to the proclamation of the amendments of the Audit Act on 7 March 1979 authorising the Auditor-General to undertake efficiency audits. Admittedly, some type of performance auditing had been done by the Office for many years prior to that time. Performance audits comprised both project and efficiency audits, with the former being seen as similar in many respects to the latter but not to the same depth. In its submission to the then Joint Parliamentary Committee of Public Accounts on 'Reform of the Australian Audit Office' in May 1988, the Audit Office noted that the initial development of performance auditing by the Office could be timed back before the 1970s. It was said that:

*Section 54 (of the Audit Act 1901) has been seen by successive Auditors-General as an authority to carry out audits of a legislative compliance and value for money nature.*¹⁰²

This was a far-sighted attitude and provided the building blocks for the development of performance auditing as we practice it today. Nevertheless, as discussed at some length in this Paper, we are still developing our approaches and skills in an ever changing public sector environment with its increasing complexity and greater demands for performance and accountability. Our people are the key to our success in these respects. We devote considerable time and resources to their personal and professional development to provide us with the ideas, initiatives, skills and commitment to fulfil our legislative mandate with quality products and advice not only to provide assurance to the Government and the Parliament, but also to add value to public administration.

The responsiveness of the auditing profession as whole is also contingent on the availability of competent, highly skilled auditors. In an environment of increasing complexity, this will become even more important. It is in this context that courses such as the Graduate Certificate in Performance Auditing—developed jointly by the ANAO and the University of Canberra—will become increasingly valued by agencies and their auditors.

NOTES AND REFERENCES

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- ¹ 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.
- ² International Federation of Accountants 2003. *Rebuilding Public Confidence in Financial Reporting – An International Perspective*, New York, July
- ³ 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).
- ⁴ 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.
- ⁵ ANAO Audit Report No. 4 2001-2002, *Commonwealth Estate Property Sales*, Canberra, August.
- ⁶ ANAO Audit Report No. 43 2002-2003, *The Sale of Sydney (Kingsford Smith) Airport*, Canberra, May.
- ⁸ See, for example, ANAO Audit Report No. 28 2003–04, 'Audit Activity Report: July to December 2003', Canberra, 12 February
- ⁹ ANAO Report No. 61 2002–03, *Control Structures as part of the Audits of the Financial Statements of Major Commonwealth Entities for the year ending 30 June 2003*, Canberra, 30 June.
- ¹⁰ See, for example, ANAO Report No. 22 2003–04, *Audits of the Financial Statements of Commonwealth Entities for the Period Ended 30 June 2003*, Canberra, 23 December.
- ¹¹ ANAO 2003, *Goods and Services Tax (GST) Administration*, Better Practice Guide, Canberra, May.
- ¹² ANAO 2004, *Annual Performance Reporting*, Better Practice Guide, Canberra, April
- ¹³ Materiality means, in relation to information, that information which if omitted, misstated or not disclosed, has the potential to adversely affect decisions about the allocation of scarce resources made by users of the financial report or the discharge of accountability by the management or governing body of the entity. The concept applies to both the quantum and sensitivity of financial information. Examples of the latter are related party transactions and act of grace payments.
- ¹⁴ ANAO Audit Report No.10 2003-2004, *Australian Defence Force Recruiting Contract*, Canberra, October.
- ¹⁵ ANAO Audit Report No.15 2003-2004, *Administration of Staff Employed Under the Members of Parliament (Staff) Act 1984*, Canberra, December.
- ¹⁶ ANAO Audit Report No.6 2003-2004, *APRA's Prudential Supervision of Superannuation Entities*, Canberra, September.
- ¹⁷ ANAO Audit Report No.11 2003-2004, *Annual Performance Reporting*, Canberra, November.
- ¹⁸ ANAO 2004, *Annual Performance Reporting*, Better Practice Guide, Op.cit.
- ²¹ JCPAA Report 396, *Review of the Auditor-General's Reports First, Second and Third Quarters 2002-2003*, Canberra, September.
- ²² ASOSAI Research Team, 2000. *Performance Auditing Guidelines*, ASOSAI New Delhi.
- ²³ INTOSAI Auditing Standards Committee, 2003. *Implementation Guidelines for Performance Auditing Standards*, INTOSAI, Vienna.
- ²⁴ The purpose of the Portfolio Budget Statements (PBS) is to inform Senators and Members of the reasons for inclusions of proposed provisions in Appropriation Bills 1 and 2 or Appropriation (Parliamentary Departments) Bill (No. 2). The major role of the PBS is to explain requests for funds through the Budget Appropriation Bills. The PBS provides sufficient information,

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- explanation and justification to enable Parliament to understand the purpose of each item in the Bill(s) and accrual budgets of the portfolio.
- ²⁵ ANAO Audit Report No.19 2001-2002, *Performance Information in Portfolio Budget Statements*, Canberra, November.
- ²⁶ ANAO 2002, *Performance Information in Portfolio Budget Statements*, Better Practice Guide, Canberra, May.
- ²⁷ ANAO 1996, *Performance Information Principles*, Better Practice Guide, Canberra, November.
- ²⁸ ANAO 2004, *Annual Performance Reporting*, Better Practice Guide, Op.cit.
- ²⁹ HR Report 2000, 'DOFA wins International Outsourcing Award,' *HR Report*, no. 220, 7 March, p. 2.
- ³⁰ ANAO Audit Report No.49 2001-2002, *The Management of Commonwealth National Parks and Reserves – Conserving our country*, Canberra, May.
- ³¹ ANAO Audit Report No.9 2000-2001, *Implementation of Whole-of-Government Information Technology Infrastructure Consolidation and Outsourcing Initiative*, Canberra, September 2000.
- ³² Humphry R. 2000, *Review of the Whole of Government Information Technology Outsourcing Initiative*, Public Hearing, Canberra, 17 May 2000.
- ³³ Howard, J. The Hon 2001, *The Centenary of the APS Oration*, Presentation to the Centenary Conference of the Institute of Public Administration Australia, Canberra, 19 June, p.5.
- ³⁴ ANAO Audit Report No.11 2001-2002, *Administration of the Federation Fund Programme*, Canberra, September.
- ³⁵ ANAO Audit Report No.43 2002-2001, *Performance Information Commonwealth Financial Assistance under the Natural Heritage Trust*, Canberra, June.
- ³⁶ *Freedom of Information Act 1982*, section 43.
- ³⁷ ANAO Audit Report No.14 2002-03, *Health Group IT Outsourcing Tender Process*, Canberra, 29 October, p. 31.
- ³⁸ Ibid.
- ³⁹ The ANAO recently completed a performance audit of intellectual property policies and practices in Commonwealth agencies. The audit found that, overall, only 30 per cent of agencies have developed specific policies or procedures for managing intellectual property. The agencies involved in the case studies had varying systems in place to manage their intellectual property. In addition, the ANAO found that the Commonwealth does not have a whole-of-government policy approach to managing intellectual property. As a result, agencies are responsible for devising their own approaches to the management of the intellectual property they generate and/or acquire. For further information, please see: ANAO 2003–04, *Intellectual Property Policies and Practices in Commonwealth Agencies*, Report No.25, Canberra, 5 February.
- ⁴⁰ Department of Communications, Information Technology and the Arts, 2000, *Government Online – The Commonwealth Government's Strategy*, Canberra, pp. 1 and 4.
- ⁴³ Heracleous, Loizos 2001, 'What is the impact of corporate governance on organizational performance?', *Corporate Governance: An International Review*, 9(3), pp. 165-73.
- ⁴⁴ ANAO, 2003, *Better Practice Guide on Public Sector Governance, Volumes 1 and 2*, Canberra, July.
- ⁴⁶ Nolan Committee of the UK, 1995. Op.cit.
- ⁴⁷ Barrett P, 2002, 'Achieving Better Practice Corporate Governance in the Public Sector', keynote address delivered to *Best Practice Corporate Governance in the Public Sector*, IQPC Conference, 26-27 June, Rydges Lakeside, Canberra, p. 10.
- ⁴⁸ Australian Stock Exchange, 2003, *Principles of Good Corporate Governance and Best Practice Recommendations*, March, found at [www.asx.com.au/about/Corporate Governance](http://www.asx.com.au/about/Corporate%20Governance)
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- ⁵³ ANAO, 1999, *Corporate Governance in Commonwealth Authorities and Companies*, Discussion Paper, May.
- ⁵⁴ ANAO, 2003, *Better Practice Guide on Public Sector Governance, Volumes 1 and 2*, Op.cit.
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- ⁵⁷ ANAO Report No.40 2001–02, *Corporate Governance in the Australian Broadcasting Commission*, Canberra, 8 April.
- ⁵⁸ UK National Audit Office 2001, *Managing the relationship to secure a successful partnership in PFI projects*, Report by the Comptroller and Auditor-General, HC 375 Session 2001-2002, November.
- ⁵⁹ The use of a PFI was considered in the tender process for the procurement of patrol boats by Defence. In announcing the tender in July 2001, the then Minister for Defence stated that the Government was keen to pursue the project under private financing arrangements, but that the Government had to be satisfied that it would receive the best outcome for the investment of taxpayer dollars. However, in arriving at the shortlist for the tender in June 2002, the Government decided to directly purchase the boats. While the use of private financing to deliver the boats and associated through-life support was considered, there was uncertainty about whether the requisite capability could be provided on a value for money basis while also ensuring that the transaction would be classified as an operating lease for accounting purposes.
- ⁶⁰ For further discussion see, for example: Barrett P. 2000, *Public private partnerships – Are there gaps in public sector accountability?* Presentation by the Auditor-General for Australia to the 2002 Australasian Council of Public Accounts Committees 7th Biennial Conference, 3 February 2003, Available: <http://www.anao.gov.au>.
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- ⁷¹ The audit sought to: assess the extent of guidance on the use of confidentiality clauses in the context of contracts at a government wide level or within selected agencies; develop criteria that could be

used to determine whether information in (or in relation to) a contract is confidential, and what limits should apply; assess the appropriateness of agencies' use of confidentiality clauses in the context of contracts to cover information relating to contracted provisions of goods and services, and the implications of existing practices of applying the criteria that have been developed; and assess the effectiveness of the existing accountability and disclosure arrangements for the transparency of contracts entered into by the Commonwealth, and whether agencies are complying with the arrangements: ANAO Audit Report No 38 2000-01, *The Use of Confidentiality Provisions in Commonwealth Contracts*., Canberra, 24 May, p. 13.

⁷² Ibid., p. 15.

⁷³ Ibid., p. 55-60.

⁷⁴ Ibid., p.64. The following types of information in, or in relation to, contracts would generally not be considered to be confidential:

- performance and financial guarantees;
- indemnities;
- the price of an individual item, or groups of items of goods or services;
- rebate, liquidated damages and service credit clauses;
- clauses which describe how intellectual property rights are to be dealt with; and
- payment arrangements.

⁷⁵ Ibid., p.65. The following types of information may meet the criteria of being protected as confidential information:

- trade secrets;
- proprietary information of contractors (this could be information about how a particular technical or business solution is to be provided);
- a contractor's internal costing information or information about its profit margins;
- pricing structures (where this information would reveal whether a contractor was making a profit or loss on the supply of a particular good or service); and
- intellectual property matters where these relate to a contractor's competitive position.

⁷⁶ Senate Finance and Public Administration References Committee 2001, *Commonwealth Contracts: A New Framework for Accountability, Final Report on the Inquiry into the Mechanism for Providing Accountability to the Senate in relation to Government Contracts*, Parliament of the Commonwealth of Australia, Canberra, September (See Appendix A).

⁷⁷ ANAO Report No.8 2002-03, *The Senate Order for Department and Agency Contracts (September 2002)*, Canberra, September, p.12.

⁷⁸ ANAO Report No. 31 2003-04, *The Senate Order for Departmental and Agency Contracts (Financial Year 2002-03)*, Canberra, February; ANAO Report No. 5 2003-04, *The Senate Order for Departmental and Agency Contracts (Autumn 2003)*, Canberra, September; ANAO Report No. 32 2002-03, *The Senate Order for Departmental and Agency Contracts (Spring 2002 Compliance)*, Canberra, March; ANAO Report No. 33 2001-02, *Senate Order of 20 June 2001 (February 2002)*, Canberra, February; and ANAO Report No. 8 2002-03, *The Senate Order for Department and Agency Contracts (September 2002)*, Canberra, 18 September.

⁷⁹ Crompton, Malcolm 2004. 'Light Touch' or 'Soft Touch' – *Reflections of a Regulator Implementing a New Privacy Regime*. National Institute of Governance, University of Canberra, March.

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⁸¹ ANAO 1999-2000, Better Practice Guide *Business Continuity Management-keeping the wheels in motion*, Canberra, 17 January.

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- ⁸⁹ Ibid.
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