

Appendix 2

Auditing Public Expenditure and the Estimates Process The Role of the Auditor-General

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Introduction

The Auditor-General's accountability role has existed since Federation. The Audit Act was passed in 1901. The legislation was given high priority, as it was the fourth Act to be passed by the first Federal Parliament.

Public accountability' is a subject which has received a certain amount of attention in the past few years, helped sometimes by questions raised by investigatory journalism. It is an issue, a reality, which affects all levels of government and public administration in democratic societies and we have even seen an increasing push for greater accountability to the public in socialist societies in recent times.

What is all the fuss about?

In our type of society, accountability means the responsibility of those entrusted with the resources of others to account to the owners of those resources. In the public sector, the requirement for officials to be held accountable to the Parliament for the use of public resources with which they have been entrusted is a foundation for citizens' trust in government. It is part of the compact we enter into when we delegate to others the right to take decisions on our behalf in the interests of the nation as a whole. Parliament is the means (in our type of society) through which the public is both informed about and (through its delegates) exercises some sort of control over government (financial) and other activities. The logic of this is quite clear when we remember that governments have no power in themselves to take money from us, the taxpayers, or use our power, unless that power has been given by the Parliament.

The role of the Auditor-General is to facilitate that accountability by providing impartial and objective reports on the stewardship and performance of officials. Central to the value of assurances provided by the Auditor-General is my independence in relation to both the Parliament and the executive (as well as my ability to perform the task of investigation and report).

The chain of accountability flows through the management of public-sector entities, Ministers, the Parliament and ultimately to the public.

At least two separate important strands are discernible in the current environment. Under one strand, Government Business Enterprises are responsible to Boards established very much along the lines of the private sector, the Chief Executive Officer (CEO) being appointed by the Board and holding office at its pleasure. The Board in turn is responsible to a Minister for the achievement of certain agreed goals. In this strand, accountability to the Parliament is through the published balance sheets and the annual report unless, of course, the Auditor-General is chosen by the organisation as its auditor, in which case, but only then, there is a direct link to the Parliament by the Public Auditor. The second strand, the main strand, the traditional strand, is the more usual mechanism of Ministerial responsibility to the Parliament for the actions of their officers, their agencies, their responsibilities on our behalf, with independent review through financial, performance and efficiency auditing procedures. This is not Caesar to Caesar.

It is Parliament's right to review public-sector entities' financial operations and other pertinent information available. Primary (but not exclusive) sources of this other information are, of course, my reports, which provide an independent assessment of the credibility of reported financial information and the performance of the entity with respect to whether:

public resources have been managed and deployed in an economical and efficient manner, and in such a way as to achieve the objectives set for the agency to the greatest practical extent;

programs meet effectively the policy goals they were designed to serve; and

there has been compliance with applicable laws, including those relating to the handling of and accounting for public moneys.

These reports are not only fundamental to the chain of public-sector accountability but are of great reassurance to the executive. Not only are they used by chief executives of the entities under audit and Ministers to discharge their respective responsibilities; the reports are usually used to provide a basis for some of the questions asked of departments and authorities by committees of the Parliament.

This might be the place to raise some questions about the inevitable tensions that arise between those reviewing and those being reviewed. Take, say, the Parliament and its committees on the one hand and the Government and its agencies on the other. While it might be nice to have an easy balance in this relationship, with no tensions, achievement may be impossible in practice. Perhaps we shouldn't seek it. On the one hand, although bound up in the heady business of directly managing an enormously complicated enterprise like the public sector, those doing so outside Parliament should conceal any impatience when asked to justify some aspect of their stewardship to the representatives of the people — this is, after all, a democratic society. On the other hand, they may ask: 'should committees not avoid the temptation to try to influence the detailed running of the public sector through the committee system, i.e. seek to run the public sector by remote control? Should the Parliament lay down broad strategy and leave the detailed tactics to the Government and its agencies?'

But how realistic is it to expect the Parliament or its committees to avoid interesting itself or themselves in detail, for often this is how a window into the busy world of policy implementation is pried open. Noting the difference between, say, the Australian and the US democratic models, if we move the balance towards the US what are the consequences for good government? Should we move more towards the UK model?

I believe the Auditor-General can help moderate these tensions by providing professional, impartial, apolitical reassurance to all parties.

It will not be in the national interest if the Office is a pawn in a power struggle between giants.

A Historical Perspective

In examining the question of the accountability of public enterprises, and the role of the Auditor-General therein, various parliamentary committees have concluded:

that authorities should be accountable (through the Parliament) to their universal guarantor, the taxpayer (Senate Committee on Finance and Government Operations 1978);

that all subsidiaries of statutory authorities be subject to audit by the Auditor-General to ensure that there was no reduction in the flow of information to the Parliament (Senate Committee on Finance and Government Operations 1982);

that all government-owned companies be audited by the Auditor-General (Joint Committee of Public Accounts 1977);

that a statutory authority should maintain the highest standards of probity and business ethics as well as being aware of its own and its Minister's accountability to the Parliament (Senate Committee on Finance and Government Operations 1985); and

that a corporation largely dependent on the public purse for its income must be financially accountable in ways in which its commercial competitors are not (Senate Committee on Finance and Government Operations 1986).

It is clear from the above that over many years the Parliament, through its committees, has expressed the view that, while it is important for the Parliament to use all avenues available to it to gather information about government activities and to ensure accountability of government to the Parliament, the Auditor-General as public-sector auditor has a primary role in this process.

The importance of the role of the Auditor-General in ensuring proper accountability of government entities to the Parliament has been confirmed in three recent reports:

the January 1989 report of the Commission on Accountability¹ (the Burt Commission) to the Western Australian Premier led to the Western Australian Auditor-General being confirmed, appointed or reappointed as auditor for all government agencies and their subsidiaries;

the Joint Committee of Public Accounts (JCPA) Report 296² recommended that the Auditor-General should be the auditor of all Statutory Marketing Authorities, Government Business Enterprises and government companies (the mandate to audit Departments and outriders was not in question); and

the Report of the Independent Auditor on a Efficiency Audit of the Australian Audit Office (AAO)³ tabled in October 1989 supported the above-mentioned recommendations made by the JCPA; plus

action in the Senate recently on legislation.

The JCPA discovered that the AAO had never been reviewed in its totality, possibly due to a complacency in political and administrative circles about the condition of the Office. A quiet tiger needs no meat? As a reviewer, one could hardly be surprised to find that Report 296 concluded that there are substantial weaknesses in the capacity of the Auditor-General and the AAO, as presently constituted, to play their part in the processes of accountability to Parliament. After all, as a reviewer ourselves we could hardly argue that against the positive value of review, but in truth the wide-ranging, bipartisan JCPA inquiry provided an opportunity for constructive criticism about the AAO to be vented; and a goad to us to treat such criticism seriously.

It now provides an opportunity for the Government to improve further the accountability mechanism, for the 78 recommendations which resulted from the JCPA's Inquiry into the AAO are central to improving the independence and effectiveness of the Auditor-General and public-sector auditor.

Parliamentary Committees

1. Commission on Accountability, *Commission on Accountability. Report to the Premier, the Honourable P.McC. Dowding, LL.B., M.L.A.*, Perth, 1989.
2. Joint Committee of Public Accounts, *Report 296. The Auditor-General: Ally of the People and Parliament. Reform of the Australian Audit Office*, Australian Government Publishing Service, Canberra, 1989.
3. Sharpe, M., *Report of the Independent Auditor on an efficient audit of the Australian Audit Office in accordance with the Audit Act 1901*, Australian Government Publishing Service, Canberra, 1989.

Parliamentary committees provide the basis for the most effective means of parliamentary scrutiny of the executive and its supporting bureaucracy. They are not viewed with unalloyed delight by some outside the Parliament. But the business of government is so complex and wide-ranging that some detailed specialisation is needed if our delegates are not to become ciphers. Through committees, parliamentarians are directly involved in the analysis and investigation of public expenditure. Committees serve to increase public accountability by undertaking their inquiries whenever possible in public and by reporting the results of their inquiries to the Parliament. Through their actions committees stimulate both parliamentary and public debate of government activities.

Those committees which are essentially concerned with financial scrutiny are primarily interested in our reports of financial regularity audits. However, efficiency audit reports are also examined, or inquired into, by the JCPA and other parliamentary committees (depending on the subject of the efficiency audit). Attachment A shows the AAO involvement in committee inquiries in 1988-89 particularly with respect to my efficiency audit reports.

Estimates

My involvement with this process is as follows:

my audit reports provide the Senate estimates committees with clues as to problem areas where questions need to be asked;

when available in time for the estimates process, my audit opinions on the financial statements of departments and authorities contained in annual reports provide assurance (or otherwise) to these committees as to the probity and propriety of financial operations;

the Senate estimates committees have the option of inviting comment, at my discretion, on matters relevant to audit reports raised during Committee hearings. In addition, committees' secretaries can obtain background briefings (but not details of the actual audit findings prior to tabling of the reports) from nominated AAO officers on the audits referred to in each report;

my Office has a direct participation by formulating and justifying our own estimates; and

I have the option of performing project performance audits or efficiency audits on the efficiency and effectiveness of part or all of the estimates process. For example, performance audits of Forward Obligations of Government Expenditures

and the Budget Management System were conducted in 1984/85 and 1987/88 respectively.

The contribution of my Office to the Senate estimates committee process was formalised with the promulgation of the *Guidelines for Provision of Assistance to Senate estimates committees by the Australian Audit Office* in late 1986. The more important arrangements provide for committee secretaries to receive advance notice of the table of contents of each forthcoming report as soon as it is ready for printing, informing them of the departments and other bodies which are mentioned in the report; and the titles of the respective sections give an indication of the subject of each of the audits reported upon. These arrangements will have to be modified to accommodate separate audit reporting adopted in 1988-89, which is a start at trying to provide information in a more timely or effective way for the Parliament. I will expand later upon these reporting innovations.

With the introduction of requirements for departments and outriders to include audited financial statements in their annual reports, each agency will be competing for limited AAO resources. The limit on my resources leads to potential problems in availability of annual reports to estimates committees. This had an impact on the inquiry, *The Timeliness and Quality of Annual Reports*. In the June 1989 report, the Senate standing committee on Finance and Public Administration found that 'If estimates committees are to make full use of annual reports they require access to the reports well in advance of hearing dates...' but the four-year tabling pattern of departmental reports shows that the majority of reports were tabled in November/December after the estimates committees' hearings in September/October. Accordingly, the Committee recommended that 'The present requirement for draft annual reports to be available to Senate estimates committees should be removed from the guidelines' and that copies of current corporate plans with explanatory notes should be provided instead.

JCPA Estimate Process Recommendations

Report 296 of the JCPA on the reform of the AAO recommended two major changes to the estimates process with respect to my Office. Firstly, it was recommended that the AAO's appropriations be included in the Appropriation (Parliamentary Departments) Bill, thus enabling the AAO estimates to be considered by a Senate estimates committee with those of Parliament and not in conjunction with those of the Department of Finance, which is presently the case.

Secondly, the JCPA recommended that a separate parliamentary committee to be titled Audit Committee of Parliament be established to advise the Auditor-General on Parliament's audit priorities and to consider and recommend on the AAO's annual appropriation, which would bring us into line with other countries such as Canada and the United Kingdom. This recommendation has been prompted by the fact that the

Department of Finance, essentially an arm of executive government and an auditee of the AAO, advises the Minister for Finance on the AAO's proposed budget.

In making these recommendations, the Public Accounts Committee commented that: 'The departure from current practice would be that the executive would not have sole responsibility for advising on the AAO's appropriations. Responsibility would be shared with the legislature, or with Parliament as a whole' and concluded that '... the process by which forward estimates would be arrived at would be very different and consistent with the principle that the entire Parliament has a special interest in maintenance of an independent and able Audit Office'.

This would, of course, tip the balance of tensions towards the Parliament and move it more to the norm in Western democracies. I put to the JCPA that there was a need for a more transparent process involving the Parliament for developing the AAO's final resource estimates submitted to the Government each year. The Committee's recommendations would do this.

The placement of the AAO (in, say, the parliamentary group) for the purposes of the budget may have some symbolic importance, but it would be unrealistic to expect the Department of Finance not to have an important role in advising the Government on the level of resources appropriate to the AAO's task. From the AAO's point of view, it would like to see this advice complemented by advice from the Parliament on what it sees as reasonable. In the final analysis, given current attitudes in Australia, one guesses that the budget ultimately would be a matter for the Government to put to the Parliament unless, in time (the sooner the better) and through the development of conventions, the United Kingdom model is followed whereby an Audit Commission of the Commons sets the appropriation (although it should be remembered the British Government still has the actual power to interpose itself). The Committee has suggested that, in our case, the Minister for Finance would be a member of the Audit Committee.

As can be seen from the preceding discussion here and in the other sessions, the parliamentary committees are important to the concept of public accountability, as they play an integral part in the scrutiny of departmental and authorities' estimates. However, the effectiveness of this role requires appropriate resources and the proper management of them (perhaps along the lines mentioned by Senators Coates and McMullan) and the development of a new balance in the relationship between the Parliament and the executive, more along the lines found elsewhere in Western democracies.

Audit of Public Expenditure

With nearly 90 years of experience, the Australian Audit Office has developed enormous expertise in public sector auditing. It has also developed and sustained over a long period its reputation for integrity, a key factor in maintaining community confidence in the system of government. If it has faults, now is the time to fix them.

The principal activity of the AAO is the audit of:

government and parliamentary departments;

other branches or outriders of the Australian Public Service;

departmental commercial undertakings;

ACT Government bodies;

statutory authorities; and

companies in which the Commonwealth has a controlling interest, including the subsidiaries of these bodies.

As at 30 June 1989, the AAO had responsibility for the audit of a total of 307 Commonwealth organisations, with some staggering statistics:

revenue/expenditure turnover of some \$255 billion;

operation of some 360 separate revenue and expenditure programs in excess of \$10 million a year (of which 47 programs exceeded \$1 billion);

total assets and liabilities of approximately \$210 billion and \$168 billion respectively, excluding the value of assets and liabilities for departments and outriders which are not available;

employment of around 488,000 staff (down from 505,000 in the previous financial year); and

approximately 1,110 large data-processing installations (up from 960 in 1987/88).

Public expenditure is therefore only one aspect of our total audit responsibility. The audit program of the AAO consists of two sub-programs, namely regularity and performance audits. The latter involves efficiency and project performance audits, while regularity audit activity involves:

financial statement audits;

government accounting and financial statement audits; and

other regularity audits.

The auditing methodology employed in these audits has evolved with the growing complexity of the Commonwealth public sector. A risk-based approach to systems-based regularity auditing utilising computer-assisted audit techniques where applicable is now used which is consistent with the devolution of public-sector management. By streamlining procedures and targeting high-risk areas for more concentrated audit attention, and contracting certain financial statement audits to the private sector (while still retaining control), I have been trying to make the best use of my scarce staff resources through the use of appropriate professional techniques in order to satisfy my regularity audit mandate.

Performance Auditing

Performance auditing procedures have also been reviewed and improved over the years. However, due to resource constraints and my extensive regularity audit responsibilities, which are mandatory, I have been unable to devote more than an average of 20.8%, of my staff resources to undertaking project performance (14.8%) and efficiency audits (6%) in the last three years. We are doing less. This is indeed unfortunate, since the reports arising from such audits provide the richest material from which questions are drawn by the Senate estimates, and other parliamentary committees.

In recognition of the value of efficiency audit reports to committees, the JCPA focused on the efficiency auditing activity of the AAO. Report 296 recommended a cycle of efficiency audits for all programs with expenditure or revenue greater than \$10m, ranging from a three-year cycle for departments to a 20 year cycle for government companies. It was estimated that this program of audits would cost an additional \$15.7m phased in over five years and would mean that 50% of the AAO's resources would be for efficiency audits and 50% for project and regularity audits (which is about the same proportion as the United Kingdom and Canadian national audit offices). An increase in efficiency audits will increase the material available to committees for the estimates process.

Audit Reporting

Procedures for the production of audit reports have not remained unchanged either. Major regularity and performance audits are now being reported immediately after an audit has been completed (to ensure audit reports are more timely) and a regular report on audits will be issued as a consolidated overview of portfolios. Previously reports on regularity and project performance audits were incorporated into consolidated

biannual reports and efficiency and special audits were the only audits reported and tabled separately.

The Future

The JCPA noted in its Report that:

The Auditor-General has a vital role to play in this [accountability] debate because he has the authority to ask how efficiently are government agencies applying their resources. He also has the means to answer that question and to inform Parliament directly. This inquiry has upheld his right to ask that question, and has sought to strengthen his capacity to form an opinion on this matter.

The pace of reform in the AAO has escalated since Report 296 of the JCPA was tabled in March 1989. I have been able to implement many of the JCPA recommendations (given present constraints) that fall within my responsibility and which do not require decisions by the Government. These have been added to our continuing program of improvements, some of which I have already mentioned; some others are briefly listed below:

fostering relations with the private sector accounting bodies and audit firms, including sub-contracting of audit work, promoting staff interchange schemes and negotiating with the Institute of Chartered Accountants to have the AAO accredited as a training centre for admission of staff to membership of the Institute;

a tighter focussing of our corporate plan;

restructuring of our task management structure and work methods (which we refer to as the 'audit manager concept') to increase productivity within present resource constraints; to improve client service; and to improve staff satisfaction;

investing heavily in better planning and control management systems; and

establishment of advisory committees comprised of representatives of the private sector, universities and others to introduce new perspectives on the AAO's strategic direction and audit practices and standards.

However, it is the JCPA recommendations requiring decisions by the Government which will have the most impact on the future of the Auditor-General and the AAO. In the context of today's workshop, a favourable reaction from the Government to the key recommendations will result in sufficient quality staff to undertake non-mandatory project and efficiency auditing activity.

These are the audit reports which stimulate the most interest from parliamentary committees and are therefore more likely to produce necessary improvements to the efficiency and effectiveness of the public sector.

Attachment A

Communications With Parliamentary Committees 1988-89 Inquiries

1. Joint Parliamentary Committee of Public Accounts

Reform of the AAO

Efficiency Audits:

- Department of Defence: Safety Principles for Explosives
- Department of Defence: Army Mapping
- Department of Defence: RAAF Explosive Ordinance
- Administration of Offsets

Department of Arts, Sport, the Environment, Tourism and Territories:
Antarctic Division (drew in part on an audit of Antarctic Division shipping
operations project audit)

Department of Defence inquiry into the development of new computer
systems DESINE and Supply Systems Redevelopment Program (AAO
provided assistance with some technical aspects)

2. House of Representatives Standing Committee on Finance and Public Administration

Efficiency Audits:

- Australian Taxation Office: Taxpayers In Unincorporated Businesses
- Australian Taxation Office: International Profit Shifting
- Department of Community Services: Home and Community Care Program

Public Sector Reforms FMIP (AAO provided a submission)

3. House of Representatives Standing Committee on Transport, Communications and Infrastructures

Efficiency Audits:

- Australian National Railways Commission: Commission Traffic
- Australian Postal Commission: Administration of Philatelic Services

4. House of Representatives Standing Committee on Publications

Efficiency Audit:

- Australian Government Publishing Service

5. Senate Standing Committee on Environment, Recreation and the Arts

The AIS arranged for the AAO to review an internal audit into weightlifting expenditure at the request of the Chair of the Inquiry into the use of performance enhancing drugs by Australian sportspersons.

6. Senate Estimates Committee E

The Special Audit Report on the Aboriginal Development Commission and the Department of Aboriginal Affairs was considered by this Committee. It also took evidence from the AAO and considered AAO's written comments on the Commission's evidence and published response to the Special Audit Report.

7. Senate Estimates Committee C

AAO annual budget explanatory notes and 1988-89 appropriations

8. Senate Standing Committee on Finance and Public Administration

The Timeliness and Quality of Annual Reports provided submission

government-owned companies -- provided submission concerned with the question of audit of the companies and maintaining the accountability chain.

