

AUSTRALASIAN COUNCIL OF AUDITORS-GENERAL

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The Chairman
Public Accounts Committee
C/- Legislative Assembly
Western Australian Parliament
Parliament House
PERTH WA 6005
e-mail – lapac@parliament.wa.gov.au

Dear Sir

Auditor General Bill 2005

Members of the Australasian Council of Auditors-General (ACAG) have been canvassed and submit the attachment in response to the abovementioned inquiry.

This represents the views of the New Zealand and all Australian members of ACAG with the exception of the Auditor-General for South Australia, who reserves his right to respond separately where he deems it appropriate rather than as a member of ACAG, and the Auditor-General for Western Australia.

The opportunity to raise comment is appreciated and I trust you will find the attached comments useful.

Yours sincerely



Frank McGuinness
Chairperson
ACAG Financial Reporting Group
27 January 2006



Response by the Australasian Council of Auditors-General (ACAG) to the Inquiry by the Public Accounts Committee into the Auditor-General Bill 2005

This response represents the views of the New Zealand and all Australian members of ACAG with the exception of the Auditors-General of South Australia and Western Australia

Committee: Public Accounts Committee

Name and organisation making submission: Frank McGuiness on behalf of the Australasian Council of Auditors-General. Contact details:
Office telephone number – 08 8999 7004
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Position Held: Auditor-General for the Northern Territory and Chairperson of the ACAG Financial Reporting Group

Preparedness of ACAG to appear before the Committee: Either the Convenor of ACAG, Mr Wayne Cameron or the Chair of the ACAG Financial Reporting Group, Mr Frank McGuiness is prepared to appear before the Committee if the Committee should desire.

Content of ACAG's submission

Broadly speaking, we support the measures in the Bill. The Bill, as drafted, should preserve the appointment of an independent Auditor-General, having powers to significantly assist the Western Australian Parliament in assuring effective public sector accountability.

However, we have some suggestions and comments on specific clauses, which are set out below. Our comments deal separately with general and specific observations.

Please note that this submission relates only to the Auditor-General Bill 2005. While no detailed comment is made on the Financial Management Bill 2005, a general suggestion to enhance the overall accountability framework, which would most appropriately reside in this Bill, is offered for your consideration and is included at the end of this submission under a section headed 'Financial Management Bill 2005'. In addition, some of our comments below, if adopted, may have consequential impacts on the Financial Management Bill 2005.

General observations

Establishment of the Office of the Auditor-General (OAG)

We note the intention that the OAG is a department of the Public Service (clause 4). It is our view that independence of the Auditor-General would be enhanced if the OAG were to be established as a statutory authority but without a board.

Use of the terms 'accounts' and 'financial statements'

Broadly speaking, we suggest the Bill is updated for more appropriate terminology.

We suggest the replacement of the term 'accounts' with a term that is more consistent with the financial reporting framework. We prefer the term 'financial report', as both Australian Accounting Standards (Australian Equivalents to International Financial Reporting Standards) and the *Corporations Act 2001* refer to 'financial reports'.

However, we suggest the replacement of the term 'accounts' is only appropriate when the subject is actually the financial report, and not where the term 'accounts' has been used to mean the books and records of an entity.

We recommend that the term 'financial statements' should also be replaced with 'financial report' as appropriate.

If adopted these changes would require the terms 'accounts' and 'financial report' to be defined.

Use of the term 'agency'

We note the use throughout the Bill of the word 'agency', which is defined by cross reference to the *Financial Management Act 2005* as "a department, sub-department or a statutory authority".

Clarity is needed as to whether or not this is intended to include all public sector bodies as defined in the *Government Financial Responsibility Act 2000* in particular part (b) of that definition being:

- (b) a body, whether corporate or un-incorporate, or the holder of an office, post or position, being a body, office, post or position that is established or continued for a public purpose under a written law.

Clarity in the use of the word 'agency' is also needed for two further reasons:

- Due to inclusion of the words "... independent external audit of the public sector and related entities." in subclause 3(b). In our view "audit of the public sector" needs to be clarified by inclusion of a definition or by cross reference; and
- To address situations where a corporate entity is established under the control of a Minister(s). In such situations the proposed legislation should require the Treasurer to determine that such entities are a "subsidiary body".

In addition, we note that the definition in the Financial Management Bill of statutory authority is a person or body listed in Schedule 1. This definition could be problematic if Government does not schedule a body, which would otherwise be considered an agency. It would be preferable if the Auditor-General Bill included a definition of "statutory authority" which would also need to include "trustees of trusts" and subsidiary bodies.

Other Clause 4 Terms used in this Act

"Auditing and Assurance Standards" are defined as those standards in force under the Corporations Act, section 336. The standards in force under section 336 will largely be those standards that govern the audit of historical financial information and will not include those relating to assurance engagements or related services. Presumably the Auditor-General will be required to have regard to all audit and assurance standards, not only those applicable to the financial audit of Corporations Law entities. Accordingly, the reference should be pursuant to section 227B of the Australian Securities and Investments Commission Act 2001

and section 336 of the Corporations Act 2001". (See further comments in this submission under clause 27.)

Para (a) (ii) of the definition of "subsidiary body" applies an outdated definition of 'control' for accounting purposes. We suggest that the updated definition of control be adopted from AASB 127 'Consolidated and Separate Financial Statements' ie "the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities".

Specific observations

Clause 13 – Audit and opinion on Annual Report on State Finances

We note and support the need for the Auditor-General to audit the Treasurer’s Annual Report on State Finances, that this report is required to be prepared in accordance with external reporting standards (as defined in the *Government Financial Responsibility Act 2000*) and that Section 4 of the *Government Financial Responsibility Act 2000* requires the report to be prepared in accordance with two accounting frameworks - both GFS Australia and Australian Accounting Standards.

The existence of two accounting frameworks referred to is under review by the Australian Accounting Standards Board, an objective of which is to converge the two frameworks. It is ACAG’s preference that, until convergence of the two standards is achieved, reporting under Australian Accounting Standards should be mandated (as a minimum).

We note also that an auditor, upon completion of an audit of a financial report, expresses an opinion on the financial report, not on the audit. Subclause 13(2) should read:

“The Auditor-General, following completion of the audit carried out under subsection (1), shall prepare and sign an audit opinion on the report stating whether”

To assure enhanced accountability we believe that subclause 13(4) should include:

“.... to the Treasurer addressed to the Parliament of Western Australia.”

Clause 14 Audits of accounts of agencies

As the draft provision is reasonably broad, better practice would indicate that an appropriate level of guidance should accompany it. Such guidance could cover both the types of audits for which dispensations may apply, and risk mitigation strategies in recognition of the higher level of risk resulting from extended periods between audits.

Clause 15 - Audits and opinions on financial statements and related information as to agencies

Clause 15(1) requires the Auditor-General to audit the financial statements, key performance indicators and other information submitted by agencies under the *Financial Management Act 2005* section 61(1). That section within the *Financial Management Act*, however, includes the agency’s report on operations and other information, which is not normally subject to audit but overviewed to ensure that the content is not inconsistent with the audited financial report.

We have concerns about the wording of the proposed wording of the audit opinion that would be required by this clause. Subclause 15(3)(a) states that Auditor-General’s opinion is to state

whether 'the financial statements are based on proper accounts and present fairly the operating results and cash flows for the period under review and the financial position at the end of that period'.

Australian Auditing Standard AUS 202 'Objective and General Principles Governing an Audit of a Financial Report' establishes standards and provides guidance on the objective and general principles governing an audit of a financial report. Paragraph 02 of AUS 202 states:

'The objective of an audit of a financial report is to enable the auditor to express an opinion whether the financial report is prepared, in all material respects, in accordance with an applicable financial reporting framework.'

The term 'proper accounts' is not defined within the Auditor-General Bill 2005, the Financial Management Bill 2005, or Australian Accounting Standards. This could suggest that the term 'proper accounts' does not form part of the applicable financial reporting framework. It is, therefore, difficult to determine whether information is presented in accordance with undefined terms.

In addition, we suggest that the introductory part of subclause 15(3) be amended to read as follows:

"The Auditor-General, following completion of the audit carried out under subsection (1), shall prepare and sign an audit opinion on the report stating whether ...".

We note that subclause 15(3) will result in the requirement for the Auditor-General to report, in one report, on financial, controls and performance information. We understand that this reflects the existing practice of the Western Australian Auditor-General. However, we remain concerned that the issue of a single auditor's report containing three separate opinions may create the risk that users of the auditor's report may find it unclear.

Clause 16 – Audits of accounts of certain subsidiary bodies

We support inclusion in the Bill of this clause. Consideration should be given to including in clause 16 a subclause similar to subclause 17(1) – that is, the agency should be required to give written notice to the Auditor-General where it performs, or intends to perform, any of its functions via a foreign subsidiary or via a local subsidiary.

For foreign subsidiaries an agency is required to ensure the subsidiary appoints an auditor nominated by the Auditor-General. There may be situations where it would be appropriate for the Auditor-General to undertake the audit himself (for example, where the accounting records for the subsidiary are maintained in Western Australia). Therefore, this clause should also enable the Auditor-General to undertake the audit himself.

Clause 17 – Audits of accounts of related entities

Subclause 17(2) states:

'The Auditor-General may audit the accounts and financial statements of a related entity of an agency to the extent that they relate to functions that are being performed by the related entity –

- a) On behalf of the agency;
- b) In partnership or jointly with the agency; or

c) As the delegate or agent of the agency.'

We agree that this clause is appropriate. However, in applying the clause, some judgement may be required and it is not stated whose judgement that should be. In the event of a disagreement between parties as to the Auditor-General's mandate, it is not clear whose decision is final. We suggest a determination be made in this respect and that this ability be included within the legislation. We believe that the decision as to whether or not to conduct an audit as envisaged should be at the discretion of the Auditor-General.

It is our view that the Auditor-General should be able to conduct audits in private sector entities in all circumstances where and to the extent that an agency performs its functions through that private sector entity. For example, the clause should capture situations where an agency out-sources a core government function to a private company. Sub-clause 17(2) would be improved by not limiting the means by which this might occur, by adding a paragraph "(d) or otherwise".

If the intention is to restrict the audit activity of the Auditor-General to certain criteria, this should be clarified within the legislation. However, it is our view that Auditor-General should be able to conduct audits of private sector entities in these circumstances and there should be no restriction.

Clause 18 – Examination and investigations

This clause provides that the Auditor-General may examine the accounting and financial management information systems of the Treasurer or an agency to determine their effectiveness in achieving or monitoring program results. There may be other non-financial systems that may need to be reviewed in order to assess program effectiveness.

Subclause 18(2)(b) includes reference to the "accounts of the Treasurer". This is not defined.

Subclause 18(2)(c) and (e) – It is not clear from these two subclauses whether or not the proposed mandate includes the discretion of the Auditor-General to conduct audits of efficiency and effectiveness of corporatised entities. It is our view that the mandate should be clarified to include such power. In addition, subclause 18(2)(e) does not cover foreign subsidiaries.

Subclause 18(2)(f) – our comments on subclause 17(2) also apply to this subclause including our concern that it would appear to contain limitations on when the Auditor-General may carry out investigations in partnerships, joint ventures and trusts formed by agencies.

Clause 22 – Audits and other services by arrangement

We support the inclusion of this Clause. Consideration could however be given to including a public interest test within the clause.

Clause 27 – Duties of Auditor-General as to audits

Subclause 27(1) – we support the discretionary power permitted to the Auditor-General in selecting how he/she will conduct audits. An important consideration in the relationship between the Auditor-General and the Parliament is transparency of process, with the enhanced accountability of the audit function that accompanies better transparency. We note

that the existing arrangement in Western Australia, whereby the Auditor-General is required to inform Parliament of any major change in the extent or character of his or her audits, seems to have proved quite satisfactory and a continuation of that approach appears to be countenanced by clause 24(2)(b) of the Bill. An alternative approach is that which is set out in the *Commonwealth Auditor-General Act*, whereby the Commonwealth Auditor-General is required to make standards for the performance of Auditor-General functions. The Western Australia Auditor-General should be in a position to adopt the standards made by the AuASB for his/her own work and if an occasion should arise where an additional requirement is deemed appropriate or an AuASB requirement is deemed inappropriate in the circumstances, he/she can specify inclusion or exclusion as the case may be. The need to specify the exclusion of an AuASB standard requirement is likely to be a rare event.

Subclause 27(1)(b) – clarity is needed as to whether or not use of the word “body” includes subsidiaries, related entities (see clause 17) and corporatised entities.

Subclause 27(2) – this subclause requires the Auditor-General in carrying out an audit, to “consider whether the requirements of relevant enactments have been complied with”. This is an extremely onerous requirement to be placed on each audit that the Auditor-General does. There is already a requirement for some legislative financial compliance reporting in the annual audit reports of agencies. Other aspects of legislative compliance could be dealt with under specific audits done under s 18 of the Bill.

Clause 39 – Audits and opinions on financial statements and related information as to the OAG

The same point as made in respect of Clause 15 and the wording of the audit opinion is relevant to subclause 39(2)(a).

Clause 35 Duty to give information overrides other duties and rights

It appears that subclause 35(2) does not deal with information that is included in contracts entered into by government entities and regarded as “commercial in confidence”. We believe that the Auditor-General’s scope of work should not be limited by such clauses in contracts and that this be clarified/confirmed.

Clause 42

We support the proposed involvement of the Public Accounts Committee in the determination of the OAG’s budget and its organisational structure.

Clause 44 – Information confidential

Subclause 44(1)(c) – makes reference to “ a person appointed to assist” and we assume that this includes “authorised persons” as defined in clause 32.

Clause 46 – Incumbent Auditor-General remains in office

We note in subclause 46(2) that the incumbent Auditor-General “...is to hold office...”. We recommend that be changed to “... may hold office ...”.

Schedule 1 clause 1 – Appointment of Auditor-General

The mechanism by which the Auditor-General is appointed is acceptable. However, as documented in ACAG's "Statement of Principles – Independence of the Auditor-General", we prefer the model whereby the Parliament should select and recommend the Auditor-General for appointment by the Governor. As a minimum, the appointment of the Auditor-General should require explicitly the approval of the nominee by the Public Accounts Committee, as in the Commonwealth *Auditor-General Act 1997*.

Review of the Audit Office

There is benefit in the conduct of external independent reviews of audit offices or, alternatively, providing the independent auditor with the power to perform audits to examine the efficiency and effectiveness of the OAG (mirroring the provisions of clause 18(2)(e)). The practice that has existed in Western Australian for a number of years whereby the Auditor-General has instigated independent reviews of the OAG appears to have worked effectively. An alternative approach is set out in section 45 of the *Commonwealth Auditor-General Act 1997*. That Act provides for performance audits to be conducted by the Independent Auditor.

In Jurisdictions where reviews of Audit Offices are undertaken, the framework for the reviews is generally included in the respective jurisdiction's audit legislation. For example, in Queensland, Part 5 Division 6 of the *Financial Administration and Audit Act 1977* requires reviews to be conducted at five yearly intervals. The QAO's view is that five years between reviews works well. Those reviews are based around a review of the Auditor-General's functions, and the Auditor-General's performance of these functions, to assess whether they are being performed economically, efficiently and effectively.

The Queensland legislation includes appropriate safeguards such as –

- a requirement for consultation with the Public Accounts Committee and Auditor-General concerning the appointment of independent, external reviewers, and the terms of reference of the review; and
- natural justice, whereby the Auditor-General is given the opportunity to respond to the reviewer's proposed report, and the response is subsequently incorporated into the report.

A copy of the *Financial Administration and Audit Act* can be found at www.legislation.qld.gov.au.

Similar legislative provisions exist in Victoria, NSW and the Northern Territory and consideration could be given to including similar provisions in the Western Australian Act.

It is noted that WA already has a review model in place. Consideration could be given to formalising this arrangement in the legislation.

Financial Management Bill 2005

General Comment

We refer to the Public Accounts Committee's request for comments regarding enhanced accountability for financial management practices and outcomes in the WA public sector. We would like to provide for your consideration, information concerning charters which facilitate reporting and accountability of Government.

Such charters exist in a number of jurisdictions. For example, Part 1A of *Queensland's Financial Administration and Audit Act 1977* includes the requirement for a Charter of Social and Fiscal Responsibility (refer www.legislation.qld.gov.au). The purpose of the Charter is to:

- State the broad social and fiscal objectives of the Government; and
- Establish a framework for assessing the Government's performance in achieving the objectives.

The Charter is aimed at providing increased transparency and accountability in developing, implementing and reporting on the Government's social and fiscal objectives.

The Public Accounts Committee may wish to consider whether a concept such as the charter and accompanying annual *Priorities in Progress* reports may further enhance WA's accountability framework. Examples of Charters and *Priorities in Progress* reports prepared in Queensland can be found at www.treasury.qld.gov.au.