

Third ACAG Conference, Canberra

**Some Current Issues Impacting  
on Performance Audits**

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## **1. INTRODUCTION**

I am delighted to welcome you all to the ANAO today, and also to this forum developed under the auspices of the Australasian Council of Auditors-General (ACAG). I am grateful for your participation and am confident it will be a useful personal development experience for you. I have many opportunities to meet my fellow Auditors-General and exchange views with them. However, there are only limited opportunities for the operational level staff in performance audit to meet their professional colleagues. This workshop therefore offers a valuable opportunity for performance auditors from around Australia and New Zealand to discuss matters of mutual interest. I note that a stimulating agenda has been developed for the two days, building on contributions from ACAG members. We have also continued the practice of holding these workshops in conjunction with the Australasian Evaluation Society Conference. It is a bonus that two of the speakers to the AES Conference have accepted our invitation to address the workshop. I am aware that some of you will also attend that conference.

Public sector environments have undergone significant reform in recent years and the performance audit role has changed commensurately. Agencies, not least among them the ANAO, must be on the front foot if they are to manage effectively the many challenges they face - from new policy directions, changing technology and agency initiatives. I would like therefore to talk to you about some of the issues currently on the ANAO agenda, how they are reflected in some recent performance audit work, and also mention some of the initiatives we have taken recently to help ensure that we meet the challenges of the contemporary public sector environment.

The following is not an exhaustive listing of relevant topics nor, given the time available, will I do them the justice they deserve. However, I hope they will help stimulate discussion. I will address them in the following order:

- The impact of information technology and communications (ITC) on the public sector environment;
- the outcomes/outputs framework;
- the growing convergence of public and private sectors;
- developing robust corporate governance frameworks; and
- the role of the public sector auditor.

## **2. THE IMPACT OF INFORMATION TECHNOLOGY AND COMMUNICATIONS (ITC) ON THE PUBLIC SECTOR ENVIRONMENT**

ITC is revolutionising the way in which the public sector operates. It has improved the ability of public organisations to communicate, to share critical information and to organise political and bureaucratic processes in a more efficient way. Information Technology has also enhanced productivity by providing new, more responsive and efficient ways of delivering public services and by providing more timely and useful information to citizens. However, it has also proved to be costly and often not managed well. Increasingly, ITC issues feature significantly on the Commonwealth

agenda: in 1997 the Prime Minister committed the Commonwealth Government to bringing all appropriate services online via the Internet by 2001.

ITC has the potential to provide a vehicle to deliver better quality products to the public more quickly, cost effectively and conveniently. The result of this could be programs designed primarily around the needs of citizens rather than just largely reflecting the organisational structure of the public sector. This could require the redesign of current governance arrangements and systems.

Using the Internet for improved service delivery will also bring new risks and exposures, matters to arouse the interest of auditors and possibly even result in a legal liability for government, which would need to be addressed. The recent ANAO Better Practice Guide on online service delivery identifies four stages of service delivery available over the Internet, as follows:

- Stage 1 comprises a website that publishes information about the agency and its services to all Internet users;
- with Stage 2 any Internet user is able to browse and interact with the agency's database or databases;
- Stage 3 includes the first two stages and permits users to enter information on the website, exchanging or transacting secure information with the agency; and
- Stage 4 is the same as the previous stage but in addition the agency, with the user's prior approval, shares that user's information with other government agencies.<sup>1</sup>

Once the decision is made as to the appropriate stage for the program in question, the manager needs to ensure that current and appropriate privacy and data security policies and practices are in place. Action should also be taken to identify and minimise any associated legal liability for government, such as might be created if incorrect or misleading information on an agency's internet site lead to a user's financial loss. The manager must also re-assess the risk and control strategies used for service delivery. In general, the extent and cost of the security required increases with the progression through Stages 1 to 3. This is due to organisations moving from protecting their website from 'hacking' attacks to the need for increased confidence in authenticating users, the need to protect agency data and to ensure the integrity of web based transactions. Agencies' options in dealing with these security issues include the use of 'firewalls' (which are basically software protection) and/or through physical separation. Data encryption systems have particular use for government agencies wishing to embark on initiatives that do more than just disseminate information.

The ANAO recognises that the widespread use of ITC has a considerable impact on agency accountability and risk management, both positively and negatively, and increasingly is incorporating these issues into audit work. The challenge for the public sector auditor working in these areas is likely to be directed less to the detection of offences and more in the application of ITC audit skills to determine whether there are adequate mechanisms to undertake the following broad capabilities:

- protect Government online systems and information assets;

- detect incidents and vulnerabilities; and
- address and resolve online security issues or incidents as they emerge; and authenticate the parties to online transactions.

More broadly, the concern is with how well we are using such assets and the contribution they are, or should, be making to agency outputs and outcomes.

The ANAO acknowledges the increasing impact of information technology and communications, which is included as a key theme in our current audit work program. Recognising the value of giving Parliament a holistic view of ITC in agencies, we recently finalised three audits of ITC in Centrelink, the Department of Veterans' Affairs (DVA) and the Health Insurance Commission (HIC) that combined performance audit and financial statement elements.<sup>2</sup> We particularly wanted to know whether these agencies' systems could be relied on to support the production of reliable financial information for inclusion in each organisation's financial statements and whether their systems adequately met quality and service delivery targets.

The results of testing indicated that reliance could be placed on DVA and Centrelink's systems and accuracy of the controls and records of the DVA and Centrelink, to enable an opinion to be formed on the financial statements. As far as the HIC was concerned, the results of testing were satisfactory for its business systems (Medicare and PBS) to the extent necessary to form an opinion on the financial statements but the financial management controls could not be fully relied on and we extended our testing around the system to provide adequate assurance on the financial statements.

With regard to the performance audit element of the project, the audit team considered that these aspects of the audit objective were best addressed using an international set of standards, particularly given the global nature of information technology developments. The team accordingly chose standards developed by the Information Systems Audit and Control Foundation, for these three audits. These standards are known as CobiT – Control Objectives for Information and Related Technology and are 34 high-level process and control objectives which fall into four main domains:

- planning and organisation;
- acquisition and implementation;
- delivery and support; and
- monitoring.

This structure is said to cover all aspects of information and the technology that supports it. By addressing these 34 high-level Control Objectives the business process owner can ensure that an adequate control system is provided for the ITC environment. In addition, corresponding to each of the 34 high-level Control Objectives is an audit, or assurance guideline to enable the review of ITC processes against CobiT's 302 recommended detailed control objectives to provide management assurance and/or advice for improvement. CobiT also contains an *Implementation Tool Set*, which provides lessons learned from those organisations that quickly and successfully applied CobiT in their work environments.

Due to issues of relevance, time and cost constraints, the audit did not address all the specific control objectives within these four main domains. The ANAO did, however, concentrate on controls critical to the business of the three agencies audited. With regard to the ITC performance audits the ANAO concluded that overall the agencies were meeting the quality and delivery targets they had set themselves for their various responsibilities, in the case of Centrelink the development and future use of ITC performance measures could be improved. We plan to continue using the CobiT objectives for future ITC performance audits of agencies.

### **3. OUTCOMES/OUTPUTS BUDGET AND ACCOUNTING FRAMEWORK**

The first accrual budget was presented to Federal Parliament in May 1999 covering the 1999-2000 financial year. These reforms changed substantially the way in which budget documentation (including the Portfolio Budget Statements [PBSs], Annual Reports and the Portfolio Additional Estimates) is constructed and reported to Parliament.

The Joint Committee of Public Accounts and Audit (JCPAA) is currently conducting a review of accrual budget documentation<sup>3</sup> with the objective of exploring how the budget documentation can be improved within the accrual framework.<sup>4</sup> Criticisms made about accrual budget documentation include the following:

- expenditure on various government activities is being obscured by the way it is reported;
- observers are unable to track the expenditure on particular programs; and
- the performance measures used by agencies are not meaningful.<sup>5</sup>

The ANAO agrees that one of the key challenges with the form of budget documentation over the years has been how to maintain consistency in concepts, format and trends in the face of change while succinctly conveying to the Parliament the outputs and outcomes expected from the budget both in terms of revenue and anticipated expenses to be funded from standing and annual appropriations<sup>6</sup>. There are considerable advantages to the Commonwealth's accrual budgeting reforms although the implementation of the changes will take time to bed down.

We have made suggestions for enhancing budget documentation,<sup>7</sup> most notably by:

- expanding the role of the PBS to include reporting on progress achieved towards outcomes by those agencies with a significant responsibility in relation to particular government outcomes;
- providing additional outyear information within the PBS so that Parliamentarians are able to place current year budget requirements and targets within context;
- improving the underlying linkages between the pricing of outcomes, outputs and strategies so as to facilitate understanding of this information by Parliamentarians; and

- encouraging agencies to consult with the ANAO on accounting policies in respect of new or complex financial arrangements at the time of budget preparation.

Once there is agreement on the scope and content of budget documentation, we suggest that presentation issues could be considered, with the aim of making the documentation more user friendly.

Our own performance audit work has recognised the challenges facing agencies in this new environment. We are keen to identify the issues facing agencies early in the life of the framework so that they can be addressed, but also, and importantly, offer practicable solutions. While the validity and reliability of performance information is a key consideration in most ANAO performance audits, we have been working on two audits specifically considering performance information with the PBSs. The first of these, Report No 46, *ATO Performance Reporting under the Outcomes and Outputs Framework*, was tabled in June of this year<sup>8</sup>.

The ANAO was responding to a request from the Senate Finance and Public Administration Legislation Committee to review agency performance information during the course of an audit program. The Australian Taxation Office (ATO) was chosen for the significance of its performance, to assist the ATO in reviewing performance reporting under its outcome and outputs framework, as well as to assess progress being made and lessons learnt. However, it is expected that all agencies will improve their performance information over time as they obtain more experience with the new framework.

The audit found that, while the ATO has established an outcome and outputs framework, there was scope to improve the specification, clarity and measurability of its outcome, outputs and performance measures and to enhance its performance monitoring and reporting arrangements. The audit made 10 recommendations aimed at improving the ATO's management of its performance reporting under its current outcome and outputs framework.

In undertaking the audit the ANAO developed a number of principles of better practice in relation to specifying performance measures and to measuring, assessing and reporting performance. In consultation with the Australian Bureau of Statistics, the ANAO developed a set of criteria based on methodology used by Statistics Canada to review ATO performance measures. It is envisaged that the audit, while focused on the ATO, can also provide timely and relevant advice to other APS agencies.

The ANAO is also conducting a cross-portfolio audit to assess performance information in the PBSs 2000-2001 and Annual Reports for 1999-2000. Both audits will provide material for a better practice guide for performance information in PBSs and Annual Reports.

#### **4. GROWING CONVERGENCE OF PUBLIC AND PRIVATE SECTORS**

##### ***Outsourcing and collaboration***

An interesting outcome of the recent public sector reform directions in Australia is that nearly all of the results the government strives to achieve require the collaborative efforts of two or more agencies/parties/levels of government. Unfocused and uncoordinated programs waste scarce resources, confuse and frustrate customers or clients (citizens) and limit overall program effectiveness. The development of effective working relationships with stakeholders is, therefore, an important element in a functioning corporate governance framework and can help to identify, overcome and even avoid fragmentation and overlaps in government programs. Market mechanisms may actually create 'islands' or 'silos' within agencies, particularly where activities are more commercially based and make coordination of services to citizens in a seamless manner that much more difficult for providers, whether in the public or private sectors.

In this respect, it is interesting to consider the United Kingdom (UK) 'Modernising Government' approach which stresses 'partnership delivery' by all parts of government as well as with the private sector.<sup>9</sup> The UK National Audit Office recently reported on its response (and strategies) to that policy, including the notion of 'joined-up' government,<sup>10</sup> with particular comments on risk management. The changes that are occurring at least reflect different risks, perhaps even additional risks, that need to be managed. A particular issue was whether the audit approach would be consistent with the need to manage those risks to achieve the required results. Auditors, generally, have continued to stress the basic differences between risk and risky management.

As governments rethink their roles in society they are being required to develop new approaches to policymaking and service delivery that are increasingly involving new partnership arrangements. As well, the evolving environment is drawing the private sector increasingly into partnerships, mergers and alliances as a means of better coordinating economic activity and generating greater returns. Consequently, networking or partnering is beginning to play a major role at the local, national and international levels and across all sectors of the economy for improved performance and effectiveness.

Such arrangements are also likely to be encouraged through the increased adoption and impact of e-government with its focus on coordination and collaboration in the business environment and with shared databases as well as greater electronic integration in a virtual 'one-stop' service delivery environment. Between agencies, these arrangements are quasi-contractual and tend to be based on 'relational', rather than 'legal', agreements, for example by Memoranda of Understanding. Nevertheless, there are compelling reasons in a number of areas for considering the extension of the relational/partnering approach involving the private sector in a more networked environment. As usual, a balance has to be struck in particular cases between the various demands on managers, which can change depending on circumstances and the environment. The following is a related observation from a private sector perspective:

*...the move to collaborative outsourcing agreements is an admission that the most successful outsourcing organisations are the ones that have a clear idea what they want the outcomes to be, rather than trying to manage (my underlining) the outsourcer.<sup>11</sup>*

In Australia, there do appear to be indications that greater coordination, collaboration, or networking, across agencies is gaining favour as a means of delivering more responsive public services to citizens. For example, a recent ANAO report<sup>12</sup> discussed how three welfare agencies were defining their particular outcomes and outputs and how the outputs of one of these agencies were directly related to the outcomes of the purchasing departments. These arrangements have been managed through a strategic partnering process rather than a legal contractual framework. These arrangements have subsequently expanded such that the particular Commonwealth agency, Centrelink, now delivers services on behalf of a total of four agencies under formal purchaser-provider arrangements. Centrelink's partnership agreement with the now Department of Family and Community Services reflects their emphasis on building trust; maintaining productive relationships; and dealing positively with legal limitations.<sup>13</sup>

A further indication of a possible move towards network bureaucracies is the renewed focus on the needs of citizens as clients or customers. This is, at least partly, a consequence of a government decision in March 1997 to introduce Service Charters in order to promote a more open and customer-focused Commonwealth Public Service. All Commonwealth Departments, agencies and Government Business Enterprises that have an impact on the public must develop a Service Charter. These Charters are to represent a public commitment by each agency to deliver high quality services to their customers. Two whole-of-government reports have been presented to Parliament reporting, among other things, performance against the 'principles for developing a Service Charter' launched in 1997. The second report concluded that:

*Service Charters are proving to be key instruments for innovation and for driving effective service delivery in the 21<sup>st</sup> Century.*<sup>14</sup>

Where service delivery has been outsourced, Service Charters will clearly have a direct impact on the private sector contractor. In particular, it is to be expected that outsourcing contracts will need to reflect the Service Charter commitments if the Charters are to have any real meaning. It will also be important to require, as part of the contractual arrangement, the provider to supply outcome, output and input information against which the provider's performance can be assessed, including whether processes are efficient and the service quality is satisfactory. In this way, even if the client is one or more steps removed from the responsible department, it should still be possible to ensure clients are receiving the appropriate level and quality of service, consistent with the Service Charter. Such an approach may also be expected to reinforce the notion of both the private sector provider and the contracting agency being dependent on one-another for delivering a satisfactory level of performance and accounting for their performance – in effect trading-off some degree of their individual control for agreement about their joint performance and results to be achieved.

Networking can be expected to evolve to include strategic arrangements and structures involving public organisations, private operators and voluntary associations as well as individual clients and the community generally. Such interaction should in turn generate new forms of service delivery and probably redefine the various relationships between government and the community over time. These moves have



important ramifications for both responsibility and accountability and raise the question, again, as to ‘who is accountable for what?’

A major aim has been to deliver services that appear seamless to the recipient.<sup>15</sup> In such arrangements, where there is joint responsibility for overseeing and implementing programs across a number of bodies, involving public and/or private sector organisations, a robust governance framework and accountability and reporting arrangements, which clearly define roles and responsibilities of the various participants, may be required. Increasingly, relevant governance arrangements will need to cross organisational boundaries to better align activities and reduce barriers to effective cooperation and coordination. Of note, in this respect, is the fact that globalisation has resulted in an increasing number of business networks operating across national borders. Networks do not necessarily require formal organisational structures to be effective but any arrangements for networking, or coordination, of activities have to be at least transparent.

More networked or partnering arrangements can also help overcome any apparent inflexibilities of a contract. Such networked arrangements are seen to enable a greater exchange of ideas and information and to allow partners to gain access to knowledge and resources of the other parties which contribute to their joint performance and results. Contract re-negotiations and variations are often more likely to involve WIN-LOSE than WIN-WIN perceptions, including a greater propensity to resort to contract clauses to resolve any problems in working arrangements. A focus on cooperation to overcome any identified problems and/or to deal positively with any issue of collaboration, coupled with a genuine commitment to mutual understanding, can lead to a more productive relationship and better results for all parties.

Realising the benefits of networking in a cross-cutting mode requires further cultural transformation in government agencies. For example, hierarchical management approaches may need to yield to more ‘partnering-type’ approaches. Process oriented ways of doing business will need to be at least complemented, if not largely replaced, by results-oriented ones. Organisations operating as virtual ‘silos or islands’ of activity under devolved authority arrangements will not only need to become more integrated with their partners, but will also have to become more externally focussed if they are to meet the needs of their ultimate clients cost-effectively. What is needed is a positive and encouraging framework for building relationships, dialogue and cooperation that can lead to:

- *clearer and more realistic performance measurements;*
- *more buy-in on both sides to achieve the results;*
- *a basis for ongoing dialogue throughout the year to improve the likelihood of achieving results; and*
- *capacity for learning and improvement.*<sup>16</sup>

### ***Private financing of government activities***

A related topic is that of the use of private finance in areas of the public sector such as infrastructure, property, defence and Information Technology and the way in which this can lead to risk transfer. Again, the use of such a facility is a test of corporate

governance arrangements, literally with shared responsibility, if not accountability. The key message in this context is the need for public sector managers to fully appreciate the nature of the commercial arrangements and attendant risks involved in private financing initiatives.

In the current budgetary environment, public sector entities in many countries have often found it difficult to provide dedicated funding for large projects out of annual budgets. The encouragement of private sector investment in public infrastructure by governments is one response to fiscal pressures. This gives rise to additional challenges and demands for public accountability and transparency because the parameters of risk are far different from those involved in traditional approaches to funding public infrastructure. Indeed, the potential liabilities accruing to governments may be significant.

Extensive use has been made of private financing in the United Kingdom (UK). The Private Finance Initiative (PFI) was introduced in 1992 to harness private sector management and expertise in the delivery of public services.<sup>17</sup> By December 1999, agreements for more than 250 PFI projects had been signed by central and local government for procurement of services across a wide range of sectors, including roads, rail, hospitals, prisons, office accommodation and IT systems. The aggregate capital value of these projects was estimated to be some £Stg 16 billion.<sup>18</sup>

The UK National Audit Office (NAO) has noted that the private finance approach is both new and more complicated than traditional methods of funding public infrastructure.<sup>19</sup> It brings new risks to value for money and requires new skills on the part of the public sector. Since 1997, the NAO has published eight reports on such projects. These reports collectively suggest that for privately financed projects to represent value for money, the price must be in line with 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.<sup>20</sup>

In Australia, most of the activity in private financing initiatives has occurred at the State Government level, particularly in relation to infrastructure projects such as roads. As you will all know, prominent examples include the Sydney Harbour Tunnel and the M2 Motorway in Sydney<sup>21</sup> and the City Link project in Melbourne. These high profile projects have been the subject of external scrutiny that has raised concerns about the exact distribution of risk and financial benefits between the public and private sectors.

At the national level, there has been increasing interest in private financing initiatives, although to date there has been limited actual adoption, notably in the property and defence projects areas. The Department of Defence has recently committed itself to examining the merits of using private financing in the delivery of Defence services, with the aim of realising financial savings or improving effectiveness. Defence services included in this examination are to cover capital equipment as well as Defence facilities, logistical support and IT programs. The clear intention on the part of Defence in widening the use of private financing, reportedly for as much as 25 to

35 per cent of all future acquisition projects,<sup>22</sup> is to achieve the best affordable operational capability.

In view of the growing interest in and use of private financing initiatives and the important financial, risk transfer and accountability issues raised, it can be expected that Audit Offices, including the ANAO, will increasingly focus their attention on examining such activities. It is hoped that such scrutiny can assist in optimising outcomes and providing assurance to the public and Parliaments about the processes adopted and outcomes achieved. The particular challenge for Audit Offices will be to determine what is meant as value for money in terms of the government purchasing policy of the day. In this context, I commend the work done by the UK NAO in examining privately financed projects and in providing sound guidance to auditors on how to examine value for money of privately financed deals.<sup>23</sup>

Convergence between the public and private sectors has drawn attention to sharing approaches and experiences in relation to corporate governance, particularly in managing the interrelationships. Managing the risks associated with the increased involvement of the private sector in the delivery of government services, particularly through contract arrangements, has required the development and/or enhancement of a range of commercial, negotiating, project and contract management skills across the public sector. We have learnt quickly that outsourcing places considerable focus and emphasis on project and contract management, including management of the underlying risks involved, both within and outside the public sector. The problem has been to achieve both management understanding of, and action on, these imperatives in a reasonable time period.

Over recent years, there has been considerable attention through the audits of the ANAO on the necessity of having in place the ‘right’ contract, as well as appropriate contract management arrangements, to assist in meeting organisational objectives and strategies. This reflects the greater involvement of the private sector in providing a wide range of public services. One important lesson we have learnt, and that is being reinforced constantly, is that:

*... clear identification and articulation of contract requirements at the outset can save considerable time, cost and effort later in contract management.*<sup>24</sup>

A common theme of these audit reports has been the deficiencies in the project and contract management skills of agency decision-makers. This is of concern given that some of these projects involve substantial resources and complexity. As well, reports have flagged a need for care in assessing value for money and negotiating, preparing, administering and amending major contracts.

Our Parliament and media have also paid particular attention to these issues during recent years with several agencies receiving significant adverse comments and publicity. I am not alone, therefore, in stating that this situation has to be addressed as a matter of urgency. The various elements of the public sector that are involved in contract administration have to reverse such concerns to win back the confidence of all stakeholders. Future audit reports will closely examine relevant contracting issues to ensure that this happens.

Recognising the challenges that agencies face in their management of contracts, the ANAO has in recent years published two volumes in its series of better practice guides that deal with contract management issues. The first of these, *Selecting Suppliers: Managing the Risk*<sup>25</sup>, was published in October 1998 with a view to providing a framework which can be used by APS officers to assess some of the financial and probity risks associated with contracting with non-government suppliers. Earlier this year we published a second Better Practice Guide on Contract Management<sup>26</sup> which contains research and experience of better practices in contract management in Australia and internationally. It places considerable emphasis on achieving an appropriate contract relationship to best manage risk in each situation. The Guide has been particularly well received, within the APS but also overseas and is now in its second print run.

### ***Commercial-in-Confidence***

One of the issues associated with increasing private sector involvement in government activity is access to contractor records and other information relevant to public accountability. This has been a problem for my office when trying to obtain information through audited agencies and also in direct approaches to private sector providers. This matter is of concern not only to the ANAO but also to public agencies in their role as contract managers, to executive government as decision-makers, and to the Parliament when scrutinising public sector activities.

ANAO has been working on this for some time. In 1997 we circulated draft model clauses to agencies and recommended their insertion in contracts. These clauses give the agency and my Office access to contractors' premises and the right to inspect and copy documentation and records associated with the contract.

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 the authority to access contractors' records and premises as necessary to monitor adequately the performance of the contract. I stress 'as necessary' because I am not advocating carte blanche access. I consider that access to contract related records and information should generally be equivalent to that which should reasonably be specified by the contracting agency in order to fulfil its responsibilities for competent performance management and administration of the contract. Access to premises would not normally be necessary for 'products' or 'commodity type' services, such as cleaning, which are provided in the normal course of business. It would be a different matter where government information or other significant assets were located on private sector premises.

The inclusion of access provisions within the contract for 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. Recently, a Parliamentary Committee drew attention to its right to

access documents and information necessary for it to effectively conduct an inquiry into the government's IT Outsourcing Initiative, where, in its opinion, accountability had been undermined<sup>27</sup>.

The JCPAA has recommended that the Minister for Finance and Administration make legislative provision for such access.<sup>28</sup> The Government response to that report stated that:

*its preferred approach is not to mandate obligations, through legislative or other means, to provide the Auditor-General an automatic right of access to contractors' premises.*

and that

*the Government supports Commonwealth bodies including appropriate clauses in contracts as the best and most cost effective mechanism to facilitate access by the ANAO to a contractor's premises in appropriate circumstances.*<sup>29</sup>

While noting the Government's response, the ANAO continues to encourage the use of contractual provisions as the key mechanism for ensuring agency and ANAO access to contractor's records for accountability purposes. The ANAO has recently completed discussions with the Department of Finance and Administration to review the content of the standard access clauses. The Minister for Finance and Administration has approved agreed clauses. This issue also has implications for agencies' security responsibilities particularly where direct control over Commonwealth assets and/or information resides with a private sector provider.

I am sensitive to the need to respect the confidentiality of genuine 'commercial-in-confidence' information. In my own experience, I have found that, almost without exception, the relevant issues of principle can be explored in an audit report without the need to disclose the precise information that could be regarded as commercial-in-confidence. In this way, the Parliament can be confident it is informed of the substance of the issues that impact on public administration. It is then up to the Parliament to decide the extent to which it requires additional information for its own purposes.

Commercial confidentiality concerns have also been addressed by a number of Commonwealth Parliamentary inquiries.<sup>30</sup> Recently, the Senate Finance and Public Administration References Committee, in its *Inquiry into the Mechanism for Providing Accountability to the Senate in Relation to Government Contracts*, addressed a motion that had been put before the Senate by Senator Andrew Murray in June 2000 providing for accountability to the Senate in relation to government contracts<sup>31</sup>. Senator Murray's motion sought to achieve greater transparency of government contracting through passage of a Senate Order that would require:

- the posting on agency web sites of lists of contracts entered into, indicating whether they contain confidentiality clauses and, if so, the reason for them;

- the independent verification by the Auditor-General of those confidentiality claims; and
- the requirement for Ministers to table letters in the Senate chamber on a six-monthly basis indicating compliance with the Order<sup>32</sup>.

The Committee tabled an initial report in June 2000. At the hearing of 12 May 2000 the ANAO had advised that it would consider conducting a performance audit on the issue of confidentiality provisions in Commonwealth contracts. In its report the Senate Committee undertook to report once more on the motion after the results of the audit were known. The ANAO report, to which I shall refer below, was tabled on 24 May 2001 after which the Committee prepared a second and final report on the mechanism proposed in the general notice of motion no. 489. The motion is now a Senate order. The changed wording of the order, passed on 20 June 2001 after the tabling of the ANAO report, reflects some of the committee's concerns described in its June 2000 report. The Committee noted in its second report:

*the order [of June 2001] works as a safeguard against the overuse of confidentiality claims in Commonwealth contracts. Agencies now need to think carefully about whether there is a genuine reason for keeping material confidential and restricting access to details of public expenditure<sup>33</sup>.*

As noted above, a few months ago I tabled an audit on *The Use of Confidentiality Provisions in Commonwealth Contracts*<sup>34</sup> which concluded there was a lack of consolidated government-wide guidance to agencies on the use of confidentiality provisions in contracts. The report also commented on weaknesses in how agencies generally deal with the inclusion of confidentiality in contracts. As part of the audit, comprehensive criteria were drawn up to assist agencies in dealing properly with confidentiality provisions in contracts and will form part of a preventative approach that relies on agencies agreeing to the use of confidentiality clauses in contracts only when they can be justified against the criteria. The Senate Committee endorsed all the criteria, as well as strengthening and clarifying the Senate Order of June 2001 aimed at increasing openness and accountability of all Commonwealth contracts.<sup>35</sup>

### ***The information technology (IT) outsourcing lessons***

The outsourcing of IT in the Commonwealth sphere in Australia arose from a government decision known as the IT Initiative, which was to transfer around \$4 billion of IT provision in Federal agencies to the private sector. The Office of Asset Sales and Information Technology Outsourcing (OASITO) managed the Initiative centrally for the government through a series of tenders dealing with groupings of agencies (clusters). These clusters were determined without adequate consultation and involvement of the agencies concerned and, in effect mandated, as opposed to agencies being allowed voluntary participation in groupings with accepted synergy and shared purpose. Within the public service, there was a variable degree of support for the Office in the way it went about letting the tenders. Several Chief Executives had significant doubts about the ability of the Initiative to deliver the savings projected for it and/or to deliver the quality of service required.

In particular, those agencies where the IT requirement was predominantly scientific (for example the Bureau of Meteorology or the Commonwealth Scientific and Industrial Research Organisation) or otherwise related to the core activities of a particular agency (for example, the payment of pensions) the arrangement posed significant problems of corporate governance for them. The approach taken by OASITO was designed to implement the Government's policy agenda under centralised direction (and control) despite the perceived reluctance (buy-in) of some of the agency heads because they did not have the degree of control necessary to best manage transition risks, and because they were ultimately responsible for the agency outputs and outcomes and the budgets involved.<sup>36</sup>

Preliminary studies identified significant savings that would accrue from implementing the Initiative. Indeed, the projected savings from the implementation of the IT Initiative were removed, upfront, from the respective agency's forward estimates. What is significant is that the financial evaluation methodology applied in the tenders did not allow for two key factors that were material to the assessment of savings arising from outsourcing the services. The evaluations did not consider the service potential associated with agency assets expected to be on hand at the end of the evaluation period under the business-as-usual case, or the costs arising from the Commonwealth's guarantee of the external service provider's (ESP) asset values under the outsourcing case. Consequently, the financial savings realised by the agencies from outsourcing, as quantified in the tender evaluations, were overstated. This was disputed by OASITO, the central overseeing agency (the Department of Finance and Administration) and by the Minister concerned.

A major issue turned on interpretation of the accounting standard dealing with finance and operational leases. The different interpretations extended into the private sector which were later reviewed by the JCPAA.

The ANAO identified<sup>37</sup> a range of issues on which agencies should place particular focus in the management of IT outsourcing arrangements as follows:

- identification and management of 'whole of contract' issues including the retention of corporate knowledge, succession planning, and industrial relations and legal issues;
- the preparation for and management of, including expectations from, the initial transition to an outsourced arrangement, particularly when a number of agencies are grouped together under a single agreement;
- putting in place a management regime and strategy that encourages an effective long term working relationship with the External Service Provider (ESP), while maintaining a focus on contract deliverables and transparency in the exercise of statutory accountability and resource management requirements;
- defining the service levels and other deliverables in the agreement so as to focus unambiguously on the management effort of both the ESP and agencies on the aspects of service delivery most relevant to agencies' business requirements; and
- the ESP's appreciation of, and ability to provide, the performance and invoicing information required by agencies in order to support effective contract

management, as well as from both an agency performance and accountability point of view.

As a response to the audit, the Government commissioned the recent review of IT outsourcing conducted by Richard Humphry (Managing Director, Australian Stock Exchange). The independent review recognised the implicit management dilemma described above and recommended that, because Chief Executives of agencies had the statutory responsibility, they should be responsible for the outsourcing decisions. In particular, decisions that impacted upon the core business of the agency needed to be taken at agency level. Mr Humphry remarked:

*Priority has been given to executing outsourced contracts without adequate regard to the highly sensitive risk and complex processes of transition and the ongoing management of the outsourced business arrangement.*<sup>38</sup>

The review, which drew heavily on the Standards Australia publication *HB 240:2000, Guidelines for Managing Risk in Outsourcing* pointed out that there were several risk management lessons to be learned as follows:

- the most significant risk factors were the unwillingness to change and the failure to buy in the appropriate expertise;
- there was a lack of focus on the operational aspects of implementation;
- there was insufficient attention paid to the necessary process of understanding the agencies' business; and
- there was insufficient consultation with key stakeholders.<sup>39</sup>

The Government agreed with the ten recommendations made by the review, some with qualification.<sup>40</sup> This included that responsibility for implementation of the IT Initiative be devolved to Commonwealth agencies in accordance with the culture of performance and accountability incorporated in the relevant financial management legislation. Agencies are required to obtain value for money (including savings) and maximise Australian industry development outcomes. Agency heads will be held directly accountable for achieving these objectives within a reasonable timeframe, as well as grouping with other agencies at their discretion, wherever possible, to establish the economies of scale required to maximise outcomes.

Agencies will also be responsible for addressing implementation risks. A separate body will be established within the Department of Finance and Administration to advise agencies, at their request and on a fee for service basis, on managing their transition. Audit experience indicates that the agency emphasis has to be on developing a robust analysis of business requirements at the initial stage, which would be the basis of a strong business case for whatever IT strategy is developed. Without OASITO's involvement, the industry can now deal directly, from the outset, with the people responsible for the function and related outputs and outcomes, as well as with those who will be managing the contract. The inability to have this relationship was the subject of criticism by the industry under the previous arrangements managed by OASITO. This is a significant lesson for all future outsourcing arrangements.



It goes without saying that the IT outsourcing contracts negotiated by government entities must also observe the public reporting systems (to which I have previously referred) that allow external scrutiny of the performance of Commonwealth agencies. Indeed the very size of the outsourcing contracts means that this principle should be observed the more carefully and the contractors made fully aware of these obligations. I note however that the recent Senate Committee's final report on the IT outsourcing initiative expressed concern about the lack of understanding regarding accountability and government contracting<sup>41</sup>. The Committee found that, in the highly centralised environment of the Outsourcing Initiative, neither OASITO nor Finance took responsibility for ensuring that private sector parties to contracts with the Commonwealth were fully informed of consequential public accountability responsibilities. The Committee warned that, unless firm measures were undertaken, the Committee believed that there is a strong likelihood that this lack of understanding would continue under the more devolved approach following the Humphry review.

## **5. DEVELOPING ROBUST CORPORATE GOVERNANCE FRAMEWORKS**

In recent years the heads of APS agencies have had a succession of responsibilities devolved to them, including oversight of contracted activities that were previously undertaken by government agencies. We have learned, of course, that although the public sector may contract out service delivery, this does not necessarily equate to contracting out the total responsibility for the delivery of the service or program. The expectation of each agency and its management is to ensure that the government's objectives are delivered in a cost-effective manner and to be accountable for that outcome and the manner of its delivery. The bottom line, as is often reiterated, is that accountability cannot be outsourced. However, in the more networked environment discussed earlier, we may need to re-think the practicality of the notion of some sharing of accountability where there is apparent sharing of responsibility.

If there is one theme that comes through my address thus far, it is that robust corporate governance frameworks give agencies the means to manage challenging circumstances.

Simply put, corporate governance is about how an organisation is managed, its corporate and other structures, its culture, its policies and strategies, and the ways in which it deals with its various stakeholders. The framework is concerned with structures and processes for decision-making and with the controls and behaviour that support effective accountability for performance outcomes/results. Key components of corporate governance in both the private and public sectors are business planning, internal controls including risk management, performance monitoring and accountability and relationships with stakeholders. The framework requires clear identification and articulation of responsibility as well as a real understanding and appreciation of the various relationships between the organisation's stakeholders and those who are entrusted to manage resources and deliver required outputs and outcomes. This is not a simple task. It takes time, effort and commitment throughout an organisation.

In a complex operating environment such as we now have, these requirements become that much more important for both accountability to, and performance for, a

wide range of stakeholders, such as is evident in the APS. Corporate governance, including agency controls, is particularly important in relation to the changing, increasingly privatised and internationalised public sector. Certainly, the demand by citizens and other stakeholders for openness and transparency of public sector agency governance (including financial status) exceeds that required of private organisations. Accountability in the areas of community service obligations, equity in service delivery and a high standard of ethics within a legislatively-based values system, are particularly critical to public sector agencies. Accordingly, one of the fundamental ways to ensure that we can meet our performance and accountability requirements is through a robust corporate governance framework in which the identification and management of risk is a key feature.

Management of key business risks tailored to a contractual environment will ensure contracting achieves benefits such as increased flexibility in service delivery, greater focus on outputs and outcomes, freedom of public sector management to focus on higher priorities, suppliers encouraged to provide innovative solutions, and cost savings in providing services.<sup>42</sup> The process of risk assessment and its treatment needs to be dealt with by agencies in an increasingly devolved environment, where they are also facing the challenges of managing outsourced service delivery and support. The following comment by Professor Richard Mulgan of the Australian National University on the accountability dilemma associated with the greater involvement of the private sector, particularly in the delivery of public services, is very challenging in these respects:

*Contracting out inevitably involves some reduction in accountability through the removal of direct departmental and Ministerial control over the day-to-day actions of contractors and their staff. Indeed, the removal of such control is essential to the rationale for contracting out because the main increases in efficiency come from the greater freedom allowed to contracting providers. Accountability is also likely to be reduced through the reduced availability of citizen redress... At the same time, accountability may on occasion be increased through improved departmental and Ministerial control following from greater clarification of objectives and specification of standards. Providers may also become more responsive to public needs through the forces of market competition. Potential losses (and gains) in accountability need to be balanced against potential efficiency gains in each case<sup>43</sup>.*

To be effective, the risk management process needs to be rigorous and systematic.<sup>44</sup> If organisations do not take a comprehensive approach to risk management then directors and managers may not adequately identify or analyse risks. Compounding the problem, inappropriate treatment regimes may be designed which do not appropriately mitigate the actual risks confronting their organisations and programs. Recent ANAO audits have highlighted the need for:

- a strategic direction in setting the risk management focus and practices;
- transparency in the process; and
- effective management information systems.

Business continuity is at the core of effective corporate governance. When it comes to the crunch, there is little point in establishing a best practice governance framework, with all the associated discipline, if, at the end of the day, the business becomes impaired for some foreseeable reason or, worse still, ceases to operate for any length of time. Whilst there is clearly a cost that needs to be taken into account as part of any risk assessment, and indeed of the application of risk management approaches and techniques, I would suggest that a more positive approach by decision-makers would regard such a cost as an investment in the future of the business.

As a result of the greater interest in, and attention applied to, related issues, last year my Office prepared a *Business Continuity Management Guide*.<sup>45</sup> The Guide includes two major features: the first part deals with business continuity management concepts in a risk management context; the second part identifies the processes and procedures required to be undertaken to produce a business continuity plan. (An accompanying Workbook provides a number of pro-forma schedules, working papers and questionnaires to facilitate the business continuity implementation process within agencies).

At the end of the day what counts is public sector performance. You are no doubt aware of the debate in the last twelve months or more as to whether the thrust of the direction being taken on corporate governance, particularly in the private sector, is more about conformance than performance. The issue, in my view, is basically about achieving the right balance between those imperatives at the right time. There has been increasing pressure for audit offices to review performance information which we are doing, admittedly somewhat differently, in our own constituencies. I was again reminded of this in the last few days when I received a copy of the Western Australian Auditor-General's Second Public Sector Performance Report for 2001.<sup>46</sup> I was particularly taken by Des Pearson's observation about lack of action even where significant issues have been identified and his comment that:

*Sound public sector management requires not only that agencies adopt an ongoing proactive approach to identifying risks and seizing opportunities for improved performance, but that they also effectively address concerns raised by external reviews.*<sup>47</sup>

At the Federal level there has been particular interest in performance management which is essentially about linking and aligning individual, team and organisational objectives and results. Importantly, however, it also provides a means of recognising and rewarding good performance and to manage under-performance. There is also an emphasis on adherence to public service Values. The main point that is being stressed, as with corporate governance, is the need for an integrated framework. Indeed performance management is an essential component of a sound corporate governance framework. You might be interested in the recent report on performance management released by the Management Advisory Committee established under the *Public Service Act 1999*.<sup>48</sup>

## **6. ROLE OF THE PUBLIC SECTOR AUDITOR**

## *Audit independence*

I cannot overstate the importance and centrality of the independent assurance that the public sector auditor can provide on the overall performance and accountability of the public sector in delivering the Government's program and services and in implementing effectively a wide range of public sector reforms. As the public and private sectors converge; as the management environment becomes inherently riskier; and as concerns for public accountability heighten; it is vital that Auditors-General have the professional and functional freedom required to fulfil, fearlessly and independently, the role demanded them.

The Federal Parliament has indicated that the additional authority and flexibility provided to public sector managers under the on-going public service reforms require enhanced accountabilities, even if this means an extra cost. Maintaining both Parliament's and the Government's confidence in the accountability of public sector organisations is a continuing challenge to our corporate governance frameworks.

I see the role of Audit Offices such as ours as more important to effective, accountable and democratic governance today than at any time in the past, the more so, given the pace of change, in particular as the roles and responsibilities of the public and private sectors become more integrated, even perhaps to the extent that the differences between the two will become more apparent than real in many aspects of the management task. However, the political environment and the notion of public interest will continue to create fundamental differences between the two sectors.

The Public Audit Forum in the United Kingdom made some observations recently about the role of the auditor, in a public sector context, in encouraging innovation and well thought through risk taking and innovation, which are relevant to our discussion today. Let me quote:

*Public sector managers are of course responsible, as stewards of public sector resources, for assessing and managing the risks associated with innovation and increased flexibility, and for ensuring the proper conduct of public business and the honest handling of public money while pursuing innovative ways of securing improvements in public services. It remains important to ensure proper accountability but this must not be approached in a rigid way which might mean missing opportunities to deliver better value for money. And auditors will respond to this new environment positively and constructively by:*

- *adopting an open minded and supportive approach to innovation (including the use of techniques tried elsewhere) examining how the innovation has worked in practice and the extent to which value for money has been achieved;*
- *in the process, supporting well thought through risk-taking and experimentation;*
- *consistent with their independent role, providing advice and encouragement to managers implementing Modernising Government initiatives by drawing on their audit work in this area,*

*seeking to identify and promote good practice so that experience can be shared and risks minimised.*

*In these ways, we believe that auditors can support and encourage worthwhile change, while providing independent scrutiny and assurance and fulfilling effectively their statutory and professional responsibilities.*<sup>49</sup>

I applaud the emphasis placed here on the contribution that auditors can make towards innovation. It is a positive view of the role of audit and one far removed from the old image of 'tick and flick' auditing.

I would also like to draw your attention to the references made to audit independence. The need for audit independence is not restricted to the public sector. There are many institutions in the private sector that have a significant impact on the level of public accountability and where under-performance has the potential to restrict public policy making. Here in Australia the collapse of our second largest insurer, HIH, has had a disastrous effect on many individuals and parts of the economy, resulting in pressure on governments to mount expensive rescue operations. Suggestions that the firm had been trading as insolvent for an extended period have raised public uncertainty about the effectiveness of public regulatory watch dogs in carrying out their functions. There are, in particular, questions about the way in which the company's auditors have performed their role. In that respect the just released report on Audit Independence by Professor Ian Ramsay will warrant close scrutiny<sup>50</sup>.

The debate about the responsibilities of external auditors and audit committees has raised the audit profile in both the private and public sectors. The ANAO sees its relationship with an audit committee and internal audit as one of partnership. One important difference is that the Office is employed by the Parliament, and not by the corporation or agency. As such, the scope and cost of an audit are decisions made by the Auditor-General and for which he or she is accountable to the Parliament. In the private sector, such decisions are the prerogative of the Board or Chief Executive but are often determined by an audit committee. It is within the authority of boards and their audit committees to direct auditors as to the scope and quality of the audit, subject to professional, including both accounting and auditing standards, requirements of these auditors.

While the Auditor-General has the statutory independence provided by Parliament, the issue of independence is important, as it is for the private sector, in the provision of non-audit services. There are basic 'conflict of interest' issues arising for both sectors, although these are clearly of greater concern for private sector auditors. Last year the US Securities and Exchange Commission (SEC), particularly its chairman in published addresses<sup>51</sup>, drew attention to the need for more stringent restrictions on the scope of non-audit relationships that accounting firms have with their clients. In some instances, non-audit income may be greater than the audit fees for specific clients. The perception is that this may impact adversely on the integrity of the audit. The fundamental principle supported by public sector auditors is that auditors must be, and should be seen to be, free of any interest or relationship that might be regarded, whatever its actual effect, as being incompatible with integrity and objectivity.

There has been a suggestion in Australia that responsibility for the appointment of auditors to companies should be given to the Australian Securities and Investments Commission (ASIC). The idea has had limited support, if only because it would raise real questions about the extent which ASIC would have to share responsibility for the effectiveness of audits. As you know, we already in Australia require disclosure of the non-audit income paid to auditors. That said, the level of such income is a secondary consideration. As well, modern auditing practice does involve a more strategic advisory role as expert consultant. The primary issue then is about apparent conflict of interest in relation to significant business processes, or processes underlying the financial statements or data to be audited.

These issues need to be considered and are moving onto the public policy agenda. IFAC did not explicitly address the level of non-audit fees in its Exposure Draft 'Independence' put out earlier this year. Nor did the draft explicitly address relevant issues for the public sector, which we have asked them to do, perhaps by way of a public sector perspective at the end of the document. As well, the Institute of Chartered Accountants and CPA Australia have established a continuing joint working party to develop a revised ethical statement on Independence for the Australian profession. It is not difficult to agree with Professor Ramsay's observation that 'the notion of professional independence is fundamental to auditing'<sup>52</sup>. He goes on to reiterate, from the Australian Statement of Auditing Practice AUP 32 on *Audit Independence* (para 6) that:

*The value of the independent audit lies both in the fact that the auditor is, and is seen to be, independent of the audited entity, and hence is able to carry out the audit free of any externally imposed constraints.*<sup>53</sup>

### ***Ensuring the continuing quality of ANAO products***

Australian audit offices cannot be detached observers of the many challenges that face public sector agencies today. We along with the rest of the public service need to be constantly alert to the issues raised by the new environment and consider what adjustments they might require to the way we do our work in a way so as best to maintain our credibility. For example, within the ANAO we consider strategic and integrated audit planning as central to upholding the quality of our products. The ANAO undertakes an on-going planning approach to ensure that its outputs are well integrated and continue to meet the needs of our primary stakeholders – Parliament and the public sector bodies. The ANAO reviews its planned approach annually as part of its budget program and brings the results together in the Audit Work Program. This is developed against the background of the APS environment, including the business risks that are likely to impact on the APS during the period under review. These risks are taken into account in identifying themes to be addressed in developing the annual performance audit work program and in evaluating and assessing potential financial statement issues to be addressed during the course of financial statement audits. The range of ANAO products, particularly the performance audit and financial statement products, aim to provide assurance that the risks facing the APS and good management of its finances and programs are being adequately addressed through a holistic and integrated audit approach.

Each year we also have regard to the need to respond to emerging tissues of interest to the Parliament. For the current year, for example, the key issues or themes are:

- Governance - HR Management;
- Governance - Financial Management;
- Governance - Performance Management and Measurement;
- Procurement and Contract Management;
- Information Technology; and
- Service delivery.

As you would expect, we also take into account questions of financial materiality, program significance, audit impact (ie likely gain from the audit), the visibility of the program and lack of recent audit coverage as well as any internal and external reviews of the program.

Our diverse product range is important for our continuing credibility with Parliament and the APS agencies that are our major stakeholders. This includes:

- agency specific performance audits and general performance audits of particular themes or common aspects of administration across a number of entities;
- financial control and administration (FCA) audits;
- financial statement audits;
- assurance control and assessment (ACA) audits; and
- protective security audits.

From my Office's perspective, reduced central oversight has meant a broadening of our approach to auditing, which once focused largely on compliance and conformance to a more pro-active involvement with agencies and entities with the goal of making more realtime contribution to enhancing public administration. For example, our Better Practice Guides are designed to assist organisations test their own systems and where applicable improve their practice and performance in line with recognised principles of better practice. Such practice is being derived from both public and private sector experience but, increasingly, is having to be developed by both parties in the new environment being created with apparently changing notions of accountability and performance assessment.

That said, we are nevertheless conscious of our audit responsibility particularly to the Parliament to report significant and/or material breaches of approved guidelines, standards and other legislation. My preferred position would be to work with agencies to implement effective processes that are preventative and not just detective. In this context, I see the relationship between internal and external audit and that with agency audit committees as being in the nature of an open partnership sharing common goals, thus generating total confidence in the relationship. I realise that agencies do not always view ANAO interest in their programs in a positive light but it is my hope that our partnership approach is understood and accepted. Of course, we work hard to nurture the relationship to ensure that from an early stage in each audit agency management is informed about and understands what we are trying to achieve.

### ***The changing skill base for auditors***

Another critical issue for us is the changing skill base for auditors. Fortunately, many of us have had experience in dealing with the private sector and in commercial operations, including financial decision making and accounting. On the other hand, the consequence of this is that our staff are greatly in demand in both the public and private sectors. Consequently, we not only have a skills enhancement challenge for our offices in a more contractually oriented environment but we also have the problem of retention of our available skills base. How we address any skill deficiencies and staff retention issues will be dependent on the particular environment in which we work. What seems obvious at this stage is that a solution will come from a suitable mixture of internal training, the use of universities and other educational institutions, interchanges between the private and public sectors, the judicious use of 'bought in' resources, and suitable rewards and recognition.

I have spent some time elsewhere in this address discussing the increasing reliance placed by public sector agencies on information technology and communications. ITC is as important for us as for other agencies. We have, for example, decided to make adjustments to the way in we handle our IT audit work. Currently our IT audit staff provide support for our Financial Statement Audit (FSA) product. It is, however, intended that to meet the growing and changing demands of IT, IT Audit will provide an integrated audit service to all service groups within the ANAO.

We are also in the early stages of working to implement a Knowledge Management strategy that will have a strong technology focus while also embracing the sharing of knowledge between people. We recognise that many aspects of Knowledge Management already exist in the ANAO and so our intention is, wherever possible, to build upon existing practices, information sources and databases rather than 'reinventing the wheel.' However, there is currently no effective coordinated approach to capturing or sharing the information and knowledge resources of the organisation. We are, quite deliberately, beginning with a modest program and building in the flexibility that would allow it to be expanded at an appropriate time in the near future.

Of particular interest to an audience of performance auditors will be the relationship we have established with the University of Canberra currently reflected in a new Graduate Certificate in Performance Auditing which is likely to become the first item in a suite of postgraduate qualifications in performance auditing that are designed to equip our performance audit staff, who come from an amazing diversity of backgrounds, the particular skills needed for this work. I know that there will be further discussion of this later in the workshop, so I do not propose to talk about this in any greater length.

### ***Some particularly challenging issues***

There are some challenging issues that face us. It is important to the success of our role that agencies see the ANAO as engaging in a partnership that will help them achieve better practice in whatever area of public administration for which they are



responsible. We work hard to ensure that agencies are fully informed about and understand each stage of the performance audit, right from the first contacts made at the preliminary study stage and, with our clearance processes, the final report. Of course, the tale that unfolds in the report is not always positive but I have always felt it important for the agency, even if it may not always appreciate the conclusions we reach, to understand our approach and accept that the recommendations we make will benefit the program under consideration.

It was noteworthy, for example, in Audit Report No 4 2001 – 02 *Commonwealth Estate Property Sales* that all seven ANAO recommendations were disagreed by Finance<sup>54</sup>, which noted in its response to the audit report, that it considers ‘*the concepts that underpin the report are fundamentally flawed.*’ While there are sometimes good reasons for differences of opinion, it is helpful if the basis for these differences is evident. In this case Finance did not elaborate on its comments in its response, other than the comments provided against each recommendation.

It is of some concern to ANAO that the Department did not agree with any of the ANAO recommendations, which were framed to achieve improved administrative practices for future property sales. While audit reports primarily provide assurance to the Parliament on administrative processes and the effectiveness and efficiency of the use of public money, a further significant value of those reports is promoting or encouraging improved administrative processes to secure better outcomes for the Commonwealth in the future. Where agencies have demonstrably taken, or are in the process of taking, action that would result in improvements in administration and/or value for money, such action is usually noted in an audit report. Recommendations for such action are only included where it is not clear that action has been taken place and/or is being contemplated.

There are some interesting issues that have arisen for us with purchaser-provider relationships, relating to access to audit documents and Chief Executive accountability. The Chief Executive of the Department of Family and Community Services has a partnership agreement with Centrelink for the delivery of welfare services. The Chief Executive has contended that he should be informed in a timely manner if significant matters relating to Centrelink arise in any audit of that agency. We respond that we provide our audit reports to the Chief Executive of any Agency concerned in accordance with legislative and professional requirements. The two parties are then able to decide how they share such information. In relation to performance audit reports, I can give a copy of a report to any person who I consider has a special interest in the report. I would have regard to any contractual or equivalent arrangements in place in deciding who has a special interest.

In fact, reasonably satisfactory arrangements are in place, admittedly because of the Centrelink Board’s cooperation. However, the Chief Executive of FaCS has recently recommended to the JCPAA inquiry into the Auditor-General Act that the legislation should recognise the accountability of the Chief Executive of a purchaser agency and require the Auditor-General to report significant and relevant matters arising during an audit of a service provider to the Chief Executive of a purchaser agency in a timely manner. The legislation should also include a broad definition of audit reports covering those more detailed reports provided to management. In the ANAO’s view, the legislation does not need to be amended to cater specifically for

purchaser/provider arrangements and is flexible enough to cope with any reasonable requirements for Chief Executive accountability.

It is relevant to note in this context that the JCPAA inquiry, which reported in September, concluded that overall the Act provided an effective framework for the ANAO to carry out its functions<sup>55</sup>. The Committee has identified five legislative amendments, which it considers would further enhance the Act. They are listed below:

- subsection 19 (3) should be amended to provide the Auditor-General with the power to circulate extracts of draft reports where necessary;
- amendments to subsection 37(4) to ensure that it reflects the original intentions set out in the Explanatory Memorandum. This amendment would remove ambiguity in the event that the Attorney-General issues a certificate requiring certain information to be omitted from a public report;
- amendments to subsection 15(2) to provide the Auditor-General with the power to provide a completed copy of a completed report to a Minister who has a special interest in the report;
- amendment to subsection 19(4) to provide for the Auditor-general to include agency comments, in full, in a final report; and
- the Committee has resolved that, as part of its power to review and change the Annual Report Guidelines, it will require government agencies to include in their Annual reports a list showing all contracts by name, value and the reason why the standard access clause , which provides the Auditor-General with access to the premises of Commonwealth contractors, was not included in the contract.

The Committee acknowledged the significance of the issues raised by the Chief Executive of FaCS and agreed with them. Nevertheless, under current arrangements, ‘the provision of audit information should be straight forward’<sup>56</sup>. From a broader viewpoint, it has to be said that the issue is not fully resolved.

## **7. CONCLUDING REMARKS**

It is both interesting and constructive to discuss issues such as those I have canvassed today with our colleagues in other audit offices. The ANAO is looking forward to the publication of our centenary history in November, which will discuss the changing role of the public sector auditor in the last one hundred years. Performance audits have only been included in our responsibilities in the last twenty or so years; the report on the first ANAO performance (or efficiency audit, as it was termed at the time) was only published in 1980. The performance audit agenda, in order to be relevant to its stakeholders, should not so much track, but rather anticipate, the forces that shape the public sector agenda. We intend that the ANAO performance audit program will continue to tackle the issues on the Commonwealth agenda in a way that is useful for agencies as well as for the Government and Parliament.

During the past decade, Australian governments at both the Commonwealth and State levels have been focussing increasingly on achieving a better performing public sector. A major imperative has been the successful management of change to provide

a more responsive public service able to provide less costly, more tailored—or better directed—and higher quality services to citizens. This new direction in public sector administration has been brought about by both a reassessment of the role of government together with emerging trends associated with globalisation and the information age, which have the potential to transform dramatically the way governments do business. Australian Governments have reacted to budgetary pressures on expenditure and, at the same time, strong demand from the community for the maintenance, and even extension, of government services, by seeking to make the administrative elements and structures that provide public services more efficient and effective. In particular, Governments have stressed the need for the public sector to be more responsive to citizens.

As discussed earlier, the various reforms have seen the APS steadily evolve towards a more private sector orientation with a particular emphasis on:

- the contestability of services;
- the outsourcing of functions which the private sector can undertake more efficiently;
- adapting, or adopting, private sector methods and techniques;
- an accent on continuous improvement to achieve better performance in an environment of devolved authority and greater management flexibility;
- ensuring a greater orientation towards outcomes, rather than mainly on process;
- direct participation by the private sector in providing public services, even so-called and traditionally regarded ‘core services’ such as policy advice and determination of citizens’ welfare entitlements; and
- increasing use of information technology and telecommunications to assist program delivery.

Underpinning the changes to both program delivery, and its supporting systems, is the evolution of a more contract-oriented and contestable public service. There has also been a shift from central agency control to a framework of devolved authority with enhanced responsibility and accountability being demanded of public sector agencies and statutory bodies.

These reforms are intended to allow the APS to manage and respond better to new challenges brought about by the changing environment. However, they can also involve greater management risks, particularly in an environment of devolved authority. Importantly, the privatisation of the public sector does not obviate, or limit, the need for accountability to stakeholders. To the contrary, in a more contestable environment which is highlighted by less direct relationships and greater decision-making flexibility, it is essential that the APS maintains and enhances its accountability; improves its performance; and finds new and better ways of delivering public services, while meeting required ethical and professional standards.

From a Parliamentary perspective, greater flexibility in decision-making needs to be matched by at least a commensurate focus on strengthening the associated accountability arrangements to ensure that decisions are appropriately made and that

those public servants making decisions can be properly called to account should the question arise. As agencies grapple with the requirements of this complex and changing environment, the ANAO is working with agency people at all levels to be seen not so much as audit 'police' but more positively as professionals who can assist agencies to meet their accountability requirements and in doing so embrace innovative practices and focus more on results. We also have to give more attention to our own performance both internally and externally. It is in the nature of our function and responsibilities that we have to lead by example. That is our particular challenge.

## NOTES AND REFERENCES

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- <sup>2</sup> The three reports are:

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- <sup>3</sup> JCPAA, 2001, Review of the accrual budget documentation, terms of reference, [www.aph.gov.au/house/committee/jcpaa/accrualbudget/tor.htm](http://www.aph.gov.au/house/committee/jcpaa/accrualbudget/tor.htm) [28 August 2001]
- <sup>4</sup> Ibid.
- <sup>5</sup> Transcript of opening statement of chairman at JCPAA hearing, 22 June 2001, [www.aph.gov.au/hansard/jointcommittee/j4854.pdf](http://www.aph.gov.au/hansard/jointcommittee/j4854.pdf) [29 August 2001]
- <sup>6</sup> ANAO, 2001, Submission to JCPAA review of the accrual budget documentation, 30 May 2001 [www.aph.gov.au/house/committee/jpaa/accrualbudget/submissions/sub7.pdf](http://www.aph.gov.au/house/committee/jpaa/accrualbudget/submissions/sub7.pdf) [28 August 2001].
- <sup>7</sup> Ibid.
- <sup>8</sup> The following discussion draws on Audit Report No 46 2000-01 *ATO Performance Reporting under the Outcomes and Outputs Framework*.
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*New Submarine Project Department of Defence. Report 368, June, p. xiv:*  
*'Recommendation 5: The Committee recommends that the Minister for Finance make legislative provision, either through amendment of the Auditor-General Act or the Finance Minister's Orders, to enable the Auditor-General to access the premises of a contractor for the purpose of inspecting and copying documentation and records directly related to a Commonwealth contract, and to inspect any Commonwealth assets held on the premises of the contractor, where such access is, in the opinion of the Auditor-General, required to assist in the performance of an Auditor-General function. (paragraph 6.20).'*
- <sup>29</sup> Government response to Recommendation 5 of the 368<sup>th</sup> Report of the Joint Committee of Public Accounts and Audit: Review of Audit Report No. 34 1997-98, New Submarine Project Department of Defence. Letter from the Prime Minister to the Minister for Finance and Administration dated 12 August 2000.
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