

Address to University of Canberra
students – Graduate Certificate in
Performance Audit

**The Role of Performance
Auditing in Strengthening
Democracies**

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I. INTRODUCTION

I appreciate the opportunity to talk to ANAO staff and staff from the ACT Audit Office on the role of performance audit in strengthening democracies, and contribute to your study and understanding of performance audit as part of completion of the Graduate Certificate. In my view, good auditing depends very much not only on the required skills and experience of our auditors but also on their knowledge and understanding of the environment in which they work.

As with many other democracies, Australian governments have been focussing more and more on achieving a better performing public sector and less costly, better focussed and higher quality services to citizens. This has required ensuring a platform of good corporate governance is in place, including accountability for performance, followed by adapting or adopting private sector methods and techniques, and sometimes direct participation by the private sector in providing public services.

My talk will cover this changing environment by:

- outlining the importance of effective corporate governance in the Australian Public Service, the accountability framework and the ANAO's contribution to (and understanding of) corporate governance and accountability in the public sector environment;
- discussing the changing nature of governance and the creation of greater participation/partnerships between the public and private sectors in response to this change;
- highlighting the part performance auditing plays in assisting such change, by:
 - making it more transparent; and
 - improving the institutional arrangements to cope with both cultural and environmental changes necessary to promote ongoing confidence in the bureaucracy and in democracy; and
- identifying challenges for the future in my concluding remarks.

II. IMPORTANCE OF EFFECTIVE CORPORATE GOVERNANCE

The importance of good corporate governance was certainly brought into sharp focus by the corporate excesses during the second half of the 1980s, and more recently, with the widely published corporate failures of Harris Scarfe, HIH, OneTel and Ansett. The challenge, as I see it, is not simply to put the various elements of good corporate governance in place. Rather, it is to ensure that those elements are effectively integrated, well understood, applied effectively and, importantly, an appropriate balance is maintained between the conformance and performance roles of the board or other governance body.

If implemented effectively, corporate governance provides the integrated strategic framework necessary to achieve the required outputs and outcomes performance, as well as discharging the organisation's accountability obligations. There is no doubt that good corporate governance is inevitably linked to good performance and achieving required results in a reasonable timeframe.

There have been many pressures for corporate governance reform commencing with the corporate collapses in the 1980s, as well as in the development of any number of statements about sound corporate governance principles, starting with the Cadbury Committee Report in 1992¹, and more lately the Turnbull Report of 1999² which have served as reference points for corporate action. Since then, academics, national governments, regulatory agencies and international organisations such as the World bank, the OECD, the Commonwealth Association for Corporate Governance and the European Union have all developed new principles and codes of Practice. In the United States, the Securities and Exchange Commission has also been very active.

In Australia, at the Federal Government level, the ANAO has published:

- 'Principles for Core Public Sector Corporate Governance'³;
- 'Applying Principles and Practices of Corporate Governance in Budget Funded Agencies'⁴; and
- 'Principles and Better Practices – Corporate Governance in Commonwealth Authorities and Companies'⁵.

The main themes of these better practice guides include: leadership, the management environment, risk management, monitoring and accountability. The Joint Committee of Public Accounts and Audit (JCPAA) has also prepared a report titled 'Corporate Governance and Accountability Arrangements for Commonwealth Government Business Enterprises (GBEs)'.⁶ I recommend these references as a good starting point for consideration of approaches in the public sector. Of particular interest to Chief Executives of Budget funded agencies was a checklist included in the second ANAO publication, referred to above. This checklist was included to assist Chief Executives to assess the strengths and weaknesses of their agencies' governance framework. We are now looking at how we might update this work in conjunction with the University of Canberra and other interested parties.

Corporate governance offers an approach by which agencies can mobilise their internal resources to review strategic direction, organisational performance and levels of responsibility, and to review command and control structures across the organisation. It emphasises the need for clear communication and up-to-date information both agency-wide and to all stakeholders. A key aspect of corporate governance is to ensure that all participants are aware of, and accept, their roles, responsibilities and accountabilities and that they have a sound understanding and appreciation of their practical importance in meeting the public interest. The framework is very people oriented involving better communication; a more systematic approach to corporate management; a greater emphasis on corporate and ethical conduct; risk management; skills development; relationship with citizens as clients; and quality service delivery.

A well governed agency will provide to its Chief Executive and its Minister, to all staff and other stakeholders, reliable, well founded, assurances that it is meeting its performance targets and that all reform agendas are being effectively implemented. Above all, a well governed agency can achieve better performance: it will have the robustness, the internal cohesion and direction essential to successfully drive the organisation forward and to respond quickly and coherently to external conditions. This must add to both the credibility and confidence all interested parties should have in our public institutions.

The Australian Agency for International Development (AusAID), which administers Australia's overseas aid program, has a key result area in its outcome and output structure to 'Promote Effective Governance' in developing countries. In its latest annual report, AusAID refers to strong governance providing a stable platform for developing countries to build effective strategies and programs to meet the needs of their poorest citizens. Further, AusAID suggests that, without the fundamentals of good governance, other approaches to poverty reduction may be unsustainable. In addition, AusAID comments that political unrest and economic crises in several countries in our region have highlighted the often fragile nature of democracy and economic progress. This reinforces the need for continued attention to standards of governance⁷.

Each year the ANAO supports countries receiving AusAID assistance to strengthen their governance through hosting delegations visiting Australia. They come here to learn about our system of governance. ANAO officers specifically talk to them about the role of the ANAO and the nature of the financial and performance audits that we conduct. In addition, from time to time, the ANAO hosts visiting officers from overseas audit offices who come to Australia for 6-12 months to learn how to conduct financial and performance audits.

III. CORPORATE GOVERNANCE AND THE ACCOUNTABILITY FRAMEWORK

Agency governance can greatly enhance accountability for performance through establishing effective systems of control. A subject of great audit interest is the control environment established by agencies and the control structures necessary to support it. I will address the important elements of what the ANAO addresses when assessing the robustness of an agency's control environment. It is important to recognise that performance audits comprise varying proportions of both assurance and performance elements. These proportions may be determined either by the nature of the audit itself and/or by the situation of the organisation determined largely by the robustness of its corporate governance framework.

How do agencies establish an effective control environment?

The notion of a control environment starts from the top of an agency. To be effective it requires clear leadership and commitment. This imperative is reinforced by the interrelationship of risk management strategies with the various elements of the control culture. The control environment of the agency will strongly influence the design and operation of control processes and procedures to mitigate risks and achieve the agency's

objectives. The clear intent and message to staff should be that such processes and procedures should be designed to facilitate rather than to inhibit performance. This approach should be promoted as good management. In short, the control environment is a reflection of management's attitude and commitment to ensuring well-controlled business operations that can demonstrate accountability for performance.

I cannot over-stress the importance of the need to directly integrate the agency's approach to control with its overall risk management plan in order to determine and prioritise the agency functions and activities that need to be controlled. Both require similar disciplines and emphasis on a systematic approach involving identification, analysis, assessment and monitoring. Control activities to mitigate risk need to be designed and implemented and relevant information regularly collected and communicated throughout the organisation. Management also needs to establish ongoing monitoring and review of performance to ensure that objectives are being achieved and that control activities are operating effectively. The achievement of the right balance is important so that the control environment is not unnecessarily restrictive nor encourages risk averse behaviour. To the contrary it should be promoting sound risk management and the systematic approach that goes with it.

What are the components of a sound control environment?

The adoption of a sound and robust control environment at the top of an agency will substantially influence the design and operation of control processes and procedures. The following is a description of the key components of a control environment which should lay the foundation for an effective control structure.

Firstly, ***control culture and management style***. Management's integrity and ethical values, preferences, operating philosophy and style greatly influence the control environment. Standards of behaviour and commitment to ethical values are reflected in management's operating style including recognition of the extent to which control is necessary to effectively govern the entity. These factors strongly influence the achievement of the entity's objectives and policies and can drive the development and maintenance of effective control structures throughout the agency.

The extent to which the agency achieves its objectives is dependent upon how well it utilises available resources. As a consequence, the effectiveness of an entity's ***planning, budgeting, monitoring and reporting processes*** is fundamental to its operations and the overall strength of the control environment.

The ***structure of the agency*** provides the framework in which activities are planned, executed, controlled and monitored. An entity's structure reflects the management approach taken, for example, with centralised or devolved authority emphasising the individual or team based approaches. The structure can also be dependent on the agency's size and the nature of its business activities. The governance structure and accountability processes should result in the appropriate assignment of responsibility within the agency. Individual sign-offs are an important element of the exercise of that responsibility.

The Chief Executive or the ***governing body of the agency***, together with senior management are responsible for devising and maintaining the control structure. In

carrying out this responsibility management should review the adequacy of internal controls on a regular basis to ensure that all key controls are operating effectively and are appropriate for achieving corporate goals and objectives. The entity's executive board, audit committee and internal audit are fundamental to this exercise. Management's attitude towards risk and enforcement of control procedures strongly influences the control environment.

An effective *audit committee* has the potential to strengthen the control environment, of which it is part, and assist the governing body foster an appropriate control culture. The Committee's strength is its demonstrated independence and power to seek explanations and information as well as its understanding of the various accountability relationships and their impact, particularly on financial performance.

Performance monitoring. Agencies need to employ effective procedures to monitor performance, including financial and non-financial aspects of their business activities. Effective procedures for monitoring an agency's performance is an integral part of maintaining a strong control environment. This pre-supposes that there is a credible performance management system in place including establishment of a performance culture, appropriate measurements, targets and assessments.

The agency's use of *information technology* greatly influences the effectiveness of the control structure. It is the responsibility of management to establish a framework for overall control over the use of information technology recognising the need to secure core agency data but with the facility to access it on a corporate wide basis. The absence of integration of many of an agency's systems puts great pressure on computing and other interfaces to ensure that accountability does not 'fall down the cracks'.

Human resources. The proper functioning and operation of any control structure is dependent on the competency and ethical standards of the agency's personnel. The skills, selection and training of the personnel involved and their understanding of controls are probably the most important requirements in establishing and maintaining an effective control environment. In part, these requirements will also depend on the state of an agency's knowledge management systems and their usefulness.

Legislative compliance. The effectiveness of the agency's systems and procedures for monitoring compliance with applicable legislative requirements, particularly those which govern their activities and financial management behaviour and accountability, is a fundamental requirement of a sound control environment. As in other management areas, it is important to know how, when and where to seek specialist assistance. This is particularly the case as the Australian Public Service (APS) moves more into an environment of contracting out, greater collaboration and networking, including partnership arrangements for service delivery both within and outside the APS.

External influences outside the control of the agency can have a direct impact on its operations and business practices. Management needs to identify such influences and assess their likely/possible impact so that prompt action can be taken to address them where it is possible and appropriate.

What are control structures?

Effective control structures provide a solid and reliable basis for efficient and effective achievement of objectives. They sustain longer term performance and results. They assist the Chief Executive or governing body of an agency to uphold their public sector corporate governance obligations. Control structures should assist with compliance with laws and regulations; minimisation of fraud; corruption and waste; fair and equitable treatment of staff and program recipients; reliable, accurate and timely reporting of financial and administrative performance; and the delivery of efficient and effective agency programs. They may be organisational arrangements, logical systems with in-built checks on decision-making and processes of a manual or computing nature. They may be early warning signals indicating lack of authority, absence of due process, or simply errors. They may be preventative and deny further access or simply shut down. Facilitative structures will indicate what needs to be done. Above all they should include a sound audit trail.

Control structures implemented within an agency should be commensurate with an acceptable level of risk, the nature of the entity and its program delivery. It must be kept in mind though that controls provide reasonable assurance, not absolute assurance that organisational objectives are being achieved. Control is a process, a means to an end, and not an end in itself. It impacts on the whole agency, it is the responsibility of everyone in the agency and is effected by staff at all levels.

The control structure will provide a linkage between the agency's strategic objectives and the functions and tasks undertaken to achieve those objectives. A good governance model will include a control and reporting regime which is geared to the achievement of the agency's objectives and which adds value by focusing control efforts on the 'big picture'. Managers are increasingly recognising the importance of sound records management and reliable access as important vehicles for control and related reports

What are the tools management can use to achieve effective control structures?

Given greater responsibility for governing bodies to maintain effective control structures, and to gain assurance to this effect, there is growing need for reliable structures, procedures and practices to support the key elements of public sector corporate governance.

The following structures, procedures and practices can assist public sector managers to discharge their control responsibilities:

- Control Self-Assessment
- Compliance Management
- Delegations of Authority
- Internal Audit
- External Audit
- Audit Committees
- Executive Boards

I will comment briefly on each element of the framework.

Control self assessment is a tool allowing governing bodies to promote a controls' culture within the entity. It is the reporting process where program managers are actively responsible for developing, assessing, maintaining and monitoring controls in their respective areas. This usually involves the completion of self assessment checklists confirming that control processes and procedures are clearly understood, implemented and operating effectively. More recently they have included 'sign-offs' for individual responsibility taken.

Compliance management is closely related to risk management. For effective compliance management, it is important that the control structure has built in mechanisms to observe legislative compliance, prevent breaches occurring and alert management of the consequences and penalties associated with non-compliance. Effective mechanisms are advisory and facilitative to promote compliance, with checks largely being of an 'exception' nature to minimise unnecessary involvement in processes which can be checked out by other means including built-in, and now generally automated, audit trails.

Delegations of authority. Governing bodies need to ensure proper attention to the adequacy and appropriateness of delegations. The *Financial Management and Accountability Act 1997* encourages Chief Executives to review existing delegations for their appropriateness. It is good practice to review delegations regularly, taking into account the risk assessment undertaken as well as any feedback from the control mechanisms in place.

Effective delegation of authority provides the linkage between the governing body, management and the individual employees who are responsible for the basis operation of control processes and procedures.

An agency's **internal audit** assists in maintaining and refining the control structure by ongoing evaluation of its effectiveness. The agency executive, through an audit committee, should ensure that internal audit coverage includes the whole control structure. Regular reports, at least on an exception basis, should be provided to the Committee with ongoing advice to the governing body. Such reporting is necessary for timely decisions on both preventative and detection actions.

Internal audit plays a significant role in the ongoing monitoring of the effectiveness of the control structure. The key functions of internal audit are to:

- provide assurance that the control structure in place is operational, efficient and effective, and that compliance with policy, processes and procedures concerning governance practices, legislation and delegations is upheld;
- audit business processes and activities and report on their efficiency and effectiveness;
- be involved in the design of control activities for systems under development;
- undertake special audit assignments at the request of the audit committee or governing body; and

- assist the external auditor with the audit of the financial statements predominantly by enabling reliance to be placed on control assurance work.

Given the high expectation of internal audit, there is a need to ensure that its performance is continually monitored. The audit committee has an important role in assessing and improving the performance of internal audit.

Audit Committee. The ANAO Better Practice Guide on 'Audit Committees' issued in July 1997 states that '*an effective committee has the potential to strengthen the control environment (of which it is a part) and assist the governing body fulfil its stewardship, leadership and control responsibilities*'.⁸

While the financial management legislation requires all public sector entities to establish an audit committee, there are sufficient arguments in the benefits themselves to justify the establishment of an effective audit committee. The Audit Committee should oversee internal audit, liaise with external audit and oversee the agency's control and risk management structures.

In respect of Internal Audit, the Audit Committee should:

- review and endorse the internal audit charter;
- take an active interest in the appointment of the head of internal audit and its staff;
- review and endorse the internal audit strategic plan and annual work program and monitor progress against the plan; and
- review internal audit reports and monitor and critique management's responses to findings and the extent to which recommendations are implemented.

In respect of External Audit, the Audit Committee should review:

- the proposed audit strategy;
- all external audit reports and critically evaluate management's responses to the findings and the implementation of recommendations;
- the financial statement preparation process and consider the appropriateness of accounting policies and disclosures; and
- external audit performance, considering independence, objectivity and effectiveness.

Both internal and external audit should work in virtual 'partnership' with the Audit Committee to strengthen its role as an effective element not just of the agency's control structure but also of its corporate governance framework. Such an approach should also assist the development of cooperative and complementary roles and action, including addressing any perceived audit expectation gaps.

In respect of control structures, the Audit Committee should review:

- documentation that supports the ongoing effectiveness of the control structure;

- representations or sign-offs by program managers on matters pertaining to the financial statements process and the control structure supporting that process; and
- and monitor compliance with policies in relation to ethics and security, privacy, fraud, conflicts of interest and the handling of sensitive information.

External audit has an important role in reviewing and contributing to the agency's control structure. It assesses the extent to which it can rely on the structure and, accordingly, has to test its robustness and completeness; identify any weaknesses that impact on the adequacy of its financial reporting process and administrative processes; and provide advice and review opportunities for more effective controls. In this way it should be able to contribute to improved effectiveness of the control structure.

Public Sector Executive Boards can support the leadership role of the Chief Executive. While the majority of the budget funded entities do not have formal boards of management the discussion paper on *'Applying Principles and Practice of Corporate Governance in Budget Funded Agencies'* comments on the idea of agencies, where appropriate, establishing executive boards as part of their governance arrangements. If the Chief Executive is not a member of the Board, the role of the latter can be advisory, or if given the necessary delegations, the Board can be an effective part of the decision-making structure.

The value of executive boards supporting the leadership role of the Chief Executive officers can be significant. Effectiveness can be enhanced by sharing and distributing workload and thus enabling more consideration and independence to be given to important and sensitive matters impacting on the administration and effectiveness of the agency. It would be expected that the major contributions would be strategic rather than operational.

An Executive Board can assist the control structure of the agency by:

- establishing and monitoring policies to ensure that the agency complies with the law and confirms with the highest standards of financial and ethical behaviour;
- adopting an annual budget for the financial performance of the agency, monitoring the results on a regular basis and ensuring consistency across budgeting, accounting and reporting systems particularly as transition to an accrual basis proceeds;
- adopting clearly defined delegations of authority across the agency; and
- ensuring that the agency has adequate reporting systems and has a proper control structure in place together with appropriate monitoring of compliance activities.

Input from the ANAO

The ANAO looks to be pro-active in providing ongoing advice and support to agencies in establishing and maintaining a sound corporate governance framework. We produce better practice guides on a range of relevant topics, including performance information, controlling performance and outcomes, and new directions for internal audit, in addition to those on corporate governance and audit committees that I have previously mentioned. We conduct seminars and workshops and contribute to a wide range of conferences conducted by agencies, professional bodies and tertiary institutions.

However, most importantly, we rate our performance on how well we interact with, and support, audit committees in these corporate governance roles.

IV. PERFORMANCE AUDIT AS PART OF THE COMMONWEALTH ACCOUNTABILITY FRAMEWORK

Our Vision - We want to be recognised for excellence in the provision of independent public sector audit and related services.

The ANAO independently reviews public sector performance and accountability regimes and aims to add value to public sector performance. We aim to do this by delivering:

- independent assessment of the performance of selected Commonwealth public sector activities including the scope for improving efficiency and administrative effectiveness (improvement in public administration); and
- independent assurance of Commonwealth public sector reporting, administration, control and accountability (assurance).

As an 'Independent Officer of the Parliament', I am the Commonwealth Parliament's independent external auditor and I report direct to the Parliament. I therefore have a unique relationship with the Parliament, independent of the government of the day. I cannot be directed by anyone regarding the performance of my functions. This makes the role of Auditor-General a fundamental element in Australia's democratic system of government. The Auditor-General and the ANAO together form a vital link in the accountability chain from the Commonwealth public sector to Parliament and, through Parliament, to the Australian people.

Our annual program of performance audits 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 the annual performance audit program. In planning our performance audit coverage, we also have regard to the need to:

- provide the Parliament with an assurance, over time, of the full range of performance of public sector agencies;
- respond to emerging issues of interest to the Parliament; and
- add value to public administration.

For the current financial year consideration of these emerging issues together with the previously mentioned business risks lead to the following themes being identified as part of the strategic planning process:

- Governance – HR Management;
- Governance – Financial Management;
- Governance – Performance Management and Measurement;
- Procurement and Contract Management;

- Information Technology; and
- Service Delivery.

The ANAO's range of audit products, particularly performance and financial statement audits, 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 addressing the observed circumstances of each agency and public sector body.

In response to the increasing focus on agency performance and results within the Commonwealth outcomes and outputs framework and the need to provide assurance to the Parliament, including on the 'health' of public sector agencies, the ANAO aims for comprehensive performance audit coverage over time. To maximise our efforts and the value added to public sector administration by the ANAO with finite resources, we are conducting more 'Across the Board' or 'Cross Portfolio' audits, accompanied by more Better Practice Guides that reflect such audit activity. We see this as an important contribution in which we can add value to public administration.

In addition to the APS wide issues, factors affecting the performance audits we conduct in individual agencies include:

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

I have already addressed at some length the importance of governance and accountability and will shortly discuss the changing nature of the public service, including, importantly, the involvement of the private sector. Now I would like to talk about the roles of evaluation and performance audit in the review of public sector administration.

Agency Evaluation and performance audit – a complementary relationship

Evaluation and performance auditing share similar aims, approaches, analytical methodologies and techniques. The following definitions provide some indications of the similarities, as well as differences, between evaluation and performance audit:

- ***Evaluation** is the systematic assessment of the appropriateness, effectiveness and/or efficiency of a program or part of a program, and its objectives are to:*

- *provide a better information base to assist managers in improving program performance;*

- *assist government decision-making and setting priorities, particularly in the Budget process; and*
 - *contribute to improved accountability to the Parliament and the public.*⁹
- *A **performance audit** is an independent, objective and systematic examination of the management of an organisation, program or function for the purposes of:*
- *forming an opinion on:*
 - *whether the organisation, program or function is being managed in an economic, efficient and effective manner; and*
 - *the adequacy of internal procedures for promoting and monitoring economy, efficiency and effectiveness; and*
 - *suggesting ways by which management practices, including procedures for monitoring performance, might be improved.*¹⁰

Differences between evaluation and audit include the following:

- evaluation often has a strong focus on policy and is able to make a qualitative assessment of policy effectiveness whereas a performance audit is focused on evaluating economy efficiency and effectiveness of administration including ethical behaviour and practices;
- audit is independent, while evaluation is not necessarily so; and
- in the public arena, independent audit is reported direct to Parliament and evaluation is reported to the Minister or Secretary (Head of agency/entity) and is often not made public.

The more important issue is the similarities between evaluation and audit and how the concepts complement each other. This focus arises from necessity – the realisation of the enormous task that confronts both groups involved and the need to gain maximum synergies from our respective work. At least for the foreseeable future, we cannot afford the luxury of distinctions based on perceptions of a significant gap between the two groups. I prefer to see such gap tested in practice rather than operating on the assumption that it precludes any kind of integration because of a presupposed different management orientation.

Both performance audit and evaluation rely on objectivity, integrity and professionalism of those conducting them. Both are diverse in the range of activity they cover. Both have annual planning schedules; employ common methodologies and analytical tools; and have similar reporting approaches. However, the similarity that I believe to be the most compelling argument in favour of a strong, harmonious approach between the two disciplines is that they have reasonably common goals:

- both are fundamental links in the accountability chain;

- both contribute to better program management and accountability for performance by commenting on a program's 'value for money' albeit sometimes from rather different perspectives; and
- both endeavour to identify better practice.

Performance audit and evaluation can be viewed as part of a continuum in the examination of the range of operations undertaken by an agency. In addition, both performance audits and evaluations can range across agencies. Indeed, a strength of many performance audits is that they can be directed to the operation of common functions or activities across a range of public sector entities. In the context of accountability then, is it possible to say anything credible and acceptable about where one finishes and the other starts on the continuum of review activity? It is, at least in the area of policy prescription, including appropriateness. Audits may bear on the merits of a particular policy, but do not comment on them or suggest alternative policy approaches. Evaluations often do.

In my view, performance auditing is best seen as a type of evaluation, since it focuses on improving program administrative efficiency and operational effectiveness, both of which are important aspects of program evaluation as well. The distinguishing feature of program evaluation is that it goes one step further along the continuum and looks at the effectiveness of program outcomes and, even further on some occasions, to make judgements about the appropriateness of the program, and policy, as a means of meeting current government policy and community needs. This tool enables a responsiveness of the government sector to public requirements and the move toward a greater outcome focus than in the past where the orientation was process and input aligned.

Most would agree that there is a role for a structured and well-directed program of evaluation in addition to performance audit to meet the Parliament's need for a comprehensive and effective accountability framework within which to assess the performance of government agencies. It is of paramount importance that agencies, utilising suitably skilled personnel, undertake proper evaluation of programs, focusing on relevant performance measures and reporting frameworks (with suitable frequency and detail) to address the intensifying focus on government accountability by taxpayers and the Parliament. Performance audit will be most effective where it complements such activity and, indeed, may often review it as a meta-evaluation. Hopefully, the latter will be viewed in a positive manner, first as a means of assurance and second as a means of improvement as necessary.

V. DEVELOPING PERFORMANCE AUDIT INTERNATIONALLY AND THE ANAO'S CONTRIBUTION

The interest in, and conduct of, performance audits has taken off around the world, particularly in developing countries. This is due in part to funding programs operated by AusAID (previously mentioned), the World Bank and the Asian Development Bank aimed at improving institutions of governance in these countries. As audit, and particularly performance audit, is one of these institutions of governance, overseas audit offices receive funding to develop their audit expertise and, increasingly in performance audit developments and practices.

Audit offices at the forefront of performance audit, such as Australia, New Zealand, the United Kingdom, Canada and the United States, provide important support to these programs by hosting audit staff from developing countries for periods of 6-12 months who come to learn how to conduct performance audits. They then return to the home audit offices to develop a program of performance audit and train others to conduct performance audits. Australia and others also attend regional conferences, seminars and training courses funded to bring together audit staff from developing countries in the region to learn about performance auditing and share their experiences.

In addition to government and bank funding, the International Audit Offices themselves address training requirements and share information on audit practices and procedures. The International Organisation of Supreme Audit Institutions (INTOSAI) represents the interests of audit offices worldwide. INTOSAI is supported by seven Regional Working Groups. The ANAO is a member of the Asian Organisation of Supreme Audit Institutions (ASOSAI), whose membership has grown from the original 11 in 1979 to a current membership of 35 audit offices.

One of the major objectives of ASOSAI is to provide opportunities for training and continuing education for government auditors, with a view to improving audit quality and performance. Towards this objective, ASOSAI reports on its web-site (www.asosai.org) that it has conducted over 90 training courses since its inception, many of which address performance audit issues. These courses are funded in three different ways, namely:

- courses organised by ASOSAI with ASOSAI funds, usually assisted by voluntary contributions from some member SAIs;
- courses organised under the auspices of the INTOSAI Development Initiative (IDI) with funding from international and regional development banks; and
- programs organised by ASOSAI member countries.

Australia has made a significant contribution to two recent initiatives in performance audit sponsored by ASOSAI.

Firstly, Australia lead a research team of six representatives of ASOSAI members which developed a draft of performance auditing guidelines. The draft guidelines were circulated to ASOSAI members for review and comment. All comments were taken into account in developing a final draft of the guidelines which were approved by the ASOSAI Governing Board at the 8th ASOSAI Assembly in Thailand in October 2000¹¹. These guidelines provide a framework for managing and conducting performance audits. They are not a detailed instruction manual and do not replace the need for audit management and staff to use their professional judgement to ensure the delivery of a quality audit product.

Secondly, Australia hosted an eight day ASOSAI Value For Money (VFM) Workshop in Canberra in October 2001. This was the second time this workshop had been presented by ASOSAI, the first one being held in Bangkok in February/March 2000.

The Workshop introduces the fundamental principles, concepts and methods of VFM or performance audit and features a large number of exercises and case studies that reinforce the practical, hands-on sharing of audit experience. One of the objectives of the Workshop was for participants to disseminate what they had learned during the workshop back in their home SAI. The Workshop was attended by 22 participants (including one from Australia), 5 instructors and 2 ASOSAI Secretariat staff from 23 ASOSAI countries.

The ANAO has developed closer connections with overseas audit offices. We are very interested in the types of performance audits they undertake; the audit findings, conclusions and recommendations they include in their audit reports; and the extent to which such audit findings may be applicable in the Australian environment. The impact of ANAO performance audit reports is enhanced when we can refer to similar audit findings in relevant circumstances in other SAI audit reports. The ANAO also has reciprocal arrangements with the UK National Audit Office to benchmark performance audit practices and procedures and with the Office of the Auditor-General in New Zealand to review performance audit reports to identify matters of good practice and areas for improvement. Such peer reviews are essential for the credibility of our audit work and the assurance they provide to all our stakeholders.

VI. CHANGING NATURE OF GOVERNANCE – THE PUBLIC/PRIVATE INTERFACE

All public sector organisations are required to be transparent, responsive and accountable for their activities. The challenge for corporate governance is how to deal with, and ensure, proper accountability for performance in all its dimensions with the greater involvement of the private sector in the provision of services to, and in particular for, the public sector. Previously such involvement of the private sector has been referred to as the purchaser-provider model. The latest emphasis has been on so-called Public-Private Partnerships (PPP) for service delivery.

In a more privatised public sector, the question becomes what is a reasonable trade-off when, inevitably in a public sector environment, the perceived needs for accountability can impact adversely on economy and efficiency. A similar observation extends to effectiveness, particularly where that concept does not embrace accountability concerns such as transparency, equity of treatment and probity in the use of public resources, including the application of public service values and codes of conduct. An appropriate balance needs to be struck, which may involve re-consideration by the Government and the Parliament as to the appropriate nature and level of accountability of both public and private organisations where there is shared responsibility, and even accountability, for the delivery of public services to the citizen.

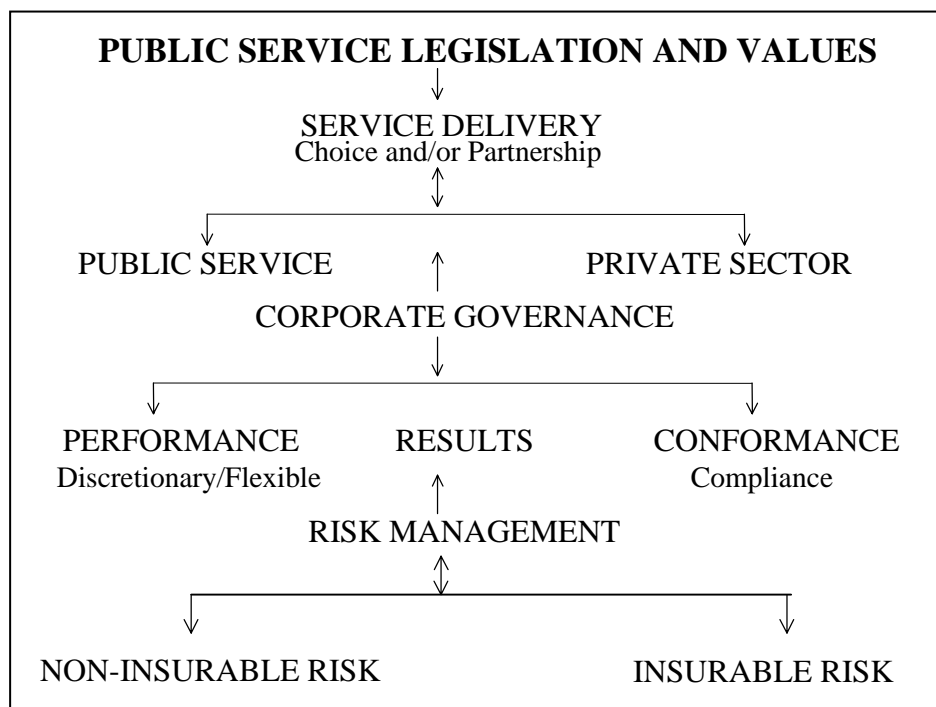
There is no suggestion on the part of the Government or Parliament that accountability expectations will be downgraded; if anything, the reforms suggest that additional authority and flexibility require enhanced accountabilities even where there may be an additional cost involved. Parliament's confidence in the accountability of public sector organisations is an on-going challenge to our corporate governance frameworks.

It has been generally recognised that networked arrangements for service delivery, which envisage more sophisticated and cooperative approaches to cross-cutting issues, are likely to focus on the importance of partnerships, coordination and joint working agreements. This is increasingly occurring at the inter-agency level. As well, networking can be expected to evolve to include strategic arrangements and structures between 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. As well, they erode differences between the public and private sectors which, in turn, often tends to focus greater attention on the remaining differences, particularly when considering issues such as public and private interest.

These moves have important ramifications for both responsibility and accountability and raise the question, again, as to 'who is accountable for what?' Are we looking at a more integrated model of public administration? Is it feasible to apply such a model to a more networked environment involving 'real' partnerships as well as direct competition on the basis of genuine competitive neutrality? Figure 1 reflects a more integrated arrangement which directly begs the question as to what trade-offs in approaches are possible and in what situations, not least in the nature and level of accountability and results that can be agreed. Probity, trust and confidence would seem immutable.

My focus here is on the possible greater integration of both sectors generally, or for selected functions, and not on the creation of two public services reflecting, for example, core government on the one hand, and quasi government operations on the other. Distinctions of the latter kind are often spoken about by Prime Ministers, Ministers and Members of Parliament but, in reality, occur incrementally through a series of policy decisions that transfer particular activities and organisations from the public to the private sector over time.

Figure 1



A major aim of modern public administration has been expressed as creating the ability to deliver services that appear seamless to the recipient¹². In other words, the citizen does not necessarily need to know whom he or she is dealing with. 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 appropriate accountability and reporting arrangements, which clearly define roles and responsibilities of the various participants, would seem to be required. Perhaps a more controversial aspect is the notion of sharing values, at least to some degree, with the private sector¹³. This may be less of a problem with the not-for-profit segment. 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 in the public to sustain stakeholder confidence.

More networked or partnering arrangements can also help overcome any apparent inflexibilities of a narrowly based contractual relationship. Such 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. They may also facilitate contract re-negotiations and variations which are otherwise 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. Without such cooperation, it would seem difficult for public sector managers to exert a great deal of influence, or accountability, on private sector providers as opposed to relying on contractual clauses and legal confrontation, even Court action.

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, meaningful dialogue and genuine 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.¹⁴

Another important aspect of developing networked solutions is the need to ensure greater availability of information and access to citizens as clients or customers. Information technology is providing significant opportunities for government to put in place facilities for existing and potential clients to have access to the information they require. Information and communications technology provides both the basis to facilitate partnerships and a compelling justification for partnering. It has been suggested that one effect upon businesses in the electronic era, with its emphasis on e-commerce and related technology based service delivery, is that they will need to work more closely together. To fully exploit opportunities created by the Internet will require organisations to develop closer working relationships with their stakeholders.¹⁵ Indeed, rapid advances in information and communication technologies are likely to demand the establishment of effective partnering and networking to ensure a responsive, efficient and cost-effective public sector providing seamless availability of information and other services to all stakeholders. It could almost be said that there is a 'tyranny of the technology', which is evident even now in many agencies, such as the Taxation Office, with their virtual total dependence on information technology.

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 (IT) and the way in which this can lead to risk transfer, or allocation, between the two sectors. 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. Nevertheless, in a 'cash-strapped' Budget environment, it does provide the opportunity to get significant projects off the ground.

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. 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,¹⁶ is to achieve the best affordable operational capability.

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.

Partnership arrangements are also likely to be encouraged through the increased adoption and impact of electronic 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.¹⁷

In Australia, greater coordination, collaboration, or networking, across agencies is gaining favour as a means of delivering more responsive public services to citizens. For example, an ANAO report¹⁸ 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. The arrangements have subsequently expanded such that the particular Commonwealth agency, Centrelink, now delivers services on behalf of a total of four large, and nine other, agencies under formal purchaser-provider arrangements.¹⁹ 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.

Another example of networking arrangements at the Federal level of Government in Australia is in the area of employment services where a market for such services has been virtually created by outsourcing currently to about 200 private sector providers the responsibility for finding jobs for unemployed people, particularly those who are long term unemployed. The arrangement is known as Job Network. The initial point of contact for a job seeker with the Network is Centrelink. That agency provides information to job seekers and registers, interviews and assesses them for the different levels of assistance.²⁰

A further indication of a greater 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 Australian Public Service. All 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 21st Century.*²¹

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.

Privacy and security

The question of access to private contractor's premises and records is important to us all which I will discuss later. What I wish to discuss here is how the privacy concerns of citizens are protected in an environment where responsibility for the delivery of services and the collection of information is performed by the private sector on behalf of the government.

For the public sector, with the increased involvement of the private sector in the provision of public services, the security of agency data, and particularly electronic data, is another critical issue that needs to be effectively managed. Contracts negotiated between Australian federal public service agencies and their private sector providers

must include provisions which acknowledge Australian Federal Government IT security requirements. In addition to the technical issues associated with the protection of the data held by government agencies from unauthorised access or improper use, there are also issues associated with the security of, for example, personal information held by government. Contracts for outsourcing service delivery need to ensure that prospective service providers are aware of the standard of protection that comes from dealing with people on behalf of the government and that the mechanisms in place do provide effective privacy protection for individuals or groups in society. A watchful citizenry will want to be certain that agencies and their contractors cannot evade their obligations.

To fully address such concerns, a Better Practice Guide, recently prepared by the ANAO²², suggests that agency Internet websites should incorporate a prominently displayed Privacy Statement which states what information is collected, for what purpose, and how this information is used, if it is disclosed and to whom. It should also address any other privacy issues.²³

The risks involved in broadening networks and Internet use also raise issues associated with who has access to an agency's records. This has consequences for the privacy and confidentiality of records, which are of considerable concern to Parliament. This is particularly the case during outsourcing, where private sector service providers have access to collections of personal records that could be used for inappropriate purposes, such as sales to other private sector organisations of mailing lists.

All Commonwealth agencies are subject to the *Privacy Act 1998*, which contains a number of Information Privacy Principles (IPPs) that provide for the security and storage of personal information. The Privacy Act defines personal information as:

*information or an opinion (including information or an opinion forming part of a database), whether true or not, and whether recorded in a material form or not, about an individual whose identity is apparent, or can reasonably be ascertained, from the information or opinion.*²⁴

The IPPs state that if a record is to be given to a service provider, the recordkeeper (ie the agency) must do everything reasonably within its power to prevent unauthorised use or disclosure of information contained in the record.

The increased involvement of the private sector in the provision of public services raises issues about the security of agency data and records, particularly in electronic form. In the past, the obligations that apply to Commonwealth agencies under the Privacy Act have not applied to private sector organisations. However, the Privacy Amendment (Private Sector) Act 2000, passed in December 2000, aims to provide privacy protection for personal records across the private sector, including those organisations providing outsourced services to the public sector. The Act enables a contract between a Commonwealth agency and the private sector supplier to be the primary source of the contractors' privacy obligations regarding personal records. The contractual clauses must be consistent with the IPPs that apply to the agency itself, and details of these privacy clauses must be released on request. The Act:

*aims to control the way information is used and stored, and bring to justice those who abuse private information for their own ends. Placed in the insecure context of e-commerce and e-mail transmission of personal details, issues of privacy have become more significant.*²⁵

For many organisations, including health services, the new private sector provisions commenced on 21 December 2001. For small businesses to which the provisions will apply (except health services), the new provisions will commence one year later. The Act will apply to ‘organisations’ in the private sector. An organisation can be an individual, a body corporate, a partnership, an unincorporated association or a trust.

Administrative law considerations

Inevitably, contracting-out blurs the boundary between public and private law. In particular, the way in which citizens may seek remedy under administrative law for decisions taken by a body that is not itself a statutory body or a government agency. As one commentator has noted:

*The administrative law system is the principal means by which government is accountable to individuals. It also reinforces and complements the mechanisms for financial and political accountability.*²⁶

Unless great care is taken, contracts can have the effect of removing an individual’s access to:

- Freedom of Information rights;
- the jurisdiction of the Ombudsman or similar review mechanisms; or
- the rights of litigation under administrative law.

Governments are responsible for a wide range of outcomes that affect the well-being of its citizens. That well-being can be understood differently in the context of a variety of social, economic, and political considerations. Governments are obliged to pursue that responsibility by selecting the most appropriate means available to them at the time. Contracts are one such instrument. The move to greater contracting by governments has been largely prompted by considerations of efficiency. But the efficient use of the public resources is not all there is to public governance. It is important that contracts entered into on behalf of the government do not have the effect of unnecessarily restricting the freedom of policy action by successive governments, while recognising the advantages in certain areas of longer term contracts for all parties concerned.

Contracts for the supply of goods and services often extend for periods in excess of the particular life of the Parliament or the government of the day. Some have consequences that can last for generations, for example, water or waste management. What is important in these circumstances is that administrators do not enter into contracts that have the effect of unnecessarily limiting the ability of governments to use their executive power flexibly for the public good. While there are clearly policy issues involved in this connection, which are generally outside the audit mandate, there are also

resourcing and other issues which would be integral to any contract on which audit assurance would be sought.

The Administrative Law principles require the ANAO's reports to refer to evidence in support of each conclusion reached. As well, each conclusion should be clear and substantiated. A conclusion that there is no evidence about a matter should not be made without having conducted reasonable inquiries to check for the existence of such evidence. In particular, we need to be clear as to the extent of a conclusion. Any conclusion expressly, or impliedly, critical of a person or body should not be made unless that person/body has been informed of the adverse material relevant to that conclusion. In addition, the person/body has to be given a reasonable opportunity to comment or respond to any adverse material. This is a matter of natural justice, with its origins in natural law, which I will shortly discuss further. However, Audit Offices are well aware of the foregoing requirements from professional auditing disciplines.

Equity Law and natural justice

In any consideration of Government contractual arrangements there are also considerations of the law of equity. A former Chief Justice of the High Court of Australia, Sir Anthony Mason, has remarked:

One aspect of the latest developments in equity is the increasing penetration of equitable doctrine into contract and commercial law...

and

It seems inevitable that equity's penetration of commercial transactions, which depends so much on the way in which parties formulate their contracts and shape their arrangements will increase.²⁷

In Australia, the High Court has made it clear that equitable doctrines can apply to the Government as well as to individuals.²⁸

My colleague, the Auditor-General of South Australia makes the following comment:

Where Government transactions are complex and the details of contractual arrangements are confidential the likelihood that outsiders will misunderstand the relationship between the Government agency and private parties increases substantially. The result is a potential future liability of Government for the reasonable reliance by those outsiders due to representations made either by the Government or the private parties involved in the transaction. It has been suggested that the protection of reasonable expectations is more important when government is involved because 'government should act and be obliged to act as a "moral exemplar" in its relationships and dealings with members of the community'.²⁹

Consistent with the Attorney-General's responsibility for the maintenance of proper standards in litigation, the Commonwealth Government and its agencies must behave as a model litigant in the conduct of litigation. Being a model litigant requires us to act

with complete propriety, fairly and in accordance with the highest professional standards. This expectation has been recognised by the Courts.³⁰

In practical terms, the foregoing discussion suggests that there is a higher standard of integrity demanded of governments and administrators when dealing with the private sector. It is also important to see that where external service providers operate on the government's behalf, they understand and abide by that higher level of expectation. Ultimately, it is the government administrator who is responsible for ensuring that higher expectations of service are met but, as noted earlier, there may be scope in collaborative arrangements for shared responsibilities in this respect.

A particular issue has arisen in relation to our performance audits about the coverage of private sector individuals and firms. As with a number of other Supreme Audit Institutions (SAIs), we provide a copy of our draft reports, in part or whole, to those affected for their comment. Our legislation provides for a period of 28 days for submission of comments on draft reports, which I must consider before preparing a final report (Section 19 of the Auditor-General Act 1997). As noted earlier, we have to provide 'natural justice', or procedural fairness as some term it, to those identified in our reports. Natural justice has been described as the minimum standard of fairness that has to be applied in the adjudication of a dispute.³¹ It consists basically of two elements, one to ensure a fair hearing, and the other to act without bias. Because of some uncertainty as to the extension of Parliamentary Privilege to such reports, questions of defamation action have arisen. The standard of proof applicable to findings in an audit report is the 'civil standard', that is, it is more probable than not that the matter found to have occurred in fact occurred. This has resulted in the ANAO having to seek legal opinions on some of its reports dealing with private sector participation in government activities.

However, there has also been a problem of the private sector seeing the draft report commentary process as being one for 'negotiation' as to what is to be included in the final report, rather than ensuring that the ANAO has an accurate understanding of the 'facts' of the situation and that those 'facts' are correct as would normally occur with public sector agencies and bodies. I made the point in my annual report last year that:

...full cooperation in responding on this basis will save all parties considerable time and cost and engender confidence in the process.³²

I went on to observe that conflicts of public and private interests are not new, but their resolution in performance audit reports is a challenge to all parties without a genuine shared understanding of what constitutes public accountability and, indeed, performance and results.

Values and Ethics

It hardly needs to be emphasised that the ethical administration of government contracts is a key consideration of Audit Offices. In practical terms, however, particularly where fraud and/or corruption is involved, there is a requirement for the application of a range of forensic auditing skills that are not often within the skillset of our public auditors. Conflicts of interest, whether real or apparent, can become increasingly difficult to define, let alone identify, as agencies become further removed from the locus of decision

making. At least contracts should be examined to make sure that they establish suitable procedures to expose potential real, or apparent, conflicts of interest.

The Financial Management and Accountability Act 1997 requires Chief Executives to promote the efficient, effective and ethical use of Commonwealth resources for which the Chief Executives are responsible (part 7, section 44). The Public Service Act sets out the Australian Public Service (APS) Values (part 3, section 10), and the APS Code of Conduct (part 3, section 13). In addition, an agency head must uphold and promote the APS Values (part 3, section 12), as well as being bound by the Code of Conduct (part 3, section 14). The latter section also binds statutory office holders. These Values and the Code of Conduct form the framework for the ANAO's Code of Conduct which also includes our professional responsibilities.

At the very least, private sector providers need to have these Values and Codes of Conduct brought to their attention. It is highly desirable that they not only be informed of, but also make some effort to understand, the requirements and implications for identified performance and results to be achieved. There are community concerns that private sector service providers are not subject to the same legal requirements as public servants are in these respects. However, it is clearly difficult to impose contractual conditions involving values and ethics that are practically enforceable. That conundrum points to the need to agree on a shared culture, including values and ethics as part of any partnership or collaborative agreement between public sector agencies and private sector providers. At a minimum, there needs to be a shared understanding of what that involves. It would be of considerable advantage to have voluntary adherence in those contractual areas where these are central issues.

VII. CHALLENGES FOR THE FUTURE

I have canvassed a range of issues associated with the importance of an appropriate governance structure; the changing environment with the greater involvement of the private sector in public activities, including notions of partnership, collaboration and networking; and the role played by the ANAO as the independent Commonwealth external auditor and member of the International Organisation of Supreme Audit Institutions. The issues raised are illustrative but indicative of the challenges we face. Public sector managers and auditors need to understand not only the issues but also the pressures on those immediately concerned. As well, auditors have to form opinions, and often advise, on those issues in the context of the changing business environment being confronted.

Audit independence

The issue of the independence of auditors is never too far away from the limelight, both in Australia and overseas, particularly in recent times in light of some notable corporate collapses, previously mentioned. Professor Ian Ramsay's Report on *Independence of Australian Company Auditors*³³ is of particular interest. The Institute of Chartered Accountants in Australia and CPA Australia also released an Exposure Draft in December 2001 on *Professional Independence*.³⁴ While the focus of these publications relates to auditors' responsibilities in conducting financial statement audits, the

independence of auditors, particularly in relation to the avoidance of conflicts of interest, actual or perceived, is equally relevant to performance auditing.

Overseas, the Comptroller General of the United States and head of the General Accounting Office (GAO), David M. Walker, announced, in a press statement last month, significant changes to the auditor independence requirements under Government Auditing Standards. Specifically on independence, the auditing standards comment:

*Auditors and audit organisations have a responsibility to maintain independence, so that opinions, conclusions, judgments, and recommendations will be impartial and will be viewed as impartial by knowledgeable third parties. An auditor should avoid situations that could lead reasonable third parties with knowledge of the relevant facts and circumstances to conclude that the auditor is not able to maintain independence and, thus, is not capable of exercising objective and impartial judgment on all issues associated with conducting and reporting on the work.*³⁵

Corresponding with the public sector changes over time, the role of the Audit Office and the place of auditing in democratic government has also changed. In today's environment, my role includes providing independent assurance on the overall performance and accountability of the public sector in delivering the Government's programs and services and in implementing effectively a wide range of public sector reforms. And I cannot overstate the importance of the independence of the Auditor-General in those respects. 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 of them.

Accent on performance information and assessment

The ANAO is keen to identify the issues facing agencies early in the life of the outputs/outcomes 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 undertaken two audits specifically considering performance information. The first of these, Report No 46, *ATO Performance Reporting under the Outcomes and Outputs Framework*, was tabled in June 2001³⁶.

The ANAO was responding to a request from the Senate Finance and Public Administration Legislation Committee to review agency performance information. 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 also conducted a cross-portfolio audit to assess performance information in the PBSs 2000-2001 and Annual Reports for 1999-2000.³⁷ The Report concluded that, overall, performance information in the PBS should be improved to enable agencies to establish and demonstrate the links between outcomes, outputs and performance indicators. It also commented that:

*A common limitation in the performance information in all 10 audited agencies' PBS and annual reports related to effectiveness indicators which did not actually measure outcome performance.*³⁸

The Report also noted:

*it was important to track overall outcomes achieved across the layers of government and through the various partnerships with other agencies, including non-government bodies, as well as the particular contribution made by the specific Commonwealth agency to the outcome.*³⁹

Overall, the Report also concluded that it would be difficult for Parliament and other stakeholders to assess agency performance with reasonable assurance as the performance information did not always include targets, or that the targets that were provided were often vague and/or ambiguous. As such, this is a factor which the ANAO will need to take into account in its future performance audits.

Contract management

It would be no exaggeration to say that most public sector managers today have to grapple with how to establish a sound contract and contractual environment. For example, outcomes can often be difficult to specify in many contractual arrangements and, indeed, may even be the combined product of more than one agency. Given these complex linkages, it can therefore be difficult to specify, in order to press for successful contractor performance, the circumstances in which 'non-performance' has occurred or what constitute enforceable responses. It can be simpler when outcomes to be achieved are defined in output terms. Specification in terms of intermediate outcomes can also be helpful.

Effective contract administration in the public sector goes beyond simply trying to hold contractors to account for each minute detail of the contract. To get the most from a contract, the contract manager and contractor alike need to nurture a relationship

supporting not only the objectives of both parties but also one that recognises their functional and business imperatives. It is a question of achieving a suitable balance between ensuring strict contract compliance and working with providers in a partnership context to achieve the required result.

The ANAO Better Practice Guide on Contract Management emphasises the importance of not only dealing effectively with risk in contracts but also in developing and maintaining a relationship with the contractor that supports the objectives of both parties and focuses on the agreed results to be achieved⁴⁰. However, as observed by the Senate Finance and Public Administration References Committee, there are also concerns that both parties do not understand, or are insufficiently aware of, the requirements for parliamentary accountability⁴¹.

Record-keeping in a more networked environment

While the National Archives of Australia would not agree, and rightly so, record-keeping is not seen by many public servants as a ‘glamorous’ or ‘exciting’ activity. Nevertheless, it is basic to good management and can be quite complex. Effective systems and operational practices are often subject to review by auditors.

Records are an indispensable element of transparency, and thus of accountability, both within the organisation and externally. As the Public Record Office in the United Kingdom observes:

*All organisations need to keep records of business decisions and transactions to meet the demands of corporate accountability.*⁴²

Records are consulted as proof of activity by senior managers, auditors, members of the public or by anyone inquiring into a decision, a process or the performance of an organisation or an individual. As such, they are an appropriate example of not only the importance of good process but also how it often contributes importantly to the myriad of public sector outcomes or results. With the move to greater outsourcing to the private sector, there is increasing concern about organisations' ability to preserve those records that are needed to support the delivery of programs and services, and to meet their accountability, as well as archival, obligations.

As you know, higher standards of accountability are expected in the public sector than is usual in the private sector. Recognising this, Parliament has passed legislation relevant to record-keeping that applies to all Commonwealth agencies, such as the *Archives Act 1983*, the *Freedom of Information (FOI) Act 1982* and the *Privacy Act 1988*. These Acts deal with the overarching issues of maintenance, archiving and destruction of records, access to records by the public, and confidentiality of records. Also of relevance, particularly from a management viewpoint, are the *Public Service Act 1999*, the *Financial Management and Accountability (FMA) Act 1997* and the *Commonwealth Authorities and Companies (CAC) Act 1997*.

The FMA Act requires that Chief Executives manage the affairs of their agencies in a way that promotes proper use (that is, efficient, effective and ethical use) of the Commonwealth resources for which the Chief Executive is responsible. A Chief Executive must ensure that the accounts and records of the agency are kept as required

by the Finance Minister's Orders. Record-keeping is also covered by the CAC Act, which requires a Commonwealth authority to keep accounting records that properly record and explain its transactions and financial position. These records have to be kept in a way that enables the preparation of financial statements and that allows those statements to be audited appropriately and effectively.

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

Transparency, through record-keeping, is an agency's first line of defence against accusations of bias, unfair treatment and other negative public perceptions. It also promotes confidence in the integrity of the Australian Public Service (APS) and provides assurance to stakeholders that the APS is making decisions in the 'public interest', particularly where procurement is concerned, as well as meeting any requirements for fairness, equity, privacy and freedom of information. Transparency also provides some guarantee of integrity of information, which improves the scope for governments to make constructive use of the internet in dealing with their citizens.

Countering the loss of corporate knowledge is another area that can be greatly assisted by a sound record-keeping culture. Corporate knowledge is largely the wealth of information and experience that is stored on paper, electronically or mentally. Of course, we are well aware that such knowledge is only useful when something is actually done with it. Loss of corporate knowledge has been a significant issue for the public sector in recent years where, due to the trend towards high turnover and increasing mobility of staff, in part the result of outsourcing activity and privatisation of public sector organisations and activities, we have seen an enormous drain on the retained knowledge of the APS through the departure of many experienced individuals. The creation and maintenance of suitable records can alleviate this problem to some extent, particularly in relation to decision-making, as part of a robust knowledge management system.

Apart from mitigating the loss of corporate knowledge, record-keeping can assist the internal functioning of agencies by improving performance. Records of performance information are important in allowing an agency to monitor its performance and benchmark itself against other organisations, to ensure that performance is at optimum level. As well, fraud is less likely in a sound record-keeping environment that supports timely and accurate recording of data, with sufficient separation of duties. We are all aware that there is a cost associated with good record-keeping. In the main, it is a risk management judgement that should be made on the basis of a systematic risk assessment with sound identification and prioritisation of both internal and external risks. This involves careful examination of what outcomes are really being required and, therefore, what record-keeping practices are necessary to achieve those outcomes. Any approach should also meet legislative requirements for record-keeping. In short, records should be

fit for their purpose. This is particularly important in any outsourcing situation where such records are being wholly or partially maintained by the private sector.

Access to records - openness and transparency in both the public and private sectors

As part of performing a statutory duty to the Parliament, the Auditor-General may require access to records and information relating to contractor performance. My legislative information-gathering powers⁴³ are broad but they do not include a statutory right of access to contractors' premises to obtain information. In September 1997, my Office circulated draft model access clauses to agencies and recommended their insertion in appropriate contracts. These clauses give the agency and the ANAO access to contractors' premises and the right to inspect and copy documentation and records associated with the contract. Latterly, with the support of Parliamentary Committees, the Government inserted useful provisions for access in the procurement guidelines.

The primary responsibility for ensuring there is sufficient access to relevant records and information pertaining to a contract lies with agency heads. A Chief Executive must manage the affairs of the Agency in a way that promotes proper use (meaning efficient, effective and ethical use) of the taxpayers' resources, as noted earlier. Such an arrangement reflects the principles of good governance accepted internationally.

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 maintenance and 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. This is important both for agency management and audit assurance to other stakeholders, including the Government and the Parliament.

Governance issues

e-Government

Information (including communications) technology is revolutionising the way the public sector actually 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. Effective management of our information assets is becoming a significant element of the growing proportion of our Intellectual Property which has to be protected and preserved.

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

As organisations embrace modern networked communications, such as the World Wide Web, they are creating a need for different styles of governance in the information age. Consequently, in many areas, consideration has to be given to the extent that information technology is core business. This is evident where it is difficult to actually separate the technology from the service being delivered. Nevertheless, there are complexities in the migration process itself in the public sector environment as the following observation notes:

Calls for government service delivery to migrate from in-line to online sooner rather than later often overlook the complex social, regulatory and legal issues governments face in changing their service delivery models⁴⁴.

The connectivity and interdependence made possible through information technology also creates vulnerabilities. The proliferation of computer viruses and hackers seeking to manipulate critical computer systems poses serious risks to government agencies, and in the private domain, and the threat will only grow in the future. Such issues also raise questions about adequate business continuity arrangements. The risks involved also raise issues associated with the privacy and confidentiality of records which are of considerable concern to the Parliament. Unless appropriately controlled, computerised operations can offer numerous opportunities for committing fraud, unauthorised tampering with data or disrupting vital operations. As with many other aspects of the move to e-government, it is often a lack of awareness from the top down that is a major barrier to implementing appropriate security measures as part of sound risk management.

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

Implications for auditors

There are many implications and consequences for auditors in the current changing governance environment. While there are variations in the mandate, focus and operating arrangements across constituencies, the fundamental role of auditors-general remains

substantially the same. That role is to provide the elected representatives of the community (the Parliament in our case) with an independent, apolitical and objective assessment of the way the government of the day is administering their electoral mandate and using resources approved by democratic processes, albeit in differing governance frameworks.

In my view, auditors-general in particular and the wider community of review agencies are an essential element in the accountability process by providing that unique blend of independence, objectivity and professionalism to the work they do.

Performance audit - adding value to public administration

The important message of this presentation is that external audit, more specifically performance audit, in helping to meet the challenges of rapid change and developing managerial styles, has to be seen to be a real contributor to the process of finding solutions for the increasingly complex problems faced by public sector managers, including issues of accountability. I am confident that this more positive role is accepted by all auditors-general.

I would also suggest that, as the pace of change remains unabated, this trend will not decline. Rather, it is likely to increase. The roles and responsibilities of the public and private sectors will be more integrated and, perhaps, 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.

Improving our capabilities and products

The ANAO has for several years now had a program of producing Better Practice Guides. These are generally well received by the agencies concerned and have provided the basis of subsequent audits. They are seen by most as a positive contribution to the overall administration of government services. In developing them we regularly draw on the experience of other jurisdictions so that the work of others finds some fruit in our publications. We would hope that what we are able to achieve also finds its way around the world where others can leverage off what we have done.

As well as Better Practice Guides, the ANAO has embarked on a program of benchmarking common activities in public administration. To date, benchmarking studies have been completed in relation to the Internal Audit and the Finance functions. My Office has now embarked on a study of the Human Resource Management function. In these projects a number of public agencies are benchmarked against each other and an extensive range (several hundred) of private and public entities. We see them as relatively high-risk projects for the office but as having substantial benefits for the management of public activity regardless of whether it is performed by the public or private sector. In particular, risk management must address:

- the need to buy in expertise. This relates as much to the range of skills within the Office as to the need for an extended knowledge of the corporate world;

- the quality of the data that is gathered – given the size of the project, it is not audited data, but relies on the data supplied by agencies;
- the range of diagnostic tools available and their relative strengths and weaknesses;
- an understanding of the differences between the environments in which the individual agencies must operate;
- the size and complexity of the project management task; and
- the need to achieve and maintain cooperation with the agencies concerned.

The benefits that can flow from such an exercise are significant. For example, the ANAO report on the Benchmarking of the Finance Function comments:

An estimate of potential expenditure reductions is made in these chapters on the basis that those organisations in the Commonwealth group with costs above the group median are moved to the median level. The potential reductions total some...20.7 per cent of current expenditure on the benchmarked finance activities.⁴⁵

Other benefits flow through to policy decision-makers, public sector managers and audit authorities. They can include:

- clear specific criteria for future audit activity and other avenues of assessment;
- where functions are to be contracted out, clear and credible performance criteria to be included in tender and contract documentation;
- credible information on which to base decisions on whether to perform functions in-house or to contract out;
- performance evaluation standards for management to help identify under-performance and reward excellence;
- the benchmarks developed through this method are already being used in other jurisdictions, leading to greater uniformity of performance expectations; and
- in the context of service charters mentioned elsewhere they can help provide for more credible communication with clients or citizens.

We can leverage off the experience and approaches taken by the private sector in many areas of benchmarking and performance management. However, there are requirements in the public sector environment which are different and need to be treated as such. Partnership arrangements have to recognise this reality and adjust to it. It is not a one-way street. As I have said many times now, auditors can facilitate both the understanding and resolution of management, accountability and performance issues within their particular areas of expertise. We can do so both by the nature of the approach we take to public/private partnerships and/or other collaborative and

networking arrangements, which seem to be a growing part of our governance arrangements, as well as by tailoring our products to assist all stakeholders. I would also expect that our audits will make a useful contribution to both understanding and developing an appropriate balance between the public and private interest in our changing public sector environment.

Finally, may I suggest the following thoughts on performance auditing for your consideration:

- the need for agencies' cooperation, insights and information (standing in the shoes of the manager);
- we have to demonstrate professionalism, open-mindedness and willingness to listen;
- reports have to be balanced, fair and pro-active, in terms of repairing and improving, not simply critical and highlighting what has not been done rather than what could be done;
- recommendations have to be clear, unequivocal and capable of being implemented within a reasonable time period. It is essential to have agencies committed to recommendations to the maximum extent possible; and
- the success of performance audit reports depends largely on acceptance and implementation of their recommendations. As well, the success depends on providing assurance to the various stakeholders and enhancing their confidence in the organisations', and their systems', approaches and results achieved.

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