

The Auditor-General
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Information Support Services

Benchmarking the Internal Audit Function Follow-on Report

Benchmarking Study

Australian National Audit Office

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of Australia 2002

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Canberra ACT
23 October 2002

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken a benchmarking study in accordance with the authority contained in the *Auditor-General Act 1997*. I present this report of this study, and the accompanying brochure, to the Parliament. The report is titled *Benchmarking the Internal Audit Function Follow-on Report*.

Following its tabling in Parliament, the report will be placed on the Australian National Audit Office's Homepage—<http://www.anao.gov.au>.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ian McPhee'.

Ian McPhee
Acting Auditor-General

The Honourable the President of the Senate
The Honourable the Speaker of the House of Representatives
Parliament House
Canberra ACT

AUDITING FOR AUSTRALIA

The Auditor-General is head of the Australian National Audit Office. The ANAO assists the Auditor-General to carry out his duties under the *Auditor-General Act 1997* to undertake performance audits and financial statement audits of Commonwealth public sector bodies and to provide independent reports and advice for the Parliament, the Government and the community. The aim is to improve Commonwealth public sector administration and accountability.

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Glossary

Assurance activities

The assurance component of internal audit is defined in this study as including:

- operational (performance) auditing—reviews of operating or business processes focusing on the efficiency and effectiveness of these processes and the associated management controls;
- compliance auditing—reviews of compliance or conformity with relevant legislation, regulations, internal instructions, codes and guidelines;
- systems auditing—reviews of information technology and telecommunications which examine the IT environment and application controls;
- financial auditing—reviews of the adequacy of internal accounting controls involving the accuracy, completeness and validity of financial information and financial reports and of the underlying accounting systems and records; and
- integrated auditing—a combination of two or more types of audits.

Consulting activities

In this study, internal audit consulting activities are those which are directed towards facilitation rather than assurance and include:

- supporting organisational re-engineering;
- control self-assessment and implementation of control programs;
- quality improvement, including systems development reviews and participation in problem solving task forces; and
- performance self-assessment.

Full time equivalent (FTE)

The effective amount of resources actually applied to an activity expressed in terms of the full time staff equivalent. For example, an employee who works for two months during the year on an activity would

	represent a full time equivalent of 2/12ths or 0.17. This is different to data requested on actual (physical) head count.
Head count (HC)	The average total number of all employees (head count) at the organisation during the financial year, including part-time and full-time employees at all locations.
Internal audit direct labour cost	The labour dollars associated with supervisors and employees whose activities consist of those in the relevant process. Labour costs are 'fully loaded' and include salaries, wages, overtime, allowances and benefits for full-time and part-time employees.
Internal audit total cost	The following items are included in total costs for the internal audit function: <ul style="list-style-type: none"> • internal audit function direct labour, including salaries, wages, overtime, allowances and benefits; • contracted services, including temporary and contract employee labour and consultants fees; • operating expenses, including supplies, training, and other locally controllable expenses, but excluding rent, depreciation, capital usage charges or allocated overhead expenses; and • outsourcing fees, including service bureau or contract fees including annual fees and monthly operating charges.
Organisational expenditure	The term, organisational expenditure, has been introduced in this report as a generic term to accommodate the different terminology used between <i>Financial Management and Accountability (FMA) Act 1997</i> organisations and <i>Commonwealth Authorities and Companies (CAC) Act 1997</i> organisations. In <i>FMA Act</i> organisations, organisational expenditure equates to departmental expenditure. In <i>CAC Act</i> organisations, it equates to operating expenditure.
Total expenditure	The organisational expenditure of the organisation, together with (where applicable) any administered budgets or expenditure.

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Summary and Key Findings

Summary

1. This benchmarking study is one of a series of benchmarking studies being undertaken by the Australian National Audit Office (ANAO) of common business processes. The primary purpose of these studies is to obtain and report quantitative and qualitative data on aspects of performance of the function or business process under review. It is part of the Information Support Services output of the ANAO.
2. This report follows on from ANAO Report No.14 of 2000–2001, *Benchmarking the Internal Audit Function*,¹ which was published in October 2000. In this latest study, 14 Commonwealth organisations² (the Commonwealth Group) completed a questionnaire for the financial years 1999–2000 and 2000–2001 based on the benchmarks included in Report No.14 of 2000–2001 and some additional questions based on the Global Best Practices® KnowledgeBase (GBP).³
3. For this study, the ANAO used a series of benchmark performance indicators for inputs, processes and outputs, based on cost, time, quantity and quality. The participating organisations' results are limited in scope in that they rely only on data provided by the organisations involved and, except for a quality assurance process, have not been audited. However, they do provide a basis for comparison across groups and should help organisations develop their own useful internal audit benchmark metrics for continuous improvement programs, business re-engineering and/or market testing. A more substantive review of the internal audit function across organisations is planned for the financial year 2003–2004.
4. The report structure is similar to that of Report No.14 of 2000–2001. Chapter 1 provides an introduction to internal audit. Chapters 2, 3 and 4 report respectively on results for inputs, processes and outputs. This report makes a number of comparisons between the participating Commonwealth organisations for the financial years 1999–2000 and 2000–2001. It also builds on the results provided in Report No.14 of 2000–2001 by using the same global comparator in this report, the GAIN Universe 1999.⁴ For certain data, where international data

¹ See also previous study, Report No. 46 of 1997–98, *Internal Audit*, Australian National Audit Office, May 1998.

² In this report, 'organisations' refers to agencies subject to the *Financial Management and Accountability (FMA) Act 1997* and statutory authorities subject to the *Commonwealth Authorities and Companies (CAC) Act 1997*.

³ Global Best Practices® KnowledgeBase, <www.globalbestpractices.com>. Please note that most areas of the KnowledgeBase are available only to subscribers.

⁴ *Global Auditing Information Network (GAIN)*, Quality Auditing Services, Institute of Internal Auditors, Altamonte Springs, USA. The GAIN universe database contained data on over 500 organisations, largely US-based private sector bodies, although 64 Australian organisations were included in the 1999 data.

is not available, the results are compared to the previous Commonwealth Group results from Report No.14 of 2000–2001 for calendar years 1997, 1998 and 1999. It should be noted, however, that the Commonwealth Group in Report No.14 of 2000–2001 is a different set of public sector participants from those reported on in this Report. Better practice observations provided in this report are drawn from previous ANAO reports, better practice guides and the Global Best Practices® KnowledgeBase.

5. Most figures are presented by quartiles, together with the median result, to allow organisations that did not participate in the study to obtain an indication as to where their own organisation might fit. As stated in previous ANAO benchmarking reports, performance against benchmarks should not be assessed in isolation. The analysis undertaken by the ANAO is indicative and cannot provide definitive insights into the differences in performance against the benchmarks by internal audit in the public and private sectors.

6. The Commonwealth Group organisations participating in the benchmark study have been provided with an individual report comparing their results with those of other organisations in the Commonwealth Group and against the GAIN Universe 1999.

Key Findings

7. The nature of this benchmarking study precludes detailed recommendations. However, the study indicates that the Commonwealth Group has made satisfactory progress on a number of aspects of internal audit operations.
8. The Commonwealth Group reported results that indicated improving performance in the following areas:
- internal audit staff membership of relevant professional bodies;
 - average years of experience of internal auditors;
 - time taken from fieldwork to issue of final report;
 - use of formal client surveys;
 - average cost per internal audit report; and
 - proportion of internal audit recommendations accepted.
9. The study found that the internal audit function in the participating Commonwealth Group organisations has the potential for further improvement in some areas, particularly in allocating more effort at the planning stage of audit activity.
10. The results for the Commonwealth Group show that the majority of internal audit activity remains focused on assurance.⁵ Given the recent issues that have arisen at the national and international level in relation to business management, these results generally reflect a justifiable focus. However, fewer organisations in the Commonwealth Group than the GAIN Universe 1999 reported conducting internal audits of laws and regulations, or audits of procedures for uncovering illegal or questionable payments. These findings are discussed in more detail at Chapter 3.
11. The above observations do not take account of, or distinguish, any differences in the environments in which internal audit operates in the public and private sectors. Therefore, the results may raise further questions for public sector organisations, which should be diagnosed through further investigation by each organisation.
12. These findings are discussed in detail in Chapters 2 to 4 of this report.

⁵ The assurance component of internal audit includes: operational (performance) auditing, compliance auditing, systems auditing, financial auditing and integrated auditing. A complete definition is at the Glossary.

Benchmark Study Findings and Conclusions

1. Introduction

An effective internal audit function

1.1 The traditional role for internal audit is well documented and understood. It centres on the examination, evaluation and monitoring of the adequacy and effectiveness of the control structure of an organisation. Increasingly, the internal audit role is being more broadly prescribed to encompass a stronger performance orientation through 'business partnerships', independent advice and consulting activities. Better practice literature now views internal audit as being forward looking in terms of the processes, techniques and tools employed by an organisation to achieve its strategic objectives.

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.⁶

1.2 A key to successful auditing is trust. It comes with functional independence and objectivity which must be supported by demonstrated performance. That performance in turn largely depends on the skills and professionalism of internal audit. For the public sector, the adoption of accrual budgeting at the Commonwealth level as well as the complementary moves to accrual accounting and reporting, have placed an increased emphasis on professional accounting ability oriented somewhat more to the private sector approach. In addition, there will continue to be a premium on investigative, analytical, statistical and communication skills.

Corporate governance

1.3 It has been increasingly recognised, in both the private and public sectors, that appropriate corporate governance arrangements are a key element in corporate success. They form the basis of a robust, credible and responsive framework necessary to deliver the required performance and accountability consistent with an organisation's objectives.

1.4 The recently published report by the Joint Committee of Public Accounts and Audit, *Report 391—Review of Independent Auditing by Registered Company Auditors*, further supports this recognition by stating that an effective and

⁶ *Standards for the Professional Practice of Internal Auditing*, The Institute of Internal Auditors, Altamonte Springs, Florida, USA, 2001.

relatively autonomous internal audit function is a key aspect of good corporate governance.⁷ The report reviewed the extent to which it may be necessary to enhance the accountability of public and private sector auditing and to determine where the balance lies between the need for external controls through government regulation and the freedom of the industry to self regulate.

1.5 By having a real and visible presence in the organisation, internal audit is also well placed to promote the principles of good corporate governance and act as a deterrent to the adoption of poor practices. To be able to fulfil this role and meet the challenges ahead it will be fundamentally important to establish a close working relationship with key internal stakeholders. These will include the 'governing body', be it a board or a chief executive, as well as with the audit committee and chief financial officer.

The audit committee

1.6 The audit committee⁸ is important for maintaining an effective internal audit operation. Internal audit and the audit committee need to develop mutual trust and confidence and a clear understanding of each other's roles and functions.

1.7 In overseeing internal audit, the audit committee should ensure that the function is appropriately resourced. In doing so, committee members should actively participate in the selection of the head of the internal audit function and seek assurances that the qualifications, and skills sets of internal audit staff (in-house or contractors) are commensurate with the agreed strategic direction.

1.8 As part of its review of internal audit, frequently undertaken on an annual basis, the audit committee would want to be assured that the quality control mechanisms established for internal audit work have been followed. In this regard, the committee may wish to consult with and seek the views of the external auditor on particular aspects of internal audit.

1.9 Some examples of the audit committee's specific responsibilities in relation to internal audit activities are: reviewing and endorsing the internal audit charter; taking an active role in the appointment of the chief internal auditor; making final informed recommendations on internal audit staffing requirements; endorsing the internal audit strategic plan and annual work program; monitoring progress against the plan; overseeing the internal audit function and its liaison with the external auditor; and reviewing internal audit reports, including the extent to which recommendations are implemented.

⁷ Joint Committee of Public Accounts and Audit, *Report 391—Review of Independent Auditing by Registered Company Auditors*, September 2002, p. 42.

⁸ For more information refer to ANAO's Better Practice Guide titled *Audit Committees* issued in July 1997.

The concept of independence

1.10 While the current national and international debate about auditor independence is focused primarily on external auditors, the independence of internal audit is also relevant. The JCPAA review into independent auditing⁹ recommended that the *Corporations Act 2001* be amended to include a statement requiring auditors to be independent. This amendment, if implemented, would send a strong message to auditors and other stakeholders reinforcing the important principle of auditor independence.

1.11 In setting international standards, the Institute of Internal Auditors (IIA) promotes independence and objectivity for internal auditors. Internal auditors are meant to perform their professional duties free of control or undue influence in the selection of audit matters and methodologies, and to possess a structural independence from the organisation being audited to enable them to investigate and report their findings.

1.12 It is expected that the various enquiries and ensuing public attention will result in scrutiny of the tests for independence and on the nature of consulting being undertaken as part of the overall services available from internal audit providers.

Benchmark study approach

Background to the study

1.13 This benchmarking report is based on a study of 14 Commonwealth organisations (the Commonwealth Group). Seven of the organisations are covered by the *Financial Management and Accountability (FMA) Act 1997* and seven by the *Commonwealth Authorities and Companies (CAC) Act 1997*. Participating organisations completed a questionnaire for the financial years 1999–2000 and 2000–2001 based on the benchmarks reported in ANAO Report No.14 of 2000–2001, *Benchmarking the Internal Audit Function*, Australian National Audit Office, October 2000, as well as some additional questions based on the Global Best Practices® KnowledgeBase.

1.14 This report makes a number of comparisons between the participating Commonwealth organisations for the years 1999–2000 and 2000–2001 as well as against the GAIN Universe 1999 group, the results for which were published in the previous study, Report No.14 of 2000–2001. The previous report also provided results for Commonwealth organisations for the calendar years 1997, 1998 and

⁹ Joint Committee of Public Accounts and Audit, *Report 391: Review of Independent Auditing by Registered Company Auditors*, September 2002, p. 98.

1999 and, where a global comparator was not available, the current Commonwealth Group results are compared to these. It should be noted that the participating organisations in the most recent ANAO study are not identical to those in the previous study. As a consequence, the results are shown as separate graphs.

1.15 The results are limited in scope to the extent that data in the study has been derived from self-assessments. The quality assurance processes undertaken by the ANAO are not sufficient to guarantee the integrity of the data. Furthermore, the results do not take into account of, or distinguish between, the different environments in which internal audit operates such as between the public and private sectors.

Study objectives

1.16 This report is one of a series of benchmarking studies undertaken by the ANAO. The general objectives of these studies are to:

- obtain and report quantitative and qualitative benchmarks of performance in the public sector; and
- compare the public sector benchmark results with equivalent international data to identify better practices and highlight opportunities for improvement.

Report structure

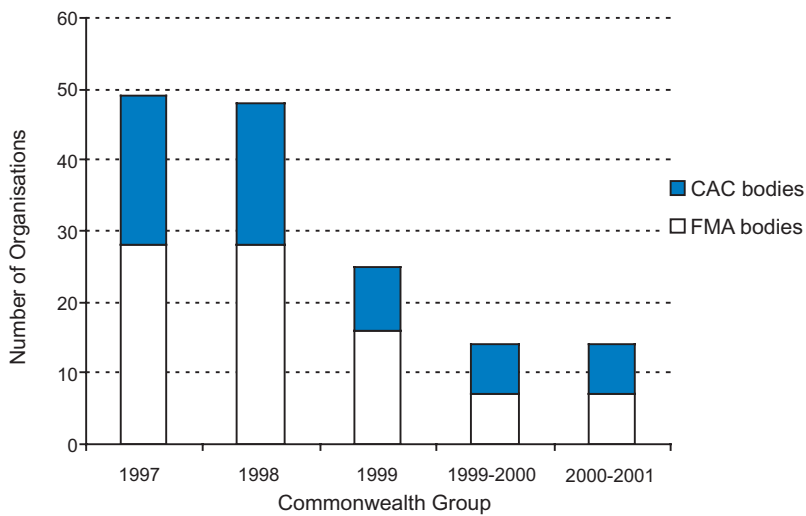
1.17 The report structure is similar to that of Report No.14 of 2000–2001. The following chapters report results against benchmarks for inputs, processes and outputs. Each chapter compares the participants' results with the relevant benchmarks for that component (input, process or output). For the study, the ANAO used a series of benchmark performance indicators for inputs, processes and outputs, based on cost, time, quantity and quality (Table 1.1 refers). The results are limited in scope in that they rely only on data provided by the organisations involved and, except for the quality assurance process, have not been audited. However, they do provide a basis for comparison across groups and should help organisations develop their own useful benchmark metrics for continuous improvement programs, business re-engineering and/or market testing.

Table 1.1**Benchmarks used for assessing internal audit**

	Input	Process	Output
Cost	<ul style="list-style-type: none"> • Cost of internal audit as a percentage of total expenditure. • Total cost of the internal audit function. 		<ul style="list-style-type: none"> • Cost per internal audit report.
Quantity	<ul style="list-style-type: none"> • Total expenditure per auditor. • Number of employees per internal auditor. 	<ul style="list-style-type: none"> • Comparison of the allocation of internal audit resources. • Comparison of resource allocation between assurance activities (percentage of reports produced). • Participation in consulting activities. 	<ul style="list-style-type: none"> • Average reports per internal auditor.
Time		<ul style="list-style-type: none"> • Allocation of effort across planning, fieldwork and reporting. • Analysis of time taken to complete an audit (excluding planning). • Analysis of the audit reporting time cycles. 	
Quality	<ul style="list-style-type: none"> • Education levels and professional qualifications of internal auditors. • Average years of experience of internal auditors. 	<ul style="list-style-type: none"> • Analysis of quality control techniques used regularly. • Use of formal and informal client satisfaction surveys. 	<ul style="list-style-type: none"> • Acceptance of recommendations (percentage).

1.18 The report is intended to assist organisations to determine their comparative performance. As stated in previous ANAO benchmarking reports, performance against benchmarks should not be assessed in isolation. The analysis undertaken by the ANAO is indicative and cannot provide definitive insights into the differences in performance against the benchmarks by internal audit in the public and private sectors. However, the provision of a public sector benchmark range for a number of different metrics will enable organisations to assess whether their internal audit function is performing within range and decide whether to investigate their performance more closely.

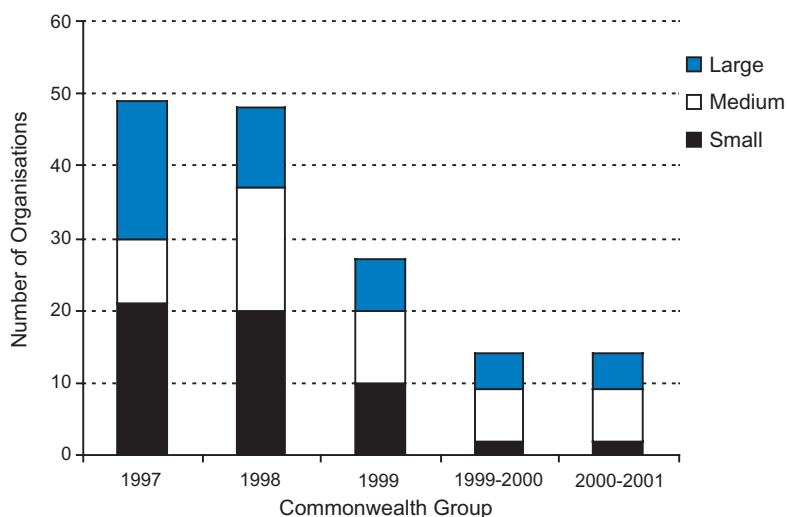
Figure 1.1
Survey participants by type



1.19 Figure 1.1 illustrates the types of Commonwealth organisations which participated in this and the previous ANAO study. As noted at paragraph 1.12, the latest study comprised seven organisations which were covered by the *FMA Act* and a further seven which were covered by the *CAC Act*. Forty-nine organisations participated in 1997, 48 in 1998 and 27 in 1999.

1.20 Figure 1.2 illustrates the participants in the two studies by size. As a proportion of all participants, fewer small organisations participated in the latest study.

Figure 1.2
Survey participants by size



Notes:

- 'Large' has been defined as involving more than \$500 million organisational expenditure; 'Medium' has been defined as involving between \$100 million and \$500 million organisational expenditure; and 'Small' has been defined as involving less than \$100 million organisational expenditure.
- Dollar amounts are actual year prices.

1.21 Table 1.2 lists the participants in the current study and the GAIN Universe 1999 group by size of internal audit group. As can be seen from the table, most organisations in both the GAIN Universe 1999 and Commonwealth Group (both years) have a small internal audit group of not more than 10 staff. By 2000–2001, however, the Commonwealth Group had an equal number of participants that had fully outsourced their internal audit function.

Table 1.2
Survey participants by size of internal audit group

Audit staff size	GAIN Universe 1999 (number = 500)	Commonwealth Group 1999–2000 (number = 14)	Commonwealth Group 2000–2001 (number = 14)
1 to 10	40%	50%	43%
11 to 25	28%	7%	7%
26 to 50	17%	7%	7%
51 +	15%	0%	0%
100% Outsourced	Not asked	36%	43%

1.22 The Commonwealth Group participating organisations have been provided with an individual report comparing their results with those of the other organisations in the current Commonwealth Group and with the GAIN Universe 1999.

2. Input Benchmarks

2.1 In the wake of recent corporate collapses, the internal audit function will continue to have an important role as a component of good corporate governance. However, internal auditing is a business activity that competes for scarce professional resources. While the importance of the role of internal audit to organisations cannot be underestimated, many executives and boards find it difficult to determine the appropriate level of investment, or inputs, required for internal audit.

2.2 This is a complex issue that is influenced by a myriad of inter-related factors. The stability of the organisation and maturity of the control structure within the organisation are key determinants of the level and quality of resources that should be applied to internal audit.

2.3 Given the complexity of this issue, it is not appropriate to rely on any one benchmark to gauge the appropriate level of investment in internal audit. The following benchmarks are generally considered to provide a sound foundation for a deeper examination of the issues affecting comparative analysis of the size and resourcing of internal auditing activities. These benchmarks are categorised in terms of the cost, quantity and quality dimensions.

Table 2.1

Internal audit input (resource) benchmarks

Dimension	Benchmark	Location
Cost	Cost of internal audit as a percentage of total expenditure	Table 2.2
	Total cost of the internal audit function	Figure 2.1
Quantity	Total expenditure per internal auditor	Figure 2.2
	Number of employees per internal auditor	Figure 2.3
Quality	Education levels and professional qualifications of internal auditors	Table 2.3
	Average years of experience of internal auditors	Figure 2.4

Cost dimension benchmarks

Introduction

2.4 The relatively small size of most public sector internal audit units can make it difficult to attract and retain staff with the knowledge base and skills set required to provide a comprehensive, value-added service. Furthermore, the role of the internal auditor is expanding. Staff require strong financial management and information technology skills and are often required to oversee service providers where co-sourcing, or outsourcing, has been implemented. Many internal audit staff have had experience in dealing with the private sector and in commercial operations, including financial decision-making and accounting, which makes them that much more in demand in both the public and private sectors. There is not only a skill enhancement challenge for internal auditors in a more contractual oriented environment, but a problem of retention of a valuable skill base.

Cost of internal audit as a percentage of total expenditure

2.5 This benchmark provides data on the cost of the internal audit function relative to total expenditure. The information needs to be considered in the context of the organisation, its risks and other governance techniques that the organisation might have in place.

2.6 Table 2.2 summarises the results for the Commonwealth Group and for the Global Group from the Global Best Practices® KnowledgeBase of 176 organisations, most of which were in the private sector.¹⁰ The percentages given relate to Government expenditure, which has been used in this case as a proxy for private sector organisational revenue. Two results are provided for the Commonwealth Group—organisational expenditure and organisational plus administered expenditure (total expenditure). The latter can range from nil to many millions of dollars.

2.7 The table shows that, using organisational expenditure only, the median result for the Commonwealth Group was 0.157 per cent for 1999–2000 and 0.133 per cent for 2000–2001. When administered expenditure is included, the median result for 1999–2000 was 0.135 per cent and decreased to 0.115 per cent for 2000–2001. Both sets of results are significantly higher than for the Global Group where the median result for 1999–2000 was 0.038 per cent and the corresponding figure for 2000–2001 was 0.037 per cent. For both sets of figures, over 75 per cent of the Global Group had a lower result than the Commonwealth Group median in both 1999–2000 and 2000–2001.

¹⁰ The Global Best Practices® KnowledgeBase comprises 569 organisations of which 176 participated in the internal audit component.

Table 2.2**Cost of internal audit as a percentage of total expenditure**

1999–2000 Study Year	Lowest Cost	25th percentile	Median	75th percentile	Highest Cost
Commonwealth Group <i>(organisational expenditure only)</i>	0.037%	0.099%	0.157%	0.225%	0.416%
Commonwealth Group <i>(total expenditure)</i>	0.015%	0.070%	0.135%	0.225%	0.416%
Global Group	0.001%	0.020%	0.038%	0.084%	0.271%
2000–2001 Study Year	Lowest Cost	25th percentile	Median	75th percentile	Highest Cost
Commonwealth Group <i>(organisational expenditure only)</i>	0.026%	0.070%	0.133%	0.241%	0.403%
Commonwealth Group <i>(total expenditure)</i>	0.006%	0.058%	0.115%	0.227%	0.402%
Global Group	0.001%	0.020%	0.037%	0.080%	0.271%

Note: Formula used: total cost for internal audit / organisational expenditure; total cost for internal audit / total expenditure.

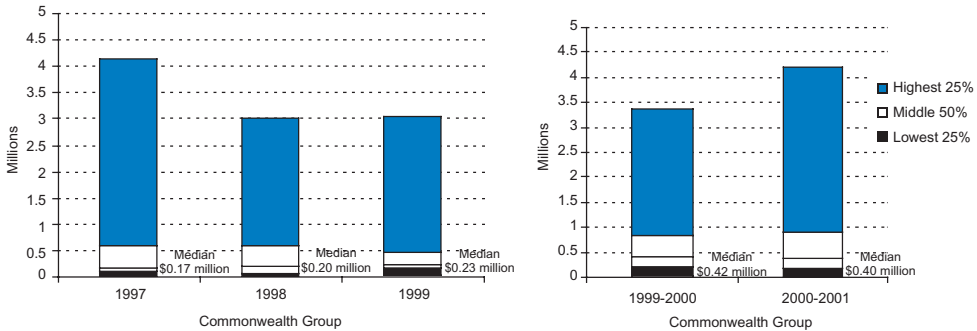
2.8 As may be expected, those organisations with larger total expenditure costs also had larger internal audit function costs for both 1999–2000 and 2000–2001. Conversely, two organisations with relatively low total expenditure had internal audit function costs in the highest 25 per cent quartile for both years. Further investigations would be required to establish the reasons for the variations in those two organisations.

Total cost for the internal audit function

2.9 Figure 2.1 summarises the total cost for the internal audit function for the Commonwealth Group for both the previous and current study.

Figure 2.1

Total cost of the internal audit function



Note: The total cost for the internal audit function includes direct labour, including salaries and wages, overtime, allowances and benefits, as well as contracted services, operating expenses and outsourcing fees. A complete definition is at the Glossary.

2.10 The cost of the internal audit function ranged widely in both the previous and current studies. While costs over all years were in a similar range the median cost of the internal audit function in 1999–2000 and 2000–2001 almost doubled from the last year of the previous study. This may, in part, be explained by the lower number of small organisations in the current Commonwealth Group. It should also be noted that in all years there was one result significantly higher than the rest of the group. If this result was removed the highest internal audit function cost in all years would be just under \$2 million.

Conclusion on the cost dimension

2.11 The median cost of internal audit as a percentage of total expenditure is higher than the Global Best Practices® KnowledgeBase Global group figures. However, the median cost of internal audit in the Commonwealth Group as a percentage of organisational expenditure and total expenditure has decreased. Although the range of costs for the internal audit function have remained similar to those of the Commonwealth Group in the previous study, the median cost has almost doubled. While this may in part be explained by a higher proportion of large organisations in the current Commonwealth Group, further analysis would be required to determine any other factors affecting this result.

Quantity dimension benchmarks

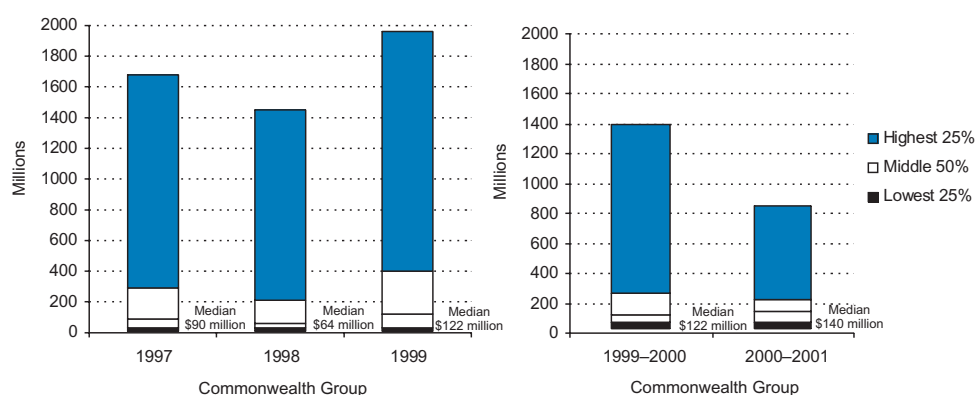
2.12 The following benchmarks provide information on the level of resources applied to internal audit.

Total expenditure per internal auditor

2.13 The following chart, Figure 2.2, measures the average total expenditure (organisational and administered expenses) per internal auditor.

Figure 2.2

Total expenditure per internal auditor



Note: Formula used: total expenditure (organisational and administered) / total full-time equivalent internal audit resources. (Internal auditors include organisation employees and, where available, outsourced staff and/or contractors.)

2.14 Figure 2.2 compares the performance of the current Commonwealth Group to that of those organisations included in the previous study. For 1999–2000 and 2000–2001, the median total expenditure per auditor was \$122 million and \$140 million respectively. In 75 per cent of organisations, total expenditure per auditor was \$269 million or less for 1999–2000 and \$228 million or less for 2000–2001. A low figure may reflect a strategic decision to invest in a higher level of resources due to the nature of the business or risk profile, or may be the result of over-staffing.

2.15 The median total expenditure per auditor was significantly higher for the Commonwealth Group in 1999–2000 and 2000–2001 compared to the figures for 1997 and 1998 but similar to that for 1999. The variation is possibly due to the differences in the number and composition of organisations in the first two years of the previous study. There is also a wide range in results for each year. For example, for the most recent year, 2000–2001, the lowest figure for total expenditure was \$25.5 million and the highest was \$853.7 million.

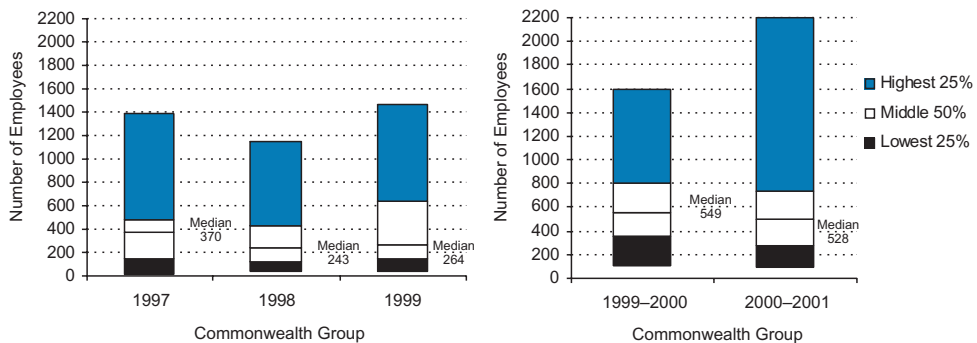
Number of organisational employees per internal auditor

2.16 One way to gauge the appropriate size of internal audit activity is to look at the number of internal auditors (the full-time equivalent) in relation to the total number of organisational employees. That is, to use the number of organisational employees as a proxy for the scale or size of the organisation.

2.17 The following chart, Figure 2.3, displays the results of this analysis for the Commonwealth Group over the last two years and compares them to the results for the previous study.

Figure 2.3

Number of employees per internal auditor



Note: Formula used: total employees/internal auditors (internal auditors include organisation employees and where available, outsourced staff and/or contractors).

2.18 The results for the Commonwealth Group for 1999–2000 ranged from 1:107 to 1:1,622 and, for 2000–2001, from 1:98 to 1:2,200. Although smaller organisations tended to have a lower ratio, this was not always the case and in all years there were some small organisations with a high ratio and some large organisations with a low ratio, indicating that the size of the organisation is not a ruling factor in determining the size of the internal audit function. A more important factor may be the inherent business risks that the organisation faces. For example, organisations with lower ratios may operate in higher risk environments, but further investigation would be required to establish this.

Conclusion on the quantity dimension

2.19 The two benchmarks for quantity indicate that, at the median, for 1999–2000 and 2000–2001, the cost of internal auditors and the ratio of internal auditors to total employees are increasing in Commonwealth Group organisations. These are not unsurprising results in that they reflect the increasingly complex role of the internal auditor as well as the increased use of co-sourcing and/or outsourcing.

Quality dimension benchmarks

2.20 As previously indicated, the role of the internal auditor is changing. A consequence is that a broader range of competencies is required than for traditional internal auditing. In addition, the introduction of a range of significant and ongoing financial management and other related public sector reforms has influenced the workload of internal audit. In this environment it may be that organisations have continued to seek additional assurance that the reforms implemented are working effectively and have used internal audit to provide this assurance.

2.21 Internal auditors need strong financial management and information technology skills to meet the needs of key internal stakeholders. As chief executives and financial managers respond to the changes that are occurring, and improve their own knowledge, they are likely to become more discerning and better able to examine and assess critically internal audit performance.

2.22 The quality of resources applied to internal audit activities is a key determinant of their effectiveness and usefulness to the organisation. The attributes generally used to indicate resource quality are: education levels, professional qualifications and relevant experience. In addition, the particular skill requirements should be aligned to the nature of the organisation's business, its risk profile and the associated needs of management. There will continue to be a premium on investigative, analytical, statistical and communication skills. A particular, and growing, requirement of internal audit management, at least in the Commonwealth public sector, is to oversee outsourced internal audit activities.

2.23 Building up a balanced pool of resources is critical to an effective internal audit function. As a minimum, the competencies of internal auditors must take into account the skills and knowledge requirements laid down by the profession. These include personal qualities, standards of education, sound judgement, innovation, operational and auditing/evaluation experience.

2.24 The necessary skill set and knowledge requirements for internal auditors are varied and complex and rarely reside wholly within one individual or even a small number of people. This can be a major issue for smaller organisations. A particular problem is attracting suitable candidates at the levels necessary to be credible, both to potential recruits and to those with whom they would be working. As well, there is the difficulty of maintaining professional expertise with limited peer contact.

Internal audit skills set

2.25 In this study the skills set of internal auditors have been assessed using the following indicators:

- education level;
- professional qualifications; and
- average years of experience.

Education level was measured by how many auditors in the organisation had an undergraduate degree or a post-graduate qualification. Professional qualifications included the number of internal auditors within the organisation who are a member of CPA Australia (CPA), the Institute of Chartered Accountants in Australia (ICAA), the Institute of Internal Auditors (IIA) or the Information Systems Audit and Control Association (ISACA). Average years experience includes all auditing experience, not just experience at the current organisation.

2.26 The following table summarises the results of the latest study for each of the above benchmarks and compares them to those for the GAIN Universe 1999.

Table 2.3

Education levels of internal auditors

	GAIN Universe 1999	Commonwealth Group 1999–2000	Commonwealth Group 2000–2001
Undergraduate degree	66%	51%	44%
Post-graduate qualification	23%	20%	20%
Membership of professional bodies	44%	62%	67%

2.27 The current study found that those organisations whose internal audit function was in-house used a wide range of training and development strategies. The nature of the internal audit program influenced the type of training, for example, fraud control and information technology. The format of the training varied and included technical updates, attendance at seminars and on the job training.

2.28 The availability of suitably qualified internal auditors was an issue in some organisations. Those organisations which had retained in-house internal audit functions, or co sourced some functions, reported varying experiences in relation to skills. One organisation supplemented staff shortages with contractors, while others noted that staff shortages had resulted in delays to the audit program. Another organisation reported difficulties in establishing new internal audit functions after machinery of government changes.

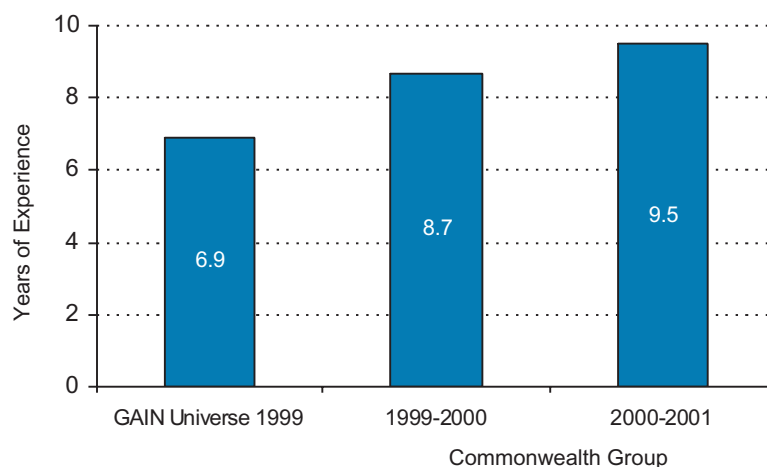
2.29 Two of the five organisations that had fully outsourced internal audit functions by 2000–2001 regarded the provider as fully responsible for providing suitably qualified internal auditors and did not report difficulties with skill levels. Another two organisations that had outsourced some components of the internal audit function reported issues with turnover of staff. One organisation that had a large and varied internal audit program noted that, while there was a high level of turnover within the service provider organisation, this was due to the audit program requiring auditors with a diverse range of skills and specialist qualifications.

Experience of internal audit staff

2.30 The average years of experience of internal auditors is another indicator of the quality of the resources applied to the internal auditing activities. Figure 2.4 compares the average years of experience for internal audit staff for the 1999–2000 and 2000–2001 Commonwealth Group against the GAIN Universe 1999.

Figure 2.4

Average years of experience of internal auditors



- Notes:
1. Formula used: for each organisation; total years experience/total audit resources.
 2. The figure for the Commonwealth Group represents the average across all organisations.

2.31 The Commonwealth Group performed well against the GAIN Universe 1999 group in this benchmark. The average years of experience for the Commonwealth Group rose from 8.7 years in 1999–2000 to 9.5 years in 2000–2001 compared to an average of 6.9 years for the GAIN Universe 1999 group. For the Commonwealth Group, the range in the years of experience of internal audit staff in individual organisations for 1999–2000 varied from three to 16 years and in 2000–2001 varied from three to 17 years.

2.32 Organisations in the study reported that the types of training which internal auditors received included fraud control, accountancy and information technology. In addition to on-the-job training and external seminars, organisations sourced formal training programs from CPA Australia, ICAA, IIA and ISACA. Most organisations reported that training was identified from individual development plans for internal auditors. The amount of training varied, depending on the needs of the individual auditor and skills requirements.

Conclusion on the quality dimension

2.33 The Global Best Practices® KnowledgeBase notes that better performing organisations will typically base internal audit skill requirements on the organisation's industry and risk profile. Because internal auditors must understand many business issues across a variety of business processes, better practice organisations build an internal audit function with business professionals, not solely audit professionals. In that way, the internal audit function attracts skilled and motivated professionals who appreciate that their tenure with the internal audit function enhances their prospects for moving on to key operational and financial positions throughout the organisation.

2.34 Two main issues pose a challenge for the quality of the internal audit function in Commonwealth organisations. As already noted, the scope of internal auditing now embraces a wider concept and the role or skills set of the internal auditor is expanding, although the internal audit function varies between organisations, depending on their business and risk management strategies. Secondly, Commonwealth organisations have reported difficulties in recruiting and retaining qualified information technology and financial auditors. While some of these skills can be supplemented through the use of contractors or outsourcing, this does not always result in long-term solutions. Some organisations which have outsourced some or all of the internal audit function have noted the difficulty in obtaining auditors who are experienced in conducting the more complex reviews that are an essential component of program and service delivery. As noted earlier in this report, there will continue to be a premium on investigative, analytical, statistical and communication skills.

Overall conclusion on internal audit resources

2.35 One of the key issues to be addressed by internal audit is how to satisfy management that it is adding value to the organisation. As with other areas of an organisation, internal audit must be able to demonstrate that it can add value at least commensurate with its costs of operation. Best practice requires that indicators used for measuring internal audit performance should be linked to

an organisation's mission and objectives to ensure that internal audit provides a value added service relevant to the needs of management.

2.36 To add value in a climate of continuous improvement flowing from an ever-changing environment is the real challenge facing internal audit in the future. This can only be achieved if internal audit has sufficient resources with the appropriate skills to provide highly specialised and focused quality advice to the audit committee and ultimately to management.

2.37 Outsourcing, in whole or in part (that is, co-sourcing), provides a mechanism whereby the internal audit resource base can access the skill sets and knowledge it needs at a reasonable cost, particularly in a rapidly changing environment.

2.38 Some Chief Executive Officers (CEOs) may be looking outside their organisations for assurance because they judge that external consultants, particularly from the large accounting firms, have a broader range of experience and expertise on which to benchmark their findings, recommendations and advice. This judgement may also reflect a view that the service is more cost-effective, as well as concerns about the increasing complexity of their own environment. It may also reflect a perceived gap in the professional capability of in-house and outsourced internal audit services. Nonetheless, there is also a premium in having a good understanding and knowledge of the business.

2.39 Responsibility for decisions about the cost, quantity and quality of inputs rest with each organisation. The measures in this chapter provide guidance only. The information obtained from organisations in this study suggests that suitably qualified internal auditors are available, but not in large numbers.

3. Process Benchmarks

3.1 As noted in the introduction to this report, the role of internal audit centres on assurance. Audits may comprise a single subject (stand-alone) or combine two or more types of audits (integrated). They are typically divided into planning, fieldwork and reporting processes.

3.2 The following table summarises the benchmarks used in this chapter for analysis and evaluation.

Table 3.1
Internal audit activity (process) benchmarks

Dimension	Benchmark	Location
Quantity	Comparison of the allocation of internal audit resources	Table 3.2
	Comparison of resource allocation between assurance activities (percentage of reports produced)	Table 3.3
	Assurance audit activity	Table 3.4
	Participation in consulting activities	Table 3.5
Time	Allocation of effort across planning, fieldwork & reporting	Figure 3.1
	Analysis of time taken to complete an audit (excluding planning)	Figure 3.2
	Analysis of the audit reporting time cycles	Figure 3.3
Quality	Analysis of quality control techniques used regularly	Figure 3.4
	Use of formal and informal client satisfaction surveys	Figure 3.5

Quantity dimension benchmarks

3.3 The following benchmarks consider the allocation of resources to assurance and consulting activities.

Distribution of resources between activities

3.4 Table 3.2 summarises the resource allocation between internal auditing activities and other administrative activities. It compares the Commonwealth Group for 1999–2000 and 2000–2001, and the GAIN Universe 1999. The results for the Commonwealth Group include organisations that have outsourced or partly outsourced internal audit.

Table 3.2**Comparison of the allocation of internal audit resources**

Resource Allocation	GAIN Universe 1999	Commonwealth Group 1999–2000	Commonwealth Group 2000–2001
Assurance	71.0%	73.3%	76.1%
Consulting	4.0%	6.5%	5.7%
Administrative	8.0%	7.2%	6.9%
Other	8.0%	6.9%	5.4%

- Notes:
1. Formula used: total hours per activity / total available hours.
 2. Leave has been excluded to emphasise the distribution of effort for actual hours worked. The gap between the total percentage figure above and 100% represents average leave used.
 3. 'Other' includes travel.

3.5 The results for the Commonwealth Group, in both years, shows that, similar to the GAIN Universe 1999 group, the majority of internal audit activity remains focused on assurance.

Analysis of assurance activities

3.6 Assurance activities include operational (performance) auditing, compliance auditing, information systems auditing, financial auditing or a combination of two or more types of audits. A more detailed definition of assurance activities is provided in the Glossary. The following table shows the distribution of resources between the various assurance activities.

Table 3.3**Comparison of resource allocation between assurance activities (percentage of reports produced)**

Type of report	GAIN Universe 1999	Commonwealth Group 1999–2000	Commonwealth Group 2000–2001
Operational	28%	23%	21%
Compliance	14%	18%	19%
Information Technology	13%	20%	19%
Financial	17%	26%	27%
Integrated	24%	41%	31%

- Notes:
1. Formula used: total hours per review type / total assurance hours.
 2. Integrated refers to a combination of two or more review types as part of the one audit. As a result, the figures do not add to 100%.

3.7 The figures for the Commonwealth Group in both 1999–2000 and 2000–2001 indicate that the participating organisations produced more financial internal audit reports and more integrated internal audit reports than did those organisations in the GAIN Universe 1999. The percentage of integrated audits undertaken in 1999–2000 was higher than for 2000–2001. This possibly reflects the activity associated with the implementation of public sector reforms.

3.8 The range of activities undertaken by internal audit groups varies widely. The following data (Table 3.4) collected from the Commonwealth Group in 1999–2000 and 2000–2001 and the GAIN Universe 1999, shows that a wide range of activities is regularly performed under the internal audit function.

Table 3.4
Audit activity

Audit activity	Percentage of Organisations Performing Audits of Assurance Activities								
	GAIN Universe 1999			Commonwealth Group 1999–2000			Commonwealth Group 2000–2001		
	R	O	N	R	O	N	R	O	N
Operational									
Management controls	88	12	0	86	14	0	86	14	0
Operating efficiency	60	40	0	57	43	0	64	36	0
Long-term contracts and purchase agreements	48	44	8	21	57	21	29	57	14
Accomplishment and effectiveness of established objectives and goals for operations and programs	44	32	24	57	36	7	64	29	7
Safeguarding of assets	64	36	0	43	57	0	43	50	7
Compliance									
Non-financial policies and procedures	64	32	4	43	57	0	36	64	0
Procedures for preventing or uncovering illegal or questionable payments	68	32	0	36	57	7	36	57	7
Laws and regulations	56	40	4	21	57	21	36	43	21
Generally Accepted Accounting Principles (GAAP)	44	44	12	36	43	21	29	57	14
Information Technology (IT)									
General IT controls (eg. physical security, disaster recovery, access control)	68	32	0	50	50	0	50	50	0
System security	76	24	0	50	50	0	50	50	0
Existing business application systems, including post-installation audits	56	32	12	36	64	0	29	71	0
New IT application systems development projects	56	28	16	36	57	7	29	64	7
Improvements to existing IT application systems	44	40	16	36	57	7	29	64	7
Controls and other aspects of local area networks	46	42	13	29	64	7	21	64	14
Major system integration projects	54	29	17	21	57	21	21	50	29
Financial									
Accuracy, reliability and completeness of financial reports	64	28	8	36	64	0	36	64	0
Adequacy of internal accounting controls	84	12	4	93	7	0	93	7	0

Key: R – Regularly; O – Occasionally; N – Never

3.9 Table 3.4 shows that the Commonwealth Group figures for 1999–2000 and 2000–2001 were similar. As may be expected, over 80 per cent of both the Commonwealth Group organisations (both years) and the GAIN Universe 1999 organisations regularly conducted audits of the adequacy of internal accounting controls and management controls. The number of Commonwealth Group organisations regularly conducting audits of operating efficiency and the accomplishment and effectiveness of established objectives and goals for operations and programs has increased, reflecting the higher accountability placed on organisations.

3.10 There were a number of differences between the reported Commonwealth Group and the GAIN Universe 1999 figures. For 1999–2000 and 2000–2001, 21 per cent of organisations in the Commonwealth Group indicated that they did not undertake audits of laws and regulations compared to four per cent of organisations in GAIN Universe 1999. Seven per cent of organisations in the Commonwealth Group, in both years, indicated that they did not conduct audits of procedures for preventing or uncovering illegal or questionable payments, whereas all of the GAIN Universe 1999 organisations undertook audits of this activity either regularly or occasionally. For 1999–2000, 21 per cent of organisations in the Commonwealth Group reported that they did not undertake audits of long-term contracts and purchase agreements compared to the GAIN Universe 1999 figure of eight per cent, although the result for the Commonwealth Group for 2000–2001 had improved, with only 14 per cent of organisations not undertaking audits of this activity.

3.11 It is acknowledged by the ANAO that a number of organisations have special investigative groups that perform some of these activities, but are not part of the internal audit section within the organisation. The activities of these groups, therefore, are not covered within the scope of this study.

3.12 A number of differences were also evident between the Commonwealth Group and the GAIN Universe 1999 for information technology audits, in particular, audits of existing business application systems, new information technology application systems development and improvements to existing systems.

Analysis of consulting activities

3.13 Consulting activities are directed to facilitation rather than assurance. These include supporting organisational re-engineering, control self-assessment and the implementation of control programs, quality improvement including systems development reviews, and participation in problem-solving task forces and performance self assessment.

3.14 There is an ever-increasing requirement for auditors to be part of review and/or evaluation activities in a diverse range of areas. It is envisaged that such participation will continue to be part of the internal audit service to management, as it would be seen as directly adding value to the organisation. Some evaluations would benefit from the skills and knowledge of internal audit staff, for example, the design of new information technology or other systems to ensure they meet accountability requirements and add to the confidence and assurance of organisation users. However, there are potential conflicts of interest likely in advisory/auditing activities, which need to be managed.

3.15 Internal audit should advise management of the risks and opportunities associated with internal audit involvement in review type tasks. Preferably, such tasks should be referred to the audit committee for consideration as part of that committee's ongoing role of overseeing, and preserving the independence of, the internal audit function.

3.16 The following table (Table 3.5) summarises the participation rates in various consulting activities.

Table 3.5
Participation in consulting activities

Activity	GAIN Universe 1999	Commonwealth Group 1999–2000	Commonwealth Group 2000–2001
Re-engineering	43%	43%	43%
Control Self-Assessment	45%	50%	50%
Quality Improvement teams	35%	50%	43%
Performance Self-Assessment	17%	21%	28%

Note: Formula used: internal audit functions participating in consulting activity / total survey population.

3.17 The results for the Commonwealth Group for 1999–2000 and 2000–2001 and the GAIN Universe 1999 were similar. However, for all activities except re-engineering (where both the Commonwealth Group and the GAIN Universe 1999 reported 43 per cent participation) they were conducted to a higher extent in the Commonwealth Group.

Conclusion on the quantity dimension

3.18 As noted previously, the majority of internal audit activities in the Commonwealth Group continue to address assurance activities. Overall the Commonwealth Group reported similar results to the GAIN Universe 1999.

However, the percentage of Commonwealth Group organisations not undertaking any form of internal audit activity relating to long-term contracts and purchase agreements, and in a number of areas of compliance is noteworthy. The results for the Commonwealth Group in relation to consulting activities were good and indicated an increased involvement in these activities. As with other results in this study, the information needs to be considered in the context of the organisation, its risks and other governance techniques that may be in place.

Time dimension benchmarks

3.19 A well-planned audit with achievable audit objectives, relevant audit criteria and detailed audit test programs contributes to an effective and efficient reporting process. Under those circumstances, fieldwork is conducted in accordance with audit standards, sufficient and appropriate audit evidence is collected and analysed, audit findings are developed against the audit criteria, conclusions are drawn against the audit objectives and, where appropriate, recommendations are made.

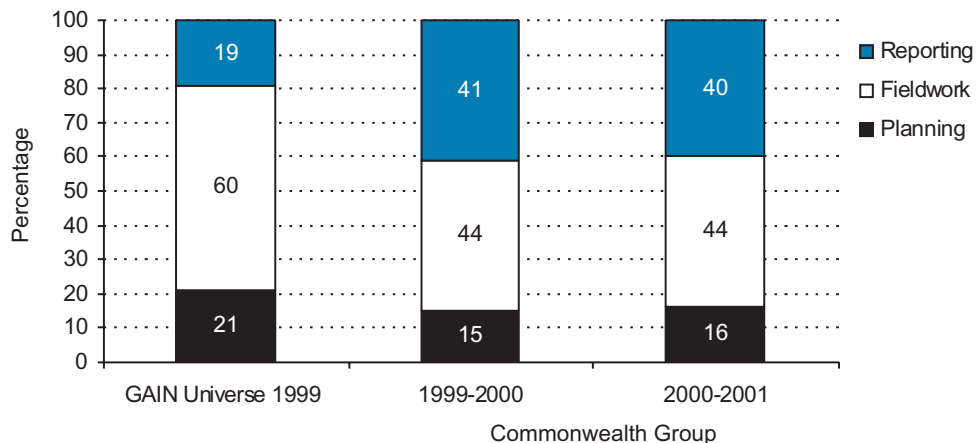
3.20 The two benchmarks that the ANAO used in relation to time examine the distribution of time within audit tasks (assurance activities) and the cycle times for these activities. Cycle time refers to the time from completion of audit fieldwork to the issue of the report.

Distribution of time within audits

3.21 The following chart compares the time taken on the planning, fieldwork and reporting processes for a typical audit.

Figure 3.1

Allocation of effort across planning, fieldwork and reporting



Note: Formula used: average of participants' allocation of time.

3.22 The results for the Commonwealth Group in 1999–2000 and 2000–2001 indicate that, compared to the GAIN Universe 1999, the Commonwealth Group allocated more resources at the reporting stage and fewer resources at the planning and fieldwork stages. For example, the GAIN Universe 1999 figures for planning were 21 per cent, compared to 15 per cent for the Commonwealth Group for 1999–2000 and 16 per cent for 2000–2001. The corresponding Commonwealth Group figures for fieldwork were 44 per cent, compared to 60 per cent for the GAIN Universe 1999. GAIN Universe 1999 organisations allocated an average of 19 per cent of time to reporting compared to 41 per cent for the Commonwealth Group for 1999–2000 and 40 per cent for 2000–2001.

3.23 Better practice emphasises that good planning at the outset is more likely to result in correctly focused work that requires minimum review or redrafting.¹¹ Specifically, good planning is more likely to ensure quality fieldwork and less time required at the reporting stage.

Audit life cycle timing

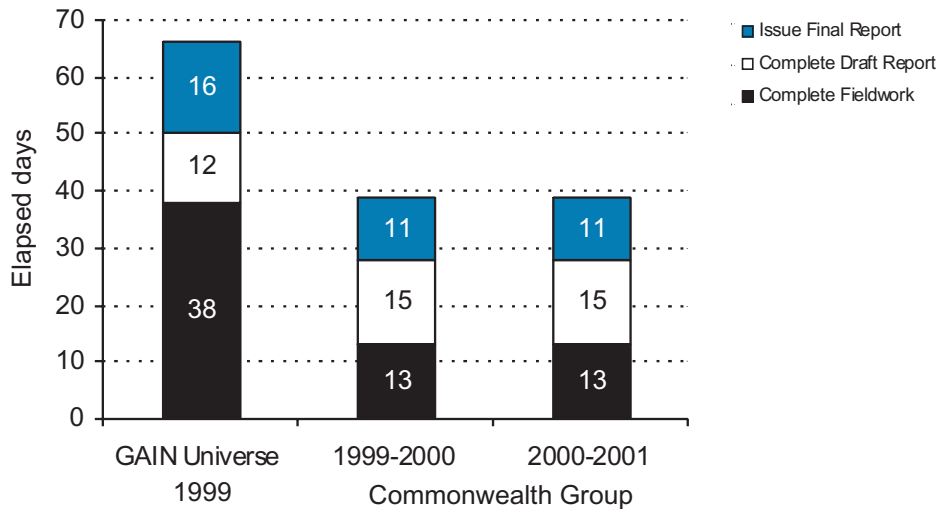
3.24 The audit report is the primary communication vehicle for internal audit. The cycle time from the completion of audit fieldwork to issuing the report is generally regarded to have a critical impact on the perceptions of quality and effectiveness.

3.25 The following two charts (Figures 3.2 and 3.3) compare the average elapsed time to complete internal audit fieldwork and to issue an internal audit report, as reported by the study participants.

¹¹ For example, Robbins S, Bergman R & Stagg I. *Management*. Prentice Hall Australia, Sydney, 1997, pp.219–220.

Figure 3.2

Analysis of time taken to complete an audit (excluding planning)

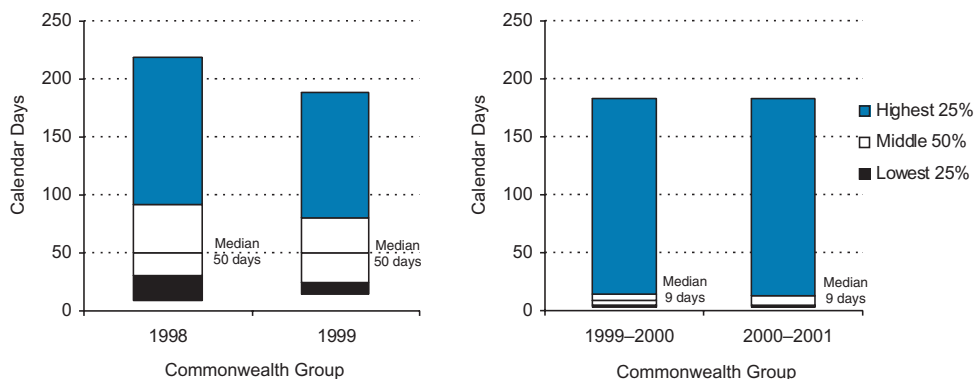


Note: Formula used: average elapsed days as computed by participants / total participants.

3.26 For the Commonwealth Group, in both 1999–2000 and 2000–2001, the average length of time taken to complete an audit was 39 days (excluding planning but including fieldwork, reporting to draft stage and final reporting) compared to the GAIN Universe 1999 figure of 66 days. As with other benchmarks in this report, this figure should be considered within the context of each organisation’s internal audit strategy. For example, some organisations may undertake a few complex audits each year (which take longer to complete) whereas others may undertake a larger number of more straightforward and shorter audits. The resources required for the respective audits will vary significantly, as will the time taken to plan, conduct fieldwork and report the results of the audit.

3.27 The cycle time to report refers to the time taken from completion of fieldwork to the production of a final report. Figure 3.3 analyses this information by quartiles for 1999–2000 and 2000–2001 and compares it to participants’ performance in the previous study for 1998 and 1999 (data was not available for 1997).

Figure 3.3
Analysis of the audit reporting time cycles



Note: Formula used: average time from completion of fieldwork to issue final report / total participants.

3.28 The latest data shows that, at the median, there has been a significant reduction in the elapsed reporting time, the median for participants dropping from 50 days in 1998 and 1999 to nine days for 1999–2000 and five for 2000–2001. The range of results is large, which is not unexpected, given the variance in size and complexity of audit reports. It should be noted that both the 1999–2000 and 2000–2001 years had an outlier result of 183 days in each year. If this result is removed the longest audit reporting time drops to 28 days for 1999–2000 and 30 days in 2000–2001. However, for 1998 and 1999 the Commonwealth Group did not have any outlier results and, as indicated in Figure 3.3, had over 50 per cent of participants recording an elapsed reporting time of greater than 50 days. Corresponding figures for the GAIN Universe 1999 group are not available.

Conclusion on the time dimension

3.29 The Commonwealth Group results for the time dimension are mixed. Cycle times for fieldwork and reporting have, at the median, improved over time. Figure 3.1, however, indicates the proportion of time spent on planning is lower than the GAIN Universe 1999. It should be noted that these benchmarks do not measure the quality of reports produced. Furthermore, they do not take account of the complexity of individual audits or the complexity of individual organisation's audit programs. Individual organisations should consider their own programs and determine an appropriate timeframe for each audit.

3.30 The Global Best Practices® KnowledgeBase notes that better performing organisations look at alternative options for report distribution. This can include, where appropriate, issuing audit reports via e-mail, or using the Internet as a

delivery system to significantly reduce cycle time. Continuous improvement teams within the internal audit function can solicit information from all audit customers and benchmark with other industry leaders to continuously improve the audit process.

Quality dimension benchmarks

3.31 The Institute of Internal Auditors publishes standards for the professional practice of internal auditing.¹² The performance standards and associated practice advisories recommend that the internal audit activity be managed in a way that adds value to the organisation. This includes:

- clarifying the objectives and scope of the work;
- identifying technical aspects, risks, processes and transactions to be examined;
- identifying the number and experience of internal audit staff required based on an evaluation of the nature and complexity of the work to be undertaken; and
- considering external resources where additional knowledge, skills and competencies are necessary.

3.32 By adhering to these standards, there is a greater chance of producing quality reports within budget.

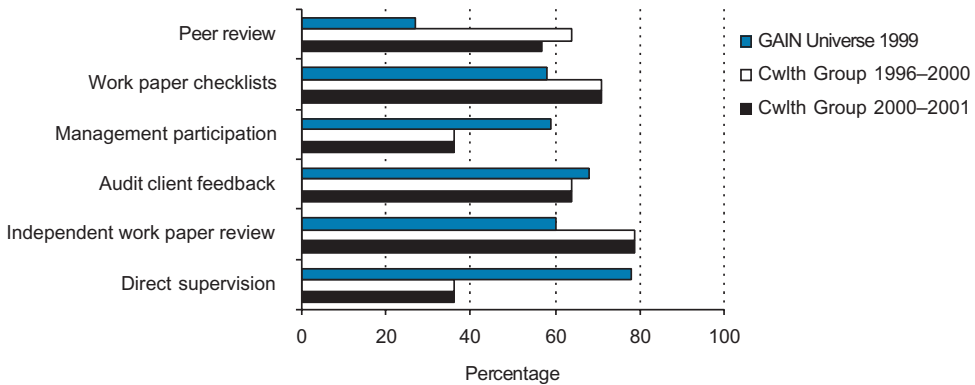
3.33 The benchmarks used to consider the quality of internal audit processes in this study report on the quality control mechanisms utilised and the use of client surveys to obtain feedback. Typically, internal audit will have in place quality control mechanisms that operate throughout the audit process. These mechanisms are generally supplemented by a quality assurance program which reviews audits and audit processes after completion for conformity with standards and compliance with policies. Internal audit may also utilise client satisfaction surveys to determine the quality of their processes and outputs.

Quality control techniques

3.34 The following chart summarises the techniques used by internal audit to maintain quality control. Study participants were asked to indicate whether they used each technique regularly.

¹² *Standards for the Professional Practice of Internal Auditing*, The Institute of Internal Auditors, Altamonte Springs, Florida, USA, 2001.

Figure 3.4
Analysis of quality control techniques used regularly

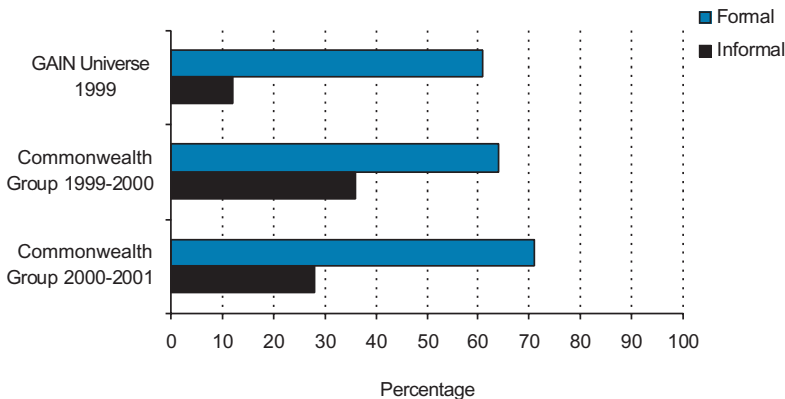


Note: Formula used: average of participants' responses.

3.35 The results for the Commonwealth Group at Figure 3.4 varied somewhat from those of the GAIN Universe 1999. The Commonwealth Group, in both years, made greater use of peer review and independent work paper review while the GAIN Universe 1999 used more management participation and direct supervision.

3.36 With regard to audit client feedback, one approach commonly adopted is to utilise client satisfaction surveys. These may be formal or informal and may be undertaken at the end of each assignment or periodically, throughout the year. Figure 3.5 summarises the use of these alternative approaches. Over half of the organisations surveyed in 1999–2000 and 2000–2001 conduct surveys at the end of each audit.

Figure 3.5
Use of formal and informal client satisfaction surveys



Note: In 1999–2000 & 2000–2001, three Commonwealth Group organisations conducted both formal & informal surveys and three organisations did not complete either.

3.37 The results indicate that, between 1999–2000 and 2000–2001, Commonwealth Group organisations are making greater use of formal client satisfaction surveys as a means of evaluating the quality of their internal audit processes and outputs. This may be due to the introduction of service charters and an increased appreciation and understanding by organisations of the practical benefits of such tools.

3.38 For organisations to satisfy their audit customer, the customer’s needs and expectations must be understood. Global Best Practices® KnowledgeBase notes that better practice organisations identify and profile their audit customer. This helps them understand and meet the customer’s needs, thereby increasing customer satisfaction. Internal auditors in better practice organisations prioritise audit customers’ needs and expectations, addressing business-critical risks first.

Conclusion on the quality dimension

3.39 There appears to have been an improvement in the Commonwealth Group in recent years in relation to the adoption and use of quality control and quality assurance techniques.

3.40 Further attention is still required in relation to the benefits from the use of client satisfaction surveys. Such surveys serve not only to obtain client feedback, but also to forge closer relationships with internal audit’s clients—a key aspect of the new definition of internal auditing.

Overall conclusion on internal audit processes

3.41 The role of the internal auditor is expanding. Most internal auditors are aware that their ability to add value by their activities depends importantly on their understanding of the ‘business’ of an organisation and, by extension, the environment in which that business is conducted. Not only does this help to ensure that the audit products are timely and relevant, but it may also provide an opportunity to influence the direction and impact of changes being made.

3.42 The results for the Commonwealth Group suggest that the Commonwealth continues to make improvements in most respects of internal audit processes. However, the results also indicate that organisations should review the amount of time that is allocated to planning, particularly in view of the continuing need to ensure that internal audit is seen to be adding value. Organisations can also take the opportunity to review the role of internal audit in relation to long-term contracts and purchase agreements, given the importance of contracting in the delivery of outputs and outcomes by Commonwealth organisations.

4. Output Benchmarks

4.1 The integrated package of public sector reforms—financial management, performance management and workplace relations—was initiated by government in 1997 to strengthen the performance culture within the public sector and make it more responsive to the needs of government and the community. The shift to an accruals based outcomes and outputs framework aims to create a more competitive, efficient and effective public sector. Organisations are required to focus more on the use of government resources and outputs produced, and to measure performance, with clearer links from the price, quantity and quality of outputs to planned outcomes.¹³

4.2 Table 4.1 summarises the cost, quantity and quality benchmarks used in this chapter.

Table 4.1
Internal audit output benchmarks

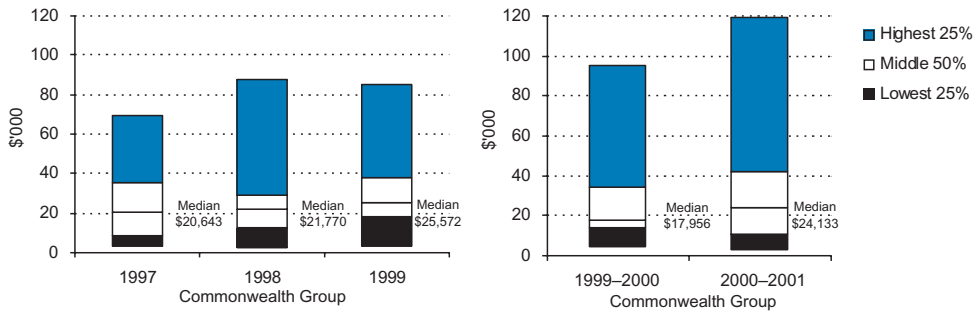
Dimension	Benchmark	Location
Cost	Cost per internal audit report	Figure 4.1
Quantity	Average reports per internal auditor	Figure 4.2
Quality	Acceptance of recommendations (percentage)	Figure 4.3

Cost dimension benchmarks

4.3 This benchmark measures the average cost per audit report (Figure 4.1). This has been derived by dividing the total cost of the internal audit function by the total number of reports produced each year, as reported by the survey participants.

¹³ See *Specifying Outcomes and Outputs*, Department of Finance and Administration, 1998.

Figure 4.1
Cost per internal audit report

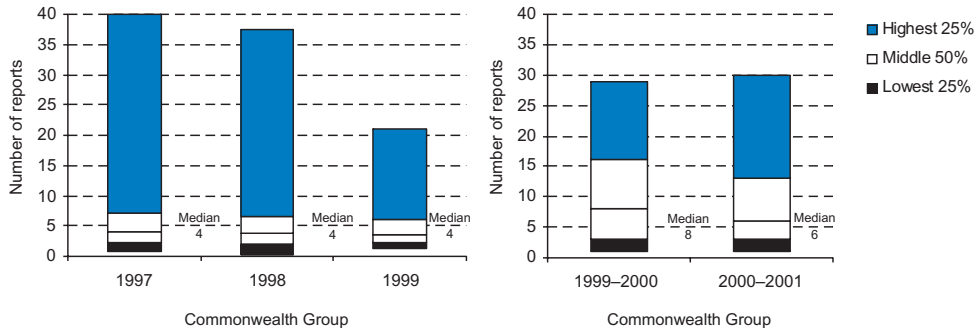


Note: Formula used: total direct cost of internal audit / number of internal audit reports issued.

4.4 Figure 4.1 highlights the median cost per internal audit report, both over time and between the two Commonwealth Groups. As shown, there has not been a significant change in the median cost of reports. There is not necessarily a good or bad result for this benchmark. For example, the difference in the median result for 1999–2000 and 2000–2001 is largely due to the differences in the number of reports produced in some organisations over the two years. The cost per report also depends on the scope, boundaries and complexity of the audit activity, which will vary between organisations. The data demonstrates the range of outcomes for the Commonwealth Group. This range may be utilised by organisations to determine an internal benchmark, for budgeting and for scaling audit activity. The size and complexity of an internal audit report will have a significant impact on associated costs. A benchmark determined internally should be based on current reporting practice and take into account the variables that can influence costs.

Quantity dimension benchmarks

4.5 A successful internal auditor is one who looks out for the CEO’s (and Board’s) interests. That auditor will ensure they understand the business and what concerns the CEO and, of course, the audit committee. The faithful completion of an approved program does not necessarily ensure its success. The internal auditor who makes time to ‘test the pulse’ of the organisation is likely to be one that makes a difference and adds value to his/her organisation. However, there is also no substitute for professionalism and experience to establish the necessary confidence and credibility in the function. Figure 4.2 compares the average number of reports produced per internal auditor. The data provided in Figure 4.2 can be useful in determining appropriate internal benchmarks. Note that the organisational context must be considered when establishing such benchmarks.

Figure 4.2**Average reports per internal auditor**

Note: 1. Formula used: number of audit reports issued / total full-time equivalent (FTE).
 2. FTE figure used is either in-house FTE or outsourced FTE (where available) or a combination.

4.6 Again, there is no overall good or bad result for this benchmark. The range of reports produced by the Commonwealth Group was similar for both Commonwealth Groups. In the first study, the number of reports produced ranged from one to 40 in 1997, one to 38 in 1998 and one to 20 in 1999. For 1999–2000, the number of reports produced per auditor per organisation ranged from one to 29, and for 2000–2001 was one to 30. Some organisations may produce fewer, but more complex reports. This benchmark does not allow for that factor. The median results for the current Commonwealth Group (eight reports in 1999–2000 and six reports in 2000–2001) are slightly higher than those reported by the Commonwealth Group for 1997, 1998 and 1999, when the median number of reports per internal auditor per organisation was four reports in each of those years.

Quality dimension benchmarks

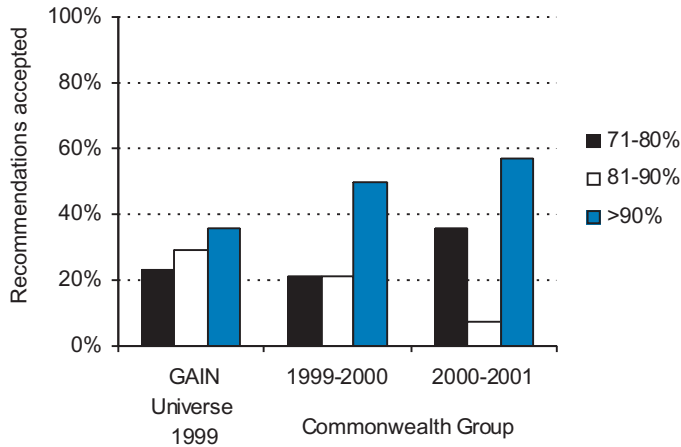
4.7 The benchmark used to measure quality is the proportion of internal audit recommendations which are accepted by management.

Implementation of recommendations

4.8 Management acceptance of audit recommendations is commonly seen as the final step in the audit process. The level of this acceptance is an indicator of the relationship between audit and its clients, and possibly the effectiveness (quality) of the internal audit report.

Figure 4.3

Acceptance of recommendations (percentage)



4.9 Figure 4.3 shows that, for 2000–2001, 57 per cent of Commonwealth Group organisations had more than 90 per cent of their internal audit recommendations accepted compared to 50 per cent of Commonwealth Group organisations in 1999–2000 and 36 per cent of the GAIN Universe 1999.

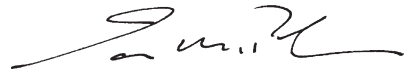
4.10 The Global Best Practices® KnowledgeBase notes that, in better practice organisations, the audit report is most effective when input from the audit customer is incorporated. Concise, clear audit reports, which express concepts simply and effectively, are the best means of getting audit recommendations implemented. The successful internal audit function amasses business process knowledge and conveys knowledge of internal controls throughout the organisation.

Overall conclusion on internal audit outputs

4.11 The cost, quantity and quality benchmarks for outputs provide a generally good result for the Commonwealth Group. The median cost per report for 2000–2001 was \$24 133 which was significantly higher than 1999–2000 (\$17 956) but similar to costs for the previous study. The average number of reports produced per auditor has, at the median, increased from four reports in 1997, 1998 and 1999 to eight reports in 1999–2000, although this dropped down to six reports in 2000–2001. The results for 2000–2001 indicate that, compared to previous years and the GAIN Universe 1999, a higher proportion of organisations had more than 90 per cent of internal audit recommendations accepted.

4.12 The ANAO notes that while these benchmarks in themselves, should not be considered an indicator of a good or bad audit program, they do provide some guidance as to the efficiency and effectiveness of the internal audit function and may be used as a basis for determining potential areas of improvement in an organisation's performance.

Canberra ACT
23 October 2002



Ian McPhee
Acting Auditor-General

Appendices

Appendix 1

About the Study

Background

The ANAO first examined the Commonwealth's internal audit function in 1989. That audit comprised a survey phase, a report to Parliament and a Better Practice Guide.¹⁴ This was followed up by a Financial Control and Administration audit reported in 1998.¹⁵ Information from the first year of a three-year benchmarking program (see below) contributed to the Financial Control and Administration audit by helping to identify which areas of internal audit required closer examination.

Those two audits and benchmarking information, together with extensive research on the topic, facilitated production of the 1998 Better Practice Guide *New Directions for Internal Audit*.

The results of a three-year benchmarking study, Audit Report No.14 of 2000–2001, *Benchmarking the Internal Audit Function*, tabled in October 2000, reported that the internal audit function is regarded by an organisation's management as a key review and monitoring mechanism. It also reported that internal audit has become more broadly defined from a function that assists clients, particularly management, in the discharge of their responsibilities, to an appraisal activity established within an organisation as a service to the organisation.

Benchmarking studies

Benchmarking studies are undertaken under the general performance audit provisions of the *Auditor-General Act 1997*. The process of benchmarking aims to systematically measure an agency's performance against its internal and external peer groups. Benchmarking is a practical tool for continuous improvement as it establishes quantifiable measures for business processes and activities, and uses these to analyse performance trends over time. Through benchmarking, an organisation may identify problem areas in its performance and target areas for the improvement of public sector administration. Benchmarking studies can be used by public sector managers in meeting their responsibilities and to inform the Parliament about aspects of public administration which are not likely to be covered by the financial statement and

¹⁴ Audit Report No.50 of 1991–1992, *Internal Audit in Selected Government Organisations*, June 1992.

¹⁵ Audit Report No.46 of 1997–1998, *Internal Audit*, May 1998.

performance audit products. They examine common business support activities and processes, including:

- systems of internal control;
- the accountability framework; and
- legislative and procedural compliance.

This product has focused on examining key issues affecting the Commonwealth public sector, including financial management and reporting, and internal audit. This report is part of a series of benchmarking studies being undertaken by the ANAO. Audit Report No.25 of 2000–2001 *Benchmarking the Finance Function*, was tabled in December 2000 and a follow on report, Audit Report No.62 of 2001–2002, *Benchmarking the Finance Function Follow On Report*, was tabled in June 2002. A report on the Chief Financial Officer function, Audit Report No.28 of 2001–2002, *An Analysis of the Chief Financial Officer Function in Commonwealth Organisations*, was tabled in December 2001.

Methodology for this study

The study reviewed 14 Commonwealth organisations: seven of the organisations are covered by the *Financial Management and Accountability (FMA) Act 1997* and seven are covered by the *Commonwealth Authorities and Companies (CAC) Act 1997*. Participating organisations completed a questionnaire for the financial years 1999–2000 and 2000–2001, based on the benchmarks reported in ANAO Report No.14 of 2000–2001, as well as additional questions based on the Global Best Practices® KnowledgeBase. The results were compared to those published in Report No.14, either the previous Commonwealth Group's results or the GAIN Universe 1999 results, where appropriate. The data collected for the previous report are for the calendar years 1997, 1998 and 1999. The data collected for the financial years 1999–2000 and 2000–2001 was collected in conjunction with the benchmarking study of the finance function.

The results are limited in scope to the extent that data in the study has been derived from self-assessments. The quality assurance processes undertaken by the ANAO are not sufficient to guarantee the integrity of the data. The results do not take into account, or distinguish between, the different environments in which internal audit operates such as between the public and private sectors.

The diagnostic questionnaire completed by each participating organisation captures a wide variety of information. The questionnaire included a number of qualitative questions, which have been compared to the Global Best Practices® KnowledgeBase 'recommended answer'. The results of these qualitative questions are provided at Appendix 2.

All monetary amounts used in this report are in Australian dollars, unless otherwise stated.

Performance Information

This study was conducted in accordance with ANAO auditing standards and the collection, analysis and reporting of results cost approximately \$183 000.

Appendix 2

Global Best Practices® Qualitative Data

The following table lists the participating Commonwealth Group organisations' responses to a series of qualitative questions about the internal audit function. The first column lists the questions asked, the second column lists the answer required to match better practice and the remaining columns list, for each of the three years of the study, the number of responses from the Commonwealth Group that were better practice, not better practice, not applicable or no answer was provided.

	Better practice answer		1999–2000					2000–2001				
	Better practice	Not applicable	Better practice	Not applicable	No answer	Total	Better practice	Not applicable	No answer	Total		
INTERNAL AUDIT												
The internal audit section consistently identifies and profiles audit customers.	Yes	10	3	1	0	14	10	3	1	0	14	
The internal audit section is able to determine the audit customer's needs and expectations.	Yes	11	1	2	0	14	11	1	2	0	14	
Audit customer needs and expectations are all treated equally.	No	3	8	3	0	14	3	8	3	0	14	
Internal auditors are viewed as operational consultants by audit customers.	Yes	11	2	1	0	14	11	2	1	0	14	
The internal audit section focuses mainly on financial and accounting risks related to business processes.	No	7	7	0	0	14	8	6	0	0	14	
Internal auditors use a specific framework for identifying and assessing business risks.	Yes	13	0	1	0	14	13	0	1	0	14	
Internal auditors use risk self-assessment techniques to identify business risks and controls.	Yes	8	4	2	0	14	8	4	2	0	14	
The internal audit section gives complete responsibility for balancing risk, control, and tolerance to management.	No	4	8	2	0	14	4	8	2	0	14	
Internal audit gathers input from all audit customers on the parameters and deliverables of the audit report.	Yes	12	1	1	0	14	12	1	1	0	14	
Audit reports have a defined scope and are clearly written.	Yes	14	0	0	0	14	14	0	0	0	14	
The internal audit section facilitates knowledge sharing and organisational learning	Yes	12	0	2	0	14	12	0	2	0	14	
The internal audit section recruits auditors independent of the needs of the audit customer.	No	3	5	6	0	14	3	5	6	0	14	
The internal audit section is made up of qualified auditors from diverse backgrounds.	Yes	10	2	2	0	14	10	2	2	0	14	
Highly skilled and experienced professionals are attracted to the internal audit section.	Yes	7	2	5	0	14	7	2	5	0	14	
Reducing audit report cycle time is a primary goal for the internal audit section.	Yes	10	3	1	0	14	10	3	1	0	14	
Information technology is strategically used to improve the audit process.	Yes	11	2	1	0	14	11	2	1	0	14	
The internal audit section avoids cosourcing or outsourcing arrangements, preferring to keep all audit projects in-house.	No	11	1	2	0	14	11	1	2	0	14	
Continuous improvement teams play a minor role in reengineering efforts in internal audit.	No	4	3	6	1	14	4	3	6	1	14	
Internal auditors use computer-aided auditing techniques (CAATs) in conducting internal audits.	Yes	12	1	1	0	14	12	1	1	0	14	
Internal auditors use information technology to improve communication within the internal audit section and its customers.	Yes	13	0	1	0	14	13	0	1	0	14	

Appendix 3

Key Findings from ANAO Report No.14 of 2000–2001

ANAO Report No.14 of 2000–2001 examined the extent to which the previous audit recommendations and the better practice guidance had been acted on and reported on information gathered over the three years 1997, 1998 and 1999. The number of participating organisations for the three years comprised 49 organisations (1997), 48 (1998) and 27 (1999). Their responses formed the basis of the report.

Report No.14 noted that the Commonwealth had maintained the positive elements of their internal audit function identified in the 1997–1998 audit,¹⁶ and had maintained satisfactory progress in many other aspects of internal audit operations between 1997 and 1999. The Commonwealth Group reported results that were equal to or greater than the GAIN Universe 1999, in the areas of:

- the level of education, qualifications and experience of internal auditors;
- the adoption of value-added consulting activities and new approaches to complement the traditional internal auditing assurance role by in-house and co-sourced internal audit functions;
- the greater use of effective quality control techniques;
- greater utilisation of external peer-based quality assurance reviews;
- better practice approaches to the structure and content of internal audit reports; and
- the level of acceptance and implementation of internal audit recommendations.

The Commonwealth Group also reported the following results that were lower than the international peer group:

- the level of investment in training internal auditors; and
- utilisation rates of formal client satisfaction surveys.

The study also found that the Commonwealth's internal audit function may have the potential to develop in some areas. Opportunities may also exist in some organisations in the following areas where the Commonwealth Group reported higher results than the international peer group. These include:

- the overall level of resources applied to internal auditing activities; and
- cycle time to produce internal audit reports.

¹⁶ Audit Report No.46, 1997–98, *Internal Audit*.

Appendix 4

Previous Audit Coverage

Audit Report No.46 of 1997–1998, *Internal Audit*, May 1998.

The objectives of this audit were to provide assurance to the Parliament on the effectiveness of internal audit operations and determine whether internal audit operate at or near better practice.

The ANAO found the internal audit function in most organisations was meeting the expectations of senior management, thus fulfilling the role articulated through the internal audit charter. However, when compared with the standards of international best practice, it was concluded that the internal audit function in the public sector is lacking in respect to a number of key measures. In particular, management support for the internal audit function was not as strong as could be expected; there is a need for improved effective communication between heads of internal audit and their audit committees and between the audit committee and its audit clients; and moving from the traditional ‘policing’ role toward the better practice role of a more value added ‘independent adviser’. The ANAO further identified the need for internal audit units to develop a continuous improvement culture and, while the content of public sector internal audit reports exceeded better practice, this outcome was diminished by the inability to report in a timely manner.

A series of recommendations were made in relation to improving the internal audit function and a better practice guide was published in conjunction with the report which contained information from research into private and public sector better practices.

**Better Practice Guide, *New Directions for Internal Audit—
A Guide for Public Sector Managers*, May 1998.**

This guide deals with the current and future role of the internal audit function—the challenges it faces, its likely direction, and the principles and practices adopted by recognised better practice internal audit units. The guide was produced for the executive management of public sector entities and their audit committees to consider whether their internal audit function is meeting their corporate governance requirements and to determine what changes, if any, will be necessary if internal audit is to remain relevant to the future strategic management of the entity.

The guide suggests that effective internal audit functions operate using the following principles:

- internal audit enjoy the full support of executive and senior management;
- internal audit seek to meet client needs through a focus on agreed business risks;
- the resources applied to internal audit activities achieve a blend of relevant business expertise, audit skills and knowledge; and
- the internal audit unit includes a culture of continuous improvement.

The guide provides detailed guidance on each of these principles and the steps required to achieve better practice.

Audit Report No.14 of 2000–2001, *Benchmarking the Internal Audit Function*, October 2000.

This benchmarking report, including its findings and conclusions, are based on the information provided by public sector organisations in response to a questionnaire issued over three years. The questionnaire was originally developed by the Institute of Internal Auditors and is commonly referred to as the GAIN Questionnaire.

The report is intended to provide a map so organisations can see where they sit in the Commonwealth and international landscape. Key performance indicators that can be used to assess performance are provided. A summary of the recommendations made in Audit Report No.46, and based on the benchmark study, overall progress by agencies on action taken on the recommendations is provided.

Refer to Appendix 3 for detailed coverage of the key findings from this report.

Better Practice Guide, *Audit Committees*, July 1997.

This guide draws on experience from both the private and public sectors as a reference for organisations seeking to improve the operation of their audit committees. It was developed as part of the audit into audit committees (Audit Report No.39 of 1996–97).

The guide provides commentary and guidance on the need for a committee, composition of the committee, the committee at work, powers and functions and accountability.

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