



AUDITOR GENERAL
WESTERN AUSTRALIA

**Auditor General's Response to
Public Accounts Committee Report Number 3
The 2001-2002 Annual Report
of the Office of the Auditor General:
A Performance Review**





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Summary of Response

I welcome the Public Accounts Committee's (PAC) attention to the work of my Office, as evidenced by its review and report to Parliament on my 2001-2002 Annual Report. The positive tone of the Committee's findings is noted, and the general thrust of the Report is supported, as are many of the Committee's individual recommendations.

I also welcome the Committee's view that the OAG could be more open regarding its operations, and will be providing more information on the cost of our various audits in future Annual Reports. However, I do have concerns regarding the suitability of the Annual Report as a vehicle for some of the other, lower level operational information sought. We have been progressively providing more information about the Office, and our work, on our website and I believe this is a more suitable medium for distributing this type of information. Use of the website allows us to provide more comprehensive information via the use of hyperlinks, as well as allowing us to better maintain the currency of information provided.

Another reason for my concern is that we had already embarked on a process of refining the contents and the timeliness of the Annual Report. That task of tabling the Report in late August would be made more complex by including information that could be better provided elsewhere.

Notwithstanding my concerns regarding the suitability of the Annual Report for presenting some of the suggested information, I fully support the Committee in its efforts to make sure that the issues raised in my reports are properly addressed. The fact that the Committee will now require agencies subject to a Performance Examination by my Office to report to the Committee as to what actions they have taken to implement audit recommendations can only improve the effectiveness of these reports.

Background

On Wednesday March 5, 2003 the Public Accounts Committee resolved to undertake a review of the Office of the Auditor General for Western Australia's Annual Report 2001-2002. The Committee's Report (its third of the Thirty-Sixth Parliament) was tabled on May 15, 2003.

This is the first time that a Western Australian Public Accounts Committee has reviewed the overall performance of the Office of the Auditor General through a formal review of the Office's Annual Report.

Overall the Committee expressed their satisfaction with the performance of the Office of the Auditor General during the reporting period, and made a number of recommendations for the Auditor General's consideration to improve the Office's performance and future annual reporting.

The Committee requested that the Auditor General provide a report to the Speaker of the Legislative Assembly within three months, or at the earliest opportunity after that time if the Assembly is adjourned or in recess, that outlines the action, if any, proposed with respect to the recommendations of the Committee.

This Report is submitted consequent to that request.

Response to Individual Recommendations

Recommendation 1 - The Annual Report should provide brief background information on the way in which terms of reference are determined for Performance Examinations.

I agree this information should be more generally available, but do not believe the Annual Report is the best place for it. Instead, I intend to table an updated statement on our audit practices (the Practice Statement) in November 2003. Additional information on our internal work practices will also be included on our website. Future Annual Reports will mention the availability of the Practice Statement, and will link to it when provided in electronic form.

Practice Statements are issued in accordance with Section 95(1)(b) of the *Financial Administration Audit Act 1985* (FAAA) which require me to inform Parliament of the particulars of any major change in the extent or character of the audit. Two major Statements were released in May 1996 (Public Sector Attest Audit Practice Statement) and November 1997 (Examining and Auditing Public Sector Performance) with periodic updates released since then, as and when required. The new Statement will offer an updated, concise, and consolidated summary of:

- why we audit;
- what we audit; and
- how we audit.

and will provide greater transparency into the selection process for examinations.

While awaiting the new Practice Statement, information on how we go about selecting possible Performance Examinations is available in a four-page brochure produced by my Office in 1994 (see Appendix A). This brochure was prepared to provide agencies selected for a Performance Examination with information on the selection process used. The paper covers the general ‘themes’ under which Performance Examinations were grouped, and the criteria used to assess the relative priority of the topics. The Office is presently reviewing the themes under which examinations will be grouped, but in the meantime, this brochure remains a useful guide to the Office’s selection process. The topic selection process used is similar to that used for the selection of Controls, Compliance and Accountability examinations which are smaller, more process focused reviews.

I do need to emphasise, however, that regardless of the procedure used the final decision on which examinations will be undertaken remains one of personal judgement, with Section 79(1)(a) of the FAAA requiring me to conduct audits in such manner as I see fit.

I also note the Committee’s concern that my Annual Report provides no explanation as to the levels of resources allocated to each investigation. From this year, I will be including a table of the costs involved in each investigation. The table will not include the ‘hours’ involved, which I believe could be misleading, as they exclude the time worked by consultants and contractors, and do not provide any indication as to the level at which the work was undertaken.

Recommendation 2 – Notwithstanding the information regarding Follow-up Performance Examinations currently included in Public Sector Performance Reports, the Auditor General’s Annual Report should provide brief summaries on Examinations and relevant conclusions drawn from Examinations.

I accept the need to be more transparent regarding Performance Examination Follow-ups, particularly where a decision has been taken either not to proceed, or to undertake a larger Follow-on Examination¹ instead. Future Annual Reports will include an appropriate commentary.

I expect that the intended Practice Statement and its associated web-based supporting statements will address the Committee’s desire for more information on the parameters associated with selecting a Performance Examination for a Follow-up.

In line with my efforts to provide advance notice of the Office’s work program on the Office’s website, the website will also include information on scheduled Follow-ups.

Acknowledging the Committee’s suggestion that the Annual Report should include details on the staff hours allocated to individual Follow-ups, future Annual Reports will include information on the costs associated with all Examinations, Follow-ups, and Follow-ons tabled in the relevant year. I will not be providing information on the hours worked because, as I explained above, the information could be misleading as hours exclude the time worked by consultants and contractors, and does not provide any indication as to the level at which the work was undertaken.

Recommendation 3 – The Auditor General should liaise with the PAC regarding instances in which agencies are considered to be significantly deficient in responding to AG Reports, including the failure to implement recommendations.

When I become aware of an agency significantly deficient in responding to one of my Reports, my present policy is to inform Parliament through either a Follow-up or Follow-on report. I do not believe I should do more than this because as an external auditor I am Parliament’s ‘watchdog’, not their ‘bloodhound’. However, as I have previously indicated to the Committee, I am willing to identify reports which have raised accountability issues that, in my opinion, would benefit from the additional specific, scrutiny of the Committee.

While at a macro level, measuring the rate of implementation of individual recommendations is certainly a possible indicator of performance, in terms of the reasonableness of recommendations made, there are a number of problems with such a measure. The principal one being that for independence reasons the Auditor General neither directs nor assist agencies to implement its recommendations. While from an audit perspective I need to be careful to avoid assuming a ‘coercive’ role, this does not apply to the PAC, which has indicated its intention to become more involved in following up with agencies on the implementation of various reports (Recommendation 5). This initiative also promises to serve as a basis for more focused Audit interactions with the Committee.

¹ Follow-on examinations have a wider scope to follow-up examinations in that they evaluate aspects of performance not covered in the initial examination.

Recommendation 4 – *The Auditor General should identify the rate at which agencies implement recommendations in Auditor General Performance Examinations and provide explanations for those recommendations not implemented, in order to provide a measure of the impact of his work in the public sector each year.*

I do not attach great importance to the measurement of the acceptance and implementation of recommendations, and for that reason do not collect these statistics. This is a view presently shared by number of other Australian Auditors General.

There are a number of problems with using the implementation of recommendations as a measure of the impact of my work. The first is that I neither direct nor assist agencies to implement recommendations. Secondly, such a measure could restrict the scope of recommendations. Thirdly, recommendations are not generally of equal importance; with some requiring a considerable time to implement. There is also the problem that some are necessarily fairly general, with others approaching the status of parenthoods statements. Any attempt to measure the impact of my recommendations is going to require significant work on their phrasing, work that I am not presently persuaded is warranted. A numerical statistic would also need to be so heavily qualified, with additional commentary to make the reader aware of the difficulty of interpretation, that it is unlikely to be of much use.

Such an approach also involves challenges similar to those identified by the Committee when counting the Matters of Significance (MoS) required by the Output Based Budgeting regime, and could even encourage auditors to write recommendations in a manner that would contribute towards a higher degree of acceptance.

Rather than simply measuring the acceptance and implementation of recommendations contained in Performance Examinations, I prefer to use a combination of Follow-up and Follow-on Examinations. Current resourcing, however, limits my ability to undertake as many Follow-ups as I might like, and in the light of current restricted resources they have a lower priority than I might otherwise prefer.

Presently I aim for between six to eight Performance Examinations each year with Follow-ups conducted after two to three years if the issue has remained significant and relevant. Where the environment and/or the issue have changed significantly in the intervening period a larger, Follow-on report may be prepared. In other cases, for example where the Performance Examination was simply intended as a catalyst for change (eg *A Means to an End: Contracting Not-For-Profit Organisations for the Delivery of Community Services*), or to focus attention on the issue (eg *Righting the Wrongs: Complaints Management in the Western Australian Public Sector*) Follow-up reports are not considered warranted.

Follow-ups are also not normally conducted for the 10 to 12 Controls, Compliance and Accountability (CCA) examinations I aim for each year. These CCA examinations are generally included in the two or three Public Sector Performance reports I table each year. While Follow-ups are not undertaken because of the shorter, more abbreviated nature of the original examinations, in some cases, such as the examination dealing with the Control of Corporate Credit Cards tabled in October 1998, I can be expected to revisit the issue on a regular basis.

Finally from the external audit perspective care needs to be exercised to avoid assuming a ‘coercive role’. Ultimately this is Parliament’s role and as a result I fully support the Committee’s decision to require any agency subject to a Performance Examination to report to the Public Accounts Committee within 12 months of the Auditor General’s Report being tabled in Parliament as to what action it has taken to implement the Auditor General’s recommendations (Recommendation 5).

Recommendation 5 – An agency subject to PEs will be required to report to the Public Accounts Committee within 12 months of the Auditor General’s Report being tabled in Parliament as to what action it has taken to implement the Auditor General’s recommendations. The Auditor General should take further action in the event that the PAC refers a matter back to the AG regarding the agency’s response.

I support the general thrust of this recommendation, particularly the required reporting of any agency subject to a Performance Examination. I would also suggest that the PAC may wish to expand this recommendation so that it covers both: Performance; and Control, Compliance and Accountability examinations.

Given the issues associated with maintaining the independence of an Auditor General, I do have some concerns at being ‘expected’ to take action when the PAC refer a report back to my Office. However, I am always happy to provide briefings or further explanation to any Parliamentary Committee, and am sure that if the PAC was unhappy with a response from an agency, and resources permitted, I would be happy to investigate further.

I also expect that if requested I would be able to make available to the PAC members of the original team involved in the Performance Examination to further ‘inform’ the Committee and assist them with phrasing the questions to the agency concerned.

The important thing to remember is that while my Office can be a catalyst for positive change, I am not, and should not be seen as an implementer of such change. That primarily remains the responsibility of the Executive, Parliament, and the agency concerned. The Practice Statement I intend to table in November will include a brief statement on the role of external audit, which is intended to emphasise this distinction.

Recommendation 6 – In order to enhance the Parliament Survey and improve the quality of feedback regarding the Auditor General’s performance, the OAG should expand the use of face-to-face interviewing of Parliamentarians.

While I am happy to build on the seven face-to-face interviews we undertook with MPs in 2003 as a method of providing anecdotal evidence for the reason behind some of the ratings received from the Parliamentary Census, the validity of more formal face-to-face interviews for audited KPIs is problematic.

Western Australia and the ACT are the only two Australian jurisdictions to require audit opinions on performance indicators. This imposes an additional degree of rigorousness on any KPI, if it is to stand up to the scrutiny of external audit. Such scrutiny includes examining, on a test basis, evidence supporting the amounts and other disclosures in the performance indicators, as well as assessing the relevance and appropriateness of the performance indicators in assisting users to assess the performance of the agency concerned.

The Parliamentary Census has withstood such scrutiny by our external auditors, currently Hall Chadwick, in whose opinion the key effectiveness and efficiency performance indicators of the Office of the Auditor General are relevant and appropriate for assisting users to assess the Office’s performance, fairly representing the indicated performance. It is unlikely that feedback from face-to-face interviews would receive the same level of support because of the difficulty in reliably verifying conclusions reached.

Having said that, however, personal interviews do create an opportunity for us to probe the reasons behind movements in the Parliamentary Census, as well as permitting us to conduct detailed questioning on a range of issues such as report design. Against that is the cost involved in any interviews, either by my own staff or by a contractor. Our own experience from the 2002 series of interviews is that given the pressure on a Member of Parliament’s time such interviews would be even more difficult to obtain than completed survey forms have been. Consequently, any assistance the Committee may offer in arranging interviews would be useful.

While the response rate from this year’s Parliamentary Census has shown a significant increase to 67 per cent (up from 58 per cent last year), and as a Census it remains free of any sampling error, I am not entirely happy relying on it as our sole effectiveness indicator. As a result, I am presently examining the attributes of a successful audit office with the hope of identifying one or two additional indicators. It is unlikely that the results of any face-to-face interviews with MPs would be suitable, however.

The Committee emphasised the need for negative responses to the Census to receive appropriate consideration, and I would like to assure Parliament that this does occur. While our external reporting emphasises the proportion of Parliamentarians who believe that my reports and services meet their needs, internally we are just as interested in the four per cent of Members (on average) who expressed their dissatisfaction with my services.

Recommendation 7 – The Annual Report of the Auditor General should include additional information to help assess situations where completion of work deviates from targets.

This recommendation is accepted, and additional information will be provided where future identified targets are not met.

Information in the 2001-2002 Annual Report included indications of the Office's performance against both internal and external targets. While the Office met all statutory requirements relating to the issuing of audit opinions, and met its own internal targets in relation to the tabling of Performance Examinations (PE) and Control, Compliance and Accountability (CCA) audits, it did miss a number of other internal deadlines. It was to these internal targets that I was referring in my foreword, and about which I provided some details on page 22.

Other internal targets were at a lower level than agencies normally disclose in their Annual Reports and I do not believe that providing information on all of them would have added to the Report's clarity. I accept, however, that we need to be more open about our internal targets, and a recent re-working of the Office's Focus Statement, which sets Divisional targets for the coming year, now clearly identifies those targets which are to be reported on externally, and those which are for internal management use only.

I have also started to provide advance notice of the Office's work program, specifically providing information to users where a review is in an advanced stage and is likely to result in a report to Parliament. In the event that I then decide not to table the report it would be my intention to provide additional information to help Parliament assess the situation.

I intend to continue my practice of reporting on projects that did not result in a report to Parliament. In last year's Annual Report I mentioned 11 projects, involving approximately 1 000 hours, that did not result in a report to Parliament, either because internal government reviews were being undertaken in the area at the time or because no significant matters were identified. If a project incurred substantial costs, greater than \$50 000, I will provide the information separately.

RESPONSE TO INDIVIDUAL RECOMMENDATIONS (continued)

Recommendation 8 – The Auditor General’s Annual Report should include more information on the process of identifying MoS.

Information on the process of identifying Matters of Significance (MoS) was included for the first time in the 2000-01 Annual Report. While I agree with the need for further explanation I am not convinced that the Annual Report is the most suitable vehicle for providing this, and will be working towards providing more information about MoS on the Office’s website.

I agree with the Committee’s Report regarding the limitations of the measure, and in an attempt to make the process more transparent have been attempting since July last year to have all MoS separately identified in each report. 2002-2003 was a year of transition in this regard, but as of July 1, 2003 all reports tabled in Parliament will have their MoS explicitly identified. This has the additional advantage that the inclusion of MoS in the draft provided to agencies for comment, as part of ensuring procedural fairness, will offer a degree of external scrutiny.

Although I am attempting to make the process of identifying MoS as objective as possible, the process is an inherently subjective one, that was introduced to meet the requirements of Output Based Budgeting. The process is likely to remain subjective given that Section 95(1) of the FAAA requires the Auditor General to submit a report to Parliament on those matters that in his opinion are of such significance as to require reporting in such manner.

Recommendation 9 – The PAC recommends that future Annual Reports of the AG include results of staff surveys as an internal performance measure, according to categories appropriate to the Office of the Auditor General of WA.

I do conduct and publish the results of staff surveys on occasion, but in general believe they are more suited as a tool for internal management than external reporting.

Recommendation 10 – The PAC should consider in detail its relationship with the AG as part of its inquiry, Review of the Role of the PAC: Ensuring Public Sector Accountability in the 21st Century”.

This recommendation is supported, and I have already provided a submission to the inquiry. In addition, I am always available if the Committee wishes to consult or take evidence.

The support of the Committee in maintaining my independence and impartiality is welcomed, and I look forward to further discussing the issues raised in the report with the Committee as the inquiry progresses.

Recommendation 11 – The Auditor General’s annual reports should provide relevant details of meetings of ACAG, including general developments pertaining to management of audit offices.

Relevant developments arising from meetings of the Australasian Council of Auditor Generals (ACAG) have, and will continue to be included in the Annual Report. However, given that ACAG is only a co-operative forum for information exchange its importance should not be overemphasised.

I must stress that any Benchmarking undertaken by ACAG is private, and can only be released publicly by agreement with other Auditors General. Only a restricted amount of information is available for public release, and this is already included in the Annual Report.

I feel that the most relevant source for information on ACAG is the ACAG website (<http://www.acag.org.au/>), where information that the Council wishes to be made public is available.

Recommendation 12 – Future annual reports should include information on progress of peer reviews in which the AG is involved and plans for future reviews of the OAG in WA.

This recommendation is supported. Consistent with past procedures, information on the next Peer Review to be conducted in 2004 will be included in this year’s Annual Report, with the results of the Review to be included in the 2003-2004 Annual Report. Also consistent with past procedures, where staff from the WA Office have been involved in a Review of another Office this will also be mentioned in future Annual Reports.

Significant coverage of the Office’s last Peer Review was included in our 1999-2000 Annual Report, with comments on the preceding Review being included in both the 1997-1998 and 1998-1999 Annual Reports. Substantial coverage has also been included in other years when considered relevant, for example in 1992-1993 and 1993-1994, however, because Peer Reviews are only undertaken every two to four years it is not considered appropriate to include information every year.

For the 2004 Peer Review I intend to continue the process previously established of providing both the Public Accounts Committee, and the Public Administration and Finance Committee with the proposed terms of reference for comment, as well as copies of the Review’s final report once complete.

Performance Examination

The Approach of the Office of the Auditor General 1994

Office of the Auditor General Western Australia

Over the past 12 months the Office of the Auditor General has developed a new approach to performance reporting consistent with international trends to shift the focus of public sector auditing from an emphasis on compliance to one of informing Parliament about the effectiveness of outcomes sought and achieved by government agencies. This approach complements existing process and control oriented examinations that will continue to be a significant part of the Work of the Office of the Auditor General.

Performance examination is part of the Office's mission to facilitate informed judgements regarding the management and operations of the public sector. An essential feature of this work is that the examinations are independent and objective.

In addition to serving the needs of Parliament it is fully intended that the Office's interactions with public sector agencies during the conduct of examinations will itself lead to improvements in their performance.

Volume 2 of the Royal Commission Report commented on this role in these terms:

"Put colloquially, the Auditor General has the proper and developing function of conducting 'value for money' audits of government programs and agencies. These responsibilities are of great importance. Their discharge must be facilitated in every way. They constitute a vital check on waste, mismanagement and the subversion of government's policies and programs".

Strategy

In seeking to achieve these goals a broad strategy for performance examination has been developed which gives a high priority to adding value to the public sector through the intervention of the Office. Whilst in all cases this will result in investigations where the Office believes there is potential for improved performance, there is also a strong interest in highlighting examples of good and best practice.

Selection

The Office has undertaken a strategic planning process to identify broad themes which will help to guide the selection of topics for consideration. The broad themes seek to reflect the anticipated interests and needs of our primary client, the parliament, and help to focus our examination work.

The themes which the Office feels will produce maximum benefit and ensure optimum coverage are:

■ **State of the State Reports**

The focus of these examinations is on major public sector financial operations. Current examples include management of trust accounts, investment funds management, taking a whole of government view.

■ **Program Performance**

Focus is on the efficient and effective translation of Government policy objectives into agency programs. The recent Utilisation of Government Schools Report is an example.

■ **Accountability**

Identifies weaknesses in accountability. Examples are Travel and Internal Audit Reports.

■ **New and Emerging Issues**

Early scrutiny of new developments will help to identify risks, so that timely corrective action can be taken. The report on Child Care is an example.

The approach to selecting topics within the themes is described as “*risk-based and value-adding*”.

Through ongoing scanning of the environment and surveys of agencies and program areas a wide range of possible topics is generated.

A set of criteria is used to rank the relative priority of the topics. Amongst the criteria considered are:

- financial materiality in relation to public funding;
- inherent risk of the program due to factors such as complexity, diversity and change;
- significance of the program in relation to their agency activities and its impact in the community at large; and
- an estimate of likely net benefits derived from conducting the examination.

It is worth noting that not all of the benefits will be measured in financial terms. Non-financial benefits may relate to improved quality of service. This may be in terms of things such as shorter waiting lists or waiting times, fewer complaints or a wider range of services and greater choice.

In determining whether to proceed with a full examination the Office gives consideration to the ranking process and most importantly to the likely value added. Priority is given to examinations where the Auditor General’s report to Parliament is most likely to result in improved performance.

To illustrate this approach the paper draws on an actual examination conducted by the Office and reported recently to Parliament. The report titled *Utilisation of School Facilities in the Metropolitan Area* was chosen for a range of reasons which included:

PERFORMANCE EXAMINATION

The Approach of the Office of the Auditor General 1994 (continued)

- financial materiality – the estimated replacement value of all school buildings is \$1.7 billion;
- inherent risk of a very significant state asset not being used in the best interests of the community;
- significance of the area – one of the most sensitive and difficult issues facing government; and
- estimated likely net benefits – more effective utilisation and planning would free up resources for other purposes and reduce the unfair disparity between the costs per student in under-utilised schools and those operating at near optimum levels.

Conclusion

The primary outcome sought of any performance examination conducted by the OAG is enhanced decision making by Parliament. In the light of the Royal Commission's findings it is evident that a well informed Parliament and community is fundamental to proper accountability. It is considered that the very act of providing performance examination reports to Parliament has a flow on effect of increasing pressure on public sector managers to evaluate their own performance.

With a secondary objective of our performance examination being enhancing performance through our interaction with agencies, the Office would fully expect that this will also increase interest in internal evaluation. It should be particularly evident from the process outline here, that where agencies have their own effective internal evaluation processes the Office's involvement would seek to build on this work.

