

Public sector auditing has never been in a hotter spotlight than in Australia, nor the redefinitions and changes more significant.

Critical Issues in Public Sector Auditing

James Guthrie

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Public sector audit has until recently received little attention in either academic or professional circles, notwithstanding its responsibility for maintaining public and Parliamentary confidence in the financial administration of Government.

In several countries, the mandate, scope, standards, reporting requirements and organizational and institutional arrangements for public sector auditing have recently been under tremendous pressure to change, and have changed.

Over time, public sector audit has evolved from providing an independent and professional assurance that the resources of government have been managed properly, in accordance with the law, and that no fraud has taken place; today, public sector audit also includes forming opinions on a range of management matters, including value-for-money and efficiency and effectiveness audits of the performance of various governmental units.

Change has taken place in Australia too. These changes have involved new or varied institutional arrangements and

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organizational forms (e.g. Australian National Audit Office), different technologies (e.g. efficiency and performance auditing) and new rules (e.g. legislation and regulation concerning efficiency audits and value-for-money audits).

With increased political, public and professional interest in public sector auditing (external and internal) there has been an increased awareness that there are several critical issues in public sector auditing which need to be explored.

The thrust of this article will be to provide an overview of the direction of change in public sector auditing (both externally and internally).

Public and Private Sector Auditing Failures of the 1980s

In recent times auditing practices in the public and private sectors of the Australian economy have been criticized, reviewed and recommendations have been made to significantly change the nature, scope, funding, organization, staffing and professional arrangements for auditing.

Estimates of the cost of the provision of audit services to the Australian economy cannot be found but approximately \$70 million was spent on internal and external audit last year in the Commonwealth public sector.

In the private sector spectacular company crashes and billion dollar losses have been accompanied by demands to seek legal redress and compensation for misleading or incompetent audit practices. A list of audit failures in the 1980s could include such names as Bond, Rothwell, Adelaide Steamship, National Safety Council, Tricontinental and Quintex.

Walker^[1,2], in discussing private sector audit failures, suggests several factors contributing to "audit failure". These factors include:

- reduced scope of external auditing to "forming an opinion of the financial reports";
- lack of independence associated with the provision of other services and an audit-tendering system for retaining or seeking new clients;
- failure of audit quality controls, within and external to the audit firms;
- economic and time pressures to introduce new methodologies which may reduce the nature and scope of the audit;
- the remoulding of the audit profession into a business which offers a variety of other services, which require marketing of these services;
- failure of the accounting profession in a self-regulatory regime to police auditing practices.

Pressures associated with audit failures have resulted in calls for drastic changes to current auditing arrangements and practices. These include the introduction of a five-year rotating auditee-auditor engagement to strengthen independence, the introduction of peer review and quality control, establishment of audit committee, improvement

in audit standards and practice statements and a closing of the "expectation gap" to improve audit quality.

The private sector's auditing problems can be stated as:

- an audit expectation gap;
- unlimited auditors liability;
- the issue of auditors' independence when other services are provided;
- poor auditing and accounting standards;
- poor performance of audit in both the public and private sectors.

The professional solutions proposed include:

- peer review;
- audit committees;
- improved standards.

In the public sector, catalysts for change have included revelations at several Royal Commissions of ministerial and Government misconduct, fraud, improper internal controls and inadequate management performance.

These and other pressures associated with the adoption of "managerialism" in government administration have created renewed interest in external and internal audit, evaluation and other review mechanisms within the Australian public sector.

Why now? A Changing Management of the Public Sector

In the past two decades in Australia there have been several inquiries into aspects of public administration. Guthrie and Parker's review[3] of administrative inquiries in Australia from 1970 highlighted the dominance of theories of rational management in these inquiries. In general a public sector management philosophy was decreed, which is referred to as "managerialism" in the public administration literature[4,5].

The guiding rhetoric for change was the pursuit of efficiency, effectiveness, value for money and accountability. Responsibility is to be decentralized, lower level operatives are to be offered a world in which they are redefined as accountable managers, public sector organizations are to be subdivided into commercial businesses and traditional organizations, and the public are to be seen as customers[6].

The prescriptions for change are rooted in the advocacy of formal rational management, emphasizing the necessity for clear goals, corporate plans and, above all, internal and external accounting systems with clear responsibility lines for performance measurement and accountability.

Variations of these changes have been attempted in most States and Territories and the Commonwealth.

Supporters of this package of changes believe that:

- the objectives can be given and can be operationalized;

- the measurement of inputs and outputs can be obtained;
- the relevant performance indicators can be found;
- the information produced will be relevant to decision making;
- the information produced will assist decision makers in making "rational decisions", far removed from politics.

These issues are central to debates concerning the changing face of public sector auditing and "accountability issues" for the 1990s[7].

Recent Changes in Organization, Scope and Funding

In recent times public sector auditing has undergone major changes in Australia. These changes have involved:

- new or varied institutional arrangements and organizational forms;
- different technologies;
- new rules.

Developments at the Commonwealth and state level have included the introduction into practice of financial statement, efficiency, effectiveness and performance and project audits, while there has been less emphasis on the traditional finance/compliance audit.

An examination of the various institutional arrangements, legislative intent and performance audit practices in various states and the Commonwealth indicates that in these different locations the technologies are distinctive with varied professional responses and rules being formulated. Different institutional arrangements are observed, and variations of the specific technologies and technical practices are instilled into the language and practice within specific locations (e.g. Australian National Audit Office, South Australia Auditor-General, Victoria Auditor-General).

Recently, there have been several Parliamentary and other reviews of public sector audit in Australia[8-12]. The changes and an overview of these inquiries are discussed in more detail elsewhere[13].

Current Issues in External Public Sector Auditing

One such review was made public with the release of the Joint Committee of Public Accounts' (JCPA) Report 296, *The Auditor-General: Ally of the People and Parliament*[10]. English and Guthrie[14] state that the JCPA in its report strongly indicated that there is a crisis at present in the organization, funding and execution of the Government audit function. The JCPA inquiry found that the Australian Audit Office had not kept pace with overseas developments and it was not fulfilling its role as defined by the Act. However, the Committee did suggest that "... the most important reasons for this situation were outside the Audit Office's control"[10, p. 243, par. 19.2]. This report and

subsequent events have highlighted several accountability and external auditing issues that have not been settled.

Guthrie[15] indicates that the report highlights several important issues. These include:

- independence of the audit function;
- auditee and auditor relationship;
- selection and payment to the auditor;
- importance of Government accountability to Parliament;
- methodology and staffing for auditing;
- present training arrangements for public sector auditors;
- establishment of a Parliamentary Audit Committee;
- expectation gap between public perceptions of audit and actual audit practices;
- differences between public and private sector audit;
- whether the role of the auditor should be extended to include reporting on performance indicators and performance (mandate and scope);
- whether all audit reports should be directed at management, the responsible Minister or Parliament (reporting process);
- what audit standards are appropriate for the conduct of compliance and performance auditing (standards);
- to what extent public sector audit work should be undertaken by private sector auditors (access).

In summary, at the Commonwealth level, as well as in various states, the organizational arrangements, the scope of audit activity and the reporting of audit findings in external public sector auditing are going through a period of significant redefinition and change.

Current Issues in Internal Public Sector Auditing

This section briefly reviews the current state of play in public sector internal audit and specifically draws upon recent developments in Victoria for illustrative purposes.

In the early 1970s the importance of internal audit was realized and several problems were identified. In evidence to the Royal Commission on Australian Government Administration (RCAGA)[16], the Commonwealth Auditor-General[17] stated that:

As part of the internal controls system the existence or otherwise of an effective internal audit is an important consideration in determining the nature of the audit by the Auditor-General... nevertheless a number of continuing problems in achieving and maintaining satisfactory standards of internal audit staffing and performance throughout the service exist.

Recently the importance of an effective internal audit function has once again been investigated and similar conclusions concerning critical issues still exist today. These investigations include the Australian National Audit Office (ANAO) report on internal audit[18], the New South Wales Treasury guidelines for internal audit[19] and the recent Victoria Auditor-General's comments on internal audit[20].

The New South Wales Treasury guidelines[19] are an update of a previous 1985 internal audit manual. The introduction to this document states that:

the objective of internal audit is to assist all members of management with the effective discharge of their responsibilities by furnishing them with analysis appraisals, recommendations and pertinent comments concerning the activities reviewed. In general internal auditors are concerned with all phases of business activity. This involves going beyond the accounting and financial records to obtain a full understanding of the function area under review.

The standards adopted are from the Institute of Internal Auditors (USA). The distinction between internal audit and programme evaluation within the report is interesting[19, p. 6]:

Programming means any set of procedures, activities, resources or management strategies designed to achieve common goals or objectives.

Program evaluation is concerned with improving outcome by measuring the appropriateness, efficiency and effectiveness of individual programs. It determines whether program objectives are consistent with government and organizational objectives and priorities where the desired results have been achieved, whether the organization has considered alternatives that might yield results more effectively and efficiently and whether the organizational branch is managing its resources (personnel, property and so on) in an economic and efficient manner.

This guideline also indicates the variety of different review activities that are presently being used in New South Wales (cf.[21]). These review activities include:

- Internal audits;
- Information systems audit (audit of computer-based systems);
- Program evaluation;
- External audit;
- External management reviews;
- NSW Parliamentary Public Accounts Committee.

In the 1990 Victoria Auditor-General's report[20] there was an extensive review of internal auditing. This follows nearly a decade of attempts to improve the internal audit function.

In 1985 the Victorian Parliamentary Economic and Budget Review Committee in its report, *Improving Government Management and Accountability*[9], identified several inadequacies regarding internal audit operations with the Victorian public sector.

These included:

- failure by many organizations to establish an internal audit function;
- limitation of the scope of internal audit coverage to financial and compliance issues;
- inadequate staff resources and training of internal auditors.

Also, over the past decade or more, reports of the Victorian Auditor-General have commented on the deficiencies in internal audit in the Victorian public sector; a special report to Parliament in 1986[22] concluded that:

- there was a serious lack of executive support for internal audit;
- many organizations had either not established or adequately resourced an internal audit unit;
- the majority of organizations had not established audit committees;
- the greater proportion of internal audit staff did not possess the necessary skills to undertake effective reviews of computerized systems;
- inadequate attention had been given to the planning processes including prioritization and coverage of all auditable areas.

In 1987, the Victorian Government adopted a policy requiring the establishment of an adequate internal audit function within all public sector organizations. A major finding of the Fergus Ryan report[23] into the Victorian Economic Development Corporation (VEDC) was the failure by the internal auditors of the VEDC (a firm of chartered accountants) to provide a timely review and report on all major risk areas of the VEDC's activities.

In late 1988 the Victorian Treasurer issued a Ministerial Statement indicating that:

Internal audit is seen by the Government as a key management control which operates principally by keeping management informed regarding the adequacy of all other controls and systems.

In 1990 a further review was undertaken by the Victorian Auditor-General to determine the progress made by government departments in establishing internal audit units in accordance with government policy directives. The review indicated that progress in the implementation of viable internal audit units within government departments and branches had been very slow and that, in the larger departments, internal audit units were not in a position to provide sufficient coverage of major auditable areas. A summary of major findings of that review follows[20]:

- Since the previous review of internal audit in 1986, there has been limited improvement in the key areas of executive commitment, planning and level of expertise (paras 2.5.13).
- Substantial scope exists for internal audit services, including EDP, to be provided under contractual arrangements (paras 2.5.42 to 2.5.48).
- The Bureau of Internal Audit has not effectively carried out its responsibilities (paras 2.5.53 to 2.5.48).
- Unlike the position with statutory authorities, there has been limited use made of audit committees within government departments (paras 2.5.51 to 2.5.52).
- Internal audit strategies dealing with fraud prevention are not effective (paras 2.5.51 to 2.5.52).

In summary, although the importance of internal public sector auditing has been recognized at least since the early 1970s, there are still significant constraints in implementing an effective internal audit function within the public sector. These constraints include lack of executive and senior management commitment, limitation in scope, lack of

resources and suitable personnel and inadequate attention to planning processes and standards of quality.

Review of Several Current Challenges

Four current challenges are discussed in this section. First is the success or otherwise of performance auditing as practised. Second, the tension in wider scope auditing between "administrative effectiveness" and "policy"; third, a review of the recent ANAO[24] efficiency audit of programme evaluation and the identification of tensions between performance auditing and evaluation; and the last challenge is concerned with "who audits the Auditor-General?"

Performance Auditing in Practice

Since the 1979 amendments to the Audit Act concerning efficiency auditing, the Commonwealth audit office embarked on "performance auditing". There is over a decade of practice in this area.

Performance auditing as practised in Australia has been far from successful; Parliamentary reviews indicate several problems with practice. Also the academic literature indicates that there are still many disputed issues which have not been settled (see[25,26,27]). These findings are supported by an examination of overseas practice.

In summary, at the Commonwealth level as well as in various states, the organizational arrangements, the scope of audit activity and the reporting of audit findings in external public sector performance auditing is going through a period of significant redefinition and change.

Review of Policy Tensions

There is tension between the Auditor-General's (AG) "administrative effectiveness", which is the comparison between stated organizational objectives and outcomes of the administrative process. However, the new spate of legislation specifically excludes the AG from reviewing "policy".

For instance, in New South Wales in the proposed legislation the following appears[28]:

Special audit not to question policy

38D Nothing in this Division entitles the Auditor-General to question the merits of policy objectives of the Government including:

- (a) any policy objective of the Government contained in a record of a policy decision of Cabinet; and
- (b) a policy direction of a Minister; and
- (c) a policy statement in any Budget Paper or any other document evidencing a policy decision of the Cabinet or a Minister.

What the differences are between "policy statement" and "objectives" set by an organization are not clear.

Caiden[29], in writing for the RCAGA, stated that:

The word "policy" is used loosely to refer to what the Minister says, or what cabinet decides, or what one has always

been doing, or what one did yesterday, or what comes within guidelines, or whatever anyone wants it to mean. Both officials and politicians are prone to resort to oracular mystification by announcing that such and such a practice is "policy".

Because policy is not defined, this allows for an overriding authority of Ministers or officials to minimize interference from the AG, especially in matters associated with performance auditing.

For example, Theophanous[30] reports on a case in Victoria where the Chairman of the Economic & Budget Review Committee (EBRC) was of the view that the Auditor-General had reviewed government policy, rather than just commented on matters of inefficiency and waste. In a report on School Cleaning within the Ministry of Education, the Auditor-General suggested that the private sector could do it cheaper. The measure of inefficiency was the estimated saving that could be achieved if private sector cleaners were used. The critical point is that it is government policy that supports salaried school cleaners and should the AG have reported on this?

Tension between Evaluation and Performance Auditing

The recent ANAO major efficiency audit of programme evaluation[24] covered the implementation by the Department of Finance of programme evaluation across the Public Service, following specific government decisions in 1987 and 1988, and included an overview of the state of evaluation in six other portfolios.

The report notes that in most State Governments and a number of other countries, notably Canada, responsibility for the central co-ordination of evaluation was not given to the same agency responsible for resource allocation. The Commonwealth was the only case noted in the research where this occurred.

The most serious deficiency noted in Finance's administration was its unwillingness to attempt an evaluation of the evaluation strategy (i.e. an examination of the costs and benefits of evaluation across the service). ANAO believes this is at variance with the Government's directive that all programmes must be evaluated over a five-year timespan. To date little data has been collected on the degree to which all programmes have been covered by evaluation, or on any costs and benefits of even major evaluations.

The audit report made several recommendations aimed at improving agency management of evaluation, in particular:

- endorsement of evaluation policy by top management;
- monitoring, reporting and implementation by central units of agencies;
- standard setting and quality assurance at agency level;
- involvement of other Commonwealth bodies and the Department of the Prime Minister and Cabinet.

The ANAO audit report found there had perhaps been a focus on process evaluation, although the number of impact

evaluations, where the effect of programmes is assessed, was increasing. Also there had been a reluctance to attempt evaluation of policy and regulatory programmes.

Who Audits the AG?

One of the issues that recent Parliamentary interest has focused upon is: who audits the AG? In Victoria legislation gives the EBRC the role of recommending the appointment of an Auditor to conduct a performance audit of the Auditor-General[31]. This should not be confused with the "normal" appointment of an auditor, who in other jurisdictions is often appointed by the Government.

Chairman Theophanous[30] recently outlined several difficult questions which the committee must consider, such as the extent to which the Auditor should examine:

- the use of audit staff versus contracting by the Office of the Auditor-General;
- the resources allocated to performance auditors by the Auditor-General;
- the overall level of resources available to the Auditor-General.

Parliamentary committees are becoming involved in the selection of, and scope of, the peer review of the Auditor-Generals.

Summary and Implications

An overview has been attempted of the direction of change in public sector auditing developments and several challenges for public sector auditing in the 1990s are identified.

Four main areas were reviewed: first, an overview of audit failures in the 1980s; second, review of certain pressures for change; third, the recent changes in the organization, funding and scope of external public sector auditing. The fourth area was a review of the current state of play in external and internal public sector auditing.

From this review, the following implications are drawn:

- (1) In recent times auditing practices in the public and private sectors of the Australian economy have been criticized, reviewed and recommendations have been made to significantly change the nature, scope, funding, organization, staffing and professional arrangements for auditing.
- (2) Recently, there have been several Parliamentary and other reviews of public sector audit (external and internal) in Australia which have been critical of past performance, funding and organizational arrangements. Never before has "public sector auditing" been in such a "hot" spotlight.
- (3) The pressures for change and the resultant reformulation of public sector auditing in Australia cannot be viewed in isolation from other public sector "reforms". These "reforms" have been linked to the rise of a managerialist view of public administration. An issue at the heart of debates about reform has been "What is public sector performance?"

- (4) Performance auditing as practised in Australia has been far from successful and there are still many issues in dispute.
- (5) There are a variety of review mechanisms being used by the executive and Parliament and different institutional arrangements and professional groups are being called upon. Internal auditing in the public sector is being called upon to undertake "broader scope" audits[32].
- (6) Developments in public sector auditing are not only limited to Australia, they are also apparent in various overseas countries.

Despite the importance of the public sector auditing debate, practical progress in the area will be slow. It is easier to promote and practise a product that attests to the "truth and fairness" of financial information and forms an opinion on compliance, rather than a product that professes to provide an independent evaluation of a public sector manager's "performance". The latter involves the attributes of "good management", "effectiveness", "efficiency" and "value for money" in a highly unstable and politically charged environment.

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James Guthrie is in the School of Accounting, University of New South Wales, Australia.