

# **PUBLIC SECTOR AUDITING THE AUSTRALIAN EXPERIENCE:**

## **A Brief Overview of Audit Environment, Audit Process and Audit Methodology.**

### **Abstract:**

The objective of this article is to explain the operational structure, audit process and audit methodology in one of the State Audit Offices (SAO) in Australia. This article has been written based on the author's work experience with one of the State Audit offices in Australia. There is a widespread belief and perception that the public sector auditing function is a lethargic, inefficient and ineffective with compared to the corporate sector auditing functions. The author confirms the fact that the public sector auditing function in Australia is almost equally efficient and effective with compared to the corporate sector auditing carried out by the professional accounting firms. There are many reasons for these efficiency and effectiveness of public sector audit in Australia. All the public sector institutions in Australia apply the Australian Equivalent International Financial Reporting Standards (AEIFRS) and accrual accounting method in preparing and reporting the financial statements. All the State Audit offices in Australia have been fully computerised and conduct their audits using audit software packages. This article explains the public sector audit environment, audit process, audit methodology, scope of audit and audit reporting function of one of the State Audit Offices in Australia. The information contained in this research article is not confidential but general information attributable to one of the State Audit Offices in Australia.

### **1.0 Introduction**

Australia has three layers of public sector institutions. They are categorised as federal government, state government and local government institutions. The federal government institutions concentrate on federal government functions which have an overall interest about Australia. These government functions and institutions include defence, education, foreign service, international relations, finance, treasury, health and aboriginal affairs etc. In addition to this federal administration structure, Australia is administratively divided into eight states and territories. They are Queensland, New South Wales, Victoria, Tasmania, South Australia, Western Australia, Northern Territory and Australian Capital Territory. Each and every state or territory has its own elected government which has its own State Legislative Assembly or State Parliament. Each state government maintains its own state government departments and other institutions in order to carry out state government administrative functions. These state government institutions include state government departments such as education, health, emergency services, transport, police and primary industries etc. The federal government administration functions and legislative matters are centred on the Federal Parliament based in Canberra. Similarly, state government administrative functions are centred on the State Legislative Assembly or State Parliament. The public accountability in the federal government institutions are monitored by the Federal Auditor General's Office which is known as the Australian National Audit Office (ANAO). Similarly, each and every state and territory has its own public accountability mechanism. The state public sector accountability is monitored and reported to the State Parliament by the State Audit Office which is headed by the State Auditor-General. The State Audit Office's main functions are to complete annual financial audits and performance audits of the state government institutions and local government councils which are within the state administrative boundaries.

The author has completed a three year financial auditing service with one of the State Audit Offices in Australia. This research article was based on the author's personal experience as an Intermediate Auditor and Senior Auditor. As mentioned in the title of the article, the objectives of this research article are to explain the administration structure of the State Audit Office, audit environment, audit methodology, scope of the audit and audit reporting function.

### **2.0 Public Accountability and State Audit Function**

The Auditor General's office, powers, audit mandate, duties and functions are of paramount importance in the arena of public accountability in the Westminster style of governments. The basic features of this public accountability in the Westminster style of government are that the parliament is elected by the people. The elected members of the parliament are given the authority and power to implement the government policies and programmes for a certain period of time. As a measure of public accountability, all the government forecasted expenditure and revenue to be approved by the parliament as an annual

budget every year. Only after approval of the budget, the government programs and policies are implemented. Accordingly, the executive<sup>1</sup> is responsible to the parliament to prove the public accountability in relation to the government revenue and expenditure. This process has been identified as the financial stewardship process. This whole concept of the financial stewardship is embedded in the agency theory. The executives are the agents of the general public. Accordingly, they are trustees of the public resources. Therefore they have a responsibility of financial stewardship. In order to ensure the transparency and accountability, the Auditor-General as an Officer of the Parliament carries out the attest function of the financial statements of the government departments and agencies and reports to the Parliament. The above explained public accountability concept and mechanism has been summarised by McPee (2006, p.3) as follows:

The office of Auditor-General makes a key contribution to the system of public accountability, serving as the external auditor of the Executive Government with a duty to report directly to Parliament on the financial stewardship and the economy and efficiency of the operations of Commonwealth entities.

Ian McPhee is the current Federal Auditor-General of Australia and he refers to the government entities as the Commonwealth entities as he is responsible for the audit of Federal Government or Commonwealth entities.

Scanlen, (1998, p. 53) highlighted the importance of the principle of accountability and financial stewardship as follows:

The Financial and Administration and Audit Act 1977 is founded on the principle of accountability. Collectively this relies on the basic premise that the executive government is accountable to Parliament for the use of public funds and consequently that it accepts the responsibility to report to Parliament thereon. A third premise rests on the assurance provided by a fully independent Auditor-General on the executive governments's financial stewardship.

The public accountability and audit process has been explained by Funnell (2001, p. 159) as follows:

The importance with which public sector audit had come to be regarded in Australia by the beginning of the 20<sup>th</sup> century was clearly affirmed when, with their fourth piece of legislation, the office of the auditor-general was established by the new Federal Parliament in January 1901. Without a strong, independent audit function there can be no guarantee that other accountability measures will have any value. The close relationship of public sector auditors with parliamentary committees of public accounts has added to the constitutional importance of their work and given them a pre-eminent standing among other independent officers. Commonwealth audit derives its importance from the constitutional requirement that government must each year apply for funding from the parliament. Parliament, in return for the privilege which it bestows on governments-raising revenue and spending it on the purposes which they favour-demands that before each annual allocation of funding they be provided with evidence, in the form of audited accounts, that the income and spending of governments as expressed in the budget accords with the permission given by the parliament.

As a control mechanism, the government expenditure and revenue received to be audited by an independent officer of the parliament. This independent officer is the Auditor-General. The Auditor-General audits the financial statements of government agencies and consolidated financial statement (whole of government financial statements) of the government. After completion of the audit, the audit reports are tabled in the parliament by the Auditor-General. These Auditor-General's reports are reviewed by the Public Accounts Committee of the Parliament and recommends the corrective actions to be taken by the executive. This is a yearly cycle.

In order to fulfil state audit function duties and responsibilities, the Auditor-General carry out a programme of performance audits and financial audits. The objective of the performance audit is to report on the economy, efficiency and effectiveness of the usage of the government resources and implementation of the government policies by the executive. The performance audits or Value for Money (VFM) audits were commenced in Australia in the early 1980s. The performance audit has been thrived under the concept of New Public Management (NPM) or Managerialism approach to the public administration. The audit objective of the annual financial audit is to provide an assurance on the public sector financial reporting function. The Auditor-General expresses an audit opinion on the financial statements of the government entities under the financial audit.

The Auditor-General's duties and functions have been summarised by John Taylor, former Federal Auditor-General of Australia as follows (Taylor, 1976, p.147); providing expert, independent, public opinions on the

financial affairs of government and its bodies and the efficiency, economy and effectiveness with which government use the resources and power provided to them by taxpayers.

He has cleverly summarised the ultimate objectives of the government audit function in which he highlighted the objectives of the government financial audit and government performance audit function.

### **3.0 Management and Structure of the State**

#### **Audit Office (SAO)**

Auditor-General is the highest official in the State Audit Office and appointed by the State Legislative Assembly or State Parliament. His functions and reporting responsibilities are governed by the Financial Administration and Audit Act. Each and every state has its own Financial Administration and Audit Act. This legislation provides the Auditor-general's mandate and the financial management guidelines for the state government entities. As an officer of the State Legislative Assembly or State Parliament, The Auditor-General is directly reporting to the State Legislative Assembly or the State Parliament. In order to discharge his duties his periodic reports are submitted and tabled in the State Parliament. These reports are reviewed by the Public Accounts Committee (PAC) of the State Parliament and recommends remedial actions to executives of the state entities.

The Auditor-General is assisted by the Deputy Auditor-General and a few Assistant Auditors-General. All the audits of state owned entities are divided among these Assistant Auditors-General. In most occasions, the authority of the Auditor-General is delegated to the Assistant Auditors-General. They sign the audit opinions and audit certificates on behalf of the Auditor-General except for qualified audit opinions. The qualified audit opinions are signed by the Auditor-General. The majority of the audit work carried out by the State Audit office is financial audits. A small percentage of performance audits or value for money audits are carried out under the supervision of one Assistant Auditor-General.

In addition to the financial and performance audit divisions, the Audit Policy and Research Division operated under the Director of Audit. The Audit Policy and Research division's responsibility is to assist the financial audit and performance audit divisions on technical issues, upgrading the policies of the State Audit Office , providing training and development, carrying out research in to the current issues , liaisons with the State Treasury and other audit offices in Australia and development and upgrading of the audit methodologies.

### **4.0 Audit Methodology and Audit Approach**

The State Audit office is operated on a fully computerised audit environment by using the on-line audit databases. Each and every audit client has a separate electronic database. The field auditors and managers are provided with the lap top computers. Their work is always updated to the audit databases maintained at the head office. The current electronic audit software is identified as the IPSAM (Integrated Public Sector Audit Methodology). This audit software has been jointly developed and operated by two State Audit Offices in Australia. This audit software is fully focused towards the public sector entities and different from the audit software packages applied by the four large accounting firms.

The State Audit Office's audit year and audit cycle commences from 1 November and ending on 30 October of the following year. This audit cycle operates in line with the financial year and reporting requirements of the public sector entities. The financial year for most of the public sector entities commence on 1 July and ending on 30 June of the following year. The same financial year commencing from 1 July of the current year and ending on 30 June of the following year is applicable for Australian business entities as well because that is the taxation year for Australian taxation purposes. The audit reports and audit opinions for these public sector entities have to be finalised by 30 September of each year after the financial year ending on 30 June.

The audit cycle and audit operations consist of the following stages;

- Audit plan and the Client Service Plan
  - Interim audit and the interim audit report
  - Final audit report and the management letter to the client
  - Summary of the audit findings and results are tabled in the State Legislative Assembly or State Parliament.
- Before the interim audit starts, audit plan and Client Service Plan is prepared. Most of the information contained in this document is based on the previous year audit results. All the audit entities are rated by using an audit risk model. Similarly, all the major transaction cycles of the state entities are also rated

by using an audit risk model. The audit risk is categorised as the High Risk, Medium Risk and Low Risk. Accordingly, the State Audit Office's audit methodology is identified as the Risk Based Audit Methodology. The entity's audit process is divided in to major transaction cycles in order to record the audit risk, documentation and audit control purposes. These transaction cycles are classified as the Revenue and Receivables cycle, Expenditure and Payables cycle, Property, Plant and Equipment cycle, Cash/Bank balances and Investments, Equity and Equity related balances and Long Term Liabilities and Loan Balances. For each and every transaction cycle, the audit risk is established based on the prior year audit results. If the audit is a new audit, the evaluations of internal controls are completed to assess the audit risk of the audit cycle and overall entity audit risk. This establishment of the audit risk and audit methodology is based on the ISA 200.20-.23 (Objectives and General Principles Governing an Audit of Financial Statements). Upon completion of the audit risk evaluation, internal control testing plan and substantive testing plan is developed.

The major component of the audit plan or Client Service Plan (CSP) is the audit budget and staff engagement plan. An audit fee is charged from the client based on the audit budget. In the audit plan or Client Service Plan, the planned audit activities are listed with the budgeted hours and the staff allocations. The engagement leader for the audit of state government departments is the Assistant Auditor-General (AAG). The Assistant Auditor-General is assisted by the Audit Manager. The other audit staffs assigned to major audits are the Audit Principle, Audit Seniors and other field auditors. Each and every audit staff member has a charge out rate which is approved periodically by the State Government. Based on the charge out rates and budgeted hours, the final audit fee is determined and communicated to the client. The audit fee is always competitive with the professional accounting firms.

At the interim stage of the audit, the internal controls of the transaction cycles are tested and evaluated. Based on this interim audit testing process, the extent of the final substantive testing process is decided. The planned audit approach given in the audit plan is confirmed or revised after the interim audit. The management letter on the interim audit is delivered to the client by 30 April of the current financial year. The interim audit or internal control testing process is conducted before the financial year end. After this process, after the financial year end, substantive testing process is carried out. After receiving the financial statements from the client, the financial statement balances are verified. After completion of this process, the final audit report is signed. The general deadline for final audit reports signing date is on 30 September. After completion of all the audit steps, the final management letter is sent out to the client for remedial actions. The annual financial audits are done as continuous audits for the state government departments and other large state owned entities. The final balances of the financial statements are verified after the financial year end.

## **5.0 Strengths of the State Audit Office's Audit Methodology, Approach and Process**

The audit work is scientifically planned and carried out. A maximum effort is taken to keep pace with the fast changing audit methodologies and processes. As mentioned earlier, audit technology is developed by the Audit Policy and Research Division. There is not much difference between the audit theory given in the latest auditing standards or auditing guidelines and the methodology applied by the State Audit Office. Most of the audit documents and audit evidence are stored in electronic data bases. The hard copy audit evidence documents are also filed but at a minimum level. The client information and testing documents such as payment summaries can be directly transmitted to the lap top computers of the field auditors. The Computer Assisted Audit Techniques (CAATS) such as statistical sampling packages are integrated with the field audit work. The audit methodology applied by the State Audit offices in Australia is far ahead of the audit methodologies applied by the audit offices in countries such as Sri Lanka and Papua New Guinea.

The other strength is the timeliness of the audit reports. The audit reporting period is well planned and deadline driven. The other strengths that I have observed is good professional training is provided to the graduate auditors and other auditors who want to improve their skills. The audit career of junior auditors of the State Audit Office commence as graduate auditors. As the name implies, the graduate auditors hold a bachelor's degree in accounting or related field. The majority of the operational audit staff (more than 90%) holds the membership of the Institute of Chartered Accountants in Australia (ICAA) or CPA Australia. The audit work carried out by the junior auditors are well reviewed and properly monitored. The audit fees charged from the clients are competitive with the private accounting firms. The other major strength of the State Audit Office is that the Auditor-General is fearlessly trying to guard his independence. However the politicians are trying to control his powers through the restrictions on budget allocations and performance

reviews of the State Audit offices. Overall, the audit reports tabled by the Auditor-General of the State Audit office are regarded highly by the parliamentarians, general public and press. The audit recommendations are implemented as soon as possible. The politicians can not interfere with the Auditor-General's recommendations.

### **6.0 Weaknesses of the State Audit Office's Audit Methodology, Approach and Process**

The advantages mentioned above could also be described as possible weaknesses in the State Audit Office's audit process and approach. The professional judgement is not always applied. The audit process and methodology is highly theoretical and even difficult to understand by the professional accountants. All the audits are time budget driven, well articulated with the current audit technology. Accordingly, the audit staff may not always have the required skills to grasp the audit methodology in order to apply to the practical field problems. I have noted that the audit program and stages are completed mechanically just to finish the audit on timely basis. In auditing the professional judgement is the most important skill. This skill has been taken over by the computer. The other weakness is the audit checking and verifications are completed by using the sampling methods. The selection of the sample may not always represent the high risk audit transaction cycles. This would prevent the detection of possible frauds and irregularities.

### **7.0 Conclusion**

The State Audit Office's major task is to complete the financial audits and performance audits (value for money audits) in order to meet the statutory requirements. These audits are done on timely basis. The Auditor-General submits the audit opinions and material issues which his staff has detected during the audit process to the State Legislative Assembly or State Parliament. The audit function and audit methodology are scientifically planned and carried out. The audit process is fully computerised. The audit methodology, timeliness and effectiveness and efficiency of State Audit Offices in Australia are far ahead with compared to the countries like Sri Lanka and Papua New Guinea. The quality of the audit process and audit outputs (audit reports) are very high.

Since the audit function has been scientifically carried out, it focuses more towards the mechanical process of the audit methodologies in which the professional judgement is not always applied. This could be a drawback as this approach may not always detect the high risk government expenditure transactions. In some occasions, the audit methodology and processes are given the high priority than that of the public expectations. The audit function of the State Audit Office operates almost in line with or competitive with the large accounting firms to achieve the effectiveness and efficiency in the audit and assurance services.

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(Footnote)

The executives have been identified as the members of the governing party of the State Parliament and heads of government organisations. The government organisations include government departments, statutory bodies and government owned companies and corporations.

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