Strategic Review of the Queensland Audit Office

March 2017

2016 Strategic Review of the Queensland Audit Office

6 March 2017

The Honourable Annastacia Palaszczuk MP
Premier and Minister for the Arts
1 William Street
BRISBANE QLD 4000

Dear Premier

I am pleased to report on the 2016 Strategic Review of the Queensland Audit Office. The Review has been undertaken in accordance with the Auditor-General Act 2009 and the Terms of Reference approved by the Governor in Council.

Our overall conclusion is that the Queensland Audit Office is fundamentally sound, and that it is a valuable part of the Queensland public sector. The Report includes five strategic recommendations and a number of operational recommendations, all set out in Part 3, which we draw to your attention.

My colleague, Graham Carpenter, and I are grateful for the assistance that we have received in carrying out the Review, both from the Queensland Audit Office and from officers of your Department. We are grateful also to the audit clients and other stakeholders who made themselves available to meet us and to provide input to the Review.

Yours faithfully

Phillippa Smith
Lead Reviewer

Glossary

AASB	Australian Accounting Standards Board
AuASB	Auditing and Assurance Standards Board
ACAG	Australasian Council of Auditors-General
The Act	Auditor-General Act 2009
ANAO	Australian National Audit Office
APES	Australian Professional and Ethical Standard
ASAE	Auditing Standard Assurance Engagement
ASPIRE	Auditing Systems by Planning Implementation Reporting and Evaluation
ASA	Auditing Standard Australia
AuASB	Auditing and Assurance Standards Board (Australia)
CA	Chartered Accountant
CCC	Crime and Corruption Commission of Queensland
COSO	Committee of Sponsoring Organisations of the Treadway Committee (May 2013)
CPI	Consumer Price Index
EQCR	Engagement Quality Control Review
FTE	Full Time Equivalent
INTOSAI	International Organisation of Supreme Audit Institutions
GOC	Government Owned Corporation
IPSAM	Integrated Public Sector Audit Methodology
IS	Information Systems
ISC	Information Steering Committee of the Queensland Audit Office
ISSAI	International Standard of Supreme Audit Institutions
MPs	Members of Parliament
PMS Audit	Performance Management Systems Audit
QA	Quality Assurance
QAO	Queensland Audit Office
SAI	Supreme Audit Institution
SAS	Specialist Audit Services division in the QAO
1997 Review	The 1997 Strategic Review of the Queensland Audit Office undertaken by Mr Tom Sheridan
2004 Review	The 2004 Strategic Review of the Queensland Audit Office undertaken by Mr Henry Smerdon and Mr Richard Anderson
2010 Review	The 2010 Strategic Review of the Queensland Audit Office undertaken by Mr Graham Carpenter and Mr Mark Gray

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1 Introduction

1.1 The Queensland Audit Office

The Queensland Audit Office is the auditor of the Queensland public sector. It is established under the Auditor-General Act 2009 ("the Act"). The Act prescribes the Auditor-General's functions and powers. The primary functions are to carry out financial statement audits and performance audits of the entities that comprise the Queensland public sector.

In the year to 30 June 2016, the QAO had revenue and expenditure of about $44.5 million. That revenue included $37 million from audit fees. Its workforce comprised 199[1] employees (equivalent to 191.5 fulltime staff), and resources from 23 audit firms. In that year, the QAO issued 435 financial statement audit opinions, and presented seven reports on those audits to Parliament. It also reported the results of 13 performance audits to Parliament.[2]

As auditor of the public sector, the QAO is independent, to the extent that the Auditor-General is not subject to direction by any person about:

a) the way in which the Auditor-General's powers in relation to audit are to be exercised; or

b) the priority to be given to audit matters.[3]

1.2 Strategic review

The Act requires a strategic review of the QAO every five years that must include:

a) a review of the auditor-general's functions; and

b) a review of the auditor-general's performance of the functions to assess whether they are being performed economically, effectively and efficiently.[4]

The strategic review is part of the QAO's own accountability to Parliament and the public.

The terms of reference for this Strategic Review are set out in Appendix 1. They detail the matters to be addressed in the review of the Auditor-General's functions and the performance of those functions. They require a particular focus on performance audit, a function that the QAO has assumed since the last strategic review in 2010. The expansion of the Auditor-General's mandate to include full performance audits was the major strategic issue covered by the 2010 Review. Most of the other recommendations of that review concerned matters in the nature of "building blocks" that would enhance the performance of the office. (The main recommendations of the 2010 Review, and the actions taken in response to them, are set out in Appendix 5.)

[1] Including both permanent staff and contracted in staff.

[2] Figures taken from QAO's Annual Report 2015–16. Further information about the Auditor-General, the powers of the Auditor-General, the QAO and its operations is set out in the Auditor-General Act 2009 and at www.qao.qld.gov.au.

[3] Auditor-General Act 2009, section 8.

[4] Auditor-General Act 2009, section 68.

In our view, the QAO is fundamentally sound. It is valued by Parliament, and its relationships with its other stakeholders are mostly good. It is operating economically and efficiently, and in accordance with its legislation. The measures recommended in 2010 are now largely in place. It is pleasing that few of the issues discussed by the reviewers in 2010 have come to our attention in 2016. The QAO has made good progress in many of those areas since 2010 and, in addition, has made impressive progress in other areas, particularly in the increased application of data analysis to its audit work.

However, we are less certain that the QAO is operating as effectively as it might. As this is a "strategic review", we have made that question our primary focus.

The effect that the QAO seeks is: "Better public services; World-class audit". We have tried to assess whether the QAO is achieving that outcome, and to identify any impediments to its doing so. Our major recommendations are directed to that end.

We have identified three strategic issues that we consider are impediments to the QAO's achievement of its vision, and of full effectiveness. We consider that:

- the QAO is under-resourced for both financial and performance auditing, but for different reasons;
- the QAO's relationships with some of its clients need to be improved, particularly but not only in relation to performance audits;
- the QAO cannot employ all the staff that it needs because, under current legislative settings, the Auditor-General cannot offer adequate remuneration to attract and retain audit staff.

We believe that these issues are inter-related, as we discuss in Part 2. Our recommendations on both strategic and operational matters are collected in Part 3. The balance of the report covers in greater detail the work of the QAO, its systems and processes, and provides the context for our conclusions and recommendations.

1.2.1 A note on terminology

The Act requires a review of the Auditor-General's functions. However, the Terms of Reference refer mainly to the QAO rather than to the Auditor-General. We have used "QAO" in this report, unless the context requires Auditor-General.

We have used "client" to refer to the public sector entities audited by the Auditor-General, rather than the technical term "auditee". We noted throughout the course of the review that both the QAO and the entities themselves almost invariably use "client".

1.2.2 Process for the Review

We, Phillippa Smith (Lead Reviewer) and Graham Carpenter, were appointed to carry out the Review by the Governor in Council on 26 July 2016, and we commenced work on it at the end of August 2016. Appendix 3 contains brief biographical notes about us. Given our respective experience, Phillippa Smith took primary responsibility for review of the QAO's performance auditing, and Graham Carpenter for the review of its financial auditing (and for writing Part 4 of this report).

During September and October:

- we conducted 41 interviews with various of the QAO's stakeholders, in Brisbane, Cairns, Gladstone and Sunshine Coast, including 30 audit clients (Appendix 4 is a list of the external stakeholders with whom we met);
- we had a range of meetings with the QAO's senior managers, collectively and individually. Those meetings included the former Auditor-General, Mr Andrew Greaves and the Deputy Auditor-General, Mr Anthony Close, who then became Acting Auditor-General;
- we met with five groups of QAO staff and one individual staff member who had responded to our invitation to contribute to the Review;
- we met seven former employees of the QAO, each individually, and received written submissions from four others, each of whom had responded to our invitation to contribute to the Review sent to employees who had left the QAO since 1 July 2011.
- the Lead Reviewer attended a meeting of representatives of departments who were or had been subject to performance audits by the QAO, convened by the Department of Premier and Cabinet in its role of coordinating relationships between the executive government and the QAO;
- we reviewed an extensive range of documents provided by the QAO;
- we sought and received answers to a range of questions from four other audit offices (the ANAO, New South Wales, Western Australia and New Zealand);
- we selected and reviewed files of financial audits and performance audits – those files are listed in the relevant parts of this report.

1.2.3 Consultation

The Act requires us to consult the Minister (in this case the Premier) and the Auditor-General on our "proposed report".[5] If we receive any comments from either the Minister or the Auditor-General, we are further required to consider and incorporate agreed amendments in our report to dispose of the comments, or to include the comments in full.

During the course of the Review, Mr Greaves resigned as Auditor-General to become Auditor-General of Victoria. The period that the Review covers includes his entire term as Auditor-General of Queensland so we considered it necessary to consult Mr Greaves on our draft report as a person with a special interest in the report.

Consultation with Mr Greaves had to occur before we submitted the proposed report for consultation under the Act, as we would not otherwise have been able to take account of any comments that he made.[6]

Consultation with Mr Greaves took place in late December and early January. We gave the QAO a copy of the draft report at the same time. Mr Greaves and the QAO jointly provided helpful comments on that draft in early January.

[5] Auditor-General Act 2009, section 70.

[6] Auditor-General Act 2009, section 70(5).

The proposed report was given to the Premier and the Acting Auditor-General as required by the Act on 27 January 2017. The Acting Auditor-General commented on the proposed report on 20 February 2017. His letter is included in this report as Appendix 7. In addition, the QAO suggested some minor but useful amendments and corrections, all of which we have incorporated into the report or otherwise resolved.

1.2.4 Thanks

We are very grateful for the co-operation that we have received from all concerned with this Review. The QAO's senior management have given us every assistance. They had prepared extensive documentation for the Review, so that we lost no time in getting under way, and they met all of our subsequent requests promptly. We thank the Department of Premier and Cabinet which has provided administrative support for the Review. Above all, we extend our thanks to those who made time to speak to us. Every meeting gave us something slightly different. Thanks to that co-operation, we have confidence that we have, as far as possible in the time available, identified the full range of issues that this Review should address.

2 Strategic issues

2.1 The role of an audit office

The purpose of an audit office is to give parliament and the public independent assurance about the performance of public entities. The primary tool is audit of each public entity's reports on its financial performance. In many jurisdictions, the audit office will also audit other aspects of the entity's performance.

An auditor must be independent of the entity that it audits, if the assurance it gives is to have credibility. In the case of a public audit office, independence is best achieved by making the audit office answerable to the Parliament, so that it is properly independent of executive government. The Parliament uses the reports of the office in scrutinising the performance of, and particularly expenditure by, the executive arm of government.

The assurance given by an audit office is valuable. In a jurisdiction such as Queensland, it meets the public's expectation that public entities are accountable. But assurance is not an end in itself. A mature audit office seeks to improve the performance of the public sector that it audits, by advice and assistance, to the extent compatible with its independence. The objective is a high-performing public sector which earns the trust of the public, as trust in government is a basic requirement for a functioning democracy.

The International Organisation of Supreme Audit Institutions,[7] in the preamble to its standard on value and benefits, says:

> "Public sector auditing … is an important factor in making a difference to the lives of citizens. The auditing of government and public sector entities by SAIs[1] has a positive impact on trust in society because it focuses the minds of the custodians of public resources on how well they use those resources. Such awareness supports desirable values and underpins accountability mechanisms, which in turn leads to improved decisions. Once SAIs' audit results have been made public, citizens are able to hold the custodians of public resources accountable. In this way, SAIs promote the efficiency, accountability, effectiveness and transparency of public administration. An independent, effective and credible SAI is therefore an essential component in a democratic system where accountability, transparency and integrity are indispensable parts of a stable democracy."[8]

The United Nations, in a resolution of the General Assembly promoting the strengthening of supreme audit institutions, also recognised "the important role of supreme audit institutions in promoting the efficiency, accountability, effectiveness and transparency of public administration".[9]

While INTOSAI and the United Nations are concerned with supreme audit institutions (national audit offices), the principles apply equally to a sub-national audit office such as the QAO.

7 A supreme audit institution (SAI) is a national audit office.

8 INTOSAI, *ISSAI 12: The Value and Benefit of Supreme Audit Institutions – making a difference to the lives of citizens*, www.issai.org

9 United Nations General Assembly Resolution A/66/209 (December 2014).

2.2 Aspirations of the QAO

The Act requires us to review the Auditor-General's functions, and to assess whether they are being performed economically, effectively and efficiently. The assessment of effectiveness requires addressing the question of purpose and the outcomes that the QAO achieves. To do so, we turned to the QAO's articulation of its objectives, as set out in its strategic plan.[10]

The QAO defines its purpose as "Independent assurance – Unique insights", and its vision as "Better public services – World-class audit". The vision statement is amplified by the three objectives listed in the strategic plan:

- "Our clients use the information we provide to improve accountability and performance;
- Our services are trusted and valued as independent, authoritative and timely;
- Our people are developed to be the best in their field and are supported by efficient and effective operations."

Given the role of an audit office described above, this vision and purpose, though aspirational, are unexceptional. (Nor are they inconsistent with those of other Australian audit offices.)

We note a change in the QAO's vision statements over the period since 2010 with a sharpening of the focus on improving the performance of the public sector.

Because this is a strategic review, while addressing the terms of reference, we have tried to assess whether the QAO is now positioned to reach its goals of improving the performance of the Queensland public sector and providing world-class audit, and to identify any issues that might impede its doing so.

2.3 Achieving the QAO's vision

We have identified three strategic issues that we consider are impediments to the QAO's achievement of its vision – in essence, they concern its relationships, its resourcing, and the current legislative settings for the Auditor-General. We consider that:

- the QAO's relationships with some of its audit clients need to be improved, particularly in relation to performance audits, but also on occasion in relation to financial audits;
- the QAO is under-resourced for financial audits, both because of vacancies it cannot fill and because of its continuing reductions in its audit fee budget;
- the QAO is effectively under-resourced for performance auditing because the performance audit team lacks "critical mass";
- the QAO cannot employ all the staff that it needs because under current legislative settings, the Auditor-General cannot offer adequate remuneration to attract and retain audit staff.

We consider that these issues are to some extent inter-related. In short: the client relationship issues appear to be caused in part by under-resourcing, and the QAO's ability to remedy the under-resourcing is limited by the requirement that it comply with public service employment provisions.

[10] QAO *Strategic Plan 2016–2020*, www.qao.qld.gov.au

The QAO is aware of and trying to address these issues, but the remedies are not always within its control.

2.3.1 Relationships with audit clients

There is evidence, from QAO's surveys of its clients and from our interviews with a range of audit clients, that QAO's relationships with its clients are not always good. We want to emphasise that, although relationships range from very good to poor, the QAO's client satisfaction survey results and our own interviews suggest that more are good than are bad. The client satisfaction surveys rate the audit services provided by the QAO. For the year ended 30 June 2016, the survey showed a rating of 78 index points for overall satisfaction with financial audit services and 77 index points for overall satisfaction with performance audit services.

Nevertheless, some of the clients to whom we spoke, while saying that they have a good relationship with the QAO, raised various problems that we believe the QAO should now address. If the sorts of problems raised with us (both real and perceived) are not addressed, they will have a corrosive effect on the reputation of the QAO. In essence, we are recommending that the QAO address the concerns of the minority who do not give positive ratings when surveyed.

Good relationships between the QAO and its clients are essential. The QAO will be able to improve the performance of the public sector, and achieve its goal of world-class audit, only if its relationships with the entities that it audits are based on mutual trust and openness. If they are not, clients will be less willing to disclose information to the QAO, or to accept its advice and recommendations.

It is worth commenting at this point on the term "client". An auditor must be independent of the entity that it audits, so the auditor is not subject to the client's direction. The extent to which an auditor can assist and advise the client is limited, lest it results in the auditor auditing his or her own work. Further, an audit office has extensive statutory powers, and can coerce its clients. So, although the QAO (like many other audit offices and auditors) refers to its "clients", the term must be understood with those qualifications. A more neutral term is "auditee", but we saw little evidence of its use in the Queensland public sector or in the QAO, so we have used "client".

Financial audit clients told us about problems such as:

- disagreements with the QAO over its approach to asset valuations;
- audit staff onsite unwilling or unable to make decisions, but not easily able to escalate issues to their offsite managers, apparently because of the managers' workload;
- an unwillingness on the part of audit teams to refer clients to examples of good practice;
- delays when contract auditors are unable to get timely advice from the QAO, for example on technical issues; and
- "surprises" and a lack of timeliness, as difficult issues arise at the last minute when the audit director reviews the file.

All of these affect the efficiency of the audit and increase the demands on the client.

The relationship with clients in relation to performance audits differs from the financial audit relationship. A financial audit happens annually, and entities' finance teams generally know what to expect. They are likely to have contact with the audit team during the year, and for big audits contact will be continual. In contrast, a performance audit is one-off. Even where a department is subject to regular performance audits, it is almost certain that each will affect a quite different part of the department, so that the experience will be new to the departmental staff concerned.

Clients' problems arising from performance audits included:

- a lack of understanding by the audit team of the client's business and the context in which it operated;
- the QAO's unwillingness to negotiate the timing of the audit;
- apparently unreasonable requests for information, often with a short response time;
- the QAO's failure to consider the cost of implementation of recommendations.

A constant theme in our discussions with QAO clients for both financial and performance audits was the cost of the audit to the client. This was not particularly a comment on audit fees – clients do not pay for performance audits and, as we comment in Part 4, we heard little complaint about fees for financial audits. Rather, clients referred to their expenditure of time and energy on the audit process, and especially on performance audits. The essence of the complaint was the QAO's failure to understand the cost of audit to the client. Smaller clients also talked about the "cost of accountability": pointing out that the aggregated costs of external audit, internal audit and an audit and risk committee are a considerable expense for a small entity.

The complaint about cost was exacerbated by two other issues: the clients' impression that the QAO did not understand the needs of the client in relation to the audit, and their perception that the QAO was unwilling to give advice, for example on good practice, and so "add value" to the audit.

The consequence for such clients is a sense of resentment, in the context of which the auditor's requests (eg, for financial transaction data for analysis) seem unreasonable. One of our interviewees described the relationship with the QAO as "too much take and no give" (on the part of the QAO). Another objected to the verb "require" – complaining that the QAO always "requires" what it wants.

Taken one by one, the matters identified may appear minor – and we acknowledge again that they are not the invariable experience. However, cumulatively, they create an impression that the QAO's focus is on completing its own work, rather than on providing value to its clients. That impression, should it become widespread, would seriously undermine the QAO's reputation and its relationships with its clients.

We believe that it is important that the QAO now address the sorts of issues that have been raised with us. As we noted in Part 1, the QAO has made good progress in improving its efficiency. That has necessarily required an internal focus. Now is the time for the QAO to increase its external focus – and we acknowledge that that work is already under way.

We believe that poor relationships can be improved, largely with better understanding by the QAO of the client's point of view and better and, in the case of performance audits, earlier engagement between the QAO and client. We discuss the matter further in Part 4 (financial audits) and Part 5 (performance audits).

In particular, we believe that it is important for the Auditor-General and Deputy Auditor-General to lead the QAO's engagement with its clients, and we recommend that they institute a schedule of visits to clients so that the Auditor-General or the Deputy Auditor-General meets the Director-General or chief executive of each major client each year.

The QAO already has a Stakeholder Engagement Strategy in place that provides for relationships between the QAO and clients at various levels. However, the Strategy says that the focus of the Auditor-General and Deputy Auditor-General is on the relationship with Parliament and parliamentary committees. We agree that the parliamentary relationship is of great importance, but we believe that the Auditor-General's and Deputy Auditor-General's relationship role should be expanded to include Directors-General and chief executives.

2.3.2 Resources

We have come to the view that a contributing cause to the relationship issue is under-resourcing of the QAO, and we believe that this issue should be addressed first.

The QAO has been on a path of continuous development since 2010. Major changes have been:

- the enactment and implementation of a full performance audit mandate;
- a reduction in staff numbers (mainly audit support) by over 20%, from 245 full-time equivalent staff at 30 June 2010 to 191.5 at 31 June 2016;
- the amendment of the Act in 2011 to permit the Auditor-General to exempt small and low risk public sector entities from audit by the Auditor-General, with a consequent elimination of a number of small audits;
- introduction of new methodologies for both financial audit and performance audit;
- an increase in efficiency, so that audit fees have remained stable or decreased – the QAO reports a decrease of 16.5% in the average cost of a financial audit opinion since 2011 for those entities that were in existence in 2011; we calculate a reduction in aggregate audit fees of over 1.1% per annum in real terms over the last seven years;
- in comparison with the other Australian audit offices, QAO productivity for both financial and performance audits is now above the average.

We commend the QAO for responding to the need "to do more with less" and acknowledge that efficient use of public resources is of great importance. However, we have come to the conclusion that the QAO has reached the point where some of its efficiencies are counter-productive. We base this view on the productivity data and other information, including the results of the *Working for Queensland* staff survey, provided to us by the QAO, and on our interviews with both clients and staff. We have recommended that the QAO review its audit fee budget for 2016–17 and its drive for further efficiencies.

We have described above the various problems perceived by financial audit clients, such as turnover in audit teams and the apparent difficulty junior audit staff onsite have in obtaining timely input from their managers, and the consequent impact on the efficiency of the audit. We heard such complaints often enough that, when they are coupled with the information we received from QAO's management and staff, we consider that there is evidence that the QAO lacks sufficient resources to perform at peak efficiency and effectiveness.

The clients we talked to often assumed that the issues they raised were caused by the QAO's shortage of staff. More worryingly, several clients attributed problems with their audits to what they perceived as QAO's inability to pay market rates to staff and (they supposed) its consequential employment of second-rate staff.

We do not accept that proposition. Nor do we necessarily accept some clients' unfavourable comparisons of QAO staff with private sector auditors. A public sector audit differs from a private sector audit in its added focus on probity and waste. Clients acknowledge that QAO staff stand out in their demonstration of public sector values of integrity and impartiality, and in their attention to those concerns that are peculiar to the public sector. Many QAO staff choose to work for the QAO precisely because of the difference between private and public sectors.

Nevertheless, the existence of these opinions underlines the urgent need for the QAO to address the issues identified.

Worrying evidence of under-resourcing comes from staff survey results. QAO employees take part in the annual public service *Working for Queensland* survey. In 2016, 74% of QAO staff participated. Half of those employees reported that they felt overloaded with work, 37% said they felt "burned out" by their work, and 32% reported an issue or significant issue with the negative impact of workload on their health. The results put the QAO in the bottom 20% of the Queensland public sector for those questions. The survey data in 2015 raised the same issues. The QAO took steps to address them, but with limited effect, as the 2016 results are significantly worse on these questions.[11] The survey results are consistent with views expressed to us in our meetings with staff.

We acknowledge that there will always be pressure on resources during peak periods for financial audits. Audit directors and managers have responsibility for numbers of audits, so cannot attend immediately to every issue. Junior staff learn by taking on responsibility in the absence of their seniors. However, junior staff told us that they want to have better access to their supervisors and managers. They want to be challenged, but they also want more on-the-job training. It is understandable that junior staff are cautious about making commitments or offering advice to a client without reference to their managers, but a consequence is the various complaints we heard from clients.

2.3.3 Performance audit

In the case of performance audits, a high percentage of performance audit staff time is allocated to audits, giving limited flexibility for training, illness, staff departures and so on. One consequence is pressure on performance audit staff. Another is cost and, to an extent, time overruns on audits. The audit teams are small, usually three people, which we think is appropriate for the size of the audits that the QAO carries out. However, the team size can reduce if a delay means that one or more of the team must move on to another audit.

Staff talked to us about the pressures of trying to meet what they regard as ambitious timeframes. The senior performance audit staff commented that, because of the small teams, a manager works as a team member and a director as an audit manager, with a consequent loss of strategic perspective that an audit director is expected to bring to an audit.

We discuss the QAO's carrying out of its performance audit function in Part 5. The conclusion that we reach is that funding for performance audits should be significantly increased – preferably doubled. In brief, the rationale for an increase is that it would enable the QAO:

- to establish a performance audit group that has "critical mass";
- to have greater flexibility to engage earlier and better with its performance audit clients;

11 This issue is discussed further in Part 6.

- to have a wider range of skills and experience within the performance audit group;
- to engage expert resource for audits and to increase sector expertise among its staff;
- to deliver a wider range of assurance on the performance of Queensland public sector agencies.

An increased budget would of course also enable the QAO to address pressures on its current staff.

2.3.4 The QAO's ability to recruit, retain and remunerate staff fairly

The QAO is well aware of the pressures on its staff and the need to fill vacancies, and is trying to do so. However, it is constrained by the legislation it operates under.

The QAO is a public service office for the purposes of the Public Service Act 2008 and a department for the purposes of the Financial Accountability Act 2009. Section 56 of the Auditor-General Act provides that the Auditor-General may set audit fee rates only with the Treasurer's approval. In effect, the legislative framework treats the QAO as if it were part of the executive and subject to government control.

The consequence is that Auditor-General's ability to employ the staff that the QAO requires and to determine their remuneration and conditions of employment is constrained. This concern has been raised in the strategic reviews of the QAO in 1997, 2004 and 2010, each time with a recommendation that the Auditor-General be given the flexibility to determine the remuneration for QAO staff. This Review makes similar recommendations.

The QAO needs to fill senior staff vacancies, mainly in its financial audits group. As for any organisation, it can either recruit externally or promote from within. The QAO has a "continuous recruitment process" in place, meaning that it is continually on the lookout for suitable candidates. The impediment to employing suitable candidates is often the remuneration it can offer.

Promotion from within is probably the more desirable option – it gives staff a career path, and it gives the QAO a cadre of senior employees who know the public sector and public sector audit and who are dedicated to the organisation. Promotion from within the organisation is particularly desirable for performance audit as there is no real market for performance auditors to recruit from, apart from other audit offices.

We consider that there are two impediments to filling senior vacancies by promotion. The first is, again, the level of remuneration that the QAO can offer. There are vacancies at director level, but there is little incentive for audit managers to seek promotion. The remuneration increase is small and the manager loses the ability to accrue "time off in lieu" to compensate for excess hours worked, yet takes on increased responsibility.

The second is that preparing staff for promotion to senior positions requires careful and tailored mentoring and training by managers. When managers and staff are stretched, that more informal sort of training and development is likely to suffer.

The QAO has done what it can to find some flexibility within the constraints of the Public Service Act. It has a few senior staff on contracts under section 122 of the Public Service Act, which enables the payment of remuneration higher than the public sector scale. With the assistance of the Public Service Commission, it has worked to obtain an attraction and retention incentive scheme for sector director positions (senior officer level), which will enable an improved remuneration level for those positions.

We discuss this issue further in Part 6. Our recommendation there is that the Auditor-General be enabled to employ staff under the Auditor-General Act, rather than under the Public Service Act.

2.3.5 Independence of the Auditor-General

The terms of reference for this Review cover aspects of the independence of the Auditor-General. The Finance and Administration Committee had commenced an inquiry into "the legislative arrangements assuring the Auditor-General's independence", but declined to comment on its inquiry so that this Review could proceed. The implication is that this Review should cover the matters that were covered by the Committee's terms of reference.

We address those matters in Part 8 of this report, with reference to the generally accepted INTOSAI independence principles.[12] The conclusion that we reach is that the current legislative framework is not appropriate for an audit office in a mature democracy.

We refer to the Auditor-General's independence at this point because the lack of flexibility in the employment of staff, as well as being a major business issue, is a practical example of the consequences that flow from the QAO's being part of the public service. A further example is the Auditor-General's inability to set basic rates for audit fees without the Treasurer's approval, also discussed in Part 8.

The accepted view (outside of the QAO) appears to be that the Queensland Auditor-General has "independence in practice", and that is sufficient protection. We acknowledge that we have found few other practical consequences of the Auditor-General's lack of independence from the executive, and none as serious as the employment matter. In our view, however, independence in practice is not sufficient. We consider that the Auditor-General's independence should have an appropriate legislative basis.

2.3.6 Recommendations

We have made five "strategic" recommendations that concern the issues that we have discussed in this Part of the Report – relationships, resourcing and independence. They are set out in the next Part.

[12] INTOSAI (November, 2007) *ISSAI 10 – Mexico Declaration on Independence*.

3 Summary of recommendations

3.1 Strategic recommendations

4.3 (iv) We recommend that, because client engagement should be led by the Auditor-General and Deputy Auditor-General, the QAO institute an annual programme of visits so that either the Auditor-General or the Deputy Auditor-General meets the Director-General or chief executive of each major client each year.

5.7 (v) We recommend that the QAO's funding for performance audits be doubled to give the QAO:

- greater flexibility to engage earlier and better with its performance audit clients;
- more scope to engage expert resource for audits and to increase sector expertise among its staff; and
- the capacity to deliver a wider range of assurance on the performance of Queensland public sector agencies.

6.3 (i) We recommend that, given:

- the results of the Working for Queensland survey in 2016 which indicate that an unacceptably high number of its staff consider that their workload is having a negative effect on their health; and
- additional audit requirements for 2016–17;

the QAO undertake a review of the 2016–17 fees budget for financial audit services for financial audits:

- to determine whether it is realistic;
- to ensure that it can maintain audit quality; and
- to consider optimal resourcing for the 2016–17 audits, including the mix of QAO staff, contracted-in staff and contract auditors.

6.3 (ii) We recommend that the Auditor-General Act 2009 be amended:

- to provide for the Auditor-General's employment of QAO staff under that Act rather than under the Public Service Act;
- to give the Auditor-General the authority to employ the staff necessary to carry out the Auditor-General's functions; and
- to enable the Auditor-General to determine the remuneration and other terms and conditions of employment of QAO staff.

8.6 (i) We recommend that:

- the Auditor-General become an independent Officer of Parliament;
- the Auditor-General's independence be strengthened in line with the suggestions made by the QAO in its submission to the Finance and Administration Committee's inquiry into "the legislative arrangements assuring the Auditor-General's independence; and
- subsections 56(3) and 56(4) of the Auditor-General Act be repealed.

3.2 Operational recommendations

Part 4 – Financial auditing

Views of audit clients

We recommend that:

4.3 (i) The Better Practice resource for *Valuing public infrastructure*, once formally issued, be subject to review by the end of 2017 to assess feedback from stakeholders, including audit clients, as to its application and usefulness.

4.3 (ii) The QAO continue to produce Better Practice resources to benefit the Queensland public sector and continue to look for ways to enhance the use of those resources by its clients.

4.3 (iii) The QAO review its practice of requiring hard copy signed financial statements from regional audit clients and accept electronic copies to ensure timeliness in the finalisation of the audit. We recommend that, if necessary, the Act be amended to allow the Auditor-General to accept electronic copies of signed statements.

Review of audit files

We recommend that:

4.4 (i) The QAO adopt a policy that handwritten notes on IPSAM files be phased out and that notes be in digital format to enable ease of reading by other audit staff and for review purposes.

Small and low risk audits

4.6 (i) We recommend that the QAO specifically assess the exemptions of Hospital and Health related foundations to determine whether the assessment of small and low risk continues to apply.

Audit analytics

We recommend that:

4.8 (i) The QAO closely monitor the results of the implementation of audit analytics taking place within the QAO to identify the costs and benefits of audit analytics in the delivery of audit services both for financial audits and for performance audits.

4.8 (ii) Formal reviews of the audit analytics programme be undertaken by the QAO following the audits for each of the next three financial years to assess the benefits arising from the use of audit analytics compared to the cost of same, including costs directly incurred by audit clients.

4.8 (iii) Actions continue to be taken to ensure that contract auditor firms will be able to integrate audit analytics into their audit methodology in providing audit services for the QAO.

4.8 (iv) The QAO consult with the Chief Information Officers at the Department of Science, Information Technology and Innovation, Department of Premier and Cabinet and Queensland Treasury to determine the viability of a data centre arrangement for the secure repository of whole of government data including financial data and, once it is established, the QAO cease to provide services to audit clients in regard to the access to data and the provision of reporting tools such as Qlikview dashboards to audit clients.

QAO auditing standards

We recommend that:

4.10 (i) The QAO Auditing Standards be revised to incorporate a section setting out the criteria on which the Auditor-General may determine which Queensland public sector entities will be subject to Australian Auditing Standard ASA701 *Communicating Key Audit Matters*.

4.10 (ii) The QAO Auditing Standards be amended to require a review of and, if necessary, revision of the Standards at least once every three years.

Funding and fees

4.12 (i) We recommend that the QAO undertake a review of the additional audit requirements for 2016–17 including:

- those related to new accounting standards, especially the expansion of audit effort required for audit of related party disclosures;
- the impact of the roll out of audit analytics including transition costs;
- the time required related to audit clients for whom key audit matters are expected to be incorporated within the audit opinions;

to determine whether the overall fee budget for financial audit services for audit clients is realistic, also taking account of the results of the *Working for Queensland* survey.

Part 5 – Performance auditing

Auditing standards

5.4 (i) We recommend that the Auditor-General amend the *Auditor-General of Queensland Auditing Standards* to incorporate guidance on the requirement that the Auditor-General refrain from commenting on the merits of government policy.

Performance audit methodology

5.4 (ii) We recommend that the QAO include in its performance audit methodology guidance on the restriction on questioning the merits of government policy.

Performance audits compared to methodology

5.4 (iii) We recommend that the QAO phase out the inclusion of handwritten notes on ASPIRE files and that notes be in digital format to enable ease of reading by other audit staff and for review purposes.

Efficiency and effectiveness of the QAO's performance audits

We recommend that:

5.5 (i) The QAO reduce to 98% its performance measure target for "performance audit recommendations implemented".

5.5 (ii) The QAO continue to work with the Finance and Administration Committee and the Parliament to improve its communication and engagement with MPs on its performance audit reports.

Opportunities for improvement

We recommend that:

5.7 (i) In 2017, the QAO select three audits planned to start in 2018 and explore opportunities for early engagement with the entities to be audited to:

- identify what value the client expects from the audit;
- consider the scope, audit objectives and timing of the audit; and
- assist the client in commencing planning and resourcing for the audit.

5.7 (ii) The QAO include as part of any follow-up audit, assessment of the cost of implementing the recommendations made in the original audit.

5.7 (iii) The QAO include in its performance audit methodology a requirement that the client be asked for an estimate of the cost of implementing proposed recommendations.

5.7 (iv) In 2019, the QAO review the efficiency and effectiveness of the operation of the steps proposed in recommendation 5.7(i).

Strategic audit planning

We recommend that:

5.8 (i) In its refinement of its criteria for selecting performance audit topics, the QAO consider whether there is adequate emphasis on improving public sector performance.

5.8 (ii) The QAO consider whether it can improve the economy of its strategic audit planning process, perhaps by increasing focus on improvement of public sector performance.

5.8 (iii) The QAO consider scheduling a performance management systems audit of a GOC or GOCs.

5.8 (iv) The QAO's strategic audit plan prepared under section 38A of the Auditor-General Act 2009 be required to be reported to the Legislative Assembly.

Part 6 – Workload trends and pressures

Resource pressures

See Strategic recommendations

Part 7 – Corporate matters

Matters that impact on the economy, efficiency and effectiveness of the QAO

We recommend that:

7.10 (i) The Auditor-General Act 2009 be reviewed to identify provisions that are outdated and that impact on the efficiency and effectiveness of the QAO, and steps be taken to seek amendment of the Act.

7.10 (ii) Consideration be given to including in the Act a provision requiring regular review of its provisions.

Part 8 – Independence

See strategic recommendations

4 Financial auditing in the Queensland public sector

4.1 Background

The long history of the QAO is based heavily on financial auditing. While the QAO's mandate has extended into performance auditing, the bulk of the audit effort for the QAO is in undertaking financial audits.

Over the years, in line with developments in auditing generally, the nature of financial auditing has developed. The QAO did have a controller role for much of its history which included pre-vetting of payments schedules intended to be made (in those days primarily by cheque). That is now in the past as the audit focus moved to risk-based auditing using a systems and controls based approach to auditing.

Times do change and move on. This section includes discussion on the development of audit analytics which represents potentially the most significant development and change to the approach to financial auditing in the Queensland public sector in recent years. The QAO is at the forefront of applying within the audit process analytical techniques drawn from the total financial transactions of audit clients.

It is important to recognise that, given the likely further developments in technology and financial/banking arrangements in the future, this change in approach to auditing of financial transactions puts the QAO in a strong position to meet those developments. Just as we have seen the emergence of direct bank transfer (and the demise of approaches such as cash payments, including for salary and wages, and also a significant reduction in number of transactions by cheque), there is strong evidence that the commercial and financial system including banking will be subject to more changes in the future.

In June 2015, the World Economic Forum on The Future of Financial Services considered "How disruptive innovations are reshaping the way financial services are structured, provisioned and consumed".

Their report noted six core functions of financial services which are expected to be impacted by rapid change: Payments, Insurance, Market Provisioning, Deposits and Lending, Investment management and Capital Raising. All those functions occur in the Queensland Public Sector. The Forum sees further developments in Streamlined Payments, Integrated Billing and in Next Generation Security.

Three of the important themes identified in the World Economic Forum Report of relevance to the public sector and the QAO, relate to automation of high-value activities, reduced intermediation and the strategic role of data including what is referred to as big data.

The actions taken by the QAO to move into audit analytics provides the office with an emerging capability that will serve the office well as these developments inevitably emerge.

4.2 Financial auditing in the Queensland Audit Office

4.2.1 Structure of this Part

This section of the report covers the following matters:

- Financial audits – views of stakeholders
- Financial audits – review of audit files
- Sector reports
- Internal control assessments
- Information systems audits
- Audit analytics
- Auditing standards developments
- QAO auditing standards
- Accounting and reporting standards
- Funding and fees
- Reporting to Parliament – sector reports.

In order to fulfil its responsibilities for financial audits across Queensland, including in regional Queensland, the QAO uses staff directly employed by the office and also contracts with private sector firms to provide audit services. Those contracted providers are referred to in this report as contract auditors, the term used in the Act. We note in the QAO's annual report for 2015–16 that it has moved to describe those providers as audit service providers

4.2.2 Work performed

In reviewing the performance of the QAO with regard to the economy, efficiency and effectiveness of the financial auditing mandate, we have sought to assess this by:

- seeking views of audit clients
- considering the stakeholder feedback to the QAO
- reviewing selected audit files
- reviewing Information Technology audits
- assessing the quality of the QAO's audit methodology
- considering the QAO's responsiveness to changing standards both for auditing and assurance and for accounting and reporting, and
- assessing the quality of Sector Reports to Parliament.

We have also considered the question of audit fees for financial audit work and noted the significant real reduction in overall audit fees charged. We have, however, noted concerns related to work load within the QAO and its impact on the health and wellbeing of the QAO staff.

We note that the QAO has introduced a new performance measure to be more transparent about audit quality. The measure is the percentage error for financial statement material error and relates to material errors in previous year financial statements. The published target for the QAO as reported in the Service Delivery Statement is to be below 5% error rate. The QAO has set an internal target of being below 1%. The reported rate for 2015–16 is 3.3%. The QAO has adopted this measure as part of its balanced scorecard to aim for a higher standard. This measure highlights the need for the QAO to actively manage its financial audit quality and to use the information about its performance to inform internal improvement activities.

We also have noted the development of audit analytics which promises to deliver further benefits in financial auditing for Queensland public sector entities.

4.2.3 Conclusion

We are of the view that the Auditor-General has achieved a high level of performance in fulfilling the financial auditing mandate of the QAO in terms of economy, efficiency and effectiveness.

We commend the Auditor-General for adopting and publishing for the first time a measure related to financial statement material error.

4.3 Financial audits – views of stakeholders

4.3.1 Background

In undertaking this strategic review, we met with a selection of audit clients across the state and received feedback on the audit processes including concerns of audit clients.

We have also considered the feedback that the QAO gathers in surveys of Members of Parliament and of its audit clients.

One of the concerns expressed by audit clients related to the challenges associated with the valuation of infrastructure. We heard strongly held views on this topic which appeared to impact negatively on the relationship between the audit clients and the QAO. To be fair though, we also received many positive comments on the relationship with the QAO with a number commending QAO staff on their willingness to work issues through.

4.3.2 Views of Members of Parliament

The QAO reports to Parliament on its financial audit work in sector reports, discussed in section 4.13.

The QAO asks Members of Parliament for their views on its performance. It aims to survey Members twice in each parliamentary term. In 2016, 37 out of 89 MPs responded to the survey.

The survey assesses MPs' satisfaction with the Auditor-General's services and reports to Parliament, and MPs' views on the effectiveness of the service and reports. In 2016, the overall satisfaction and effectiveness score was 71 index points, compared to 76 index points in the previous survey in 2014.

We comment further on the survey of MPs in section 4.13.

4.3.3 Views of financial audit clients

Each year, the QAO seeks the views of its financial audit clients on the financial audit services it provides to them. The surveys are carried out by an independent company, ORIMA Research, on behalf of ACAG. Because the survey uses a common set of questions, it allows comparison across the Australian audit offices. The survey questions concern the conduct and reporting of the audit. It asks the clients to assess the quality of the audit and the audit process, and the value to it of the QAO's financial audit services.

The financial audit clients generally rate those services highly. The overall performance index score for 2016–17 (for the results available to December 2016), is 78.8 index points – a slight increase over the score of 78.4 index points for the comparable client group in 2015–16. The QAO's target is 80 index points, which it has yet to reach.

The overall performance score has increased year by year, from 72 index points in 2011-12 to 78 index points in 2015–16. In recent years, clients have assessed the value of the audit services more highly than the audit process or the reporting of the audit.

We note that we have not seen the scores for the other Australian audit offices, so we cannot comment on how the QAO compares with its peers.

4.3.4 Views of financial audit clients on asset valuation

Audit clients expressed concerns related to the processes of valuation of infrastructure assets. Some held the view that the QAO prefers asset valuations to be prepared by an external asset valuation firm rather than asset valuations being prepared by internal resources even where such qualified and experienced staff are available. As indicated by some audit clients, the perception is that QAO is looking for an external asset valuation "brand" to rely upon. Those audit clients have the view that the QAO does not look in the "black box" of valuation where an external firm has been employed but delves very deeply into the approach, methodology and processes for determining fair value where the valuation is undertaken internally.

In discussions with staff in the QAO we were advised that this is not the case – the QAO hold the view that whether the valuation is internally developed and determined or whether an external asset valuation firm is used, the methodology is subject to assessment equally between those two different means of undertaking a valuation.

There was also concern on choice of approach in some areas, such as whether the use of "greenfields" or "brownfields" valuation methodology was the most appropriate. We have been advised by the QAO that ACAG has raised this issue with the AASB although we note that, as at December 2016, this issue is not included on the Work Program of the AASB.

In another case, the valuation of assets for regulatory processes was not deemed appropriate by the QAO for audit purposes, with the QAO requiring an additional valuation to be undertaken for accounting and reporting purposes at an additional cost to the audit client. That audit client indicated also that it had not been possible to determine the reason why it was not acceptable for accounting/auditing purposes.

Costs of determining appropriate asset valuations for accounting/reporting is significant for many audit clients. The asset valuation approach should, in our view, be able to be undertaken internally where there is capable asset management/valuation expertise internally, without a perception that this is not going to be acceptable to the QAO. Audit clients must however accept that the QAO has a responsibility to ensure that the valuations are soundly based and in accordance with Accounting Standards. We have been assured by the QAO that external valuations are subject to audit at the same standard as the valuation methodology and processes used through an internal process.

We are of the view that a better understanding of the expectations of the QAO in terms of asset valuation for infrastructure is required. It appears that misunderstanding of the QAO's views and approaches is having a negative impact on the relationship with audit clients.

During our review, we were advised that a Better Practice resource, *Valuing public infrastructure* was under development by the QAO. We commend the QAO for developing this Better Practice resource and trust that this will be of benefit to both QAO auditors and audit clients in the processes of valuation. We have been advised that the draft Better Practice resource will be available for peer and expert review in December 2016. Following further testing in early 2017 with a range of stakeholders including audit clients and contract auditors, it is intended to be formally launched in March 2017. As with any area of complexity such as infrastructure asset valuation, there would be benefit in giving stakeholders including audit clients the opportunity to comment on the Better Practice resource following utilisation for the current financial year to allow for further feedback and updating if required.

Recommendation

4.3(i) We recommend that the Better Practice resource for *Valuing public infrastructure*, once formally issued, be subject to review by the end of 2017 to assess feedback from stakeholders, including audit clients, as to its application and usefulness.

4.3.5 Better Practice resources and other internal control advice generally

Better Practice resources

We expect that the Better Practice resource on valuing public infrastructure will be welcomed by audit clients.

Clients are also keen to receive the benefit of the experience that is gained by the QAO from undertaking audits for a wide range of public sector entities across the state.

The following resources have been issued in recent years:

- performance reviews;
- leading accountability – governance;
- managing machinery of government changes;
- fraud and corruption self-assessment tool;
- risk management maturity model;
- service logic model.

We note that some of these resources have been issued following a performance audit and are designed to share knowledge and learnings gained as part of undertaking the performance audit.

We see benefits for the public sector from the QAO sharing the knowledge and learnings it gains from undertaking both financial and performance audits through the issue of Better Practice resources. It makes better use of work that the QAO has already carried out, and is consistent with the QAO's focus on improving the performance of the public sector.

We note the argument that providing advice on better practice can create an independence risk – the risk that the auditor then reviews its own work. However, we do not consider that the QAO's Better Practice resources cross that boundary. The QAO makes available resources that a public entity can use or not as it chooses, which does not change the public entity's responsibility for its own operations.

We note that these resources are developed using funds from appropriation and accordingly are designed for whole of the public sector use. In Part 5, we recommend an increase in the appropriation, to enhance the QAO's performance audit work. Such an increase would enable the QAO to put more resource into developing and rolling out its Better Practice resources, to the benefit of the Queensland public sector.

Internal control advice

Several audit clients we met with were keen to receive advice on controls with a view to further improving the control environment. Some had the impression that the audit team members did not have the time to provide this type of information and were constrained by their budget for the audit. We comment elsewhere in this report on the issue of audit budget constraints.

While it is not the role of the auditor to offer detailed advice on the internal controls of an audit client because of the need for independence, audit staff are in a unique position to identify control elements which could assist audit clients more widely. We note that the QAO identifies and communicates internal control weaknesses and monitors those weaknesses. In the audit process, there are recommendations included for consideration by management of the audit client which is monitored by the QAO.

We were advised by audit clients that reductions in their so-called back office staff have presented challenges in terms of financial management controls in their agency. The focus of both the current and previous Queensland governments is on frontline staff and service delivery. We were told of challenges for staff who interact with the QAO both in terms of availability to respond to requests for information from the QAO and in ensuring appropriate actions on matters raised in audit reports. This places pressure on the agency at times of work pressures, including end of year financial reporting.

One recent issue of direct concern to all audit clients relates to frauds committed in Queensland public sector entities – most notably in local government entities. These received extensive media coverage. The frauds being committed related to invoicing fraud including inactive vendors being changed to active, changes to bank account details, changes to vendor contact details and changes to vendor payment terms.

The QAO identified immediate actions required to be taken and ensured this was communicated to all public sector entities. The response of the QAO in addition to internal actions to inform internal staff and contract auditors was:

- email to all Chief Financial Officers regardless of size of entity;
- briefings to audit committees;
- discussions with Queensland Shared Service agency;
- September 2016 *Insights* article.

This type of quick response to a critical issue of break down in controls has been welcomed by audit clients and in particular by those in a governance role, including audit committees.

An important initiative of the QAO in recent years relates to encouragement in simplifying financial statements, especially the volume and usefulness of notes forming part of the financial statements. Many Departments and other public sector entities have successfully reduced the overall size of financial statements which provides positive benefits in terms of readability of financial statements.

Conclusions

The ability of the QAO to assist audit clients with the development of Better Practice resources is welcomed. This has the benefit of enhancing the relationship between auditor and audit client, and should lead to improvement in the performance of the Queensland public sector.

The responsiveness of the QAO to the recent fraud activity in providing advice on controls is to be commended.

> **Recommendation**
>
> 4.3(ii) We recommend that the QAO continue to produce Better Practice resources to benefit the Queensland public sector, and continue to look for ways to enhance the use of those resources by its clients.

4.3.6 Views of regional audit clients with respect to timeliness in finalising the audit

Some regional audit clients expressed concerns that the QAO requires an original signed copy of the financial statements to be sent to Brisbane before the finalisation of the audit process and prior to the provision of the signed audit opinion.

The view expressed was that this is an outdated practice in times of widespread use of digital information and should be changed, as it potentially has an impact on timing for regional audit clients and regional contract auditors. An example of a local government in the channel country of North Queensland was given to us by a contract auditor, where the practice directly impacted on the timing of finalisation and signing of the audit opinion.

The view of the QAO is that the independent audit report is issued on the receipt of scanned signed copies. The QAO awaits the receipt of final original signed copy for finalisation, with the final hard copy being included in the audit client's annual report.

While there appears to be some confusion on this issue, there is nonetheless a perception on the part of regionally based audit clients that they are disadvantaged under present arrangements.

We have been advised by the QAO that a project is under way to improve secure information sharing between the QAO and clients including Parliament using digital rights management.

Conclusion

We conclude that there would be benefits, including in terms of relationships, if there could be actions taken such that waiting for a hard copy of signed financial statements was not seen as impacting on timeliness of finalising an audit and in providing an audit opinion.

We have been advised by the QAO that in order to achieve this there would be a need for a change in legislation.

Recommendation

4.3(iii) We recommend that the QAO review its practice of requiring hard copy signed financial statements from regional audit clients and accept electronic copies of signed statements to ensure timeliness in the finalisation of the audit. We recommend that, if necessary, the Auditor-General Act 2009 be amended to allow the Auditor-General to accept electronic copies of signed statements.

4.3.7 Timeliness of advice

One regionally-based audit client expressed concern as to timing of receiving advice related to accounting treatment. We were advised that the contract auditor firm advised a position but it needed to be referred to QAO in Brisbane. There apparently was a delay before a view was obtained from QAO which was critical from the viewpoint of the audit client.

Whilst this appeared to be an isolated case, there remains a need where there is urgency with commercial negotiations to ensure a timely audit response to accounting treatment queries.

4.3.8 Changeover of auditors

Overall, audit clients were happy that the contract auditor was not being changed over too frequently. There were however some examples where there had been turnover. Audit clients' preference is to have some stability, with a preference for an internal QAO team or contract audit firm for five years.

4.3.9 Audit fees

During our meetings with audit clients we were advised that, for most, their audit fees had declined in recent years. In some instances, audit clients indicated that although the audit fee may not have increased, the internal costs of accountability for audit clients has been increasing significantly, including for some regulatory costs and also costs such as for internal audit/audit committees. Some audit clients also referred to internal costs required in obtaining asset valuations, including the cost of engaging external firms where internal valuation capability was available.

Whilst some would like to see further reductions in audit fees, the general view of our interviewees was that the audit fee was fair.

4.3.10 Meeting with Auditor-General or Deputy Auditor-General

Audit clients recognise that the QAO has audit responsibilities spread right across the state. Nonetheless, some audit clients would like to have the chance to meet personally with the Auditor-General or the Deputy and believe this should be by those individuals travelling more, including to rural and regional Queensland.

We have been advised that, normally in July of each year, the Auditor-General and the Deputy Auditor-General undertake a regional client visit with a view to demonstrating a regional focus and to hear directly from those audit clients of issues facing rural and regional audit clients. We note this did not take place in 2016, although the Deputy Auditor-General with Sector Directors visited regional Queensland to discuss the results of client satisfaction surveys, obtain direct client input into the project to refresh the parliamentary reports, and build stronger audit client engagement. QAO has indicated an intention of holding a regional visit to North West Queensland in 2017.

We consider that client visits should become a greater part of the role of the Auditor-General and Deputy Auditor-General. We have said in Part 2 that we believe there is a need for the QAO to improve client relationships, and that engagement with clients is best led by the Auditor-General and Deputy. We recommend annual meetings between the Auditor-General or the Deputy and Directors-General and chief executives of each major client. We consider that such meetings will be an important part of building stronger relationships.

Recommendation

4.3(iv) We recommend that, because client engagement should be led by the Auditor-General and the Deputy Auditor-General, the QAO institute an annual programme of visits so that either the Auditor-General or the Deputy Auditor-General meets the Director-General or chief executive of each major client each year.

4.3.11 Understanding of the client's business

One concern raised by a number of audit clients was that the QAO do not understand their business. This is a challenge for any audit firm who, depending upon the size of the audit client, may only be working within the audit client for interim and end of year audit purposes for a few weeks each year. We have been advised that developments in the methodology for financial audits within QAO are such as to allow for more information to be collated within the system both on the audit client and the industry or business within which they operate.

Care is however needed on the part of the QAO to ensure the relevance of the information collected and how that may be used when interacting with audit clients.

4.4 Financial audits – review of audit files

4.4.1 Background

As part of the Strategic Review, we identified six financial audit files for review. These reviews were of audits that had been undertaken using the IPSAM audit methodology and accordingly were all undertaken by staff employed within the Queensland Audit Office.

These files were chosen to enable a review of a range of organisations from different sectors. In some cases, these audit clients were chosen following concerns or issues raised during meetings as part of our stakeholder consultation process.

In undertaking the reviews, specific attention was paid to the use of audit analytics as part of the financial audit process.

4.4.2 Our review of files

We reviewed the following files:

- Department:
  - Department of Transport and Main Roads (2015/16)
- Government-owned corporations:
  - Ergon Energy Limited (2015/16)
  - Port of Gladstone Limited (2015/16)
- Hospital and health service:
  - Children's Health Queensland (Hospital and Health Service) (2015/16)
- Local government:
  - Cairns Regional Council (2014/15)
- Shared service providers:
  - Queensland Shared Service ASAE Assurance Report on Controls (15/16) (Departmental)
  - Sparq (15/16) (Shared Service Provider to Energex and Ergon)
- University:
  - Queensland University of Technology (2015 Calendar Year)

In our reviews, we noted strong compliance with the IPSAM audit methodology including quality review requirements.

We did identify some examples where the record keeping could be improved within IPSAM files. These issues have been discussed with senior management at the QAO. This included some instances of hand-written notes within the audit files which were very difficult to read. We noted the same issue with some of the performance audit files. None of these matters impacted on the quality of the audit undertaken or the findings of those audits. We note that senior management are aware of this issue and actions to improve housekeeping of files are being taken.

4.4.3 IPSAM methodology

We note that the use of IPSAM methodology on a Lotus database has provided a sound audit methodology for use by auditors of financial reports within the Queensland Audit Office since being developed some 12 years ago. QAO has a project under way which has the aim of ensuring the financial audit methodology remains at best practice in meeting the needs of the office.

The project will consider the most appropriate audit methodology including automated working papers for the office. This revision includes consideration of how automated auditing techniques such as audit analytics can be incorporated into the methodology and work practices.

4.4.4 Quality review of financial audits undertaken by Queensland Audit Office

The Auditing Standards for the QAO include a requirement to comply with Quality Assurance Standards.

These include:

- *ASQC 1 Quality Control for Firms that Perform Audits and Review of Financial Reports and Other Financial Information, Other Assurance Engagements and Related Services Engagements.*
- *ASA 220 Quality Control for an Audit of a Financial Report and Other Historical Financial Information*
- *APES 320 Quality Control for Firms.*
- *APES 325 Risk Management for Firms*.

A review was undertaken by QAO's Internal Audit on Audit Quality Management for the QAO. The report was issued in February 2016.

That review noted that considerable effort has been invested by the QAO into quality assurance framework and practices in 2014 and 2015. We see the use of open file (hot) reviews as positive and consider that it has strengthened the overall quality assurance framework.

Issues identified from those reviews have been considered by the QAO with actions identified under consideration in the review of the financial audit methodology, including making changes to IPSAM.

4.4.5 Audit engagement letters

During our review, it appeared that a new audit engagement letter is provided to an audit client only when there is a change of both the Chair and the Chief Executive Officer of an audit client. We understand, however, that QAO audit policy is that a change in senior management and/or those charged with governance may require the issue of a new engagement letter. We endorse this policy especially as there will be instances of a new Chair or Chief Executive Officer coming to the position without having had the QAO as their auditor in the past, so that there is benefit in the QAO establishing a relationship with them early in their term of appointment.

4.4.6 Conclusions

Our review of IPSAM files provided us with assurance that there is generally a high standard of compliance with the methodology.

We noted some examples where there were opportunities for improvements in what we would refer to as housekeeping matters associated with the IPSAM files. While none of these matters impacted on the quality of the audit being undertaken, the inclusion of very limited and difficult to read notes of important meetings, including entry and exit interviews is not appropriate for the QAO.

We noted concerns of a number of audit clients with matters relating to asset accounting and reporting including valuations. There appears to be room to provide greater clarity on the expectations of the QAO with the aim of assisting audit clients. We note the intention to issue a Better Practice resource on Asset Valuations.

We believe there are benefits in having a new audit engagement letter in all cases of a new Chair or a new CEO being appointed to an audit client.

Recommendation

4.4(i) We recommend that the QAO adopt a policy that handwritten notes on IPSAM files be phased out and that notes be in digital format to enable ease of reading by other audit staff and for review purposes.

4.5 Internal control assessments

4.5.1 Background

During 2014–15 financial year, the QAO introduced an initiative focusing on an assessment of the controls in place by audit clients to ensure that these controls are suitably designed to prevent and correct a material misstatement.

The Committee of Sponsoring Organisations of the Treadway Commission (COSO) framework identifies five elements of internal control as follows:

1 Control environment

2 Risk assessment process

3 Monitoring of controls

4 Control activity

5 Communication

The three areas of attention are:

1 control design and implementation

2 year-end close process

3 quality of draft financial statements

Within those three areas of attention, a rating system has been designed to measure how the audit client has performed against the COSO framework with a rating of:

- Effective Green
- Generally effective Amber
- Ineffective Red

4.5.2 What do the results of audit assessment seek to achieve?

This assessment process appears to be designed to raise standards for a range of matters under the COSO internal control framework and is to be commended. It is also seeking to drive improved performance related to year-end close processes. As an example, the Under Treasurer in January 2014 recommended a number of strategies to enable timely completion of financial statements at year end by:

- finalising non-current asset valuations by 31 March;
- preparing complete pro forma financial statements by 30 April;
- resolving accounting issues by 30 April;
- completing hard or soft close processes;
- concluding all asset stocktakes by 30 June.

4.5.3 Views of audit clients

Feedback from audit clients is that the internal controls assessments are a tough mark given that under Control Design and Implementation, one deficiency (even if treated as not significant) will mean an amber light assessment. Also, a green light on Quality of Draft Financial Statements will not be achieved if there is an adjustment to one of three key financial statement components.

4.5.4 Conclusion

From the perspective of audit clients, it does appear to be a very high standard to be achieved.

Nonetheless we support the processes designed to improve the quality of internal control and the timeliness and quality of financial statements.

4.6 Small and low risk audits

4.6.1 Background

One of the recommendations from the 2010 Review was that the Act be amended to allow the Auditor-General to dispense with the audit of small size/low risk public sector entities, with such entities being required to engage an appropriately qualified auditor and to provide a copy of the audited financial statements (including the audit report) to the Auditor-General as soon as practicable after completion.[13]

4.6.2 Legislative change

The Act was amended in 2011 to include a new Section 30A as follows:

Section 30A Exemption of public sector entities from audit by auditor-general under s 30

(1) The auditor-general may, by written notice given to a public sector entity, exempt the public sector entity from audit by the auditor-general for a financial year under section 30.

(2) The auditor-general may grant the exemption only if the auditor-general is reasonably satisfied that the audit of the public sector entity for the financial year is small in size and of low risk having regard to a general standard mentioned in section 58(1)(a)(iii).

(3) If the auditor-general grants the exemption, the public sector entity must engage an appropriately qualified person to audit the public sector entity for the financial year.

4.6.3 Amendment to the Auditor-General of Queensland Auditing Standards

In September 2012, the Auditing Standards were amended to incorporate a section on "Criteria for identifying whether audits of public sector entities are small in size and low risk".

These incorporate a "small in size" criterion which is based on an assessment of revenue and consolidated gross assets thresholds established in Section 45A of the Corporations Act 2001 in relation to small proprietary companies.

The assessment of "low risk" is made by considering a list of factors including:

- nature of the entity, its business and the industry in which it operates;
- stability of the entity structure and its key management personnel;
- complexity of the entity's financial systems and the appropriateness of internal controls;
- financial stability of the entity;
- extent of significant issues previously identified.

13 Strategic Review 2010 Recommendation 16(ix).

4.6.4 Experience

During 2012–13, 40 entities were offered exemption of which 24 immediately accepted the exemption. In later years, a further four entities accepted the exemption, making a total of 28 entities which are exempt from audit by the QAO but are required to arrange for an auditor to be appointed.

The 2010 Review had identified a potentially larger group of entities for exemption being 134 possible entities which might qualify. Included in this number were a number of small water boards which at the time were subject to industry reforms and while small were not considered to be low risk.

The QAO has indicated that the main reason why a number of small/low risk entities did not take up the offer of exemption was because they were happy with the current services provided by the QAO.

Included amongst the exempted entities are a number of Queensland Hospital or Health Foundations and a health-related research organisation.

We were informed that the Minister for Health in 2014 wrote to the QAO expressing concerns over the exemption of Hospital Foundations. The QAO, when reviewing exemptions which are given to cover a period of three years but need to be assessed annually, will be considering the Minister's concerns in the next risk assessments.

4.6.5 Conclusions

As is required, after each exemption period and if circumstances have changed or if there are issues with the quality of the audit being performed, the QAO will review the assessment of small and low risk status for each of the exempted entities.

We recommend that, given a concern being expressed related to hospital foundations/research entities being exempt from audit by the QAO, an assessment of that exemption be specifically undertaken at the time of next assessment of those audit clients.

Recommendation

4.6(i) We recommend that the QAO specifically assess the exemptions of Hospital and Health related Foundations to determine whether the assessment of small and low risk continues to apply.

4.7 Information systems audits

4.7.1 Background

The QAO has an information systems (IS) risk audit group headed by an experienced director. This group provides a range of IS audit services with a budget for this audit work incorporated into the overall fee budget for relevant audit clients. The IS audit service cost is charged to the audit client as part of the fee for QAO financial audit services or for performance audits, directly against the cost of the performance audit the cost of which is met from appropriations.

4.7.2 Methodology

The IS risk audit group uses the QAO Information Systems Audit Methodology which has recently been reviewed and refreshed. This methodology draws heavily on the Information Systems Audit and Control Association standards and guidelines and the COSO framework.

There is a set of main product lines for information systems audit within the financial audit:

- understand and document the IT environment and related internal controls;
- develop an information systems audit strategy for the financial audit;
- audit the design and implementation and/or operating effectiveness of IT general controls;
- audit and design and implementation and/or operating effectiveness of application controls;
- undertake assurance reports on controls at service organisation (ASAE 3402) engagements where a client is also a service organisation and there is a separate methodology for these types of engagements.

4.7.3 IS Risk Audit Group

The group operates on a user pays basis and internally charges other parts of the QAO for services provided. In the case of financial audits and ASAE 3402 audits, the charges are directly included in the fees to financial statement audit clients.

The group consists of a director and staffing of 6.6 FTE. In addition, if specialist IS audit expertise is required, those costs are charged to the relevant audit client or to another area of QAO such as costs directly related to a performance audit assignment.

4.7.4 ASAE 3402 audits

In undertaking this Strategic Review, a review of the IPSAM files for Queensland Shared Services and Sparq was undertaken. Further information is provided in the section on financial audits using IPSAM.

Overall the files were well documented and in accordance with the relevant standards and methodology. The reports outlining the control environment including any deficiencies were well supported within the files.

4.7.5 Changing nature of information systems in the public sector

It goes without saying that the impact of information systems on the public sector will continue to evolve. In addition, the ways of interacting with the banking system and also between and with providers of goods and services to the public sector will continue to change and develop. It is also likely that the way that consumers of goods and services from the public sector interact and transact with the government agencies will continue to be impacted with developments in technology which should provide benefits for the consumers and for government agencies.

The requirement for information systems to support these developments will also take advantage of technology enhancements which, while providing some challenges from a control perspective, will also provide benefits including in the audit thereof.

Included among these developments, from an audit viewpoint, is the use of audit analytics in the audit process. Information related to the audit analytics developments in the QAO is provided separately in this Part of the report.

Given changes within the public sector related to developments in technology, including further attempts at paperless offices, the IS methodology will need to be reviewed in light of these expected developments. We note the latest version of financial information systems such as the SAP financial management system enable direct transaction information and approvals to occur online with some achieving a reduction in services required from outsourced providers.

4.7.6 Conclusion

The QAO has the benefits of a specialised and experienced IS risk audit capability which seeks to ensure that audit requirements related to information systems and related controls are appropriately incorporated within the overall audit process.

4.8 Audit analytics

4.8.1 Background

As part of considering opportunities to develop more efficient and effective audit methodologies with the aim of more cost-effective delivery of audit services, the QAO has commenced a programme to develop and introduce audit analytics within the office.

QAO's rationale for the use of audit analytics is within the context that extracting and analysing client data has always been an integral part of the financial and performance audits by the QAO. As stated by the QAO "this ad hoc process repeated annually at many of our clients, often involved a lot of manual work on both our and your (the audit client's) behalf to get the data in a format that was readable by our audit software."[14]

[14] QAO Information Bulletin.

This has included transfer of data on physical media such as USB or CD-Rom, risky both in respect to physical security over the information and the quality/completeness of the data.

Audit analytics, however, is more than having client data sourced in a more secure and efficient collection of data. It closely links with developments in the way transactional services both to and from government are likely to be further impacted in the future and which will require audit review processes to evolve.

Auditors including the QAO have been using what is referred to as small-scale audit analytics through the use of CAATs (computer assisted audit techniques) and other techniques for many years. This has been achieved through interrogation of a sub-set of data provided by an audit client for analysis and testing.

In May 2015, QAO established a dedicated QAO audit analytics team (originally titled Data Analytics) to support and advance the use of audit analytics in the conduct of audits with the aim of improving the quality of audit and to also deliver benefits for audit clients.

4.8.2 Definition of audit analytics

One definition of audit analytics or data analytics for auditing is as follows:

> "Audit data analytics" is the science and art of discovering and analysing patterns, identifying anomalies, and extracting other useful information in data underlying or related to the subject matter of an audit through analysis, modelling, and visualisation for the purposes of planning or performing the audit.[15]

Audit analytics can include analytical procedures such as:

- ratio analysis;
- trend analysis;
- regression analysis;
- general ledger account reconciliation and analysis;
- journal entry analysis;
- segregation of duties analysis;
- three-way match procedure;
- cluster analysis;
- data mining.[16]

It is evident that, if audit analytics is a mechanism for external audit which provides benefits exceeding cost within the audit process both for auditors and audit clients, and improves the quality of audit work, the technique of using audit analytics on the extensive level of data held by audit clients will have merit. Benefits may arise during all phases of the audit process including planning, risk assessment, testing of controls and substantive procedures and in drawing overall conclusions from the audit.

[15] American Institute of Certified Public Accountants – this definition first appeared in an AICPA White Paper "Reimagining Auditing in a Wired World" August 2014.

[16] Source: Chartered Professional Accountants, Canada – Audit Data Analytics Alert June 2016.

The above comments are generally directed to auditing of financial reporting information and which has been the main focus in assessing the benefits of audit analytics.

4.8.3 Audit analytics for performance auditing

The QAO also undertakes performance audits and for some entities, audits of performance management systems. This section reviews the existing use of audit analytics by the QAO in performance audits, and explores the opportunities for audit analytics to provide additional benefits in undertaking performance audits.

Recent performance audit reports provided to the Legislative Assembly included:

- Queensland public hospital operating theatre efficiency (Report No 15: 2015–16);
- Strategic procurement (Report No 1: 2016–17).

Both these audits used audit analytics capability to assist in the analysis, interpretation and presentation of data. This included being able in the reports to highlight relevant information in tabular and graphical format to assist Parliament and other users of the reports.

In undertaking a performance audit, there will inevitably be a need to analyse a significant volume of data, both financial data and related non-financial activity or other performance data. The ability to present that information in a format which is easy for a reader to digest is a key benefit from the use of the graphical presentation tools available.

The QAO has been able to enter into an agreement with the Australian Bureau of Statistics to obtain key statistical data which will be of benefit in some future performance audits.

There is the likelihood of further opportunities for wider use of audit analytics in performance audits, including linking financial data with data from other sources to consider performance related to a particular programme or service unit.

4.8.4 Audit client awareness of the development of audit analytics

The QAO has sought to make audit clients aware of the developments through articles in its *Insight* publication, information communicated to audit clients including presenting to Audit and Risk Committees or equivalent, presentations to regular gatherings of Audit Committee Chairs and other interested persons, and also specific responses to concerns raised by audit clients.

We are aware of concerns being expressed by a number of audit clients about security issues, especially with regard to sensitive data such as employee and banking data. Some other audit clients have expressed concerns with security of data such as personal student record data for vocational and higher education institutions. Assurances have been provided by the QAO as to tight security arrangements for data held by the QAO.

Another concern expressed was the cost of providing the data to the QAO. There are costs in initially setting up the arrangements for the transfer of data from the financial systems of the audit client and in ensuring that transfer of data proceeds smoothly. In some circumstances audit clients have outsourced data storage and management which means that in order to process the transfer of data to the QAO, a cost is incurred by the audit client.

4.8.5 Use of audit analytics by contract auditors

The collection and verification of completeness of data is a role that the QAO is undertaking for selected audit clients and which includes many audit clients who have their audits undertaken by contract auditors. In all instances, the contract auditors use their own audit practices and methodologies in undertaking the audit.

Our discussions in August/September 2016 with contract auditors identified limited knowledge as to the proposed development and use of audit analytics, although some mentioned that they had been briefed by the QAO on the programme to develop audit analytics.

It was however evident that use of audit analytics as proposed by the QAO is not something that is currently widely practised by other Auditors-General around Australia or by contract auditors in Queensland or generally within Australian auditing practice. Audit firms do apply analytical testing of data, but generally this is of a subset of data within the audit client.

A number of the large firms have produced publications identifying the benefits from the use of audit analytics or data analytics. The focus of some of these publications is on the provision of internal audit services or for forensic audit work.

The QAO adopts an approach treating internal staff and contract auditors as being part of the one office of the Queensland Auditor-General. Accordingly, the QAO has commenced a process to consult with contract auditors to ensure that the potential benefits arising from the use of audit analytics are able to be integrated with the contract auditors' own audit methodologies. Each contract auditor appropriately uses their own audit methodology in the delivery of audit services for the QAO.

The QAO has indicated that it is working with contract auditors to consider how the use of audit analytics can be effectively used by the contract auditor in conjunction with that firm's own audit methodology.

4.8.6 Challenges in implementing audit analytics

QAO have recognised that managing the change process will require a concentrated focus including awareness and specific training programmes for staff and also for contract auditors.

We were advised that, in 2015–16, the project had established the data collection processes and controls and had delivered the Planning Dashboards. Wider use of audit analytics in 2016–17 including establishing Controls Testing Dashboards and use of audit analytics in substantive testing is planned. Audit analytics using the wholesale collection of data is an important QAO strategic development. Given there are costs involved, the QAO will need to demonstrate how the use of audit analytics provides benefits in the audit process.

There is a cost in establishing and using audit analytics, including the costs of collection and storage of data, the costs of analysing, and also costs in developing Qlikview dashboard reports. This cost forms part of the audit fee to be paid by audit clients in the case of financial audits, and in the case of performance audits comes from Parliamentary appropriations. There is also a cost to audit clients in arranging the provision of data, with some audit clients needing to incur a cost associated with outsourced data management arrangements. This is seen by some audit clients as a significant cost.

4.8.7 Is auditing coming full circle?

A recent report has raised the question of whether auditing has come full circle? That report notes that:

> "It (auditing) once involved an exhaustive examination of every transaction and balance, following all (or most) of them through the system. Auditors started to question this fully substantive approach in the 1950s. By the mid-70s, risk analysis and controls testing, sampling and flowcharts, risk based auditing standards and the concept of materiality were the norm. They have been the hallmarks of external auditing ever since. But had it been possible at either of those points in time to examine all of the invoices automatically, cheaply and fast, it is very unlikely that we would be where we are today. For some, audit analytics challenges many established concepts, including the concept of an audit itself, as well as the way they are performed and regulated. Questions arise as to the importance of the distinction between risk assessment, substantive procedures and tests of controls when a complete data set is examined and at one level, audit analytics should enable auditors to see the big picture again, more easily than they have been able to in the past."[17]

4.8.8 What is happening in offices of other Auditors-General?

We are not aware of any developments in audit analytics similar to the approach in the QAO in any other audit offices in Australia or New Zealand. The QAO is aware that a number of other Auditors-General have established audit analytics teams that are generally within their information systems audit teams, but believe that they are not at the level of the QAO in terms of maturity. The QAO is aware of the use of audit analytics by New York State, as part of its comptroller function, with a view to determining fraud and mismanagement.

Like any significant new development, there are risks for the office which takes on a project of this nature. Having said that, it is noted that the QAO was an early mover with one other state in the development in 2007 of a financial audit methodology IPSAM which is now used by the majority of audit offices in Australia.

Cleary there would be benefits for the QAO if other state or territory audit offices were to make a move into audit analytics in a similar way to the QAO approach, from the sharing of knowledge and learnings and in enhancing audit methodology in support of these developments.

4.8.9 What has happened to date?

In the second half of 2014–15, the QAO established a unit of specialist audit and technical staff to drive what was then described as data analytics (now referred to as audit analytics). This followed a pilot project in the first half of 2014–15 to enhance the use of audit analytics in QAO audits. The pilot focused on innovation in data collection and analysis as well as considering forms of reporting especially in the form of dashboard reporting.

[17] Institute of Chartered Accountants in England and Wales – Report Audit analytics for external auditors 2016.

In establishing audit analytics, the QAO became aware of audit clients who were interested in the dashboard reporting being made available to them for their own use. We are aware of agreement being reached to enable reports to be released for a number of audit clients, including interrogative capability. This raises the question as to whether this is an appropriate role for the QAO, given its responsibility as an external auditor as compared with the role of a consultant assisting audit clients who are being granted access to dashboard reports. The QAO has offered some training and assistance in the processes of accessing the information and in using the Qlikview software.

A quick review of approaches to audit or audit analytics overseas highlights this as a relatively new development noting the example of New York State mentioned earlier in this section.

4.8.10 Do auditing standards need to change?

Auditing standards currently are issued on the basis that testing 100% of transactions is unlikely in an audit. Any move to widespread use of audit analytics raises the question of whether changes to auditing standards will be needed. There is however some conjecture as to whether audit/audit analytics is a wholesale change requiring significant rewrite of audit standards or whether it is necessary only to revise auditing standards to take account of the development of audit/data analytics.

4.8.11 Providing data back to audit clients together with dashboard analytical capability

As mentioned earlier we note that the QAO is able to provide the data in dashboard format back to audit clients.

We also note that the QAO in allowing access to the department's own data is offering to provide a consulting service to audit clients. We do not believe this is a role envisaged within the audit mandate for the QAO. Within the approval document to be accepted by an audit client prior to being able to access QAO's Qlikview dashboard, there is an offer from the QAO to provide key staff at the audit client an overview of the dashboards, a walkthrough of its capabilities, and a memorandum of understanding which accompanies access. QAO is also offering to make a key contact available within the financial audit team to ensure any concerns of the audit client are addressed. This appears to us to be the QAO taking on a consulting role.

We can understand the interest of departmental staff, including internal audit, in having the data in a form which can be analysed including through Qlikview dashboard reporting. The challenge for departments is ensuring that this delivers real benefits for departmental staff over what is already available in analytical tools, both within the functionality of the financial systems of the department or from analytic software already held by internal audit within the department. In addition, it would be expected that in any departmental internal audit assignment, data will need to be drawn from sources in addition to financial data which would suggest that other analytical tools will be required to deliver benefits as part of the internal audit. The access to dashboard information such as Qlikview of that entity's information could however be a catalyst to assist in identifying how audit analytics tools can be a benefit to the agency.

4.8.12 Risks associated with implementing audit analytics

Like any new development, there are costs and risks to be managed with the use of audit analytics as well as opportunities, which are likely in time to provide benefits both to external auditors such as the QAO and to audit clients.

These risks need to be considered in the light of previous data collection and storage arrangements including downloading of data to USBs and transfer of data to portable computing devices. The move to collecting and storing data through the audit analytics project creates a more secure environment and an improvement in data integrity and governance of data. Data access is now centrally managed within the QAO with improved data governance including controls over access to data.

There are risks with a project of this nature some of which are:

- failure to adequately train audit staff in the use of the audit analytics toolset and dashboards (action – being addressed through training and awareness and application);
- failure of staff to use the audit analytics in the audit process (action – responsibility of QAO leadership sector directors to address);
- security breach of data held by the QAO (action – maintained in Government Information Systems data centre CITEC);
- incomplete or corrupted data being collected/held (action – close attention to this during initial collection phase and in updating working closely with audit clients);
- non-integration of audit analytics with contract auditor audit methodology which is relied upon in the provision of services to the QAO by contract auditors (action – trials being undertaken with a contract auditors with a focus on linking with the contract auditors' own audit methodology);
- privacy issue associated with data held and the use thereof (action – no data is able to be accessed by any other party than the QAO and the audit client);
- failure of audit staff to properly understand and interpret the finding of the audit analytics (action – training and workshops);
- costs to audit clients in provision of data including in some cases costs due to outsourced data management arrangements;
- cost of collecting and storing the data and costs of related software exceeding the benefits to be derived from more efficient and effective audit analytical procedures (action – to be monitored by the QAO).

4.8.13 Interest in obtaining and managing data at a whole of government level

We are aware that there is strong interest both within and outside the public sector in the use of data analytics, including the capacity to analyse what has been referred to as "big data". This interest is noted in a number of Australian states and the Commonwealth.

We note that New South Wales has established a centralised data centre with a view to using whole of government data for a range of sources. The New South Wales development has been to establish a Data Analytics Centre (DAC) within the Department of Finance which was first announced in August 2015. The role of the centre is outlined on its website as follows:

> "The NSW Data Analytics Centre facilitates data sharing between agencies to inform more efficient, strategic, whole-of-government evidence based decision making. It does that by leveraging internal and external partnerships so that the right capabilities, tools and technologies are applied. The key functions of the DAC include to:
>
> - deliver priority analytics projects using whole of government data in a secure environment;
> - advise on NSW government challenges and potential solutions using audit analytics;
> - manage a secure environment for data sharing;
> - establish and maintain a register of data assets;
> - coordinate consistent data management definitions and standards;
> - advise on making de-identified data open to the public;
> - advise on best practice audit analytics, cyber security and privacy measures."[18]

In establishing the centre, New South Wales passed legislation to remove any barriers to the sharing of government sector data. The New South Wales Parliament passed The Data Sharing (Government Sector) Act 2015 in November 2015.

In Queensland, a recent performance audit undertaken by the QAO on Strategic Procurement[19] made recommendations seeking to improve procurement practices in Queensland.

One of the recommendations (No 5) reads as follows:

> "We recommend that the Office of the Chief Adviser Procurement and the Department of Science, Information Technology and Innovation collaborate with government departments to develop a procurement data strategy that identifies and assesses:
>
> - what procurement data government departments need to record;
> - how procurement data should be categorised, ideally using a universally recognised categorisation approach;
> - cost-benefit of options for improving existing systems to improve the quality and accessibility of procurement data from a central source."

We have noted separately a level of interest in accessing the data which is being collected by QAO, although access would rightly be restricted to an entity's own data. On the other hand, the establishment of a central source of data related to strategic procurement would be sourced from different entities within the public sector. Hence the need to consider the question of determining where and how a central data base should be established and what types of information needs could be met from a central data base.

[18] Website https://www.finance.nsw.gov.au/nsw-data-analytics-centre (accessed 17 October 2016).

[19] Report No 1: 2016–17.

4.8.14 Management of whole of government data

In line with initial developments in New South Wales, and also in the Commonwealth where a Public Sector Data Management Project brings together government data from a number of sources, it appears likely that whole-of-government data management will become more widely considered.

There appear to us to be benefits in managing and storing data of this nature centrally rather than multiple databases being established. It is noted that a response to the recommendation from the Strategic Procurement performance audit quoted above may lead to a central database for strategic procurement.

In the event that Queensland does take action to develop a centralised data centre which incorporates financial data, there are likely to be benefits from having the data currently being collected by the QAO available for other requirements of government. This is subject to addressing privacy issues as New South Wales has done. If it were to be established, the QAO would still need to verify the data to ensure that it can be relied upon for audit purposes. The QAO believes that its data centre as established is a “production-strength” data centre and there is capability for this to be expanded to include other data sets such as government workforce data, assets and procurement data. This is under consideration by the QAO.

4.8.15 Conclusions

The initiative of the QAO to establish an audit analytics capability is to be commended and is expected when fully implemented to deliver efficiencies in the delivery of audits and savings for audit clients.

The development of audit analytics techniques would be enhanced through other audit firms both in the private and public sectors also moving to develop capability and thereby enable the sharing of learnings from the initiative.

The mandate of the Auditor-General does not extend to providing consulting services to audit clients. The professional accounting bodies through APES 110[20] sets out independence requirements and identifies limitations on the non-audit services that can be undertaken by the auditor. It is now a widely-held position that the external auditor should not provide other consulting services to the entity subject to audit by that firm.

20 Code of Ethics for Professional Accountants.

Recommendations

We recommend that:

4.8(i) The QAO closely monitor the results of the implementation of audit analytics taking place within the QAO to identify the costs and benefits of audit analytics in the delivery of audit services both for financial audits and for performance audits.

4.8(ii) Formal reviews of the audit analytics programme be undertaken by the QAO following the audits for each of the next three financial years to assess the benefits arising from the use of audit analytics compared to the cost of same, including costs directly incurred by audit clients.

4.8(iii) Actions continue to be taken to ensure that contract auditor firms will be able to integrate audit analytics into their audit methodology in providing audit services for the QAO.

4.8(iv) The QAO consult with the Chief Information Officer at Department of Science, Information Technology and Innovation, Department of Premier and Cabinet and Queensland Treasury to determine the viability of a data centre arrangement for the secure repository of whole-of-government data including financial data and, once it is established, the QAO cease to provide services to audit clients in regard to the access to data and the provision of reporting tools such as Qlikview dashboards to audit clients.

4.9 Auditing Standards developments

4.9.1 Determining and communicating key audit matters

An important recent development in Auditing Standards in Australia is the issue of ASA 701[21] in December 2015 by the AuASB. This standard is the Australian equivalent of an International Auditing Standard of the same name (ISA 701). The Auditing Standard is to apply to listed entities with application for reporting periods ending after 15 December 2016. It defines key audit matters as:

> Those matters that, in the auditor's professional judgement, were of most significance in the audit of the financial report of the current period. Key audit matters are selected from matters communicated with those charged with governance.[22]

4.9.2 Main features of the Standard

The main features of the new Standard include:

(a) mandating the communication of key audit matters in the auditor's reports of audits of listed entities;

21 *Communicating Key Audit Matters in the Independent Auditor's Report*.

22 *ASA 701 Communicating Key Audit Matters in the Independent Auditor's Report*.

(b) enabling auditors of other entities to decide whether to include key audit matters in their auditor's reports;

(c) how the auditor determines key audit matters:

(i) determining from the matters communicated with those charged with governance, those matters that required significant auditor attention;

(ii) taking into account areas of higher assessed risk, significant auditor judgements, involving significant management judgements and the effects of significant events or transactions; and

(iii) determining the most significant matters for inclusion in the auditor's report;

(d) how the auditor is to describe individual key audit matters;

(e) circumstances in which a matter determined to be a key audit matter is not communicated in the auditor's report; and

(f) the audit documentation requirements related to key audit matters.

4.9.3 Application of the Standard

As outlined in the Auditing Standard *"(the) Auditing Standard applies to audits of general purpose financial reports of listed entities and also in circumstances when the auditor otherwise decides to communicate key audit matters in the auditor's report. This Auditing Standard also applies when the auditor is required by law or regulation to communicate key audit matters in the auditor's report"*.[23]

Noting that it is a mandatory requirement for auditors of listed entities but not for other entities, an important question for the Queensland Auditor-General will be to which entities in the Queensland public sector, if any, the Standard should be applied.

There is a strong argument that any significant Queensland public entity which competes with entities in the private sector (where one would expect listed entities to be involved) should be audited on a similar basis to those which are listed entities.

The criteria for including key audit matters in the audit report of a non-listed entity is left to the auditor to determine. We have been informed that the former Auditor-General intended to apply the standard to audit reports for departments, significant statutory bodies and government-owned corporations for reporting periods ending 30 June 2017 and for local governments for reporting periods ending 30 June 2018.

With this in mind, the QAO has undertaken a trial based on the 2015–16 financial year for eleven significant audit clients (all of whom have their audit opinions signed by the Auditor-General). This experience has highlighted the likelihood that key audit matters will be related to asset valuations, remaining useful lives, impairment of assets, completeness of revenue, estimating services provided or received not valued at fair value, valuation of certain financial instruments, operating expenditure/capital expenditure split and rehabilitation provisions.

[23] ASA 701 Communicating Key Audit Matters in the Independent Auditor's Report.

It is worth noting that there are some key audit matters which would not be required to be included in an audit report. These are:

(a) where a law or regulation precludes public disclosure; or

(b) in extremely rare cases, where the auditor determines that the matter should not be communicated because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of the communication.

The audit report, in the event of a key audit matter not being communicated, must indicate that a key audit matter was not reported and the rationale for that decision. The auditor is required to communicate with an appropriate level of governance of the audited entity identifying the key audit matters to be reported or advising if none will be reported upon in the audit report.

4.9.4 Example of key audit matters being reported

The New Zealand Controller and Auditor-General is the auditor of Air New Zealand Limited and for the year ending 30 June 2016 through contracted auditor Deloitte provided a report on the audit of the group financial statements which included adopting the key audit matters standard.

Their report included the following:

Key audit matters[24]

Key audit matter	How our audit addressed the key audit matter
Revenue recognition	
The Group's revenue primarily consists of passenger revenue which totalled $4,481 million in the year to 30 June 2016 as outlined in note 1. Passenger revenue is complex due to the various fare rules that may apply to a transaction, and as tickets are typically sole prior to the day of flight. The Group requires complex IT systems and processes to correctly record these sales as transportation sales in advance and then as revenue when flights occur. We have included revenue recognition as a key audit matter due to the significance of revenue in the financial statements and the substantial dependence on complex IT systems.	We have evaluated the systems, processes and controls in place over passenger revenue in advance and also assessed key account reconciliation processes. We have tested the IT environment in which passenger sales occur and interfaces with other relevant systems. We also assessed the quality of information produced by these systems and tested the accuracy and completeness of reports generated by these systems and used to recognise or defer passenger revenue. We performed an analysis of passenger revenue an passenger revenue in advance and created expectations of revenue based on our knowledge of the Group, in industry and key performance measures, including airline capacity and revenue per available seat kilometre. We have compared this to the Group's revenue and obtained appropriate explanations for significant differences. We are satisfied revenue has been appropriately recognised.

[24] Air New Zealand Limited Report on the Audit of the Group Financial Statements 2016.

Key audit matter	How our audit addressed the key audit matter
Aircraft lease return costs	
Certain aircraft under operating leases are required to be returned to the lessor at the expiry of the lease term in a specified condition. The Group estimates the cost of returning aircraft to a specified condition and has made provision for this in the current period of $295 million as explained further in note 16. This is a key audit matter due to the size of the balance and the level of judgement required by the Group in determining the estimate. The provision is calculated taking into account a number of variables and assumptions including the number of future hours or cycles expected to be operated, the expected cost of maintenance and the lifespan of life-limited parts. It also takes into account forecast inflation and foreign exchange rates. It is based on the Group's historical experience, manufacturers' advice and contractual obligations in determining the present value of the estimated future costs of major airframe inspections and engine overhauls required under the lease conditions.	We have evaluated the appropriateness of the provision by performing the following: • We assessed the terms and conditions of new or updated lease agreements to understand the return conditions and ensuring that the calculation had been updated for changes in operating leases. • We assessed the key assumptions and challenged the Group as to their reasonableness by reviewing internal and external source documentation such as operating cycle history, supplier costs for various components, consumables and labour, maintenance plans and market data such as forecast inflation and exchange rates. • We challenged changes in assumptions from prior periods and reviewed the history of provisions made against actual costs incurred on the return of aircraft under lease agreements and when an overhaul occurs. • We tested the arithmetical accuracy of the calculation and evaluated the sensitivity of the calculation to the various variables and assumptions. We found the assumptions and resulting estimates to be reasonable.
Aircraft-residual values and useful lives	
Group aircraft and related assets total $3,987 million at 30 June 2016 as outlined in note 11. The useful lives and residual values of aircraft may be influenced by external changes to economic conditions, demand, competition and new technology. The Group considers these changes when reassessing the useful lives and residual values of aircraft to determine the appropriate depreciation rates. Residual values are denominated in US$ and are sensitive to exchange rate fluctuations as well as projected values. This is a key audit matter due to the level of judgement required by the Group in determining fleet lives and residual values which impacts carrying values and the depreciation charge.	We challenged the Group's assumptions underpinning the calculation of residual values by comparison to external information such as third party sales prices, industry data and period end exchange rates. We also assessed the historical accuracy of assumptions around residual values when aircraft are disposed of. We evaluated the controls in place over the calculation of depreciation, in particular around the initial input of, or changes to, residual values and useful life information. We then used analytical procedures to test the depreciation calculation. We consider the Group's assessment of the residual values and useful lives of aircraft for use in calculating depreciation to be reasonable.

4.9.5 Conclusions

In fulfilling the mandate to audit and report, the Queensland Auditor-General has an important independent role which may require the issue of a qualified audit report or an audit report which incorporates an emphasis of matter within the audit report. That responsibility may now extend to determining key audit matters and the responsible inclusion of information on key audit matters within the audit report.

In so doing, this brings a level of responsibility to ensure that key audit matters are backed by evidence and appropriate working papers to document the audit processes to support the reporting of that information.

The likelihood of having key audit matters will have an impact on the existence and quality of information provided by audit clients in notes as part of the financial statements and will mean that auditors have a responsibility to forewarn of likely key audit matters under consideration.

The QAO is to be commended for undertaking a trial of key audit matters for significant audit clients and in communicating with audit clients to enable audit clients to prepare for the additional information being included in the Auditor-General's audit opinion.

4.10 QAO Auditing Standards

4.10.1 Background

Auditing Standards as issued by the AuASB have the force of the law.

The Queensland Auditor-General reinforces these Standards and incorporates some additional public sector requirements through the issue of Auditor-General of Queensland Auditing Standards under Section 58 of the Auditor-General Act 2009. The Standards apply to both financial and performance audit. Their application to performance audit is discussed in Part 5. These Standards are required to be tabled in the Legislative Assembly.

The additional requirements within the Standards to cover requirements of auditing in the public sector which are additional to attestation type audits relate to:

- matters of probity and propriety of matters associated with management of public sector entities;
- acts or omissions that have given rise to a waste of public resources;
- assessment of compliance with relevant acts, regulations, government policies and other prescribed requirements;
- performance audits of public sector entities (other than government-owned corporations);
- auditing performance management systems of government-owned corporations and controlled entities;
- joint or collaborative audits;
- reporting to the Legislative Assembly on matters of significance arising from audits.

The Standards also provide guidance on:

- general standards applying to the selection, engagement and quality control of the work of contract auditors;
- general standards to be applied in deciding whether an audit of a public sector entity for the financial year is small in size and low risk.

Following the 2010 Review, the Standards were reviewed and a revised version tabled in the Legislative Assembly in September 2012.

4.10.2 Keeping the Standards up to date

The Auditing Standards had been reviewed internally within the QAO in 2016 with the finding that no changes were needed to be made.

An Internal Audit Report on Quality Management undertaken in the QAO in February 2016, also concluded that the standards remain current but recommended the addition of a requirement for a formal review each three years.

In our review, we noted that a new Auditing Standard *ASA 701 Communicating Key Audit Matters* (discussed in the previous section of this report) will have an impact on the QAO Auditing Standards. In particular, the processes to determine coverage of ASA 701 will be required, given that the Standard is not mandated for public sector entities (the Standard is mandated for listed entities). The decision is left to the auditor of other entities such as public sector entities including government owned corporations and other corporate entities in the public sector, as to whether the auditor decides to communicate key audit matters in the auditor's report. Given that ASA 701 does not apply directly to public sector entities but provides a discretion to the Auditor-General as to its application to public sector entities, we believe that incorporating the criteria for determining those audit clients to which ASA701 may be applied needs to be included in the QAO Auditing Standards.

4.10.3 Conclusions

We believe that the QAO Auditing Standards are effective for the work of the QAO.

We note however that the move to apply Auditing Standard ASA 701 will require the inclusion of details on which types of audit clients will be subject to the key audit matters assessment and reporting as part of the audit report. Information on the criteria to determine whether an audit matter is one which requires reporting within the audit report will need to be incorporated into the Standards. The Standards may also require some further clarification as to where a law or regulation would preclude public disclosure and in the rare cases where a matter should not be communicated because of adverse consequences which may outweigh the public interest benefits of the communication. We note this would also include what is believed to be commercial in confidence information of the audit client.

Recommendations

We recommend that:

4.10(i) The QAO Auditing Standards be revised to incorporate a section setting out the criteria on which the Auditor-General may determine which Queensland public sector entities will be subject to Australian Auditing Standard *ASA701 Communicating Key Audit Matters*.

4.10(ii) The QAO Auditing Standards be amended to require a review of and, if necessary, revision of the Standards at least once every three years.

4.11 Accounting and Reporting Standards

4.11.1 Background

This section outlines current identified changes to Accounting Standards which will have an impact on accounting and financial reporting for audit clients of the QAO and for which there are auditing implications.

These are:

1. extension of the application of Related Party Standard AASB 124 to not-for-profit entities;
2. revenue from contracts with customers;
3. lease accounting;
4. income of not-for-profit entities.

4.11.2 Application of Related Party Standard to not-for-profit entities including Queensland public sector entities

The audit responsibilities of the QAO will be expanded in 2016–17 with the requirement to audit related party disclosures by not-for-profit public sector entities under Accounting Standard AASB 124.[25]

The QAO has taken action to alert audit clients of this Accounting Standard new requirement. One of these actions is an article in the July 2016 QAO Bulletin on Related Party Disclosures – guidance for not-for-profit public sector entities.

The QAO has also issued an Accounting Issue Resolution Paper internally for their audit staff on 18 May 2016 covering the question of whether Ministers are related parties of GOCs. The Resolution Paper concludes as follows:

- shareholding Ministers of GOCs are key management personnel under AASB 124 Related Party Disclosures;

[25] *AASB 124 Related Party Disclosures*.

- other Ministers are related parties of GOCs because they are key management personnel of the parent entity (the state);
- GOCs should disclose shareholding Ministers as key management personnel with nil compensation. In addition, GOCs need to incorporate transactions and balances with all Ministers and their close family members into their related party disclosures, including for comparatives.

At the time of finalising our Review, we were informed that the Government is considering a proposal that the Queensland Treasury in conjunction with the Department of the Premier and Cabinet collect and collate related party information for Ministers and provide that information to departments, government-owned corporations and other public sector entities to incorporate in their related party disclosures related to Ministers.

The Standard requires an expansion in the level of reporting by all audit clients. A key requirement of the Standard is to identify the key management personnel within each public sector entity and to identify required disclosures.

We note that the policy position on disclosure requirements for local government has been settled with the publication of guidance from the Department of Infrastructure, Local Government and Planning on 24 February 2016. This includes guidance on identifying the key management personnel which includes elected members.

Queensland Treasury has now issued guidance for state government departments and other entities. As indicated earlier, the Government is currently considering the process for collecting and collating related party information of Ministers in their role as key management personnel.

4.11.3 Revenue from contracts with customers

The Australian Accounting Standard on Revenue[26] provides a comprehensive model for accounting for revenue from contracts with customers. This includes a five-step revenue recognition model.

The Standard will be welcomed by both preparers and auditors in terms of providing greater clarity on the accounting treatment for revenue from contracts.

4.11.4 Lease accounting

The Australian Accounting Standard on Leases[27] will have application for accounting periods ending after 1 January 2019 and will have a significant impact on reporting entities which have a significant level of those operating leases which currently are not accounted in the same manner as for finance leases.

In effect, when applied, the standard will require the capitalising of future operating lease payments as a liability and bringing to account an asset related to the rights obtained under the lease. As an example, future lease payments for the lease of office accommodation will be brought to account as a liability and the right to occupy and use the benefits derived from the leased premises will be recorded as an asset.

[26] *AASB 15 Revenue from Contracts with Customers*.

[27] *AASB 16 Leases*.

The outcome of this process will be to add to the level of assets reported by public sector entities and to also increase the level of liabilities reported.

While still two reporting periods away from application, the QAO and audit clients will need to address the implications of capitalising future benefits from operating leases and reporting of the liability related to the future payments of the operating lease.

4.11.5 Exposure Draft – Income of Not-for-profit entities[28]

In April 2015, the AASB issued an exposure draft seeking comment on what could in time be a new Standard. As at 7 September 2016, the AASB in its work programme has indicated that a standard is intended to be issued in the second half of calendar 2016.

The exposure draft indicates that the Australian Accounting Standards Board is considering the vexed question of accounting for grants which are classified as non-reciprocal grants in terms of obligations on the recipient of the grant.

The current accounting requirement is to bring to account as income all grants received unless there is a formal legal requirement associated with the expenditure, or return, of the grant funds provided. This has created confusion related to measuring the results of certain entities within the not-for-profit sector, including universities.

While the proposed change in the accounting standards will still leave a requirement to bring to account as income that part of the grant made for capital purposes, it will mean, if approved, that accounting for grants for operational purposes may be able to be more closely matched with relevant expenses.

The exposure draft indicated that the proposed standard aims to:

- better align not-for-profit revenue with the new revenue standard AASB 15 *Revenue from Contracts with Customers for for-profit entities*; and
- address concerns that the current revenue recognition guidance for not-for-profit entities in the standard on contributions[29] results in premature recognition of revenue in some cases.

In order to apply the proposed new standard, reporting entities will need to determine whether the income received is under a contract with a customer, a donation or a combination of both. A contract with a customer would exist if two criteria are met:

1. the entity has a legally enforceable contract with a customer; and
2. that contract includes “specifically specific” promises for the not-for-profit entity to transfer goods or services to the customer or third party beneficiaries.

If there is no identified contract with a customer, the recognition of income will be similar to AASB 1004 whereby the income would be recognized when control of the resource is obtained, it is probable that future economic benefits will be received and the fair value can be reliably measured.

[28] ED260 *Income of Not-For-Profit Entities*.

[29] AASB 1004 *Contributions*.

Where the two criteria for a contract are identified, the income related to the grant would be recognised when the promise made to the customer has been satisfied.

Once the standard has been issued, both the QAO and audit clients will need to review the finalised standard and assess the implications related to its application including considering whether early adoption may be desirable for those entities with a strong interest in improved reporting such as Universities.

4.11.6 Exposure Draft – *Reporting Service Performance Information*[30]

This exposure draft was issued in August 2015. The draft standard as at November 2016 is now under re-deliberation by the AASB.

The objectives identified in the exposure draft are as follows:

Objective 1	The objective of this [draft] Standard is to establish principles and requirements for an entity to report service performance information that is useful for accountability and decision-making purposes.
Objective 2	The primary objective of a not-for-profit entity is to provide goods and/or services for community or social benefit. Therefore, users (eg funders – donors and taxpayers) of not-for-profit entity reporting require information about an entity's objectives, whether the entity has achieved those objectives and how efficiently and effectively the entity has used its resources to achieve its objectives.
Objective 3	Because of the primary objective of a not-for-profit entity, the needs of users extend beyond information traditionally provided in general purpose financial statements. Accordingly, entities shall also report on their service performance. Specifically, in relation to: (a) the inputs used by the entity in delivering outputs; (b) the outputs delivered by the entity; (c) the outcomes sought to be influenced by that entity; (d) the efficiency of an entity in achieving its service performance objectives; and (e) the effectiveness of the entity in achieving its service performance objectives.
Objective 4	This [draft] Standard acknowledges that the type of service performance information that is useful for accountability and decision making will differ between entities. It establishes information requirements in respect of both outputs and outcomes, and provides guidance on the detailed information that should be provided in relation to service performance objectives and performance indicators, depending on an entity's circumstances. This [draft] Standard also provides guidance to assist entities in determining the appropriate balance of information to present.[31]

This standard would have a direct impact on the reporting of performance by public sector entities once issued.

30 ED270 *Reporting Service Performance Information*.

31 ED 270 *Reporting Service Performance Information*.

It is noted that ACAG, of which the QAO is a member, made a submission to the AASB on the exposure draft in which it supported the principles-based approach. These are that an entity reports performance information that:

(a) is useful in accountability and decision-making purposes;

(b) shall be appropriate to the entity's service performance objectives;

(c) clearly shows the extent to which an entity has achieved its service performance objectives; and

(d) should enable users to assess the efficiency and effectiveness of the entity's service performance.

In responding to the exposure draft, ACAG suggested that a fifth principle be included being that performance information:

(e) is unbiased and capable of independent verification.

At the time of drafting this report, the exposure draft does not address the question as to whether service performance information should be subject to audit. One would expect that in the event of the exposure draft becoming a standard, the AuASB would consider the question of audit of performance information.

4.12 Funding and fees

4.12.1 Background

The Terms of Reference for the Strategic Review require us to assess "whether the funding of the QAO is both appropriate and appropriately used to discharge the functions and objects of the QAO".

The funding of the office of the Auditor-General is a combination of fees charged to audit clients primarily for financial audit activities, appropriation revenue for other services (primarily for performance audits) and other revenue which for 2015–16 consisted primarily of licence fees, storage services, and recovery of costs for the Energex performance audit.

The figures for 2015–16 actuals are:

Audit fees	$37.146 million
Appropriation revenue	$6.422 million
Other revenue	$.872 million
Total	$44.440 million

The estimated income for 2016–17 as provided in the Budget Papers is:

Audit fees	$35.274 million
Appropriation revenue	$6.629 million
Other revenue	$.692 million
Total	$42.595 million

In each year, as outlined above, the audit fees figure represents the actual or, for 2016–17, the budget figure for audit work carried out or to be performed primarily of a financial audit nature. The Budget for 2016–17 shows a decrease in expected audit fee income of around 4.2% in nominal dollars whilst the overall budget for the QAO will decrease by 4.1%. We note that this continued reduction in audit fees arises primarily from productivity improvements within the QAO.

The appropriation funding is used to meet the cost of performance audits, preparing reports to Parliament including sector reports, the Auditor-General and the Deputy Auditor-General, special investigations or other ad hoc discretionary investigation work performed in the public interest, and general advice and assistance to audit clients including central agencies.

The 2016–17 Budget for the QAO continues a trend where the overall fees charged to audit clients has been decreasing in real terms.

We note that the actual level of income and expenses in 2008–09 for audit fees and appropriation revenue was:

Audit fees	$33.793 million
Appropriation revenue	$5.853 million

These figures indicate that there has been a decline in real terms of revenue (and costs in aggregate to audit clients) over the past seven years comparing 2008–09 figures with the 2015–16 actuals as follows (noting CPI Brisbane movement over that seven-year period of 19.4%):

Audit fees	$3.203 million (decline in real terms over 7 years 8.6%)
Appropriation revenue	$.567 million (decline in real terms over 7 years 8.8%)

4.12.2 Benchmarking of audit fees

The 2010 Review included a recommendation that the "QAO develop a more comprehensive programme of benchmarking of audit fees for comparable entities with a view to ensuring greater consistency in the determination of fees".

In response, the QAO has taken a number of actions including introducing zero-based budgeting for audit clients such that one-third of jobs are benchmarked annually.

Since 2015–16, zero-based budgeting of audit fees occurs annually for all in-house local government audits over $10,000 and for contract auditor audit assignments where QAO effort exceeds $8,000.

In addition, the QAO is benchmarking all Hospital and Health Services audit fees based on the level of revenue for each Hospital and Health Service.

4.12.3 Contract auditor fees

As noted in the 2010 Review, the private sector is an important provider as contract auditors for the QAO.

The 2010 Review noted that 91,281 hours of audit work were performed by contract auditors in 2008–09 which accounted for 45% of audits by number and 43% of audits by value of fees. In comparison, the number of audit hours undertaken by contract auditors in 2015–16 was an estimated 81,767 hours which accounted for 46% of audits by number and 37% of audits by value.

In the 2010 Review, it was noted there were then 60 firms pre-qualified with 36 holding contracts. Currently 38 firms are pre-qualified to hold contract auditor work of which 23 have current contracts with the QAO. There are 41 partners in those firms who currently hold contracts. In 2010 there were 55 partners of those firms with current contracts.

The trend to reduce the number of firms who were contract auditors which was occurring in 2010 has continued. This reinforces the approach to ensure that those firms providing contract auditor services are able to ensure depth of experience. In some cases, a contract auditor will be providing services to a number entities within one sector which provides benefits both in terms of cost and also in terms of expertise to undertake audits within that sector.

Prequalified firms are identified in line with the quality requirements of the auditing standards to determine which firms are assessed as having the capability and required standards to undertake contract audit work for the QAO. For the pre-qualified firms, there is a competitive process for what is normally a package of audit assignments to source the audit requirements for that audit client or group. Effectively, the QAO develops work packages for firms designed to suit the size and capability of the firms chosen to submit a proposal.

The QAO monitors the relative cost of undertaking audit services as between the private sector and internal provision. It is noted that the weighted average cost per hour excluding travel for contract auditors in 2015–16 is $150.42 per hour as compared with QAO's weighted average cost of $144.01 per hour. It is noted that the QAO does not pay payroll tax which, together with the profit margin of private sector firm, indicates that the average cost is comparable.

It is noted that the current Queensland Government's position is not to outsource services that are currently provided by the public sector. The ability of the QAO to have a mix of contract auditors from both internal staffing and from the private sector enables an appropriate mix of resourcing to meet the audit timeframes including during peak audit workloads in July and August and also early in the calendar year for audit clients with a 31 December balance date.

4.12.4 Use of blended audit teams

A recent development of the QAO has been to establish mixed or blended team arrangements with contract auditors. One recent example was to contract for audit staff of a contract auditor to work with senior QAO audit staff including an audit manager.

This bringing together of expertise from both within the QAO and the private sector contract auditors has merit in terms of ensuring the appropriate level of experience and expertise is used on audit assignments. The QAO notes that it provides workforce flexibility, risk mitigation, better allocation of specialist skills and continuity for audit clients and will be expanded further.

4.12.5 Fee rates for QAO internally sourced audit services

It is noted that between 2011 and 2016 the fee rates charged by the QAO for audit services (other than for contract auditor services) which need to be approved by the Queensland Treasurer under the Act were frozen. This followed a significant increase in 2011. We note that the weighted average hourly cost of audits undertaken by QAO staff rose only marginally from $140 per hour in 2011 to just under $144 per hour in 2016. The 2016 figure is prior to a recent increase of 2.5% per annum, effective from 1 October 2016, sought by the Auditor-General and approved by the Treasurer under section 56 of the Act. Further 2.5% increases in QAO audit rates will take effect in 2017, 2018 and 2019.

4.12.6 Relative efficiency of in-house and contract audit service provision

We are required to consider the relative efficiency of in-house and contract audit service provision.

As noted earlier in this section, the average cost of in-house provision of audit services is marginally lower than that of contract audit services. This difference can be attributed to no payroll tax being levied on in-house provision of audit services by the QAO and a profit element for private sector auditors.

Other factors are the use of contract audit firms in regional Queensland which has a direct benefit for audit clients from a reduction in travel and accommodation costs and costs associated with audit staff time travelling to and from those regional areas.

The use of contract audit firms by the QAO is a major factor in being able to address the challenges of peak audit periods especially after the end of financial years ending 30 June each year.

We are of the view that the QAO has a good balance of internal and external audit provision to efficiently meet their mandated audit responsibilities. The arrangements for use of contract audit firms with the QAO in-house team together with the use on some selected audits of blended teams represents a sound and efficient resourcing strategy for the QAO.

4.12.7 Forensic audit capability

During our consultation with the Finance and Administration Committee of the Queensland Legislative Assembly a question was raised concerning whether the QAO needed greater forensic audit/accounting expertise. We understand forensic auditing and accounting to be the auditing and accounting skills necessary to analyse and prepare financial information for use as evidence in court proceedings (often a fraud trial).

The QAO has a Memorandum of Understanding with the Crime and Corruption Commission (CCC). Where the QAO suspects fraud, it will refer the matter to the Crime and Corruption Commission or the Queensland Police Service. The QAO notes, however, that its interests differ from the interests of those authorities. They are concerned with individual cases, whereas the QAO is interested in systemic problems. There is a question as to whether, with forensic auditing capability, the QAO could identify (and prevent) fraud at a systemic level.

We understand that forensic auditing and accounting expertise is hard to come by. While we encourage the QAO to explore such opportunities when they arise, we think that the scarce forensic resource is currently better concentrated in the CCC.

4.12.8 Conclusions

The QAO has delivered aggregate audit fee savings for audit clients over the past seven years in excess of 1.1% in real terms annually.

The QAO has sound practices in using a mix of internal and external audit resourcing which ensures that peak audit load periods for undertaking financial audits can be met.

The drive to deliver productivity improvements and real savings in audit fees for audit clients, however, does appear to have come at a cost. As discussed in Part 6, the results of the *Working for Queensland* Survey indicate that the QAO has performed poorly on the element related to workload and health.

We do not consider that there is a requirement for the QAO to have forensic audit expertise available among the internal staffing of the office.

Recommendation

4.12(i) We recommend that the QAO undertake a review of the additional audit requirements for 2016–17 including:

- those related to new accounting standards, especially the expansion of audit effort required for audit of related party disclosures;
- the impact of the roll out of audit analytics including transition costs; and
- the time required related to audit clients for whom key audit matters are expected to be incorporated within the audit opinions;

to determine whether the overall fee budget for financial audit services for audit clients is realistic, and taking account of the findings from the *Working for Queensland* survey.

4.13 Reporting to Parliament – sector reports

4.13.1 Background

The Auditor-General provides a number of sector reports to Parliament each year. The reports inform Parliament about the Auditor-General's financial audit work.

The sector reports tabled during financial year 2015–16 were:

- Results of Audit: Education sector entities 2015 (Report 18: 2015–16);
- Results of Audit: Local government entities 2014–15 (Report 17: 2015–16);
- Queensland State Government: 2014–15 financial statements (Report 10: 2015–16);
- Public Non-financial Corporations: 2014–15 financial statements (Report 7: 2015–16);
- State Public Sector Entities: 2014–15 financial statements (Report 6; 2015–16);
- Hospital and Health Services: 2014–15 financial statements (Report 5: 2015–16).

The following sector reports tabled in 2016–17 to the time of this report are:

- Energy: 2015–16 results of financial audits (Report 5: 2016–17);
- Rail and Ports: 2015–16 results of financial audits (Report 6: 2016–17);
- Water: 2015–16 results of financial audits (Report 7: 2016–17);
- Queensland state government: 2015–16 results of financial audits (Report 8: 2016–17);

These reports are provided to Parliament in accordance with Part 3 Division 3 of the Auditor-General Act 2009 and are tabled in Parliament in accordance with Section 67 of the Act.

4.13.2 Parliamentarians' views on sector reports

We referred in section 4.3 to the QAO's survey of Members of Parliament. In response to the 2016 survey:

- 81% of MPs said that they were satisfied with the Auditor-General's reports and services, (85% in 2014);
- 70% of MPs thought that the Auditor-General was "effective" or "highly effective" at informing Parliament on the accountability and performance of the public sector (66% in 2014);
- 81% of MPs said that the Auditor-General's reports and service provide valuable information on public sector performance (95% in 2014); and
- 78% said that the Auditor-General provides timely reports and services (92% in 2014).

Ninety-one percent of MPs said that they had referred to the QAO's financial audit reports in the previous year, and gave positive ratings across all aspects of the reports. Seventy-four percent agreed that the reports assisted them in monitoring the accountability and financial performance of the Queensland public sector.

4.13.3 Views of audit clients subject to sector reports

We received a number of comments on Sector reports, mainly focused on education sector concerns about comparability of the financial numbers reported by universities, in part because of some universities reporting an underlying result due to concerns with accounting treatment of grants. In addition, the two universities we met made the point that a range of other benchmarking information is available within the sector and is seen as being more relevant from their point of view.

A concern expressed during our discussion with government-owned corporations which were grouped as public non-financial corporations is that this group is a very divergent group of entities with very different businesses.

4.13.4 Changes in sectors for reporting in 2016–17

We have noted that the sector reports which have been tabled during 2016–17 highlight changes to the composition of sectors adopted by the QAO.

Sector reports now have been tabled with separate energy entities in one sector report and a separate sector report for rail and ports. We commend the QAO for this change as it will provide more meaningful information on entities within each of those sectors.

We also noted that, for the 2015–16 sector reports, the QAO for the first time incorporated the results of internal control assessments for the entities within this sector. As indicated elsewhere in this report, we support the use of the “traffic light” reporting to encourage improvements in the quality and timeliness of financial reporting.

4.13.5 Conclusion

We consider that the sector reports provide a useful resource for Parliament and can also be of benefit for audit clients in those sectors. We commend the QAO for the changes in composition of sector reports for 2015–16 and believe this will provide more meaningful reports to Parliament on those important sectors `of the Queensland public sector.

5 Performance auditing

5.1 Introduction

5.1.1 Terms of reference

The Terms of Reference ask us to "place particular focus on evaluating the QAO's expanded mandate in relation to performance audits", as this is the first time that QAO's performance audit work has been subject to a statutory strategic review.

The Act requires us to assess whether the QAO is carrying out the performance audit function economically, effectively and efficiently. The parts of the Terms of Reference most relevant are those concerning the appropriateness, efficiency and effectiveness of audit processes and standards ("Methodology" paragraphs a, b and d), the standard and quality of service provided to the Parliament, audit clients and executive Government (paragraph e), and:

h) evaluating the effectiveness of the recommendations made by the QAO in audit reports and the costs and benefits associated with their implementation;

i) evaluating the QAO's understanding of the Queensland public sector and related entities' core business and functions being performance audited, taking into account feedback provided by entities the subject of performance audits.

5.1.2 Work performed

In carrying out our assessment of the QAO's performance auditing, we have addressed the following questions:

- The appropriateness and effectiveness of the QAO's processes for performance auditing, examining whether:
  - the QAO has appropriate auditing standards;
  - the QAO's methodology for performance audits complies with those standards;
  - the audits carried out conform to the methodology;
  - the QAO has an appropriate process for selecting audit topics of greatest value.
- The efficiency and effectiveness of the QAO's performance audits, including:
  - QAO's measures of cost, timeliness and impact of its performance audits;
  - cost and benefit of performance audits;
  - clients' experience of performance audits;
  - the costs and benefits of performance audits.
- Opportunities for improvement.

We drew on our interviews with a range of clients and QAO managers and staff, and in particular:

- selected three performance audits to consider in depth:
  - *Monitoring and reporting performance* Report 18: 2013–14;
  - *Managing water quality in Great Barrier Reef catchments* Report 20: 2014–15;
  - *Provision of court recording and transcription services* Report 9: 2015–16;
- examined the QAO's performance audit methodology for compliance with the relevant auditing standards;
- using the performance audit assessment in section 4 of the ACAG *Governance and auditing performance framework for self-assessment and external review,* we assessed the methodology used in the three audits selected, and in three other audits:
  - *Right of private practice in Queensland public hospitals* Report 1: 2013–14;
  - *Procurement of youth boot camps* Report 13: 2014–15;
  - *Royalties for the regions* Report 4: 2015–16;
- read a range of other performance audit reports, in particular those discussed with our interviewees;
- considered the QAO's strategic audit planning process.

5.1.3 Structure of this Part

Because this is the first review of the QAO's performance audit work, we have set out the legislative basis for the performance audit mandate and described the QAO's approach to performance auditing and to strategic audit planning.

The structure of the rest of this Part is:

- Performance audit mandate:
  - recommendations of the 2010 Review;
  - legislation;
  - performance management systems audits;
- The QAO's performance audits:
  - performance audits 2011–16;
  - resources applied to performance audits;
  - cost and duration;
- Does the QAO have appropriate auditing standards for performance auditing?
- Does the QAO's methodology for performance audits comply with those standards?
- Do the QAO's performance audits conform to the methodology?
- Efficiency and effectiveness of performance audits:
  - clients' experience of performance audits;
  - costs and benefits;
- The restriction on commenting on government policy;
- Opportunities for improvement;
- Strategic audit planning – selecting performance audit topics.

5.2 The performance audit mandate

5.2.1 Recommendations of the Strategic Review 2010

The 2010 Strategic Review discussed the arguments for and against extending the Auditor-General's mandate to a full performance audit mandate. They concluded that the mandate should be broadened to enable the Auditor-General to carry out performance audits, consistent with other Australian jurisdictions, and recommended accordingly.

The Review noted that, as a matter of convention, it is generally considered inappropriate for an Auditor-General to comment on matters of government policy, and they recommended that the legislation require the Auditor-General to refrain from commenting on the merits of government policy.

They also recommended that the QAO be required to prepare a three-year Strategic Audit Plan for performance audits, updated annually, and to consult the relevant parliamentary committee, potential audit clients and other affected parties on the draft Plan.

Finally, in that section, the 2010 Review recommended that the Auditor-General have a limited power to audit a non-government body in receipt of government funding – sometimes called a "follow the dollar" power.

The main recommendations of the 2010 Review are set out in Appendix 5.

Response to the recommendations

The Public Accounts and Public Works Committee undertook two inquiries in response to the 2010 Review. The first, *Inquiry into an Evaluation of the Effectiveness of the Performance Management Systems (PMS) audit mandate*[32] focused on the recommendations concerning the proposed performance audit mandate and strategic audit plan. The Committee accepted the Review's recommendations that the PMS audit mandate be broadened, and recommended to the government that it amend the Auditor-General Act accordingly. The Government supported that recommendation.

In response to evidence it received during the Inquiry, the Committee added a recommendation concerning the Auditor-General's use of experts in performance auditing. It recommended that the QAO receive sufficient additional funding "to enable the strategic use of subject experts in all performance auditing".[33] The Government supported that recommendation in principle.

The Committee's recommendations and the Government responses to them are set out in Appendix 5.

[32] 2010, Report No. 5.

[33] 2010, Report No. 5, Recommendation 4.

5.2.2 Performance audit mandate – the legislation

The Act was amended in August 2011 to permit the Auditor-General to carry out performance audits.

Section 37A(1) of the Act allows the Auditor-General to conduct a "performance audit" of "all or any particular activities of a public sector entity". However, the Auditor-General may conduct a performance audit of a public sector entity that is a government owned corporation (GOC) or a controlled entity of a GOC only at the request of the Legislative Assembly, the parliamentary committee, the Treasurer or appropriate Minister (section 37A(6)).

Section 37A(3) says that:

> "the object of the performance audit includes deciding whether the objectives of the public sector entity are being achieved economically, efficiently and effectively and in compliance with all relevant laws".

Section 37A(5) provides that the Auditor-General "must not question the merits of policy objectives of the state or a local government", and lists several types of documents that might evidence such policy objectives.

S38A requires the Auditor-General to prepare a "strategic audit plan" for the performance audits that the Auditor-General intends to conduct in the following three years, prior to the end of each financial year. That is, the plan must be prepared each year, for the subsequent three years. The Auditor-General must give a draft of the plan to the parliamentary committee, which has 42 days to comment on the draft, and the Auditor-General must take account of any such comments in finalising the plan. The Auditor-General must also consult "any relevant entity" on the draft plan. The final plan must be published on the QAO's website.

The 2011 amendments also included a new power to "follow the dollar", which is broader in scope than the 2010 Review envisaged. Section 36A provides that the Auditor-General "may conduct an audit of a matter relating to property" given by a public sector entity to a non-public sector entity. The object of such an audit includes "deciding whether the property has been applied economically, efficiently and effectively for the purposes for which it was given to the non-public sector entity".

There is no explicit requirement that the Auditor-General publish or table reports of performance audits, although section 63(b) permits the Auditor-General to prepare for the Legislative Assembly a full report on a particular audit, where the Auditor-General considers it to be in the public interest to do so.

Other pre-existing provisions of the Act apply to the Auditor-General's conduct of performance audits – such as freedom from direction, application of auditing standards, access to documents and property, obtaining information and evidence, and the obligation to consult affected parties.

Another 2011 amendment of relevance to performance auditing was a new power to carry out joint or collaborative audits with an Auditor-General of the Commonwealth or another state (section 42A).

Comparison with other Australian jurisdictions

The QAO's performance audit mandate is similar to the mandates of the Commonwealth, Victorian, New South Wales, and Western Australian audit offices.

5.2.3 Performance management systems audits

Prior to the 2011 amendment, the QAO had the mandate to audit “performance management systems”. The object of a performance management systems audit “includes deciding whether the performance management systems enable the public sector entity to assess whether its objectives are being achieved economically, efficiently and effectively” (section 38, prior to 2011 amendment).

The performance audit mandate enacted in 2011 supersedes the performance management systems audit mandate, except for GOCs and controlled entities of GOCs – that is, section 38 now applies only to GOCs and controlled entities of GOCs.

We have not separately considered performance management systems audits in the course of this review, as the QAO has not carried out any performance management systems audits since 2011. Nor does the QAO’s Strategic Audit Plan for 2016–19 propose any performance management systems audits. That said, the evaluation of an entity’s performance management systems audits can be part of a performance audit – a senior manager in the QAO described performance management systems auditing to us as a “subset” of performance auditing. Examination of performance management systems was central to the performance audit *Monitoring and reporting performance, Report 18: 2013–4,* and has been part of several other audits.

However, GOCs are an important part of the Queensland public sector. As the performance audit mandate does not apply to GOCs, we have recommended below, in discussing the QAO’s strategic audit planning, that it consider whether it should schedule performance management systems audits of GOCs.

5.3 The QAO’s performance audits

5.3.1 Performance audits 2011–16

The QAO tabled its first performance audit under the new mandate in November 2011. It has now completed more than 50 performance audits, including four follow-up audits, each resulting in a report tabled in Parliament.

Only one audit has concerned a GOC: *Financial risk management practices at Energex*,[34] which was carried out following a request from the Treasurer under section 37A(6) of the Act.

There are several audits that the QAO commenced but then stopped after preliminary work. In each case that we are aware of, the audit stopped for good reason – usually that the preliminary work suggested that the timing was inappropriate. In two of those cases, the audit was deferred to a future year. The Auditor-General changed the scope of proposed work on the management of abandoned mines (2012–13) and it was completed as *Environmental regulation of the resources and waste industries*.[35]

[34] QAO, 2015–16: Report 14.

[35] QAO, 2013–14: Report 15.

Use of the "follow the dollar" power

Several of the audits have involved the use of the section 36A "follow the dollar" power – for example *Implementing the National Partnership Agreement on Homelessness*[36] and *Early Childhood Education*.[37] The practical effect of the provision is that the Auditor-General's powers to obtain evidence and information can be exercised in relation to private entities. It enables the Auditor-General to examine the use of public funds by non-public sector entities. The QAO told us that it had not encountered any problems in the use of the power.

Collaborative audits

The QAO has not as yet participated in a collaborative audit with other Australian audit offices under section 42A. We understand that some other audit offices are unable to collaborate on audits because of legislative restrictions on their disclosing information obtained in the course of the audit. The QAO notes that it would have been advantageous in several audits to have been able to share information reciprocally with the Australian National Audit Office, including in *Managing water quality in Great Barrier Reef catchments*.

Instead, the audit *Implementing the National Partnership Agreement on Homelessness in Queensland*[38] was done concurrently with other audit offices, who shared audit objectives and methodology. A second concurrent audit on mental health in high risk professions is now under way.

Referrals

The QAO's website invites suggestions for suggestions for performance audit topics and information about waste financial mismanagement by a public sector entity. It provides an opportunity for Members of Parliament and members of the public to refer a matter to the QAO.

Three performance audits have arisen from referrals, in each case referred by the Minister responsible for the entity:

- *Financial risk management practices at Energex*, Report 14: 2015–16;
- *Provision of court recording and transcription services*, Report 9: 2015–16;
- *Procurement of youth boot camps*, Report 13: 2014–15.

5.3.2 Resourcing of performance audits

The QAO's Performance Audit Services division has 17 (16.6 FTE) staff: an Assistant Auditor-General, three directors, seven managers, four senior auditors and two auditors. The performance auditors have diverse backgrounds. About half have accounting and auditing experience. Others have a background in education, policing, and the military, and in other parts of the public sector, and in the private sector.

36 QAO, 2012–13: Report 6.

37 QAO, 2015–16: Report 19.

38 QAO, 2012–13: Report 6.

The Performance Audit Services team was established in 2011 when the Auditor-General's mandate changed to performance auditing from performance management systems auditing. Initially, the team comprised the performance management systems auditors. Only three of the former performance management systems auditors now remain, so the majority of the current staff have joined the team since 2011.

The budget for performance audits in 2015–16 was $4.2 million. Each year, $600,000–$700,000 is used to contract in expert assistance.

We return to the question of resourcing in section 5.7 below.

5.4 Appropriateness and effectiveness of the QAO's processes for performance auditing

5.4.1 Does the QAO have appropriate auditing standards for performance auditing?

The *Auditor-General of Queensland Auditing Standards* (September 2012) ("the Standards") set out the general standards that the Auditor-General applies to audit, as required by the Act. They apply to performance auditing as well as to financial auditing, and generally do not distinguish between the two types. The Standards are discussed in section 4.10.

The Standards require the adoption of standards issued by the Australian Auditing and Assurance Board (AuASB) to the extent that those standards are consistent with the Act. The AuASB standard most directly applicable to performance auditing is *Standard on Assurance Engagements ASAE 3500 – Performance Engagements*. (This standard has been under review by the AuASB for some time and should be replaced soon.) Also relevant are the standards on *Assurance Engagements other than Audits or Reviews of Historical Financial Information* (ASAE 3000) and on *Compliance Engagements* (ASAE 3100), and the standards concerning quality.

Conclusion

We consider that the Standards, by incorporating the applicable AuASB standards, are effective for the QAO's performance auditing.

Recommendation

We have a further recommendation for amendment to the Standards, in addition to those amendments recommended in section 4.10 in relation to financial audits.

The primary purpose of the *Auditor-General of Queensland Auditing Standards* is to allow the Auditor-General to set standards relating to those matters that are peculiar to public sector auditing. One of those matters concerns the requirement in section 37A(5) of the Act that the Auditor-General refrain from commenting on the merits of government policy, an issue we examine in section 5.6. The Auditor-General has issued a "factsheet" setting out his interpretation of the restriction, available on the QAO's website.

We consider this issue to be of sufficient importance that it should be included in the Standards.

Recommendation

We recommend that:

5.4(i) The Auditor-General amend the *Auditor-General of Queensland Auditing Standards* to incorporate guidance on the requirement that the Auditor-General refrain from commenting on the merits of government policy.

5.4.2 Does the QAO's methodology for performance audits comply with the auditing standards?

We have examined the QAO's methodology for the conduct of performance audits. At the time of our Review, the QAO was carrying out a comprehensive update of the methodology. In assessing the methodology for compliance with the auditing standards, we have focused primarily on the refreshed methodology.

The updated methodology does not change the QAO's substantive approach to performance auditing. The purpose of the update is to improve clarity and accessibility, especially to supporting documents, and to make more explicit a focus on client engagement. It creates a comprehensive online database for staff in SharePoint that brings together and organises all relevant material – standards, policies and processes. The filing system for performance audits, and thus the record of the audit, continues to be a Lotus Notes application called ASPIRE.

The updated methodology divides an audit into six stages: initiation, planning, conduct, reporting, close out, and follow-up. The ASPIRE file in Lotus Notes reflects those stages. Planning, conduct, and reporting are the stages which most closely relate to the auditing standards. Each stage is broken into a series of process steps. By way of example, the planning stage has six steps:

- understand activity;
- assess materiality and audit risk;
- develop audit strategy;
- develop audit work programme;
- brief client;
- complete planning quality assurance checklist.

The intranet page for each step has guidance on completing the step, and references to relevant parts of the auditing standards and QAO policies. For example, the page for "develop audit strategy" contains:

- a description of the audit strategy document
- references to the applicable AuASB standards and QAO policies;
- the steps, and guidance on them, that the auditor needs to take in developing the strategy:
  - confirming or revising the audit objectives, lines of inquiry and audit criteria;
  - setting audit scope – the boundary of the audit;

- developing the budget and audit plan;
- finalising and issuing the audit strategy.

In working through the methodology in the course of this Review, we found it comprehensive and easy to follow. We consider the SharePoint database to be a notable improvement on the Performance Audit Manual which it replaces.

Guidance on writing

As well as a template for reports to Parliament, there is guidance for the writers of performance audit reports available on the QAO intranet: the *QAO guide for writers* is an interactive tool that has guidance about plain English writing, style and grammar, and structure and layout.

Quality assurance

Quality assurance for performance audits is prescribed by auditing standards, and the QAO policies on Quality Control and Engagement Performance (which apply to both financial and performance audits).

The methodology requires completion of a quality assurance checklist at the end of each of the planning, conduct and reporting phases. The checklist covers the steps in each stage that are required by the auditing standards. It is prepared by the audit team leader, and reviewed by the engagement leader. The engagement quality control reviewer (see below) signs off on each QA checklist.

The Engagement Performance policy requires the appointment of an engagement quality control reviewer (EQCR) for all performance audits, other than follow-up audits. The Assistant Auditor-General for Specialist Audit Services appoints the EQCR for each performance audit. In practice, the EQCR for a performance audit is usually the relevant sector director.

Engagement quality control review is a process designed to provide an objective evaluation of the significant judgements made by and the conclusions of the audit team.[39] The evaluation is made before or at the time the audit is finalised and reported.

Some QA files are also subject to "cold" review – that is, after the audit is complete. The QAO's Assistant Auditor-General for Specialist Audit Services selects two audits for review each year. The reviews may be carried out within the SAS team, or contracted to external reviewers.

Two audit reports are reviewed by another ACAG office, as part of a reciprocal peer review arrangement. That review focuses on the report, rather than the detail of the audit process. It looks at the internal logic of the report, its presentation and readability.

<u>Comment on quality assurance</u>

The results of the quality assurance reviews are generally positive, and both the ACAG reviews and those commissioned or carried out by SAS offer suggestions for improvement of the reports.

[39] AuASB (2014) Auditing Standard ASAE 3000.

The EQCR must be independent of the audit. Because of his or her interest in providing value to clients in the sector, and in maintaining good relations with them, a sector director has an interest in the conduct and outcome of the audit. We do not believe that interest to be incompatible with the role of EQCR. We note from the audit files that we examined that the sector director/EQCR usually attended the first engagement meeting with the client. That is an appropriate use of the sector director's relationship with and knowledge of the entity to be audited. However, we note the risk that the sector director could be drawn into the audit, especially should problems arise. The QAO assures us that it is aware of that risk and monitors it.

Engagement with audit client

The methodology prescribes client involvement in performance audits at the planning, conduct, and reporting stages of the audit. The QAO has prepared a brief *Performance Audit Practice Statement,* available as a "factsheet" on its website, which outlines the performance audit process and offers advice to the auditee on preparation for the audit.

At the close of each of those three stages, the QAO produces a formal document for the client's chief executive, which the QAO and the auditee will meet to discuss.

The first, from the planning stage, is the Audit Strategy, which confirms the audit scope and conduct. It describes the audit objective/purpose, sub-objectives, and line of inquiry for each, and the criteria against which each line of inquiry will be assessed. It also sets out the audit timeframe, and the roles of the primary contact persons for the QAO and the audit client.

At the end of the conduct stage, the QAO prepares an end of conduct brief, which summarises its understanding of material facts, and sets out its audit findings. The end of conduct brief does not include the QAO's conclusions or recommendations.

The reporting stage produces a preliminary report that includes the QAO's conclusions and recommendations, and the proposed report, as required by the Act. Both draft reports are for consultation with the client and any affected parties with a special interest in the report.

Improvement

<u>Restriction on questioning the merits of government policy objectives</u>

We discuss this issue in section 5.6 following, and we have recommended above that the Auditor-General's interpretation of the restriction be included in the *Auditor-General of Queensland Auditing Standards*.

We note that there is no obvious reference to the restriction in the audit methodology. While the Auditor-General's position is clear, and evidenced by a factsheet on the QAO website, we consider that the issue should be included in the guidance in the performance audit methodology. The question of relevant government policy should be considered at the time of inclusion of the topic in the Strategic Audit Plan, but the methodology allows that audit objectives, sub-objectives and criteria may be revised at the time the audit is commenced. Further, not all performance audits are included in the Strategic Audit Plan, as some arise from referrals.

Guidance on the restriction could usefully be included in or linked to the sections on Initiation/Gain preliminary topic knowledge, which includes the guidance on selection of audit criteria, and in Planning/Develop audit strategy, which requires setting or reconfirmation of audit objectives and lines of inquiry.

We do not doubt that the QAO is constantly aware of the restriction. However, given the importance of the issue, we consider that there is merit in explicitly including it in the methodology.

Conclusion

We have compared the refreshed methodology for performance audits with ASAE 3500, ASAE 3000 and ASAE 3100, and we consider that the methodology meets the requirements of those standards. We consider that there are sufficient quality assurance procedures in place to ensure that audit conclusions are appropriate.

In addition, we have considered the previous methodology, in the course of reviewing our sample of audit files, discussed in the next section. We are satisfied that that methodology also met the requirements of the auditing standards, including the requirement for quality assurance.

Recommendation

We recommend that:

5.4(ii) The QAO include in its performance audit methodology guidance on the restriction on questioning the merits of government policy.

5.4.3 Do the QAO's performance audits conform to the methodology?

To assess compliance with the methodology, we selected six audits for review:

- *Monitoring and reporting performance*, Report 18: 2013–14;
- *Managing water quality in Great Barrier Reef catchments*, Report 20: 2014–15;
- *Provision of court recording and transcription services*, Report 9: 2015–16;
- *Right of private practice in Queensland public hospitals*, Report 1: 2013–14;
- *Procurement of youth boot camps*, Report 13: 2014–15;
- *Royalties for the regions*, Report 4: 2015–16.

The first three listed are those chosen for in-depth review. We assessed only five for compliance, as one – *Managing water quality in Great Barrier Reef catchments* – used a different methodology. For that audit, the QAO trialled methodology called AmP (Audit method – Performance), which is the methodology used by the Victorian Auditor-General's Office. We note that independent reviews of the Victorian audit office have found that the AmP methodology complies with auditing standards.[40]

[40] PwC (2013) *Performance audit of Victorian Auditor-General and Victorian Auditor-General's Office.*

We assessed the QAO's application of its performance audit methodology to the five audits using the performance audit assessment in section 4 of the ACAG *Governance and auditing performance framework for self-assessment and external review*. We did not examine all work papers, but we are confident that there was no material non-compliance with the Standards. We consider that the QAO has applied the methodology appropriately.

We note some flexibility in the application of the methodology. For example, internal steps (such as a formal briefing to the Auditor-General) might be dispensed with. In the *Provision of court recording and transcription services* audit, the Auditor-General decided to dispense with a preliminary report and move straight to the statutory proposed report. Any departures from the methodology that we identified appeared to be appropriate and were approved by the Auditor-General.

Comments

We have three comments arising from our review of the QAO's application of the methodology.

Recommendations in reports

The performance audits invariably result in recommendations to the client concerning steps to be taken to remedy or improve the matters audited. We consider that recommendations should be specific and measurable. It should be clear to the auditee exactly what actions the Auditor-General is recommending. Further, it ought to be possible to determine whether the recommendations have been implemented.

We noted in some of the earlier performance audits that some of the recommendations were general rather than specific and measurable. For example, in the *Managing water quality in Great Barrier Reef catchments* audit, one of the five recommendations was: "… that the design and implementation of programs attributed to the Reef Plan is reviewed to establish they are most effective and efficient". That recommendation does not identify who was expected to carry out a review, nor does it specify the standards against which efficiency and effectiveness should be assessed.

The specificity of recommendations has improved in more recent audits, and the refreshed methodology requires recommendations to be clear and practical. It also requires the auditor to discuss draft recommendations with the client, to increase the likelihood that recommendations are practical and will add value.

We note the QAO has recently adopted a performance measure concerning the percentage of performance audit recommendations implemented. (We comment on this measure in the next section.) If the QAO is to report accurately on that measure, it is essential that its recommendations are able to be implemented and that it will be clear when they have been implemented.

Quality of reports

We have read a number of the QAO's performance audit reports in the course of the Review. We consider that they are of good quality, in terms of structure and readability, and in their use of graphics. We note that they are rated satisfactorily by ACAG peer reviewers. The three reports assessed in 2015–16 each scored 3.5 out of 5. The QAO's target is 3.

Legibility of records

Our third comment repeats a point made in relation to the financial audit files that we reviewed. Sometimes meetings are evidenced only by handwritten notes of limited detail and legibility. Although there are typewritten notes on the files that we reviewed in many cases, we consider that the QAO ought to require an adequate and legible record of all meetings, as we have recommended in section 4.4. The ASPIRE file should be a complete record of the audit. But it is also important that members of the audit team who have not attended a meeting have access to a complete and accurate record of the meeting.

Conclusion

Based on our review of selected files, we consider that the QAO's performance audits comply with its performance audit methodology in all material respects. We consider that the QAO has applied the methodology appropriately.

Recommendations

We recommend that:

5.4(iii) The QAO phase out the inclusion of handwritten notes on ASPIRE files and that notes be in digital format to enable ease of reading by other audit staff and for review purposes.

5.5 Efficiency and effectiveness of the QAO's performance audits

5.5.1 The QAO's measurement of efficiency and effectiveness

The QAO's efficiency and effectiveness measures for reports and advice to Parliament, which includes the performance audit reports, and the targets and actual results for 2015–16 are:

	Target	Actual
Efficiency measures		
• Average cost of reports tabled ($000)	$390	$336.2
• Average time taken to produce reports (months)	< 8	8.3
Effectiveness measures		
• Parliament's overall satisfaction with all QAO services	80%	81%
• Audit entities' overall satisfaction with the services	80%	77%
• Performance audit recommendations implemented by audit entities	100%	66.7%
• Benefits from performance audits (benefit-cost ratio)	>1	>1

Source: QAO Annual Report 2015/16

The QAO benchmarks its performance against its ACAG peers. In 2015–16:

- the average cost of an audit was $336,200, which was about 15% higher than the ACAG average;
- the average time spent on a performance audit by QAO was 8.3 months, compared with an ACAG average of nine months;
- the productivity of the QAO performance staff (measured by hours charged to audits) was higher than the ACAG average – 75% compared to 66%.

Variances in budget and time

We note from our review of audit files and other documentation that there have been some significant variances in actual versus budgeted expenditure for audits, though accuracy of budgeting has improved in recent years.

In 2011–12 and 2012–13, variances were as high as 60% over budget (*Tourism industry growth and development*)[41] and often between 30% and 50 % in those earlier years. In 2014/15, the average variance was closer to 8%, but with some wide variations both over and under.

In 2015–16, aggregate expenditure on performance audits was 1.2% under budget (compared to 20% over budget in (2011–12), but that figure disguises some significant variations. However, two of the three largest variances were referrals, so were not subject to the extensive prior research that would be the case for a planned audit.

The three audits that we selected for review each showed cost and time overruns, but we could not discern from the ASPIRE files what the causes were.

The data that we have reviewed also shows overruns in elapsed time, but the overrun is usually a matter of a few weeks. There did not appear to be a correlation between high cost variances and overruns in budgeted time of audits.

Comments – efficiency

We have found it difficult to assess from the available data whether the QAO's performance auditing is efficient but, on balance, we conclude that it is.

We do not find the ACAG comparative figures useful. The comparisons are valid only if performance audits are of the same size and complexity in each of the ACAG offices, and performance audits can be of any size and complexity. Scope and complexity of audits will vary within offices as well as across offices. The QAO's average cost of performance audit has been as high as $446,739 (2013–14), which illustrates the variability of the figures.

<u>Productivity</u>

We note that, compared to its ACAG peers, the QAO has higher productivity, roughly comparable audit duration, yet a higher average cost per audit. Explanations may lie in differences across ACAG offices in

[41] Report 3: 2012–13.

size and scope of audits and use of expert advice on audits. Another possible explanation is the more senior staff profile in the QAO performance audit group, a matter that we return to in section 5.7.

Variances from budget

We know that cost overruns are a common feature of performance audits. We asked each of the ANAO, New South Wales, Western Australian and New Zealand audit offices about their accuracy in time and cost budgeting. All acknowledged variances, both under and over. In our experience, variances can be caused by unexpected issues arising in the course of the audit, difficulties and delays in obtaining information, and prolonged and contentious consultation on a draft report.

Unexpected issues arising in the course of the audit is sometimes referred to as "scope creep" – increasing audit scope in the course of the audit. We note that several of the performance audit clients that we interviewed complained about scope creep. In our view, examining unanticipated issues that arise in the course of the audit can sometimes be necessary. It is important, however, that a change in scope be formally approved by senior management, taking account of the materiality and relevance of the new issue. Any change in scope that we identified in the course of our review of performance audit files had been properly approved.

Variances in time taken by audits do not appear to be significant. As noted above, the QAO's average elapsed time for an audit is better than the ACAG average of nine months. Several performance audit clients commented that the issues subject to audit had ceased to be relevant by the time the audit report was published. We interpret such comments as a reference to the retrospective nature of the audit rather than to a few weeks' overrun.

Conclusion – efficiency

We consider, on balance, that the QAO's performance auditing is efficient. The factors that contribute to that view are:

- the QAO's high productivity for performance auditing, as compared to other ACAG offices;
- the downward trend in the average cost of performance audits;
- the increased number of performance audits completed;
- the lower than average elapsed time for its performance audits when compared to other ACAG offices;
- more accurate budgeting, allowing for efficient workflow; and
- increasing experience of performance audit staff.

However, as already mentioned, we are concerned that the drive for efficiency may have created unnecessary pressures on staff. We discuss that matter further in section 5.7.

Comment – effectiveness measures

The QAO has adopted two new effectiveness measures for performance auditing:

- the number of performance audit recommendations implemented by the relevant agencies (target: 100%); and
- benefits from performance audits (target: benefit-cost ratio > 1).

The first measure replaces the measurement of the number of recommendations accepted by audited agencies. The measure now is that the recommendations are not only accepted by an agency, but also implemented, which shows a clear focus on improving the performance of the public sector. We comment further on the second measure in section 5.5.3.

We commend the QAO for these measures. They go to the heart of effectiveness, and will be an exacting standard to meet.

In 2015–16, in relation to the first measure, the QAO took eight reports tabled in 2013–14 containing 66 recommendations. Because some recommendations applied to multiple agencies, 204 recommendations had been accepted by clients. The QAO assessed that 67% of the 204 had been fully implemented, thus falling well short of the 100% target. Another 28% had been partially implemented.

We consider that a target of 100% is unrealistic. We note that the QAO will review the measure during 2016–17, and we suggest that it should be reduced to 98% of recommendations fully implemented. We think that the threshold should be high, as an incentive to the QAO to make recommendations that are implementable. But there will be circumstances in which an Auditor-General should make recommendations that an agency is reluctant to implement, even if they are accepted at the time of the audit. We consider that a target of 100% could be an incentive to avoid recommendations that might be unpalatable to entity. We comment further on the cost of implementation of recommendations in section 5.7.

Recommendation

We recommend that:

5.5(i) The QAO reduce to 98% its performance measure target for performance audit recommendations implemented.

5.5.2 Parliament's views of performance audits

We spoke to the Finance and Administration Committee, and met separately with the Chair and Deputy Chair of the Committee. Both the members of the Committee and the QAO agree that Parliament is not currently making best use of the QAO's performance audit reports.

We referred in section 4.3 to the QAO's surveys of Members of Parliament. In response to the 2016 survey:

- 47% said Auditor-General's performance audit reports address their key areas of interest to a high or very high extent (compared to 45% in the previous survey in 2014);
- 97% said that they had referred to performance audit reports in previous year (84% in 2014); and
- at least 75% rated the reports favourably on readability, clear identification of public sector agencies' performance and clear communication of significant issues and their implications.

MPs' main use of performance audit reports will occur where the relevant Parliamentary Committee chooses to examine the report.

The QAO holds a briefing for MPs after each report is tabled. MPs to whom we spoke said that the sessions were valuable, but hard to attend because of their other commitments. Recent attendance has been low. There is general agreement that there should be a better mechanism for the QAO to inform and engage MPs on the results of the performance audits.

The general reason for broadening the Auditor-General's performance audit mandate advanced by the 2010 Review was to strengthen public administration and accountability in Queensland. It proposed as its first ground:

> "Parliament, as the Auditor-General's client should have its auditor provide independent reports on the performance of public sector entities and on government programs/activities. This would enable an objective assessment as to whether public resources are being used with appropriate economy and efficiency, and are delivering government programs and activities effectively and in compliance with appropriate laws and regulations."[42]

We agree with that proposition, and encourage the QAO to continue to work with the Finance and Administration Committee and the Parliament to improve the communication with Members on its performance audit work.

Recommendation

We recommend that:

5.5(ii) The QAO continue to work with the Finance and Administration Committee and the Parliament to find ways to improve its communication and engagement with MPs on its performance audit reports.

5.5.3 The client's experience of performance audit

Client satisfaction surveys

Much of the feedback from the QAO's performance audit clients is positive. As noted in section 4.3.3, the QAO carries out surveys of its clients through an independent company, ORIMA Research. The research is conducted on behalf of ACAG, and uses a core set of common questions which allows comparability across the offices.

The QAO scores over 60% on most of the criteria against which it is assessed for performance audit services and, on professionalism of auditors, as high as 100%. The overall measure of client satisfaction shows an upward trend over the five years of the performance audit mandate from 73 index points to 77 index points for 2015–16. There was a drop in 2014–15 to 68 index points, the lowest score the QAO had obtained, so the latest result is a significant improvement. The QAO's target score is 80 index points, which it has yet to achieve.

[42] 2010, *Report of the Strategic Review of the Queensland Audit Office*, at page 119.

The lowest scores consistently concern auditors' understanding of the client organisation's business and operating environment, and the balance and fairness of the tabled report. Judging from clients' comments included in the survey report, the two appear to be related – the client sees the report as unfair because it lacks contextual information about the client's business and operating environment.

Where the client consents, the completed survey is given to the QAO. Several of the completed surveys held by QAO (to which we had access) concern performance audits that we discussed with the relevant client in the course of our interviews. In four of the five cases, the survey responses did not reflect the negative comments made to us in our interviews. We read the survey results after the interviews, and we have not asked the clients to explain the difference.

The issues raised by the survey results are largely consistent with the findings of research by the Queensland University of Technology commissioned by the QAO, and the views we heard in our interviews with QAO performance audit clients.

Queensland University of Technology research

The QUT research, which is nearing completion, concerns the future of performance auditing. The researchers have set out to determine the major challenges and solutions that performance auditors and their clients expect performance auditing to face in the next five to ten years. The participants are the Australian audit offices, five international audit offices, and performance audit clients in Queensland.

Participants were asked to look five to ten years into the future and identify the major challenges or obstacles facing the auditing of the performance of government service delivery, and to propose solutions.

The challenges identified by the clients included:

- performance audits undertaken without a proper understanding of the client's business or operating context;
- the need for more collaborative and constructive relationships between client and performance auditor;
- the cost of finding, generating, assessing, interpreting and integrating relevant data for the performance auditor;
- a shortage of skilled and experienced performance auditors;
- client scepticism about the inherent value of performance auditing.

The challenges identified by the audit offices included:

- stakeholder tensions and a lack of stakeholder engagement;
- shortfalls in performance audit capability and capacity;
- shortcomings in current audit approaches and practices;
- demonstrating and communicating the "value proposition" of performance auditing.

Solutions proposed by clients suggest that they want better engagement with the auditors. They include "consulting and collaborating far more closely with clients" and "robust collaborative front-end loading – organising and planning for success". The audit offices too proposed "improving stakeholder consultation, collaboration and inter-agency cooperation".

Client interviews

Similar challenges emerged from our interviews. We listed in Part 2 of this report some of the complaints that we heard:

- a lack of understanding by the audit team of the client's business and the context in which it operated;
- the QAO's perceived unwillingness to negotiate the timing of the audit;
- apparently unreasonable requests for information, often with a short response time.

As we noted in Part 2, these criticisms are made in a context of concern about the cost of the audit to the client, and often the cost of implementation of recommendations. We note again that these issues are not the invariable experience of performance audit clients.

We identified two further issues in the course of our various interviews. First, it is clear that many performance audit clients do not understand the performance audit process, despite explanations from the QAO at the outset of the audit, and its *Performance Audit Practice Statement* factsheet. Secondly, there can be a disjuncture within the client organisation, between its management and the staff actually dealing with the audit and auditors. Consequently, the end of conduct brief or draft report comes as a surprise to the managers to whom it is sent. Both perhaps are reflected in the challenges identified by the audit office participants in the QUT research.

We return to these issues in section 5.7.

Cost and benefit of performance audits, and the cost of implementing recommendations

<u>Cost</u>

Clients complained to us about the cost of audit. Performance audits are funded by Parliament, so cost refers to the time and effort that the client puts into the audit, which has both a financial and an opportunity cost. No performance audit client that we asked had quantified those costs. We asked the other audit offices that we consulted whether, to their knowledge, any of their performance audit clients had measured the cost of the audit. None had.

Clients also complained to us about the cost of implementing performance audit recommendations. The point is not consistently made in the client survey responses that we have seen. However, the question in the survey concerns whether the recommendations are capable of being implemented, rather than the cost of their implementation. We note an example quoted in an ORIMA survey report that concerns a recommendation that could only be implemented if the agency concerned received additional funding, which it appeared would not be forthcoming.

The examples given to us of recommendations costly to implement appeared to be of poorly specified recommendations. We have already emphasised the importance of clear, specific and measurable recommendations.

The 2010 Review noted a concern on the part of central agencies that QAO reports often recommended new whole-of-government protocols that would require enforcement or monitoring by central agencies. The QAO says that the majority of its recommendations since 2012 have been agency-specific, although there have been audits such as *Monitoring and reporting performance* where whole-of-government recommendations were appropriate. The QAO notes that the issue has not been raised with it again.

The terms of reference ask us to evaluate the effectiveness of the QAO's performance audit recommendations. We considered that the best measure is the opinion of the performance audit clients to which they apply.

Indications are that clients mostly regard the recommendations as effective. The ORIMA client survey measures clients' perceptions of the audit process, audit reporting, and audit value. The overall score for performance audit services, as we have noted, was 77 index points. The score for audit value was 75 index points, up from 70 in 2014–15. The elements of the value section of the survey were:

- the recommendations in the tabled audit report were practical (ie, capable of being implemented);
- the audit will help us improve the performance of the audited activity;
- we value the contribution the audit made by providing us with assurance about the effectiveness of our administration of the audited activity.

The survey attributes the increase in score from 70 to 75 to the higher ratings for practicality of audit recommendations.

The other indicator is the extent to which recommendations are accepted and implemented. The QAO has measured the number of recommendations accepted, but has now moved to measuring the number of accepted recommendations actually implemented. As we noted above, the QAO reported for 2015–16 that 67% of 204 recommendations made in 2013–14 had been implemented.

The numbers of recommendations accepted were 95% in 2014–15, 98% in 2013–14, and 96% in 2012–13. It is open to the client not to accept recommendations, although clients seem to be reluctant to decline to accept recommendations. We take the high acceptance rate as an indication of effectiveness. The primary concern about recommendations seems to be the cost of implementation.

Benefit

The results of the client surveys show that most of QAO's performance audit clients recognise benefit in their audit. Most of those performance audit clients whom we interviewed acknowledged that, despite the effort and cost, their organisation had derived benefit from the audit.

As we have noted, the QAO adopted a new performance measure for "benefits from performance audits" in 2015–16. The measure is a benefit-cost ratio where the target is greater than one – that is, that benefits from audits out-weigh the annual cost of the performance audit programme ($4.33 million).

The QAO has instituted a Performance Audit Benefits/Impact Statement to support the new measure. It will be prepared at the end of an audit, and added to over the following year or 18 months when there is information about benefits and impacts flowing from the recommendations.

The QAO assessed that it had met that target for 2015–16[43] on the strength of its audit *Managing privately-operated prisons*.[44] That audit found that the operating costs of the two privately managed prisons are 19% lower than for publicly managed prisons. In particular, the medical costs at the privately managed prisons are $4.4 million lower than they would be in the publicly managed prisons.

[43] QAO Annual Report 2015–16 page 57.

[44] Report 11: 2015–16.

The QAO recommended that a cost-benefit analysis be completed of options for delivering medical services more cost-effectively in publicly managed prisons.

This is only a potential saving, as the criterion set by the QAO is that the benefit or saving need only have been identified; it need not have been realised. Realisation is the responsibility of the client. Therefore, the QAO's assessment of benefit would not usually take account of the cost of implementing the recommendations.

An example of a benefit realised followed the audit *Right of private practice in Queensland public hospitals*.[45] The audit identified unclaimed revenue, of which public health providers subsequently recouped $11 million.[46]

The QAO says that it expects its approach to setting targets and measurement to mature over time. We note that a more accurate cost-benefit ratio might take account of the cost to the client of implementing recommendations.

The challenge for the QAO, and for its performance audit clients, is to maximise the benefit of the audit to the client (and the QAO), while minimising the cost of both the audit and implementation of recommendations. We believe that there are solutions, as we discuss in section 5.7 below.

Conclusion – effectiveness

The key issues that have emerged consistently are:

- QAO's poor understanding of the client's business and its operating environment;
- clients' poor understanding of performance audit and the process that the QAO will follow;
- QAO's alleged failure to consider either the cost or the value of the audit to the client;
- the challenge to both the QAO and its performance audit clients of maximising value and minimising cost of a performance audit.

Each of those issues impacts on overall performance audit effectiveness. However, we consider that, overall, the QAO's performance audit work is effective, although we think that its effectiveness can be improved.

We have taken the clients' level of acceptance of performance audit recommendations as a measure of their effectiveness. We note that the primary concern about recommendations seems to be about cost of implementation.

45 Report 1: 2013–14.

46 QAO Annual Report 2013–14.

5.6 Restriction on questioning government policy – section 37A(5)

Before turning to opportunities for the QAO to deliver greater value through its performance audits, we examine one other issue that arose in our interviews with stakeholders.

Section 37A(5) says that the Auditor-General must not question the merits of policy objectives of the state or a local government. It was enacted at the time the performance audit mandate was broadened in 2011. It is clear that the restriction applies when the Auditor-General is carrying out a performance audit, though it is unclear why it would be limited only to the performance audit function.

The provision recognises, in short, that is the prerogative of an elected government to determine policy objectives. Critique of government policy is the main role of the opposition. Decisions about policy objectives are "political", and not the preserve of the Auditor-General. Implementation of government policy is the role of the public service.

The QAO argues from a different angle, saying that "the point of this restriction is to avoid the auditor-general becoming involved in political debate and thus affecting the perceived independence of the role".[47]

Either way, the Auditor-General, as auditor of the public service, can properly audit whether the objectives of a public sector entity (that is, the implementation of a government policy objective) have been achieved economically, efficiently and effectively.

It was suggested to us that the QAO had crossed the line between policy and implementation on several occasions. Four reports were drawn to our attention:

- *Results of audit: State public sector entities for 2012–13*, Report 11: 2013–14 (concerning the construction of 1 William Street);
- *Monitoring and reporting performance*, Report 18: 2013–14;
- *Maintenance of public schools*, Report 11: 2014–15
- *Management of privately operated prisons*, Report 11: 2015–16.

We reviewed those reports but did not find any instances of the Auditor-General questioning the merits of government policy.

Following the disagreement concerning 1 William Street, the QAO published a factsheet *Auditing government policy*. In preparing the factsheet, the QAO drew on the experience of other Australian Auditors-General and consulted a range of people on a draft. The factsheet draws a distinction between questioning the merits of policy objectives and assessing and commenting on how well policy objectives are being achieved, including an assessment of the methods used to implement policy.

[47] QAO, *Auditing government policy,* https://www.qao.qld.gov.au/reports-resources/fact-sheets

Comment

We have looked at material prepared by the QAO on this issue. We consider that the factsheet *Auditing government policy* is a helpful guide to the issue, but method of implementation requires careful consideration, as in some cases a "method" might itself be policy.

The factsheet takes a hypothetical example of a "law and order" policy and sets out matters which are the government's prerogative, and those which are implementation and amenable to audit by the Auditor-General. We agree with that analysis.

However, a slide presentation prepared by the QAO for a session on performance auditing convened by the Department of Premier and Cabinet[48] again uses the hypothetical law and order policy. A note to one of the slides reads thus:

> We distinguish between public or government policy, such as reducing crime, and the implementation of the policy, such as increasing the number of police officers or opening new police stations.

This goes further than the examples in the factsheet *Auditing government policy*, although it was only a speaking note for a presentation. We are not persuaded by the view that a high-level aspiration of a government such as reducing crime is the limit of the government's policy, and that everything else is "method" or implementation. In the reviewers' experience, decisions as to numbers of police officers and the location of police stations are usually highly political. Such decisions are likely to have been made by the government rather than by officials and are, in our view, matters of government policy. Commenting on them would risk involving the QAO in the sort of political debate it seeks to avoid.

In the hypothetical example given, we suggest that appropriate questions for an Auditor-General could be whether the acquisition of new of police stations met the standards of good procurement practice, or whether the recruitment and training of new police officers followed good practice.

Conclusion

We consider that the QAO is aware of the importance of refraining from comment on the merits of government policy, and is careful to do so in all its work, not just in performance audits. We have not seen evidence in any of the reports that we have reviewed that the Auditor-General has commented on the merits of policy.

[48] This initiative is discussed further in the following section.

5.7 Opportunities for improvement

5.7.1 Relationships with performance audit clients

The QAO's strategic goal is to improve the performance of the public sector. It follows that a key objective of a performance audit should be to add value to the client organisation by providing an opportunity for the client to improve its performance. That requires a co-operative working relationship between auditor and client. A client's antagonism towards, or even grudging acceptance of, the QAO and the audit will erode the value of the audit.

We have discussed above some of the comments made to us by performance audit clients, which suggest that sometimes the QAO's relationships with its clients are less than satisfactory, although we acknowledge again that the QAO has positive working relationships with many of its clients. As we have said in Part 2, we believe that the QAO should address such issues, whether or not they are the experience of the majority, because any poor relationships will undermine the value and reputation of the performance audit programme and the QAO.

As we have described in relation to both performance audit and financial audit, the cause of poor relationships seems to be a range of (sometimes minor) irritations. The problem is not the quality of the QAO's work – that was rarely the subject of complaint, and we have recorded our conclusion that that work is both efficient and effective. But the full value of that work will not be realised if relationships between the QAO and its clients are not good.

In the case of performance audits, we believe that efficiency and effectiveness will increase if relationships improve. The obvious solution is to address the irritants, and the strategy for doing so is, in essence, better communication.

We think that the irritants can be considered under three headings:

- QAO's understanding of the client's business and its operating environment;
- Clients' understanding of performance audit and the process that the QAO will follow;
- QAO's consideration of the cost and the value of the audit to the client;

QAO's understanding of the client's business

The QAO's client survey in 2014–15 contained low scores for the QAO's understanding of the client's business and operating environment and for the fairness and balance of the report, and the two appeared to be connected. In response, the QAO took steps to increase sector knowledge, including formal and informal training for performance audit staff, and ensuring that the knowledge of the sector director was available to the performance audit team. As we noted earlier, the QAO's performance audit staff come from a range of backgrounds and experience, and they bring that knowledge and experience to their audit work. Scores for those areas improved in the 2015–16 survey, though they were still among the lowest scoring components.

In fact, a performance audit team can never understand the client's business or its operating environment as well as the client. Further, a performance audit will only cover a small subset of a client's business, so it is unlikely that a QAO sector director, who may well know the sector and even the agency well, will have had much visibility of that particular area. The knowledge rests with the client.

The challenge for both QAO and client is transfer of sufficient knowledge to the QAO to enable the client to have confidence in the audit, without either the fact or perception of loss of independence on the part of the QAO. We consider that the performance audit team should be prepared to listen to the client's comments about the way the business works at all stages of the audit, from scoping the topic to reporting the results of the audit. We note that the performance audit methodology provides for client engagement at every key stage. Listening carefully to the client does not, in our view, compromise independence.

We encourage the QAO to look for ways in which it can compensate for its lack of understanding of the client's business. In several audits, the QAO has used a secondee from the client entity or an associated organisation (eg an industry inspectorate) to assist with the audit. We note that secondment from the client can threaten the independence of the audit team and needs to be carefully managed.

We are aware of a performance audit in another jurisdiction which concerned case management systems in two agencies[49]. Agency A seconded a senior staff member from its case management team to the audit office to work on the part of the audit that concerned Agency B. Likewise, Agency B seconded a staff member to the audit office to work on the part of the audit that concerned Agency A. The advantage to the audit office was current and practical knowledge of and advice on case management. The advantage to the clients was that the audit team included someone with expertise in case management, and that the secondment provided a development opportunity for their employees.

Several performance audit clients complained that early drafts of a report were "full of errors" and "showed that the QAO had not been listening". We suggest, however, that letting the client have an early draft possibly containing factual errors is one way in which the QAO seeks to redress its limited knowledge of the client and its operating environment, to draw out more evidence, and to give the client opportunity to explain details that the QAO may have misunderstood. Again, the underlying issue appears to be lack of communication.

<u>Use of experts</u>

Engaging experts either to advise or to work as part of an audit team will often help to compensate for lack of knowledge about the audit subject area. However, it can create a further challenge if the client does not respect the expert or the expert's neutrality.

The Public Accounts and Public Works Committee in its *Inquiry into an Evaluation of the Effectiveness of the Performance Management Systems (PMS) audit mandate*[50] in 2010 received submissions from a number of departments concerned that the QAO, whether carrying out performance management systems audits or performance audits, often lacked knowledge and understanding of the subject matter. The Committee accepted that it was a major issue for agencies, commenting that "given the size of the division it follows that they cannot be experts in everything".

49 Office of the Auditor-General, New Zealand (2014) *Accident Compensation Corporation: Using a case management approach to rehabilitation*; *Ministry of Social Development: Using a case management approach to service delivery*.

50 2010, Report No. 5.

In agreeing with the 2010 Reviewers that the performance audit mandate should be broadened, it said:

> "Whilst the Auditor-General is confident that the QAO has the capacity to expand the mandate, he needs to ensure that there is judicious use of external experts/advisers. The committee agrees that it makes sense that subject area experts, including secondments from within departments, be utilised over the course of the audit. Whilst this may increase the cost of the audits, it will ensure that the audit arrives at more accurate conclusions which will be of benefit both to Parliament, QAO and the agency being audited. However, the committee is conscious that any increase in funding must reflect a demonstrable benefit and it encourages the Auditor-General to be strategic in his use of experts as funding is not infinite."[51]

The Committee went on to recommend that "sufficient additional funding be provided to QAO to enable the strategic use of subject experts in all phases of performance audits".[52] The government accepted that recommendation in principle, on the basis that the QAO should seek any such additional funding by submitting a business case in the normal budget process. We understand that the QAO has made one, unsuccessful, bid for additional funding, in relation to the *Right to Private Practice* audit.

As we have noted, the QAO spends between $600,000 and $700,000 on expert advice for performance audits each year. It has established processes for engaging experts and ensuring their independence. The QAO has increased its use of experts since 2011 from within its existing funding.

Clients' understanding of the performance audit process

The QAO has made efforts to help clients to understand the performance audit process. They have prepared a *Performance Audit Practice Statement* factsheet explaining the general process, and the Audit Strategy for each audit describes the audit for the client before the audit commences. The scoping and planning of the audit is likely to have involved a range of meetings between the QAO and managers and staff of the client entity.

The Department of Premier and Cabinet (DPC) has established a Queensland Audit Office Central Co-ordinator role, one purpose of which is to develop the "maturity of the working relationship between Queensland Government Departments and the Queensland Audit Office". Part of the strategy is to convene a twice-yearly meeting of Senior Officer representatives from across government to:

- enhance awareness and understanding of the QAO performance audit mandate;
- share learnings and recommendations from performance audits;
- enhance engagement and collaboration between the QAO and the Queensland Government.

We are aware of two meetings that have taken place attended by both the QAO and departments. Both took the form of workshops at which the QAO gave presentations about performance auditing. At the first workshop in November 2015, the QAO sought and received feedback from departments about their experience of performance audits. At the second meeting in April 2016, the QAO summarised the feedback that it had received, and the solutions that it proposed.

[51] Paragraph 237.

[52] Recommendation 4.

The solutions included enhancements to the QAO's audit approach and communications:

- asking the client to provide an induction session for the audit team;
- greater focus on technical specialists used;
- publishing its approach to performance auditing;
- investigating whether the auditors could spend more time actually in the department when carrying out the audit;
- increasing progress updates during the audit, including with the department sponsor for the audit;
- seeking the department's perspective on proposed recommendations.

We commend DPC on the initiative, which should prove a useful forum for both departments and the QAO. It has already provided an opportunity for clients to learn from the QAO about performance audit, and for the QAO to learn about clients' experience of the audit.

The challenge for a department subject to a performance audit is to ensure that information learned from this forum, and from other sources, is available to the managers and staff in the department actually dealing with the audit. As performance auditing becomes more entrenched, each department will develop a body of knowledge. At the moment, however, even if a department has been subject to performance audits before, it does not follow that the experience gained by one team in the department will be passed to the next.

We suggest that Internal Audit, where it is located in the department, may be a good repository of knowledge. We talked to one department's Head of Internal Audit who had facilitated several performance audits in his department. He was a point of contact for the QAO, and able to find the appropriate people in his department to deal with the QAO's questions.

It is the audit client's responsibility to make sure that the right members of its staff and management are involved in the audit at the right stages. We noted earlier in this report that difficulties can arise at the end of conduct brief or draft report stage if management have not been kept informed of the progress of the audit.

Clients need also to understand the amount of resource that an audit will consume. We suggest that the client should appoint a staff member to manage the department's day to day involvement in the audit, and relieve that person of some or all of their usual duties for the duration of the audit. The client needs also to understand in advance what data the QAO will require.

Clients are increasingly aware that they need to prepare for a performance audit. However, although the QAO's strategic audit plan provides at least two years' warning, some said that is not sufficient. They said that a paragraph or two in the plan is not enough to enable them to focus their preparation.

Addressing these issues needs early engagement between client and QAO. We recommend below that, well prior to the formal initiation of the audit, the QAO engage with those in the client who will actually be involved in the audit. We observe that the QAO is aware of the need for better communication, and note the steps listed above that it has already implemented or proposes to implement. We note also that there is more focus on client engagement in its refreshed performance audit methodology.

Cost and value of audit

As we have noted, a challenge for both the QAO and its performance audit clients is to maximise the value and minimise the cost of a performance audit. The current client complaint is that the QAO does not think about the value or cost of the audit to the client.

Value

Performance audits give assurance about the performance of public entities. Their primary value lies in the benefit to Parliament and the public of public entities being held to account.

The issues raised with us concerned the value to clients of individual audits. Assessing value to the client may involve consideration of timing, scope, audit objectives, and criteria. We suggest again that this is a matter of communication between the QAO and the client at an early stage. The QAO must of course preserve its independence. Whether and when a performance audit takes place, and the scope of the audit, must be solely the decision of the Auditor-General. But we do not believe that listening more to the client means a loss of independence.

We heard several comments that the QAO would not negotiate the timing of the audit. The QAO has audits tightly scheduled and it is possible that, at the point that the client wanted to negotiate timing, the QAO had already carried out significant work in planning the audit.

There is also a question of the opportunity for learning that the audit will provide. Measuring the client's performance against best practice might not always provide the best opportunity for learning. We have in mind cases where best practice has not been applied because of urgency, or because the particular activity is outside the department's usual business, or for other circumstances. Measurement against a best practice standard is likely simply to establish that best practice was not followed. More value might come from considering instead or in addition, what is best practice in cases of urgency, or how should an agency approach something which is outside its experience?

The question of value to the client (and more widely) is one that the QAO should consider as part of its strategic audit planning. We comment in the next section 5.8 that the criteria used for topic selection may not give sufficient weight to improving the public sector performance.

Cost

It is inevitable that there will be both financial and opportunity costs associated with the audit and, usually, with the implementation of recommendations. More effective engagement between the QAO and the client can help to minimise costs.

We remarked earlier that we were hampered in assessing the efficiency of the QAO's performance auditing because no client that we asked had measured the cost of implementing recommendations, or the cost of the performance audit itself.

We think that the cost of implementing recommendations should be measured, so far as is reasonably possible, not least to contribute factual data to the QAO's calculation of the benefit-cost ratio of its performance auditing.

We also suggest that the QAO should, when discussing draft recommendations with the client, ask for an estimate of the cost of implementation. Assessing the cost of implementation should routinely be part of any follow-up audit.

Assessing the cost to the client of a performance audit is more difficult. We considered whether we should recommend that the QAO ask a few clients to measure the cost. Measurement might only be an estimate. It could be measured in terms of money and time spent on the audit, and take account of disruption or delay to other work. The point would be to compile a body of information that would help future audit clients to prepare for and provide adequate resources for the audit.

In the end, after discussing that proposal with the QAO, we concluded that because of the variation in size and nature of performance audits, the information compiled would probably not be useful.

Nevertheless, there is a clear need for the QAO to assist clients to prepare for the audit. The QAO needs to give early warning of what it will need from the client, in terms of both the role and likely time commitment of the client's nominated liaison person and the probable need for the client to provide dedicated staff resource to manage the client's involvement with the day to day audit process. As we have noted, those discussions need to take place with the people who will be involved in the audit.

Conclusion

Performance auditing was a new function for the QAO late in 2011. We consider that performance auditing is now well established, but that there is room for improvement.

We recommend several practical steps intended to address the matters that appear to us to impede good relations between the QAO and some of its performance audit clients. Underpinning those recommendations is the need for better communication. The relationship between auditor and auditee must always be professional and at arm's length, but that does not prevent its being co-operative and mutually respectful.

We believe that these problems will lessen over time, as clients' familiarity with performance audits increases, and the DPC forum continues to provide an opportunity for clients to share their experiences of performance audits.

Recommendations

We recommend that:

5.7(i) In 2017, the QAO select three audits planned to start in 2018 and explore opportunities for early engagement with the entities to be audited to:

- identify what value the client expects from the audit;
- consider the scope, audit objectives and timing of the audit; and
- assist the client in commencing planning and resourcing for the audit.

5.7(ii) The QAO include as part of any follow-up audit, assessment of the cost of implementing the recommendations made in the original audit.

5.7(iii) The QAO include in its performance audit methodology a requirement that the client be asked for an estimate of the cost of implementing proposed recommendations.

5.7(iv) In 2019, the QAO review the efficiency and effectiveness of the operation of the steps proposed in recommendation 5.7(i).

5.7.2 Parliament's use of performance audit reports

In considering opportunities for improvement, we refer again to the question of the usefulness to Parliament of the performance audit reports. We have recommended in section 5.5 that the QAO continue to work with Parliament to find ways to improve its communication and engagement with MPs on its performance audit reports.

5.7.3 Resourcing of performance audits

The performance audit group is small. In 2016–17, it comprises 16.6 full time equivalent staff. Numbers of audits have steadily increased and, as the budget for performance auditing has stayed roughly the same, the average cost per audit has decreased:

Financial year	Performance audits completed*	Average cost of audit**
2011–12	7	$363,326
2012–13	11	$400,171
2013–14	10	$446,739
2014–15	13	$334,206
2015–16	13	$336,183

* Compiled from QAO data

** Source: ACAG Macro Benchmarking report 2016

We discuss in Part 6 our concern that the QAO's efficiencies, while commendable, have placed pressures on staff that are evident in the staff survey results. Performance audit staff told us they feel pressured in trying to meet what they regard as ambitious timeframes.

The QAO delivers its audit programme with high productivity. The ACAG benchmarking survey shows that QAO "non-attest audit staff" charge 73% of available hours to audit activities, compared to an average across ACAG offices of 66%.

We think that the QAO is doing as much as it can with its current performance audit budget, and we doubt that there are further efficiencies to be found. We have discerned pressures on performance audit staff. We consider that the performance audit budget should be substantially increased, preferably doubled, notwithstanding the relationship issues that remain to be addressed. Indeed, it is possible that tight timeframes contribute to the relationship difficulties.

We see the following advantages of increased funding. A larger performance audit group with an increased budget would have:

- greater flexibility to engage earlier and better with clients;
- a wider range of skills and experience within the group;
- greater opportunity for sector specialisation;
- more capacity to contract in expertise as needed for each audit;
- the capacity to carry out larger audits and programmes of audits, and to experiment with different ways of delivering assurance on performance of the Queensland public sector;
- the capacity to carry out more performance audits to assist Parliament in its scrutiny of the performance of the public sector;
- the ability to employ and train more junior staff.

Increased funding would enable the QAO to create a performance audit team that has "critical mass".

The QAO's performance audit mandate compares most readily with that of Victoria, in that both the Victorian Auditor-General's Office and the QAO carry out performance audits in central and local government. The Victorian office has a funding of $16 million for 29 performance audits and reports on the results of financial audits. A QAO budget of around $8.5 million would be considerably less than Victoria, but larger than the performance audit budgets in New South Wales and Western Australia.

We are confident that the performance audit group, and the office, are competently and tightly managed, and that increased funding would be used carefully.

Earlier engagement

We are conscious that the suggestions we have made in the previous section for smoothing the course of performance audits would require more flexibility in the delivery of the programme, and more time spent in client engagement and could, in the short to medium term, incur more cost.

Expert resource

As we have discussed above, the view that the performance auditors lack understanding of a client's business is a major concern for performance audit clients. We noted that it was likewise a concern at the time of the 2010 Review. Although the QAO has made efforts both to increase its use of experts and increase the skills and experience of its staff, an increased budget for engaging expert resource would enable it to do more.

We note in particular the view of the Public Accounts and Public Works Committee, quoted in the previous section, that “subject area experts, including secondments from within departments, be utilised over the course of the audit”. That is, the expert resource should be engaged throughout the audit, and not asked only to review findings and reports. The QAO has used experts in that way, for instance in the *Managing water quality in the Great Barrier Reef catchments* audit, but it comes at a cost.

We suggest that, if funding is increased, the current expenditure on expert resource should be doubled at least.

Wider range of audit products

As we will examine in the next section, the QAO has a comprehensive strategic audit planning process. It yields a wide range of topics for potential audits – we understand that there were around 90 possible options considered for the last plan – and considerable effort is then spent whittling the list down to 15 or so.

An increased budget would enable the QAO to carry out work on more of the topics. We suggest too that a larger budget and larger team would give the flexibility to:

- carry out larger audits;
- deliver programmes of audits – for instance, looking at the same issue(s) across multiple agencies;
- explore different ways of providing assurance on the performance of Queensland public sector entities – for example shorter, sharper pieces of work perhaps delivered in “real time”; and
- formalise the QAO’s production and rollout of Better Practice resources.

Increased staff

We are particularly attracted to the possibility of the QAO’s employing more junior staff in the group. The QAO has difficulty in recruiting to the team. There is no external market for performance auditors. The function is a blend of auditing, organisational review and public policy. A performance audit group benefits from having people from a variety of backgrounds, but those people, when employed, are unlikely to have auditing skills. The best solution is to employ and train more junior staff who can be promoted as vacancies occur.

Further, the performance audit group has almost no junior staff at the moment. The team comprises:

- one Assistant Auditor-General;
- three audit directors;
- seven audit managers;
- four senior auditors;
- two auditors.

The senior performance audit staff told us that a manager essentially works as a team member and a director as an audit manager, with a consequent loss of the strategic perspective that an audit director is expected to bring to an audit.

We collected information about the composition of performance audit teams from the four audit offices that we consulted. The QAO's ratio of "managers" (the Assistant Auditor-General, directors and audit managers) to audit staff is about 64%: 36%. In each of the other offices, managers comprise less than 50% of the group, and in three cases less than 40%. We acknowledge that the comparisons will not be exact, as roles will differ across offices.

We consider that QAO would benefit from having more staff at the level of auditor and senior auditor. It would enable the performance audit directors to work at a more strategic level, and give them more time to engage with clients. Junior staff would eventually provide a pool of candidates for audit manager and director positions. There should always be a relatively high proportion of "managers", as performance auditing requires maturity and judgement, but we think that proportion should be in the range of 35–40%.

We note that doubling the performance audit budget would not necessarily mean a doubling of the number of performance auditors employed by the QAO. Some of the additional budget could augment the support functions for performance audits, such as audit analytics and quality assurance, carried out in the Specialist Audit Services Group.

Conclusion

We consider that the QAO is ready to expand its performance auditing function. Increased resource would enable the QAO to address the various client relationship issues that we have discussed, and enhance the value to Queensland of the performance audit programme.

We suggest that the funding increase should be spread over three years, to enable carefully managed growth.

Recommendation

5.7(v) We recommend that the QAO's funding for performance audits be doubled to give the QAO:

- greater flexibility to engage earlier and better with its performance audit clients;
- more scope to engage expert resource for audits and to increase sector expertise among its staff; and
- the capacity to deliver a wider range of assurance on the performance of Queensland public sector agencies.

5.8 Strategic audit planning

5.8.1 Process

The QAO has developed a comprehensive process – the QAO describes it as “structured and rigorous” – for strategic audit planning. The process is well described in a factsheet published by the QAO on its website. The QAO’s intention is to focus its audit efforts where it can have greatest impact and maximise the value of its audit work to the community.

The essential steps in QAO’s strategic planning process are:

- understanding what is important, by continuous environmental scanning and engaging with its stakeholders;
- applying rigorous assessment criteria to decide what to audit;
- communicating the plan.

Environmental scanning

The SAP (strategic audit plan) page on the intranet links to a range of sources and resources to aid environmental scanning. The stakeholders consulted throughout the year include parliamentary committees and public sector entities. The QAO welcomes suggestions for performance audit topics through its website.

It also actively seeks suggestions from its staff. The QAO intranet home page includes a tile labelled “suggest an audit topic” which links to a list of topics already in the system (to avoid duplication) and a form seeking information about the topic, the origin of the idea, and the type of audit (performance audit or other) it might justify. The submitted form goes to the SAP Co-ordinator who checks for completeness of the submission and any duplication, and forwards it to the appropriate manager for consideration. If the topic is to proceed, it will be researched in detail, and if thought viable, included on a long list of possible topics.

Decision-making

The various topics gathered yield an extensive list of potential performance audits – a list of about 90 for the 2016–19 strategic audit plan. Each topic on that list is assessed and scored against 12 “business drivers”:

- Relevance to key stakeholder groups:
  - Parliament;
  - Government;
  - public entities;
- Significance:
  - financial;
  - economic;
  - social;
  - environmental;

- QAO's ability to provide:
  - assurance;
  - valued insights on the topic;
- Priority and timing:
  - sector priorities;
  - whether there is a performance gap in the public entity/sector that an audit would address;
  - timing – when is the appropriate time for the audit?

The drivers are of equal weight and each scored out of five. The scores determine a shortlist which goes to the QAO's executive management group to consider for inclusion in a draft strategic audit plan.

In deciding which topics to audit, the QAO also considers the following factors, in addition to the 12 drivers listed above:

- whether the shortlist covers the four elements of the performance audit mandate – economy, efficiency, effectiveness and compliance;
- the coverage of sub-sectors of the public sector, and of relevant parliamentary committees;
- what skill sets are required to carry out the audit and whether they are available, either within the QAO or externally;
- whether there are current or proposed changes in the public sector which would impact on the audit.

The draft plan contains ten or so audits for each of the three years, and one or two follow-up audits for the first year.

Consultation and communication

The Auditor-General consults the Financial Administration Committee on the draft plan, as required by the Act. The QAO also consulted on the draft 2015–18 and 2016–19 plans with the executive management groups of all departments.

The strategic audit plan is published on website as the Act requires.

Further developments

The QAO says that it will continue to refine its strategic audit planning process by:

- refining the 12 business drivers;
- enhancing its communications with stakeholders;
- exploring ways to get more ideas for audit topics from its stakeholders;
- improving its environmental scanning; and
- looking for opportunities to collaborate on planning with other Australian jurisdictions.

5.8.2 The strategic audit plan

The strategic audit plan which results from this process is comprehensive. The 2016–19 plan:

- discusses the results of the QAO's environmental scanning;
- sets out the audit topics for the first of the three years each with a summary of the topic;
- briefly describes the financial audit programme and the sector reports that will flow from it;
- lists the areas of control focus planned for the three years; and
- identifies the audit or audits selected for follow-up.

The plan also includes five appendices that:

- set out the audits planned for the three years, each with a summary of the topic;
- show the acquittal of the previous plan – the progress of audits and changes made to the programme;
- describe the QAO's strategic audit planning process;
- in a diagram, link the proposed audits to Queensland's priorities and to the global trends identified by the QAO's environmental scanning; and
- describe the QAO, its functions and mandate.

The Act requires a strategic audit plan for the performance audits that the QAO intends to carry out. However, the plan that the QAO prepares covers not only performance audits, but all the reports that the QAO intends to table in Parliament – including the sector reports arising from the financial audits – and the particular aspects of internal financial controls that will be subject to in-depth review over the three years of the plan.

5.8.3 Comment

The strategic audit planning process and the plan that it yields are comprehensive and thorough. The development of the plan requires input from across the QAO, so it draws on the knowledge of the whole organisation, and encourages co-operation across teams.

The plan covers more than the proposed performance audits. By giving advance notification of the areas of control focus, it allows entities time to prepare for the audit and to remedy any defects, thus promoting improved performance in the public sector.

Improving the performance of the public sector

We looked in the strategic audit planning process for a focus on improving performance in the public sector, to align with the QAO's strategic purpose.

The 12 business drivers (listed above) cover wide territory, particularly when coupled with the concern about coverage of all sectors and all elements of the mandate. However, in examining the drivers, it was not apparent to us that there is direct consideration given to the improvement of the performance of the public sector, the QAO's primary objective. Only two of the criteria – the relevance to public entities, and whether the audit would address a performance gap – are likely to have that focus. Three others – relevance to Parliament and to the government, and the ability of the QAO to provide valuable insights – might do.

Nor, we note, does the value of the audit to the client have specific focus in any of the drivers.

We note that the QAO's consultation with the Finance and Administration Committee and the executive management groups of Departments provides an opportunity to canvas these issues.

We suggest that the QAO review the drivers to ensure that there is sufficient focus on improving performance in the public sector, and that the focus is explicit in the criteria. Ten audits can never cover all of the areas inherent in the drivers and we suggest that, if it is not explicit, a focus on improving the performance of the public sector could be diluted by the range of other factors to be considered.

Cost

The thoroughness of the strategic audit planning process gives us some concern. The QAO spent $314,000 on the preparation of the 2016–19 strategic audit plan, which is roughly the cost of a performance audit. The cost of preparation of the 2015–18 plan was lower ($248,000), but it was considerably higher for the two previous plans.

Higher costs for the earlier plans are to be expected, as they will have included the cost of developing the planning system. However, we would expect costs to continue to fall. The increase in 2016 is partly explained by more time spent by senior staff on consultation with agencies' executive management groups. We encourage the QAO to try to reduce the cost of the planning.

We agree that the QAO needs an efficient system to identify and prioritise best projects on which to spend its limited budget – $4.33 million in 2016–17. We acknowledge too that there are benefits from the planning work beyond the production of a plan. The topics and research for them form a corporate database which will inform planning in future years. The increased consultation with stakeholders by senior QAO officers has intrinsic value: we discuss elsewhere in this report the need for greater engagement between senior officers of the QAO and its clients.

But the cost is high relative to the cost of a performance audit. There are competing arguments. On the one hand, given the small budget, it is important for the QAO to identify carefully the ten most valuable topics. On the other hand, given that all of the topics on the long list have sufficient merit to be on the list, probably 40 or 50 of the 90 (to use the 2016 figure) have merit, so less care could be taken in choosing among them.

Further, of the ten or twelve new topics selected for the third year of each plan, only 50% or 60% may ever be carried out. Topics will be removed from the plan, for good reason, as circumstances change. The QAO's target is to complete at least 50% of the topics first listed in year 3 of each plan.

We note that, were the QAO's performance audit budget to be increased as we have suggested, the strategic audit planning process could be used to select a greater number of audit topics or to propose other forms of assurance with no additional cost, and possibly a slight reduction in cost.

Comments on the strategic audit plan for 2016–19

We have two comments concerning the form of the strategic audit plan.

The environmental scan forms the first part of the plan. However, it is not overtly linked to the proposed audits. It is left to the reader to make the linkage. We suggest that the plan could include clearer links to the audit topics selected, to show their relevance to the matters identified in the environmental scan. There is a diagrammatic representation in an appendix that maps each topic to Queensland priorities, and to the global trends discussed in the environmental scan, but it is at too high a level to explain the specific relevance of the topic.

That is particularly the case for the year 3 audits. The description of those audits only appears in an appendix, yet that is the new material in the plan. We suggest that they could be discussed earlier in the plan, and perhaps integrated into the environmental scan section.

Government Owned Corporations

The performance audit mandate does not apply to GOCs, but the performance management systems audit mandate does. We note that the QAO has determined that no performance management systems audit of a GOC has been necessary to date.

However, GOCs are an important part of the Queensland public sector, and the QAO has the mandate to carry out performance management systems in them. We suggest that the QAO should consider whether they should use that mandate and schedule a performance management systems audit in a GOC or GOCs.

Publication

The strategic audit plan is a significant and costly undertaking for the QAO. It fulfils a statutory requirement. It advises the Queensland public sector on the Auditor-General's intended work programme for the forthcoming three years. Yet the Act only requires that it be published on the QAO website.

Given its significance, we suggest that the plan should be tabled.

Recommendations

We recommend that:

5.8(i) In its refinement of its criteria for selecting performance audit topics, the QAO consider whether there is adequate emphasis on improving public sector performance.

5.8(ii) The QAO consider whether it can improve the economy of its strategic audit planning process, perhaps by increasing focus on improvement of public sector performance.

5.8(iii) The QAO consider scheduling a performance management systems audit of a GOC or GOCs.

5.8(iv) The QAO's strategic audit plan prepared under section 38A of the Auditor-General Act 2009 be required to be reported to the Legislative Assembly.

6 Workload trends and pressures

6.1 Introduction

The terms of reference ask us to examine trends in the QAO's workload. In this context, we have considered the numbers of audits carried out by the QAO, the resources that it has to do that work, and its improved productivity.

We also consider further the resourcing pressures, discussed in Part 2, that we believe need to be addressed.

6.2 Workload

In 2015–16, the Auditor-General issued 435 financial audit opinions, compared with 568 opinions in 2010–11. The decrease is due in part to the reduction in the number of small audits following the amendment of the Auditor-General Act in 2009, which allowed the Auditor-General to dispense with the audit of small and low-risk audits in certain circumstances (discussed in section 4.6). Audit numbers have also been affected by machinery of government changes and a reduction in the number of water authorities under the Water Act 2000.

In terms of hours, the audit workload has also decreased over that period, by about 41,000 hours. About 31,000 fewer hours are now provided by in-house resource, and 10,000 fewer hours by contract auditors.

6.2.1 Resources

Contract auditors – "one workforce"

The QAO uses both its own staff and contract auditors to carry out its financial audit programme each year. It refers to its staff and its contract auditors as "one workforce". A little over a third of its audits (in terms of fees) are contracted out.

As noted in Part 4, the QAO has pre-qualified 38 firms to conduct audits on its behalf, of which 23 firms have current contracts.

QAO staff

Numbers of QAO staff have reduced each year since 2010. At 30 June 2010, the QAO employed 251[53] staff, or 245 full-time equivalents (FTEs). At 30 June 2016, the numbers were 199, or 191.5 FTEs. That is a reduction of 53.5 FTEs or 22%. We understand that the reduction was achieved mainly through natural attrition.

[53] These figures include both permanent staff and contracted in staff.

Over the same period, the number of hours charged to audits by QAO staff has remained steady. In 2010–11, QAO staff delivered 199,745 audit hours – for both financial and performance measurement systems audits. In 2015–16, QAO staff delivered 198,737 audit hours. The difference of 1008 hours (0.5%) between 2010 and 2016 represents less than one FTE.

The decline in staff numbers has occurred disproportionately in non-audit staff. The 2010 Review noted a significant increase in audit support staff (HR, IT, Finance, etc) between 2004–05 and 2008–09, to comprise 24% of total staff. It recommended that the QAO aim to return the level of audit support staff to 15–18% of total staff. The proportion of non-audit staff at 30 June 2016 was 21.4%.

Turnover of staff is fairly stable, at about 15% per annum (15.5% in 2015–16). The QAO regards that figure as acceptable. It is consistent with other Australian audit offices, for which the average attrition rate for 2015–16 was 15%.

Staff costs

Commensurate with the decline in staff numbers, the QAO's salary costs are $1.8 million less than in 2010–11. That reduction is offset by an increase in remuneration rates and other costs of QAO's operations (excluding contract auditors), giving a net saving of $622,000. The QAO has calculated that taking account of inflation, the net reduction in costs is $3.4 million in 2010–11 dollars, or a saving of 7.9%.

Summary of changes from 2011 to 2016

QAO	2011	2016
Full-time equivalent staff (includes contracted-in staff)	245	191.5
Headcount (includes contracted-in staff)	251	199.5
Audit fee income (QAO and contracted audits)	$38.178 million	$37.146 million
Appropriation revenue	$6.223 million	$6.4 million
Audit hours (QAO staff)	194,026 (08-09)	163,077
Audit hours provided by contract auditors	91,821 (08-09)	81,767
Audit opinions issued	568	435
Financial Audit Services staff (actual FTE at 31 October 2016)		100.5 FTE
Financial Audit Services staff (budget FTE at 31 October 2016)		111
Financial and Compliance Audit Division (actual)	143 (at 12/2009)	
Reports to Parliament on results of financial audits	6	7
Performance audits reported		13
Cost of performance audits		$4.1 million
Performance Audit Services staff (actual/budget)		16.6 FTE
Performance management systems audits reported	5	
Cost of performance management systems audits	$1.79 million	
Performance management systems audit staff (2010)	15	
Contracted audit firms	27	23
Audit fees earned by contracted auditors	$12.004 million	$14.127 million

6.2.2 Productivity

The QAO uses two productivity measures. The first compares total hours charged to fee for service activities (financial audit) and to activities funded by Parliament (performance audits, reports, and strategic audit planning) with total paid hours – referred to as “overall” hours. The second measure compares the charged hours to the hours staff are “available” for work – that is, total hours at work after accounting for leave taken.

As would be expected, given the reduction in non-audit staff and therefore the ratio of non-audit to audit staff, the QAO’s annual productivity has improved on both measures between 2010 and 2016:

- overall hours, from 42.3% in 2010–11 to 51.2% in 2015–16;
- available hours, from 56.6% in 2010–11 to 63.8% in 2015–16.

Other Australian audit offices use similar productivity measures, but the measures used for the Macro Benchmarking Survey carried out by Orima Research for ACAG exclude strategic audit planning from “audit hours”. On those measures, the QAO’s productivity has also improved:

- overall hours, from 46% in 2010–11 to 51% in 2015–16;
- available hours, from 55% in 2010–11 to 62% in 2015–16.

In contrast to the QAO’s improvement, the average productivity figures for the state and territory audit offices have changed little over the same period, remaining steady at around 49% (overall hours) and 61% (available hours). The QAO’s productivity is therefore above the average on both measures and the second most productive office on both measures.

The QAO told us that it attributes the increase in productivity not only to the rationalisation of its audit support services, but also to better scheduling of staff to audits to minimise downtime, roughly doubling the contracted-in staff to augment its own workforce at peak periods, and more closely monitoring the performance of individual staff.

The Macro Benchmarking Survey attributes the higher productivity to the QAO’s relatively low (7%) allocation of the hours of audit staff to non-audit activities (such as development of audit methodology, planning, and external relationship management), and to its relatively higher rate of leave taken.

However, we speculate that some part of the increase in productivity may be attributable to the QAO’s difficulty in recruiting and retaining financial audit staff, which we discuss below. While staff numbers fluctuate, the QAO has consistently carried vacancies in its financial audit services team, at both senior and more junior levels. That means that fewer audit staff complete the same volume of audit work by working longer hours. The productivity figures are based on “paid” hours and do not capture all of the additional hours worked, as senior staff are not paid for overtime. It is also possible that staff do not record some hours worked in excess of target.

We have commented in Part 4.12 on the significant decreases in the audit fees paid by clients. We have noted that a further 4.2% reduction in revenue for the QAO from audit services in budgeted for 2016–17 places further pressures on the office to deliver productivity increases. Although there are potential opportunities from the wider use of audit analytics, 2016–17 is likely to be a transition year for some audits as auditors develop capability in the use of audit analytics. We think that productivity gains from this source are unlikely to be achieved until 2017-18. We have also noted in section 4.9 that, from 2016–17, additional audit effort will be required related to new accounting and auditing standards.

We record again our concern that further productivity gains may come at the expense of staff health and welfare.

6.2.3 Conclusion

The productivity of the QAO's audit workforce has improved to a level where the QAO's productivity ranks second among its Australian peers. We commend the QAO on that improvement.

Compared to 2009, the QAO has fewer audit staff carrying out an equivalent volume of audits, measured by hours. The overall volume of audits has reduced by about 41,000 hours. The number of performance audits completed in 2015–16 is more than double the number performance management systems audits in 2011.

We are concerned however, that attempts to find further productivity gains may have an adverse effect on staff health and welfare.

6.3 Resource pressures

We return to the question of the QAO's shortage of audit staff, which we discussed in Part 2 (Strategic Issues). We have three main concerns about under-resourcing:

- staff shortages create pressure on existing staff;
- under-resourcing is inefficient, not least because Auditor-General is unable to resource audits as planned; and
- under-resourcing impacts on QAO's relations with its clients.

6.3.1 Pressures on staff

We consider that the pressures on staff are a matter of concern.

Those pressures are reflected in the QAO's results for the annual *Working for Queensland* survey, in both 2015 and 2016. Half of the employees who participated in the 2016 survey (74% of staff) reported that they felt overloaded with work, 37% said that they felt "burned out" by their work, and 32% reported an issue or significant issue with the negative impact of workload on their health.

The QAO's scores on these questions have never been high, but these results are a significant deterioration from 2015. As we noted in Part 2, the results put the QAO in the bottom 20% of the Queensland public sector for those questions.

The results are consistent with what staff told us in our meetings with them. Most of the staff who attended those meetings were audit staff. The survey distinguishes between audit and non-audit staff, but not at the level of detailed questions. At the more general level, the survey shows that 29% of audit staff said that they had limited or no issues about workload and health, compared with 39% of support staff. That suggests that the concern about workload is more an issue for audit staff than it is for support staff.

The score for perceptions of organisational fairness was also low. Organisational fairness includes factors such as fair treatment of employees and fairness of performance assessment and reward.

The QAO acknowledges that "workload and health" is a material issue,[54] and it is a key focus of its strategic workforce plan. The QAO is also focusing on ways to improve perceptions of organisational fairness.

In response to the survey results, the QAO has put in place a range of measures. It is improving the sophistication of its workforce planning systems. It is encouraging staff to focus on health and well-being and providing stress tolerance sessions for staff and, in 2017, providing sessions on work/life balance and personal effectiveness.

It is also running workshops with staff to better understand the underlying issues, and to involve staff in identifying actions that might improve the situation. The workshops have identified as issues:

- long hours, and long hours sitting;
- insufficient planning and allowance for contingencies creates high or unrealistic workloads;
- inconsistent distribution of workloads;
- insufficient delegation of tasks;
- insufficient communication within and across teams when help is needed.

The QAO is taking steps to address these issues, including creating two new director positions that it is currently recruiting to fill. It has also enhanced its graduate intake programme.

We endorse those actions.

6.3.2 Inefficiencies

Resource shortages give rise to inefficiencies in:

- staff turnover and the need to recruit and train new staff;
- frequent and prolonged recruitment processes;
- disruption to resourcing plans;
- lack of continuity on audits.

We examine the QAO's difficulties in recruiting and retaining certain grades of audit staff below.

In deciding which audits to contract out, the Auditor-General takes account of the optimum mix of permanent staff and contracted support, client location, the suitability of audits for contracting out and a critical mass requirement for the QAO. However, careful planning can be upset by staff shortages. In 2015, the QAO contracted out additional audits of fee value $900,000. Those audits were to have been carried out by QAO staff. The contracting out compensated for a shortage of five staff.

[54] QAO Annual Report 2015–16, page 4.

6.3.3 Impact on client relations

We discussed the matter of client relationships in Part 2. Financial audit clients raised with us issues such as:

- disagreements with the QAO over its approach to asset valuations;
- audit staff onsite unwilling or unable to make decisions, but not easily able to escalate issues to their offsite managers, apparently because of the managers' workload;
- an unwillingness on the part of audit teams to give advice on good practice;
- delays when contract auditors are unable to get timely advice from the QAO, for example on technical issues; and
- "surprises" and a lack of timeliness, as difficult issues arise at the last minute when the audit director reviews the file.

We note that all of these problems can be attributed (though not exclusively) to pressures on audit staff resulting from staff shortages. In our view, addressing staff shortages would assist in improving relationships with financial audit clients. It would enable better engagement with clients and might assist with turnover in audit teams, a frequent complaint.

Recommendation

We recommend that:

6.3(i) Given:

- the results of the *Working for Queensland* survey in 2016 that indicate that an unacceptably high number of its staff consider that their workload is having a negative impact on their health; and
- the additional audit requirements applicable in 2016–17;

the QAO undertake a review of its 2016–17 fees budget for financial audit services:

- to determine whether it is realistic;
- to ensure that it can maintain audit quality; and
- to consider optimal resourcing for the 2016–17 financial audits, including the mix of QAO staff, contracted-in staff and contract auditors.

6.3.4 Recruitment and retention difficulties

The QAO's evidence is that it cannot attract and retain enough audit staff because it cannot offer sufficiently attractive remuneration or conditions of service. The QAO generally seeks auditors in a private sector rather than a public service market, but it is covered by the Public Service Act and therefore by public service classification levels and remuneration rates.

There are vacancies in Financial Audit Services that the QAO has struggled to fill, particularly at Director (senior officer) and Auditor (A03/A04 levels). The Auditor level is one of high turnover, and recruitment does not keep ahead of departures. At 31 October 2016, Financial Audit Services was (net) 10.5 FTE under budgeted strength. The main shortages were two directors and nine auditors. There has also been a sector director position vacant for two years, which was eventually filled by an internal promotion of a Technical Director from the Specialist Audit Services team, although the appointment shifted the vacancy to that team.

The QAO also has difficulty recruiting to Performance Audit Services, although at 31 October that team was fully staffed. However, that full complement includes several contractors who do not wish to take up permanent employment with QAO because of the remuneration and conditions of employment the Auditor-General is able to offer.

These shortages are exacerbated by the need to resource projects such as the refreshing of both the financial audit and the performance audit methodology, discussed elsewhere in this report, and other projects necessary to build and maintain the QAO's audit capability.

The QAO has attempted to fill vacancies through a continuous recruitment process – that is, being ready to consider possible candidates at any time.

We noted in Part 2 that the QAO has difficulty in filling senior vacancies by internal promotion, due again to the level of remuneration that it can offer. There is little incentive for audit managers to seek promotion as the remuneration increase is small and the manager loses the ability to accrue "time off in lieu" to compensate for excess hours worked, while taking on increased responsibility.

Further, preparing staff for promotion to senior positions usually requires careful and tailored mentoring and training by managers. When managers and staff are stretched, training and development is likely to suffer.

Analysis of QAO's grading and remuneration structure

In 2014, the QAO engaged professional advisors to carry out an analysis of the remuneration and grading systems within the QAO and to advise on a structure that would better enable the QAO to attract and retain audit staff.

The analysis identified that the public service classification scheme of eight levels lacked flexibility and did not fit well with the structure of the QAO's work, particularly for Financial Audit Services. Narrow width of job size ranges meant that similar roles fell into different grades and were paid differently, and that small changes in jobs gave rise to the need to reclassify the job.

The consultant compared QAO remuneration to General Market data – a database covering over 200,000 positions from 600 organisations across Australia, both private and public sector, but excluding mainstream public service – as that market best reflected the market in which the QAO needs to recruit. On that analysis, QAO's then current remuneration was on average 20% lower than the 25th percentile[55] in the general market, with the disparity increasing as the job size increased. That is, the disparity was greatest at the levels of director and sector director, the level at which the QAO has the greatest difficulty in recruiting.

The review proposed a grading structure that would enable the QAO to group together jobs of similar work to provide a logical basis for remuneration management. It recommended job families (auditor, senior auditor, audit manager, director) that align to the work actually performed in Financial Audit Services.

55 The 25th percentile is the point at which 75% of firms pay more and 25% pay less.

It recommended that the QAO should aspire to position its remuneration at the 25th percentile of the general market but that, given the context at the time, the target should be a midpoint 10% below the 25th percentile, as appropriate for a public sector office. The review identified 28 positions below the proposed range. The annual cost at the time to move those positions to the minimum (not the mid-) point in the ranges would have been $136,000. Ninety-five positions were below the aspirational 25th percentile range. The annual cost to move those 95 positions to the minimum point in that range would have been $883,000.

However, the QAO cannot implement either the proposed grading structure or new remuneration ranges while the office is covered by the Public Service Act.

As a fall back option, the QAO has done what it can to find some flexibility within the constraints of the Public Service Act. It has a few senior staff on contracts under section 122 of the Public Service Act, which enables the payment of remuneration higher than the public sector scale. It has also worked with the Public Service Commission to obtain an attraction and retention incentive scheme for sector director positions, which will enable a remuneration level for those positions higher than the public service rate.

6.3.5 Conclusion

We believe that the QAO should have the flexibility to recruit the staff that it needs to discharge its functions, and to remunerate them appropriately. It does not, in our view, have that ability at the moment. We note that this issue has been identified by the reviews of the QAO in 1997, 2004 and 2010, each time with a recommendation that the Auditor-General be given the flexibility to determine the remuneration for QAO staff.

We acknowledge that there are mechanisms such as section 122 contracts and attraction and retention schemes that may give the QAO a little leeway, but we do not think they are adequate to address the problem.

We consider that the Auditor-General should be able to employ staff under the Auditor-General Act, and thus outside the public service framework. We note that, in setting terms and conditions of employment, the Auditor-General could be required to have regard:

- to the public service terms and conditions where appropriate, which would be for most non-audit positions; and/or
- to remuneration rates paid by auditing firms in Queensland.

Recommendation

6.3 (ii) We recommend that the Auditor-General Act 2009 be amended:

- to provide for the Auditor-General's employment of QAO staff under that Act rather than under the Public Service Act;
- to give the Auditor-General the authority to employ the staff necessary to carry out the Auditor-General's functions;
- to enable the Auditor-General to determine the remuneration and other terms and conditions of employment of QAO staff.

7 Corporate matters

7.1 Introduction

The terms of reference ask us to consider:

f) the structure of the QAO, including the delegation and allocation of responsibilities;

g) management systems and processes used by the QAO, including:

   i. appropriate internal and external performance indicators to monitor efficiency and effectiveness;

   ii. internal communication and sharing of performance information;

   iii. human resource issues, including formal and informal staff training and guidance;

   iv. administrative systems and processes used by the QAO;

   v. whether the funding of the QAO is both appropriate and appropriately used to discharge the functions and objects of the QAO;

   vi. appropriate protocols for communication by and with the QAO;

   vii. any other matters which impact on the economy, efficiency and effectiveness of the QAO.

Some of these matters are covered elsewhere in the Report, but for the sake of completeness, we consider each again.

It is hard to overstate the importance of efficient and effective corporate systems in an organisation that assesses the efficiency and effectiveness of others' systems. We are pleased to say that we consider the QAO's corporate systems and processes to be satisfactory. We make no recommendations for improvements to them. Our only recommendation in this Part concerns review of the Act to identify outdated provisions that impact on the QAO's efficiency and effectiveness.

7.2 Organisational culture

We first consider the QAO's culture, although it is not explicitly covered by our terms of reference.

In 2015, the QAO launched a refreshed culture and values statement – a professional services culture underpinned by four values. The work included evaluating the Queensland public service values and testing whether they were appropriate for the QAO. The development and implementation process involved both management and staff. The new values are:

- We engage with purpose:
  - being frank, fair and honest in dealings;
  - setting clear expectations and managing to them;
  - listening to learn and communicating clearly to inform.

- We challenge ourselves:
  - questioning the status quo;
  - seeking new knowledge and applying new skills;
  - taking measured risks when trying new things.
- We deliver on our commitments:
  - taking responsibility and holding ourselves accountable;
  - doing the right things and doing things right;
  - understanding before acting.
- We care about people:
  - demonstrating respect for others and their contribution;
  - considering how our actions affect others;
  - sharing our knowledge and expertise;
  - supporting and celebrating the success of others.

The four values are widely disseminated within the QAO on posters, and "Engage, Challenge, Deliver, Care" forms the headline on the intranet home page. Discussion of each employee's demonstration of the values forms part of the performance assessment process.

We have referred at several points in this report to the *Working for Queensland* survey. The QAO has formulated ten agency-specific questions designed to measure the extent to which the values are embedded in the organisation. In 2016, the responses to the questions ranged from 94% to 55% positive, and mostly had a low negative response (the rest of the respondents were neutral). The lowest positive responses were to the statements: "leaders model our values and behaviours" (55% positive) and "our values guide the decisions we make" (58% positive).

Almost all of the scores were lower than in 2015, possibly because the values had only recently been introduced and perhaps had a higher profile when the 2015 survey took place. However, the two lowest scoring questions were each eleven points lower than in 2015, and we encourage QAO management to investigate why.

7.2.1 Conclusion

We consider that the QAO's culture is professional and positive. We commend the QAO for the work it has undertaken to establish values for the organisation. We encourage QAO management to examine why the 2016 *Working for Queensland* survey of staff gave relatively low positive responses to the statements "leaders model our values and behaviours" and "our values guide the decisions we make".

7.3 Structure of the QAO, and delegation and allocation of responsibilities

The Auditor-General is the accountable officer for the QAO. The Auditor-General and the Deputy Auditor-General lead the QAO. The QAO is organised into three operational divisions – Financial Audit Services, Performance Audit Services, and Specialist Audit Services – and a corporate support team. Each of the operational divisions is led by an Assistant Auditor-General, who reports to the Auditor-General. The corporate support team reports to the Deputy Auditor-General. There is also a small Office of the Auditor-General led by an Executive Officer who is also Head of Internal Audit. He reports to the Auditor-General.

Specialist Audit Services includes the following teams:

- Audit analytics
- Information systems audits
- Technical and treasury
- Methodology
- Learning and development
- Resourcing.

The Corporate team includes Finance Services, Human Resources Services and Information Services.

The Office of the Auditor-General supports the Auditor-General and the Deputy Auditor-General in their strategic oversight of the Office and has responsibility for monitoring the performance of the office. It includes the QAO's communications function and internal audit. As noted above, the Executive Officer is Head of Internal Audit.

7.3.1 Organisational review

This structure came into being following a review and redesign of the organisational structure in 2013. The purpose of the review was "to best position QAO to be an efficient operation with clear accountabilities that delivers high quality audit outputs".

The structural issues that prompted the review included a high number of Assistant Auditors-General and other senior positions, more layers of hierarchy than seemed necessary, and decision-making weighted towards higher levels of management. The QAO wanted to reduce silos between divisions of the organisation, to ensure effective audit support for both financial and performance audits, and to reduce the number of corporate support positions – a matter we discussed in the previous Part.

It also wanted to clarify accountabilities throughout the organisation.

The result was a structure that:

- centralised all audit support functions for both financial and performance audit in Specialist Audit Services;
- reduced the number of Assistant Auditors-General responsible for financial audits, from three to one;

- removed a line of management from corporate services, by having the leaders of the three corporate service teams report directly to the Deputy Auditor-General as chief operating officer;
- remove redundancy in corporate services.

It also consolidated the sector structure and sector director roles to enable a better focus on building relationships with clients.

7.3.2 Governance and management structure

To the extent possible in an organisation in which both governance and management rest with the chief executive and senior managers, the QAO's structure permits some distinction between the two.

The QAO's governance and management structure comprises:

- Executive Management Group committee:
- Operational Management Group committee;
- Information Steering Committee; and
- Audit and Risk Committee.

The Executive Management Group is the key support for the Auditor-General in discharging his or her duties under the Auditor-General Act and as accountable officer. It provides leadership to the QAO in achieving the objectives in its strategic plan, and in monitoring organisational performance. Its members are the Auditor-General, Deputy Auditor-General, and the three Assistant Auditors-General. The Executive Officer attends meetings. The committee meets monthly.

The Operational Management Group is chaired by the Deputy Auditor-General. It has as members the Deputy Auditor-General, the three Assistant Auditors-General, the Executive Officer and the Chief Financial Officer, Chief Technology Officer and Director – Human Resources. It provides support to the Deputy Auditor-General in his role as chief operating officer. The Operational Management Group also meets monthly.

The Information Steering Committee is a subcommittee of the Executive Management Group. It ensures effective governance of major information projects in accordance with the QAO's strategy for information communication and technology, and provides direction to the Chief Technology Officer to ensure alignment of ICT and the QAO's business needs. The members of the committee are the Deputy Auditor-General, the Assistant Auditors-General for Performance Audit and Specialist Audit Services and the Executive Officer. The Chief Technology Officer attends the meeting but is not a member of the committee.

The Audit and Risk Committee provides independent advice and assurance to the Auditor-General by oversight of the risk, control and compliance frameworks, including internal audit, that underpin the QAO's corporate governance. The committee has the power to access the staff and information it needs to discharge its duties. The committee consists of three members, external to and independent of the QAO. It meets quarterly.

The QAO also has a Workplace Health and Safety Committee which is chaired by the Director, Human Resources. Its membership comprises the members of the Executive Management Group and employee representatives. The committee meets quarterly.

We note that, at the time of the 2010 Review, there were two other committees carrying out specific functions – the Executive Staffing Group and the Women's Leadership Group. These committees no longer operate. Where necessary, issues relating to staffing are dealt with by the Operational Management Group. We understand that both management and staff agreed that the separate committees were no longer required.

We believe that the QAO's committee structure is effective and efficient. Each committee has a clear and comprehensive charter or terms of reference, available to all staff on the QAO intranet. Meeting agendas and minutes are also generally available on the intranet, but the meeting papers are not.

Measures of effectiveness

The QAO's policy on Governance of Committees requires each committee to carry out an annual self-review. We have read the responses for the 2016 reviews of the Executive Management Group, the Operational Management Group and the Information Steering Committee. Each member of a committee is asked to rate two questions on a four-point scale. The first is whether the committee is "positioned for success", considering its purpose, membership and processes. The second is whether the committee is operating effectively – whether its purpose is being achieved, whether members are prepared for the meeting and particulate fully, and whether the committee identifies and explores key issues. The questionnaire also asks for suggestions for improvement.

The ratings for all three committees were positive, but less so in the case of the Information Steering Committee. Suggestions for improvements were made for both that committee and for the Operational Management Group.

Another measure of the effectiveness of governance and management is staff views. The *Working for Queensland* survey includes respondents' opinions on organisational leadership and executive capability.

Sixty-two percent of the 141 staff who completed the survey had a positive view of the organisational leadership of the QAO, and 14% a negative view (the remaining 24% being neutral). That result was seven percentage points lower than in 2015, but still placed the QAO in the first quintile for the Queensland Public Service, nine points above the average.

The survey asked the most senior respondents (remuneration of $120,000 or more) to rate executive capability. The 20 respondents (presumably including the senior managers) rated executive capability highly – positive scores on 13 questions ranged from 79% to 100%. In comparison to the Queensland Public Sector, the QAO ranked slightly below average on four questions, slightly above on another three, and well above on the remaining six.

The lowest scoring questions (both 79% positive) concerned courage in the provision of advice and decision-making and commitment to personal development.

7.3.3 Delegations

The QAO has policies on *Financial and Administrative Delegations* and *HR Delegations*. The policies are required to be reviewed annually. We have reviewed the policies and the delegation levels and agree with the QAO that they are appropriate.

The Auditor-General also delegates the signing of audit opinions to some QAO officers.

7.3.4 Conclusion

We consider that the QAO's simplified organisational structure is appropriate and efficient. It provides clear accountability for all functions, with no apparent overlaps.

In our view, the governance and management structure is appropriate. The structure allows the Executive Management Group to function as a governance committee, with operational management resting primarily with the Deputy Auditor-General supported by the Operational Management Group.

We believe that the financial, administrative and human resource delegations in operation in the QAO are appropriate.

7.4 Performance monitoring and reporting

The QAO uses a balanced scorecard system to plan and monitor its performance for internal reporting purposes. The measures are grouped under the headings of Customer, Financial, Employee and Operational, and are reviewed at least annually. Selected measures are reported externally in the QAO's Statement of Service Delivery and Performance Statement.

The QAO is endeavouring to move the focus of its measures from outputs to outcomes. For example, it now measures the number of its performance audit recommendations implemented rather than the number accepted. The target for that measure is 100%, which we have commented on in Part 5. We have suggested that the target is not realistic, and recommended that the QAO consider reducing it to 98%.

Consistent with its focus on outcomes, in 2016 the QAO adopted an integrated reporting approach for the first time in its Annual Report for 2015–16.

The QAO has commissioned its external auditors to audit its performance statement. The audit is conducted in accordance with *ASAE 3000 Assurance Engagements Other than Audits or Reviews of Historical Financial Information*. The audit involves obtaining evidence to support the information disclosed in the Performance Statement, to give reasonable assurance that the information is not materially misstated.

We commend the QAO on this step. Publication of performance information, both financial and non-financial, is an important part of a public entity's accountability. Audit gives the users of that information assurance that it can be relied on. We agree with the QAO that audit of non-financial performance information is as important as audit of financial performance reports.

7.4.1 Conclusion

With the one reservation noted above, we consider that the QAO's performance framework is effective, and that the measures it uses for both internal monitoring and reporting and for external reporting are appropriate.

We commend the QAO for obtaining assurance on its performance statement from its external auditor.

We also commend the QAO for its move towards integrated reporting in its Annual Report for 2015–16.

7.5 Internal communication and the sharing of performance information

The QAO communicates with its staff in a variety of ways, including team meetings, quarterly staff seminars, divisional planning days and management forums. The primary day to day tool for communicating a range of information to staff is the intranet. As well as carrying frequent posts of information of passing interest to staff, it includes in a structured way most of the information about the QAO, its structure, policies and processes that an employee needs. We have used the resources on the intranet extensively in carrying out this review.

The *Working for Queensland* survey includes questions that relate to communication. In the 2016 survey, 79% of the staff who responded said that their manager kept them informed about what was going on, and 83% said that their manager listened to what they had to say. In each case, the score was well above the average for the Queensland Public Sector.

The survey statements are not confined to corporate performance information. However, when coupled with the fact that we did not hear complaints about lack of communication in our meetings with staff, we are comfortable that communication between management and staff is not a cause for concern in the QAO.

7.5.1 Conclusion

We consider that communication between QAO's management and staff is satisfactory.

7.6 Human resource issues, including training

The major human resource issues confronting the QAO concern workforce recruitment, retention and remuneration, which we have covered in the previous Part.

We comment here on the following matters:

- performance management;
- training and development.

7.6.1 Performance management

The QAO has a formal system for performance management set out in its policy on *Managing Performance and Conduct*. The system involves setting goals for each employee and six-monthly monitoring of progress against the plan. The goals are focused on four areas – performance, customers, QAO's internal processes, and learning and growth. Each performance review also assesses the employee's alignment with the QAO's four values, discussed above, but that aspect of performance is not formally rated.

Development plans form part of the performance management process. A development plan is intended to record the aspect of performance (technical or otherwise) that the employee will concentrate on in the ensuing six months. We consider learning and development further in the next section.

The purpose of the performance management system is both to encourage and recognise good performance and to manage poor performance. The policy on *Managing Performance and Conduct* is comprehensive, setting out both the roles and responsibilities of each party and the processes to be followed. There is further guidance for both managers and staff on the intranet.

Effectiveness measures for performance management

The QAO monitors the operation of the performance management system. The balanced scorecard records in the "employee" section the percentage of performance reviews that are overdue, with a target of less than 5%. In June 2016, 6% (10) of the reviews for the six months ended 30 April 2016 were overdue, and four for the previous period ending 31 October 2015.

The three questions in the *Working for Queensland* survey that concern performance management receive positive responses:

- I receive useful feedback on my performance (61% positive and 16% negative);
- My performance is assessed against clear criteria (51% positive and 27% negative); and
- I have had productive conversations with my manager in the past twelve months (65% positive and 15% negative).

The first two responses are not overwhelmingly positive, but are on a par with the average for the Queensland Public Sector. The third response, which is ten points ahead of the Queensland Public Sector average suggests that dissatisfaction might concern the formal assessment system while "on the job" coaching and mentoring operates better.

7.6.2 Training and development of staff

Training and development is an important focus for the QAO. Improved capability and performance of staff is essential for improving audit quality and capability.

Delivery of training and development is both external to the QAO and in-house.

The QAO's budget for external training is 2% of the personnel budget (around $425,000). It covers supporting employees to obtain their professional accounting qualification and to undertake training and development tailored to the needs of individuals – whether to become fully competent in their particular role, or for career development. It also covers employees' professional membership fees. Much of the technical training is delivered in-house by QAO's own experts, in formal conferences or informal "lunchbox" sessions.

Other training is carried out in-house from a corporate training budget managed by Human Resources. In 2015–16, training programmes covered management and leadership development, stakeholder engagement, presentation skills, plain language and Qlikview (the programme used for audit analytics). The programme for 2016–17 includes further training on management and leadership development and data analysis, professional scepticism, internal consulting skills for support service staff, and cultural awareness training for those working with indigenous communities.

In 2015, the QAO introduced an electronic platform for the delivery of in-house training programmes. It provides a library of courses that employees can complete when convenient. It also enables the QAO to track whether employees have completed mandatory training, such as professional ethics and workplace health and safety courses.

We note too the training and development opportunities that can come from secondments to other public entities, or from working in a "blended" audit team – a team comprised of QAO and audit service provider staff.[56]

Effectiveness measures for training and development

The responses to the seven questions in the *Working for Queensland* survey that concern development range from 34% to 74% positive responses. All but two responses are over 50% positive, and all but the same two are above, usually significantly above, the average for the Queensland Public Service.

The responses suggest that the QAO's training and development system is effective. The questions with the highest positive response concern access to learning and development opportunities (74% positive and 12% negative), opportunities in the QAO to develop skills and knowledge (72% positive and 10 % negative), and perceptions of the QAO's commitment to developing its employees.

The two questions with a lower positive rating concern career development – encouragement to pursue developmental opportunities in other workplaces (34% positive and 31% negative) and satisfaction with the opportunities for career development (44% positive and 23% negative).

We are not surprised that those questions attract a relatively low level of positive response. The QAO is unique in the Queensland Public Sector – no other organisation can offer experience in financial attest audit or performance audit. For that reason, a career as a public sector auditor in Queensland is really limited to a career in the QAO.

However, developmental experience need not be limited to audit. We have discussed elsewhere in this report the importance of an auditor's understanding a client's point of view and secondments to clients would help with that understanding.

[56] Discussed in Part 4.

The QAO reported that it achieved 63 hours' professional development per auditor in 2015–16,[57] and has informed us that the average development hours for all employees (auditor and non-auditor) is consistently over 50 hours per employee per year. The Macro Benchmarking report suggests that the amount of training for QAO's financial audit staff was equivalent to the average for the Australian audit offices. However, the training for performance auditors was below the average.

The balanced scorecard includes measures for capability/competence plans in place for financial audit and SAS staff. The target is 100%, which was met in 2015/16. The balance scorecard also includes the rate of professional development hours per permanent FTE undertaken by financial audit staff. The target is 50 hours, but the actual result at June 2016 was 71 hours. (That figure is calculated using different methodology from that used for the Macro benchmarking survey.)

Conclusion

We consider that the QAO has effective systems for performance management and training and development of staff. Both systems are delivered on an electronic platform, and information about them is readily available to staff. Actual training and development exceeded targets in 2015–16. The feedback from staff, as measured by the responses to the *Working for Queensland* survey, is generally positive.

7.7 Administrative systems and processes

Many of the QAO's administrative systems are discussed elsewhere in this report. In this section, we comment on the QAO's policies library, its strategic and business planning, and on its replacement of legacy IT systems.

7.7.1 Policies and procedures

The QAO has an extensive suite of finance, human resource, and information and technology policies. There are also policies, administered by the Executive Officer, that cover governance matters, and other issues such as public interest disclosures, staff use of social media and visiting overseas delegations.

The policies are readily available on the intranet. Each policy provides for regular review and a version control page in each suggests that they are regularly reviewed and updated.

We consider that the suite of policies is comprehensive and appropriate.

7.7.2 Planning

The QAO has several strands of planning, which flow from and support its strategic plan. We referred in Part 2 to the strategic plan for 2016–19, and the purpose, vision and objectives it describes. The QAO's operational plan, budget and service delivery statement and its workforce strategy all align with the strategic plan.

[57] *QAO Annual Report 2015–16*, page 21.

The Strategic Audit Plan and planning process are discussed in section 5.8.

We consider the planning process to be comprehensive and effective.

7.7.3 IT systems

The QAO relies on various systems to plan, resource and deliver its audit services, and to invoice clients. It is upgrading its internal systems and related processes to improve office productivity and to reduce costs, and because a number of the systems are no long supported by the software provider.

The business case for the QAO Legacy System Refresh Project was accepted in December 2015.

eTrack

One of the systems in the process of being replaced is the practice management system, eTrack. At the time of the 2010 Review, eTrack was performing poorly and, as a consequence, was not being used fully. The 2010 Review recommended that "QAO take steps to ensure that eTrack provides a reliable and effective practice management system for the future and that staff be encouraged to utilise its capabilities".[58]

We are aware that the QAO has worked hard over the past seven years to improve the performance of eTrack and to ensure that it was used more widely. However, eTrack is to be replaced from 30 November 2016 with functionality being incorporated into the Microsoft Dynamics AX solution.

Legacy Systems Refresh project

The Legacy Systems Refresh dates from 2013. QAO management were aware that there was a high level of manual processes occurring outside of its systems (including eTrack), creating "built in" inefficiencies. In addition, there were systems which did not meet functional requirements to support QAO business operations, and proprietary approaches to data management across systems which did not allow for removal of data duplication and additional processing.

The QAO investigated outsourcing the service provision or the application provision that supports the service, in line with the then Queensland Government's contestability agenda. However, the review identified that the cost of service delivery for support services which could be outsourced would not achieve any productivity gains.

In 2014, the QAO analysed the options of doing nothing, upgrading its current systems with the latest versions, and refreshing the legacy systems with "best of breed" systems. The financial assessment was that the refreshing of legacy systems was the best option because of reduced software licence fees, lower project implementation costs due to integrated business processes, and the ability to reallocate staff to more productive activities.[59]

[58] Strategic Review 2010 Recommendation 10(iv).

[59] QAO Legacy Systems Refresh Project Business Case, December 2015.

The Legacy Systems Refresh Project completed Phase 2 which includes the financial systems replacement. This element of the system went live on 4 July 2016. Phase 3 of the Legacy Refresh Project which includes the replacement of eTrack was completed in November 2016.

The Legacy Systems Refresh project is forecast by the QAO to cost $2.434 million (being half operating expense and half capital expense). The QAO expects savings of $64,000 per annum from the annual cost of systems support. Other benefits will flow from the improved functionality of systems.

Training in the new system

We note that as part of the new systems coming online, the QAO is planning and implementing a programme of awareness and training for all staff.

As with any new system, strong leadership will be required from the Auditor-General and senior management to ensure that all relevant functionality is used for the benefit of the office.

Organisational change following implementation

The QAO has received a report recommending organisational requirements following the implementation of the Legacy Systems Refresh Project. This has been actioned with a number of changes to roles and some new appointments made to reflect the needs of the QAO following the Legacy Systems Refresh.

Business benefits realisation

As part of the business case for the new systems there were benefits identified from implementation. As with any new system, discipline will be needed to ensure that the business benefits are realised and savings achieved.

Conclusion

The Legacy Systems Refresh programme has been successfully completed and now provides a range of integrated systems to provide support for the delivery of audit services by the QAO.

7.8 Funding of the QAO

Funding of the QAO is considered in section 4.12 of this report, and in relation to performance audits, in section 5.7.

7.8.1 Conclusion

The terms of reference ask us to consider whether the QAO’s funding is appropriate, and whether it is appropriately used. We have concluded that the funding derived from audit fees is appropriately used. However, as discussed in section 4.12, we consider that the funding for financial auditing is not adequate, and have recommended that the QAO review its fees budget for 2016–17.

We consider that the parliamentary funding for performance audits, reporting the results of financial audits to Parliament, strategic audit planning, and funding the Auditor-General and Deputy Auditor-General positions is appropriately used.

However, for the reasons set out in section 5.7, we consider that the funding for performance audits should be increased.

7.9 Communications

The QAO has refocused its communications strategy from operational to strategic. The communications strategy supports its stakeholder engagement activities, and the delivery of the QAO's strategic and business plans.

The QAO's communications are many and various – including communications with clients, audit service providers, members of Parliament, and members of the public. The QAO's communications team is located in the Office of the Auditor-General, and supports the range of communications carried out by the organisation. However, QAO management and staff must communicate with a wide range of stakeholders, with and without the input of the communications team.

The QAO's media strategy is reactive – that is, it does not seek media attention. It alerts media shortly before the release of a report, but does not offer further comment.

We have mentioned earlier in this report the various factsheets that the QAO publishes on its website, and commented on the clarity and presentation of its reports to Parliament. We note too the QAO's newsletter to clients called *Insights*, and its website. We have used the material on the website extensively in carrying out this review. We have found the website comprehensive and well-organised.

Several of the stakeholders with whom we met in the course of this Review spoke appreciatively of the QAO's briefings for Audit Committee chairs. Contract auditors also spoke positively of the QAO's briefings for them.

We have discussed communications elsewhere in this report, most notably our view that the QAO needs to improve its relationships and communications with its clients. The formal strategy and processes that we have mentioned in this section will support that work.

7.9.1 Conclusion

We are satisfied that the QAO has considered all aspects of its communications, and that it has a comprehensive strategy to manage communications and its relations with its stakeholders. We have commented elsewhere in this report on the opportunity to improve communication and relationships with clients.

7.10 Other matters which impact on the economy, efficiency and effectiveness of the QAO

We have discussed in Part 6 our view that the QAO's difficulties with recruitment, retention and reward of staff give rise to inefficiencies.

We have discussed in Part 5 our view that the QAO's performance audit function would work more efficiently if it were better resourced.

The QAO has drawn to our attention a number of instances in which the provisions of the Act appear to be outdated, and which impact on its economy, efficiency and effectiveness. An example concerning acceptance of electronic copies of signed financial statements is referred to in section 4.3.6. We recommend that steps be taken to remedy those matters.

We suggest also that consideration be given to including in the Act a requirement for regular review of its provisions, to ensure that they stay in line with developments in auditing and in public sector auditing in particular. A review of the Act could be aligned with the five-yearly strategic review.

There are no other matters that we consider impact significantly on the QAO's economy, efficiency and effectiveness.

Recommendation

We recommend that:

7.10(i) The Auditor-General Act 2009 be reviewed to identify provisions that are outdated and that impact on the efficiency and effectiveness of the QAO, and steps be taken to seek amendment of the Act;

7.10(ii) Consideration be given to including in the Act a provision requiring regular review of its provisions.

8 Independence of the Auditor-General

8.1 Terms of reference

The terms of reference for this Review refer to the question of the Auditor-General's independence.

We are asked to note the Finance and Administration Committee Report No 23 *Inquiry into the legislative arrangements assuring the Auditor-General's independence*, the evidence given to the Committee's inquiry, and that the Committee determined not to comment on the inquiry to allow this strategic review to proceed.

We interpret that provision as an invitation to comment on the matters that were the subject of the inquiry.

8.1.1 Inquiry into the legislative arrangements assuring the Auditor-General's independence

The Finance and Administration Committee Report No 23 describes the background to its inquiry, and sets out its terms of reference. It records the Committee's decision "to report on the details of the inquiry process to date to ensure that the next strategic review of the Office of the Auditor-General can commence and can consider matters under this inquiry's terms of reference" (section 1.3).

The Committee's terms of reference were to inquire into:

- the effectiveness of section 56 of the Auditor-General Act 2009;
- the legislative arrangements for the independence and accountability of the Auditor-General and the Queensland Audit Office;
- how the Queensland arrangements compare to the arrangements in New Zealand and other Australian jurisdictions;
- how the Queensland arrangements compare with international best practice;
- other independence issues.

The Committee received eight written submissions and heard oral evidence from four of those submitters. The submitters are listed in its report. Copies of the written submissions and transcripts of hearings are publicly available on the Committee's website.[60]

All of the submitters acknowledged the importance of Auditor-General independence, and most made suggestions for strengthening the independence of the Queensland Auditor-General.

[60] http://www.parliament.qld.gov.au/work-of-committees/committees/FAC/inquiries/past-inquiries/QAOIndependence

We have considered the evidence given to the Committee, and have found it to be pertinent and valuable. We draw particular attention to the QAO's submission which addresses the Committee's terms of reference thoroughly and contains careful analysis of the Queensland arrangements. As the evidence given to the Committee is a publicly-available resource, we have decided not to include a detailed analysis in this report, but to refer to the inquiry evidence where applicable.

8.1.2 Structure of this Part

Accordingly, this Part is structured as follows:

- international and Australian best practice;
- comparison of Queensland's arrangements to best practice;
- comparison of Queensland's arrangements to those in other Australian jurisdictions and in New Zealand;
- the effectiveness of section 56 of the Auditor-General Act 2009;
- conclusion.

8.2 Independence of Auditors-General – best practice

The basic principle of audit independence is that an auditor must be independent as far as possible of the entity he or she is auditing. The auditee must not be able to influence the scope of the audit work or the reporting of the auditor's opinion. In the case of an Auditor-General, the auditee is primarily executive government.

Best practice in the independence of Auditors-General concerns an Auditor-General's independence from the Executive. In essence, the intention is to ensure that an Auditor-General:

- is not appointed or dismissed by executive government, and that his or her remuneration is set independent of executive government;
- has sufficient resources to discharge his or her functions, and that executive government cannot limit resources; and
- has the discretion to decide what work to carry out, and the scope, timing and reporting of that work, without interference from executive government.

In a parliamentary democracy such as Queensland, best practice is that an Auditor-General is an independent Officer of Parliament, and matters such as appointment and resourcing of the Auditor-General are the responsibility of the Parliament.

The key documents that set out best practice are:

- ISSAI[61] 10 – *Mexico Declaration on Independence* and ISSAI 11 – *INTOSAI Guidelines and Good Practices Related to SAI Independence*;[62]
- ACAG's *Statement of Principle on the Role of the Auditor-General*;[63]
- Australasian Council of Public Accounts Committees' (ACPAC) *Statement on the Minimum requirements for the independence of the Auditor-General*.[64]

Each of these documents was provided to the Committee to assist with its inquiry, often by more than one submitter.

8.2.1 INTOSAI principles

ISSAI 11 defines eight core principles as essential requirements of proper public sector auditing:

1. The existence of an appropriate and effective constitutional /statutory/legal framework and of *de facto* application provisions of the framework.
2. The independence of SAI heads … including security of tenure and legal immunity in the normal discharge of their duties.
3. A sufficiently broad mandate and full discretion, in the discharge of SAI functions.
4. Unrestricted access to information.
5. The right and obligation to report on [the SAI's] work.
6. The freedom to decide the content and timing of audit reports and to publish and disseminate them.
7. The existence of effective follow-up mechanisms on SAI recommendations.
8. Financial and managerial/administrative autonomy and the availability of appropriate human, material, and monetary resources.

The principles are aspirational. The reviewers are not aware that any jurisdiction yet meets all eight principles, though several jurisdictions come very close.

[61] International Standard of Supreme Audit Institutions.

[62] http://www.intosai.org/issai-executive-summaries/view/article/issai-10-the-mexico-declaration-on-sai-independence-eger.html

[63] http://www.acag.org.au/sop.htm

[64] http://www.parliament.qld.gov.au/documents/committees/FAC/2013/QAOIndependence/submissions/005.pdf (attachment to ACAG submission).

8.2.2 ACAG principles

The ACAG principles are consistent with the INTOSAI principles, but they cover one additional matter – the Auditor-General's own accountability:

- the Auditor-General must be fully accountable for the performance and use of public resources in discharging the mandate of the office;
- the Auditor-General must be primarily accountable to Parliament (not the executive government) in a manner consistent with the office's independence.

8.2.3 ACPAC principles

The minimum requirements for an Auditor-General's independence defined by ACPAC again are consistent with the INTOSAI principles. They focus on the role of Parliament, and also cover accountability. The principles include:

- an Auditor-General should be an officer of Parliament;
- the Parliament should select an Auditor-General, and be responsible for any termination of appointment;
- an Auditor-General should report annually to Parliament;
- Parliament should appoint the external auditor of an audit office;
- the performance of an audit office should be subject to periodic annual review, by a reviewer nominated by Parliament or a Parliamentary Committee.

8.3 Comparison of Queensland's arrangements to best practice

The QAO's submission to the Committee's inquiry contains a careful comparison of the Queensland position to the INTOSAI principles.

We have considered the QAO's analysis, and agree with it. The analysis identifies a number of areas in which the Queensland arrangements fall short of the principles, particularly in relation to:

- Principles 1 and 2 and the need for freedom from influence by the Executive in the Auditor-General's appointment and conditions of employment, and
- Principle 8 – financial and managerial/administrative autonomy and the availability of appropriate human, material, and monetary resources.

The QAO makes various suggestions for changes that would strengthen the Auditor-General's independence. We endorse the suggestions made by the QAO, and we recommend that they be implemented.

8.4 Comparison of Queensland's arrangements to those in other Australian jurisdictions and in New Zealand

In 2009, ACAG commissioned a survey of the extent to which the Australasian audit offices met the standards of the INTOSAI principles. The survey was updated in 2013 following significant changes to legislation affecting the Commonwealth, Queensland, Northern Territory, Tasmanian and Victorian Auditors-General – *Independence of Auditors General: A 2013 update of a survey of Australian and New Zealand legislation*.[65]

The study provides a comparison of Queensland's arrangements to those of the other jurisdictions. Several submitters drew the study to the Committee's attention.

The study identified 60 factors that contribute to each of the principles and made an assessment of the extent to which each factor was subject to the control of Executive government. Each office was given a score for each factor. The scores range from zero, where legislation was silent or where the factor was directly controlled by executive government, to nine, where the factor was embedded within the jurisdiction's legislation, or ten in its constitution. The full range of ranking was not applicable to every factor.

In 2013, following the changes to the Auditor-General Act in 2011, Queensland scored 320 (out of a possible 400) compared to 246 in 2009. That put it fourth out of the 10 jurisdictions, though more recent changes in the ACT legislation may have reduced its ranking to fifth.

Not surprisingly, the principle on which the Queensland office scored lowest was Principle 8 – financial and managerial autonomy. We have discussed earlier in this report the practical implications of the constraints on the Auditor-General's ability to recruit and remunerate staff, and recommended that removal of those constraints.

While the study contains detailed and useful analysis, we do not find the scoring helpful. In our view, the 60 factors are by no means of equal importance, yet it seems that they are not weighted for scoring purposes.

8.5 The effectiveness of section 56(3) of the Auditor-General Act 2009

Section 56(3) of the Auditor-General Act enables the Auditor-General to decide the basic rates (hourly rates) of fees that the QAO will charge for audits, but subject to the Treasurer's approval. We assume that the purpose of the provision is to enable the Treasurer to limit or prevent increases in the audit fees paid to the QAO by public sector entities. As the QAO is funded mainly by fees for financial audits, that would enable a Treasurer to limit the funding for the office.

[65] Dr Gordon Robertson, PhD, PSM June 2013 available at http://www.acag.org.au/research.htm

However, we have come to the view that section 56(3) is ineffective, and suggest that it be repealed. We hold this view both because the provision (if it is intended to manage the funding of the office) lessens the Auditor-General's independence from executive government, and because we think it is ineffective, as discussed below.

We note that the Committee's terms of reference referred to the effectiveness of section 56 in its entirety. This section of the report concerns subsections (3) and (4) only. Subsections 56(1) and (2) enable the Auditor-General to charge fees and recover reasonable costs for financial audits, and subsection (5) enables recovery of unpaid fees as a debt due to the Auditor-General. We consider those provisions to be effective.

8.5.1 Relevance of basic rates to audit fees

We discuss decreases in audit fees in section 4.12 of this report, and the QAO's productivity increases in Part 6. Both sections are relevant to this question. In summary, since 2011:

- there have been no increases in the basic rates, although the Treasurer has recently approved annual adjustments of 2.5% for each of the next four years;
- the QAO's productivity has increased from 56.6% to 63.8% (calculated on "available hours");
- overall audit fees have reduced by over 1.1% per annum in real terms over the last seven years; and
- the QAO projects a further nominal decrease of 4.2% in overall audit fees in 2016/17.

That is, the reduction in fees was unrelated to the basic rates. Further, the QAO does not intend the increase in basic rates approved from 31 October 2016 to lead to increases in its overall audit fees.

In short, in the past five years, the basic rates have had little effect on audit fees. If there were to be regulation of audit fees, we suggest that regulation of the basic rates would not be the right lever.

8.5.2 Perverse incentives created by regulation of basic rates

The QAO's hourly rates should derive from the QAO's costs attributable to financial audit, divided by the number of hours QAO staff work on financial audits.

We have recorded elsewhere in this report the QAO's reduction in costs (mainly through reduction in staff numbers), its increase in audit efficiency, and the consequent increase in productivity. However, the increase in audit efficiency (meaning a decrease in audit hours) happened more quickly than a decrease in costs. That is, audit hours worked and charged for decreased, so fee income decreased, but costs decreased more slowly.

To offset the projected deficit, in 2013, the Auditor-General sought the then Treasurer's approval to increase basic rates. The Treasurer declined to approve an increase.

In the event, the QAO managed the deficit by bringing work forward from the next year. However, we note the perverse incentives inherent in this situation. Another solution would have been to work unnecessary hours on audits, thus decreasing audit efficiency and productivity, but maintaining income and avoiding a deficit.

8.5.3 Regulation of Auditor-General's audit fees

The evidence would seem to be that section 56(3) is not effective in controlling the price of an audit.

We consider it beyond the scope of this Review to determine whether there should be regulation and if so, by whom.

From an independence "best practice" angle, any regulation of an Auditor-General's fees should not rest with executive government. Executive government ought not to be able to determine the level of resource that the Auditor-General has to carry out audits. As noted above, the freeze on basic rates had the effect of depriving the Auditor-General of adequate funding for a time.

We note that the Auditor-General has opportunity for self-regulation, in that the QAO contracts out about a third of its audits. The Auditor-General therefore knows the fees charged by private sector audit service providers, and has an incentive to keep the QAO's own fees comparable. As we have noted in section 4.12, we consider that they are comparable.

8.5.4 Repeal of sub-sections 56(3) and 56(4)

The term "basic rates of fees" is not defined in the Act. As far as we are aware, it is not a term used in other Australian jurisdictions. As noted above, the basic rates do not have a direct effect on the fees charged by the QAO.

We suggest therefore that the requirement for basic rates of fees be removed from the Act, and with it the requirement for the Treasurer's approval of the fee rates. In consequence, section 56(4) should also be repealed.

It may be desirable to add to section 56(1) a requirement that the Auditor-General charge reasonable fees, which would be consistent with section 56(2) which refers to the charging of "reasonable costs and expenses".

8.6 Conclusion

We consider that the QAO lacks the structural independence appropriate for a competent audit office in a mature democracy. The evidence given to the Committee, and particularly the QAO's submission, describe a number of areas in which the independence of the Queensland Auditor-General falls short of best practice.

The QAO's institutional arrangements are such that the QAO could be constrained or influenced by executive government. This Review has not found any evidence that the Queensland government has attempted to constrain the QAO, nor do we think it likely that the QAO would accept such constraint quietly. But the fact is that the QAO's institutional arrangements fall well short of international best practice.

We consider that the area of most immediate concern, one we have referred to in various parts of this report, is the Auditor-General's lack of independence in relation to the resourcing of his office.

Our view is that the QAO is a competent and effective part of the QAO public sector. It takes seriously its accountability to Parliament and publicly. We believe that it is fit to be trusted with more autonomy.

Some of the areas identified may appear to have symbolic value only, but the perception and reality of independence can be of equal importance. For that reason, we recommend that the Auditor-General be recognised as an independent Officer of Parliament.

Lessening the role of executive government in the arrangements pertaining to the Auditor-General would increase Parliament's role – in matters such as appointment, setting the budget for the QAO, and monitoring its performance. It is for Parliament to decide what role it should have.

Recommendations

8.6 We recommend that:

(i) The Auditor-General become an independent Officer of Parliament;

(ii) The Auditor-General's independence be strengthened in line with the suggestions made by the QAO in its submission to the Finance and Administration Committee's inquiry into "the legislative arrangements assuring the Auditor-General's independence";

(iii) Sub-sections 56(3) and (4) of the Auditor-General Act be repealed.

Appendix 1: Terms of reference

2016 STRATEGIC REVIEW OF THE QUEENSLAND AUDIT OFFICE

TERMS OF REFERENCE

INTRODUCTION

The Queensland Auditor-General and the Queensland Audit Office carry out independent audits of the Queensland public sector and related entities. The scope of the Auditor-General's audit mandate includes annual financial audits and scheduled performance audits.

SCOPE

In accordance with Section 68 of the *Auditor-General Act 2009* (the Act), a strategic review of the Queensland Audit Office (QAO) is to be conducted at least every five years. The strategic review, as defined in Section 68(7) of the Act, is to include:

a) a review of the Auditor-General's functions

b) a review of the Auditor-General's performance of the functions to assess whether they are being performed economically, effectively and efficiently.

The appointed reviewer will be required to generally assess and provide advice and recommendations about the functions and the performance of the functions of the Auditor-General and the QAO, in order to assess whether they are being performed in accordance with the requirements of the Act. The appointee will be required to place particular focus on evaluating the QAO's expanded audit mandate in relation to performance audits, which has not been the subject of a strategic review under the Act in the past.

The strategic review is to examine all structural and operational aspects of the QAO, as well as its relationship with public sector entities, relevant Ministers, the Treasurer and the Parliament of Queensland.

The strategic review is to consider the recommendations:

- from the 2010 strategic review
- of the former Public Accounts and Public Works Committee report on the 2010 strategic review
- the Government's response to the Public Accounts and Public Works Committee report, particularly to the extent to which they have been implemented and whether they are achieving the desired objectives.

The strategic review will note the Finance and Administration Committee Report No. 23 *Inquiry into the legislative arrangements assuring the Auditor-General's independence*, the inquiry's evidence, and that the Committee determined to not comment on the inquiry to allow the strategic review of the QAO to be conducted.

The appointee will have the powers vested in them under Section 69 of the Act in order to conduct the review.

METHODOLOGY

In conducting the strategic review, the appointee is to have regard to the QAO's existing governance framework including strategic and operational plans, the organisational structure, corporate and operational management, operational conduct, internal/external policies, and audit service provisions of the QAO.

The strategic reviewer is to give particular reference to:

a) whether existing processes are appropriate to the QAO's audit mandate, the needs of public sector agencies and emerging public sector organisational structures

b) the effectiveness of existing processes, and in particular the effectiveness of the auditing standards issued by the Auditor-General and the performance audits, in fulfilling the audit mandate within the contemporary accountability requirements of Queensland's system of government

c) examination of trends in the workload of the QAO, including an examination of current and past methodologies relating to practices and procedures employed by the QAO

d) the operational efficiency of QAO audit methodology and relative efficiency of in-house and contract audit service provisions

e) the standard and quality of service provided to the Parliament, audit clients and executive Government

f) the structure of the QAO, including the delegation and allocation of responsibilities

g) management systems and processes used by the QAO, including:

    i. appropriate internal and external performance indicators to monitor efficiency and effectiveness

    ii. internal communication and sharing of performance information

    iii. human resource issues, including formal and informal staff training and guidance

    iv. administrative systems and processes used by the QAO

    v. whether the funding of the QAO is both appropriate and appropriately used to discharge the functions and objects of the QAO

    vi. appropriate protocols for communication by and with the QAO

    vii. any other matters which impact on the economy, efficiency and effectiveness of the QAO

h) evaluating the effectiveness of the recommendations made by the QAO in audit reports and the costs and benefits associated with their implementation

i) evaluating the QAO's understanding of Queensland public sector and related entities core business and functions being performance audited, taking into account feedback provided by entities the subject of performance audits.

The strategic review should also take into account:

- consideration of comparative models, practices and procedures used by offices in other jurisdictions equivalent to the QAO, with particular focus on jurisdictions with a performance audit mandate;
- the results of the Finance and Administration Committee oversight of the Auditor-General including related reports and transcripts of Estimate hearings;

- interviews with staff (including all staff who indicate they wish to be interviewed by the appointee) and former staff of the QAO, both individually and in focus groups (interviews with former staff are optional)
- consultation with key Government agencies including the Department of the Premier and Cabinet and Queensland Treasury, particularly in relation to the Strategic Audit Plans for the performance audits of the QAO
- consultation with other key stakeholders, including accounting firms that conduct business with the QAO.

PROPOSED TIMELINES AND KEY DELIVERABLES

As required under Section 70(1) of the Act, the reviewer must give a copy of the proposed report on the strategic review to the Premier and the Auditor-General prior to finalising the report. Under section 70(2) of the Act, the Premier and the Auditor-General may, within 21 days after receiving the proposed report, give the reviewer written comments on anything in the proposed report, in which case the reviewer must comply with Section 70(3) of the Act.

In accordance with Section 70(4) of the Act, the final review report is to be presented to the Premier and the Auditor-General in a suitable format for tabling in the Legislative Assembly. This should occur no later than ten business days after complying with sections 70(1) and 70(2) of the Act. The final review report must be substantially the same as the proposed report, apart from any changes made under Section 70(3).

Sections 70(6) and 70(7) of the Act provide that the Premier must table the strategic review report in the Legislative Assembly within three sitting days after receiving the report, and that the report be referred to the Finance and Administration Committee for examination, who may comment on any aspect of the report and make recommendations.

Appendix 2: Linkage of review report to the terms of reference

Terms of reference		Relevant Part of report
Scope		
(a)	A review of the Auditor-General's functions	4 and 5
(b)	A review of the Auditor-General's performance of the functions to assess whether they are being performed economically, effectively and efficiently	4 and 5
The appointee will be required to generally assess, and provide advice and recommendations about, the functions and the performance of the functions, of the Auditor-General and the QAO, in order to assess whether they are being performed in accordance with the requirements of the Act. Required to place particular focus on evaluating the QAO's expanded audit mandate in relation to performance audits, which has not been the subject of a strategic review under the Act in the past.		2, 4 and 5 5
The review is to examine all structural and operational aspects of the QAO, as well as its relationships with public sector entities, relevant Ministers, the Treasurer and the Parliament of Queensland		6 and 7
Consideration is also to be given to the recommendations agreed by the Government arising from both the 2010 strategic review, and the related Parliamentary Committees' reports on the review and the Government's response to the Committee's report, particularly the extent to which they have been implemented and whether they are achieving the desired objective		Appendices 5 and 6
The strategic review will note the Finance and Administration Committee Report No 23 Inquiry into the legislative arrangements assuring the Auditor-General's independence, the inquiry's evidence, and that the Committee determine to not comment on the inquiry to allow the strategic review of the QAO to be conducted.		8
Methodology		
(a)	Whether existing processes are appropriate to the QAO's audit mandate, the needs of public sector agencies and emerging public sector organisational structures	4 and 5
(b)	The effectiveness of existing processes, and in particular the effectiveness of the auditing standards issued by the Auditor-General, in fulfilling the audit mandate within the contemporary accountability requirements of Queensland's system of government	4 and 5
(c)	Examination of trends in the workload of the QAO, including an examination of current and past methodologies relating to practices and procedures employed by the QAO	6
(d)	The operational efficiency of QAO audit methodology and the relative efficiency of in-house and contract audit service provision	4 and 5
(e)	The standard and quality of service provided to the Parliament, audit clients and executive Government	4 and 5

Terms of reference	Relevant Part of report
(f) The structure of the QAO, including the delegation and allocation of responsibilities	7
(g) Management systems and processes used by the QAO, including: • appropriate internal and external performance indicators to monitor efficiency and effectiveness; • internal communication and sharing of performance information; • human resource issues, including formal and informal staff training and guidance; • administrative systems and processes used by the QAO; • whether the funding for the QAO is both appropriate and appropriately used to discharge the functions and objectives of the QAO; • appropriate protocols for communication by and with the QAO; • any other matters which impact on the economy, efficiency and effectiveness of the QAO.	7
(h) Evaluating the effectiveness of the recommendations made by the QAO in audit reports and the costs and benefits associated with their implementation	5
(i) Evaluating the QAO's understanding of Queensland public sector and related entities core business and functions being performance audited, taking into account feedback provided by entities the subject of performance audits.	5

Appendix 3: Reviewers – biographical notes

Phillippa Smith – Lead reviewer

Phillippa Smith was Deputy Controller and Auditor-General for New Zealand, from 2005 until 2015. She also spent five years in the New Zealand Office of the Auditor-General in the 1990s as Assistant Auditor-General – Legal. She led a review of the Irish Comptroller and Auditor-General's Office in 2008. Phillippa is a lawyer by training, and has worked in the public and private sectors in New Zealand and in the voluntary and private sectors in England. She holds degrees in Law, Arts, and Public Policy from Victoria University of Wellington.

Graham Carpenter

Graham Carpenter is a Fellow Chartered Accountant with experience covering both the public and private sectors. He, with another, undertook the previous Strategic Review of the QAO as tabled in 2010. His past experience includes being a Partner of Chartered Accounting firms including with BDO Queensland, as Northern Territory Auditor-General, Comptroller-General in Victoria and as an Assistant Under-Treasurer in Queensland Treasury. He currently holds Board positions with Brisbane South Primary Health Network Ltd, as a Council member on CQUniversity and is chair or member of a number of Audit/Risk/Compliance Committees. His past Board experience includes as Chair of BCITF (Qld) Ltd trading as Construction Skills Queensland, as Chair of Stanwell Corporation Ltd/Tarong Energy Corporation Ltd and member of a number of other boards.

Appendix 4: List of interviewees

Queensland Parliament	Finance and Administration Committee, Chair and Deputy Chair Other Members of the Committee
Ministers	Queensland Treasurer Minister for Health
Departments	Aboriginal and Torres Strait Islander Partnerships Communities, Child Safety and Disability Services Environment and Heritage Protection Housing and Public Works Justice and Attorney-General Premier and Cabinet Public Service Commission Queensland Health Queensland Treasury Transport and Main Roads
Health and Hospital Services	Children's Health Queensland Hospital and Health Service Cairns and Hinterland Hospital and Health Service
Local governments	Local Government Association of Queensland Brisbane City Council Cairns Regional Council Gladstone Regional Council Sunshine Coast Council Yarrabah Aboriginal Shire Council
Statutory bodies/ GOCs	Energex Limited Gladstone Area Water Board Ports North Authority Limited Gladstone Ports Corporation Limited QIC Limited Stanwell Corporation Limited Queensland Rail
Universities	Sunshine Coast University University of Queensland
Grammar schools	Brisbane Boys Grammar School

Audit service providers	Three contract audit firms including two firms in Cairns
Independent officers	Crime and Corruption Commission Integrity Commissioner Ombudsman
Queensland Audit Office	Auditor-General Deputy/Acting Auditor-General Assistant Auditors-General Staff including separate meeting with Sector Directors and graduates Former staff (individual meetings) Chair of the Audit and Risk Management Committee External Auditor

Appendix 5: Summary of recommendations of 2010 Strategic Review of the QAO responded to by the Parliamentary Committee/Government

2010 Review Recommendations	Public Accounts and Public Works Committee Position (Reports No 5 of September 2010 and Report No 7 of March 2011)	Government response to reports of the Public Accounts and Public Works Committee	Current status
RN.3(i) That the Auditor-General raise with the Treasurer the inclusion in the *Financial Accountability Act* of the requirement for accountable officers and statutory bodies to ensure value for money is obtained in delivering services, and in purchasing, developing and augmenting assets.	That the Treasurer and Minister for State Development *and* Trade enact amendments to include the principle of 'value for money' in the *Financial Accountability Act 2009.* (No. 7, rec. 1)	The Government supports the Recommendation and will introduce a Bill that provides for amendments to the *Financial Accountability Act 2009* in order to give effect to this recommendation. It is considered that adopting this recommendation by amending the primary legislation will reflect the importance of 'value for money' as a fundamental overarching principle of public sector financial management.	The Financial Accountability Act 2009 in Section 61 requires Accountable officers to "achieve reasonable value for money by ensuring the operations of the department or statutory body are carried out efficiently, effectively and economically."
RN.5(iii) That the Auditor-General give consideration to wider involvement of subject matter experts in the planning, audit field work and reporting for PMS audits.	The committee recommends that sufficient additional funding be provided to QAO to enable the strategic use of subject experts in all phases of performance audits. (No. 5, rec 4)	The Government supports this recommendation in-principle. If the QAO is unable to meet any additional costs in its normal budget allocation, any additional funding sought by the QAO in response to this recommendation should be included in a business case for consideration in the normal budget process. This business case should address the resourcing/capacity utilisation issues raised in the 2010 QAO Strategic Review.	Responsibility of the Auditor-General

2010 Review Recommendations	Public Accounts and Public Works Committee Position (Reports No 5 of September 2010 and Report No 7 of March 2011)	Government response to reports of the Public Accounts and Public Works Committee	Current status
RN.7(i) That there should continue to be regular annual adjustments to the basic rate of QAO audit fees, subject to the approval of the Treasurer in accordance with Section 56 (3) of the *Auditor-General Act 2009*. *RN.7(ii)* That the annual adjustment to be determined by the Treasurer should be based on an assessment of wages and other costs relevant to the operations of the QAO, but should also take into account: • productivity and/or efficiency considerations, especially those relevant to the funding of core government departments • any adjustment factor to reflect market movements in audit fees generally.	That the Treasurer and Minister for State Development and Trade consult with the Auditor-General in regard to the setting of audit fees to enable the inclusion of contracted audit overhead costs to be spread across all audit clients. (No. 7, rec 2)	The Government notes the Recommendation. It is noted that the allocation of audit overhead costs is primarily a matter for the consideration of the Auditor-General with regard to the Queensland Audit Office budget framework. The Treasurer's involvement in the setting of audit fees relates to approving charge-out rates for auditors rather than in relation to the allocation of audit overhead costs.	Responsibility of the Auditor-General to action including in consultation with the Treasurer on audit fee rates; refer section 8.5 of this report).

2010 Review Recommendations	Public Accounts and Public Works Committee Position (Reports No 5 of September 2010 and Report No 7 of March 2011)	Government response to reports of the Public Accounts and Public Works Committee	Current status
RN.11(i) That the QAO continue to pursue strategies for achieving a more flexible remuneration structure for professional audit staff.	That the Public Service Commission (the PSC) continue its periodic consultations with the Auditor-General in regard to options in adopting a more flexible remuneration structure in order to ensure the QAO is best placed to provide a competitive environment for QAO staff. (No. 7, rec. 3)	The Government supports the Recommendation. It is noted that although the Public Service Commission (PSC) works in partnership with public service agencies to support and provide advice on workplace reforms, the Public Sector Industrial and Employee Relations (PSIER) division in the Department of Justice and Attorney-General is the lead agency in Government for issues in relation to remuneration structures. Consequently, it is proposed that any consultation on these matters include officers from the PSIER division and the PSC. In addition, as the Auditor-General is primarily responsible for the remuneration structure of Queensland Audit Office staff, it is considered appropriate that consultation on these issues occur at the instigation of the Auditor-General.	Actioned by the Auditor-General; refer Part 6.

2010 Review Recommendations	Public Accounts and Public Works Committee Position (Reports No 5 of September 2010 and Report No 7 of March 2011)	Government response to reports of the Public Accounts and Public Works Committee	Current status
RN.15(i) That the *Auditor-General Act 2009* be amended to include a requirement for the QAO to prepare a three-year Strategic Audit Plan for PMS audits, and to update the plan each year. The plan should incorporate indicative audit topics over the three years, with more specific and definite scoping of topics for the first year. *RN.15(ii)* That the Auditor-General and the Chair of the PAPWC agree on a protocol for consultation with the PAPWC on the draft Strategic Audit Plan for PMS audits prior to the commencement of each financial year. *RN.15(iii)* That the Auditor-General consult with potential audit clients and other affected parties, and consider their feedback, prior to finalisation of the Strategic Audit Plan for PMS audits. *RN.15(iv)* That, following the passage of appropriation, the Auditor-General finalise the Strategic Audit Plan for PMS audits, and publish it on the QAO website.	The committee recommends that the *Auditor-General Act 2009* be amended to allow for the provision of the following: a. include a requirement for the QAO to prepare a three-year Strategic Audit Plan for performance audits and to update the plan each year; b. the Auditor-General consult with the PAPWC and consider their feedback, prior to finalisation of the Strategic Plan; c. the Auditor-General consult with potential audit clients and affected parties and consider their feedback, prior to finalisation of the Strategic Plan; d. following the passage of appropriation, the Auditor-General finalise the Strategic Audit Plan and publish it on the QAO website; e. in undertaking performance audits, the Auditor-General to take into consideration performance management standards and guidance issued by government. (No. 5, rec. 5)	The Government supports this recommendation. While there is currently regular consultation between the Auditor-General and the parliamentary committee on audit matters, the QAO does not publish a formal plan for PMS audits. The Government agrees that there is opportunity to implement an enhanced process, through the development of a three-year 'Strategic Audit Plan', which provides for a more transparent and accountable system that provides for greater input from stakeholders earlier in the planning process. It is noted that the Strategic Audit Plan will encompass indicative audit topics for the future audits over a three year period, with more specific and definite scoping of topics for the first year. However, the Auditor-General will still maintain a degree of flexibility and independence in such a plan to accommodate changing circumstances and priorities.	Auditor-General Act 2009 amended – Section 38A

2010 Review Recommendations	Public Accounts and Public Works Committee Position (Reports No 5 of September 2010 and Report No 7 of March 2011)	Government response to reports of the Public Accounts and Public Works Committee	Current status
RN.16(i) That the *Auditor-General Act 2009* be amended to broaden the audit mandate to enable the Auditor-General to undertake performance audits, such amendment to be generally consistent with legislation applying in other Australian jurisdictions. *RN.16(ii)* That the *Auditor-General Act 2009* be amended to include a requirement for the QAO to prepare a three-year Strategic Audit Plan for Performance Audits, and to update the Plan each year. *RN.16(iii)* That the Auditor-General and the Chair of the PAPWC agree on a protocol for consultation with the PAPWC on the draft Strategic Audit Plan prior to the commencement of each financial year. *RN.16(iv)* That the Auditor-General consult with potential audit clients and other affected parties, and consider their feedback, prior to finalisation of the Strategic Audit Plan.	The committee recommends that the *Auditor-General Act 2009* be amended to allow for the provision of the following: a. mandate to allow for the conduct of a performance audit of government agencies with the exception of government owned corporations; b. a performance audit of a government owned corporation may be conducted at the request of the Parliament, the responsible minister, the Treasurer, or the Public Accounts and Public Works Committee; c. Auditor-General not to question the merits of government policy; and d. the Auditor-General to have regard for the audit priorities of the Parliament when deciding upon the programme of performance audits. (No. 5, rec. 3)	The Government supports this recommendation. The Government notes the views of the 2010 QAO strategic reviewers that the QAO has now fully utilised and exhausted its existing mandate through expanding both the number and depth of analysis of PMS audits since the 2004 strategic review. It is noted that the Public Accounts and Public Works Committee concurs with this analysis, and agrees with the strategic reviewers that there is now a strong case for broadening the Auditor-General's mandate to include full performance auditing. The Government considers that a carefully planned and scoped schedule of full performance audits will assist Government departments and agencies to improve their performance and increase the value created for clients and stakeholders from service delivery. Full consultation with accountable officers regarding the scope of each performance audit and the use of whole of Government policies and plans as a benchmark to assess the performance of service provision will be critical to the success of full performance auditing.	Auditor-General Act 2009 amended – Section 37A
RN.16(v) That, following the passage of appropriation, the Auditor-General finalise the Strategic Audit Plan, and publish it on the QAO website.	The committee recommends that sufficient additional funding be provided to the QAO to enable the preparation of the Strategic Audit Plan. (No. 5, rec. 6)	The Government supports this recommendation in-principle. Any additional funding sought by the QAO in response to this recommendation should be included in a business case for consideration in the normal budget process. This business case should address the resourcing/capacity utilisation issues raised in the 2010 QAO Strategic Review.	Responsibility of the Auditor-General

2010 Review Recommendations	Public Accounts and Public Works Committee Position (Reports No 5 of September 2010 and Report No 7 of March 2011)	Government response to reports of the Public Accounts and Public Works Committee	Current status
RN.16(vi) That the *Auditor-General Act 2009* be amended to require the Auditor-General, in undertaking performance audits, to take into consideration performance management standards and guidance issued by the government. *RN.16(vii)* That, concurrent with expansion of the performance audit mandate, the *Auditor-General Act 2009* be amended to incorporate a provision to ensure that: • where there is a clear government or local government policy or guideline, the performance audit would be assessed against the relevant policies for that entity or group of entities; and • in undertaking performance audits, the Auditor-General is not empowered to question the merit of policy objectives of the government.	The committee recommends that the *Auditor-General Act 2009* be amended to allow for the provision of the following: … c. Auditor-General not to question the merits of government policy; and (No. 5, rec. 3)	The Government supports this recommendation.	Auditor-General Act 2009 amended – section 37A

2010 Review Recommendations	Public Accounts and Public Works Committee Position (Reports No 5 of September 2010 and Report No 7 of March 2011)	Government response to reports of the Public Accounts and Public Works Committee	Current status
RN.16(viii) That the *Auditor-General Act 2009* be amended to provide a power for the Auditor-General to undertake an audit as to whether a grant or other financial benefit provided to a person or body that is not a Queensland public sector entity has been applied economically, efficiently and effectively for the purpose for which it was given and in compliance with relevant legislation, standards and guidelines, in circumstances where: • there is a request from the Premier; and • the Auditor-General agrees to such a request, provided that, prior to making such a request, the Premier must be satisfied that there is prima facie evidence of: • a breakdown or failure of the normal procedures for accounting for the expenditure of funds advanced by the state; or • other evidence of a failure to acquit such funds in accordance with agreed procedures, including the achievement of agreed performance targets.	That the Premier and Minister for Reconstruction enact amendments to the Auditor-General Act to allow the Auditor-General the power to investigate any matter relating to public money, other money or statutory authority money *[or]* to public property or other property. (No. 7, rec. 5) That the Premier and Minister for Reconstruction enact amendments to the Auditor-General Act to ensure that when a decision is made by the Auditor-General to utilise the power noted in recommendation 5 above, the reasons for that decision should be disclosed in the publication of the report. (No. 7, rec. 6)	The Government supports both Recommendations. It is considered that the provision of a new power to conduct audits in relation to public money or property will improve the accountability arrangements in relation to financial transactions involving non-government parties. The Premier will introduce a Bill that provides for amendments to the *Auditor-General Act 2009* in order to give effect to these recommendations.	Auditor-General Act 2009 amended – Section 36A

2010 Review Recommendations	Public Accounts and Public Works Committee Position (Reports No 5 of September 2010 and Report No 7 of March 2011)	Government response to reports of the Public Accounts and Public Works Committee	Current status
RN.16(ix) That the *Auditor-General Act 2009* be amended to allow for the Auditor-General to dispense with the audit of small size/low risk public sector entities, with such entities being required to engage an appropriately qualified auditor and to provide a copy of the audited financial statements (including audit report) to the Auditor-General as soon as practicable after completion.	That the Premier and Minister for Reconstruction enact amendments to the Auditor-General Act to allow for the Auditor-General to dispense with the audit of small size/low risk public sector entities, with such entities being required to engage an appropriately qualified auditor and to provide a copy of the audited financial statements (including audit report) to the Auditor-General as soon as practicable after completion. (No. 7, rec. 7) That the Premier and Minister for Reconstruction, in consultation with the Auditor-General, agree upon appropriate processes to: assess the risk prior to agreeing to dispense with the audit of the entities referred to in Recommendation 7 above; and, assess the risk of continuing to dispense with these audits on an ongoing basis. (No. 7, rec. 8)	The Government supports the Recommendations. It is considered that adopting these recommendations will enhance the flexibility and efficiency of the auditing operations of the Auditor-General and the Queensland Audit Office. The Premier will introduce a Bill that provides for amendments to the *Auditor-General Act 2009* in order to give effect to these recommendations.	Auditor-General Act 2009 amended – Section 30A.
RN.16(x) That the *Auditor-General Act 2009* be amended to provide for a fixed, non-renewable seven-year term of appointment for the Auditor-General.	That the Premier and Minister for Reconstruction enact amendments to the Auditor-General Act to provide for a fixed, non-renewable seven year term of appointment for the Auditor-General. (No. 7, rec. 9)	The Government supports the Recommendation. It is considered that adopting this recommendation will further strengthen the integrity of the position of the Auditor-General. The Premier will introduce a Bill that provides for amendments to the *Auditor-General Act 2009* in order to give effect to this recommendation.	Auditor-General Act amended – Section 10

Appendix 6: Summary of other recommendations of 2010 Strategic Review of the QAO

2010 review recommendations	Current status
RN.4(i) The QAO Auditing Standards be revised to incorporate a provision that any act or omission that might give rise to a waste of public resources can be part of the examination of an audit.	Included on page 8 of the QAO Auditing Standards
RN.5(i) That the Auditor-General, in undertaking PMS audits, give consideration to utilising the power to provide opinions on whether performance measures for individual public sector entities are relevant and appropriate, having regard to their purpose, and fairly represent that entity's performance.	Auditor-General considers that this would require an amendment to legislation.
RN.5(ii) That the QAO institutes a standard practice of holding initial discussions with the relevant Accountable Officer or Chief Executive Officer of an audit entity with a view to obtaining input on the scope and objectives of PMS audits, as is now being introduced. *RN.5(iv)* That the Auditor-General continue with programs to develop the internal skill base for undertaking PMS audits. *RN.5(v)* That the Auditor-General ensure that quality review standards for PMS audits are observed. *RN.5(vi)* That for PMS audits, the QAO and the audit client ensure that matters of a factual nature are settled at an earlier stage of the audit process such that these matters do not detract from the quality of the audit when the management letter is provided. *RN.5(vii)* That opportunities be taken by the Auditor-General and senior staff of the QAO to educate audit clients on the mandate for and benefits arising from PMS audits. *RN.6(i)* That the QAO upgrade the nature and quality of information available for tenderers submitting proposals for contract audit work to ensure appropriate risk-assessed fee quotes can be made. *RN.6(ii)* That the QAO assess whether the use of contract auditors for a group of entities within a particular sector or industry would provide benefits for the QAO and audit clients in terms of specialisation in that sector/industry.	All have been implemented as part of the ongoing development of the QAO's performance audit practice.

2010 review recommendations	Current status
RN.7(iii) That the QAO needs to provide a more consistent, coherent and transparent basis for the determination of fees, through an Audit Fee Charter which commits the QAO to: • ensure that the Engagement Leader for each audit is required to present and explain the QAO's audit fee proposal to an entity's Audit Committee as part of the Annual Client Service Plan; • provide a detailed disaggregation of the composition of the audit fee for an entity, including scoping issues, identification of major • provide an opportunity for audit clients to seek further information, clarification and/or justification of fees prior to the commencement of the audit plan; • undertake a zero-base approach to the determination of fees for an entity at least once every three years, or where the audit fee is expected to vary from the previous year by more than 10% (for reasons other than a change in the basic rate); • ensure that, during the course of the audit task, any variation in audit fees of greater than 10% from the original fee proposal is notified to, and acknowledged by, the Accountable Officer or Chief Executive and the Audit Committee of an entity prior to any additional costs being incurred by the QAO. *RN.7(iv)* That the QAO develop a more comprehensive programme of benchmarking of audit fees for comparable entities with a view to ensuring greater consistency in the determination of fees, including: • internal benchmarking of fees for comparable size and type of entities; • external benchmarking, both with ACAG, and with private sector audit firms where relevant and practical.	While an Audit Fee Charter has not been introduced actions have been taken on these issues apart from dot point 3 related to an audit client seeking further information, clarification and justification which would be potentially impacting on the independence of the Auditor-General in establishing the scope of the audit. QAO now undertakes an internal benchmarking of fees and assesses fees against appropriate criteria for the nature of the organisation involved. This includes sector assessment such as Hospital and Health Services where the audit fees as benchmarked against revenue. QAO through the use of Audit Service Providers receive benchmark information on fees from the private sector.
RN.8(i) The QAO should aim to ensure that audit support functions return to around 15–18% of total staffing, consistent with the level achieved prior to 2008–09, unless a higher level can be justified by demonstrable improvements in the productivity of front-line audit service delivery (as measured for example by better capacity utilisation).	Refer Part 6 of this Report.
RN.9(i) That the recommendations of the Thomson Report relating to the EMG be adopted viz *"Noting cross reference to Standard 1.2.9, the development of a dashboard of key result areas is recommended. This will enable management reports to be further refined and simplified.* *That actions for key issues areas be developed prior to EMG meetings to enable a more proactive approach to decision making."*	Implemented

2010 review recommendations	Current status
RN.9(ii) That the QAO's Risk Register be amended to include the following risks, as recommended by the Thomson Report: • "*HR planning is not in line with strategic planning* • *Changing mix of clients relating to sale of government assets, increased contracting out of government services, rationalization of local government and the impact of fixed overheads.* • *Increased use of contracting out of audit work."*	Implemented
RN.9(iii) that the effectiveness of the ISC is regularly assessed to ensure that it is adding greater strategic value to the consideration of emerging information technology issues impacting on the QAO, including ongoing refinement of eTrack, IPSAM and ASPIRE.	Implemented
RN.10(i) That the Annual Work Plan's projected workload for each coming year incorporate a contingency provision for additional hours likely to be required for unplanned activity, taking into account what has occurred on average in previous years.	Not implemented. This review has highlighted pressures on resources – refer Part 6 of this Report.
RN.10(ii) That the QAO's audit resourcing model be further refined to provide improved focus on the nature and size of the audit task, and on the assessment of audit risks. This would mitigate the risk that inbuilt inefficiencies in resourcing are perpetuated through the current configuration of the model.	Implemented
RN.10(iii) That the QAO's audit resourcing model be further developed to provide a rolling three year forward plan to identify and address emerging issues which will impact resourcing needs of the QAO into the future.	Implemented.
RN.10(iv) That the QAO take necessary steps to ensure that eTrack provides a reliable and effective practice management system for the future, and that staff be encouraged to utilise its capabilities.	Refer section 7.7 of this report.
RN.11(ii) That the Auditor-General ensures adequate consultation and communication with staff, and takes account of timing issues, in undertaking any major or sensitive changes in staffing benefits or other human resources policies.	Implemented
RN.13(i) That the QAO focus greater attention on lifting its performance on macro measures of productivity and capacity utilisation.	Improved productivity and capacity utilisation has been achieved.
RN.13(ii) That the QAO aim to lift its performance to be ranked in the top 2–3 Audit Offices in Australia, and consistently above average, for most key ACAG performance indicators.	Ongoing
RN.17(i) That the Auditor-General give consideration to an expanded focus of audits of infrastructure and IT investments, building on the work already undertaken in these areas.	Implemented

2010 review recommendations	Current status
RN.17(ii) That the Queensland Auditor-General continue to actively pursue opportunities for co-operation with Auditors-General at the Commonwealth level and in other states and territories, with a view to ensuring that there is no unnecessary waste or duplication of resources in auditing of Commonwealth–state programmes.	Refer section 5.3.1 of this Report.
RN.17(iii) That the QAO develop strategies to manage emerging trends in its workload and its internal resourcing capacity over a three-year planning horizon and to ensure the ongoing sustainability of its business.	Refer Part 6 of this Report.

Appendix 7: Response from the Queensland Audit Office to the proposed report

Your ref:
Our ref:

Queensland Audit Office
better public services

17 February 2017

IN-CONFIDENCE

Dear Ms Smith and Mr Carpenter

Strategic Review of the Queensland Audit Office

Thank you for conducting your strategic review of the QAO. You have provided my executive team and I with important perspectives on ways we can further improve the value we provide to Queensland's system of government and citizens through the independent assurance we provide. I have found the strategic review process to be a useful mechanism in providing 'checks and balances' to the QAO, and supporting the independence of the role of the auditor-general.

We appreciate your strategic assessment that:

> *"In our view, the QAO is fundamentally sound. It is valued by Parliament, and its relationships with its other stakeholders are mostly good. It is operating economically and efficiently, and in accordance with its legislation. The measures recommended in 2010 are now largely in place. It is pleasing that few of the issues discussed by the reviewers in 2010 have come to our attention in 2016. The QAO has made good progress in many of those areas since 2010 and, in addition, has made impressive progress in other areas, particularly in the increased application of data analysis to its audit work".*

I acknowledge that the key message of your review is that to achieve full effectiveness there are some client relationship issues that if they were to become widespread, would limit our potential.

The vision that we adopted around a year ago of *better public services*, recognises the importance we place of focusing on our clients at the heart of what we do. We are continuously looking to improve the services that we deliver to ensure they continue to contribute to this vision. Your advice on increasing our external focus supports and confirms our strategic direction and we appreciate your acknowledgement of the work that is already under way.

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Strategic recommendations

I accept the recommendations that the QAO:

- institute an annual programme of visits with directors-general and chief executives [4.3 (iv)]
- undertake a review of the 2016-17 fee budgets for financial audit services [6.3 (i)].

I support the recommendations that the government:

- double QAO's funding for performance audits to enable us to engage earlier and better with our clients, increase our use of external experts and increase sector knowledge, and to provide a wider range of assurance on the performance of Queensland public sector entities [5.7 (iv)].

  This will enable the QAO to realise its full potential in effectiveness and we are well placed to apply additional funding to good effect in improving the efficiency, effectiveness and economy of government service delivery.

- amend the Auditor-General Act 2009 to enable me to employ QAO staff under this Act rather than the Public Service Act, to allow me to employ the staff necessary to carry out the auditor-general's functions, and to enable me to determine the remuneration and other terms and conditions of employment of QAO staff [6.3 (ii)].

  This is a fundamental issue that has been raised as recommendations in successive strategic reviews. We have done everything that we can do within our constraints, but we require a change to our legislation to mitigate the associated risks you have identified.

Operational recommendations

I accept all recommendations within our control relating to the provision of financial audit services, and accept all recommendations relating to the provision of performance audit services and Better Practice resources, subject to the approval by government of strategic recommendation 5.7 (iv).

I support all recommendations outside of our control where legislative change is required [operational recommendations 4.3 (iii), 5.8 (iv), 7.10 (i), 7.10 (ii), 8.6 (i), 8.6 (ii), and 8.6 (iii)]. My office has already undertaken consultation and prepared a submission paper on assuring the independence of the auditor-general, as well as draft legislation changes associated with administrative issues. I await further consideration from the Finance and Administration Committee.

Phillippa and Graham, I would like to thank you both for the manner in which you undertook your strategic review. You spent significant time understanding QAO's strategies and operations and meeting with a wide range of our stakeholders.

Finally and most importantly, I would like to recognise the efforts and outcomes achieved by QAO's workforce over the period of strategic review, and thank you for demonstrating QAO values of engaging, delivering, challenging and caring.

Yours sincerely

Anthony Close
Auditor-General (acting)