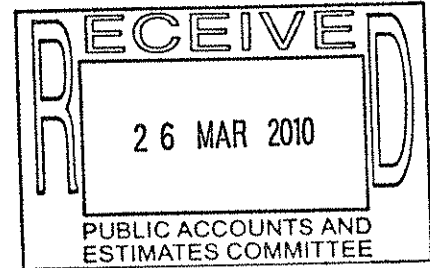


25 March 2010

Public Accounts and Estimates Committee
Inquiry into Victoria's Audit Act 1994
Parliament of Victoria
Spring Street
East Melbourne VIC 3002

Via email to: paec@parliament.vic.gov.au



Dear Sir/Madam

Discussion Paper

Inquiry into Victoria's Audit Act 1994

Thank you for the opportunity to comment on the Discussion Paper for the Inquiry into Victoria's Audit Act 1994. CPA Australia, the Institute of Chartered Accountants in Australia and the National Institute of Accountants (the Joint Accounting Bodies) have considered the discussion paper and our comments follow. The Joint Accounting Bodies represent over 180,000 professional accountants in Australia. Our members work in diverse roles across public practice, commerce, industry, government and academia throughout Australia and internationally.

General Comments

Where the Auditor-General (AG) and members of the AG's Office are members of a professional accounting body in Australia they have professional obligations to comply with relevant professional and ethical, and auditing and assurance standards. It is recognised within these standards that where professional and legislative obligations differ, legislation takes precedence. The Joint Accounting Bodies recommend that in making changes to the Audit Act, the Committee should attempt to minimise these differences.

The AG occupies a unique and important position in seeking to provide assurance to the Parliament and the public regarding accountability for public money. The public interest is paramount and the professional independence of the AG is critical to the AG being able to undertake their role without fear or favour, in the public interest.

Many discussion topics covered in this Discussion Paper are matters which go beyond what can be considered to be within the normal purview of professional accounting bodies. Where topics are not directly relevant to the accounting profession no specific comment is made.

Chapter 3 Potential Legislative Amendments Dealing with Auditor-General's Relationship with Parliament

No specific comments made on the topics highlighted in this Chapter.

However, when considering the topics covered in this Chapter the Joint Accounting Bodies refer the Committee to the existence of robust, tried and tested assurance arrangements in the accounting profession. These arrangements stress the critical importance of independence as the cornerstone of assurance. Any potential legislative amendments should be cognisant of these arrangements, which include:

- > An assurance standard on *Performance Engagements* which outlines requirements for conducting performance audits. Therefore, there is no need for assurance requirements to be separately identified in the Audit Act (refer *Section 3.2.7 Consultation by the Auditor-General with the Committee on performance audit specifications*);

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- > Discussion in the *Code of Ethics* of the intimidation and familiarity threats that may exist when an audit partner assumes a position of authority within an audit client. "Cooling off" periods are defined in these arrangements, and the Joint Accounting Bodies recommend that such periods be enforced for the AG when he/she vacates office (refer *Section 3.2.8 Employment in the Victorian public sector of person vacating the office of Auditor-General*); and
- > Discussion of how confidential information should be handled (refer *Section 3.2.9 Production of documents by the Auditor-General to the Committee*).

Chapter 4 Audits of Non-Judicial Functions within Victoria's Courts

The Joint Accounting Bodies support audits by the AG of non-judicial functions of the Courts. However, these audits should only be undertaken in the presence of appropriate safeguards in relation to such matters as:

- > Ensuring that the separation of powers between the different arms of Government is not impaired;
- > The existence of identifiable separate non-judicial functions for the Courts that can be audited quite separately from the judicial functioning of the Courts; and
- > Clearly defined responsibilities and scope

Chapter 5 Operational Powers and Responsibilities of the Auditor-General

Sections 5.2.1 (Right of access to premises and records and private sector contractors) and 5.2.2 (Extent of legislative authority to investigate and audit matters pertaining to public money and public property)

The Joint Accounting Bodies support the ability of the AG to investigate matters relating to public money and property, including access to relevant records of information held by private sector contractors. This is based on the view that ultimate public accountability rests with the Parliament.

However, access to private records by the AG should be considered as something which is the exception, rather than the rule. Furthermore, it should only be done where adequate safeguards are in place. That is:

- > Exception Rather Than Rule – governments should ensure that contractual arrangements with private contractors – which involve public monies – include provisions that allow for access. Nevertheless, they should in the first instance include provisions that require other means of discharging accountability, such as robust internal audit arrangements and reporting to the contracting agency
- > Safeguards – outlining clear reasons when access provisions may be invoked, maintaining appropriate confidentiality and commercial requirements, inclusion of provisions in contracts, receiving permission before access and so on.

Permitting the AG: (i) access to records and premises of private contractors; and (ii) to investigate and audit matters pertaining to public money and public property; has the potential to clarify relationships between private sector providers and Parliament. Furthermore, it means that the AG will be able to audit and review entire programs and arrangements of which the work of private contractors may only be a part. In contrast, it may be construed by some as potential interference in commercial arrangements.

In our view there is no sound rationale, from the public policy perspective, to allow for the possibility that, where a matter is outsourced it reduces the capacity of the AG to examine the situation. If the capacity of the AG is hampered by not permitting ready access to a contractor's records then public accountability is compromised. It is possible that some agencies may then see outsourcing as a means of reducing scrutiny – which would be an outcome that is not in the public interest.

It should also be recognised that outsourcing, without appropriate scrutiny, exposes the agency to an increased potential for fraud and loss of public money. At the very least, there should be a requirement in formal outsourcing agreements that the AG will be granted unfettered access to relevant records in order to preserve the concept of public accountability with respect to the spending of public money.

Sections 5.2.3 (Provisions relating to policy objectives of government), 5.2.4 (Incidental functions of the Auditor-General) and 5.2.5 (Consolidation of Auditor-General's general powers)

No specific comments made on these Sections.

However, the Joint Accounting Bodies recommend that the Committee be cognisant of the self-review threats to independence that are created by the provision of non-assurance services to assurance clients, when considering the incidental functions of the AG.

Section 5.2.6 (Application of Auditing Standards)

The Joint Accounting Bodies do not support the assignment of discretion over the application and use of Australian Auditing and Assurance Standards and relevant professional and ethical standards. In our view the AG must be directed to use, as a minimum, the Auditing and Assurance Standards promulgated by the national standard setter, the AUASB. It is then perfectly acceptable to permit the AG to supplement these standards, if deemed desirable and appropriate, but the 'base line' should be the AUASB suite of standards.

Many staff working in the AG's Office will be members of a professional accounting body and will therefore have a professional obligation to comply with Australian Auditing and Assurance Standards, as well as Professional and Ethical Standards (issued by the APESB). These standards include specific paragraphs that relate to the Public Sector and the application by AGs. However, as noted previously these standards recognise that members may not need to comply with requirements in the standards where legislation requires otherwise (i.e., effectively a "carve out" exists for members already). The Joint Accounting Bodies believe that differences between professional and legislative obligations should be minimised where possible.

Furthermore, by allowing the AG to set standards on auditing practice – which may potentially differ from the standards established by the AUASB – leads to inconsistency and potential confusion surrounding auditing practices. The Joint Accounting Bodies note that the AUASB has recently issued revised and redrafted auditing standards which are based on internationally developed standards (ISAs), issued by the IAASB. These standards have been subjected to extensive international public scrutiny to ensure that they are of the highest quality, and in turn, promote greater audit quality. Furthermore, in issuing the Australian standards, the AUASB has spent considerable effort in ensuring that the standards are applicable to the public sector.

[Note: Auditing and assurance standards in Australia are issued by a Government body, the AUASB. As such, strictly speaking they are not "professional" standards as described in the Discussion Paper. These standards are legally enforceable for audits and assurance engagements conducted under the provisions of the *Corporations Act 2001*.]

Sections 5.2.7 (Legal Professional Privilege)

No specific comments made on these Sections.

Sections 5.2.8 (Annual audits of performance indicators developed by government and its agencies)

The provision of an audit opinion on the internal controls pertaining to financial reporting is part of the reform to reporting in the United States under the Sarbanes-Oxley Act. However, requirements were also imposed upon management under the Sarbanes-Oxley Act such that management needs to undertake a review of the internal controls. Furthermore, the auditors also need to form an opinion on that management review. Although some parties in Australia have raised the furnishing of an audit opinion on internal controls as a possibility, we have not progressed down that path.

The Joint Accounting Bodies are of the view that until the provision of an opinion on internal controls pertaining to financial reporting becomes standard practice in Australia, such provisions should not be included in the Act. However, we recognise that it may be an opportunity for the public sector to demonstrate leadership (through legislating best practice) on this topic. It is acknowledged that strong internal controls, which are adhered to, will tend to reduce the incidence of fraud.

It is difficult to argue against the view that accountability would be strengthened by encompassing these additional audit elements. However, if consideration is being given to their introduction, it is worthwhile considering the responsibilities of management in respect to the existence and operation of internal controls pertaining to financial reporting.

Sections 5.2.9 (Audit of overseas entities), 5.2.10 (Disclosure of information to external parties), 5.2.11 (Legal issues experienced by the Auditor-General concerning sections 3, 12 and 15(1)(b) of the Audit Act) and 5.2.12 (Charging of audit fees)

No specific comments made on these Sections.

Sections 5.2.13 (Application of the statutory definition of 'Authority' to Administrative Offices and multiple entities) and 5.2.14 (Involvement of the Auditor-General as the auditor of State Companies)

No specific comments made on these Sections.

However, the Joint Accounting Bodies recommend that in relation to determining the audit requirements for authorities and State companies, the Committee considers the recent proposals by Commonwealth Treasury to change the reporting and assurance requirements pertaining to companies limited by guarantee. These changes recognise that for smaller entities reporting and assurance requirements should differ from the requirements for larger entities. These differences include either no assurance, or limited assurance (review) engagements for smaller entities.

Sections 5.2.15 (The Auditor-General's power to call for documents), 5.2.16 (Incorporation of comments of audited agencies in reports of the Auditor-General tabled in Parliament), 5.2.17 (Reporting of sensitive material) and 5.2.18 (Immunity protection)

No specific comments made on these Sections.

However, it is worth noting that where documents and other relevant information are not provided by the reporting entity to the auditor, the auditor needs to consider how this will impact upon the audit opinion.

Chapter 6 Contemporary Developments and Emerging Issues – Matters Raised by the Department of Treasury and Finance

No specific comments made on this Chapter.

Chapter 7 Other Potential Amendments

Comments are offered in relation to the following sections.

Section 7.1.3 (Authority to delegate power to express an audit opinion on financial statements)

Reference is again made to recent proposals by Commonwealth Treasury to change the reporting and assurance requirements pertaining to companies limited by guarantee. Smaller entities (with revenue of less than \$1 million) would not require an audit be conducted. Instead alternative arrangements, such as no assurance or a limited assurance (review) engagement, are proposed.

Section 7.1.5 (Provision of reasonable assistance and facilities to the Auditor-General and staff)

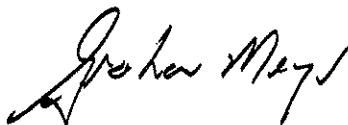
The Joint Accounting Bodies support an amendment of this kind which would impose an obligation on reporting entities which is similar to the obligation that exists for reporting entities under the *Corporations Act 2001*.

The professional accounting bodies are committed to assisting where possible in the development and implementation of the highest quality, most effective and efficient legislative framework in Australia. We hope that the comments provided are of assistance to the Treasury. If you have any questions regarding this submission, please do not hesitate to contact Gary Pflugrath (CPA Australia) at 02 9375 6244, or Andrew Stringer (Institute) at 02 9290 5566, or Tom Ravlic (NIA) at 03 8665 3143.

Yours sincerely



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