

VAGO

Victorian Auditor-General's Office

14 March 2008

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Ms Valerie Cheong
Executive Officer
Public Accounts and Estimates Committee
Parliament House
Spring Street
Melbourne VIC 3002

Public Accounts and Estimates Committee

Submission No. 1

Dear Ms Cheong,

Re: Public Accounts and Estimates Committee

Inquiry into findings of Victorian Auditor-General Reports 2006-2007

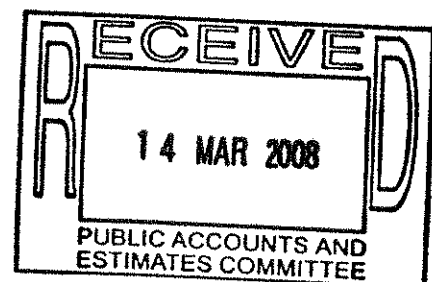
I refer to your invitation for submissions to the Committee's Inquiry into findings of Victorian Auditor-General Reports.

Please find attached my submission in relation to the New Ticketing System Tender performance audit (*October 2007*).

Yours sincerely,



D D R Pearson
Auditor-General



VICTORIAN AUDITOR-GENERAL'S OFFICE

**SUBMISSION TO THE
PUBLIC ACCOUNTS AND ESTIMATES
COMMITTEE**

**INQUIRY INTO FINDINGS OF VICTORIAN
AUDITOR-GENERAL REPORTS 2006-2007**

**NEW TICKETING SYSTEM TENDER
PERFORMANCE AUDIT**

14 March 2008

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1 Introduction

This submission relates to the Auditor-General's October 2007 performance audit report on the New Ticketing System (NTS) Tender (2007-08:4). The submission covers:

- the role, responsibility and authority of the Auditor-General to undertake performance audits in the public sector, including in relation to entities such as the Transport Ticketing Authority
- the audit methodologies and quality controls applied by the Victorian Auditor-General's Office (VAGO) in conducting performance audits
- VAGO's performance audit of the NTS Tender.

2 Functions and powers of the Victorian Auditor-General

2.1 Appointment of the Auditor-General

Under the *Constitution Act 1975*, the Auditor-General is appointed by the Governor in Council on the recommendation of the Public Accounts and Estimates Committee (PAEC). He is appointed for a term of seven years.

The Auditor-General is an independent officer of the Parliament. Subject to the *Constitution Act*, the *Audit Act 1994* and other laws of the State, the Auditor-General has complete discretion in performing or exercising his functions or powers.

In particular, he is not subject to direction from anyone in relation to whether or not a particular audit is to be conducted, the way in which a particular audit is to be conducted, or the priority to be given to any particular matter.

2.2 The role of the Auditor-General in relation to Parliament

The *Audit Act 1994* establishes the legislative framework for the role and functions of the Auditor-General and identifies his statutory powers and responsibilities.

The Act authorises the Auditor-General to undertake audits within the public sector.

The Act addresses the relationship between the Auditor-General and the Victorian Parliament and the PAEC. The Act assigns statutory responsibilities to the PAEC in relation to performance audits conducted by VAGO. These responsibilities include:

- reviewing and commenting on the Auditor-General's draft annual plan
- involvement in the formulation of objectives and scope of performance audits.

Section 19 of the Act requires an external performance audit of the Auditor-General's office to be conducted at least once every three years. The external auditor is appointed by the PAEC. The external performance audit aims to determine whether the Auditor-General and VAGO are achieving their objectives effectively and are doing so economically and efficiently and in compliance with the Act.

The report was tabled in Parliament in December 2007 (Parliamentary paper number 50).

2.3 VAGO's performance audit function

VAGO conducts performance audits under section 15 of the *Audit Act*. A performance audit determines whether an agency or group of agencies are effectively meeting their objectives, using its resources effectively, economically and efficiently and in compliance with all relevant Acts.

A performance audit can also involve an assessment of:

- whether performance indicators included in agency reports of operations are relevant, appropriate and fairly represent actual performance (section 8)
- whether public moneys received by non-public-sector organisations have been applied economically, efficiently, and effectively (section 16C).

The *Audit Act* requires the Auditor-General to have regard to the appropriate use of public resources, including probity, waste, financial prudence and fraud.

The types of performance audit undertaken by VAGO are categorised as:

- audits with a broad scope of review of effectiveness, economy and efficiency
- audits with a limited scope of review of aspects of effectiveness, economy and efficiency
- audits which review compliance and probity.

Performance audits are funded from Parliament's appropriation. They:

- provide independent assurance to Parliament regarding whether public funds are being spent prudently and in accordance with Parliament's expectations
- provide independent assessment and testing of an area of public sector activity in order to improve resource management and add value through recommended improvements
- are a means of holding public sector managers accountable for their performance, as well as recognising and advising Parliament of management initiatives and achievements.

2.4 Parliamentary reporting by the Auditor-General

The Auditor-General may report to the Parliament on any audit carried out by or on behalf of the Auditor-General. The report may include, with some restrictions, any information the Auditor-General thinks desirable in relation to matters that are the subject of the audit. The Auditor-General must set out the reasons for opinions expressed in the report, and may include any recommendations arising out of the audit that he thinks fit to make.

Prior to tabling a report for Parliament, the Auditor-General must provide a proposed report, or part of it, to authorities related to the audit, or who have an interest in the audit, and request comments for inclusion in the report. For performance audits, the authority or department head must be given at least ten business days after receiving the proposed report to provide comments. The Auditor-General must include the comments, or a summary of them, in the report to the Parliament.

2.5 2007 performance audit of VAGO

The most recent performance audit of VAGO was completed in December 2007. The audit provided a positive assessment, concluding that "*the Victorian Auditor General and VAGO is complying with the legislative objectives, undertaking the audit mandate in accordance with the Act and Australian Auditing Standards and achieving their corporate objectives. VAGO is operating in compliance with the Audit Act 1994.*"

3 How VAGO conducts performance audits

3.1 Professional standards

The *Audit Act* requires the Auditor-General to apply standards made by the Auditing and Assurance Standards Board (AuASB) in the conduct of audits. The two standards that deal directly with the conduct of performance audits are AUS 806 *Performance Auditing* and AUS 808 *Planning Performance Audits*.

Auditing Standard AUS 806 sets out the professional standards required to be met in relation to:

- planning a performance audit
- using the work of an expert
- establishing audit criteria
- collecting and assessing audit evidence
- maintaining audit documentation
- reaching and checking audit conclusions and reporting
- recommendations and management responses.

Under the standard, the auditor should adopt an attitude of professional scepticism throughout an audit, recognising that circumstances may exist which could cause performance information to be materially misstated.

Noting that the work of an auditor is permeated by professional judgment, AUS 806 makes particular comment on:

- gathering audit evidence, for example in deciding the nature, timing and extent of audit procedures
- drawing conclusions based on the audit evidence gathered
- seeking corroborating evidence from different sources or of a different nature in making assessments and forming conclusions.

Auditing Standard AUS 808 addresses a number of critical elements in conducting a performance audit, including:

- audit mandate
- knowledge of the business
- audit objectives and scope
- materiality and risk
- auditability
- criteria and evidence
- skills, competence and knowledge
- audit plan and program.

VAGO's performance audit methodology is built around these performance audit standards. The methodology also requires VAGO's staff to consider and, where relevant, apply the principles embodied in other relevant standards issued by the AuASB and the Accounting Professional & Ethical Standards Board (APES) not specifically written for performance audits. A list of these standards is at [Appendix 1](#).

3.2 Quality assurance and governance

Compliance with the *Audit Act* and the Australian auditing standards is required for all VAGO audits. VAGO's policies, guidelines and processes were developed with the aim of ensuring that all performance audits conducted by VAGO demonstrably comply with these requirements.

There are several important risks inherent in performance auditing. They include reaching an incorrect conclusion, and making impractical or perverse recommendations. Effective quality assurance is critical for managing the risks associated with performance auditing.

To achieve compliance with the Act and the standards, and to manage the risks associated with performance auditing, VAGO has established quality control and assurance mechanisms.

3.2.1 Roles in the quality assurance framework

Each performance audit is conducted within a governance framework that assigns particular responsibilities and accountability to members of the audit team and to senior management.

The Auditor-General oversees the conduct of all performance audits. The Auditor-General may direct or provide feedback to the audit team at any stage during an audit.

The Auditor-General is assisted by a Senior Management Group comprising the Chief Operating Officer (COO), three Assistant Auditors-General (AAGs) and the Executive Director, Corporate Services.

Two of the three AAGs lead the divisions that undertake performance audits; Performance Audit Group and Financial Audit Group. The AAGs advise the Auditor-General on the draft specification and key documents produced by the audit team (draft specification, issues papers, preliminary and proposed draft material) and are responsible for delivering VAGO's annual performance audit program.

The audit team regularly updates the AAG, COO and Auditor-General on the progress of the audit, issues arising, and other aspects of the audit.

The audit team usually comprises of three or four VAGO staff. For some audits, one or more subject matter experts are engaged to assist the audit team. For others, a reference committee is established in place of or in addition to these experts. This structure provides a breadth of experience and capability to an audit topic, a diversity of views and balanced opinions. It also reduces the risk of an actual or perceived bias during the audit process.

3.2.2 The quality assurance process

During the planning phase, the quality assurance process operates to ensure that:

- the audit specification is properly focused, i.e. the audit objectives and scope are sound and focused on the most appropriate aspects of the audit activity
- the audit criteria are relevant and appropriate to the assessing performance for the area of audit focus
- that audit risks are adequately addressed in the audit plan and testing program.

The Auditor-General, COO and AAGs each provide quality assurance over the team's outputs during this phase.

During the conduct phase, the team implements the audit testing program and the engagement leader and team leader provide quality assurance over the work conducted. They also monitor compliance with the VAGO methodology, the professional auditing standards and the audit program, and determine whether sufficient and appropriate evidence exists to support the emerging audit findings. The team leader provides feedback to the AAG, COO and Auditor-General at regular intervals.

Similarly, in the reporting phase, the report is drafted by the audit team, overseen by the engagement leader. The AAG, then the COO and the Auditor-General, review the material at the preliminary draft and proposed draft stages before it is issued to agencies for comment.

Before the Auditor-General approves the report for printing, the team leader, engagement leaders and AAG are required to sign-off that:

- sufficient appropriate evidence has been obtained to substantiate the findings included in the parliamentary report
- that due consideration has been given to all performance audit issues identified in the audit specification
- that the audit has been conducted in accordance with professional standards and VAGO's performance audit methodology.

3.2.3 Audit evidence

Evidence is the information the auditor collects and tests against audit criteria to make findings. The evidence and findings are subsequently used to support the auditor's judgement and conclusions regarding the agency, program, activity or function being audited.

Establishing the audit evidence is the foundation of performance audit reports. The validity of performance audit findings, conclusions and recommendations depends on the reliability of the evidence collected. For this reason, determining the sufficiency and appropriateness of audit evidence is the major focus of VAGO's procedures, and is emphasised in the performance audit standards and in professional auditing practice.

Auditing Standard AUS 806 *Performance Auditing* requires the auditor to obtain:

- sufficient and appropriate audit evidence to be able to draw reasonable conclusions
- corroborating evidence from different sources or of a different nature in making assessments and forming conclusions. In a performance audit, evidence may be predominantly qualitative in nature, therefore, the need to seek corroborating evidence is important.

Auditing Standard ASA 500 *Audit Evidence*:

- provides explanatory guidance on what constitutes audit evidence
- requires the auditor to obtain sufficient and appropriate evidence
- provides explanatory guidance on audit procedures for obtaining audit evidence.

The concepts of 'sufficiency' and 'appropriateness' of audit evidence are interrelated, and not mutually exclusive. Sufficiency of audit evidence will usually depend on its appropriateness and vice-versa.

3.2.4 Determining the sufficiency of audit evidence

Sufficient evidence refers to the quantity of evidence needed to reliably support the audit's findings and establish the facts. There is enough evidence if a reasonable person can be persuaded that the audit findings are valid. Factors that may affect the sufficiency of evidence include the:

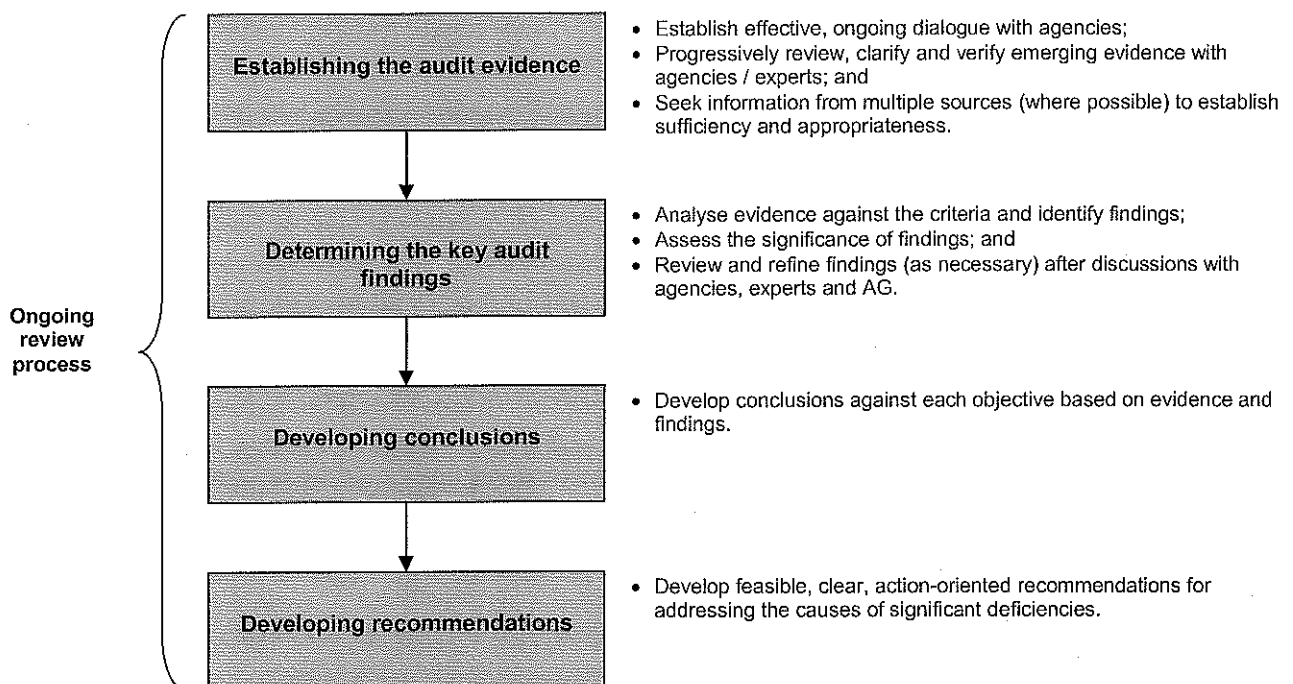
- quantity of evidence. This is particularly important when sampling procedures are used. A sufficient number of items must be examined to match the level of assurance required
- completeness of evidence. This refers to the amount and type of evidence gathered, and to the extent to which it collectively addresses the material aspects of the audit objectives and scope, or the criteria being tested.

If the evidence does not fully address the audit objectives and scope or criteria (i.e. it is insufficient), this may compromise the validity of the findings and conclusions drawn, or they may require qualification.

The audit team uses its judgment in determining what is sufficient evidence, in the context of the audit objectives, scope, and criteria.

3.2.5 Developing the audit results

The findings, conclusions and recommendations emerging from a performance audit are progressively documented, tested, verified, refined and finalised through regular and open dialogue within VAGO and, at specific times and on a 'no surprises' basis, with the agencies being audited. The diagram below outlines the four main stages in compiling the results of a performance audit. The activities in each stage are carried out progressively and iteratively.



4 VAGO's performance audit of the NTS tender

4.1 Background and context for the NTS tender

There are only a small number of suppliers of automated ticketing systems worldwide. Two major equipment suppliers dominate the Australian market.

Recent acquisitions of ticketing systems in Australia and internationally have involved a contract for the supply of a propriety system. The Victorian Government identified a number of flaws associated with this approach, including delays in project delivery, barriers to combining the best individual elements into a whole system, and technical barriers to changing equipment and suppliers during the contract period.

In June 2003, the Transport Ticketing Authority (the Authority) was established to manage Victoria's existing MetCard ticketing system and to procure and manage a New Ticketing System (NTS) to replace MetCard. The Authority was created as a public entity under the *State Owned Enterprises Act 1992*. A Board of Directors was appointed in February 2004.

In establishing the tender, the Government made a decision to avoid the problems associated with similar procurements, and to endorse a new approach to procure the ticketing system – in particular, to deliver an 'open architecture' solution, to encourage industry players to explore new partnering opportunities, to provide improved value for money, and to encourage new entrants into the market.

The Government utilised an innovative tender approach that made use of new techniques including parallel negotiations, interactive bidder feedback and bid revision (while still applying the Victorian Government procurement principles). This new approach was a key rationale for establishing the Authority under the SOE Act, in order to give it more flexibility in how it ran the tender.

4.2 An innovative tender process

In July 2004, the Authority issued the Request for Tender (RFT). The Authority's tender requirements were specified in terms of business outcomes, rather than in regard to what form the system would take. This was designed to allow bidders to propose innovative solutions to meet the system needs.

The tender process involved three main phases: initial offers, revised offers, and negotiation. At each stage, offers were assessed by an Evaluation Committee, taking advice from five Advisory Teams.

The NTS procurement approach was designed to sever the ticketing system into discrete, interchangeable components.

Recognising that it was unlikely that a single tenderer would submit a tender that provided the most appropriate solution, the tender identified six separate work packages that could be bid for individually or as a 'whole-of-solution' offer. The six packages comprised five equipment packages (rail, tram, bus, hand held devices and retail) and a core work package (provision of business services, systems and supporting infrastructure and integration).

Each of the packages was required to meet open architecture requirements. Open architecture enables the equipment devices, databases and networks provided by different suppliers tendering for the NTS to be interchangeable, either during the tender phase to achieve the best mix of packages, or during the contract period should a particular supplier or equipment element need to be replaced.

The RFT allowed tenderers to change consortium partners and equipment suppliers during the tender process, and allowed the Authority to take a single work package of one bidder and combine it with packages of other bidders. The rules encouraged bidders to discuss re-partnering opportunities to incorporate each other's work packages into a single offer.

Where tenderers submitted whole-of-solution bids, they were also required to submit prices for the individual work packages should only part(s) of their offer be accepted and combined with parts of other tenderers' offers. This severability allowed a wider range of suppliers to be involved in the tender than otherwise possible, and enabled tenderers to assemble a tender which contained the best available work packages.

In using an innovative approach of this type, there was an increased risk of litigation related to the tender. The industry was already well known for the litigating of contract awards. This had delayed implementation of ticketing systems in other jurisdictions. Litigation was especially expected where bidders were used to more traditional forms of tendering, and may have been unhappy that a new procurement approach was seeking to avoid the proprietary systems usually offered by the original equipment manufacturers.

To address this risk, the NTS tender rules specifically gave the Authority a large degree of flexibility in how it ran the tender process, evaluated offers and interacted with tenderers.

To ensure that tenderers understood the process and were satisfied that the tender was being conducted appropriately, the Authority required the tenderers to raise any probity issues throughout the tender process and, at certain stages, to sign declarations that the tenderer was satisfied with the probity integrity of the tender before advancing the tender to the next stage.

These steps were designed to air probity issues promptly and to minimise the risk of subsequent litigation.

In July 2005, the NTS contract was awarded to Keane Australia Micropayment Consortium Pty Ltd ('Kamco'). Kamco is a consortium of Keane Inc., Ascom, ERG Group and Geisecke and Devrient Australasia.

4.3 Investigation and performance audit of the NTS tender

Following an article in the press about a suspected leak of Authority documents, the then Minister for Transport requested the Auditor-General to investigate the suspected leak. VAGO began this investigation in July 2005.

VAGO reported on the results of the examination of the leak of tender information in a letter to the Minister for Public Transport in January 2007. In summary, we found:

- the Authority's internal controls limited access to the leaked Authority information to seven staff
- no evidence of any of these staff members providing the documents to anyone outside the Authority.

During the course of the investigation, VAGO received claims from a number of parties about the integrity of the NTS tender. In January 2007, the Auditor-General commenced planning for a full performance audit of the tender. The specification for this audit was developed in consultation with the PAEC and the Authority. The audit began in July 2007. Relevant information that had been collected as part of the investigation was carried across to the performance audit.

The objective of the audit was to determine whether the tender process for the new ticketing system was properly conducted and to identify lessons and relevant areas of good practice for the future management of major tenders.

The scope of the audit covered:

- the planning and governance arrangements for the tender
- the conduct of the tender, including the Authority's compliance with its tender process, procedures and associated probity controls
- whether the tender process, procedures and associated controls were consistent with sound procurement principles
- the extent to which the Authority achieved its procurement objectives
- the alleged leak of tender information.

The audit methodology involved a detailed examination of the NTS tender arrangements, including the governance and planning arrangements for the tender, and the various elements of the tender process itself.

Audit evidence was gathered through discussions with Authority staff, other agencies involved in the tender, specialist advisors engaged by the Authority, the Probity Auditor and tenderers, and by reviewing:

- the Authority's tender documentation, including its business plan, market analysis and feedback, RTF documentation, probity plans, advisory team plans and evaluations
- the tenders
- the Authority's tender evaluation process
- communications between the Authority and tenderers (comprising meetings, email and telephone communications)
- the Authority's management of probity issues
- the role of the Probity Auditor in the tender.

The evidence collected and examined for the investigation and performance audit included approximately 100,000 Authority documents, more than 100,000 emails, and hundreds of hours of taped meetings.

The results of the performance audit were tabled on 31 October 2007. The performance audit report is available on the internet via www.audit.vic.gov.au.

5 Appendix 1

5.1 Standards issued by the Auditing and Assurance Standards Board and Accounting Professional and Ethical Standards Board

Standards issued by the AuASB and Accounting Professional & Ethical Standards Board (APES), not specifically written for performance audits include:

- ASA 100 Preamble to AUASB Standards
- ASA 200 Objective and General Principles Governing an Audit of a Financial Report
- ASA 210 Terms of Audit Engagements
- ASA 220 Quality Control for Audits of Historical Financial Information
- ASA 230 Audit Documentation
- ASA 240 The Auditor's Responsibility to Consider Fraud in an Audit of a Financial Report
- ASA 250 Consideration of Laws and Regulations in an Audit of a Financial Report
- ASA 260 Communication of Audit Matters with Those Charged with Governance
- ASA 300 Planning an Audit of a Financial Report APES 110 Code of Ethics for Professional Accountants
- ASA 315 Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement
- ASA 320 Materiality and Audit Adjustments
- ASA 330 The Auditor's Procedures in Response to Assessed Risks
- ASA 402 Audit Considerations Relating to Entities Using Service Organisations
- ASA 500 Audit Evidence
- ASA 505 External Confirmations
- ASA 508 Enquiry Regarding Litigation and Claims
- ASA 520 Analytical Procedures
- ASA 530 Audit sampling and other means of testing
- ASA 540 Audit of Accounting Estimates
- ASA 545 Auditing Fair Value Measurements and Disclosures
- ASA 560 Subsequent Events
- ASA 570 Going Concern
- ASA 580 Management Representations
- ASA 600 Using the Work of Another Auditor
- ASA 610 Considering the Work of Internal Audit
- ASA 620 Using the Work of an Expert
- APES 110 Code of Ethics for Professional Accountants
- APES 320 Quality control for firms
- APES 410 Conformity with Auditing and Assurance Standards.

These standards were developed primarily to guide the conduct of financial audits. However, the principles contained in them are relevant to performance audits, or apply to the general control arrangements established for managing audit practices.