

# *Parliament of Victoria*

## *Public Accounts And Estimates Committee*

### *Performance Audit of the Victorian Auditor-General and the Victorian Auditor-General's Office*

*Conducted by Mr John Phillips*

*December 2004*

*Melbourne  
Sydney  
Canberra  
Brisbane*

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## 1. Executive Summary

### 1.1 Introduction

The Public Accounts and Estimates Committee (PAEC) has, as required by Section 19 of the Audit Act 1994 (the Act), requested that a Performance Audit of the Victorian Auditor-General's Office (VAGO) be undertaken. The review is to determine “whether the Auditor General (AG) and the Victorian Auditor General's Office are achieving their objectives effectively and doing so economically and efficiently and in compliance with the Audit Act 1994”.

John Phillips of Acumen Alliance has been appointed in accordance with the Act to undertake the review. John Phillips (and Acumen Alliance) have, by virtue of Sub-Section 19 of the Act, the same powers of access given to the Auditor-General under sections 11, 12 and 14 of the Act.

### 1.2 Objectives

The review was directed towards answering the following question:

*Is the Auditor General of Victoria and VAGO achieving their objectives effectively, economically and efficiently and in compliance with the Audit Act 1994 (as amended).*

### 1.3 Scope

The Audit was conducted in accordance with the requirements of the Audit Act 1994 and Statement of Auditing Standard AUS 806 “Performance Auditing” and other relevant Auditing Standards and professional statements. The review was wide ranging, covering a number of aspects of VAGO's processes and outputs. The terms of reference are included in Appendix 1 to this report.

#### **1.4 Approach to the Review**

Our approach to the review included the following:

- Detailed review of VAGO files, documents and records
- Interviews with key VAGO Staff and senior officers of various public sector agencies
- Survey data completed by members of Parliament and senior officers of public sector agencies
- Interviews with representatives of other Australian based Auditors General, and
- Review of relevant research materials from overseas jurisdictions.

#### **1.5 Acknowledgments**

Acumen Alliance would like to thank the Auditor General and all VAGO personnel who participated in the review, the members and Secretariat of the PAEC who provided timely assistance to us, the members of the Legislative Assembly and Council who responded to our survey, and senior staff of public sector agencies who provided valuable input to the review.

In particular, the co-operative and positive attitude towards the review from all VAGO staff was very encouraging.

#### **1.6 Overall Conclusion**

The Audit Act outlines 3 clear objectives for the Auditor General. These are:

1. *To determine whether financial statements prepared by the Victorian Public Sector present fairly the financial position and financial results of operations of authorities and the State*
2. *To determine whether:*
  - a. *Authorities are achieving their objectives effectively and doing so economically and efficiently and in compliance with all relevant Acts*
  - b. *Victorian public sector operations and activities are being performed effectively, economically and efficiently and in compliance with all Acts*
3. *To determine whether financial benefits given by the State or an authority to non-government bodies are being applied economically, efficiently and effectively and for the purposes for which they were given.*

*Conducted by Mr John Phillips*

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*In pursuing these objectives, it is the Parliament's intention that regard is had as to whether there had been any wastage of public resources or any lack of probity or financial prudence in the management of public resources.<sup>1</sup>*

In discharging this role, the AG sets out in his 2001/02-2003/04 Corporate Plan (the period covered by this review) a series of objectives (which in totality encapsulate the AG's legislative responsibilities). These are set out below:

- 1. To deliver value adding reports to Parliament*
- 2. To undertake high quality independent audit activities*
- 3. To meet the needs and expectations of our stakeholders*
- 4. To be identified as a preferred employer*
- 5. To manage our business with maximum efficiency and effectiveness.*

Although we have discussed with the AG a number of recommendations necessary to ensure VAGO becomes more efficient and effective in achieving the AG's objectives, we draw attention to a number of positive developments at VAGO during the review period including:

- Introduction of a "plain English" reporting style, which has significantly improved the quality and clarity of audit reports and which is in turn leading to a more effective focus on audit scope, audit criteria and audit recommendations in performance audits and special reviews. This is reflected in steadily improving agency satisfaction ratings
- Consistent with the AG's purpose of improving performance and accountability in the VPS, a better understanding of agencies business operations, and a general willingness amongst staff to improve relationships with agencies and "add value" where possible
- Strong commitment to strategic audit planning through the continued development of the Strategic Audit Planning, Policies and Standards Group
- Independent Quality Assurance review processes for all audits including performance and financial audits and special reviews
- A commitment to continuous improvement initiatives across the office. For example, we note the recent introduction of the Performance Audit Business Improvement Project and further development of elements of the Financial Audit method and supporting technology
- Significant attention to maintaining the standard and quality of IT infrastructure across the office
- Introduction of senior staff with wider skill sets (particularly to support the conduct of performance audits)
- Improvement in management processes and information systems as a basis for improved planning and management of the office

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<sup>1</sup> Source: Audit Act 1994 (as amended)

- Development of a communication protocol with the PAEC designed to clarify respective roles and responsibilities
- Introduction of special audit briefings for Parliamentarians
- Improved communication with Agency Audit Committees
- Enhancement of the staff survey to better understand key staffing and cultural issues across the office, and
- Introduction of Good Practice Guides that facilitate the distribution of appropriate best practices across the public sector.

Our recommended improvements include:

- To ensure optimum allocation of audit resources across the public sector, amendments to the strategic audit planning process to give more formal attention to Whole of Government risks including information technology (IT) risks
- To provide the AG with the opportunity to better synchronise its work plan with current issues, changes to the content of the annual plan, and the consultative process with the PAEC in respect of this plan
- To further improve the consultative process between the PAEC and the AG enhancement of the current protocols to concentrate more on the on going development of the full annual work program and the results of audits completed and less on the detailed specifications of individual audits
- To support the conduct of more consistent and efficient performance audits and special reviews, the further development of a performance audit method, and refinement of the existing electronic workpaper system
- To support the more efficient and effective conduct of financial audits, new investment in the development of guidance manuals and electronic tools as well as a more formal strategic analysis of computer audit needs and capabilities
- To improve staff performance and morale, develop a more strategic focus on the development and management of VAGO's human resources, supplemented by closer attention to individual coaching / mentoring, professional training and development
- To enhance the quality of management information, continue improvement in the recently implemented Practice Management System
- To ensure results of independent quality reviews can be incorporated into the following year's financial audit round, changes in the timing and focus of these reviews, and
- To enhance the role of the VAGO Audit Committee , review its charter and composition.

Our overall conclusion is as follows:

<i>Terms of Reference</i>	<i>Conclusion</i>
Is the Victorian Auditor General and VAGO operating in compliance with the Audit Act 1994 (as amended) and achieving their objectives?	We have found 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 substantially achieving the corporate objectives. VAGO is operating in compliance with the Audit Act 1994.
Is the Victorian Auditor General and VAGO operating effectively, economically and efficiently.	By reference to Audit Offices in other Australian jurisdictions the Victorian Auditor General and VAGO are largely operating effectively, economically and efficiently. We have made a number of recommendations in this report to address areas of operation where improvements are required.

***Response by Mr Wayne Cameron, Auditor General of Victoria.***

*I have considered your report and recommendations and I largely accepted those recommendations that fall within my responsibility to implement.*

*I am encouraged that your report concludes that:*

- *the Office is complying with the legislative objectives, undertaking the audit mandate in accordance with the Audit Act 1994 and Australian Auditing Standards and substantially achieving the corporate objectives;*
- *the Office is largely operating effectively, economically and efficiently.*

*Your report also notes many positive developments by the Office since the last performance audit. The report’s recommendations should assist us in our continuous improvement efforts.*

*Conducted by Mr John Phillips*

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*The Office has continued the substantial change process that began on my appointment. Change is not without risk and I am pleased that the report acknowledges the progress we have made. Over the last three years we focused on delivering quality products and services. Our outputs to parliament increased significantly and we have received positive feedback on the continuing improvement in the quality of our reports and recommendations.*

*We recognise, and the report confirms, that excellence is about continuous improvement. To this end our new corporate plan focuses on being more responsive and collaborative in using our knowledge to shape awareness and direction on emerging issues and to stimulate better performance in the public sector. All our efforts are directed towards improvement, whether in providing parliament with assurance about the accountability of public sector agencies or in making recommendations on ways in which agency performance can be more efficient, effective and economic.*

*I am particularly pleased that the report supports the existence of a strategic audit planning group separate from those responsible for audit delivery. The report also recognises that it is unique among Australian Audit Offices and reflects contemporary and emerging practice in some overseas jurisdictions.*

*The commentary in the report proposes that our work program and effort should primarily have a risk focus. An Auditor-General's primary role is to provide assurance to the Parliament and ultimately the community across the full ambit of the Victorian public sector's activities. My legislative mandate requires me not only to focus on areas of risk, but also areas aimed at identifying opportunities to improve performance and responding to issues of high public interest. My Office will continue to balance the consideration of risk with the broader mandate of the Auditor-General.*



### 1.7 Summary of Findings, Conclusions and Recommendations

The following are summarised findings, conclusions and recommendations in relation to our review. Each area is cross-referenced to the specific terms of reference to which it relates:

#### 1.7.1 Governance

<i>Subject matter and Terms of reference (ToR)</i>	<i>Governance Findings and Conclusions</i>	<i>Recommendations</i>
<p><b>Purpose and Objectives of VAGO</b></p> <p><b>ToR: 2.2</b></p>	<p>The AG prepares an Annual Plan, which is tabled in Parliament in accordance with section 7A of the Act. This plan outlines the AG’s outputs and products, indicative areas of audit interest, key performance indicators (KPIs), office management initiatives, funding requirements and forecast financial statements.</p> <p>The AG’s annual report provides accountability against the KPIs outlined in the Annual Plan.</p> <p>Our review found that:</p> <ol style="list-style-type: none"> <li>1. The Annual Plan appropriately sets out the AG’s objectives and purpose, relevant to the requirements of the Act.</li> <li>2. The outline of work in respect of “Parliamentary Reports” (principally relating to reporting on performance audits and special reviews) is defined as “areas of audit interest”. The AG determines what audits in these areas will be undertaken during the year and at what time. Accountability for this output area is achieved by virtue of the KPIs set for costs, quantity of reports delivered, timeliness and agency satisfaction.</li> <li>3. The AG’s externally reported KPIs are substantially accurate.</li> </ol>	<ol style="list-style-type: none"> <li>1. There are no recommendations for this area.</li> </ol> <p>Separate recommendations in respect of KPIs are summarised in 1.7.7</p>
<p><b>Business Planning</b></p>	<p>In conjunction with the Annual Plan, a Business Plan for VAGO is</p>	<ol style="list-style-type: none"> <li>2. Business plans at business unit level should use a</li> </ol>

<b>Subject matter and Terms of reference (ToR)</b>	<b>Governance Findings and Conclusions</b>	<b>Recommendations</b>
<b>ToR: 2.2</b>	<p>prepared which outlines a series of KPIs, which are reported on quarterly to the PAEC and to the Department of Treasury and Finance (as part of the appropriation output acquittal). This business plan is supported by individual business plans for each operating division which have more detailed KPIs that are reported internally to the Senior Management Group (SMG).</p> <p>We noted some business plans at individual business unit level omitted key information that we would expect to be in such plans.</p>	<p>consistent template that includes strategies, activities, timelines and milestones, budget and resource requirements, revenue projections (where applicable), and KPIs. We believe the business plan for the Strategic Audit Planning, Policies and Standards Group (SAPPS) is an appropriate template to use.</p>
<p><b>Performance against office scorecard</b></p> <p><b>ToR: 2.3(h)</b></p>	<p>We reviewed in detail VAGO’s performance against its internal scorecard for 2003/04 and found some discrepancies in the data reported. Whilst VAGO manage its KPIs through quarterly reports to DTF and monthly financial reports, as this scorecard becomes an integral part of the future management of the office, we believe these discrepancies may impact the usefulness of the scorecard as a management improvement tool. We understand VAGO is aware of these discrepancies and is seeking to understand how these have occurred.</p> <p>In its annual assessment of its performance against the office “scorecard” for 2003/04, VAGO acknowledge that significant improvement is required in the area of project management of performance audits and special reviews. It is pleasing to note VAGO have recognised these issues and are introducing a number of measures to deal with them.</p>	<p>3. VAGO need to continue to analyse the processes by which the internal scorecard is prepared and ensure the data and reports used are accurate.</p> <p>4. We support the initiatives recently introduced by VAGO to better manage assignments from a cost and timeline perspective. The results of these measures should be monitored regularly and reinforced by appropriate training.</p>
<p><b>Internal Audit</b></p> <p><b>ToR: 2.9</b></p>	<p>We reviewed various aspects of the VAGO Audit Committee and internal audit function including:</p> <ul style="list-style-type: none"> <li>▪ The Audit Committee charter</li> <li>▪ The internal audit charter and scope of work</li> </ul>	<p>5. In respect of the VAGO internal audit function:</p> <ul style="list-style-type: none"> <li>a. The Audit Committee should amend its charter, formally adopt an internal audit charter and improve its annual self assessment process</li> </ul>

<b>Subject matter and Terms of reference (ToR)</b>	<b>Governance Findings and Conclusions</b>	<b>Recommendations</b>
	<ul style="list-style-type: none"> <li>▪ The Internal Audit annual program, and</li> <li>▪ A sample of audit reports.</li> </ul> <p>We found that in overall terms the Audit Committee and internal audit function operated satisfactorily, with some attention required in the following areas:</p> <ul style="list-style-type: none"> <li>▪ The Audit Committee’s current charter requires revision to better reflect its responsibilities. We understand a revised draft is being considered</li> <li>▪ We noted the Audit Committee self-assessment process could be more comprehensive</li> <li>▪ We noted a draft Internal Audit charter has yet to be adopted</li> <li>▪ The current internal audit program is solely focussed on business support areas. We note the VAGO risk management plan identifies a number of high risk areas in operational groups</li> <li>▪ We noted no formal process exists whereby the Audit Committee monitor and ensure previous internal audit recommendations are being implemented</li> <li>▪ Internal audit reports do not clearly identify the objectives of the audit, scope, conclusions and clear identification of recommendations, agreed management plans, timelines and responsibilities, and</li> <li>▪ The composition of the Audit Committee may require revision to ensure it is seen to be fully independent of line management functions.</li> </ul>	<ul style="list-style-type: none"> <li>b. The scope of the annual internal audit program should be reviewed to possibly include controls over areas of potential high-risk (not being audit risk) to the operational groups.</li> <li>c. Internal audit reports should clearly identify the objectives, scope, conclusion, recommendations, agreed management plans, timelines and responsibilities. Additionally, a process should also be implemented whereby the Audit Committee monitor and ensure recommendations from all assurance activities commissioned by the Committee are being implemented. Further, the results of these reports should be reflected in the offices’ overall risk management plans, and</li> <li>d. It may be prudent for VAGO to review the composition of the Audit Committee and consider whether it is appropriate that the Senior Executive responsible for all areas in the current internal audit program be the sole management representative.</li> </ul>
<b>Use of Private Audit Contractors and consultancies</b>	We reviewed the policy and processes used by VAGO for the contracting of audits. We found that VAGO complied with VGPB procurement guidelines in all material respects. We noted some issues of efficiency which may improve the process, all of which	6. We understand VAGO are considering ways in which they may be able to streamline the contracting process. We support these initiatives. We also believe VAGO could consider the establishment of a panel of service

<b>Subject matter and Terms of reference (ToR)</b>	<b>Governance Findings and Conclusions</b>	<b>Recommendations</b>
<b>ToR: 2.8</b>	VAGO are currently examining.	providers to further improve the efficiency and effectiveness of the contracting process.
<b>Follow up on previous Performance Audit</b>  <b>ToR: Other matters</b>	<p>We reviewed the recommendations made in the previous performance audit review of VAGO undertaken in 2001. It is pleasing to note a number of these have been successfully implemented.</p> <p>However some recommendations agreed to by the AG have not been fully achieved at this point. These include:</p> <ul style="list-style-type: none"> <li>▪ Linkage of the office wide risk assessment to areas of focus outlined in the internal audit program now exists, although the internal audit program continues to focus primarily on business support areas and does not consider areas of high risk in operational groups, and</li> <li>▪ Enhancements to the office’s financial audit methods to assist in improving documentation on better linking financial statement risk and the extent of audit work required – despite some enhancements, this issue is still evident.</li> </ul>	<p>7. We have no separate recommendations under this area.</p> <p>(We note that matters not yet fully actioned from the last Performance Audit are covered elsewhere in this report)</p>
<b>Other matters</b>  <b>ToR: Other matters</b>	<p>Section 19 of the Act specifically precludes the appointment of a person who is either an agent of the AG (section 7F), a delegate of the AG (section 7G) or the independent auditor (section 17) as the Performance Auditor under section 19. These amendments were introduced in 2003.</p> <p>As currently drafted, section 19 of the Act still allows the Performance Auditor, following the completion of his or her audit, to undertake audit work for the AG under section 7F and / or section 7G. We consider that if such an appointment was made, there may be a perception of a conflict of interest.</p>	<p>8. To remove any perception of a conflict of interest, appropriate controls should be introduced by the PAEC to specifically preclude the Performance Auditor appointed under section 19 of the Act, to be appointed under sections 7F and / or 7G subsequent to completion of the performance audit. We would expect a reasonable period for such a requirement would be for 2 years following the completion of the Performance Audit. Such a requirement could be enforced at the contractual stage or enshrined in the Act. We note this is a matter for the PAEC and not the AG. We would be</p>

<i>Subject matter and Terms of reference (ToR)</i>	<i>Governance Findings and Conclusions</i>	<i>Recommendations</i>
		happy to accept that such a requirement retrospectively apply to our appointment.

### 1.7.2 Strategic Audit Planning

<i>Subject matter and Terms of reference (ToR)</i>	<i>Strategic Audit Planning Findings and Conclusions</i>	<i>Recommendations</i>
<p><b>Annual Planning cycle</b> <b>ToR: 2.2, 2.3(a)</b></p>	<p>The Annual Plan (inclusive of the annual work program) and the subsequent reporting on its achievement are important components of the AG’s accountability to Parliament.</p> <p>Given the long lead times involved in its preparation (as a result of the timetable imposed on it by the requirements of the Act in relation to the government budgetary process) the Annual Plan only provides an outline of potential areas of performance audit investigation that may be undertaken. Further, proposed special reviews are not identified even though they are an important part of the VAGO annual work program as they often address areas of major public interest.</p> <p>In our view the key to the optimum allocation of audit (excluding financial audit) resources is an understanding of emerging risks across the Whole of Government. We consider changes to the annual planning cycle are warranted to ensure such risks are reflected in a timely manner in the planning process. This will improve the relevance of the annual work program and enhance accountability to Parliament.</p> <p>We note that VAGO prefers the term “themes” to the term “risks”.</p>	<p>9. The annual planning cycle be amended along the following lines:</p> <ul style="list-style-type: none"> <li>▪ Phase 1 (up to December) – Identify the Whole of Government risks and confirm selection criteria, in consultation with the PAEC. Preparation of the statutory Annual Plan and operating budget.</li> <li>▪ Phase 2 (January to March) – Develop the final sector audit plans and identification of areas of audit interest in line with the major risks at the Whole of Government level. Refinement of annual budget.</li> <li>▪ Phase 3 (April to May) – Develop the annual work program and submit it for consultation with the PAEC. We note the annual work program as described would not form part of the Annual Plan tabled in Parliament.</li> </ul>
<p><b>Selection of Audit Topics</b></p>	<p>The processes undertaken to identify and select areas for audit coverage are critical to the AG’s corporate purpose of “improving</p>	<p>10. The process by which portfolio sector audit plans are prepared, together with their linkage to the annual plan</p>

<i>Subject matter and Terms of reference (ToR)</i>	<i>Strategic Audit Planning Findings and Conclusions</i>	<i>Recommendations</i>
<p><b>ToR: 2.3(a), 2.4(a), (b)</b></p>	<p>performance and accountability in the public sector”. The identification of potential audit topics for consideration by the AG is one of the responsibilities of the “Sector Directors” in the “strategic planning group”(SAPPS). We support the existence of a planning and liaison group separate from the groups carrying responsibility for audit delivery. This is unique amongst Australian audit offices. Sector Directors prepare “sector audit plans” which have 3-year planning horizons and are updated annually. The 10 sector plans are important documents in the planning cycle representing the culmination of detailed examinations of portfolios, discussions with key portfolio representatives and VAGO officers, reviews of critical planning and budget information and the outcomes of recent audit activity.</p> <p>Topics are selected by reference to four criteria, namely risk, materiality, potential for improvement and potential for enhanced accountability. In selecting topics within sectors VAGO sees these criteria as equally important and regards immediacy as the key determinant when prioritising projects.</p> <p>We believe the planning process should be improved by:</p> <ul style="list-style-type: none"> <li>▪ More formally assessing risks from a “ Whole of Government” perspective</li> <li>▪ Strengthening the relationships of Sector Directors with the relevant portfolio senior executives to further enhance their knowledge of portfolio operations</li> <li>▪ More formally explaining the prioritisation of “areas of audit interest” by reference to the selection criteria, and</li> <li>▪ More formally addressing Information Technology (IT) risks in a Whole of Government context as IT systems become increasingly important and sophisticated. The recent appointment of a Victorian Government Chief Information</li> </ul>	<p>requires improvement. In particular:</p> <ol style="list-style-type: none"> <li>a. Additional training and guidance for Sector Directors on engaging with portfolios is required to assist them in preparing sector audit plans. This guidance should note the importance of maintaining a visible presence at Audit Committee meetings</li> <li>b. A documented “Whole of Government” scan of major risks / themes should precede the development of the final plans – this would provide context to the risks / themes identified at the portfolio level</li> <li>c. Where Whole of Government and / or Departmental risk management plans are prepared they should be more formally assessed in developing an understanding of the key risks / themes affecting the portfolio. If they are not available from the executive then they should be sought from the Audit Committee</li> <li>d. Sector audit plans should explain the prioritisation of “areas of audit interest” by reference to the selection criteria. High risk areas should be given primary consideration, and</li> <li>e. Further attention should be given to IT developments across the “Whole of Government” with particular consideration given to preparing a specific IT plan utilising specialist IT resources.</li> </ol>

<i>Subject matter and Terms of reference (ToR)</i>	<i>Strategic Audit Planning Findings and Conclusions</i>	<i>Recommendations</i>
	Officer (CIO) is a reflection of this.	

### 1.7.3 Stakeholder Relationships

<i>Subject matter and Terms of reference (ToR)</i>	<i>Stakeholder relationships Findings and Conclusions</i>	<i>Recommendations</i>
<p><b>PAEC relationship</b></p> <p><b>ToR: 2.3(f)</b></p>	<p>The PAEC has been assigned a number of responsibilities under the Audit Act 1994. These responsibilities represent the means by which Parliament:</p> <ul style="list-style-type: none"> <li>▪ Ensures the accountability of the AG, and</li> <li>▪ Protects and supports the independence of the AG<sup>2</sup></li> </ul> <p>The development during the review period of a formal communication protocol between the AG and the PAEC has been a positive initiative. The introduction of briefings to members of Parliament by the AG on reports tabled in Parliament has also been a positive initiative.</p> <p>In considering the role of the PAEC in the context of the AG, we believe the relationship could be further enhanced with a more balanced allocation of PAEC time spent on discussing:</p> <ul style="list-style-type: none"> <li>▪ Appropriate audit topics encompassing performance audits and / or special reviews</li> <li>▪ The resulting annual work program</li> <li>▪ The status of the complete annual work program including upcoming special reviews and financial audits, and</li> </ul>	<p>11. The annual consultative process between the AG and the PAEC is amended to enable greater consultation on the development and status of the annual work program and the results of audits tabled in Parliament. This would involve:</p> <ol style="list-style-type: none"> <li>a. Revising the timelines and content of the annual plan (refer earlier recommendation relating to annual planning cycle). This would enable the PAEC and the AG to discuss the content of the full annual work program much closer to the commencement of the financial year to which the program relates and provide the PAEC (and Parliament) with a greater opportunity to contribute to the risk assessments and selection criteria which will shape the development of the detailed annual work program.</li> <li>b. The current protocol provides for a quarterly report and briefing to the PAEC by the AG. We support this initiative and believe this can be further enhanced by reporting on the status and development of the complete annual work program, planned activity for the next quarter in</li> </ol>

<sup>2</sup> Source: VAGO/PAEC Protocol June 2003

<b>Subject matter and Terms of reference (ToR)</b>	<b>Stakeholder relationships Findings and Conclusions</b>	<b>Recommendations</b>
	<ul style="list-style-type: none"> <li>▪ VAGO reports tabled in Parliament.</li> </ul>	<p>light of any revision in risk assessments, reporting of additional KPIs as set out later in this report. This would effectively replace the detailed discussions on the approach to individual audit areas previously selected for attention.</p> <p><i>We are mindful of the fact that Section 7A(1)(a) of the Act requires a work program to be included in the Annual Plan. If our revised Annual Plan containing a list of risks to be considered and / or themes to be followed is not considered a “work program” as envisaged by the Act, then the wording of the Act should be amended. However we would be sympathetic to the view that a description of a “series of audits scoped to address a set of stated risks” does constitute a “work program” in the context of VAGO as a whole.</i></p>
<p><b>Survey of users</b></p> <p><b>ToR: 2.6</b></p>	<p>As part of our review, we issued separate surveys to:</p> <ol style="list-style-type: none"> <li>1. All 132 members of the Victorian Parliament (both Legislative Assembly and Council)</li> <li>2. Board or Audit Committee Chairs of some 46 public sector agencies, and</li> <li>3. Departmental secretaries / CEO’s / CFO’s of some 260 public sector agencies.</li> </ol> <p>The overall response rate across the 3 groups was 40%, which provides a valid basis on which to derive overall conclusions. In addition we conducted interviews with selected representatives of certain agencies.</p> <p>The surveys asked respondents to rate VAGO across a range of</p>	<p>12. There are no separate recommendations for this area.</p>



<i>Subject matter and Terms of reference (ToR)</i>	<i>Stakeholder relationships Findings and Conclusions</i>	<i>Recommendations</i>
	<p>areas including service delivery, planning and supervision, technical competency, communication, VAGO staff attitude and performance, value adding, reporting, quality control, use of agents and specialists, performance audits and special reviews.</p> <p>The overall rating, combining each area and each type of respondent was satisfactory to good with favourable comments received for communication and interaction, contribution to and attendance at audit committees, the generally positive attitude of VAGO staff and adherence to meeting reporting timelines.</p> <p>Areas for attention included being more proactive and timely in resolving issues, more prompt issuing of management letters after finalisation of financial audits, and greater consistency in the conduct of audits. In addition, a number of respondents were unaware of the Good Practice Guides. Further some agencies interviewed were unaware of the Portfolio Strategic Audit Planning process and the role of the Sector Director.</p> <p>The results of the survey and our discussions support a number of our recommendations made in other parts of this report including:</p> <ul style="list-style-type: none"> <li>▪ Changes in the way sector audit plans are prepared and the relationship these have to the annual plan – leading to improved identification of significant sector wide audit topics</li> <li>▪ Improving the execution of the role of the Sector Director</li> <li>▪ Reinforcing the importance of the “plain English” style of reporting, and</li> <li>▪ Reviewing the way in which “Good Practice guides” are published and disseminated.</li> </ul>	
<b>Good Practice guides</b>	In the period this review covers, the AG has published a number of	13. In determining the most appropriate method to publish

<i>Subject matter and Terms of reference (ToR)</i>	<i>Stakeholder relationships Findings and Conclusions</i>	<i>Recommendations</i>
<p><b>ToR: 2.5</b></p>	<p>Good Practice guides. These are:</p> <ul style="list-style-type: none"> <li>▪ June 2002 - Framework for Government Advertising and Marketing</li> <li>▪ February 2004 - CFO, Role and responsibilities</li> <li>▪ June 2004 - Managing Internet Security, and</li> <li>▪ June 2004 - Managing Risk across the Public Sector</li> </ul> <p>In general, feedback from Agencies on the guides (via interviews and survey) was positive, although the practical use of the guides was minimal and a number were not aware of their existence notwithstanding that the guides were distributed to Secretaries, CEO's and CFO's.</p> <p>As a matter of principal, we believe that the efficient and effective distribution and sharing of intellectual capital gained from audit activity undertaken by the AG is appropriate, where such information is applicable to the wider public sector.</p> <p>We note the practice is consistent with other Australian Audit Offices. Further, it is consistent with the AG's corporate purpose of improving performance and accountability in the Victorian public sector.</p> <p>Now that a number of guides have been released, we believe it appropriate for the AG to seek agency feedback on their use, applicability, form and content, prior to investing in further similar publications.</p> <p>We also noted that the AG published in June 2004 an "Occasional Paper" on "Measuring and Reporting on Sustainability. This paper came out of the first phase of the performance audit of "Managing</p>	<p>and distribute sector wide audit recommendations and / or general guidance material, the AG should incorporate into its next round of surveys an opportunity for agencies to comment on the Good Practice guides issued to date, the relevance of the content and the most appropriate and effective means by which they should receive future relevant sector wide "guidance". We consider that an additional distribution channel may be Chairs of Agency Audit Committees.</p> <p>14. Prior to developing any further "occasional papers" the AG should ensure that sufficient stakeholder interest exists to provide a degree of comfort that investment in</p>

<i>Subject matter and Terms of reference (ToR)</i>	<i>Stakeholder relationships Findings and Conclusions</i>	<i>Recommendations</i>
	<p>Logging in State Forests”. We are advised by VAGO that this paper was developed for a special purpose and as such was termed “occasional”. In this context and given the favourable feedback, we believe this particular paper was fully justified under the AG’s mandate. We would however be concerned if such papers were to become a regular output without first ensuring there are sufficient interested stakeholders who would receive value from such an investment.</p>	<p>such a paper will provide value to the public sector.</p>

**1.7.4 Financial Audit**

<i>Subject matter and Terms of reference (ToR)</i>	<i>Financial Audit Findings and Conclusions</i>	<i>Recommendations</i>
<p><b>Method, Fieldwork and conclusions</b></p> <p><b>ToR: 2.3(d), (i), (j)</b></p>	<p>We reviewed a number of audit files (encompassing in house and externally contracted audits) covering the period under review and found no evidence that any inappropriate audit opinions had been issued.</p> <p>Whilst VAGO’s methodology is consistent with Australian Auditing Standards it is not fully supplemented by sufficient detailed guidance material to support the assessment and identification of inherent / control / audit risk, the selection of the particular audit approach (eg, compliance / substantive / systems based), and the determination of the level and type of audit work to be undertaken (ie, work program steps).</p> <p>In the audits examined, the nature and extent of documentation was also inconsistent and some sets of workpapers were not easy to follow and interpret. This could be attributable to a lack of guidance material and structured training.</p> <p>We acknowledge that through the review period, VAGO have</p>	<p>15. To improve the effectiveness, efficiency and consistency of approach we consider that further investment is required in developing financial audit methods, guidance material and training programs. Such investment should be undertaken in conjunction with the development of new supporting audit technology (refer below).</p>

<b>Subject matter and Terms of reference (ToR)</b>	<b>Financial Audit Findings and Conclusions</b>	<b>Recommendations</b>
	<p>progressively updated their current financial audit manual to reflect changes in Auditing Standards and an improved focus on audit risk.</p>	
<p><b>Supporting technology</b> <b>ToR: 2.3(d)</b></p>	<p>Our examination of financial audits involved a review of the use of EFINA (VAGO’s automated financial audit workpaper package). We note:</p> <ul style="list-style-type: none"> <li>▪ EFINA is not a fully integrated and linked electronic workpaper system and as such effectively only provides an electronic storage facility for workpapers. Whilst it does serve as a useful file index it is not conducive to quick and efficient cross checks, aggregations and comparisons, and</li> <li>▪ The system does not contain an “intelligent” logic layer, which, for example, enables adjustments and / or issues identified in detailed schedules to automatically flow through to lead schedules. The system does not therefore take advantage of the relationship between different sections of the audit file to facilitate an efficient audit.</li> </ul> <p>We understand VAGO have recently commenced discussions with the Queensland Audit Office (QAO) on an initiative to jointly re-develop audit methods and supporting technology.</p>	<p>16. To ensure VAGO remain up to date in the use of audit technology and are able to effectively discharge their assurance role and retain and attract staff, we support the decision to review the use of EFINA. This should be undertaken in the context of a wider project in relation to development of supporting guidance to the financial audit method (as referred to above). Prior to finalising any agreement with the QAO in respect of such a project, the AG should be satisfied that all options for a replacement have been considered, including evaluation of existing packages in the private sector and joint development with other Audit Offices. Once all options have been properly considered, a business case should be developed with a clear statement of project scope, deliverables and timelines, together with identification of capital and recurrent funding requirements.</p>
<p><b>Use of Internal Audit</b> <b>ToR: 2.3(d)</b></p>	<p>VAGO does consider the work of Internal Auditors. However, VAGO does not in all cases clearly document the impact of internal audit work on their audit approach and their work programs.</p>	<p>17. In relation to the use of work conducted by Internal Audit, VAGO should undertake appropriate training to ensure audit files contain documentation setting out how an Agency’s Internal Audit function has been assessed, the conclusions drawn by the Audit Team and the resulting impact on VAGO’s audit approach and work program.</p>
<p><b>Independent Quality</b></p>	<p>We noted a robust policy exists for external experts to conduct an</p>	<p>18. Independent reviews of June year-end audits should be</p>

<b>Subject matter and Terms of reference (ToR)</b>	<b>Financial Audit Findings and Conclusions</b>	<b>Recommendations</b>
<p><b>reviews</b></p> <p><b>ToR: 2.3(j)</b></p>	<p>annual independent quality review of a sample of financial audit files (covering both in house and contracted audits). The reviews are commissioned independently of the Financial Audit Group.</p> <p>We noted some issues with the independent review of the June 2003 and December 2003 round of audits:</p> <ul style="list-style-type: none"> <li>▪ The independent review for these periods was combined and findings subsequently only reported in June 2004. Resulting recommendations for improvements have had limited application for the June 2004 round of audits as most of these audits are planned and commenced by this time, and</li> <li>▪ The review was designed to cover the overall audit process and did not therefore examine all workpapers in detail.</li> </ul>	<p>conducted as soon as possible after completion to allow sufficient time for any recommendations and improvements to be incorporated into the subsequent year's audit planning process. Independent reviews of December year-end audits should be separately conducted so as not to delay the reporting of recommendations for the June round of audits.</p> <p>19. In view of our own findings in respect of the need to improve the consistency of documentation on audit files and ensure workpapers clearly link risk to work programs and audit evidence, particular emphasis on workpaper consistency and clarity should be incorporated into the next round of independent quality reviews.</p>
<p><b>IT Audit</b></p> <p><b>ToR: 2.3(d)</b></p>	<p>VAGO's Computer Risk Management Group (CRM) currently comprises four staff members. CRM is involved in 30-40 financial audits per year. When requested, they are also involved in performance audits and special reviews.</p> <p>Increasing sophistication of information systems across the public sector represents a Whole of Government and financial audit risk. It is important that VAGO has sufficient skilled resources, if not to perform the necessary IT environment and application reviews themselves, then to ensure that appropriate IT professionals are engaged to do so.</p> <p>We understand that VAGO is actively recruiting to increase their CRM resource base. Such decisions should be made in the context of the scope and amount of work required to be undertaken in IT across client agencies, which will come from a strategic analysis of</p>	<p>20. We recognise that the recruitment and retention of appropriate IT skills is difficult. However, we believe that CRM is sufficiently important to warrant the implementation of a formal CRM human resources strategy that addresses the areas of IT audit risk identified across client agencies. To maximise the effectiveness of existing resources, we also recommend that consideration be given to expanding the usage and current suite of computer interrogation packages.</p>

<i>Subject matter and Terms of reference (ToR)</i>	<i>Financial Audit Findings and Conclusions</i>	<i>Recommendations</i>
	IT audit needs.	

### 1.7.5 Performance Audit

<i>Subject matter and Terms of reference (ToR)</i>	<i>Performance Audit Findings and Conclusions</i>	<i>Recommendations</i>
<p><b>Method</b></p> <p><b>ToR: 2.4(c)</b></p>	<p>VAGO’s Manual for Auditing Performance (MPA), which is based on Australian Auditing Standards 806 and 808, contains statements of theoretical principle. Whilst we agree that the manual should not be overly prescriptive, further development of detailed guidance material is required to support the conduct of performance audits. We note such developments are in progress.</p> <p>We acknowledge that performance auditing is a younger discipline than financial audit and methods and procedures are evolving. We note there have been significant changes during the review period in the approach to performance audits undertaken and the audit methods used. The adoption of the new reporting format earlier this year is now leading several improvements. VAGO recognise further work is required to develop its performance audit methodology and have established a Business Improvement Project (BIP) to drive this forward.</p>	<p>21. To improve consistency in approach and outcomes of performance audits, recent efforts (via the Business Improvement Project) to develop a method and supporting guidance material should be accelerated. This should include guidance on how to complete the work necessary to satisfy the revised reporting requirements for special reviews and performance audits.</p>
<p><b>Management and size</b></p> <p><b>ToR: 2.4(f)</b></p>	<p>We have considered the size and number of Performance Audits undertaken by VAGO on an annual basis.</p> <p>The size and cost of performance audits will vary, depending on the subject matter, the issues to address, the required approach and the resourcing requirements. We do not believe there is a definitive</p>	<p>22. Our belief is that the critical success factors for the efficient and effective completion of a performance audit are a well defined audit criteria, achievable audit timelines (to both ensure budget is met and retain currency of recommendations) and use of appropriately skilled staff. In our view, the most critical determinant</p>

<i>Subject matter and Terms of reference (ToR)</i>	<i>Performance Audit Findings and Conclusions</i>	<i>Recommendations</i>
	<p>guideline that can be set for the appropriate size of a performance audit as there are case-by-case issues that will ultimately shape this.</p>	<p>of efficiency and effectiveness should be timeliness as this provides the basis on which cost can be managed and currency / relevance of the report outcomes can be ensured. In view of this, we believe VAGO should ensure that where performance audits are scheduled to run for say greater than say 7-9 months from commencement to completion, then consideration be given to conducting the audit in stages to enable recommendations to be progressively released and actioned. We note this practice was undertaken in the recent audit “Managing Logging in State Forests”.</p>
<p><b>Scoping and Planning</b> <i>ToR: 2.4 (c)</i></p>	<p>Significant time is spent scoping and planning Performance Audits. At the commencement of the review period, such audits were outlined by the SAPPS Group and handed on to the Performance Audit Group. In some cases this resulted in:</p> <ul style="list-style-type: none"> <li>▪ Additional hours being spent on agreeing the scope of audits between the initial “audit area summary” prepared by the SAPPS Group and the detailed plan prepared by the Performance Audit Group, and</li> <li>▪ Modifications to the original audit topic and scope.</li> </ul> <p>We note that Sector Directors in the SAPPS Group now identify the broad areas of audit interest and pass primary responsibility for the final scoping to the Performance Audit Group.</p>	<p>23. Collaboration between the two groups has become progressively more efficient and effective throughout the review period, although we note further room for improvement. We also suggest that a standard “change schedule” be introduced to ensure that all modifications to the original scope are recorded and explained.</p>
<p><b>Fieldwork and reporting</b> <i>ToR: 2.4(d), (g)</i></p>	<p>We found no evidence of any significant non-compliance with statutory requirements including Australian Auditing Standards.</p> <p>However, some performance audits have not been conducted efficiently and effectively, particularly in the areas of scope and definition of assessment criteria, control of cost and timelines and management of communications with agencies. Accordingly,</p>	<p>24. To ensure further improvement of the performance audit program, continued attention is required in relation to:</p> <ul style="list-style-type: none"> <li>a. Development of the performance audit method and supporting guidance material (refer recommendation 21)</li> </ul>

<b>Subject matter and Terms of reference (ToR)</b>	<b>Performance Audit Findings and Conclusions</b>	<b>Recommendations</b>
	<p>elements of the performance audit program have not been as efficient and effective as VAGO would have intended.</p> <p>We note VAGO is aware of this and is taking appropriate steps to enhance efficiency and effectiveness via the Business Improvement Project (BIP).</p>	<p>b. Establishing clear and relevant audit criteria  c. Management of audit costs, progress against plan and achievement of agreed timelines for completion of the audit, and  d. Ensuring communication with agencies as part of the audit process is conducted at the appropriate levels, commensurate with the varying audit stages of the audit process.</p> <p>A number of these issues will also be addressed by the recommendations we have made in respect of the scoping and planning of performance audits.</p>
<p><b>Significant out of scope issues</b></p> <p><b>ToR: 2.4(e)</b></p>	<p>In our review of several Performance Audit and Special Review files we noted a high level of awareness of potential out of scope issues. We further noted the Post Audit debriefing process specifically includes identification of any additional issues warranting audit attention.</p>	<p>25. We understand the Post Audit De-Brief form is currently being reviewed and revised. We recommend the review be completed and the form be reintroduced as soon as practical.</p>
<p><b>Supporting technology</b></p> <p><b>ToR: 2.4(d)</b></p>	<p>We reviewed the EMPERA working paper package. This package is used to store workpapers and assist in the management of performance audits and special reviews. It has not been fully and consistently applied throughout the review period.</p> <p>We believe EMPERA is an appropriate tool for the recording and management of performance audits and special reviews. However, the package needs to be revised to better suit the new reporting structures being progressively introduced.</p>	<p>26. The Business Improvement Project (BIP) currently underway in Performance Audit should include the updating of EMPERA to bring it into line with new methods, reporting frameworks and overall audit management techniques. Further, the use of EMPERA should be enforced as the accepted standard means of documenting performance audits.</p>
<p><b>Independent Quality reviews</b></p>	<p>We note a robust policy of independent quality review exists in performance audit.</p>	<p>27. We have no recommendations in this area.</p>



<b>Subject matter and Terms of reference (ToR)</b>	<b>Performance Audit Findings and Conclusions</b>	<b>Recommendations</b>
<b>ToR: 2.4(d)</b>	A number of independent quality reviews of selected Performance Audits and Special Reviews have been conducted over the review period. These have been undertaken by representatives of the NSW Auditor General’s Office and by leading Academics. We have found these reviews to be thorough and constructive. Further, efforts are being made by VAGO to implement resulting recommendations.	
<b>Appropriateness mix of Resources</b>  <b>ToR: 2.4(h)</b>	We have noted improvements over the review period in the use of appropriately skilled resources on performance audits. Overall we believe that there is an appropriate balance between the use of in house resources and specialist providers.	28. We have no recommendations in this area.
<b>Measuring efficiency and effectiveness</b>  <b>ToR: 2.4 (I)</b>	<p>We note the recent introduction of several KPIs for measuring the efficiency and effectiveness of Performance Audits. These are:</p> <ul style="list-style-type: none"> <li>▪ Cost vs budget</li> <li>▪ Timeliness, and</li> <li>▪ “Quality” - Agency satisfaction</li> </ul> <p>We believe that each of these measures is appropriate. However, a measure of quality does not completely exist, although agency satisfaction goes some way towards this. We recognise the difficulty in establishing such a measure.</p>	29. We recommend the conclusions from the independent quality reviews conducted on performance audits be included in the KPIs as a possible means of measuring the effectiveness and efficiency of performance audits.

### 1.7.6 Special Reviews

<i>Subject matter and Terms of reference (ToR)</i>	<i>Special Reviews Findings and Conclusions</i>	<i>Recommendations</i>
<p><b>Method</b> <b>ToR: 2.4(c)</b></p>	<p>13%<sup>3</sup> of total audit time is spent on “special reviews” (reported under section 16(1) of the Act). Hence they are a substantial component of VAGO’s annual activity. Special reviews include compliance reviews of sector wide issues, performance reviews, financial / attest reviews and general exploratory / investigative reviews. The recently revised Manual of Performance Auditing (MPA) provides the method for the conduct of all non-financial audits. In the absence of supporting guidance material, a wide variety of approaches were applied during the review period. We acknowledge that in the last 6 months standard reports have been developed for this area as a basis for ensuring greater consistency in the future.</p>	<p>30. We support the initiative to include special reviews in the Performance Audit Business Improvement Project and the new 3 tiered reporting framework recently introduced. We consider it essential that guidance material be developed to support the application of the method outlined in the MPA. A possible way to approach this may involve the defining of broad categories within which reviews may be classified (compliance reviews, performance reviews, financial / attest reviews and general exploratory / investigate reviews) and accordingly developing guidance material to support each category.</p>
<p><b>Supporting technology</b> <b>ToR: 2.4(d)</b></p>	<p>Refer comments on EMPERA in performance audit.</p>	<p>31 Refer recommendation on EMPERA in performance audit.</p>
<p><b>Management and staffing</b> <b>ToR: 2.4(d), (f)</b></p>	<p>During the review period, the Financial Audit Group has performed the majority of “special reviews”. The AG has recently established a small rapid response team to ensure prompt response to urgent issues of audit interest that arise during the course of the year. We note that this team comprises representatives with sector planning, Financial audit and performance audit backgrounds. We support this initiative.</p>	<p>32. It is important that appropriate skills are used in the conduct of special reviews. In a number of cases this may require the involvement of staff from performance audit group. Whilst we note that this happens on occasions, we suggest that greater emphasis be placed on the importance of allocating appropriately skilled staff from all operational groups to special reviews in the future.</p>

<sup>3</sup> Based on 2003/04 production records

**1.7.7 Business Management**

<i>Subject matter and Terms of reference (ToR)</i>	<i>Business Management Findings and Conclusions</i>	<i>Recommendations</i>
<p><b>Practice management System</b></p> <p><b>ToR: 2.3(b)</b></p>	<p>Since completion of the last Performance Audit, VAGO have introduced a new Practice Management System called MARS.</p> <p>We found MARS to be a robust system. Given its recent introduction, it will require on going refinement and improvement. In particular, we note that an established standard suite of MARS management reports needs to be developed from the many reporting options currently available.</p> <p>We reviewed the manner in which Financial Audit staff are assigned to particular audit engagements. We note that staff scheduling is now being conducted on a more centralised basis without reference to an appropriate system that allows Managers to view staff availability across the entire audit group.</p>	<p>33. To assist Directors and Managers in the discharge of their management and supervisory roles, a standard suite of MARS management reports should be defined. Further, on going training in the use of MARS will be required to ensure it is used in an effective and efficient manner.</p> <p>34. We recommend that VAGO consider the acquisition and / or development of a simple centralised scheduling system to support the optimum allocation of financial audit staff to audit assignments across the whole group.</p>
<p><b>Costs and Charges</b></p> <p><b>ToR: 2.3(b), (c)</b></p>	<p>We reviewed the basis on which costs are accumulated and charged.</p> <p>We confirmed that there is no evidence of cross subsidisation of costs between financial audit, performance audit and special reviews.</p> <p>We note that costs incurred in obtaining some additional information from agencies for the audit of the State’s consolidated Annual Financial Report are being included in the fee charged for the agencies financial statement audits. We note these costs are not material and are therefore satisfied that no breach of Section 10(2) exists.</p> <p>Further, we noted that standard VAGO practice is to “write on”</p>	

<b>Subject matter and Terms of reference (ToR)</b>	<b>Business Management Findings and Conclusions</b>	<b>Recommendations</b>
	<p>time when financial audit costs are less than budget, and to “write off” time where costs exceed budget (where there is no justification for seeking an increased fee from an agency). This is a reflection of general commercial practice, but it may not strictly accord with section 10(1) of the Act and may lead to some cross subsidisation of audit fees between agencies.</p>	<p>35. We recommend that VAGO review the practice of “write on and offs” and assure itself that it is operating within the intent of section 10(1) of the Act. If appropriate, the Act may need to be amended to provide VAGO with flexibility in respect of the application of financial audit fees across all agencies.</p>
<p><b>Internal IT systems</b> <b>ToR: 2.3(b)</b></p>	<p>We reviewed a number of aspects pertaining to VAGO’s IT infrastructure and systems including:</p> <ul style="list-style-type: none"> <li>▪ Underlying infrastructure</li> <li>▪ Disaster recovery and business continuity plans, and</li> <li>▪ The IT strategy, including governance and resourcing arrangements.</li> </ul> <p>We noted a number of positive developments over the review period including:</p> <ul style="list-style-type: none"> <li>▪ Complete upgrade and standardisation of hardware, software and network infrastructure, supported by well documented and formalised procedures for IT administration</li> <li>▪ Development of a Disaster Recovery Plan</li> <li>▪ Development of an IT Strategies that align with corporate objectives, and</li> <li>▪ Successful implementation of a number of discrete applications that support the improved operations of the office.</li> </ul> <p>We noted the development of a business continuity plan should be addressed.</p>	<p>36. VAGO should develop a formal business continuity plan to ensure in the event of a disaster, key functions and processes can be resumed without significant delay.</p>
<p><b>HR Policies and processes</b> <b>ToR: 2.7</b></p>	<p>Over the review period, a number of initiatives in respect of HR have been introduced including a revised graduate recruitment strategy, implementation of a revised VPS career framework,</p>	<p>37. A HR Strategic Plan be developed that links to and supports the achievement of the recent 3 year Corporate Plan. We recognise that the corporate plan up to</p>

<i>Subject matter and Terms of reference (ToR)</i>	<i>Business Management Findings and Conclusions</i>	<i>Recommendations</i>
	<p>introduction of an induction program, and significant policy development in a number of areas.</p> <p>Our review indicates that whilst some attention at the micro level is being given to the management of VAGO human resources, there is limited strategic analysis of VAGO’s human resources.</p> <p>While there are a number of annual HR initiatives implemented by VAGO, these are not the result of a comprehensive understanding of what actions or plans are required over a 3 to 5 year period to ensure VAGO’s human resources are best able to meet the legislative and corporate plan objectives.</p> <p>We note there has been an increase in staff turnover, the reasons for which have been identified through exit discussions and include a lack of appropriate professional development planning, scheduling of work, career progression and changes in personal career paths.</p> <p>We believe VAGO’s current approach to managing and developing its human resources is predominantly operationally focussed. Whilst this is necessary there is an imbalance between this focus and a more strategic and forward planning approach, which may lead to improved management of human resources.</p>	<p>2003/04 provided a strategic framework for the development of HR initiatives, but that the 2004/05 corporate plan has less emphasis on prescriptive HR requirements, hence the need for a more formalised approach to this area. We note, an appropriate framework for the development of such a strategy is outlined in the VAGO 2003/04 annual report.</p> <p>38. Current recruitment practices generally reflect contemporary practice and should be continued, with an on going emphasis on:</p> <ul style="list-style-type: none"> <li>a. Ensuring diverse means of advertising vacancies</li> <li>b. Sourcing staff from diverse backgrounds and experience, and</li> <li>c. When recruiting for manager or above positions, experience in agencies or industries in addition to high-level technical skills be emphasised</li> </ul> <p>39. Whilst reporting on staff turnover is undertaken, more analysis is required for VAGO to better understand the reasons for the rate of staff turnover. No documentation was sighted that brought a strategic analysis to better inform decision making on this important issue. Such an analysis may better identify the reasons and causes and is a necessary precursor for the development of rectification strategies that may be employed in the short and long term.</p> <p>40. It is recommended that consistent with the VPS career framework VAGO develop and adopt formal succession planning strategies to address the impact of a potential departure of senior staff across the office.</p>

<i>Subject matter and Terms of reference (ToR)</i>	<i>Business Management Findings and Conclusions</i>	<i>Recommendations</i>
<p><b>Culture</b></p> <p><b>ToR: 2.3(e)</b></p>	<p>We note that VAGO is aware of the importance of developing a positive culture. The existence of an annual staff survey demonstrates a desire to better understand and improve staffing and cultural issues. Whilst the survey response rate averages 69%, the results provide a useful indicator of the positive aspects of VAGO's culture and areas for improvement.</p> <p>The elements of a culture that are conducive to effective and efficient operations of VAGO would include a common understanding of:</p> <ul style="list-style-type: none"> <li>▪ The office's mission and vision</li> <li>▪ The office's values, and</li> <li>▪ The office's plans to achieve its vision.</li> </ul> <p>The recent survey undertaken by VAGO indicates a significant number of employees (&gt;60% of responses) identifying a number of positive trends over a 3-year period in areas such as:</p> <ul style="list-style-type: none"> <li>▪ Meeting the Parliament's and public expectations</li> <li>▪ Meeting agency and other stakeholder expectations</li> <li>▪ Commitment to quality service, and</li> <li>▪ Improving technology available to staff</li> </ul> <p>The survey also indicates some employees (~25-30% of responses):</p> <ul style="list-style-type: none"> <li>▪ Were uncertain that all staff were aligned to the AG's vision and values, and</li> <li>▪ Did not consider that the Senior Management Group set clear plans and directions and kept staff informed about future plans.</li> </ul> <p>These results and our various discussions with VAGO staff indicate</p>	<p>41. To ensure staff understand the AG's vision and its impact on office plans, increased attention is required in a number of areas, including:</p> <ol style="list-style-type: none"> <li>a. Acknowledgement of the results of the staff survey and demonstrable action plans identified to address issues noted</li> <li>b. Improved focus on coaching / mentoring and counselling and appraising all staff. This includes honest and open assessment of performance and development of identifiable action plans (including structured training plans) to address any deficiencies noted, and</li> <li>c. Reinforcement through internal training and staff meetings of the office's vision values and plans to achieve.</li> </ol>

<i>Subject matter and Terms of reference (ToR)</i>	<i>Business Management Findings and Conclusions</i>	<i>Recommendations</i>
	<p>that further work is required to develop a cohesive culture to ensure VAGO staff understand the office’s vision, how it is to be achieved and their role in achieving that vision.</p>	
<p><b>Benchmarking and Best Practice</b></p> <p><b>ToR: 2.3 (g), (h).</b></p>	<p>In conducting this review we visited and held discussions with senior officers of both the Australian National Audit Office and Queensland Audit Office.</p> <p>We generally noted that VAGO compares well to these offices in a range of areas including the existence of a separate strategic audit planning group, the relationship with the PAEC, the widening skill set across the office, and commitment to independent quality reviews.</p> <p>However, there have been some initiatives introduced elsewhere the AG should consider, principally relating to use of external independent resources for stakeholder surveys and reporting of additional KPIs.</p> <p>We understand VAGO are reviewing a possible joint initiative with other Audit Offices in respect of an enhanced survey process, conducted by an independent firm</p> <p>We note the practice in some jurisdictions of disclosing in performance audit reports the costs of conducting such audits. In the interests of promoting transparency generally, VAGO should disclose the cost of their performance audits in their reports, but only within reasonable bands of variation.</p> <p>We note that VAGO reports on a number of KPIs through its scorecard, including:</p>	<p>42. Whilst we acknowledge that VAGO undertake surveys of Agencies and Parliamentarians, we would suggest consideration be given to engaging external independents to conduct such surveys. Specifically:</p> <ul style="list-style-type: none"> <li>a. VAGO conducts a full external independent survey of Parliamentary members every 2 years, and</li> <li>b. An external independent survey on a sample basis of Agencies who have received Performance Audits as well as conduct “face to face” interviews.</li> </ul> <p>43. Consistent with the PAEC’s “Report on the 2002/03 Budget Outcomes”, consideration be given to reporting on some additional KPIs or performance measures, these being:</p> <ul style="list-style-type: none"> <li>■ Percentage of internal / administrative resources (measured in dollars) devoted to audit support</li> <li>■ Percentage of audit hours of audit staff charged against annual available hours (staff utilisation) for each operational group</li> <li>■ Percentage of annual budget invested in learning and development</li> <li>■ Cost of completed performance audits</li> </ul>

<i>Subject matter and Terms of reference (ToR)</i>	<i>Business Management Findings and Conclusions</i>	<i>Recommendations</i>
	<ul style="list-style-type: none"> <li>■ Timeliness of reports to parliament</li> <li>■ Level of adherence to approved time and cost budgets, and</li> <li>■ Training goals achieved</li> </ul> <p>We consider that the list of KPIs could be extended.</p>	<p>We believe these measures could be included in the quarterly report currently provided to the PAEC by the AG to further enhance its usefulness.</p> <p>44. So as to be fully transparent, VAGO should disclose in each performance audit report the cost of the audit within reasonable bands of variation, say \$100k. Costs should be determined in a manner comparable with other Audit Offices and the basis disclosed.</p>

### 1.7.8 Audit Act

<i>Subject matter and Terms of reference (ToR)</i>	<i>Audit Act Findings and Conclusions</i>	<i>Recommendations</i>
<p><i>Performance Audits</i></p> <p><i>ToR: Other Matters</i></p>	<p>We note Section 15(3) of the Act requires the AG in consultation with the PAEC, to determine the intervals at which performance audits are conducted and the number to be conducted in any one year. We consider planning for performance audits to be adequately covered in the provisions of the Act covering the development of the annual plan and work program.</p>	<p>45. Section 7A of the Act adequately provides for the development of the Annual Plan. Accordingly, the need for Section 15(3) of the Act should be reviewed.</p>



## 2. Governance – Detailed Findings and Recommendations

### Terms of Reference

- 2.2 Assess the appropriateness of the purpose and objectives set by the Auditor General in his Annual Plan and determine the extent to which they are being achieved.

### 2.1 Observations – Annual Plan

#### *Purpose and objectives*

The Audit Act outlines 4 clear objectives for the AG. These are:

1. *To determine whether financial statements prepared by the Victorian Public Sector present fairly the financial position and financial results of operations of authorities and the State*
2. *To determine whether Authorities are achieving their objectives effectively and doing so economically and efficiently and in compliance with all relevant Acts*
3. *To determine whether Victorian public sector operations and activities are being performed effectively, economically and efficiently and in compliance with all Acts, and*
4. *To determine whether financial benefits given by the State or an authority to non government bodies are being applied economically, efficiently and effectively and for the purposes for which they were given.*

*In pursuing these objectives, it is the Parliament's intention that regard is had as to whether there had been any wastage of public resources or any lack of probity or financial prudence in the management of public resources.<sup>4</sup>*

Every 3 years, VAGO produce a Corporate Plan. This outlines purpose, objectives, outcomes, key strategies to achieve outcomes and how performance will be measured.

<sup>4</sup> Source: Audit Act 1994 (as amended)

The 2001/02-2003/04 and 2004/05-2006/07 Corporate Plans state the purpose of VAGO is:

*“(to contribute to improved – 2001/02) (improving – 2004/05) performance and (enhanced – 2001/02) accountability in the Victorian Public sector”*

The 2001/02-2003/04 Corporate Plan identifies the following 5 objectives of VAGO, and the rationale for each:

Objectives	Rationale
Deliver value adding reports to Parliament and meet the needs and expectations of stakeholders	Recognises Parliament as VAGO’s primary client
Undertake high quality independent audit activities	Commitment to best audit practice
Meet the needs and expectations of our stakeholders	Establishes priority attached to relationships with the PAEC, peak bodies, relevant professional organisations and the community
Be identified as a preferred employer	Reflects desire to be an employer of choice and attract and retain competent staff
Manage our business with maximum efficiency and effectiveness	Recognised as an exemplary State agency in terms of managing VAGO business and reporting our annual performance to Parliament

The Corporate Plan is supported by an Annual Plan. The Annual Plan sets out the key outcomes, outputs, products and services, planned work program for the ensuing year, Office management initiatives, funding requirements and an outline of the areas of major audit interest. Refer section 2.2 for more detailed discussion on the annual planning process.

This plan is tabled in Parliament by June 30 of each year, as required by section 7A of the Act.

To achieve the objectives set out in the Act, VAGO have defined 2 outputs, with specific products within these outputs. These are as follows:<sup>5</sup>

<sup>5</sup> Source: 2003/04 Annual Plan

<b>Output 1</b> <b>Parliamentary reports and services</b> <b>Products</b>	<b>Output 2</b> <b>Audit reports on financial statements</b> <b>Products</b>
Performance audit reports Reports on special reviews and other investigations Reports on the state's finances Results of annual financial statement audits of Public Sector agencies Responding to inquiries from Members of Parliament and the public Assistance to Parliament Contributions to enhancing accountability Certification of Warrants (required under the Constitution Act 1975 and Financial Management Act 1994)	Audit opinions on financial statements of public sector agencies Audit opinion on the State's annual financial report Review of the Budget's estimated financial statements Reports to Ministers Management letters to audited agencies

The Business Plan further outlines broad delivery strategies for each product, the related cost and performance measures (covering cost, quantity, timeliness and quality) for each output.

The Business Plan is supported by Group Business Plans that include detailed strategies, actions, timelines, responsibilities and performance measurement indicators aimed at meeting the planned outcomes. We noted a variety of approaches to the documentation of group business plans, with the model used for the Strategic Audit Planning, Policies and Standards (SAPPS) group the most comprehensive. Progress towards achievement of these plans is reported each quarter through the Senior Management Group (SMG). Progress on key actions are monitored through the SMG.

### *Achievement of Purpose and Objectives*

The 2003/04 VAGO Business Plan outlines 4 key objectives in the operation of the Office. These are:

- To deliver value adding reports and to meet the needs and expectations of stakeholders

- To undertake high quality independent audit activities
- To be identified as a preferred employer, and
- Manage our business with maximum efficiency and effectiveness.

Further, the 2003/04 Business Plan outlines a “scorecard” which is a series of internal and external performance measures and targets (these include the output performance measures that are set out in the Annual Plan). The “scorecard” sets out a series of measures and targets for each objective outlined in the Business Plan. These are used to assess the degree to which VAGO meets its objectives. Reporting against external measures is undertaken quarterly to the PAEC and to the Department of Treasury and Finance (as part of the appropriation output acquittal). Individual business plans for each operating division, which have more detailed KPIs, are reported internally to the SMG.

## **2.2 Findings – Annual Plan**

### *Corporate and Annual Plans*

In respect of the corporate, annual and business plans we noted:

- The Corporate, annual and business plans are of a high quality and provide a basis for meeting legislative requirements
- The purposes and objectives set out are generally in accordance with stakeholder expectations, and
- The Branch business plans that support the overall Business Plan are not consistent in format and in some cases do not contain important information relating to the operation of that branch (it is noted such information is available in other documentation).

### *Achievement of Objectives*

In reviewing achievement of objectives, it is first necessary to consider whether the measures outlined provide an appropriate basis on which to measure achievement of the relevant objective. Set out below is each objective with commentary on suitability of measures defined:

No.	Objective	Comments on measures
1	To deliver value adding reports and to meet the needs and expectations of stakeholders	<ul style="list-style-type: none"> <li>▪ Feedback from PAEC and Parliament is received and assessed in respect of satisfaction with relevance of topics and the quality of VAGO reports</li> <li>▪ Surveys are undertaken of agencies in order to measure satisfaction with VAGO work (this survey covers a range of key attributes).</li> </ul>
2	To undertake high quality independent audit activities	<ul style="list-style-type: none"> <li>▪ There are a number of measures reported:               <ul style="list-style-type: none"> <li>○ Timeliness of opinions produced</li> <li>○ Numbers of reports tabled, audit opinions issued, and</li> <li>○ Reports to Ministers and management issued within established timeframes.</li> </ul> </li> </ul> <p>We believe these measures are appropriate.</p>
3	To be identified as a preferred employer	<ul style="list-style-type: none"> <li>▪ Additional measures to the target of 30 hours per person, could be considered in respect of % of annual budget invested in learning and development</li> </ul>
4	Manage our business with maximum efficiency and effectiveness	<ul style="list-style-type: none"> <li>▪ Measure for productivity levels achieved for each operational group be supplemented with a productivity target</li> <li>▪ Additional measure reported should be % of budget allocated to support resources.</li> </ul>

We reviewed the “Performance Report Against Office Scorecard”, dated 6 July 2004 and presented to the SMG meeting of 15 July 2004. This report assesses forecast performance against performance for the 2003/04 year (as set out in the Business Plan).

In respect of this assessment process:

- It provides a reasonable basis for measurement of achievement of VAGO’s purpose and objectives, and
- VAGO undertakes a regular performance measurement process, with clear actions identified for areas not achieving target.

In respect of actual performance against the targets themselves, we note the following:

- Targets were achieved or exceeded for:
  - Feedback from agencies on efficiency and timeliness of audit activities

- o Reports to Ministers within established timeframes
- o Attendance at high risk client audit committee meetings
- o Results over a range of employee statistics including turnover, vacancies, sick leave and staff development, and
- o Training hours per employee.
- Targets nearly achieved, but requiring attention:
  - o Timeliness of opinions expressed on financial statements of agencies
  - o Management letters for financial audits issued within established timeframes, and
  - o Productivity levels achieved for all operational groups.
- Targets not achieved and requiring significant focus:
  - o Timeliness of reports to Parliament
  - o Level of adherence to time and cost budgets, and
  - o Length of time between audit specification and draft report to agency.

We note VAGO has acknowledged that additional work is required to improve the project management of performance audits and special reviews, particularly in respect of budgets and timelines. We further note the remedial action proposed to address these areas and we support these initiatives.

In respect of the results of the performance assessment process itself, this is covered in section 2.4. Suggestions for additional KPIs are included in 2.12.

### 2.3 Recommendations – Annual Plan

- ✓ Business plans at business unit level should use a consistent template that includes strategies, activities, timelines and milestones, budget and resource requirements, revenue projections (where applicable), and KPIs. We believe the business plan for the Strategic Audit Planning, Policies and Standards Group (SAPPS) is an appropriate template to use. **[Recommendation #2]**

#### Terms of Reference

2.3(h) Are VAGO’s performance measures and benchmarks adequate and comparable with other jurisdictions?

### 2.4 Observations – Performance Measurement Framework

The budget papers set the high-level performance measures for VAGO.

The 2 key outputs for VAGO are:

- Parliamentary reports & services, and
- Audit reports on finished statements.

There are 4 key measures attributed to each of the 2 outputs, these being:

- Quantity (number)
- Quality (percent)
- Timelines (percent), and
- Cost (\$ million).

VAGO reports against these measures on a quarterly basis to the DTF and to the PAEC. These performance results are also included in the Annual Report.

These high level indicators are supported by more detailed individual measures as set out in the following documents:

- Victorian Government (DTF) budget estimates – outputs
- VAGO Corporate Plan
- VAGO Annual Plan
- VAGO Business Plan (includes “scorecard”), and
- VAGO individual operating groups – Business / Operational Plans.

Reporting on these measures is as follows:

- Monthly and quarterly operational reports from operating groups  
↓
- Individual reports by group presented at SMG meetings  
↓
- Quarterly consolidated operating results presented and approved at Quarterly SMG meetings  
↓

Conducted by Mr John Phillips

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- Quarterly DTF report approved by SMG and sent to DTF and a Quarterly Report to the PAEC, and
- ↓
- Report as required in the Annual Report.

Performance reporting is sourced from the VAGO internal reporting systems – i.e. the practice management system known as “MARS”. A standard monthly agenda item is the “Finance and Productivity Report”. At the conclusion of 2003/04, SMG received a paper “Performance Report Against Office Scorecard” (agenda item c2a) with the following key components:

- Summary of Results / Findings
- Implications
- Timing
- Recommendations, and
- Scorecard Indicators.

Suggestions for improvement are identified and analysed by senior management. We noted that useful recommendations for business improvement and efficiency have been endorsed by the SMG at their meetings.

In addition to these internal measures, VAGO uses a benchmarking framework to measure its performance. This is the “Australasian Council of Auditors General” (ACAG). ACAG prepares an annual “Macro Benchmarking” report. All Australian State Auditors General participate together with the Commonwealth AG.

The most recent Benchmark Report was issued in February 2004 for the year covering 2003. The aim of the annual report by ACAG is to provide comparable information to member audit offices on quantitative and qualitative benchmarks of audit operations in the context of the different characteristics of each jurisdiction. To achieve this objective ACAG attempts to isolate expenditure that is or maybe unique to certain audit offices to ensure greater comparability of costs. The cost structure is based on Audit Opinions and Reports to Parliament – the 2 key “Outputs / Deliverables” against which the VAGO reports to DTF.



## 2.5 Findings – Performance Measurement Framework

Having reviewed the performance measures it appears that these are appropriate and provide a reasonable and acceptable basis of true measurement. Thought could be given to providing or reporting on some additional KPIs or performance measures these being:

- Percentage of internal / administrative resources (measured in dollars devoted to audit support)
- Percentage of audit hours of audit staff charged against annual available hours (staff utilisation) for each operational group
- Percentage of the annual budget invested in learning and development, and
- Cost of completed performance audits.

## 2.6 Recommendations – Performance Measurement Framework

- ✓ Recommendations in respect of performance measures are referred to in section 2.12 of this report.

## 2.7 Observations – Review of Internal Performance Measures

As identified above SMG review the performance data monthly and consider recommendations for improvement at the monthly SMG meetings.

VAGO has developed a set of performance indicators and targets which are outlined in its Annual and Business Plans and reported in its Annual Report. These are used to assess the degree to which VAGO meet 4 key areas of performance in respect of each output class. The key areas of measurement are cost, quantity, timeliness and quality.

## 2.8 Findings – Review of Internal Performance Measures

We reviewed in detail VAGO's forecast performance report to 30 June 2004 as presented to the SMG in July 2004. Our review revealed the following:

- For Performance audits there is some inconsistency between the treatment of actual costs incurred and estimated costs (eg, printing costs) to complete, and
- There were some discrepancies in relation to the reported training hours and sick leave.

As this scorecard becomes an integral part of the future management of the office, we believe these discrepancies may impact the usefulness of the scorecard as a management improvement tool. We understand VAGO is aware of these discrepancies and is seeking to understand how they have occurred.

In its annual assessment of its performance against the office “scorecard” for 2003/04, VAGO acknowledge that significant improvement is required in the area of project management of performance audits and special reviews. It is pleasing to note VAGO have recognised these issues and are introducing a number of measures to deal with them.

## 2.9 Recommendations – Review of Internal Performance Measures

- ✓ VAGO need to continue to analyse the processes by which the internal scorecard is prepared and ensure the data and reports used are accurate. **[Recommendation #3]**
- ✓ We support the initiatives introduced by VAGO to better manage assignments from a cost and timeline perspective. The results of these measures should be monitored regularly and reinforced by appropriate training. **[Recommendation #4]**

### Terms of Reference

2.3(g) Does VAGO adopt best practice in Public Sector management and auditing?

## 2.10 Observations – Best Practice

In the course of our examination, we visited and held discussions with senior officers in both the Australian National Audit Office and the Queensland Audit Office and researched trends in overseas audit offices.

## 2.11 Findings – Best Practice

In a range of areas including its concentration on strategic planning, its relationship with Parliament, its consultative relationship with the PAEC, and its commitment to independent quality reviews, VAGO compares well to Audit Offices in other jurisdictions. The development of its performance audit and reporting methodologies, the broadening of its skill base and its concentration on “adding value”, will facilitate achievement of best practice in some areas.

As demonstration of VAGO’s desire to meet best practices in public sector auditing, we note the following:

- As a member of the Australasian Council of Auditors General (ACAG), VAGO is able to identify and distil emerging best practice. There are a number of specific committees which form part of ACAG:
  - o Technical Advisory Committee

- o Performance Audit Group
- o IT Infrastructure Group, and
- o Corporate Support Group.

The Technical Advisory group addresses issues about audit policies and procedures; accounting treatment and accounting standards. This group meets a number of times each year, as well as telephonic hook ups as needed. Typically through this group responses are developed to address either accounting or audit exposure drafts

- The AG is a member of the Accounting Standards Board and other VAGO Senior Officers are members of other relevant committees such as the CPA Centres of Excellence in Auditing and External Reporting
- VAGO has developed a working relationship with Department of Treasury and Finance (DTF) involving regular meetings to discuss accounting and audit issues across the Whole of Government with the aim of reviewing all accounting and external reporting changes, FRD's and Bulletins that the DTF intend to publish or submit for approval from the relevant Minister
- It is not uncommon for AG's from overseas to visit Victoria to discuss best practices. Similarly the Victorian AG has only recently visited Canada and the USA for discussions on trends there, and
- Staff are encouraged to attend conferences and presentations as a means of keeping up to date with public sector issues.

Two areas we noted where, relative to other jurisdictions, improvements could be made were in relation to surveys of Agencies and reporting additional KPIs.

## 2.12 Recommendations – Best Practice

- ✓ Whilst we acknowledge that VAGO undertake surveys of Agencies and Parliamentarians, we would suggest consideration be given to engaging external independents to conduct such surveys. Specifically:
  - o A full external independent survey of Parliamentary members every 2 years, and
  - o An external independent survey on a sample basis of Agencies who have received Performance Audits supplemented by “face to face” interviews.

We understand VAGO are reviewing a possible joint initiative with other Audit Offices in respect of an enhanced survey process, conducted by an independent firm. **[Recommendation #42]**

- ✓ Consistent with the PAEC's “Report on the 2002/03 Budget Outcomes”, consideration be given to reporting on some additional KPIs or performance measures, these being:

- o Percentage of internal / administrative resources (measured in dollars) devoted to audit support
- o Percentage of audit hours of audit staff charged against annual available hours (staff utilisation) for each operational group
- o Percentage of the annual budget invested in learning and development, and
- o Cost of completed performance audits.

We believe these measures could be included in the quarterly report currently provided to the PAEC by VAGO to further enhance its usefulness.  
**[Recommendation #43]**

**Response by Mr Wayne Cameron, Auditor General of Victoria.**

*I note there is a need to improve performance measures, however, the suggested measures of percentage of audit hours of audit staff charged against annual available hours (staff utilisation) for each operational group and cost of performance audits are already in place and reported and monitored internally. They are, however, not reported in external documents.*

Terms of Reference	
2.9	Is the scope, quality and effectiveness of the internal audit function adequate?

**2.13 Observations – Internal Audit Function**

We reviewed various aspects of the VAGO Audit Committee and internal audit function including:

- The Audit Committee terms of reference
- The Internal Audit charter and scope of work
- The Internal Audit annual program, and
- A sample of audit reports.

**2.14 Findings – Internal Audit Function**

We found that in overall terms the function operated satisfactorily. However, attention is required in the following areas:

- The Audit Committee’s current charter requires revision to better reflect its responsibilities. We understand a revised draft is being considered

- We noted the Audit Committee self-assessment process could be more comprehensive
- We noted a draft Internal Audit charter has yet to be adopted
- The current internal audit program is solely focussed on business support areas. We note the VAGO risk management plan identifies a number high risk areas in operational groups
- We noted no formal process exists whereby the Audit Committee monitor and ensure previous internal audit recommendations are being implemented.
- Internal audit reports do not clearly identify the objectives of the audit, scope, conclusions and clear identification of recommendations, agreed management plans, timelines and responsibilities, and
- The composition of the Audit Committee may require revision to ensure it is seen to be fully independent of line management functions.

**2.15 Recommendations – Internal Audit Function**

- ✓ In respect of the VAGO internal audit function:
  - a. The Audit Committee should amend its charter, formally adopt an internal audit charter and improve its annual self assessment process
  - b. The scope of the annual internal audit program should be reviewed to possibly include controls over potential areas of high-risk (not being audit risk) to the operational groups
  - c. Internal audit reports should clearly identify the objectives, scope, conclusion, recommendations, agreed management plans, timelines and responsibilities. Additionally, a process should also be implemented whereby the Audit Committee monitor and ensure recommendations from all assurance activities commissioned by the Committee are being implemented. Further, the results of these reports should be reflected in the offices’ overall risk management plans, and
  - d. It may be prudent for VAGO to review the composition of the Audit Committee and consider whether it is appropriate that the Senior Executive responsible for all areas in the current internal audit program be the sole management representative.

**[Recommendation #5]**

Terms of Reference	
2.8	Is the process for evaluating tenders from private audit firms conducted with due regard to probity?

## 2.16 Observations – Use of Private Audit Firms

The process for contracting of private audit firms is documented in the Contract Manual. The manual has recently been updated and has sufficient information to outline the requirements for engaging private firms. Under VGPB procurement policy, the VAGO is exempt from public tender for purchases greater than \$100k, although VAGO has chosen to adopt VGPB's procurement policies as the basis for contracting to all private audit firms.

There is a 2-stage process for the contracting of audit work:

### 1. Registration of Interest

VAGO advertise a list of audits that will be put out to tender and firms are asked to "Express an Interest" in the audits that they would like to tender for.

### 2. Tenders

At least 3 firms are then invited to tender. They must separately tender for each individual audit.

Special circumstances may arise which justifies exemption from the process. These circumstances may include:

- The acquisition by an authority of a new controlled entity
- The financial accounting function of an authority is operated by another authority
- The existing provider may no longer provide audit services, and
- The appointment of a specialist(s) to assist on performance audits or special reviews from an area of specialisation not previously covered by the Expression of Interest process.

Tenders for contracted audits have been in place since 1999. Currently, VAGO stagger the audit rounds to reduce the financial risk to firms that have a number of audits. Consequently, this has resulted in a realigning of the period of VAGO's contract term so that not all audits come up for tender at the same stage. Some small audits or regional based audits are grouped and tendered out as a package.

A 3 person evaluation panel is used to evaluate each tender. The members of the last panel included a Director from Financial Audit, Director from Strategic Planning and Deputy Auditor General as the Chair. Each member of the panel completes a conflict of interest declaration prior to performing the evaluation.

### 2.17 Findings – Use of Private Audit Firms

We reviewed the policy and processes used by VAGO for the contracting of audits and we also reviewed and tested 12 audit tenders covering all tender rounds and covering a variety of private firms. We found that VAGO complied with VGPB procurement guidelines in all material respects. We noted some issues of efficiency which may improve the process, all of which VAGO are currently examining including:

- Not going to public tender for audits less than \$100k (as per VGPB policy), and
- Bundling more audits together to make it more efficient for private firms to submit a bid.

In addition, to the above points, we believe that VAGO should also consider the establishment of panel of service providers and devise criteria to ensure that financial audits are allocated to firms of sufficient size, standard and location based on the risk assessment and location of the audit.

VAGO have a Contracts Manual, which defines the process for the contracting of audits, which complies with the VGPB procurement guidelines. From the sample of files reviewed, VAGO are complying with the Contracts Manual.

### 2.18 Recommendations – Use of Private Audit Firms

- ✓ We understand VAGO are considering ways in which they may be able to streamline the contracting process. We support these initiatives. We also believe VAGO could consider the establishment of a panel of service providers to further improve the efficiency and effectiveness of the contracting process. **[Recommendation #6]**

Terms of Reference
Other matters required: Appointment of the Performance Auditor

### 2.19 Observations – Performance Auditor

Section 19 of the Act specifically precludes the appointment of a person who is either an agent of the AG (section 7F), a delegate of the AG (section 7G) or the independent auditor (section 17) as the Performance Auditor of the AG and VAGO under section 19. These amendments were introduced in 2003.

### 2.20 Findings – Performance Auditor

As currently drafted, section 19 of the Act still allows the Performance Auditor, following the completion of his or her audit, to undertake audit work for the AG under section 7F and / or section 7G. We consider that if such an appointment was made, there may be a perception of a conflict of interest.

## **2.21 Recommendation – Performance Auditor**

- ✓ To remove any perception of a conflict of interest, appropriate controls should be introduced by the PAEC to specifically preclude the Performance Auditor appointed under section 19 of the Act, to be appointed under sections 7F and / or 7G subsequent to completion of the performance audit. We would expect a reasonable period for such a requirement would be for 2 years following the completion of the Performance Audit. Such a requirement could be enforced at the contractual stage or enshrined in the Act. We note this is a matter for the PAEC and not VAGO. We would be happy to accept that such a requirement retrospectively apply to our appointment. **[Recommendation #8]**



### 3. Strategic Audit Planning – Detailed Findings and Recommendations

Terms of Reference
2.3(a) Is the annual planning process adequate and effective?

**3.1 Observations – The Annual Planning Timetable**

Section 7A of the Act requires the AG to prepare and table in both Houses of Parliament an Annual Plan that sets out the proposed work program for the ensuing financial year. The Act further requires that a draft annual plan be presented to the PAEC for consultation prior to tabling in Parliament. The broad outline of timings in respect of planning activities is as follows:

Timing	Activity
Up to November	Environmental scan of audit universe
December	Prepare draft annual plan for next financial year
By late January	Submit draft annual plan to PAEC for comment
February	Consult with PAEC on draft annual plan
By 31 March	Comments received from PAEC on draft annual plan
April	Incorporate PAEC comments, specifically noting where PAEC comments have not been reflected in plan
After passing of annual appropriation Acts	Finalise Annual Plan
By 30 June	Table final Annual Plan in both Houses of Parliament and present to PAEC

Traditionally the term “proposed work program” as used in section 7A(1)(a) of the Act has been interpreted to mean an outline of all activities in aggregate as well as a list outlining the performance audit topics / scopes the AG proposes to undertake after consultation with the PAEC under section 15. As the difficulties associated with defining individual audits so far in advance have become more and more evident the AG has softened terminology in an effort to ensure that the

Annual Plan is not misinterpreted. This outline of performance audit topics is now headed “Areas of Potential Audit Interest” – and deliberately includes more “areas” than VAGO expects to cover under section 15.

Appendix 2 of the 2004/05 Annual Plan indicates that investigations into 5 of the potential audits listed in the 2003/04 Annual Plan have been deferred. None of these topics were deferred without careful thought. We have sighted internal memoranda which contain reasonable explanations for the deferral of all these examinations.

VAGO has allowed for a similar “drop off rate” again in 2004/05 by describing 19 areas of major audit interest against a target of 12 performance audits for the year. Each area is described in broad terms and is generally not targeted at “specific agencies”.

The 19 areas are:

- Areas carried forward from the 2003/04 Annual Plan:
  - Human Resource Management - Recruitment
  - Managing adverse events in public hospitals
  - Management of selected aspects of public transport franchising arrangements
  - Quality of TAFE education – meeting the needs of selected industries, and
  - State security – co-ordination of response.
- New areas commenced in 2003/04:
  - Establishing sustainable forests, and
  - Regulating operational rail safety.
- New areas of interest for 2004/05:
  - Adequacy of internal reporting in selected agencies
  - Strategic human resource planning
  - Quality of performance management and reporting of tourism programs
  - Management of occupational health and safety in selected areas of the public sector
  - Storm water drainage in metropolitan Melbourne
  - Primary industry research management
  - Effectiveness of strategies to minimise absenteeism in schools
  - Management of intellectual property in selected areas of the public sector
  - Bed management in acute public hospitals

- o Out of home care (including foster care)
- o Victorian workcover authority – claims management system, and
- o Health purchasing practices.

As events have transpired, the AG reported on two performance audits in the September quarter via the August Public Sector Agencies report. These were:

- Development of Policy advice
  - o which was noted in the 2002/03 and 2003/04 plans but not in the 2004/05 plan, and
- Managing offenders on community corrections orders (interim report)
  - o which was one of the five deferred audits referred to above.

### 3.2 Findings – The Annual Planning Timetable

It is clear that the Annual Plan is not proving a reliable guide to the specific performance audits VAGO undertakes in any given year. In our view this is inevitable given the long lead times involved in the timetable imposed on it. From an operating perspective, the current planning cycle introduces inefficiencies into the business planning process.

In these dynamic times, it is critical to develop management strategies which recognise, and promote, an ability to respond to changing circumstances. It is not surprising that detailed plans formed 18 months in advance have not come to fruition, and we would be concerned if VAGO's ability to scope and execute individual audits was in any sense constrained by pressures to adhere to the particular "areas of interest" identified in the Annual Plan.

The State Budget cycle dictates that formal strategic and resource planning is performed in accordance with the existing timetable. Whether or not the plan should be sufficiently detailed to include the scope of individual performance audits is however problematical. Not only are the issues which underlie the identification of particular topics subject to change in the intervening period, but the selection can send out misleading signals. Moreover there is little doubt that from time to time some agencies can take advantage of the lead time to introduce reviews or other mechanisms designed to defer or avoid becoming a "selected agency".

In our view the key to the optimum allocation of performance audit resources is an understanding of emerging risks confronting the Whole of Government. We suggest that consultation with the PAEC along these lines at the commencement of each planning cycle may not only be more beneficial than discussion of individual audit scopes, but also that this timing would sit logically with internal VAGO processes geared to responding to risks in changing times. Under these arrangements the views of the PAEC would be injected into the selection process in its formative stages, rather than in its closing stages as at present.

We would then suggest that a summary of these Whole of Government risks be included in the Annual Plan. We discuss risks including VAGO's preference for the term "themes" further in 3.8 below.

### 3.3 Recommendations – The Annual Planning Timetable

- ✓ The annual planning cycle be amended along the following lines:
  - Phase 1 (up to December) – Identify the Whole of Government risks and confirm selection criteria, in consultation with the PAEC. Preparation of the statutory Annual Plan and operating budget.
  - Phase 2 (January to March) – Develop the final sector audit plans and identification of areas of audit interest in line with the major risks at the Whole of Government level. Refinement of annual budget.
  - Phase 3 (April to May) – Develop the annual work program and submit it for consultation with the PAEC. We note the annual work program as described would not form part of the Annual Plan tabled in Parliament.

#### [Recommendation #9]

- ✓ *We are mindful of the fact that Section 7A(1)(a) of the Act requires a work program to be included in the Annual Plan. If our revised Annual Plan containing a list of risks to be considered and / or themes to be followed is not considered a "work program" as envisaged by the Act, then the wording of the Act should be amended. However we would be sympathetic to the view that a description of a "series of audits scoped to address a set of stated risks" does constitute a "work program" in the context of VAGO as a whole. [see Recommendation #11]*

#### **Response by Mr Wayne Cameron, Auditor General of Victoria.**

*I note the observation that the performance audit program is affected by changes that arise between the time the audit is planned and the time the audit is scheduled. Our recent practice is to reconcile those inter-year movements in the Annual Plan, however, it maybe more appropriate that such a reconciliation appears in the Annual Report.*

### 3.4 Observations – Separation of the Strategic Planning Function

Responsibility for strategic planning is undertaken by Strategic Audit Planning, Policies and Standards (SAPPS) Group which is separate from those responsible for audit operations. This is unique amongst Australian audit offices and reflects contemporary and emerging practice in some overseas jurisdictions.

Within SAPPS, the critical functions of sector leadership, strategic audit planning and tactical support fall to the Assistant AG and 4 "Sector Directors".

In developing the Annual Plan for 2003/04, the AG established advisory panels for the Education, Health and Local Government sectors as a means of ensuring that VAGO was fully up to date with the latest issues and developments in those sectors. These groups continue to meet periodically to stimulate debate though they do not play a pivotal role because it is difficult to find specialists who are cognisant of all the relevant issues yet independent of the agency(s) concerned.

### **3.5 Findings – Separation of the Strategic Planning Function**

We support the development of a strategic planning and liaison group separate from those responsible for conducting audits. We also see merit in the use of consultative groups to help draw out issues confronting departments and agencies.

VAGO's sector directors are able to gather intelligence and develop relationships within their designated sectors free of the pressures of organising audit assignments and from the narrow perspectives that can develop out of particular audit experiences. They are therefore well placed to develop relationships with agency officers without compromising the independence of the office as a whole and to steer the audit groups into the areas of greatest risk.

Under VAGO's organisational structure, whether or not areas of audit interest are identified effectively, and whether or not performance audits are scoped efficiently and effectively, depends very much on the knowledge and skill of the sector directors, and on their ability to communicate effectively, both between VAGO and departments / agencies and within VAGO itself.

To do their jobs effectively, sector directors need to be out in the field building an understanding of the risks inherent in the operations of their designated sectors. Careful recruitment and / or succession planning needs to be applied to sector director positions for just as impressive and / or effective sector directors can positively impact the allocation of resources, and enhance the credibility of VAGO, the converse also applies.

Sector directors are not given any particular training for their unique roles. Different approaches and different emphases between sector directors can lead to different assessments of similar problems or similar assessments of different problems.

We believe that it is fundamental to their role that the sector directors develop relationships with agency executives and attend Audit Committee meetings in accordance with VAGO policies. Some agencies interviewed showed us a comprehensive status report provided by their sector director of all VAGO activities within the sector and spoke positively of monthly meetings with the sector director designed to keep both parties well informed of developments. However others did not fully understand the role of their sector director. This points to the need for continuing efforts to help lift their profile.

### **3.6 Recommendations – Separation of the Strategic Planning Function**

- ✓ Additional training and guidance for Sector Director's on engaging with portfolio executives is required to assist them in preparing sector audit plans. This guidance should note the importance of maintaining a visible presence at Audit Committees. [**Recommendation # 10a**]

### 3.7 Observations – The Use of Sector Plans

Underpinning the overall Annual Plan are 3-year sector plans prepared by the respective sector directors. All ten sector plans for 2004/05 were prepared in accordance with a standard table of contents as set out below:

#### **SECTOR PLAN**

**2004-2007**

#### **CONTENTS**

##### **1. Sector Profile**

- Sector composition
- Functions of the portfolio

##### **2. Govt Priorities and Responses**

- Key State Government initiatives
- Key commonwealth Government initiatives
- Parliamentary committees coverage

##### **3. Environmental Analysis**

- The remote environment
- Portfolio risk assessment

##### **4. Proposed Coverage**

- Current VAGO activities
- Summary table of proposed coverage
- Summary of proposed coverage for 3 years (one page per topic including for each -background, rationale for selection, objectives and scope)

Generally speaking, the sector plans contain excellent information on the activities of each portfolio, and on the policies and initiatives arising out of them.

Section 4 of each plan identifies “potential areas of audit interest” for presentation to a special strategic audit planning forum comprising the SAPPS group, the General Managers, the Deputy AG and the AG. The Financial and Performance Audit Directors take part in the meeting when their specialist areas are discussed. In the ordinary course of events the draft list will go through several iterations before it is finalised. While the aim of the discussions is to reach consensus on the selection of “areas of audit interest”/ topics to be included in the Annual Plan, the AG reserves the right to make the final selection.

In the Annual Plan the final selection is grouped under seven broad “themes” as follows:

- Governance and public sector management
- Developing and managing the State’s infrastructure
- Sustainability of natural resources and the environment
- Developing the economy, sectors and regions
- Protecting the community
- Fostering a skilled creative and learning community, and
- Servicing the well being of the community.

The full 3-year plans for each sector are reassessed each year, that is audits proposed for the second year of a planning period, do not automatically roll forward to become the “potential areas of audit interest” for the first year of the next planning period. The planning process is comprehensive in that it embraces special reviews as well as performance audits (and financial audits). Accordingly some matters of concern to the PAEC are covered in VAGO’s planned work program, though they are not flagged as “areas of (performance) audit interest” to be discussed with them.

VAGO does not attempt to undertake a Whole of Government risk assessment and none of the sector plans contain risk assessments for individual sectors. The sector plans do not include any formal ranking of issues / areas / topics / problems / concerns by importance / significance. As “immediacy is a key determinant when prioritising projects”, VAGO effectively regards the three year timetable itself as a “ranking”.

To the extent that the “final selection” of topics differs from their original recommendations, the sector directors amend the summaries of proposed coverage included in Section 4 of their sector plans and ensure that each proposed audit is fully justified by reference to the agreed selection criteria. These selection criteria are set out in 3.16.

The sector directors do not, however, amend sections 1–3 of their draft plans to reflect the views expressed at the strategic planning forum. It is not therefore uncommon to find matters / issues that are emphasised in the environmental analyses being paid limited attention in the “Proposed Coverage”, and to a lesser extent, vice versa. Accordingly the final sector plans do not always flow entirely logically from start to finish.

The final section of each plan contains a brief outline of all of the proposed audits for the sector for the 3 year planning period. Each outline concludes with a justification or rationale for the selection. The outline of the topic “Adequacy of internal reporting in selected agencies”, for instance, finishes with the paragraph:

“The selection of this topic reflects the vital importance of internal reporting as part of effective public sector corporate governance processes. Some of our more recent audits suggest that the quality of reports to management may be inadequate in some instances”.

The reason this “topic / area”, or indeed any of the 2004/05 areas, has been chosen ahead of other potential areas is not made clear, although the deferral of some seemingly important potential topics until years two or three of the plan can be inferred from the fact that similar topics were covered in previous years.

### **3.8 Findings – The Use of Sector Plans**

Since its inception the strategic planning arm of the SAPPS group has built up an impressive library bank of information for each sector and its planning process has a depth and precision not evident in the other Australian audit offices we visited. From year to year the sector plans serve as an excellent management tool in co-ordinating resources, fielding enquiries and monitoring follow up activities.

During the course of the review period, the sector plans have become progressively sharper and more focussed. All of the 2004/07 plans include commentaries directly relevant to the identification of appropriate “areas of audit interest” and pay close attention to the agreed selection criteria.

In reviewing the annual planning process we paid particular attention to the environmental analyses contained in section 3 of the sector plans. We were advised that the sub-section headed “Portfolio Risk Assessment” was originally included in the standard table of contents on the assumption that the risk profile prepared by each department and major agency would be available for consideration in the environmental scan and that it was never the intention of SAPPS to undertake risk assessments of their own as part of the strategic planning process.

In response to our enquiries about portfolio risk assessments, VAGO indicated that whilst some departments did not make them available, others had not actually formally prepared them and that the Central Agencies had not prepared a Whole of Government risk assessment (we have not verified this statement with the Central Agencies). As a matter of course we believe that VAGO should write to the Chairs of the Departmental Audit Committees specifically to request copies of portfolio risk assessments – and should regard the absence of a risk management plan as a risk factor in itself when assessing the exposures arising out of any such sectors. We note that VAGO examined the quality of risk management in the public sector in the performance audit, “Managing Risk in the Public sector” and made a number of recommendations aimed at improving the development of these plans. The AG has also issued a Good Practice Guide on the subject.



Under generally accepted auditing principles, the nature and extent of work performed in and around an “audit subject” depends on a proper assessment of the risks facing that subject. It follows that the identification of “areas of audit interest” within the larger area of the Victorian public sector should be heavily influenced by the risks confronting the Victorian public sector. To efficiently allocate resources in the public interest, we believe it is fundamental to begin with an understanding of areas where successful policy/project outcomes are most at risk.

We recognise that the sector directors communicate closely with the AAG responsible for the central agencies sector plan and that through the high level discussions that take place towards the end of the selection process the final plan does achieve a measure of overall balance. Clearly VAGO is acutely aware of the need to contemplate issues from a state-wide perspective. This is reflected by the introduction of the seven “themes” listed in the 2002/03 Annual Plan.

However the formal process has several of the elements of a “bottom up” approach to planning which tends to be less conducive to the development of a properly weighted plan than an unambiguously “top down” approach would be. We believe that the plan should be developed more from a “Whole of Government” risk perspective – and less from a sector issues perspective.

VAGO has indicated to us that it regards “themes” as “inverse risks” and that it would prefer to move forward using this terminology so as to avoid negative or alarmist connotations of “risk”. We have no difficulty with this as long as VAGO’s in house processes do in fact represent “risk” assessments taking into account core concepts such as “consequences” and “likelihood”.

In response to ToR 2.4 (a), we discuss the selection of performance audit and special review topics in more detail again under section 3.17 of our report, but we believe that VAGO’s strategic planning process should begin with a formal analysis of Whole of Government risks (“inverse themes”). Until and unless it does so, it will be difficult for VAGO to demonstrate that it has optimised its selection of “areas of audit interest”.

### 3.9 Recommendations – The Use of Sector Plans

- ✓ A documented Whole of Government scan of major risks / themes should precede the development of the final sector plans, this would provide context to the risks / themes identified at the portfolio level. **[Recommendation # 10b]**
- ✓ Where Whole of Government and / or Departmental risk management plans are prepared they should be more formally assessed in developing an understanding of the key risks / themes affecting the portfolio. If they are not available from the agency executive then they should be sought from the Audit Committee to assist VAGO in developing an understanding of portfolio risks. **[Recommendation #10c]**

### 3.10 Observations – Planning for Special Reviews

To discharge the objectives set out in section 3A of the Audit Act, the AG has wide-reaching and appropriate powers to review the activities of the State.

Investigations / examinations undertaken under these powers, which are neither financial audits nor performance audits under section 15, have come to be termed “special reviews”. In 2003/04 special review hours were around 50% of performance audit hours or 13% of total audit hours.

In the section of the 2004/05 Annual Plan headed “Performance audit program” there is a table summarising “major audit coverage” for 2002/03, 2003/04 and 2004/05 (proposed). Of the 19 items listed for prior years, 6 were “special reviews”. Special reviews play a significant role in VAGO’s work for the State, and it is impossible to obtain a full appreciation of VAGO’s strategic plan without considering them.

The sector plans for 2004/05 provide for 34 special reviews covering all sectors and including major capital works and IT projects as well as other areas of considerable public interest. The range of potential special review topics is illustrated by the list of 2003/04 special reviews in 7.1.

There is every chance that matters of concern to the PAEC not identified in the Annual Plan have in fact been earmarked for attention in VAGO’s overall planning processes as “special reviews”, rather than as performance audits under section 15 of the Act.

The list of special reviews developed during the strategic planning process is under constant review and can change at any time as issues arise through the year. Although some special reviews stand to be deferred or narrowed, the list is far more likely to grow than to contract.

The need to consider a special review forms part of the strategic planning process, which includes input from a variety of sources, including:

- Results of Financial Audits and Performance Audits
- Letters from Parliamentarians
- Letters from community groups
- Enquiries to VAGO from the general public
- Issues highlighted in the media
- Parliamentary debates (from Hansard), and
- The Government Gazette.

Some special reviews are follow-ups of performance audits. As a matter of policy, VAGO follows up all performance audits within two years of the performance audit.

Traditionally, the larger part of special reviews were performed by financial auditors during their off peak periods. As special reviews are tending to move away from straight compliance areas into areas of performance, officers from the performance audit group are involved from time to time.

To facilitate an immediate response to urgent issues and ensure that important special reviews are not deferred in the face of the financial and performance audit commitments of individual directors and managers, a quick response team has just been established. This team comprises staff with sector planning, financial audit and performance audit backgrounds. It is not intended that this team absorb all the work but rather that they cover staff scheduling conflicts and deal with urgent requests. We see this as a positive development.

### 3.11 Findings – Planning for Special Reviews

To this point we have deliberately avoided defining special reviews except to say that they are investigations / enquiries / confirmations, which are not financial audits or section 15 performance audits.

We have done so because we believe that in the context of the AG's overall mandate there is little real difference between at least some special reviews and a performance audit, except of course for the operation of section 15. We fully acknowledge that by virtue of sheer size they have been very different in the past, but we see no substantive reason for this to continue.

We recognise that section 15 of the Act refers to efficiency, effectiveness and economy. A special review which deals with only efficiency and effectiveness, cannot on a literal reading of section 15 be a performance audit. In our view, the “three E’s” are such closely related terms that the use of “and” instead of “and/or” is effectively meaningless for all practical purposes.

In a policy statement issued in October 2003, the AG outlined a separate “policy for the conduct and reporting of special reviews and investigations” quoting section 16(1) of the Act as its authority:

“Generally special reviews / investigations may consider:

- Whether there has been any wastage of public resources or any lack of probity or financial prudence in the management or application of public resources
- Financial and administrative management
- Compliance with legislative, policy, procedural and control requirements, and
- Better practice administrative processes.

Conclusions about economy, efficiency and effective may be made during special reviews or investigations, however, it is important that these are considered carefully in the light of the scope of the activity being examined.

Special reviews may cover an aspect of a single authority or have an across agency perspective”.

In our view, special reviews often pick up elements of efficiency, effectiveness and / or economy. We accept that in the past the performance audits undertaken by VAGO have been larger than this description suggests. But just as this policy statement does not preclude large special reviews, there is nothing to preclude a small performance audit either.

We have already suggested that the PAEC be consulted in the formative stages of a revised planning process based on a systematic assessment of the key risks confronting government policy. As many of these risks will be monitored through special reviews, we recommend that proposed special reviews be incorporated into a revised consultative program alongside proposed performance audits.

In doing so we are not in any way suggesting that the PAEC needs to be consulted before a special review can commence, as timeliness is often of the essence. In fact as a corollary to bringing special reviews into the main consultative process, we believe that the provisions of section 15 in and around the commencement of performance audits ought to be relaxed.

Given the profile of many of the areas subject to review it is becoming increasingly important to ensure that specialist skills are brought to bear on these assignments wherever possible. This is likely to lead to heavier involvement from performance audit than has been the case in the past.

### 3.12 Recommendations – Planning for Special Reviews

- ✓ It is important that appropriate skills are used in the conduct of special reviews. In a number of cases this may require the involvement of staff from performance audit group. Whilst we note that this happens on occasions, we suggest that greater emphasis be placed on the importance of allocating appropriately skilled staff from all operational groups to special reviews in the future. **[Recommendation #32]**
- ✓ Given the importance of special reviews in the conduct of the AG’s mandate, the detailed work plan submitted to the PAEC for consultation (as Phase 3 of our recommended Annual Planning cycle) should embrace special reviews. [This is implied in Recommendation #9 and Recommendation #11].

#### ***Response by Mr Wayne Cameron, Auditor General of Victoria.***

*Special reviews and investigations, as indicated in our policy, are less about efficiency, economy and effectiveness and more about probity, waste, compliance and governance. I have concerns about the inclusion of inquiries and investigations of a sensitive nature in a consultative process.*

### 3.13 Observations – Planning for Potential IT Exposures

IT systems across the State are becoming increasingly complex, and the successful implementation of government policy is becoming increasingly dependent on the efficiency and effectiveness of the management of its investment in technology and of the risks associated with that technology.

Over recent years VAGO has specifically reported on a number of IT issues including:

- Parliament information technology upgrade
- RMIT student management system
- Mobile Data Network, and
- Electronic procurement in Victorian Government.

From the list of proposed special reviews above it is clear that IT matters are considered in the strategic planning process.

In 2003, the Government created the positions of Chief Information Officer (CIO) and Chief Technical Officers (CTO) to oversee IT strategy and delivery across the public sector.

### 3.14 Findings – Planning for Potential IT Exposures

The recent appointments of a CIO and CTO reflect not only the State's increasing dependence on sophisticated IT applications but also on the continuing emergence of opportunities to generate efficiencies by combining and interfacing systems and databases across and between sectors. IT applications which are efficient and effective in a sector context may not be efficient and effective in a "Whole of Government" context. There are therefore limitations in a sector by sector approach to strategic IT planning.

Some form of "matrix" combining Whole of Government IT risk and sector by sector IT exposure needs to be incorporated into the planning process. We are not satisfied that VAGO has yet acquired a full appreciation of the implications of the latest State-Wide IT plans and initiatives.

The appointment of the CFO and CTO, as well as a number of IT issues, were noted in the Infrastructure and Central Agencies sector plans respectively. Although the CTO is employed by the Department of Infrastructure we do not believe that the issues emerging from that role should be absorbed into the Infrastructure sector plan, nor for that matter do we believe that they should somehow be joined with the CIO - related issues nominally seen to attach to the plan for the Central Agencies.

IT is one source of state - wide risk that should properly be viewed from the “top down”.

### 3.15 Recommendations – Planning for IT Exposures

- ✓ Further attention should be given to IT developments across the Whole of Government with particular consideration given to preparing a specific IT plan utilising specialist IT resources. **[Recommendation # 10e]**

**Response by Mr Wayne Cameron, Auditor General of Victoria.**

*My 2004-05 Annual Plan, required to be prepared in accordance with the protocols, by 31 January 2004 took account of the IT environment at that time. We continue to monitor state-wide IT initiatives and have factored any developments into our work program. I consider that we have a full appreciation of the implications of the latest state-wide IT plans and initiatives.*

Terms of Reference	
2.4(a)	Does the selection criteria for Performance Audits and Special Reviews ensure that key risks and major programs receive adequate audit coverage?
2.4(b)	Is the rationale supporting selection of potential Performance Audits adequate?

### 3.16 Observations – Selection of Audit Topics

The criteria for selection of areas of interest are clearly stated in the SAPPS Group planning guide.

“When assessing areas for examination, we use these:

- **Potential social, environmental and financial risks to the community** (our reference – criteria #1)

This is the perceived risk or impact of a particular activity incorporating:

- Areas of significance for the social and physical well-being of the community
- Areas of environmental interest, such as the likely impact on the natural environment through the degradation of air, land or water or changes to the built environment, and

- Significance of financial impact on the community of the agencies, sector or Whole of Government operations
- **High public interest and / or materiality of public resources (criteria #2)**  
This considers issues of high public interest. They may be sensitive and / or significant. Materiality (ie the financial value) may be high.....
- **Potential for improved resource / financial management (criteria #3)**  
These are opportunities for improved economy efficiency and effectiveness. These aspects are interlinked .....(and include) waste , probity and compliance with legislation.....
- **Potential for enhanced accountability (criteria #4)**  
This considers enhancing accountability through greater transparency and disclosure...

Current government policy directions and past external audit coverage are also considered. However they are not relevant in all cases and are therefore regarded as adjuncts to the above criteria. The key criteria are regarded as equally important when assessing potential coverage. Immediacy is a key factor when prioritising key projects.

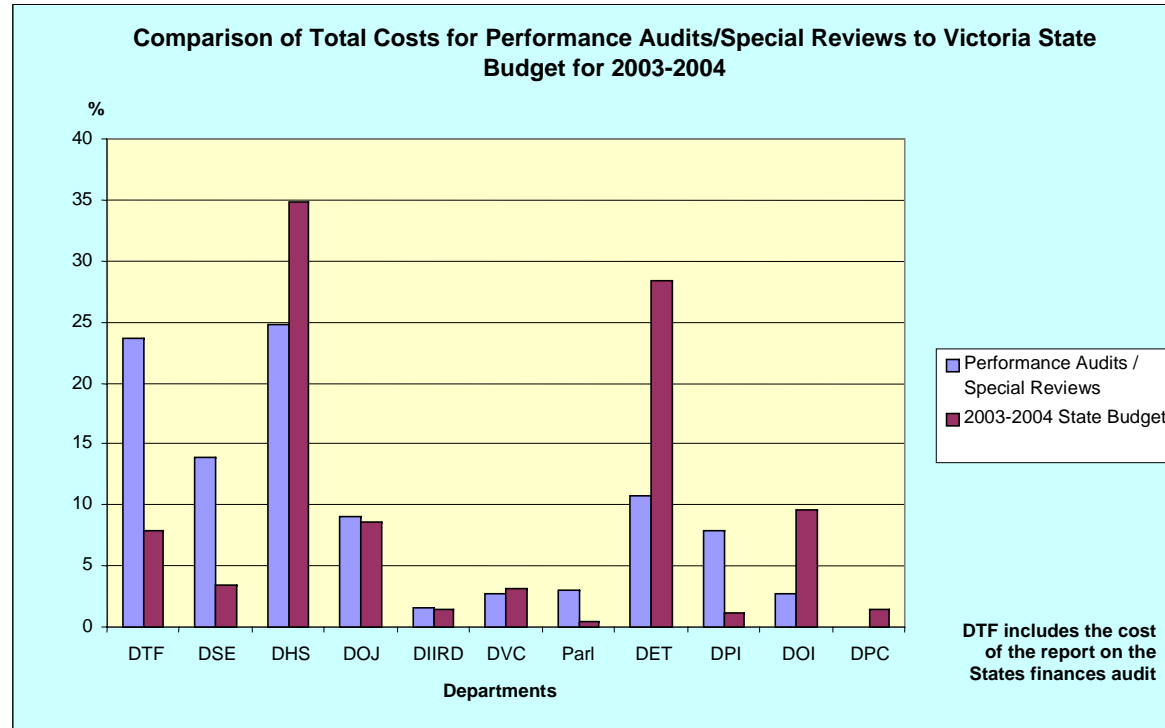
These processes guide us to the areas with greatest potential for us to contribute improved public sector performance and enhanced accountability. It should also be noted that consideration of these criteria should not limit the way in which the Auditor-General's mandate is applied to the stated outcomes.”

All of the areas of audit interest nominated in the last two Annual Plans have been justified by reference to these criteria.

### 3.17 Findings – Selection of Audit Topics

We are conscious that the AG's own judgment is paramount in the final selection of audit topics and it is not for us with the benefit of hindsight, to make our own particular judgments about the areas chosen during the review period. Although consultation between the Assistant AG and the sector directors brings a state-wide perspective into topic selection, we have not, as noted in 3.7 and 3.8, been given any information that clearly explains why some of these areas have been included ahead of others to ensure that the relative audit effort afforded each sector is appropriate in a Whole of Government context.

The graph below shows VAGO's relative performance audit (and special review) expenditures by sector last year and compares it with the relative expenditures shown in the State Budget. We draw no particular conclusion from this, not so much because one year is not a sufficient period from which to base any meaningful judgements, but because relative expenditure is only one element of relative risk.



VAGO’s selection criteria represent a thorough collation of the selection criteria applied in similar jurisdictions. Our concern is not with any of the selection criteria per se, but with the fact the guidelines explicitly state that all criteria are “equally important” with “immediacy” being a key factor when prioritising projects. In considering the allocation of scarce audit resources we are not sure that this should necessarily be the case. In the ordinary course of events we would not deem it appropriate for VAGO to overlook an area of significant risk to the well being of the community in favour of an area about which the community might ideally need more information.

We are also concerned that the process does not formally prioritise areas with differing degrees of risk – differing levels of public interest – differing scopes for improvement – differing needs for transparency. Every sphere of government activity will interest some members of the public to some extent. At what point does that level of interest become sufficient to justify one audit ahead of another audit which might say, help significantly reduce wastage?

We would retain VAGO’s 4 criteria but would tend to see them falling into 2 broad categories as follows:



- Risk to the community etc (#1 and #2 above), and
- Potential for improved resource management / performance / transparency (#3 and #4 above).

The first step in the selection process should be to identify all areas of high risk and to carefully consider them for at least one (short) special (compliance) review during the three year planning period. We believe that whenever it is decided not to allocate any audit resources to a high risk area, the decision ought to be fully explained and regularly reviewed through careful monitoring by the sector directors. We believe that high risk areas, both state-wide and sector specific, should be given primary consideration in the planning process.

Only after all high risk areas are considered should areas which carry medium risk and / or considerable potential for improved performance and / or disclosure be addressed. To facilitate this some attempt should be made to grade possible audit areas by reference to the categories of selection criteria described above. This would lead to more penetrating explanations of the rationale for the selection of topics than is available at present.

As reflected in VAGO's current policy, the timing of some government initiatives will fundamentally influence the allocation of topics into years, half years, quarters and / or months. But it is the intrinsic risk and / or potential for improvement that ultimately distinguishes a high priority audit from a low priority audit. For reasons of logistics, a medium-high risk audit may be scheduled to start a month before a high risk audit, but that is not to say that it is of higher priority, and that it should somehow preoccupy key specialists at the expense of the high risk assignment.

We see the ranking of potential audit areas against the criteria as the next logical step in the evolution of effective and transparent selection procedures. We recognise that this will lead to some re-engineering of the sector plans and appreciate that the assessment process will need some careful thought, but we believe that topic selection is sufficiently fundamental to VAGO's role to demand this higher level of sophistication.

We note that there is some ambiguity in the phraseology of the final sentence of the selection policy. It is "a given" that the AG's judgements on topic selection will prevail. We believe the final sentence is superfluous and should be removed.

We agree with VAGO that timeliness ("immediacy") is a key consideration in strategic planning and scheduling. It is for this reason that we have recommended changes in the planning cycle and in the nature of the interaction with the PAEC.

### 3.18 Recommendations – Selection of Audit Topics

- ✓ Sector audit plans should explain the prioritisation of "areas of audit interest" by reference to the selection criteria. High risk areas should be given primary consideration. **(Recommendation # 10d)**

## 4. Stakeholder Relationships – Detailed Findings and Recommendations

### Terms of Reference

2.3(f) Is the relationship between VAGO and its clients (particularly the PAEC and the Parliament) effective?

#### 4.1 Observations – PAEC and Parliament Relationship

The Victorian Constitution Act 1975 provides that the AG is an independent officer of the Parliament. The Audit Act further prescribes the precise nature of the relationship between the AG, the PAEC and the Parliament. This encompasses the requirement to prepare and table in both Houses an annual plan through to the requirement that the AG account annually to the Parliament on his / her activities via an Annual Report.

In respect of the PAEC, a “Statement of Protocols” has been established that sets out the consultation and communication process between VAGO and the PAEC to both enshrine the independence of the AG and the accountability of the office to the Parliament.

Both the AG and the Chair of the PAEC signed the protocol in June 2003. The protocol is available to all VAGO staff on the VAGO intranet.

The protocol encapsulates the processes by which the statutory functions of the PAEC in respect of the AG are effectively discharged in a practical sense. This covers:

- Consultation on the draft annual plan and budget
- Performance audit specifications
- Briefings on reports of the AG
- Co-ordination of respective annual work programs
- Responses by the AG to reports of the PAEC that may involve the AG
- Provision of resourcing assistance to the PAEC by the AG, and
- AG seeking feedback from the PAEC on performance of the AG.

In a practical sense, the AG will meet with the PAEC on a regular basis throughout the financial year. These meetings cover:

- Discussions with the PAEC on performance audit specifications. Such meetings are held with the PAEC Sub Committee on Performance Audits. The PAEC will receive the draft specification some 8 business days ahead of the meeting. The AG attends the meeting with nominated VAGO staff responsible for the proposed audits. Proceedings of the meeting are recorded in Hansard. Following the meeting, the Hansard transcript is forwarded to VAGO staff in attendance who have the opportunity to correct the record (subject to limitations). Subsequent to this, VAGO will update its specification as discussed with the PAEC. A final specification is then sent to the PAEC for information with a covering note explaining where PAEC comments have been addressed
- The AG consults with the PAEC on the Annual Plans. This involves consultation on strategic priorities and overall objectives as the planning process commences (around October - this is to ensure that there is a degree of co-ordination between the AG and PAEC on common areas of interest), submission of the draft plan to the PAEC by end of January / early February, subsequent discussions between the PAEC and AG on the draft plan and budget during February and receipt by the AG of formal comments from the PAEC prior to the AG finalising the plan and budget for tabling in Parliament, and
- Following the tabling of AG reports in Parliament, the AG will brief the PAEC on the contents of the report(s) to assist the PAEC in understanding the key issues addressed in the AG's reports.

In respect of the Parliament, the relationship is complimentary to the PAEC relationship. This involves:

- The AG must table his / her annual plan and budget in both Houses of Parliament prior to the commencement of each financial year
- Reports issued by the AG must also be tabled in Parliament (this can be out of session), and
- The AG also holds briefings on tabled reports for Parliamentarians to aid in their understanding of the issues raised and to give them the opportunity to ask questions of the principal review team.

The AG also receives several requests annually from Parliamentarians in respect of certain government programs and / or activities that may require audit investigation.

Reporting to Parliament is a critical component of the relationship between the AG and Parliament. The AG's reports are its final product and the end result of the application of its methods and practices as executed by its staff and agents.

## **4.2 Findings – PAEC and Parliament Relationship**

The development, during the review period, of a formal communication protocol between the AG and the PAEC has been a positive initiative as has been the introduction of briefings to members of Parliament on reports tabled in Parliament. In considering the role of the PAEC in the context of the AG, we believe the relationship could be further enhanced with a more balanced allocation of PAEC time spent on discussing:

- Appropriate audit topics encompassing performance audits and / or special reviews
- The resulting annual work program
- The status of the complete annual work program including upcoming special reviews and financial audits, and
- Reports tabled in Parliament.

Consistent with our findings on the annual planning process, we believe the timing and content of the interaction between the AG and the PAEC could be further developed to allow the PAEC more opportunity to contribute to the debate on selection of appropriate audit topics, the development of the resulting annual work program and monitoring the progress of the annual work program throughout the financial year.

The Act currently requires all performance audit specifications to be discussed with the PAEC, however other audits (some of which may be as large and / or as strategically important) are not subject to PAEC review prior to commencement. Further the distinction between the definition of a performance audit and other audits (in particularly special reviews) is open to some degree of interpretation. Further the process requires the AG to produce a specification earlier than might otherwise be effective. Consequently, the consultative process with the PAEC does not produce an optimal outcome for either the AG or the PAEC.

Other interactions with the PAEC on reports tabled in Parliament are appropriate and should continue. However, we believe such interaction should take place in conjunction with reporting on the status and on going development of the annual work program.

#### **4.3 Recommendations – PAEC and Parliament Relationship**

- ✓ The annual consultative process between the AG and the PAEC is amended to enable greater consultation on the development and status of the annual work program and the results of audits tabled in Parliament. This would involve:
  - a. Revising the timelines and content of the annual plan (refer earlier recommendation relating to annual planning cycle). This would enable the PAEC and the AG to discuss the content of the full annual work program much closer to the commencement of the financial year to which the program relates and provide the PAEC (and Parliament) with a greater opportunity to contribute to the risk assessments and selection criteria which will shape the development of the detailed annual work program, and

- b. The current protocol provides for a quarterly report and briefing to the PAEC by the AG. We support this initiative and believe this can be further enhanced by reporting on the status and development of the complete annual work program, planned activity for the next quarter in light of any revision in risk assessments, reporting of additional KPIs as set out later in this report and costs for completed performance audits. This would effectively replace the detailed discussions on the approach to individual audit areas previously selected for attention.

*We are mindful of the fact that Section 7A(1)(a) of the Act requires a work program to be included in the Annual Plan. If our revised Annual Plan containing a list of risks to be considered and / or themes to be followed is not considered a “work program” as envisaged by the Act, then the wording of the Act should be amended. However we would be sympathetic to the view that a description of a “series of audits scoped to address a set of stated risks” does constitute a “work program” in the context of VAGO as a whole. [Recommendation #11]*

#### Terms of Reference

- 2.6 By use of a survey of key stakeholders, has VAGO achieved its objectives, delivered value added recommendations and value for money?

#### 4.4 Observations – Survey

As part of our review, we issued separate surveys to:

1. All members of the Victorian Parliament (both Legislative Assembly and Council) comprising 132 members
2. Board or Audit Committee Chairs of some 46 public sector agencies, and
3. Departmental secretaries / CEO’s / CFO’s of some 260 public sector agencies.

We received completed responses from 14% of group 1, 28% of group 2 and 55% of group 3. The overall response rate across the 3 groups was 40%, which provides a valid basis on which to derive overall conclusions. In addition we conducted interviews with selected representatives of certain agencies.

The surveys asked respondents to rate VAGO across a range of areas comprising service delivery, planning and supervision, technical competency, communication, VAGO staff attitude and performance, value adding, reporting, quality control, use of agents and specialists, performance audits and special reviews.

The overall rating, combining each area and each type of respondent was satisfactory to good. In addition, we held discussions with selected representatives of certain agencies across the VPS.

## 4.5 Findings – Survey

Areas where favourable comments were received included:

- Overall communication and interaction had improved. As an example, the audit strategy memorandum received good feedback, but Agencies would like to receive this document earlier to allow time for consideration
- Contribution to and attendance at audit committees has been positively received
- Generally positive attitude of VAGO staff and relationship with staff of agencies – many noted significant improvement over the past 3-5 years
- Generally there was good feedback on adherence to meeting agency reporting timelines, and
- Consistent with VAGO’s purpose of improving performance and accountability in the VPS
  - A general willingness and attitude amongst staff to improve relationships with agencies and “add value” where possible, and
  - A better understanding of agencies business operations.

Areas where improvements were noted included:

- Need for VAGO to be more proactive and timely in resolving issues, although some respondents have noted a general improvement in this area
- Delays in receiving management letters after finalisation of audits. In addition, reports were noted to be of variable quality and depth in terms of issues identified and the relative rating of issues from minor to major
- The quality of some performance audits and special reviews was viewed as variable
- A number of respondents were unaware of the Good Practice Guides and their existence had not been discussed by VAGO with some agencies
- Some variability on the quality of the financial audit (eg, increased use of more junior staff) and a lack of adherence to reporting timelines was noted, with most of these pertaining to contracted audits, and
- Some agencies interviewed were unaware of the role of the Sector Director, had not met the relevant VAGO officer and were unaware of the Sector Strategic Audit Planning process.

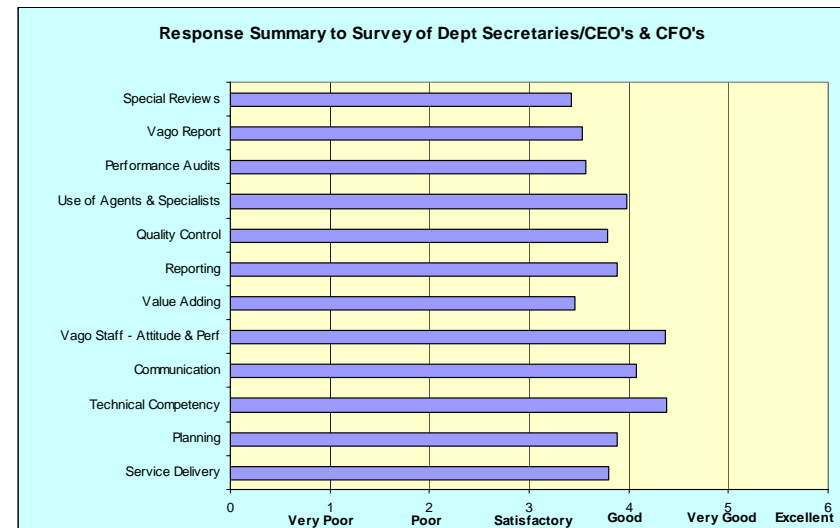
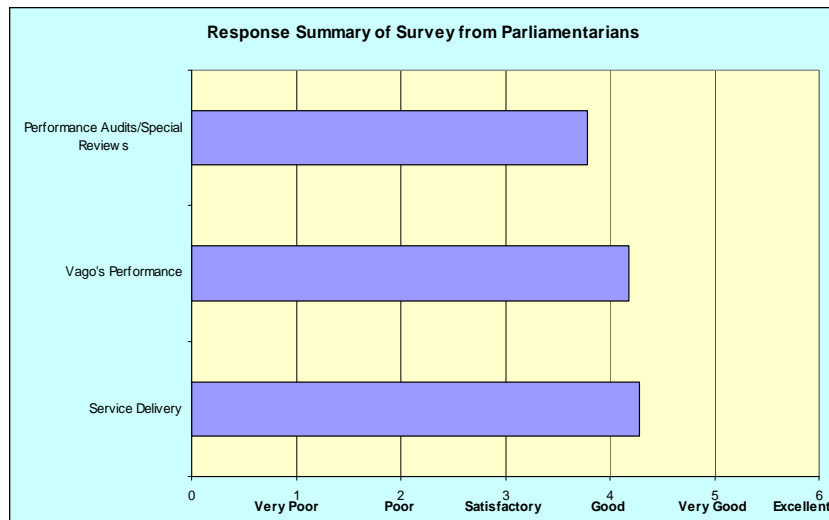
In terms of responses from Parliament, the overall rating was good to very good, with all respondents impressing on the importance of the independence of the role of the AG, the ease in which reports could be read and VAGO’s general responsiveness. Areas for improvement were noted in respect of:

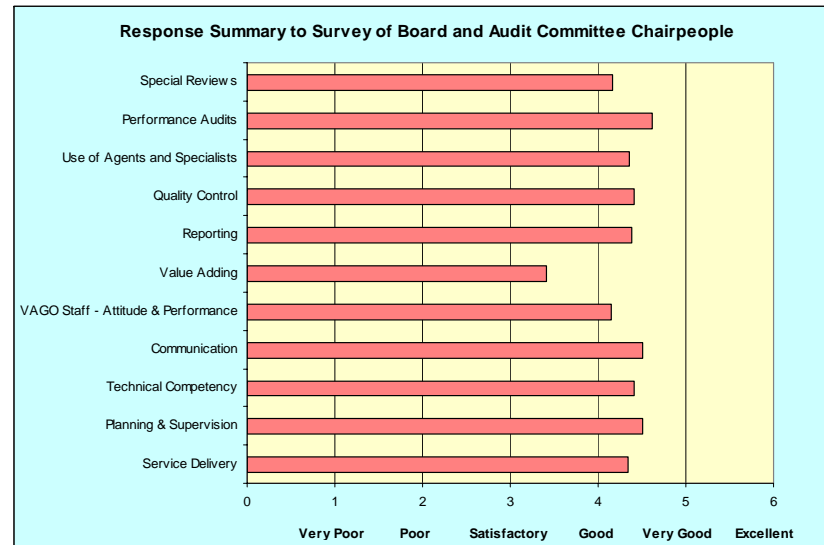
- Some variable quality in reports

Conducted by Mr John Phillips

- Improving the audit topic selection process to ensure significant areas of public interest are identified, and
- The need to be more responsive to emerging areas of public interest.

The results of the survey are graphically illustrated below:





#### 4.6 Recommendations – Survey

✓ There are no updated recommendations for this area.

The results of the survey and our discussions support a number of our recommendations made in other parts of this report including:

- Changes in the way strategic audit plans are prepared and the relationship these have to the annual plan – leading to improved identification of significant sector wide audit topics
- Improving the role of the Sector Director
- Reinforcing the importance of the “plain English” style of reporting, and
- Reviewing the way in which “Good Practice guides” are published and disseminated.

#### Terms of Reference

2.5 Is there value in VAGO publishing Good Practice guides?



#### 4.7 Observations – Good Practice Guides

In the period this review covers, VAGO has published a number of Good Practice guides. These are:

- June 2002 - Framework for Government Advertising and Marketing
- February 2004 - CFO, Role and responsibilities
- June 2004 - Managing Internet Security, and
- June 2004 - Managing Risk across the Public Sector.

#### 4.8 Findings – Good Practice Guides

In general, feedback from Agencies on VAGO's guides (via interviews and survey) was positive, although the practical use of the guides was minimal and a number were not aware of their existence, notwithstanding that the guides were distributed to Secretaries, CEO's and CFO's.

As a matter of principle, we believe that the efficient and effective distribution and sharing of intellectual capital gained from audit activity undertaken by VAGO is appropriate, where such information is applicable to the wider public sector. VAGO proposes to progressively review action taken by agencies in response to the guides using the checklists as audit criteria.

We note the practice is consistent with other Australian Audit Offices. Further, it is consistent with VAGO's corporate purpose of improving performance and accountability in the Victorian public sector.

Now that a number of guides have been released, we believe it appropriate for VAGO to seek agency feedback on their use, applicability, form and content, prior to investing in further similar publications.

We also noted that VAGO published in June 2004 an "Occasional Paper" on "Measuring and Reporting on Sustainability". This paper came out of the first phase of the performance audit of "Managing Logging in State Forests". We are advised by VAGO that this paper was developed for a specific purpose and as such was termed "occasional". In this context and given the favourable feedback, we believe this particular paper was fully justified under VAGO's mandate. We would however be concerned if such papers were to become a regular output without first ensuring there are sufficient interested stakeholders who would receive value from such an investment.

#### 4.9 Recommendations – Good Practice Guides

- ✓ In determining the most appropriate method to publish and distribute sector wide audit recommendations and / or general guidance material, VAGO should incorporate into its next round of surveys an opportunity for agencies to comment on the Good Practice guides issued to date, the relevance of the content and the most appropriate and effective means by which they should receive future relevant sector wide “guidance”. We consider that an additional distribution channel may be Chairs of Agency Audit Committees. **[Recommendation #13]**
  
- ✓ Prior to developing any further “occasional papers” VAGO ensure that sufficient stakeholder interest exists to provide a degree of comfort that investment in such a paper will provide value to the public sector. **[Recommendation #14]**

## 5. Financial Audit – Detailed Findings and Recommendations

### Terms of Reference

2.3(d) Are VAGO’s financial audit methodologies, practices and procedures adequate and appropriate?

#### 5.1 Observations – Financial Audit Methodology

Under the Audit Act 1994 the Victorian Auditor General is responsible for the provision of an independent opinion on the prescribed (under Section 3 of the Act) Victorian Government Authorities financial reports.

Under Section 13 of the Act “the general auditing standards as issued from time to time by CPA Australia and the Institute of Chartered Accountants in Australia must be applied in the performance of functions and exercise of powers in relation to audits under this Act.”

Accordingly the AG has applied all Australian Auditing and Assurance Standards as issued by the Auditing and Assurance Standards Board of the Australian Accounting Research Foundation (AUS) as its methodology. AUS 202 “Objectives and general principles governing an audit of a financial report” states:

*“the objective of an audit of a financial report is to enable the auditor to express an opinion whether the financial report is prepared, in all material respects, in accordance with an identified financial reporting framework.”*

AUS 106 “Explanatory framework for standards on Audit and Audit related services” states that an audit:

*“is designed to provide a high but not absolute level of assurance on an accountability matter. The auditor expresses this as reasonable assurance in recognition of the fact that absolute assurance is rarely attainable due to such factors as the need for judgement, the use of testing, the inherent limitations on internal control and the fact that much of the evidence available to the auditor is persuasive rather than conclusive in nature.”*

With this in mind the aim of the modern financial auditor is to concentrate on areas where the fair presentation of the financial statements are most at risk. VAGO’s audit approach as explained in the Office’s “Audit Victoria Financial Audit Methodology (AVFAM)” is consistent with this.

AVFAM states that “to ensure that financial statement audits are carried out in a cost effective, manner that satisfies professional, contractual and legal standards and ensures a high level of service to client entities”, VAGO’s audits are to be:

- Risk based
- Top down
- Objective driven, and
- Controls orientated.

AVFAM was introduced for the financial reporting periods ending on or after 30 June 1999. AVFAM is kept in electronic form as a readily assessable Lotus Notes Database and provides guidance on general auditing principles and procedures.

In addition to AVFAM, the SAPPS group maintains a “Financial Audit Policy Manual” (FAPM) which contains comprehensive general information on the AG’s role and responsibilities for use when conducting financial audits as well policy guidance and relevant background sector information. This is updated twice each year to cover changes in auditing standards. As long as they comply with the requirements set out in this manual, external audit firms engaged by VAGO use their own methodology and work paper packages.

AVFAM applies in tandem with EFINA, VAGO’s electronic workpaper package for use in planning managing conducting and documenting all in house financial audits. EFINA was developed approximately 8 years ago on a Lotus Notes Database platform. It was designed as an inbuilt quality assurance mechanism by forcing audit teams to follow a standard file structure with a number of embedded forms for consideration and completion as well as review and sign off schedules.

## 5.2 Findings – Financial Audit Methodology

As an in-house purpose built package, EFINA has provided excellent value for money. However it does not have a multi screen facility and it does not contain a layer of “artificial intelligence” or logic. The financial audit process generally draws heavily on checks and cross references between related transactions and balances within the double entry accounting framework. Automated linkages between detailed and summary schedules ensuring that adjustments and / or issues identified in detailed schedules flow through to lead schedules are not available under EFINA.

Over recent years, the audit profession has had to re-examine its attitudes and approaches particularly in relation to the supervision of junior staff. This has led to a review of the depth of supporting material underlying high level policy statements and the use of technology as a productivity and control tool.

During the conduct of our review VAGO has been examining its options for a major overhaul of its financial audit methods. We are pleased to note that it is not merely looking at a replacement for EFINA but at its audit manual as a whole. This reflects the extent to which electronic workpapers are integral to, and inseparable from, the development of methods, procedures, guidelines and training programmes.

We believe this overhaul is timely. We trust that VAGO will ensure that its future audit manual carries more supporting information than AVFAM does at present. Examples of areas which could be expanded include:

- Guidance to help ensure work programs properly reflect initial assessments on risk, materiality and internal audit work undertaken
- Risk libraries covering key areas in the context of the Victorian public sector to assist in developing appropriate work programs
- Control libraries to assist in assessing controls in specific auditable areas
- Common audit program steps for specific auditable areas
- Standard methods of ensuring all applicable audit component assertions are appropriately and adequately addressed by the work program
- Standard methods of ensuring initial work programs are amended in the light of unexpected findings etc
- Guidance on forming and drafting appropriate conclusions
- Guidance in ensuring appropriate sample sizes etc, and
- Examples of immaterial or lower risk areas regularly over-audited (at the expense of a greater focus on material or higher risk items).

We understand that at least some of the “Big 4” Accounting Firms have decided not to licence and support their audit software and that others which might be available are unsuitable because of their heavy orientation to private sector profit disclosure requirements. We have been advised that VAGO is about to commit to a joint exercise with the Queensland Audit Office (QAO) to develop a cost effective methodology including software for use in the future.

In principle we support the decision to bring its financial auditing method up to date though we have not reviewed the basis behind the decision to work with the QAO in doing so. We trust that a formal cost benefit analysis will be performed before any major expenditure decisions are taken, and that a full project management and project governance plan will be prepared to clarify and monitor scope, deliverables, timelines and budget.

### 5.3 Recommendations – Financial Audit Methodology

- ✓ To improve the effectiveness, efficiency and consistency of approach we consider that further investment is required in developing financial audit methods, guidance material and training programs. Such investment should be undertaken in conjunction with the development of new supporting audit technology. **[Recommendation #15]**
- ✓ To ensure VAGO remain up to date in the use of audit technology and are able to effectively discharge their assurance role and retain and attract staff, we support the decision to review the use of EFINA. This should be undertaken in the context of a wider project in relation to development of supporting guidance to the financial audit method (as referred to above). Prior to signing any formal agreement with the QAO in respect of such a

project, VAGO should satisfy itself that all options for a replacement have been considered, including evaluation of existing packages in the private sector and joint development with other Audit Offices. Once all options have been properly considered, a business case should be developed with a clear statement of project scope, deliverables and timelines, together with identification of capital and recurrent funding requirements. **[Recommendation #16]**

#### 5.4 Observations – Financial Audit Training

As noted above, the supervision and training of staff is central to the efficient and effective management of a financial audit function particularly in times of change.

Training and development programs will typically fall somewhere between the two extremes of formal classroom training and informal “on the job” training. In recent times VAGO has made a conscious decision to concentrate on classroom training in selected areas in favour of an increased dependency on on-the-job training.

#### 5.5 Findings – Financial Audit Training

If on-the-job training is to be successful it must build from a strong base of common understanding. On the job training can in fact exacerbate inefficiencies and promote misunderstandings if it is introduced where practices vary.

We understand that VAGO’s commitment to the development of a new methodology carries with it a commitment to the development of comprehensive training material, and emphasise the importance of ensuring the new software is not introduced without a heavy measure of case study based classroom training covering all levels of staff, particularly those mid to senior level staff who supervise junior staff.

#### 5.6 Recommendations – Financial Audit Training

- ✓ There are no new recommendations under this section except to highlight the importance of training to the successful implementation of new audit methods and software. [Refer Recommendation #15]

#### 5.7 Observations – IT Audit

The increasing sophistication of information systems across the public sector represents both a Whole of Government risk and a financial audit risk. It is important that VAGO has sufficient skilled resources, if not to perform the necessary IT environment and application reviews themselves, then to ensure that appropriate IT professionals are engaged to do so.

Some of VAGO's IT audit work is performed by members of the financial audit group with CRM audit experience. Computer Risk Management Group (CRM) has varied between four and six staff members this year. The staff members are involved in 30–40 financial audits per year as well as in some performance audits and special reviews. They presently use several data interrogation packages to extend their audit coverage.

### 5.8 Findings – IT Audit

We understand that VAGO is actively recruiting to increase their CRM resource base. We note the difficulties audit firms generally have in obtaining the skills increasingly required in the difficult market for IT specialists. We would be keen to see VAGO undertake a thorough strategic analysis of its IT audit needs across its full client base as the basis of a long-term resourcing plan.

VAGO should carefully examine the alternative approaches adopted in the private sector, which range from teaching IT to financial auditors, to teaching audit to IT consultants. Although it may decide to rely on subcontracting IT specialists to assist with highly technical applications, it should take care to ensure that it has sufficient in house skills to identify and manage high level IT audit issues.

We also encourage VAGO to remain abreast of the market in respect of any new computer interrogation packages that emerge and to identify new applications for the use of the packages it has at present.

### 5.9 Recommendations – IT Audit

- ✓ We recognise that the recruitment and retention of appropriate IT skills is difficult. However, we believe that CRM is sufficiently important to warrant the implementation of a formal CRM human resources strategy that addresses the areas of IT audit risk identified across client agencies. To maximise the effectiveness of existing resources, we also recommend that consideration be given to expanding the usage and current suite of computer interrogation packages. [**Recommendation # 20**]

#### Terms of Reference

2.3(j) Is VAGO complying with Auditing Standards and Quality Control over contracted audits?

### 5.10 Observations – Contracted Audits

The Financial Audit Policy Manual (FAPM) which sets out VAGO’s requirements when it contracts out financial audits requires contractors to comply with auditing standards. In the past VAGO relied on reviews of client financial statements and contractor audit clearance reports to satisfy itself that it could rely on the work of contracted auditors. It is now concentrating more on having an involvement in the audit process through attendance at Audit Committees, participation in the development of the plan and regular contact during the audit examination itself supplemented by pre-signing reviews of financial statements.

As part of its overall program for obtaining comfort on the work of other auditors, VAGO also arranges for full independent quality reviews to be performed on all new service providers and all service providers with an unsatisfactory prior post audit quality assurance review. It also conducts follow up reviews of service providers who are deemed to be satisfactory but had deficiencies that needed to be addressed.

We reviewed several files from sub-contracted auditors as well as the reports prepared by independent experts engaged to carry out reviews on VAGO’s behalf.

### 5.11 Findings – Contracted Audits

We support the balance of work VAGO is currently undertaking to ensure compliance with auditing standards and have found that its independent quality review program is being strongly managed and systematically co-ordinated.

### 5.12 Recommendations – Contracted Audits

- ✓ There are no new recommendations for this area.

We address certain matters in relation to the overall quality review program, particularly as it relates to VAGO’s own audits, in section 5.17.

Terms of Reference	
2.3(j)	Are all financial audits supported by plans, work papers, evidence, and appropriate quality control processes?

### 5.13 Observations – Financial Audit Evidence and Workpapers



Our review of the efficiency and effectiveness of financial audit planning and documentation over the past three years was based on the quality assurance audit tools used by the Institute of Chartered Accountants in Australia, in particular its checklist for a review of audit engagements. Our sample which embraced a range of agencies both small and large across several portfolios covered the work of a number of audit directors.

VAGO's approach to each audit is set out in an Audit Strategy Memorandum (ASM). This standard form makes provision for all the broad matters we would expect to see covered in a "risk based" audit strategic plan including the overall approach (eg, compliance / substantive / systems based), background on the auditee (or client), assessment and identification of inherent / control / audit risk key deliverables, extent of reliance on internal audit and emerging issues. The ASM leads to a work program setting out the level and type of audit work to be undertaken (ie, audit steps) including sample sizes and on to the detailed workpapers.

As noted above, audits are managed through the EFINA database supported by an executive file (containing core administrative and strategic documentation) and hard copy files where appropriate. Evidence is documented through a mixture of embedded workpapers, word documents, excel spreadsheet and client prepared schedules.

Quality control is generally the responsibility of the Principal Officer authorised to sign the financial statements on the AG's behalf - either a Financial Audit Director or the General Manager of Financial Audit (or on occasion, the AG). A Support Officer (being the Deputy AG, the Assistant AG or another Principal Officer) is assigned to each high and medium high risk audit in an overview role. These roles and other responsibilities including manager responsibilities for the review of detailed schedules are set out in FAPM.

Overlaid over these ongoing processes is VAGO's quality review program conducted by a suitable independent expert or experts.

We conducted a detailed review of financial audit workpapers covering both large and small agencies across a number of portfolios involving several Principal Officers. The audits examined were from the 2002, 2003 and 2004 audit rounds.

#### **5.14 Findings – Financial Audit Evidence and Workpapers**

VAGO's overall review and quality control framework is very sound by reference to generally accepted auditing principles. FAPM is an extremely thorough document and the fact that it has been kept up to date through the changes in auditing standards that have taken place over the last few years is commendable.

We found a wide range of inconsistencies in the workpapers of our initial sample of audits. Taken individually, many of these inconsistencies might be seen as poor housekeeping but when taken together (the instances of incomplete cross-referencing and loosely worded conclusions, as well as the voluminous files of less than relevant copy documents) were too widespread to overlook and raised questions about the precision of the process.

After extending our sample and discussing a number of audits with the managers and / or directors involved, we found no evidence that any inappropriate audit opinions had been issued. However, we do not believe that all financial audits were conducted as efficiently as VAGO's policies would dictate.

We draw attention to three general matters:

- The balance of audit evidence held on EFINA and that maintained in supporting hard copy files clearly varies between audits. Whether or not a conclusion is based solely on the electronic records or is affected by manual records as well is not always clear. This slows review and follow up procedures and increases the possibility of omissions and duplications. As noted in section 5.2 the fact that there are no automatic linkages between workpapers limits efficiency
- Many if not most sets of workpapers contained papers and copy documents which were not directly relevant to the audit steps undertaken. For an audit to be efficient and effective it must go directly to the core evidence. Not only do superfluous schedules slow the review process but they can divert attention to immaterial transactions and balances, and
- VAGO's standard "Preliminary Assessment of the Internal Audit Function" form is routinely completed for every client with an internal auditor. However the impact of the internal audit conclusion on the audit approach is not always clearly documented. On occasions this appeared to contribute to less than efficient combinations of substantive and compliance procedures.

We note that one of the findings of the 2001 Performance Audit review was that:

*".... audit documentation available did not clearly link conclusions on potential risks in financial operations of a client with the subsequent extent of control testing, analytical review and detailed substantive testing that was required to be undertaken as part of the audit process conducted by staff of the Victorian Auditor-General's office."*

Despite VAGO's efforts to improve the ASM and heighten the focus on risk in planning each audit, the correlation between audit work done, the initial planning decisions and the underlying risk assessments is still not clear from the workpapers.

Our detailed review of a large number of sets of financial audit workpapers drew attention to the need for more modern financial audit software as part of a new methodology to enhance VAGO's efficiency and effectiveness.

### **5.15 Recommendations – Financial Audit Evidence and Workpapers**

- ✓ In relation to the use of work conducted by Internal Audit, VAGO should undertake appropriate training to ensure audit files contain documentation setting out how an Agency's Internal Audit function has been assessed, the conclusions drawn by the Audit Team and the resulting impact on VAGO's audit approach and work program. [**Recommendation #17**]
- ✓ Refer section 5.3 for recommendations in respect of improving the Financial Audit method, supporting guidance and technology.

### 5.16 Observations – Independent Quality Reviews of Financial Audits

Independent quality reviews are organised annually by the Strategic Audit Planning, Policies and Standards Group.

### 5.17 Findings – Independent Quality Reviews of Financial Audits

VAGO's quality reviews are conducted by third parties with appropriate skill and experience. We observed clear commitment to the process and careful management of coverage of the program from year to year. The results were collated and reported systematically.

We noted some issues with the independent review of the June 2003 and December 2003 round of audits:

- The independent review for these periods was combined and findings subsequently only reported in June 2004. As most of the mid year audits had commenced or been planned by that time, the resulting recommendations for improvements had limited application for the June 2004 round of audits, and
- While the review identified the main weakness in VAGO workpapers noted above, i.e. lack of clear linkages between risks, work programmes and audit steps as well as several housekeeping errors and omissions, it did not include any attempt to "re-perform" detailed steps and did not therefore draw out the full extent of the work paper inefficiencies we encountered.

### 5.18 Recommendations – Independent Quality Reviews of Financial Audits

- ✓ Independent reviews of June year-end audits should be conducted as soon as possible after completion to allow sufficient time for any recommendations and improvements to be incorporated into the subsequent year's audit planning process. Independent reviews of December year-end audits should be separately conducted so as not to delay the reporting of recommendations for the June round of audit. [**Recommendation #18**]
- ✓ In view of our own findings in respect of the need to improve the consistency of documentation on audit files and ensure workpapers clearly link risk to work programs and audit evidence, particular emphasis on workpaper consistency and clarity should be incorporated into the next round of independent quality reviews. [**Recommendation #19**]

## 6. Performance Audit – Detailed Findings and Recommendations

### Terms of Reference

2.3(d) Are VAGO's performance audit methodologies, practices and procedures adequate and appropriate?

#### 6.1 Observations – Performance Audit Method and Procedures

Under Auditing Standard AUS 806 “Performance Auditing”, performance audits consider any or all of the “three E’s” – economy, efficiency and effectiveness. “Economy” address the acquisition of resources at the lowest cost and at the appropriate time; “efficiency” describes the use of resources acquired such that output is maximised for a given input or that inputs are minimised for a given output; and “effectiveness” deals with the achievement of objectives or other intended outcomes. As outputs are influenced by the extent to which guidelines are being followed, performance audits as defined are expected to include an element of compliance work.

The key to a successful performance audit is to establish clear and unambiguous criteria of efficiency, effectiveness and economy in the area of audit interest. It is now generally accepted, that to a very large extent at least, performance audits involve identifying and measuring objectively performance indicators and comparing those indicators with appropriate benchmarks.

During the review period, VAGO maintained a measure of control over its practices and procedures through the use of EMPERA. This is a Lotus Notes database system, which provides a workpaper and review framework under the headings planning, management, implementation and reporting.

This database was based on “Victorian Performance Audit Methodology” (VPAM), which is a comprehensive and respected manual both when it was first prepared in 1991 and when it was re-issued in March 1996. With the art of three E’s auditing progressively developing since that time, VAGO recognised earlier this year that VPAM needed updating and issued a new “Manual for Performance Auditing” in June of this year. The new manual is subject to ongoing review and enhancement. As it stands it is a high level document drawn largely from AUS 806 and its accompanying standard, AUS 808 “Planning Performance Audits”.

One of the major and most visible initiatives taken by VAGO over the past twelve months has been the introduction of “plain English” reporting.

This initiative which has been supported by extensive training and strong editorial assistance has forced Performance Audit to think clearly through the structure of its reports – and in so doing to its audit process as a whole. In the light of this and the increasing focus on audit criteria and project outcomes, a new report structure was put into place earlier this year.

As EMPERA is not designed around the “audit criteria”, it is not geared to this reporting framework. Accordingly it is not used consistently. With some notable exceptions, it is not being used to help control audits as originally intended.

On the other hand the new reporting structure reflects greater clarity in VAGO’s approach to performance audits, and is leading to progressively more efficient practices and procedures. These are discussed under 6.5.

## 6.2 Findings – Performance Audit Method and Procedures

It is apparent from a review of the performance audit reports issued over the past three years that approaches have varied widely between individual managers and directors. To a large extent this is symptomatic of the evolution of the performance audit discipline as described above.

In mid 2002, the NSW Audit Office completed a peer review of performance auditing at VAGO. Despite concluding that VAGO’s reports were satisfactory in compliance with auditing standards, the NSWAO commented that performance audit reports prepared by VAGO tended to identify “issues” rather than “criteria”.

“While issues promote an understanding of the basis of the audit, the approach tends to promote consideration of several matters, some of which may be beyond the initial objectives and scope of the audit. There is a risk, therefore, that audits will become larger in size than required.

Performance audit methodology translates issues into audit criteria. This criteria make the issues auditable and direct the collection of “sufficient and appropriate” evidence. Issues inform criteria, but it is not possible to measure performance against issues.

In addition, criteria should be integral to the audit planning and included in the published report.

We note that issues are required to be included in the audit specification provided to the PAEC ...”

Over the past twelve months VAGO has made a noticeable attempt to move away from “issues auditing” to a sharper approach which focuses on “audit criteria”. This is now been built into a new “Business Improvement Project” set up within the Performance Audit Group. The new report structure referred to above is central to this initiative for it describes the conduct of an efficient and effective performance audit viz.

Objective – Criteria – Facts / Evidence – Analysis / Interpretation – Conclusion – Recommendation

Though built on the back of a critical re-examination of its report structure, which itself grew out of the “plain English” initiative, the Performance Audit group is now well advanced in formalising a sound new methodology.

The AG’s decision in November 2003 to adopt a “plain English” approach to reporting represented a significant milestone in the development of performance auditing at VAGO. VAGO now has in place a comprehensive Style Guide prepared by the Plain English Foundation and supported by quarterly assessments against detailed benchmarks covering such things as vocabulary, readability, use of verbs, sentence lengths and various “clutter” ratios.

We believe that “plain English” is highly appropriate in an audit context in that:

- It is precise and expresses ideas exactly
- It is clean and helps readers to comprehend content
- It is readable and easy to absorb
- It is efficient and saves time
- It improves accountability by specifying precisely who is doing what, and
- It improves credibility by being consistent and professional.

Under the principles of the “plain English initiative” VAGO has made an effort to report in a clear and concise manner and this has led to a reduction in the length of its reports. We recognise that some readers will be disappointed that some detailed historical background information is no longer included in audit reports. However we do not believe it is the AG’s role to publish factual information not directly relevant to the audit objectives and which ought to be available from departments and agencies. Furthermore, the time and cost of doing so cannot be justified. The overwhelming majority of stakeholders are interested in succinct objective summaries of the key issues, and our survey as a whole confirms that the move to more concise reports has been a positive development.

Despite common commitment to the new report structure, we have detected some continuing ambivalence in relation to the use of EMPERA. We believe that the EMPERA concept fits well with the conduct of a performance audit and should therefore be retained. We accept that some directors and managers may find other means of documenting and managing an audit more straightforward, but for reasons of quality control and consistency some standard tool has to be imposed.

The present configuration of EMPERA is clearly out of date, but it is not a technologically complex program and we understand that VAGO has the in house expertise to make the necessary changes at reasonable cost and within a reasonable time frame. We suggest that the redesign of EMPERA be formally added to the Business Improvement Project as a priority.

We note that responsibility for all audit methods nominally rests with SAPPs. However SAPPs is currently resource constrained and it is thoroughly appropriate that those in Performance Audit who have the necessary skills continue the present drive to establish a fully up to date performance audit methodology.

### 6.3 Recommendations – Performance Audit Method and Procedures

- ✓ To improve consistency in approach and outcomes of performance audits, recent efforts (via the Business Improvement Project) to develop a method and supporting guidance material should be accelerated. This should include guidance on how to complete the work necessary to satisfy the revised reporting requirements for special reviews and performance audits. **[Recommendation #21]**
- ✓ The Business Improvement Project (BIP) currently underway in Performance Audit should include the updating of EMPERA to bring it into line with new methods, reporting frameworks and overall audit management techniques. Further, the use of EMPERA should be enforced as the accepted standard means of documenting performance audits. **[Recommendation # 26]**

#### Terms of Reference

2.4(c) Is the planning and ongoing management of Performance Audits adequate?

### 6.4 Observations – Performance Audit Planning and Management

A dedicated organisational unit within VAGO headed by a General Manager undertakes performance audits. Staff in this unit concentrate on performance audits, but are called upon to assist with special reviews from time to time.

To assess the adequacy of planning and management of individual performance audits, we reviewed in depth the workpapers for 5 randomly selected audits and discussed the work done with the relevant directors. Our sample was biased towards audits conducted later in the review period on the basis that this would lead to more valid recommendations moving forward. We supplemented this work by perusing the specifications and final reports of several other performance audits.

The basis of our review was compliance with the requirements of AUS 806 and 808. Whilst these standards cover general principles they do provide some criteria for assessment of “adequacy”. Accordingly we performed our review under the following headings:

- Adherence to the Audit mandate
- Development of the knowledge base – extent of the environmental scan
- Development of the specification
- Preparation of the audit program

- Management of the program including budgetary control and stakeholder interaction
- Quality and sufficiency of audit evidence
- Development and nature of conclusions
- Clarity of reporting, and
- Post Audit protocols including internal and external debriefing.

The extent, or “quality”, of compliance with these subjective criteria varied widely amongst the audits examined. However we found no breaches of auditing standards.

One clear indicator of management efficiency is adherence to budget. Set out below is a list of budgeted and actual costs for the nine audits tabled since 30 June 2003:

Performance Audits	PAEC est	MARS est	MARS Act *	Variation (MARS est & MARS Actual)	Variation (PAEC est & MARS Actual)
	\$	\$	\$	%	%
Development of policy advice	371,750	453,000	459,657	-1.47	-23.65
Establishing sustainable forests #	406,300	676,113	631,086	6.66	-55.33
Budget Development and management within depts	377,650	381,645	371,152	2.75	1.72
Addressing the needs of Victorian prisoners	295,100	352,318	362,894	-3.00	-22.97
Improving literacy standards	372,660	510,195	533,911	-4.65	-43.27
Beating the bugs	408,340	529,815	397,061	25.06	2.76
Delivery of home & community care	450,000	528,000	512,398	2.95	-13.87
Managing emergency demand in public hospitals	450,000	550,000	568,759	-3.41	-26.39
Public housing maintenance	368,255	364,975	317,519	13.00	13.78
	3,500,055	4,346,061	4,154,436	4.41	-18.70

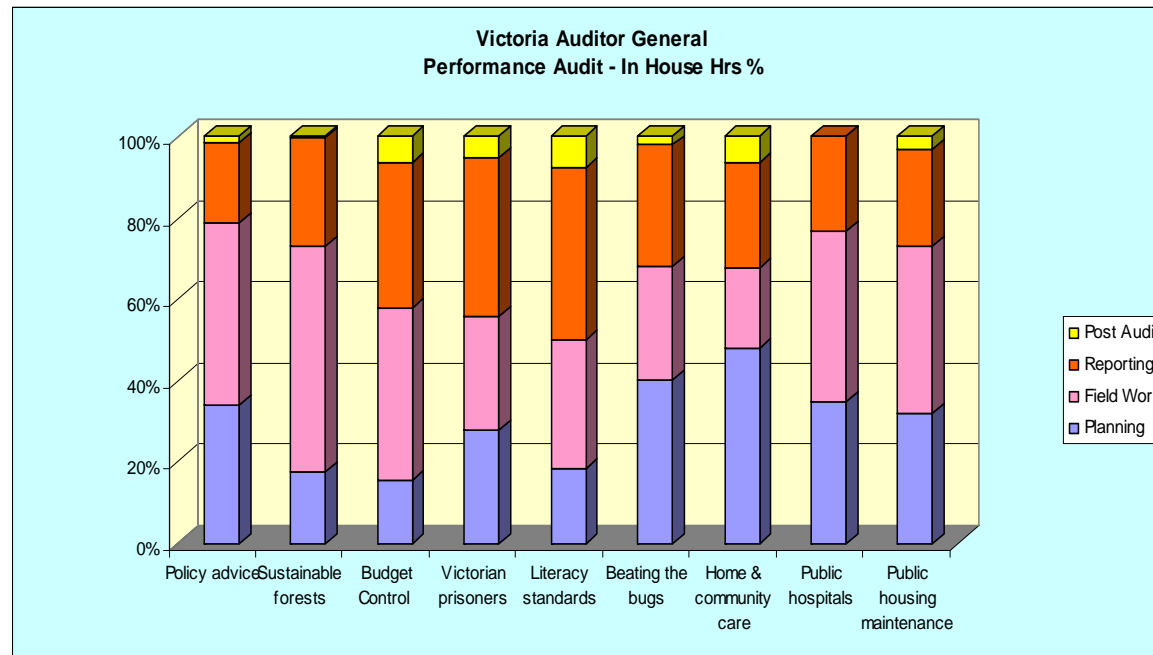
\* As reported to SMG

# Cost includes Cost of Occasional Paper



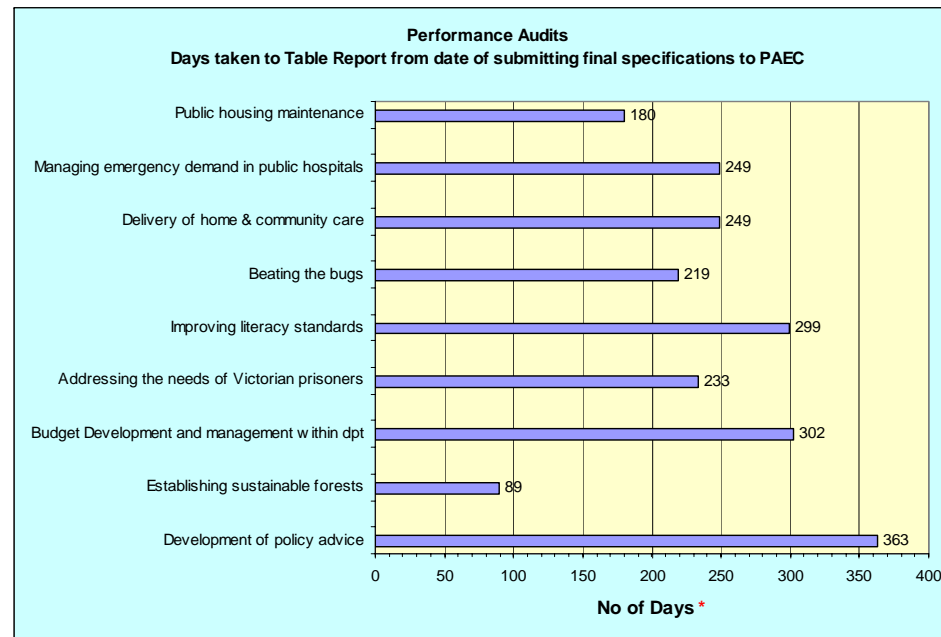
This table demonstrates that whilst VAGO finds it difficult to estimate costs when drafting initial specifications for discussion with PAEC, it manages its budgets responsibly once the audit gets underway.

VAGO’s costing system divides audit expenditure between four types of activity being Planning, Fieldwork, Reporting and Post Audit. Set out below is a table showing the relationship between these elements of total audit costs for the last nine performance audits tabled:



There is no clear industry standard for each of these activities but VAGO’s benchmarks of 20%, 50%, 25% and 5% respectively are quite reasonable. We accept that some of the classifications overlap and the distinctions are arbitrary, but suggest that overall, VAGO’s fieldwork represents a smaller proportion of total costs than it should.

Elapsed time is another measure of management efficiency. In the last twelve months elapsed times from agreement of the final specifications have been as follows:



VAGO’s internal targets vary from audit to audit but have typically been around 7 months or 210 days. These results reflect some wide variations between individual audits.

### 6.5 Findings – Performance Audit Planning and Management

We have found, and VAGO would agree, that some of the performance audits undertaken during the review period have not been conducted as efficiently and as effectively as they would have liked, particularly in the areas of scope and definition of assessment criteria, control of cost and timelines and management of communications with agencies.

In normal circumstances we take the view that inefficiencies are usually reflected in disproportionately high planning and reporting time, although we are reluctant to criticise heavy planning times per se because thorough planning is critical to a successful audit. We believe that directors and group leaders should concentrate on shaping the conduct of an audit and training staff in the field so that major revisions to draft reports are not required. The new standardised reporting framework should make it easier for staff to “write as they go” and so promote greater efficiency.

From our file review we believe that as a general rule audits are being conducted more efficiently and effectively now than they were twelve months ago. We have observed far clearer linkages between objectives and conclusions in the reports tabled in Autumn 2004 than in any other series of audits tabled during the review period.

We would suggest that inefficiencies stem from two sources being the determination of audit criteria from the outset and agency relations. Looking forward we are confident that these issues will be mitigated.

*Planning - Failure to clarify audit criteria*

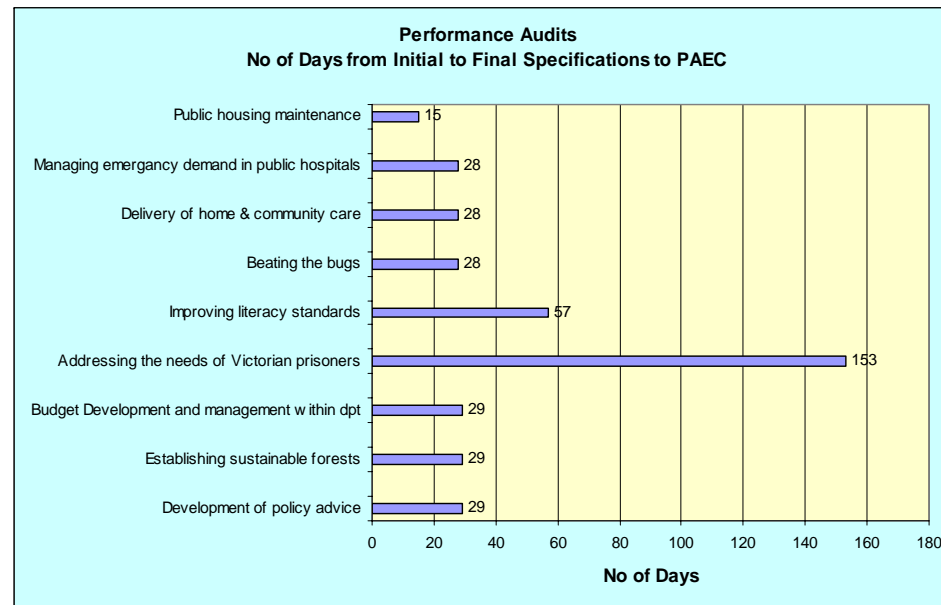
Failure to clearly determine audit criteria from the outset inevitably leads to misunderstandings and ambiguities. There are fine lines between strategic planning to define objectives, initial planning to identify audit criteria, detailed planning to establish sources of evidence and fieldwork to obtain that evidence.

Early in the review period, additional hours were spent agreeing the scope of the audits between the initial “audit area summary” prepared by SAPPS and the detailed plan proposed by the Performance Audit Group. Resulting modifications to the original topic and scope may then have been interpreted as “scope creep.”

It is now policy that whilst responsibility for preparing the final specifications rests with the Performance Audit Group, planners and auditors are to work collaboratively throughout. Although this collaborative approach is leading to greater efficiency, it needs to improve further. In time the development of some simple non prescriptive aide memoir may assist both groups.

In any event, we believe it is important to develop a standard form which traces the original agreed specification to the final report explaining any and all adjustments made during the course of the examination. This would fall neatly into the review of audit management practices included in the Business Improvement Project.

The present requirement to pause – typically, for around a month (see graph below), to formalise specifications for submission to the PAEC, is not always conducive to the smooth and efficient conduct of a timely examination. It is difficult to plan efficiently without engaging the agency and it is difficult to efficiently engage the agency when the topic remains subject to consultation. Events move on, agency executives fill their diaries and thought processes are interrupted. Whether or not an auditor will make any significant changes to a detailed work program without going back into the field is problematical.



As noted previously, we would like to see the PAEC concentrate on high level quarterly discussions of audit coverage going forward rather than on the detailed approach to work in areas that have already been selected. It is in drawing out areas of risk and potential for improvement and / or transparency that the PAEC can really add value – and it is in the formative stages of detailed planning that their observations can be of the greatest benefit to VAGO.

The inefficiencies involved in artificially separating the planning and fieldwork phases of an audit in these rapidly changing times should be considered in reviewing the allocation of PAEC time between discussions on the overall program and discussion on the specification of individual audits.

*Agency relations*

Some measure of agency resistance to audit scrutiny is inevitable, but unclear audit criteria and / or lack of knowledge of operational matters can exacerbate that resistance.

Some of the inefficiencies noted in the review period reflected failure to consider all the relevant facts on a timely basis which in turn reflected some lack of understanding of appropriate reporting channels and some lack of sympathy with cultural issues and competing priorities.

By demonstrating deeper sector knowledge and a sharper methodology, and by moving forward seamlessly from planning to implementation, we would hope that VAGO will obtain greater cooperation, which will lead to more efficiency.

The stated objectives of the Performance Audit Business Improvement Project are to:

- Make the planning and production cycle more efficient
- Apply resources more efficiently
- Improves monitoring and reporting, and adherence to timelines and milestones
- Further develop the “Manual for Auditing Performance”, and
- Integrates these improvements with the Offices overall budget, business plan, processes and KPIs.

This initiative demonstrates VAGO’s concern to secure improvements in the planning and ongoing management of its performance audits. We have seen evidence that these initiatives are being acted on.

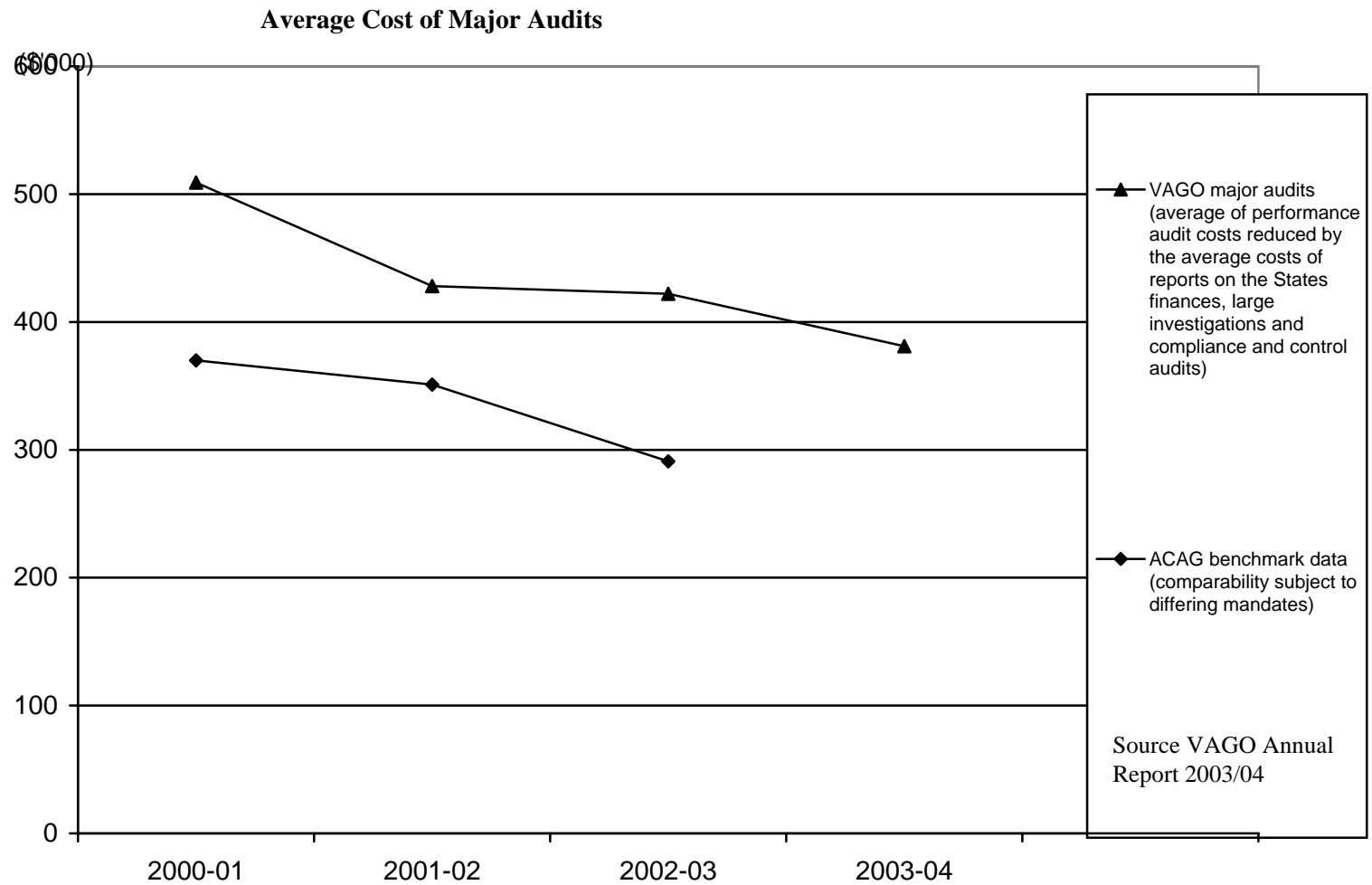
### 6.6 Recommendations – Performance Audit Planning and Management

- ✓ Collaboration between the SAPPS and Performance Audits groups has become progressively more efficient and effective throughout the review period, although we note further room for improvement. We also suggest that a standard “change schedule” be introduced to ensure that all modifications to the original audit scope are recorded and explained. **[Recommendation #23]**
- ✓ To ensure further improvement of the performance audit program, continued attention is required in relation to the development of the performance audit method and supporting guidance material (refer Section 6.3), establishing clear and relevant audit criteria, management of audit costs, progress against plan and achievement of agreed timelines for completion of the audit; and ensuring communication with agencies as part of the audit process is conducted at the appropriate levels, commensurate with the varying audit stages of the audit process. **[Recommendation # 24a to d]**

Terms of Reference	
2.4(f)	Should the existing practice of tabling a considerable number of Performance Audits be varied to include larger Performance Audits that address significant issues of public interest?

### 6.7 Observations – Size of Performance Audits

Over the past three years VAGO has tabled 26 performance reports under section 15 of the Act. At one time each of these audits may have been regarded as “small” – but by today’s standards they are in fact relatively large as demonstrated by the following graph:



Under section 15(3) of the Act, the AG is required to predetermine the interval at which performance audits are to be conducted and the number of audits to be performed in each financial year. VAGO has set itself a target of 12 performance audits for 2004/05.

## 6.8 Findings – Size of Performance Audits

In our view the potential benefits flowing from an audit dissipate over time. There is a very real chance that 6 months after the commencement of an audit some of the underlying facts will be starting to change. Accordingly we believe that a \$500k to \$600k audit taking 7 to 9 months to complete is in fact a large audit, and that the trend should perhaps be to a greater number of smaller audits than are carried out at present.

It is conceivable, particularly in the case of a project, which straddles departments, that construction of a multi-faceted audit taking well over 9 months and costing well over \$500k may be appropriate. But equally the most efficient and effective use of performance audit resources in any given year may be to conduct a series of 5 to 7 month audits each costing no more than \$350k. We do not believe there is an optimum sized audit, nor therefore do we believe there are an optimum number of audits. This is pertinent to our view that special reviews often have elements of the performance audit mandate in their objectives and that they should be included in annual work program discussions with the PAEC.

During the review period, VAGO broke its examination of sustainable forests into two parts in order to bring its initial findings into the public arena on a timely basis. We support this initiative and suggest that this approach be considered if, and when, any large-scale audits are deemed appropriate in the public interest. The sooner the report, the quicker the recommendation and the faster the corrective action.

We recognise that although the AG's mandate implies that the office conduct a "series of investigations as, and when necessary", the number of reports (to be) tabled in a year, serves as the basis for the appropriation of its funds. If this practice is to continue, then we believe the number of reports tabled should not be seen as a relevant performance benchmark.

## 6.9 Recommendations – Size of Performance Audits

- ✓ Our belief is that the critical success factors for the effective completion of a performance audit are a well defined audit criteria, achievable audit timeliness (to both ensure budget is met and retain currency of recommendations) and use of appropriately skilled staff. In our view, the most critical determinant of effectiveness should be timeliness as this provides the basis on which cost can be managed and currency / relevance of the report outcomes can be ensured. In view of this, we believe VAGO should ensure that where performance audits are scheduled to run for greater than, say, 7–9 months from commencement to completion, then consideration be given to conducting the audit in stages to enable recommendations to be progressively released and actioned. We note this practice was undertaken in the recent audit "Managing Logging in State Forests".  
**[Recommendation # 22]**

**Terms of Reference**

2.4(d) Is the investigative process and quality control procedures adequate to support the conclusions arising from Performance Audits?

**6.10 Observations – Performance Audit Quality Control**

All performance audit reports are subject to careful scrutiny by the agency being audited. The performance audit process itself therefore includes a discipline to ensure that sufficient evidence is obtained to support conclusions. In this respect we note that agencies have questioned the facts obtained and the conclusions drawn from some of the audits undertaken during the review period, although this has been the exception rather than the rule. Where this has occurred the report acknowledges the differences.

During the review period VAGO has arranged for two independent quality reviews of performance audits and special reviews as well as two desktop reviews of selected performance audit reports. Apart from the comment that the purpose of some Special Reviews was not made clear, the reviewers drew positive overall conclusions. They did, however, make a number of recommendations summarised as follows:

Date	Quality Reviewer	Scope of Review	Main Recommendations	Notes / References
Aug 02	NSW Audit Office	2 audits & 2 reviews	<ul style="list-style-type: none"> <li>Undertake audits of narrower scope</li> <li>Ensure closer collaboration between SAPPS and PA</li> <li>Concentrate on audit criteria</li> <li>Extend boundary of planning into implementation stage</li> <li>Reduce the length of reports</li> <li>Improve cross referencing, and</li> <li>Introduce an accountability checklist</li> </ul>	(1) (2) (3) (4) (5) (6) (6)
Nov 03	Selected Academics	2 audits & 2 reviews	<ul style="list-style-type: none"> <li>Greater clarity in the rationale for selection audit topics</li> <li>Improve audit planning procedures</li> <li>Consider increased use of issue analysis and argument mapping to ensure clarity, rigour and logic</li> <li>Clarify objectives of the audit specification process and review the amount of work done prior to consultation with the PAEC</li> <li>Consider reducing length of reports</li> <li>Cross reference recommendations to evidence</li> </ul>	(7) (6) (8) (4) (5) (6) (5)



Date	Quality Reviewer	Scope of Review	Main Recommendations	Notes / References
			<ul style="list-style-type: none"> <li>• Agree guidance on structure and format of reports</li> <li>• Review the use of EMPERA, and</li> <li>• Provide greater guidance for conduct of Special Reviews</li> </ul>	<p>(6) (6)</p>

**NOTES**

- 1) This picks up the concern re “issues auditing” – and mirrors our recommendation that as far as possible audits should not continue for more than 7 – 9 months without some sort of formal report.
- 2) As noted in Section 6.5 this recommendation has been acted upon – though there is still room for improvement.
- 3) This has been addressed through the new reporting format.
- 4) This supports our recommendation re changes in the timing and nature of the PAEC consultative process.
- 5) This recommendation has been actioned in association with the plain English initiative.
- 6) These matters – including the revision of EMPERA – have been taken up in the Business Improvement Project.
- 7) This has been actioned – though in our opinion a new approach to strategic planning is required as per section 3 of this report.
- 8) With the injection of new skills into the performance audit group these techniques are now being applied to good effect.

**6.11 Findings – Performance Audit Quality Control**

VAGO has demonstrated a positive attitude to independent quality control procedures and to acting on recommendations arising from these reviews.

**6.12 Recommendations – Performance Audit Quality Control**

- ✓ There are no recommendations for this area.

Terms of Reference	
2.4(e)	Is the process to manage significant issues that are identified in Performance Audits but are outside of the scope of the audit adequate?

**6.13 Observations – Performance Audit Scope Management**

Procedures to manage issues identified during the conduct of performance audits have been progressively tightened during the review period.

As a formal Performance Audit procedure, directors are asked to submit a formal debriefing paper to SMG at the completion of each audit.

During our investigations we sighted numerous file notes memos and minutes of meetings etc, which indicated a high level of awareness of potential downstream issues as well as evidence that the sector directors are very conscious of follow on generally. The SAPPS Group maintain systematic records of the leads / issues which come to their attention during the year.

We observed thorough SPPS disciplines designed to ensure that those matters which are identified, are recorded and considered during strategic planning.

#### 6.14 Findings – Performance Audit Scope Management

From our file review and our discussions with all performance audit directors we believe that VAGO makes reasonable provision for the identification and follow-up of the potential future audits (and / or “special reviews”), which arise during the conduct of performance audits.

We believe that the standard form debriefing document provides excellent discipline to ensure that potential future audit topics are captured and followed through. We are aware that the form is currently being reviewed to give it a more dynamic forward-looking emphasis. We trust that the revised form will be issued shortly.

#### 6.15 Recommendations – Performance Audit Scope Management

- ✓ We understand the Post Audit De-Brief form is currently being reviewed and revised. We recommend the review be completed and the form be reintroduced as soon as practical. **[Recommendation #25]**

Terms of Reference	
2.4(g)	Has VAGO complied with all statutory requirements in the conduct and performance of Performance Audits?

#### 6.16 Observations – Performance Audit Statutory Compliance

Section 15 of the Act is the principal statutory provision relating to VAGO’s performance audits. Subsection (1) states that the Auditor General may conduct any audit he or she considers necessary to determine:

- a) Whether an authority is achieving its objectives effectively and doing so economically and efficiently and in compliance with all relevant Acts, or
- b) Whether the operations or activities of the whole or any part of the Victorian public sector .....are being performed efficiently economically and effectively in compliance with all relevant Acts.

All of the performance audits we have examined during this review have been designed along one or other or both of these lines. We note that section 15 does not call for the AG to express an opinion stating whether or not an activity has been efficient effective and economic, but rather empowers the AG to conduct an audit. Section 16(3) states that draft reports for audits conducted under section 15(1) must be copied to appropriate agency heads for comment.

**6.17 Findings – Performance Audit Statutory Compliance**

We believe that VAGO has conducted its performance audits in accordance with all relevant statutory requirements throughout the review period.

In some jurisdictions, it has been standard practice to conclude performance audit reports with a “one line” overall opinion that “the agency(s) has / has not performed efficiently, effectively and economically”. As the “three E’s” are all subjective and relative terms, they only acquire meaning by reference to specified benchmarks or criteria. Nothing is absolutely efficient or inefficient, except by reference to a valid performance standard. AUS 806 does not call for a singular opinion, nor is there anything in the Act, which suggests otherwise.

We believe that VAGO’s policy of drawing a conclusion in relation to each objective (by reference to stated criteria) is entirely sound.

For reasons discussed elsewhere in this report, we believe that section 15(2) which calls for audit specifications to be discussed with the PAEC in advance should be interpreted very loosely and that section 15(3), which calls for consultation around the number of audits to be conducted in a year be repealed (refer Section 9).

**6.18 Recommendations – Performance Audit Statutory Compliance**

- ✓ There are no recommendations for this area.

Terms of Reference	
2.4(h)	Is the mix between specialist expertise contractors and suitably qualified in house staff in undertaking Performance Audits appropriate?

### 6.19 Observations – Performance Audit Resourcing

In the middle of this year, the performance audit group addressed an emerging skills shortage by introducing five new staff members from a variety of backgrounds. VAGO now has a healthier mix of investigatory, project management and traditional auditing skills in the performance audit group than it has had for some time.

To effectively undertake a performance audit in the Victorian public sector often involves some expert assistance and contractors do have to be introduced from time to time. In some instances it is difficult to find an expert who has not, through that very expertise, done some work in the past for the agency being audited. VAGO is very conscious of this and does take care to avoid conflicts of interest when tendering for specialist assistance.

### 6.20 Findings – Performance Audit Resourcing

We have found no reason to suggest that VAGO is placing inappropriate or insufficient reliance on specialist contractors in completing performance audits.

### 6.21 Recommendations – Performance Audit Resourcing

- ✓ There are no recommendations for this area.

Terms of Reference	
2.4(i)	Is the criteria against which efficiency and effectiveness of Performance Audits and special reviews are measured appropriate?

### 6.22 Observations – Efficiency and Effectiveness of Performance Audits

As reflected in Section 6.4 there are no single generally accepted criteria by which to assess the efficiency and effectiveness of performance audits and special reviews.

Against this background, VAGO’s three KPIs are reasonable:

- Cost vs Budget
- Elapsed time, and

- Quality - “agency satisfaction”.

VAGO’s variable performance against the first two of these criteria has been previously commented on. Its third criteria, “agency satisfaction”, provides a more favourable picture as shown in the table below:

PERFORMANCE AUDIT	Satisfaction Rating
Development of policy advice	N/A <sup>6</sup>
Establishing sustainable forests	N/A <sup>7</sup>
Budget Development and management	82
Addressing the needs of Victorian prisoners	79
Improving literacy standards	86
Beating the bugs	90
Delivery of home & community care	79
Managing emergency demand in public hospitals	87
Public housing maintenance	88

These overall “satisfaction” ratings summarise responses to a series of written questions sent to the agency by the SAPPS group at the completion of each audit and signed by the General manager or CEO of the agency / division concerned. The surveys cover:

- Value of the report to the Agency including general benefits of implementation of recommendations, timeliness
- Quality of Report including Validity of evidence, readability etc
- Relevance of topic re four selection criteria (as per Section 3.16)
- Audit process including understanding of topic, timeliness of discussions etc
- Scope for Improvement, and
- Responses to recommendations – detail incl. intention to implement, timeframe etc.

Average ratings have improved during the review period.

<sup>6</sup> Survey not yet processed

<sup>7</sup> Survey not yet processed pending completion of subsequent phases

### 6.23 Findings – Efficiency and Effectiveness of Performance Audits

On the basis that the recommendations of a well regarded audit are likely to be actioned and hence to “add value”, VAGO uses the “agency satisfaction” KPI as its main indicator of “quality”. While we agree that one of the main distinguishing characteristics of a good auditor is the ability to win acceptance of a constructive yet initially unpopular recommendation, we caution against sole use of the “satisfaction KPI”. On the other hand, the survey from which the rating is determined is relatively comprehensive, and is designed to ensure that robust reports rate relatively highly.

We are not aware of any other criteria VAGO should apply to assess the efficiency and effectiveness of its performance audits though we suggest that it may be able to build some sort of quality rating into its independent review process in the future. We believe it is taking all reasonable steps to attempt to find and apply measures by which to assess the efficiency and effectiveness of its own work.

Moving away from quality measures, we note that in some other jurisdictions, reports include a note quoting the cost of the audit. We accept that in the spirit of full and frank disclosure this practice has much to recommend it. However the full value of an assurance activity extends beyond the immediate benefits accruing from individual examinations, and the cost of an assurance activity is not necessarily evident from the content of final report. We would not want uninformed readers to compare audits by comparing costs and we would not want VAGO to feel a need to include unnecessary information in reports to somehow justify a reported cost.

We note that the “cost” figures quoted in this report are in fact recorded hours multiplied by a standard rate (which includes a significant overhead component) plus third party costs. Accordingly, although they reflect audit costs as generally understood, they overstate the direct cost specifically attributable to particular examinations.

On balance we believe that in the interests of promoting transparency generally, VAGO should disclose the cost of performance audits in their reports, but that the time and cost involved in determining a finite number is not warranted. We suggest that disclosure of costs within \$100k bands would be appropriate eg, “The final cost of this audit is expected to be between \$200k and \$300k. In this context cost includes an appropriate allocation of general office overhead.”

### 6.24 Recommendations – Efficiency and Effectiveness of Performance Audits

- ✓ We recommend the conclusions from the independent quality reviews conducted on performance audits be included in the KPIs as a possible means of measuring the effectiveness and efficiency of performance audits. **[Recommendation #29]**
- ✓ So as to be fully transparent, VAGO should disclose in each performance audit report the cost of the audit within reasonable bands of variation, say \$100k. Costs should be determined in a manner comparable with other Audit Offices and the basis disclosed. **[Recommendation # 44]**

## 7. Special Reviews – Detailed findings and Recommendations

### 7.1 Observations – Special Reviews Method and Procedures

As previously noted, the term special reviews has come to cover any form of investigation that is not a financial audit or a performance audit conducted in accordance with section 15 of the Act.

During 2003/04, a wide variety of such reviews were performed, as set out below:

Topic	General Description / Comment
Parliament IT upgrade	Request from Speaker of the Legislative Assembly to assess management of Parlynet risks
Gippsland Waste Water – Dutson Downs	Compliance review – but also review of soil recycling impacts
Catchment management in Victoria	Review following 2002 financial audit
Teacher workforce planning	Performance Audit follow up
Injury Claims by TAC	Performance Audit follow up
Austin Hospital Redevelopments & Mercy Hospital for Women Relocation	Project management review (inc some efficiency and effectiveness)
Airport transit link	General Review
Restoration of country rail services	Project management review (inc some efficiency and effectiveness)
Synchrotron project	Project management review (inc some efficiency and effectiveness)
Police station capital works	Project management review (inc some efficiency and effectiveness)
Prison bed expansion	Project management review (inc some efficiency and effectiveness)
Mobile data network	Project management review (inc some efficiency and effectiveness)
National Gallery of Victoria Redevelopment	Status report
Melbourne Market Authority Investment in Fresh Chain Ltd	Viability Review
Park charges management	Compliance Review

Topic	General Description / Comment
City office Accommodation Consolidation	General Review
Local government internal financial reporting	General Review
Financial viability of TAFES	Financial Review
City link tolling	Compliance Review
Overseas Projects Corporation Financial Review	Ombudsman reference / financial audit follow up
International students in Victorian Universities	Performance Audit follow up
Nurse workforce planning	Performance Audit follow up
Investment attraction and facilitation in Victoria	Performance Audit follow up
Management of roads	Performance Audit follow up

Many special reviews have been undertaken on the basis that scopes would be adjusted and redefined as the investigations took shape. By their very nature they were not seen as different iterations of a “standard product or service” and hence not as exercises to be tackled using the guidelines contained in VPAM.

In February this year under the “plain English” initiative VAGO developed a set of standard report structures for special reviews:

- I. For projects with one audit question
- II. For projects with a main question and sub-question, and
- III. For results of financial audits.

These report guidelines are adaptations of the performance audit reporting structure noted above and so effectively follow the same logical steps as follows:

- Understand the background and objectives of the audit
- Identify audit criteria
- Obtain facts / evidence against the criteria
- Analyse / interpret the facts
- Draw a conclusion from the analysis of the evidence, and
- Make appropriate recommendations.



It has been made clear that the Business Improvement Project including the Manual for Performance Audit (MPA) applies to special reviews as well as to performance audit. This is in line with our earlier recommendation that the somewhat artificial distinction between at least some special reviews and performance audits be broken down.

## 7.2 Findings – Special Reviews Method and Procedures

A number of the reviews undertaken in recent times have been most easily described as “project status reports”. But enquiries into the status of a project either concentrate on compliance with the project guidelines or on its efficiency, effectiveness and / or economy. We believe that all special reviews are either:

- Compliance audits
- Efficiency, effectiveness and / or economy reviews
- Financial investigations
- Performance audit follow ups, or
- “Special Requests” eg, references from the Ombudsman

In our view VAGO’s recent establishment of a standard reporting structure represents a major step forward, from which should develop clearer and more comprehensive guidance material for the conduct of special reviews in the future.

The majority of special reviews have been set up on the Special Review module in EMPERA, although many of VAGO’s audit schedules have only been maintained in hard copy. To help control special reviews in the future we believe that EMPERA databases designed around the three new special review report formats ought to be rigorously applied.

## 7.3 Recommendations – Special Reviews Methods and Procedures

- ✓ We support the initiative to include special reviews in the Performance Audit Business Improvement Project and the new 3 tiered reporting framework recently introduced. We consider it essential that guidance material be developed to support the application of the method outlined in the MPA. A possible way to approach this may involve the defining of broad categories within which reviews may be classified (compliance reviews, performance reviews, financial / attest reviews and general exploratory / investigate reviews) and accordingly developing guidance material to support each category. **[Recommendation # 30]**
- ✓ The work on special review guidance material should include a formal review of the special review module of EMPERA as the standard means of documentation and file management. **[Recommendation # 31** (as an extension of Recommendation #26)]

## 8. Business Management – Detailed Findings and Recommendations

### Terms of Reference

2.3(b) Are VAGO's internal systems, including IT systems that measure productivity, adequate and effective?

#### 8.1 Observations – IT Infrastructure (including database, server, LAN, WAN)

Over recent years VAGO has completed infrastructure projects aimed at upgrading and standardising hardware, software and the general network infrastructure. As a result network infrastructure and hardware is relatively new with major upgrades completed in 2001/02.

Currency of infrastructure is endorsed by a policy statement (“Replacement Policy for Computer Hardware”) stating hardware is to be replaced every 3 years. Systems performance and security is reviewed periodically as a basis for upgrade decisions. For example, recently the Information Technology Group (ITG) has identified a need for a review of hard disk space (although no timeframe has yet been set) and completed a review of security with some improvements identified and awaiting scheduling.

ITG's business is managed through an IT Strategy plan, IT Steering Committee and an IT Business Plan. The IT Steering Committee serves to assist IT with strategic planning and policy making tasks. The Steering Committee consists of representative business groups served by IT, ensuring each unit has input into the overall IT Plan. The business plan is maintained in MS Project, which includes all short term strategic actions from the IT Strategic Plan as well as tasks identified from performance monitoring and periodic reviews and prioritised through the Steering Committee or IT Management.

Infrastructure is well documented and formal procedures are in place for common administration tasks including backup and review of system logs. Infrastructure documentation includes clear detail including server identity, purpose, applications and roles, and contains information covering:

1. Server hardware specifications
2. Internal Network Schematic
3. DRP Site Schematic, and
4. Switched Local Area Network.

## 8.2 Findings – IT Infrastructure

The VAGO's likelihood of being a recognised standard of excellence in public sector auditing depends, in part, on effective and efficient use of Information Technology (IT) in both computer aided audit methods and back office support. Effective IT supports not only the analysis of client data in support of financial statement and performance auditing, but also the functions of parliamentary reporting and management of general business operations.

VAGO's replacement policy for computer hardware clearly states VAGO's commitment to managing IT systems through its requirement for a major assessment after three years and annual reviews thereafter. Given the most recent major IT infrastructure upgrade program was completed in 2001/02, VAGO's IT infrastructure would appear to support current demand and the management approach should keep infrastructure in line with the organisation's strategy. Capacity planning is scheduled to review disk space utilisation in the near term and periodical monitoring of the network and server performance is performed with any issues identified, prioritised and resolved in a structured manner.

## 8.3 Recommendations – IT Infrastructure

- ✓ There are no recommendations for this area.

## 8.4 Observations – DRP and Business Continuity Planning

VAGO has a relatively well-developed Disaster Recovery Plan (DRP) for IT Infrastructure. Version 2.0 of this document was released in June 2004.

The DRP provides identification of critical business IT systems outlining the maximum tolerable outage (timeframe) for such services. The DRP specifically limits the plan's scope to immediate IT requirements and excludes such items as paper-based files, personnel, Wide Area Network (WAN) and remote access data communications.

Located off-site are detailed procedures for the recovery of critical business systems from a disaster.

## 8.5 Findings – DRP and Business Continuity Planning

Business continuity management comprises many elements, which when combined, define the approach VAGO will undertake to resume after a break in business continuity. Although there are some differences in terminology usage within the industry, a Business Continuity Plan (BCP) is generally accepted as dealing with the maintenance of business operations immediately following the disruption, while a Disaster Recovery Plan deals with the restoration of infrastructure to its original state after a disruption. IT DRP's therefore naturally focus on IT infrastructure matters, while BCP's are wider in focus.

The VAGO DRP is well developed and tested, but the lack of a BCP covering non-infrastructure matters is less than optimal. The Business continuity planning process frequently uncovers matters not identified in a DRP, such as key-staff risks, organisation morale and stress management, decision escalation and authorisation processes, (etc) and provides back-up (alternative) procedures and processes for continuing operations should the DRP fail because of unforeseen disaster combinations such as loss of the warm site at the same time as the primary site, or secondary equipment failure (which can occur because of real-world network traffic load). A simple issue, such as loss of a key decision maker, or loss of the phone system or flooding from fire suppression equipment can neutralise an otherwise excellent DRP.

## 8.6 Recommendations – DRP and Business Continuity Planning

- ✓ VAGO should develop a formal business continuity plan to ensure in the event of a disaster, key functions and processes can be resumed without significant delay. [**Recommendation #36**]

## 8.7 Observations – IT Strategy

The VAGO has a relatively well-developed IT infrastructure. The development and maintenance of the IT Infrastructure is managed in an organised way through a documented IT Strategic Plan. The IT Strategic Plan covers the period 2004/05 to 2006/07 and has been developed after consultation with all business groups, endorsed by the IT Steering Committee and approved by the SMG (on 17 June 2004).

The IT Strategic Plan consists of two main sections:

1. The information technology strategies, and
2. Key actions and activities.

## 8.8 Findings – IT Strategy

The information technology strategies are a collection of actions, strategies and outcomes aligned with the corporate objectives, on which the long and short term plans for the VAGO are based. These plans are current and appear to adequately address the organisation's key business functions as a whole for both the long and short term.

The second section consists of key actions and activities along with the identification of selected strategic tasks to be included in the current year's IT Business Plan. Management monitoring and reporting of strategic tasks is managed by the IT Steering Committee who prioritise the activities of the IT Strategic Plan, and monitor the progress of current strategic tasks. Regular reporting on progress against these initiatives is also undertaken to the SMG on a monthly basis.

## 8.9 Recommendations – IT Strategy

- ✓ There are no recommendations for this area.

### Terms of Reference

2.3(c) Are VAGO's time recording and costing systems adequate?

## 8.10 Observations – Time Recording and Costing Systems

In mid 2003 VAGO introduced MARS as its primary system for time and cost recording. This followed an earlier initiative which was suspended on the basis of concerns about the long term viability of some of the tenderers. This tender process came in response to a recommendation in the previous performance audit. MARS has been developed to capture all the core information necessary to manage and control audit operations from costs by auditee (client) to staff utilisation by staff member.

We reviewed the system from the development of budgets for assignments through to build up of costs from individual staff timesheets through to the final reports.

## 8.11 Findings – Time Recording and Costing Systems

The introduction of MARS represented a major step forward for VAGO. The system is now reliably in place. It incorporates detailed audit trails that provide a strong basis for control. We are pleased to note that VAGO has an active program in place to improve this new system.

We note that MARS has a comprehensive reporting capability. While this will prove an asset, going forward a more limited suite of standard reports ought to be developed in the interests of consistency and efficiency.

By reference to the audit trails available in MARS we do not believe that there has been cross-subsidisation of costs between financial audit, performance audit and special reviews. We did find that some costs incurred in obtaining additional information from agencies for the audit of the State's Consolidated Annual Financial Report are being included in the fee charged for the agencies financial statement audits but we are satisfied that they are not sufficiently material to represent a breach of Section 10(2).

We also noted that standard VAGO practice is to “write on” time when financial audit costs are less than budget, and to “write off” time where costs exceed budget (where there is no justification for seeking an increased fee from an agency). We accept that this is a reflection of general commercial practice, but it may not strictly accord with section 10(1) of the Act and may lead to some cross subsidisation of audit fees between agencies.

VAGO has not purchased a staff-scheduling module to interface with the main system. We are not uncomfortable with VAGO’s view that its audit groups are not sufficiently large to warrant such an investment. Traditionally financial audit staff have been managed in small teams. This can restrict staff development and lead to pockets of under and over utilisation. Accordingly scheduling is now being conducted on a more centralised basis. To facilitate this we suggest VAGO consider a simple system which allows managers to view staff availability across the entire financial audit group.

### 8.12 Recommendations – Time Recording and Costing Systems

- ✓ To assist Directors and Managers in the discharge of their management and supervisory roles, a standard suite of MARS management reports should be defined. Further, on going training in the use of MARS will be required to ensure it is used in an effective and efficient manner **[Recommendation #33]**
- ✓ We recommend that VAGO review the practice of “write on and offs” and assure itself that it is operating within the intent of section 10(1) of the Act. If appropriate, the Act may need to be amended to provide VAGO with flexibility in respect of the application of financial audit fees across all agencies. **[Recommendation #35]**
- ✓ We recommend that VAGO consider the acquisition and / or development of a simple centralised scheduling system to support the optimum allocation of financial audit staff to audit assignments across the whole group. **[Recommendation #34]**

#### Terms of Reference

2.7	Are VAGO’s strategies for recruiting, training, remuneration and retention of qualified staff adequate?
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### 8.13 Observations – HR Strategies

The 2001/02 to 2003/04 Corporate Plan recognised the importance of people to the success of the VAGO. This is reflected in the objective “to be recognised as a preferred employer”. The key strategies outlined in the Plan to deliver on this objective were:

- Devise recruitment practices that keep pace with the changing external environment and attract competent and skilled people to the office

- Implement well designed annual learning and development programs for our staff that will assist them to attain high standards of professional skills and performance
- Provide a stimulating work environment for our staff and make available to them up-to-date technology and business processes
- Manage our people in an exemplary manner in line with our corporate values, and
- Progressively introduce a 360 degree feedback regime.

The performance measures and key targets set for achievement of these were:

Performance measure	Key target
Feedback from annual employee attitude surveys on our commitment to corporate values and the well being of our people	Increasingly positive responses received from staff
Results of annual staff performance assessments	Assessments over period of the plan indicate progressive attainment by staff of higher standards or professional skills and performance
Trends in a range of employee related statistics including voluntary turnover, vacancy levels, incidence of sick leave and percentage of time devoted to staff development	A clear positive trend in these statistics

Whilst there is no specific “HR Strategy” document, the Business Plan of VAGO sets out annual initiatives in respect of the strategies outlined in the Corporate Plan. The Human Resources Group reports quarterly to the SMG on progress on achievement of these initiatives.

VAGO has a number of ways in which it collects data on the status of its workforce. These include:

- Annual survey of staff, conducted by an independent firm
- Survey of agencies and other stakeholders on their perception of the quality of VAGO work
- Performance assessments / appraisal conducted with staff
- Data collection on a range of HR related information (HR Workforce report, Workforce Profile report) which are reported to SMG quarterly, and
- Exit interviews with departing staff.

#### 8.14 Findings – HR Strategies

Whilst annual business plans outline HR related initiatives, these are developed in the absence of an overall HR strategy that links into the Corporate Plan. Such a strategy would provide a framework within which such annual initiatives would be placed in context. The Corporate Plan provides the context and framework for what the office wants to achieve, and broadly how it will achieve it. A HR Strategy would provide more detail on the position / status of HR (some diagnostic analysis using the various data collection methods in place), the strategies required to deliver on the objectives of the Corporate Plan, the timelines for these strategies over the planning period (3 years in VAGO's case), accountabilities, performance measures and targets.

The quarterly reporting to SMG can then provide a further basis on which achievement of annual initiatives are contributing to the overall achievement of the HR strategy and hence the overall corporate strategy. The current workforce reporting, whilst a positive initiative, does not have a contextual framework in which to assess the various data elements provided. As such, the quarterly report is submitted "for noting" rather than driving a series of action items that may address some of the issues the report details.

For example, a review of recent HR related information provides the following:

- Potential succession planning issue with 8 officers at EO level approaching an age where retirement is a viable option. In addition, 18% of staff are 50 years or older, with most of these at senior levels
- Turnover of staff increasing from approximately 13% in 2002 to nearly 23% in 2004
- Staff retention issues – of the 27 new additions to staff in 2002, 12 had left VAGO by July 2004, and
- 28% of staff at EO level are female. In addition, 76% of female staff are at VPSG 4 level and below.

Whilst these are only a snapshot of the HR profile, they provide some insight into some of the key strategic HR issues facing VAGO over the next 3 years. An appropriately developed HR strategy would provide a basis on which these (and other issues) would be addressed in the context of delivering on the overall corporate plan objectives.

A strategy would include:

- A diagnostic analysis of the status of HR across VAGO – key issues and risks
- The potential impact on the achievement of VAGO Corporate Plan objectives of these issues and risks
- Strategies that will address these issues and risks. This would include coverage of areas such as workforce planning, performance management, learning and development, work practices, change management
- Performance measures and targets



- Accountabilities and timelines
- Budget and resourcing requirements, and
- Maximising opportunities for development by arranging secondments to other agencies across the Public Sector (including the PAEC).

### 8.15 Recommendations – HR Strategies

- ✓ A HR Strategic Plan be developed that links to and supports the achievement of the recent 3 year Corporate Plan. We recognise that the corporate plan up to 2003/04 provided a strategic framework for the development of HR initiatives, but that the 2004/05 corporate plan has less emphasis on prescriptive HR requirements, hence the need for a more formalised approach to this area. We note, an appropriate framework for the development of such a strategy is outlined in the VAGO 2003/04 annual report. [**Recommendation # 37**]

### 8.16 Observations – HR Recruitment

As part of its 2001/02-2003/04 Corporate Plan, a key strategy was:

“Devise recruitment practices that keep pace with the changing external environment and attract competent and skilled people to the Office”.

The annual business plans for 2002 to 2004 included a range of initiatives in support of this strategy. These included:

- Development of a recruitment strategy, including policies and procedures
- Development of a reward and recognition strategy
- Development of a an office wide induction program, and
- Improvements to the graduate recruitment program.

The recruitment of VAGO staff is undertaken utilising one of the following options:

- Advertising internally
- Advertising in the Victorian Public Sector Notices
- Graduate recruitment through universities
- School-leaver recruitment

- Newspapers and internet (eg, Seek) advertisements, and
- Utilisation of recruitment consultants and / or search firms.

The table below outlines the position vacancies by grade, the method of advertising the vacancy, and where the successful candidates were sourced from.

Grade	Method of Advertising		Candidate source	
	Internal <sup>8</sup>	External <sup>9</sup>	Internal	External
Assistant Auditor General		1		1
General Manager		1		1
Director	2	2	2	3
Manager		4		6
Senior	1	3	4	10
Auditor	1		1	
Graduate		3		35
Admin assistant	2			2
<b>Total</b>	<b>4</b>	<b>16</b>	<b>7</b>	<b>58</b>

Source: VAGO

The table indicates that:

- VAGO is utilising various means of advertising for vacant positions, rather than just relying on internal and VPS sources
- Senior management positions (Manager and above) are being externally advertised / searched to ensure the best possible candidates are being given the opportunity to be sourced, and
- Of the 21 new starters that were externally sourced (excluding graduates and admin assistants), 7 were from government, 5 from accounting firms, 4 were from other audit offices, 4 were from commerce, and 1 from an industry body. This shows a diversity in skills and experience being brought to VAGO which should assist in addressing one of the key themes emerging from VAGO client surveys in relation to improving the understanding of agency business.

<sup>8</sup> Advertised within VAGO and VPS only

<sup>9</sup> Includes newspaper, seek, search, VPS notices

### 8.17 Findings – HR Recruitment

We believe recruitment practices are in line with contemporary practices and meet the objectives set out in the Corporate Plan.

Agency survey results conducted by VAGO, and feedback we have received from agencies via our interviews and surveys identified an issue from an agency perspective that VAGO staff needed to improve their understanding of the “industry” the agencies worked within.

Whilst it is understood that staff develop expertise over time in particular areas of agency environments, attention should continue to be placed on attracting staff who already possess this expertise.

### 8.18 Recommendation – HR Recruitment

- ✓ Current recruitment practices generally reflect contemporary practice and should be continued, with an emphasis on:
  - Ensuring diverse means of advertising vacancies
  - Sourcing staff from diverse backgrounds and experience, and
  - When recruiting for manager or above positions experience in agencies or industries in addition to high-level technical skills be emphasised.

**[Recommendation #38]**

### 8.19 Observations – HR Retention

Data provided by VAGO indicates the following turnover rates for the past 3 years:

Year	Turnover (%)
2001/02	13%
2002/03	15%
2003/04	23%

As demonstrated above, the rate of turnover is increasing. However it is comparable on a 3 year average to other similar public and private sector audit organisations. Of additional relevance is what level of staff within VAGO was the figure most significant. This is set out in the table below:

Level	Turnover (%) <sup>10</sup>
VPS / VPSG 1 to 3	24%
VPS / VPSG 4 to 6	12%
Executive Officer	11%

In addition, we examined the number of cessations of staff who had commenced since 2002. This is as follows:

Year	Commencements	Cessations <sup>11</sup>
2002	27	12
2003	17	5
2004	21	2

Whilst this shows some improvement, it is still worth noting that over 40% of new starters at VAGO in 2002 had left the office by July 2004. In addition, these staff were all at senior auditor level and below.

For all separations, the HR Group undertake exit interviews, the results of which are summarised for the SMG. Common themes emerging over 2003/04 are resource scheduling, communication and training (particularly for graduates).

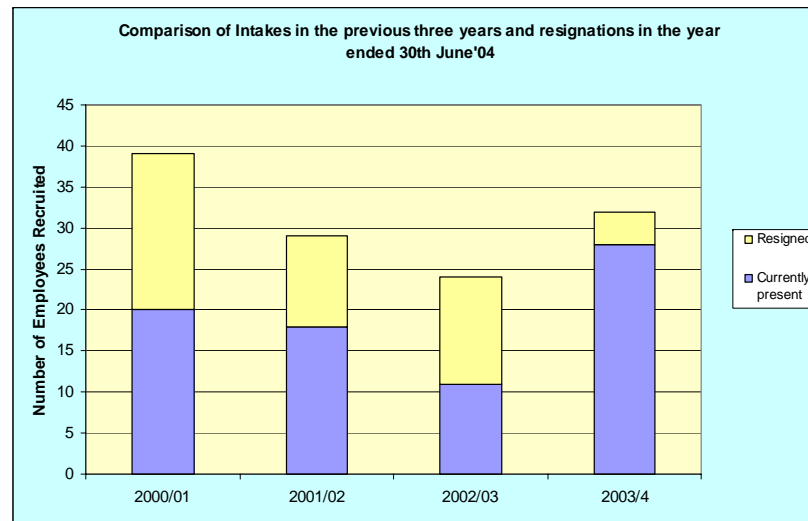
## 8.20 Findings – HR Retention

Whilst this industry generally has a turnover rate in excess of 15%, VAGO’s rate of turnover is increasing. The increasing rate of staff turnover is of some concern, particularly as a significant proportion of cessations are at levels where significant staff training is invested. This will also potentially impact on succession planning as it may leave far fewer officers to progress within the system.

<sup>10</sup> Staff cessations 2001 to 2004 / staff in classification 2001 to 2004

<sup>11</sup> Represents staff who commenced in and since 2002 who have now left (as at July 2004)

In reviewing the 2004/05 Business Plan, the increasing rate of staff turnover is recorded in the summary of KPIs for 2003/04. However, the plan notes that the rate of recruitment is “keeping pace” with this turnover rate. Whilst this may be true, this is not in itself the solution. The plan goes on to state that action plans will be developed to “...recruit and retain sufficiently skilled work force...”, without specifically outlining what these plans might be.



### 8.21 Recommendation – HR Retention

- ✓ Whilst reporting on staff turnover is undertaken, more analysis is required for VAGO to better understand the reasons for the rate of staff turnover. No documentation was sighted that brought a strategic analysis to better inform decision making on this important issue. Such an analysis may better identify the reasons and causes and is a necessary precursor for the development of rectification strategies that may be employed in the short and long term. **[Recommendation #39]**

### 8.22 Observations – Succession Planning

We reviewed the number of staff approaching “retirement” age (mainly those staff on the Revised Super Scheme who are approaching an age of 54 years, 11 months). This revealed:

- 5 staff are within 2 years of this milestone

- Of these, 3 are in Financial Audit, with 2 at Manager level and 1 at Director level
- The remaining 2 are in Performance Audit with 1 at Senior Manager level and 1 at Senior Analyst level, and
- There are a further 3 officers who are within 5 years of 54/11 all of whom are in the Strategic Audit Planning Group, with 1 at AAG level and 1 at Director level.

### 8.23 Findings – Succession Planning

Our investigations suggest that VAGO is experiencing higher retention rates at the more senior middle management and senior management level. In addition, senior management levels may become depleted as these officers reach retirement age in the next few years. These matters may impact the management of the office. It is our opinion that increased attention could be paid to these areas as a means of developing a long term solution.

### 8.24 Recommendations – Succession Planning

- ✓ It is recommended that consistent with the VPS career framework VAGO develop and adopt formal succession planning strategies to address the impact of a potential departure of senior staff across the office. [**Recommendation #40**]

### 8.25 Observations – Learning and Development

VAGO in their 2 last Corporate Plans have placed significant importance on the provision of quality learning and development opportunities. To support this, a number of annual initiatives were identified, including:

- The Learning and Development program – covering professional development plans, leadership / management development, performance management, information technology and knowledge management, and
- Training needs analysis / training development plans.

In 2003/04, VAGO recently completed a Learning and Development Framework. This framework has been prepared in the context of the introduction of the VPS Career Framework. In addition, a Learning and Development Steering Committee was recently formed comprising senior executives across VAGO. Its role is to broadly oversee the Learning and Development program.

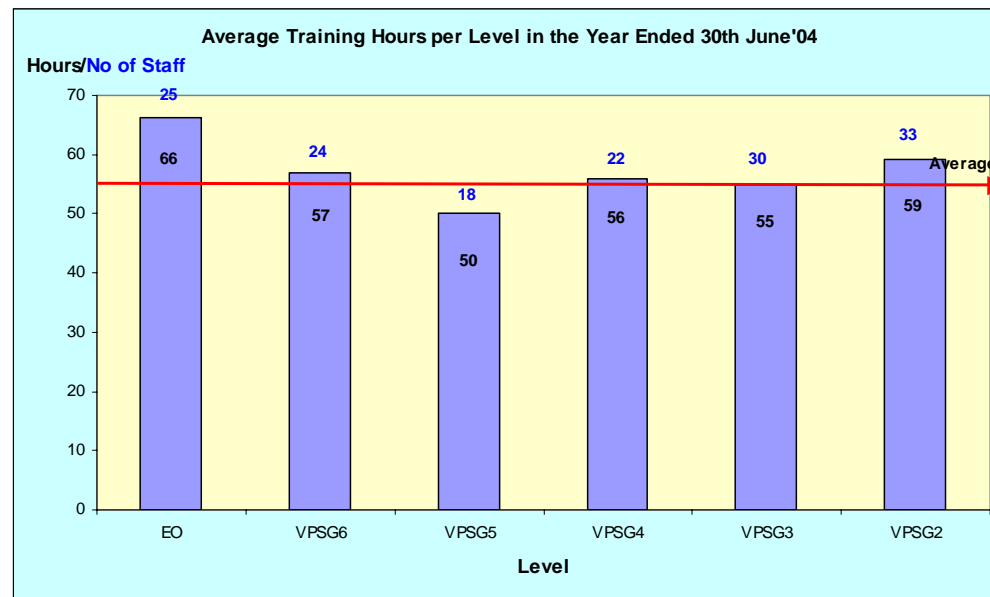
Within this framework, the individual training needs of staff are ascertained through the performance assessment and management process to determine the type and amount of training to be provided. Senior Audit Office Management advised Acumen Alliance during this review that all staff had recently undergone full performance assessments.

VAGO does not set a target for training hours against positions, rather an across the board target of hours / employee is set. These targets for the last 3 years have been as follows:

- 2001/02 – 30 hours per person
- 2002/03 – 30 hours per person, and
- 2003/04 – 30 hours per person

VAGO’s annual scorecard assessment indicates that this target has been achieved, although we have noted elsewhere in this report some discrepancies in the data reported, which VAGO are investigating.

Based on data supplied by HR, we set out below training hours actually recorded by the VAGO HR systems for the past year in respect of each level of VAGO staff.



### 8.26 Findings – Learning and Development

The graph above suggests that VAGO staff are receiving more than their target allocation of 30 hours professional training per year.

The type of training undertaken by staff is mixed, and emanates from the need to maintain professional qualifications, feedback from supervisors during performance reviews, office wide needs, initiatives from senior management and individual needs assessment.

It would be expected given the need to ensure Trainees and Graduates understand and are competent in Auditing that as newcomers to the profession they would receive a high level of training in the first years of their employment. There is also a professional requirement on all professional staff within the office holding CPA or CA qualifications to meet the ongoing CPE requirements of those professional bodies.

Training records should reflect the training provided to staff internally, as well as reflect all training that professional staff have undertaken externally.

We consider that in the context of the recent introduction of the new VPS career framework, training and development is appropriate.

### 8.27 Recommendations – Learning and Development

- ✓ There are no recommendations for this area.

#### Terms of Reference

2.3(e) Is the culture of management in VAGO adequate and having a positive effect on performance?

### 8.28 Observations – Culture

We note that VAGO is aware of the importance of developing a positive culture. The existence of an annual staff survey demonstrates a desire to better understand and improve staffing and cultural issues. Whilst the survey response rate averages 69%, the results provide a useful indicator of the positive aspects of VAGO's culture and areas for improvement.

The elements of a culture that are conducive to effective and efficient operations of VAGO would include a common understanding of:

- The office's mission and vision
- The office's values, and
- The office's plans to achieve its vision.

### 8.29 Findings – Culture



The recent survey undertaken by VAGO indicates a significant number of employees (>60% of responses) identifying a number of positive trends over a 3-year period in areas such as:

- Meeting the Parliament's and public expectations
- Meeting agency and other stakeholder expectations
- Commitment to quality service, and
- Improving technology available to staff.

The survey also indicates some employees (~25-30% of responses):

- Were uncertain that all staff were aligned to VAGO's vision and values, and
- Did not consider that the Senior Management Group set clear plans and directions and kept staff informed about future plans.

These results and our various discussions with VAGO staff indicate that further work is required to develop a cohesive culture to ensure VAGO staff understand the office's vision, how it is to be achieved and their role in achieving that vision.

### 8.30 Recommendations – Culture

- ✓ To ensure staff understand the AG's vision and its impact on office plans, increased attention is required in a number of areas, including:
  - a. Acknowledgement of the results of the staff survey and demonstrable action plans identified to address issues noted
  - b. Improved focus on coaching / mentoring and counselling and appraising all staff. This includes honest and open assessment of performance and development of identifiable action plans (including structured training plans) to address any deficiencies noted, and
  - c. Reinforcement through internal training and staff meetings of the office's vision values and plans to achieve.

#### **[Recommendation #41]**

## 9. Audit Act – Detailed Findings and Recommendations

### Terms of Reference

Other Matters: Audit Act

### 9.1 Observations – Audit Act

In the course of our review we carefully examined the processes of the Audit Act.

### 9.2 Findings

To facilitate efficient and effective planning and to enhance the PAEC consultation process we believe that sections 7A and 15(2) of the Act ought to be interpreted a little more broadly than they are at present (refer Section 3.3 and 4.2).

As indicated in section 8.12 of this report, Section 10(1) of the Act may need to be reviewed to provide VAGO with workable flexibility in respect of the application of financial audit fees across all agencies.

We note Section 15(3) of the Act requires the AG in consultation with the PAEC, to determine the intervals at which performance audits are conducted and the number to be conducted in any one year. We consider planning for performance audits to be adequately covered in the provisions of the Act covering the development of the annual plan and work program.

### 9.3 Recommendations

- ✓ Section 7A of the Act adequately provides for the development of the Annual Plan. Accordingly, the need for Section 15(3) of the Act should be reviewed. [**Recommendation #45**]

**APPENDIX: TERMS OF REFERENCE**

Ref	Sub Questions
2.2	Is the purpose and objectives of the VAGO appropriate?
	Are these objectives being achieved?
	<b>Annual Planning Process</b>
2.3(a)	Is the annual planning process adequate and effective?
	<b>Internal Systems</b>
2.3(b)	Are VAGO’s internal systems, including IT systems that measure productivity, adequate and effective?
2.3(c)	Are VAGO’s time recording and costing systems adequate?
	<b>Audit Methodologies</b>
2.3(d)	Are VAGO’s audit methodologies, practices and procedures adequate and appropriate?
	<b>Culture and Relationships</b>
2.3(e)	Is the culture of management in VAGO adequate and having a positive effect on performance?
2.3(f)	Is the relationship between VAGO / PAEC / Parliament adequate and appropriate?
	<b>Benchmarking</b>
2.3(g)	Does VAGO adopt best practice in Public Sector management and auditing?

Ref	Sub Questions
2.3(h)	Are VAGO's performance measures and benchmarks adequate and comparable with other jurisdictions?
	<b>Financial Audits</b>
2.3(i)	Is VAGO complying with Auditing Standards?
	Does VAGO have adequate quality control processes for contracted financial audits?
2.3(j)	Are all audits supported by plans, work papers, evidence, and appropriate quality control processes?
	<b>Planning</b>
2.4(a)	Do the selection criteria for Performance Audits and Special Reviews ensure that key risks and major programs receive adequate audit coverage?
2.4(b)	Is the rationale supporting selection of potential Performance Audits adequate?
2.4(c)	Is the planning and ongoing management of Performance Audits adequate?
2.4(e)	Is the process to manage significant issues that are identified in Performance Audits but are outside of the scope of the audit adequate?
2.4(f)	Should the existing practice of tabling a considerable number of Performance Audits be varied to include larger Performance Audits that address significant issues of public interest?
	<b>Quality Control and Reporting</b>
2.4(d)	Are the investigative process and quality control procedures adequate to support the conclusions arising from Performance Audits?
2.4(i)	Are the criteria against which efficiency and effectiveness of Performance Audits and special reviews are measured appropriate?
	<b>Compliance with Statutory Requirements</b>

Ref	Sub Questions
2.4(g)	Has VAGO complied with all statutory requirements in the conduct and performance of Performance Audits?
	<b>Resourcing</b>
2.4(h)	Is the mix between specialist expertise contractors and suitably qualified in house staff in undertaking Performance Audits appropriate?
2.5	Is there value to public sector agencies in VAGO publishing good practice guides?
2.6	By use of a survey of key stakeholders, has VAGO achieved its objectives, delivered value added recommendations and value for money?
2.7	Are VAGO's strategies for recruiting, training, remuneration and retention of qualified staff adequate?
2.8	Is the process for evaluating tenders from private audit firms conducted with due regard to probity?
2.9	Is the scope, quality and effectiveness of the internal audit function adequate?