

The Annual Allan Barton Memorial Research Lecture

CPA Australia Congress Canberra 20th October 2020

Auditor- General's response to lecture of Professor Roger Simnett - Maintaining Confidence in Audit in a Changing World

Introduction

An audit is an important means of enhancing the degree of confidence of intended users in the subject matter of the audit. Maintaining this confidence requires that a number of key factors exist and key challenges met. I would like to highlight three of these areas, all of which have been covered to some degree by Professor Simnett. Firstly, the basic underpinnings of audit need to be in place and be seen to be in place. Secondly, auditors need to continually assure themselves that their work remains relevant to their users. Finally, auditors need to maintain the capability to meet the needs of a dynamic environment.

1. The key underpinnings of audit

Professor Simnett referred to the "trust deficit" and the importance and roles of accounting and auditing in trust building.

In the public sector context, the Parliament is the primary user of financial and performance audit reports. The objective of reporting to the Parliament is to improve the accountability and transparency of the public sector. Public sector financial and performance audits are designed to promote transparency of the use of public resources and to assist the Parliament in decision-making, including on funding particular programmes for delivery by an entity.

Independence

The ANAO is a critical part of the accountability and integrity framework for the Australian public sector. A key underpinning of this is the independence of the role of the Auditor-General and the ANAO. Independence is the foundation on which the value of an audit is built. An auditor must be independent, and be seen to be independent, for their opinions, findings, conclusions, judgments and recommendations to be impartial and viewed as impartial by reasonable and informed third parties.

The statutory independence of the Auditor-General is provided for in the *Auditor-General Act 1997*. The Auditor-General is an independent officer of the Parliament, and has complete discretion in the performance or exercise of functions or powers. In exercising those powers, the Auditor-General is not subject to direction from anyone in relation to whether or how a particular audit is to be conducted or the priority to be given to any particular matter.

There are other legislative provisions that ensure the Auditor-General's independence, for example, those regarding appointment, tenure, removal from office and payment of audit costs by the Parliament.

The current legislative frameworks within which the ANAO operates also contain several challenges to the Auditor-General's independence. The Parliament's Joint Committee of Public Accounts and Audit (JCPAA) is currently conducting a review of the *Auditor General Act*. The terms of reference

include considering the adequacy of provisions relating to the independence of the Auditor-General as an Officer of the Parliament and the audit independence of the ANAO.

For the audit sector to maintain confidence of users all elements of it need to be and seen to be independent. The regulator (ASIC) must not be perceived as being too responsive to auditors as compared to users. The standard setter (AUASB) must be seen to balance the interest of the user and the preparer of the audit report.

In summary, independence in the system must be designed to demonstrate that the system is acting beyond its own interest.

Audit Quality

Audit quality is critical for maintaining confidence in information provided by entities to their stakeholders. Quality audits of financial reports or non-financial performance information enable users to rely on the auditor's independent assessment of that information. Delivering quality public sector audits results in improved public sector performance through accountability and transparency.

It is important in maintaining the confidence of users of audit reports that auditors not only undertake quality audits, but also demonstrate that their work is of a high quality. External scrutiny of audit work, and transparency about that scrutiny, is vital in demonstrating audit quality.

External oversight of quality at the ANAO is provided in a number of ways. All audit reports produced by the ANAO are public documents, tabled in the Parliament. The Joint Committee of Public Accounts and Audit reviews all Auditor-General reports tabled in the Parliament and conducts inquiries into selected reports. These inquiries assist in maintaining quality by addressing the work performed in the audits. The ANAO also voluntarily engages ASIC and the NZ Office of the Auditor General to conduct external quality reviews of its work and publishes the findings of these reviews on its website.

External scrutiny, such as that provided by ASIC to the audit sector, is most effective where those subject to the scrutiny are open to the findings and transparent about their responses to them. While there should always be opportunity for debate, continuous public dispute as to the quality or meaning of regulatory outcomes does not serve to enhance community trust.

The impact of audit

In my experience the impact of audit on public sector performance is pervasive and positive. It is far more than the publication of a report. The mere existence of both financial and performance audit moderates public sector activities to be more consistent with the expectations set out in the legislative and regulatory framework.

The impact of audit can be difficult to assess. What is clear is that impact should not simply be measured by high profile audits like the Home Insulation program¹, or Community Sport Funding², where interest in the issues raised by the ANAO spilled into wider debate in the Parliament and the community. Nor can it be judged only by the direct impact of audit work, such as the number of audit or parliamentary committee recommendations agreed and implemented or issues identified and rectified during an audit.

¹ Auditor-General Report No. 12 of 2010-11 Home Insulation Program

² Report No. 23 of 2019-20 Award of Funding under the Community Sport Infrastructure Program

The potential for scrutiny from the ANAO often motivates entities to conduct a review of their own performance. In this way, the ANAO's Annual Audit Work Program plays a key role in driving improvement in the sector before audits formally commence.

Even where the entity has already reviewed the program that will be audited, the ANAO's assurance plays a crucial role in ensuring transparency and accountability. There is a substantial difference between management-initiated internal reviews and external audit, driven mainly by independence and public reporting.

2. Broader Information needs of stakeholders

Professor Simnett spoke about the importance of the annual report as a key communication mechanism, noting that information users are increasingly looking beyond items currently disclosed in these public reports for their decision-making. He also stated that accounting and auditing have to evolve in order to meet these information needs.

A key aspect in increasing confidence in audit is providing assurance on information that is important to users of that information. That is, auditors need to focus on areas where assurance can add the most value. Three such areas are non-financial performance reporting, key audit matter reporting and dealing with culture and ethics.

Non-financial Performance reporting

Non-financial performance reporting is a form of extended external reporting (EER), of which Professor Simnett spoke. A key differentiator of the public sector is that non-financial information is regularly seen as more important than financial performance information, providing the key indicators of success. Appropriate and timely performance information strengthens accountability by informing the Parliament and citizens about the impact of public sector entities' activities relative to government objectives.

Over the past five years the ANAO has published seven audits covering 34 entities in relation to the non-financial performance reporting framework established by the PGPA Act. The results of these audits indicate that there is still substantial improvement that needs to be made to entities' non-financial performance reporting before they can be fully relied on by Parliament.

On the other hand, the quality of audited financial statements is consistently high. This is why I strongly support the introduction of mandatory auditing of entity performance statements in a similar manner to which financial statements are audited. The ANAO is currently undertaking a pilot of the audit of entity performance statements at the request of the Minister for Finance. Providing assurance over this information to the Parliament has the potential to be an important means of increasing transparency and accountability in the sector.

Key audit matter reporting

The ANAO has voluntarily applied key audit matter reporting in the financial audit reports of all departments of state and a number of major Australian government entities since 2016–17. The purpose of communicating key audit matters is to provide greater transparency about the audit that was performed. Communicating key audit matters is aimed to help users of financial statements better understand those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements. I consider key audit matter reporting to be better practice in the financial auditing profession.

Professor Simnett referred to the post-implementation review of key audit matter reporting. I welcome this review, particularly consideration of whether the auditor should conclude on specific

key audit matters. My experience has been that the restrictions on concluding on individual matters have impaired the usefulness of the information provided by the reporting. An example of this is where a key audit matter is identified because of an audit finding being raised in a prior year audit, such as where there is a weakness in internal controls. The ability to conclude on whether the finding has been resolved would enhance transparency to the Parliament.

Culture and ethics

A challenge that has increasingly faced the ANAO's audit work is how the culture of an organisation is considered during an audit. The performance of an entity cannot always be determined by the extent to which it complies with a particular framework. In many audits, culture comes into the frame in relation to the governance arrangements of organisations. Professor Simnnett noted that institutions need to do the right thing – not only because it is legally required, but rather because it reflects the right ethical behaviour. More and more the right thing is being defined as not just technical compliance with a requirement, but also with meeting its intent. As users of financial and non-financial information raise the bar in terms of their expectations about transparency and accountability, the question arises whether there is a role for audit assurance regarding culture and ethics.

As auditors, we spend a lot of time in the business of organisations we audit. If we become aware of ethical issues and do not report on this, then are we part of the problem? Should auditors instead be part of the solution? For example, if an auditor identifies that management has attempted to manipulate their financial information but, as a result of the audit, this is amended prior to signing the audit report, what is the role of the auditor in reporting the 'unethical' behaviour? As the financial information is not materially misstated at the time the auditor's report is signed, there is no impact on the audit opinion, but should the auditor report the matter to users, such as parliament or shareholders in a public company? If we do not are we complicit in the behaviour?

As public sector auditors, issues identified in our audit work are not only reported internally to management, they are reported to the Parliament and made public. This transparency is important in increasing the confidence provided by audit.

The ANAO is currently considering the design of an appropriate audit framework against which to test ethics. Greater scrutiny in this area will help ensure that the public sector is looking beyond technical compliance and operating in line with community expectations of integrity and honesty.

3. Maintaining the capability to meet the needs of a dynamic environment

Professor Simnnett spoke to the challenges of the increasing importance of technology and the need for auditors to be aware of, and consider, the impact on information relevant to their audit.

Technological advances over the last decade have enabled the collection and analysis of large datasets to reveal trends, patterns and associations, and change the interface between citizens, businesses and government. In pursuing advances in technology and data analysis, government continues to improve how it delivers services online — an approach that has been readily adopted throughout the pandemic response. At the same time, the ongoing shift to digital services brings additional risks to stability and security of systems, management of data privacy and integrity, and business continuity. As such, technology and data analysis play an important role in the work of the ANAO.

With growing cybersecurity threats, it is necessary for organisations to understand their information and data risks and protect their critical information assets from malicious actors. This is particularly relevant during the COVID-19 pandemic, where fast-paced program implementation has seen increased reliance on, and utilisation of, online services to support government action. Appropriate cybersecurity, as required by the mandatory Australian Government frameworks in place, remains a focus in audit work.

Cyber resilience and compliance with mandatory IT security policies has been a key program of audit in recent years. Since 2013–14, the ANAO has conducted five performance audits to assess the controls over cyber security for 17 different government entities. These audits found that compliance with mandatory requirements of information security continued to be low.

Similarly, the IT control environment is the category that consistently has the most number of financial audit findings, with the most common area relating to weaknesses in security management.

Data analytics capability in the ANAO

Building the ANAO's data analytics capability is a particular priority as the entities the ANAO audits continue to collect, generate and share ever-increasing volumes of data and information. Increased capacity in this space will enable automation of some audit processes and assist in the development of new audit products. Data analytics is also enabling the ANAO to better identify financial reporting, fraud and operational business risks, and tailor our approaches to deliver more targeted risk-based audits. This use of technology assists the ANAO in continuing to deliver high quality audits in a changing environment.

The effective use of technology by the ANAO to support cooperation and communication with entities remains a key focus of the ANAO. We are working closely with public sector entities to increase opportunities for remote access to entity systems. This has been of vital importance in our ability to audit during the pandemic. The ANAO will continue to leverage technology to support the delivery of our work, maintain connection with entities, and increase the flexibility of our audit approach.

Impacts of the COVID-19 pandemic on the ANAO

Due to prior year investments in technology, ANAO staff have been well placed to work remotely during the COVID-19 pandemic.

The ANAO commenced monthly assurance reviews of Advances to the Finance Minister given the size of advances available (in the order of \$40 billion), and to provide the Parliament with timely assurance and transparency of the Australian Government's pandemic response. The ANAO has released a multi-year COVID-19 audit strategy as part of the 2020–21 Annual Audit Work Program. The strategy outlines how the ANAO will respond to the COVID-19 pandemic in three phases.

Early audits will have a strong focus on risk management in the sector: risk emerging from rapid design and implementation; how entity risk appetite has changed and how new risk tolerance levels have been articulated and actioned; and strategies being put in place to achieve acceptable levels of compliance.

Through our work to date on financial audits during the pandemic, we are seeing issues emerging which have provided challenges to entities in preparation of financial statements. These issues include material uncertainties arising in asset valuations and difficulties in performing inventory stocktakes.

Conclusion

In conclusion, the existence of scrutiny in the form of audit has pervasive and positive impacts on public sector performance. Confidence in the audit process can only be maintained if audits are independent in fact and appearance, are of a high quality and focus on information that is of most value to users of that information. In a changing world, audit must continue to evolve to meet the changing needs of those users.