
Performance Audit of Victorian Auditor – General and Victorian Auditor – General's Office

November 2013

Distribution list

Members of Public Accounts and Estimate Committee (PAEC)

Mr John Doyle – Victorian Auditor-General

Ms Valerie Cheong – Executive Officer, Public Accounts and Estimate Committee (PAEC)

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Mr David Morris MP
Chair
Public Accounts and Estimates Committee
Parliament House
Spring Street
EAST MELBOURNE VIC 3002

25 November 2013

Dear Mr Morris

Performance Audit of the Victorian Auditor-General and the Victorian Auditor-General's Office 2013

I am pleased to submit this final report following the completion of the Performance Audit of the Victorian Auditor-General and the Victorian Auditor-General's Office.

This report has been completed in accordance with the Agreement between PwC and the Parliament of Victoria dated 27 June 2013.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Andrew Nicolaou', written in a cursive style.

Andrew Nicolaou
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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 in order to determine whether the Auditor-General (AG) is achieving its objectives and is in compliance with the Audit Act 1994.

VAGO has a long history of public service in Victoria. The first Auditor-General was appointed in 1851 and successive Auditor-Generals, or equivalent, have played a significant role in the independent review of the operations of the Victorian public sector and reporting to the Victorian Parliament.

The powers and functions of VAGO are legislated by the Audit Act 1994, providing VAGO with the legal basis for the conduct of the office's operations and activities. The Act enables VAGO to have access to all government information and the freedom to report findings arising from audits to the Victorian Parliament.

Under the legislation, the Public Accounts and Estimates Committee (PAEC) require a triennial Performance Audit to ensure that VAGO is achieving its objectives economically and efficiently and in compliance with the Act. These audits provide assurance to the public and Parliament that the Auditor-General and VAGO are operating as expected and that, just as VAGO encourages and promotes continuous improvement across the Victorian public sector, this audit affords the same opportunity to VAGO.

1.2 *Objectives*

The review has been conducted to provide a report to PAEC on whether the Auditor-General (AG) and the Victorian Auditor-General's Office (VAGO) are achieving their objectives effectively and doing so economically and efficiently and in compliance with the Audit Act 1994.

1.3 *Scope*

In accordance with the Terms of Reference as outlined within the Performance Audit of the Victorian Auditor-General and the Victorian Auditor-General's Office Tender (Tender reference number PAECRFT052013) and our contract dated 27 June 2013, we have performed a review to report to PAEC 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.

Work has been performed in three key streams:

- **Stream 1:** Review of the Office of the Auditor-General
- **Stream 2:** Review of conduct and management of Financial Audits
- **Stream 3:** Review of conduct and management of Performance Audits.

Refer to Appendix A for further details on the scope of this review.

1.4 *Approach and methodology*

Our overall approach and methodology consisted of five phases, which were supported by ongoing stakeholder management and reporting processes as follows:

- **Phase 1:** Planning and review preparation
- **Phase 2:** Desktop review and workshops with VAGO management
- **Phase 3:** Assessing the performance of VAGO
- **Phase 4:** Collating findings from all streams

- **Phase 5:** Reporting and presentation.

These phases were performed through:

- Discussions with relevant VAGO staff and stakeholders
- Review of relevant documentation
- Selected surveys to VAGO auditees
- Where appropriate, consideration of relevant benchmarks and better practices.

Refer to Appendix B for further details on the approach and methodology for this review.

The report is divided into 5 sections

- **Section 1:** Executive summary
- **Section 2:** Recommendations
- **Section 3:** Office of the Auditor-General
- **Section 4:** Conduct of Financial Audits
- **Section 5:** Conduct of Performance Audits

1.5 Overall conclusion

From the evidence gathered, we can conclude that the Auditor-General and the Victorian Auditor-General's Office are operating in compliance with the Audit Act 1994. Further the Auditor-General and the Victorian Auditor-General's Office are, in all material respects operating effectively, economically and efficiently and achieving their objectives under the Act.

Since the previous Performance Report in 2010 we would note the following positive findings from our audit.

- There has been a significant improvement in the staff morale across VAGO and the organisation has been increasingly active in addressing previously identified staff issues. The feedback from staff surveys and focus groups clearly indicates that VAGO is a preferred employer
- The retention rate at VAGO has improved since 2010 and this reflects the improvements in staff morale and encourages continuity of staff across the sectors whilst not compromising VAGO's independence
- VAGO continues to deliver the Financial Audit program on a timely basis with generally positive feedback from the auditees around the quality of the audit service provided
- VAGO continue to deliver a significant number of Performance Audits which generally attracted positive feedback from PAEC
- In the past 3 years VAGO has enhanced management of their risks through improvements to their risk management activities and has developed a Continuous Improvement Register to drive improvements projects across the office
- VAGO has worked closely with the Audit Offices in other jurisdictions to benchmark their activities and to work together to improve the audit services provided.

We have made certain observations and recommendations which, if implemented, will further enhance the efficient and effective operations of the Victorian Auditor-General's Office and further enhance the Auditor-General and the Victorian Auditor-General's Office contribution towards improving the public sector.

1.6 Recommendations

Our recommendations fall into two broad categories:

- Strategic recommendations – these recommendations are aimed at further enhancing the impact VAGO has in improving overall public sector performance
- Operational recommendations – these recommendations could be implemented quickly to enhance the operations of VAGO and are aimed at improving efficiency and quality outcomes

Section 2 of the report includes the detailed strategic recommendations and a summary of the operational recommendations which are included in the other relevant sections of the report.

1.7 Acknowledgements

We would like to take this opportunity to thank the AG and VAGO employees for their assistance and cooperation during the review.

2 Recommendations

Strategic recommendations

2.1 Model for delivery of Financial Audits

Observations & analysis

The current delivery model at VAGO outsources over 370 audits to professional services firms, known as Audit Service Providers (ASPs), representing 50% of the Financial Audit budget. All government departments' Financial Audits are completed by VAGO directly. A number of agencies are also directly audited by VAGO across all of the Victorian public sector. There are a number of Financial Audits completed by ASPs where VAGO has indicated specialist skills are required which are not available within VAGO. These audits are largely in the financial services sector, such as the funds management, banking and debt management, insurance and superannuation entities. The balance of the audits outsourced to ASPs are mainly as part of a resourcing strategy as referred to below.

In relation to this we make the following observations:

- The previous Auditor-General had stated his preference for outsourcing of a large volume of audits and in 2009 a review of the “Financial Audit Resource Strategy” concluded that the existing strategy for outsourcing should continue with some revisions and modifications. No reassessment of the model has been considered since then
- Based on the recent benchmarking across the Audit Offices in Australia, VAGO outsource the largest proportion of Financial Audits compared to the other jurisdictions, representing 66% of the Financial Audits completed annually. The average across all jurisdictions is currently 32%.
- Total ASP spend in the past 3 years is approximately \$33m
- The cost of the ASP audits is passed onto the agencies at invoiced costs plus the cost of VAGO's time spent on the audit. As this arrangement is a pass through there is little natural commercial incentive at VAGO to challenge the ASP cost on an annual basis. The agencies do not participate in providing a challenge to the fee.
- Feedback from the auditees has indicated that insufficient focus on contract management has resulted in higher costs and overruns by ASPs. ASPs have sometimes negotiated directly with the auditees for these overruns and there is little evidence that VAGO exercises control over the ASP costs (other than through the market tenders).
- The cost of ASPs has increased by approximately 5% annually since 2010. There has been little challenge from VAGO of these cost increases over the period; they have been accepted as “market driven”. It was noted that recent audit tenders have resulted in price decreases which has been attributed to a more competitive environment for the ASP's.
- Through our discussions with a number of the auditees the increases in audit fees in the past 3 years have been a cause for concern and there is a view that VAGO has provided little clarification or rationale for these increases.
- The pure economic rationale for outsourcing is limited as the price/rate quoted by the ASPs will always include a profit margin compared to the VAGO price/rate which is based on a cost recovery. Whilst it could be argued that ASPs may be more efficient, for the reasons outlined above there is likely to be less price tension applied by VAGO (as ultimately the cost is a pass through paid by the agency).
- Whilst the argument around the need for specialist firms is valid to a certain extent in the specialist areas of financial services audits, it is open to challenge as to whether this argument applies to all audits currently outsourced.

Recommendation

Notwithstanding recent cost decreases through tendering, it is appropriate for VAGO to review its current model for Financial Audit delivery and consider whether it may be appropriate to complete a larger proportion of these audits internally. There are potentially economic benefits to the public in revisiting and optimising the model delivering the ASP audits more economically and improving the contract management aspects of ASP audits.

Key matters that VAGO should consider include:

- Opportunity for more effective management of the overall audit costs where a larger volume of audits is completed by VAGO and audit fees would be less impacted by the profit imperatives of the ASPs. This should reduce the Section 29 fees borne by agencies. Even with audits requiring specialist skills, there would be scope for VAGO staff to be more involved in the audit delivery.
- More active contract management practices, challenging the ASP plans and costs, including overruns, rather than passing on CPI costs annually to auditees.
- With the significant improvement in staff morale and VAGO viewed as a preferred employer there is an opportunity to attract more high quality staff. In addition, the possibility of working across both financial and Performance Audits is likely to enhance the attractiveness of job offering in the market place.
- Greater leverage of staff across both Financial and Performance Audit disciplines would enable better management of the cyclical nature of the Financial Audit schedule and broaden the skills base of staff and allow greater synergy and knowledge sharing across all the audit groups. (Refer Recommendation 2.2 for further consideration of the resourcing model).
- An increase in audits completed by VAGO could also require a consideration of the current operating model and the capacity of the existing Financial Audit leadership group to manage the audit delivery requirements for a larger portfolio of audits managed internally. Appointment of additional senior staff would enhance the technical capability of the audit team and enable VAGO to build deeper relationships with their clients.
- There are some potential costs associated with an increase in audit staff which would need to be included in the analysis:
 - Accommodation costs
 - Recruitment expenses
 - Human resources management for additional staff
 - Administration costs, increase due to larger workforce and decrease due to reduction in administration of ASPs.

In considering the above options it would be appropriate to take into account the funding implications for Section 29 fees versus Performance Audit appropriations. Refer 2.3 below.

Auditor-General response - Accepted

The balance of audits delivered internally versus those delivered by contractors will be considered as part of an overall review of VAGO's funding model and proposed changes in the types of outputs VAGO produces.

Responsible:

Executive Director Audit Support Group (ED ASG) / Assistant Auditor General Financial Audit (AAG FA)

Timing:

September 2014

2.2 VAGO Internal resourcing model

Observations & analysis

VAGO's current resourcing model has two separate audit functions for Financial and Performance Audits. Each audit group have their industry sector groups which are led by sector directors. Senior staff generally remain in a sector group for up to 5 years before being rotated into another sector. This rotation policy also applies to other staff except for specific requests or a need for staff transfers. Secondments between the two audit groups do occur but are usually limited to some Financial Audit staff working within Performance Audit. There are limitations due to insufficient qualifications of Performance Audit staff to work on Financial Audits.

Through the staff surveys and focus groups there were some concerns expressed around organisational cohesion and from our discussions with senior VAGO staff, interaction and collaboration between the two audit groups is limited. The knowledge of sectors across the two groups is significant and the opportunity to share this knowledge is limited under the current resourcing model. This shared knowledge could better inform both Financial and Performance Audits conducted across the sectors, thereby enhancing the quality of the audit outcomes.

In addition, with reference to Recommendation 2.1 Model for Delivery of Financial Audits, an increase in staff to undertake a greater number of Financial Audits provides an opportunity to share and leverage across the two groups. Feedback from auditees has reflected that the more junior audit staff, particularly on Performance Audits, may not fully understand the organisation. A larger audit group with opportunities to work across both audit types could address these knowledge gaps and enable staff to have a more "complete" picture of the auditee, both financial and operational. This would also assist in the completion of the Performance Audits within shorter timeframes. This would allow the results and benefits from the audits to flow on a more timely basis, thereby enabling improvements to the public sector to be realised.

Recommendation

Due to the cyclical nature of the Financial Audits there is an opportunity to more effectively leverage staff across the two audit groups and potentially other staff within VAGO and better utilise staff for both audit disciplines. An integrated staff model would have some significant advantages for VAGO:

- Broaden the skills and expertise of staff across VAGO and encourage staff development in different audit activities and industry sectors and allow great depth of resources for succession planning
- Improve the auditing skills across VAGO, particularly enhancing the audit capability of Performance Audit team for staff with non audit specialist expertise
- Increased diversity and skills of resources would allow VAGO to expand its thought leadership on both public sector financial reporting and public sector performance
- Enhance knowledge sharing across the VAGO teams regardless of audit discipline which could lead to more effective coverage across the public sector with a more comprehensive understanding of the issues and challenges across the departments and agencies
- Improve organisational cohesion by reducing the silos across VAGO
- Larger pool of resources to complete all audit assignments, this would balance workload for all staff but in particular sector directors where the output based workload for Financial Audit sector directors seems disproportionately high compared to Performance Audit sector directors.

Auditor-General response - Accepted

VAGO will consider the advantages and disadvantages of the integrated staffing model recommended and how it can be built into planning without compromising the efficiency and quality of audits.

Responsible:

ED ASG

Timing:

April 2014

2.3 Funding Implications

Observations & analysis

Whilst the potential benefits around pursuing Recommendations 2.1 and 2.2 above are justified, further consideration needs to be given to the implications around VAGO funding. Currently the Financial Audit program is funded by Section 29 fees levied on the departments and agencies for the cost of the audit. Performance Audits along with the other costs of VAGO are funded through annual appropriations. In the 2013/14 Budget audits fees are estimated at \$23.1m and the balance of VAGO revenue of \$15.6m is received from annual appropriations. The direct cost of the AG position is funded separately from the costs of VAGO.

A change in the model for ASPs and greater leveraging of staff working across both audits disciplines would require consideration of how costs of staff working across both audit types should be funded and in particular to ensure that there is no cross subsidisation of audits from audit fees levied on the departments or agencies. In particular, the cost of Financial Audit staff engaged on Performance Audits would not be able to be recovered through Section 29 fees which would act as a financial disincentive to VAGO.

An option for VAGO would be a full appropriation model whereby both Financial and Performance Audits would be funded directly from appropriations and there would be no risk of cross subsidisation between the two audit groups. Such a significant change would require detailed discussions with the Department of Treasury & Finance and broader government and Parliament support.

Recommendation

VAGO should undertake a comprehensive review of the current funding model to consider the most appropriate funding model required for the implementation of all or components of the recommendations in Recommendations 2.1 and 2.2 (to remove any unintended financial disincentive to leveraging the total resources to VAGO).

Auditor-General response - Accepted

VAGO will review funding models including consideration of a fully appropriated model.

Responsible:
ED ASG

Timing:
Early 2014

2.4 Performance Audit methodology

Observations & analysis

Through our discussions with a significant number of auditees and review of the Performance Audit files, there are a number of elements of the Performance Audit methodology which have been identified as requiring improvement. These areas include:

- The duration of the audit and the impact of the elapsed time on the audit report delivery. The average duration of the audit is 7-9 months which may result in the impact of the audit being diluted as the subject matter for the audit may be “out of date” when the audit is completed. The initial planning for the audit can take between 2-3 months and reporting can take up to 2 months. It is acknowledged that the lapsed times are driven by current rigid requirements and practices around scoping feedback from stakeholders, set timeframes for draft findings consultation, draft reporting timeframes etc.

- Perception that issues are determined by VAGO too early, ie. during the planning phase. There is also a perception that VAGO is not always prepared to consider additional evidence provided by auditees to rebut or provide greater context. It is noted that sometimes this is due to such evidence coming forward late from more senior executives, eg. Deputy Secretary level, as they are not involved or engaged early enough by their own teams.
- The focus of the audit is often on programs that have been completed and the audit outcomes focus on history rather than looking forward to how the public sector can be improved during projects, programs or initiatives “in flight mode”. Greater focus on audits that are likely to make a difference by having an impact on outcomes set to be achieved by government policy, programs, initiatives and projects would enhance the value delivered by the VAGO Performance Audits.
- Insufficient VAGO senior staff involvement through the execution phase can result in issues with auditees during the reporting phase where issues should have been confirmed and focus should be on practical recommendations and management actions. Specifically, more active and timely interactions by Sector Directors and the Assistant Auditor-General with senior auditees at departments and agencies, including at Secretary level if needed, can deliver better outcomes for the public sector overall.

These proposed improvements do not in our view compromise the independence of the Performance Audit mandate.

Recommendation

- Enhancement to detailed scoping and planning activities to avoid the perception of a “scatter gun” approach to document requests and discussions, reduce time taken to develop audit plan and ensure criteria and measurement are clearly defined and shared up front.
- Planning meetings to involve the most senior VAGO staff, eg. Sector Directors and Assistant Auditor-General, with senior auditees, sometimes at Secretary level as required. This would provide good context up front, share the focus of the audit, agree criteria and target areas where the audit can make a difference. It would also remove the perceived criticism by auditees that VAGO did not engage at a sufficiently senior level to take into account complexities and challenges that agencies and department Executive are grappling with and provide appropriate balance in the report’s findings.
- Written issues to be supported by fuller evidence prior to discussion of drafts with senior auditees, including appropriate quality review and internal challenge of the issues by senior VAGO team members.
- Greater level of contact with senior auditees on emerging issues during the execution phase through engagement discussions between senior VAGO staff and senior auditee staff which could streamline the reporting timelines and deliver the final report on a more timely basis.
- Streamline the Performance Audit milestones to more appropriately reflect what actually happens and reduce the excessive focus on “complying” with rigid deadlines where more complete evidence could be utilised, given more time.
- Involvement of senior Performance Audit executives (Sector Directors and Assistant Auditor-General) more consistently over the course of the audits to ensure issues are clearly identified, evidence based, challenged internally and discussed with auditee executive management at the appropriate level as promptly as possible.
- Greater flexibility in the Performance Audit processes mandate could encourage more timely completion of audits and provide the opportunity for VAGO to react quickly to issues when identified and undertake audits or investigations to respond to public and government concerns.

Auditor-General response - Accepted

Many of the suggestions in the recommendation reflect current practices; the Assistant Auditor-General Performance Audit is involved in key audit meetings where sensitive issues arise that may require escalation or more senior involvement. Increased onsite presence of sector directors during the conduct phase of audit will be considered.

The time taken to complete audits is in part determined by requirements in the Audit Act 1994 such as consultation on specifications. Greater flexibility in the performance audit mandate to streamline these processes would be welcomed by VAGO.

Contingent on legislation changes

For those components not contingent on legislation

Responsible:

Assistant Auditor General Performance Audit (AAG PA)

Timing:

First quarter 2014

2.5 Performance Audit reporting

Observations & analysis

The mandate for Performance Audits under the Audit Act 1994 is to establish whether the public sector use resources economically, efficiently and effectively and in compliance with all relevant legislation.

The Performance Audit reports tabled in Parliament are comprehensive and include significant content on the audit scope and work completed. The Audit Summary at the front of the Performance Audit report includes an overview of the recommendations by VAGO and a brief mention of the submissions and comments received from the auditees.

In the main body of the report the individual recommendations are reported under the relevant section headings. However the management responses to the report are generally included in an Appendix to the report in the form of long general commentary/responses by department/agency Accountable Officers (several in some cases). These are not designed to always directly address the individual recommendations in the main body of the report. Through our review of selected Performance Audit files and reports it was often difficult to confirm which audit recommendations had been accepted and what management were proposing to do to action the audit recommendations.

Recommendation

In order to enhance the value of the Performance Audit report and increase the auditees' accountability for the findings and the recommendations it would be more appropriate for each recommendation to have a specific management response and when required, an appropriate formal action plan for actioning the recommendation, including timelines for implementation and the relevant responsible officers. As a minimum a summary of the recommendations and management actions should be included in the front of the report (eg. table format). Detailed recommendations and management response and action plans could be made available as an Appendix to the report or as a separate document for ease of review and reference.

Audit best practice supports that where an audit report contains detailed recommendations it would be expected that there would be a formal management response including an action plan, timetable for implementation and responsible officer. In addition, the inclusion of the detailed response provides management and the auditor with the opportunity to undertake a follow up review to validate the actions taken.

The current legislation provides for the department or agency to include in the report submissions or comments. However the legislation does not require these comments or submissions to include a formal response to the recommendations including an action plan to address the recommendation and timelines for implementation.

It may be appropriate to review the current legislation to enable the AG to request formal responses from the department or agency which include their proposed actions to address the recommendations identified in the report or provide comment where the audit recommendation is not accepted or cannot be actioned.

Auditor-General response - Accepted

VAGO has no power to mandate the content of agency responses. Agencies are encouraged in their responses to audits to advise VAGO of acceptance of recommendations, actions to be taken, and timing for those actions. Amending the legislation to enable the Auditor-General to request formal responses from the department or agency which include their proposed actions is supported.

Contingent on legislation changes

2.6 Follow up reviews

Observations & analysis

VAGO does not currently undertake any formal follow up review program around Performance Audits. Where VAGO undertake further Performance Audit work in the same department or agency it may undertake a follow up review of previous audits but this approach is inconsistent across the sector groups. In addition, on occasions VAGO may request information from the auditee as to the status of actions taken following the Performance Audit.

The PAEC undertakes a follow up program with information requested from the departments and agencies as to the status of the Performance Audit recommendations but this information is not validated by VAGO. In addition, departments and agencies may undertake their own follow up process as part of their internal audit or continuous improvement initiatives.

The current format of Performance Audits reports makes a formal follow up process challenging as the quality and detail of the management responses are inconsistent and do not easily support a formal follow up process.

Recommendation

VAGO should consider the development of a formal follow up program, following enhancements to Performance Audit reporting, with the program to commence in the Annual Plan 2014-15. The follow up program should be risk based and focus on the Performance Audit reports where significant issues were identified and a follow up audit would be in the public interest and reflect the AG's formal mandate. This follow up report should be formally reported to Parliament in the same manner as a Performance Audit report.

In determining the scope of a follow up audit, VAGO should take into account existing follow up activities including attestation to PAEC, internal assurance programs by departments and agencies and the extent of independent oversight exercised by departments' Audit Committees and/or agency Boards.

Because of the legislative matters raised in Recommendation 2.5 above relating to the AG obtaining formal responses and actions to report recommendations, there may be a limit in the AG's ability to undertake a comprehensive follow up program for all recommendations included in audit reports. In conjunction with the matters raised in Recommendation 2.5 above, it may be appropriate to consider how best to extend the AG's mandate to include formal reporting to Parliament of the status of actions taken by departments and agencies in relation to the recommendations arising from Performance Audit reports.

Auditor-General response - Accepted

VAGO is currently in the process of designing a comprehensive follow up program and is in consultation with PAEC on the process. The follow up program will leverage off agency responses to audit recommendations and to be fully effective is contingent on amendments to the Act identified in recommendation 2.5.

Contingent on legislation changes

2.7 Stakeholder engagement

Observations & analysis

Through our discussions with key external stakeholders and responses from auditee surveys, concerns were expressed over the adequacy of engagement by VAGO senior audit staff with their key external stakeholders. In particular the following feedback was received:

- Insufficient involvement by senior VAGO management throughout the course of the audit (particularly Performance Audits)
- Bottlenecks arise with the ASPs and VAGO at critical phases of the Financial Audit which can lead to delays in financial reporting and adverse comments from agencies and Boards
- Adverse feedback from some agencies around service, responsiveness and communication from VAGO on audit decisions and interactions with ASPs
- Stakeholders indicated that it would be constructive to audit delivery to have a stronger focus on relationship management across the sectors with one point of contact for all VAGO interactions
- Stakeholders would like VAGO senior staff to communicate with senior management at the auditees early and often to discuss and confirm audit issues as soon as they are fully developed and confirmed. This would improve the timeliness and quality of the reporting process.

Recommendation

Whilst acknowledging that Sector Directors have a senior role across their sectors, there is a need to consider further strategies and initiatives to improve stakeholder engagement and minimise the perception of adversarial interactions.

Initiatives to be considered by VAGO could include:

- Development of formal stakeholder engagement plans for individual departments and larger agencies to drive relationship accountability and performance
- Consideration of one VAGO point of contact for each department and larger agency across all audit activity
- Development of annual communication protocols with departments and larger agencies to identify key touch points for all planned audit activity over the 12 month period
- Identification of relationship service teams across VAGO as a point of contact for all auditees to consider any issues or concerns in the audit process particularly around financial reporting periods
- Assistant Auditor-Generals or Sector Directors actively seek out to engage with senior auditee management over the course of the Performance Audits including planning discussions and attendance at key meetings to discuss findings and supporting evidence, consider proposed actions and management feedback.

Auditor-General response - Accepted

VAGO is currently assessing a range of stakeholder engagement initiatives including greater liaison and communication with Departments and sectors. Initiatives to date include increased audit committee attendance, and the Performance Audit agency forum for key departmental audit contacts. A stakeholder engagement framework is being developed for the local government sector which will provide a framework for other sector engagement strategies to be developed.

Responsible:

Executive Director Policy & Coordination Directorate (EC PCD)

Timing:

July 2014

2.8 Technology capability

Observations & analysis

In the previous VAGO Performance Audit in 2010 there were a number of recommendations in relation to IT Audits which VAGO is still currently implementing. The recommendations related to VAGO developing computerised techniques for future audits and expanding the use of IT resources in the future. Since the previous audit VAGO has developed an IT Strategy which includes the development of the use of technology in audits and CAATS tools have been purchased by VAGO and additional staff hired to be utilised on audits. However it is only in the current 2012/13 year that data assurance techniques have been utilised on Financial Audits. As these audits were ongoing during our Performance Audit we have not reviewed the effectiveness of the use of these data assurance techniques on the audit outcomes.

Current better audit practices involve significant investment in data analytics capability to improve the effectiveness and efficiency of audits. Audit techniques that are being undertaken in the profession include:

- Continuous / real time auditing – techniques to analyse financial transactions in “real time”
- Data analytics – utilising data analytics techniques to test financial balances and transactions more effectively, with less exposure to sampling error
- CAATs – running “scripts” over selected data sets to identify discrepancies or unusual transactions for further analysis.

Recommendation

VAGO should invest further in the utilisation of technology across all audit activities. In the first instance this can be more effectively developed for the Financial Audits and then consider their potential value to the Performance Audit activities.

VAGO should consider the need for stronger capability and resources in this area and as a reflection of its importance to the future of auditing ensure that the development is led by a senior staff member of VAGO with appropriate support from and access to the AG. This initiative should be supported and resourced more actively. Progress over the last 6 years has been slow. The benefits from pursuing this recommendation includes likely efficiency gains – smarter auditing and effectiveness gains - coverage of larger sets of data, less sampling risk and the employee value proposition of being at the forefront of the profession.

Auditor-General response - Accepted

VAGO agrees that further investment in technology capability is required and a distinct role for an Assistant Auditor-General Information System Audit has been created and recently advertised. There are budget implications to such investments that must be considered and could limit the ability of VAGO to address this recommendation expeditiously.

Responsible:

Assistant Auditor General Information Systems Audit (AAG ISA)

Timing:

Commence early 2014

Summary of operational recommendations

| VAGO Area | Summary recommendation | Report Ref | Focus |
|-------------------------------------|---|------------|--------------------------------------|
| VAGO Governance and Planning | <ul style="list-style-type: none"> Develop VAGO's role as a leader in public sector reform through publication of better practice guides or equivalent for financial management, reporting and Performance Audit themes. This may require a change to the legislation to extend the AG's mandate to include these activities in their mandate. | 3.1 (a) | Effectiveness |
| | <ul style="list-style-type: none"> VAGO to consider a detailed review and analysis of corporate services costs, including more detailed benchmarking of its resources and costs against other jurisdiction audit offices to identify and pursue potential efficiencies | 3.1 (a) | Economy / Efficiency |
| | <ul style="list-style-type: none"> Streamline the Annual Plan from a 4 year to a 12-24 month outlook. Potential benefits around significant resources currently utilised being redirected to audit delivery with no diminution in the overall quality of the plan | 3.1 (c) | Efficiency |
| | <ul style="list-style-type: none"> Ensure that the costs allocation model for VAGO's overhead costs is adequately documented to ensure transparency, minimise the risk of cross subsidisation across the audit groups based on the current funding model | 3.1 (e) | Economy |
| | <ul style="list-style-type: none"> Continue to monitor and report on any gaps between the actual and published costs for Performance Audits and provide appropriate explanation/actions for any significant variances | 3.1 (g) | Economy |
| | <ul style="list-style-type: none"> Develop technology capabilities of VAGO for utilisation on audit programs to drive more efficient and effective audits | 3.1 (g) | Efficiency / Effectiveness |
| | <ul style="list-style-type: none"> Ensure timely implementation of the proposed business improvement project for monitoring ASP performance | 3.1 (g) | Efficiency / Effectiveness / Economy |
| | <ul style="list-style-type: none"> Performance Audit to develop a formal process for monitoring of contractor performance to assess both effectiveness and economic value in the audit delivery | 3.1 (g) | Economy / Efficiency |
| | <ul style="list-style-type: none"> VAGO to review Recommendation 6 of the 2010 Performance Audit in regard to reporting the impact of Performance Audits on government activities. Such reporting could provide additional insights on the effectiveness of Performance Audits and set expectations around improvement in the public sector. | 3.1 (g) | Effectiveness |

| VAGO Area | Summary recommendation | Report Ref | Focus |
|---|--|------------|----------------------------|
| Human resources management | <ul style="list-style-type: none"> Development of succession plans for senior leadership roles and leadership with critical skills/experience to ensure effective management of audits and development of staff and minimise staff disruption when senior staff leave the organisation | 3.2 (b) | Effectiveness / Efficiency |
| | <ul style="list-style-type: none"> Assess the root cause of low scores on organisational cohesion to ensure that any interventions developed to address the issue are practical and will drive improvements in the ways of working. Strong organisational cohesion will drive a more effective organisation and enable greater acceptance of any structural changes which may occur. | 3.2 (c) | Effectiveness |
| | <ul style="list-style-type: none"> Incorporate strategic workforce forecasting into annual planning process with a 12 monthly review cycle and 6 monthly validation to enable more effective management of VAGO's budget requirements | 3.2 (e) | Efficiency |
| | <ul style="list-style-type: none"> Consolidate learning and development capability within the People and Culture team to ensure greater oversight of the various programs and drive efficiencies through one point of administration | 3.2 (f) | Efficiency |
| | <ul style="list-style-type: none"> Establish processes to measure the benefit delivered from professional development activities, to optimise return on investment in training and balance costs to align with agreed benefits | 3.2 (g) | Economy / Effectiveness |
| Monitoring and measuring performance effectiveness | <ul style="list-style-type: none"> Management should provide greater clarity and definition around the traffic light system in Monthly Management Reports to enable more effective discussions around results and any variances | 3.3 (a) | Effectiveness |
| | <ul style="list-style-type: none"> Provide greater clarity and information around the performance measures across the Annual Plan and the Business Plan and alignment between the two plans. This could promote more effective discussions of performance at EMG and, where performance measures are not being achieved, with appropriate action plans to be agreed by EMG collectively | 3.3 (b) | Effectiveness |
| | <ul style="list-style-type: none"> With reference to Recommendation 2.7 in Section 2 of the report, VAGO to develop a formal follow up program for Performance Audits including prioritisation criteria, initial scopes etc. Reference is also made to the current 2013 Report's recommendation to revisit Recommendation 6 from the 2010 Report around the impact of Performance Audits on government activities | 3.3 (h) | Effectiveness |

| VAGO Area | Summary recommendation | Report Ref | Focus |
|---|--|------------|---------------|
| Conduct and management of Financial Audits | <ul style="list-style-type: none"> Enhance documentation of overall approach and judgements made – “Telling the story of the audit” to ensure all the audit outcomes are fully supported by documented evidence | 4 (b) | Effectiveness |
| | <ul style="list-style-type: none"> The robustness of substantive analytical review requires strengthening to ensure adequate explanations are included on the audit file | 4 (b) | Effectiveness |
| | <ul style="list-style-type: none"> The completeness and consistency of documentation regarding audit procedures designed to address the risk of fraud should be improved for consistency across the files and in compliance with IPSAM | 4 (b) | Effectiveness |
| | <ul style="list-style-type: none"> File maintenance and documentation of audit evidence could be improved so that the audit file can stand alone as the repository of all audit evidence | 4 (b) | Effectiveness |
| | <ul style="list-style-type: none"> Consider documentation around the rationale for no further audit procedures on untested balances and where there are variations from the sample testing guidance | 4 (b) | Effectiveness |
| | <ul style="list-style-type: none"> Ensure that prior to year end there are clear guidelines issued to both VAGO auditors/ASPs and auditees on financial statement materiality thresholds and requirements/protocols for late audit adjustments | 4 (c) | Efficiency |
| | <ul style="list-style-type: none"> The use of a template or practice aid during the gathering of evidence would prompt teams to more fully comply with the required elements of documentation and consider the selection technique and size prescribed within IPSAM | 4 (d) | Effectiveness |
| | Efficiency opportunities to be considered by VAGO: | 4 (b) | Efficiency |
| | <ul style="list-style-type: none"> The work of internal auditors to be used more effectively to optimise VAGO resource use where appropriate Identify audit risks and responses more clearly to ensure audit resources are optimised Greater use of templates to guide audit teams in documenting audit work more efficiently | | |
| Conduct and management of Performance Audits | <ul style="list-style-type: none"> Clearer identification of risk, materiality and complexity within AmP of each Performance Audit. This would provide greater clarity and inform the level of staffing and expertise for an engagement, including involvement of senior management. | 5 (a) | Effectiveness |

| VAGO Area | Summary recommendation | Report Ref | Focus |
|-----------|--|------------|----------------------------|
| | <ul style="list-style-type: none"> Ensure supporting documentation for monitoring of budgets captured on the AmP file to enable review of budget outcomes | 5 (a) | Economy / Efficiency |
| | <ul style="list-style-type: none"> Provide guidance on documentation to be included in the issues paper section, to enable linkage of the final report to this section | 5 (a) | Effectiveness |
| | <ul style="list-style-type: none"> Streamline the number of key milestones in the AmP file to more accurately reflect the key dates to be completed and reduce focus of the audit on achieving milestones and greater focus on delivering quality report to stakeholders | 5 (a) | Efficiency |
| | <ul style="list-style-type: none"> Audit working papers to clearly document the rationale and approval for audit scope changes such as reduction in sample sizes or amendments to locations or agencies included in the audit | 5 (c) | Effectiveness |
| | <ul style="list-style-type: none"> Significant delays in audit delivery should be formally communicated to relevant external stakeholders as soon as practicable. This will allow VAGO to respond promptly to any queries and provide learnings on reasons for delay to avoid similar situations occurring in the future. | 5 (e) | Efficiency / Effectiveness |

3 Office of the Auditor-General

3.1 VAGO Governance and Planning

Terms of reference

Review the governance structure and planning activities of VAGO with particular attention to:

- (a) The adequacy and appropriateness of the organisational and management structures in place to promote the effective governance of the VAGO activities and operations

Summary of observations

VAGO is currently structured around its key areas of delivery with four business units:

- **Financial Audit** – Delivery of Financial Audits, including Methodology and Standards
- **Performance Audit** – Delivery of Performance Audits
- **Policy and Coordination Directorate (PCD)** – Policy management and support to Office of AG
- **Audit Support Group (ASG)** – Support services including finance, human resources.

VAGO has an Executive Management Group (EMG) which comprises the Auditor-General, the Chief Operating Officer (COO) and the heads of the four business units. The EMG meets on a monthly basis and receives a Monthly Management Report (MMR) for monitoring performance and to focus on strategic initiatives of the business and delivery of key business plans. Sub committees report to EMG on their activities and have been established to manage occupational health and safety, procurement and staff issues. There are two other committees who report directly to the AG: the Remuneration Committee and the Technical Issues Committee. In addition VAGO has independent Audit Committee which monitors key risks of VAGO and has oversight of the internal audit program. This is discussed in (f) of this section.

The structure appears reasonable for current management of the activities of VAGO. There is appropriate oversight by the EMG and the supporting committees appear to work adequately. Implementation of the recommendations in Section 2 may require VAGO to reassess the current structure particularly in relation to managing any additional resources, impact of greater leveraging the staff across the two audit groups, building the technical capability and financial management implications from any revisions to the funding model for VAGO.

The key delivery areas at VAGO have gone through some change in the past 3-4 years. PCD was established in 2009 and provides a range of support functions to the AG including policy and governance. ASG was established in 2012 following a review by the State Service Authority on the most effective and efficient model for business support activities in VAGO. The ASG currently has 25 staff, representing 15% of total staff at VAGO and its annual budget is \$7.3m, representing 19% of total VAGO budget. A recent benchmarking exercise across all the Audit Offices in Australia has identified that VAGO is in the top three for corporate services costs. The range in the analysis was between 13% – 25% for staff and 8% – 21% for expenditure.

VAGO's current activities have been strongly focussed on the delivery of the audit programs and there has been limited development of VAGO's role as a leader in the public sector. Through the audit programs VAGO is in a strong position to develop better practice guides on key themes and learnings across the public sector. In particular the data gathered through Financial Audit areas of focus could be compiled to better practice guides for the wider public sector.

The same applies to the development of better practices and insights from Performance Audits. The strong focus on Program Performance and IT Projects by VAGO can be leveraged to provide a catalyst for improvement in the public sector.

The AG has a leadership role in financial reporting across the public sector in both Victoria and Australia. VAGO should consider how they can best share their knowledge and expertise with their client base and beyond and work with Department of Treasury & Finance to potentially develop a centre of excellence in public sector financial management, reporting and performance.

Recommendations

- Develop VAGO's role as a leader in public sector reform through publication of better practice guides or equivalent for financial management, reporting and Performance Audit themes. This would enhance the role of the AG and VAGO as leaders in public sector reform across Victoria and Australia
- VAGO to consider a detailed review and analysis of corporate service costs, including more detailed benchmarking of its resources and costs against other jurisdiction audit offices to identify and pursue potential efficiencies.

Auditor-General response - Accepted

VAGO is considering better practice guides in the future and is actively considering increasing outputs to promote good public sector management practices; this would be assisted by appropriate amendments to the *Audit Act 1994*.

Contingent on legislation changes

Auditor-General response - Accepted

VAGO is currently reviewing its whole of office operations including non-audit functions. A detailed cost analysis will be undertaken once the operational groups have been established and a full funding model review completed.

Responsible:

ED ASG

Timing:

July 2014

Terms of reference

- (b) the quality of Strategic Planning undertaken by VAGO in terms of its comprehensiveness, relevance and clarity of direction

Summary of observations

VAGO has developed a Strategic Plan (the Plan) for the period 2010 – 2015, the Plan sets out five key result areas:

- Reports and Advice
- Parliament
- Audit Client
- People
- Organisation.

The Strategic Plan will be updated for the next 5 years following the appointment of the new AG. In addition VAGO develops an annual Business Plan which covers the key initiatives and activities that VAGO will undertake during the year and aligns with the Strategic Plan and the Annual Plan.

Recommendation

There are no recommendations for this area.

Terms of reference

- (c) the adequacy and effectiveness of VAGO's annual planning process including intelligence gathering and stakeholder consultation in relation to the identification of areas of audit focus, having regard to risk factors and other relevant consideration across the Victorian public sector

Summary of observations

VAGO's Annual Plan (the Plan) takes 10 months to complete and costs VAGO approximately \$1m per annum. The Plan covers the financial and Performance Audit program, including Performance Audit topics and Financial Audit areas of focus for a four year period.

The process for development of the Plan involves the following key activities:

- Sector scanning
- Initial stakeholder liaison with selected senior stakeholders across the Victorian public sector
- Development of the draft plan within VAGO including sector identification of the Performance Audit topics and Financial Audit focus areas, roundtable discussions and basic scoping undertaken
- Initial draft Plan discussed with key departments and agencies as required
- Consultation with the Public Accounts and Estimates Committee on the draft Plan
- Presentation of final draft to EMG and AG
- Final approval by AG.

The Plan is a comprehensive document which involves a significant investment of resources by staff at VAGO. The current Plan has a 4 year forward outlook, however as the Plan is updated annually the proposed audits and topics in years 3 and 4 will often change to reflect changing priorities and risks in the state. A 12 -24 month outlook of audits and topics in the Plan would provide adequate notice of VAGO's projects whilst ensuring the Plan retains its relevance.

Recommendation

- Streamline the Audit Plan from a 4 year to a 12-24 month outlook. Potential benefits around significant resources currently utilised being redirected to audit delivery and with no diminution in the overall quality of the Plan.

Auditor-General response - Accepted

The Annual Plan approach is being reviewed with a focus on allowing VAGO to have more flexibility to respond to emerging issues.

Responsible:

AAG PA

Timing:

June 2014

Terms of reference

- (d) the relevance and appropriateness of VAGO's Annual Plans for 2010-2011, 2011-2012, and 2012-2013, to VAGO's legislative mandate and Strategic Plan, and the extent to which the activities identified in the Annual Plans have been, and are being achieved

Summary of observations

The mandate of the AG is broad and the Annual Plans appear comprehensive in their coverage over the key areas in the Victorian public sector. The Plan development includes stakeholder engagement with senior members of the Victorian public sector and review by the PAEC. Feedback in relation to the content of the Plan has been generally positive and there has been no indication that the areas covered are not appropriate. It has been noted that the 4 year outlook of the Plan may be too long as priorities and risks can change quickly in the public sector. This has been considered in the comment above.

In relation to the Strategic Plan, VAGO continues to meet its requirements under the key components of the Strategic Plan:

- Reports and Advice
- Parliament.

Recommendation

There are no recommendations for this area.

Terms of reference

- (e) the extent and quality of internal planning directed at the efficient and effective management of VAGO (eg. workforce engagement; succession planning; fee setting and cost recovery; and budget and expenditure control)

Summary of observations

Workforce engagement

Productivity and billing rates are established each year for each grade. VAGO requires all staff to submit time cards weekly and all timesheets require approval by an individual's manager or director. A Financial Audit dashboard is used by the executive team to monitor productivity of staff against established targets per sector. The Performance Audit dashboard also reports target and actual hours and costs for each Performance Audit (high level only).

The format of the VAGO Monthly Management Report ("MMR") has recently been revised (September 2013). The previous MMR reported total employee costs and hours as well as hours and FTEs by Business Unit. Recreational leave and flex leave balances were also reported as well as total sick leave hours taken, hours spent on staff development, long service leave hours and other paid leave hours. The revised MMR now reports total FTEs, sick leave hours and staff turnover and flex leave and annual leave excesses are reported to the business units separately by HR. These changes were to enable the EMG to focus on the strategic elements of workforce management and enable the business units to manage at the micro level.

Fee setting and cost recovery

In accordance with Section 10 of the Audit Act 1994 an Authority and/or Minister must pay to the Consolidated Fund an amount determined by the AG to defray the reasonable costs and expenses incurred by or on behalf of the Auditor-General in conducting an audit of the financial statements of the authority and expressing an audit opinion on them in accordance with the Act.

As outlined in Recommendation 2.1 in Section 2 for audits carried out by ASPs (selected through a competitive tendering process), the full cost charged by the Audit Service provider is passed through to the Authority as well as additional costs for VAGO's internal review (currently approximately 15% of the ASP fee).

Costs for audits carried out by VAGO staff are budgeted based on staff charge out rates and the estimated effort required by grade which is determined through the audit planning process. Charge rates for 2013/14 were established by taking the average salary per grade divided by 1680 hours (deemed to be the number of hours after leave is considered). This result was then multiplied by a factor to reflect the allocation of VAGO office overhead costs.

Performance Audits are funded through an annual appropriation and there are no fees charged for Performance Audits to the auditees.

Under the current resource model the fee setting calculator process is considered reasonable.

Budget and Expenditure Control

VAGO's annual budget is contained in the annual Business Plan. The objective of VAGO's budget is to deliver a nil surplus. The annual budgeting process commences in February each year when current and prior year data is collated. A number of assumptions are made for certain expenses through consultation with the business and using prior year data. A staff resource plan is used to budget staff costs, ASP fees. Accommodation costs are based on leases, contracts/agreements, and depreciation and other costs such as capital asset charges are also established. The remaining elements of the budget are built through discussion with each of the business units.

VAGO operates through two output groups, OG1 and OG2. OG1 relates to the provision of parliamentary reports and services (funded through the annual general appropriation), and OG2 relates to the delivery of Financial Audits and provision of audit reports on financial statements of public sector entities which is funded through Section 29 revenues.

For budget year 2013-14 the cost split between OGI and OG2 was 40%/60%. This split was predetermined at the start of the year and is based on either fully allocating costs to OG1 and OG2 or allocating costs using base ratios or special ratios. The budget is also split by VAGO departments as follows: Financial Audit -52%; Performance Audit – 22%; Audit Support Group – 19% and PCD & the AG's Office – 7%. A base ratio was determined for each of these departments to allocate costs to OG1 or OG2. The base ratio is used to allocate the majority of costs however special ratios are used where the base ratio is not appropriate.

We reviewed these ratios and costs allocations and noted that VAGO has been reviewing its cost allocation model to ensure greater transparency and equity in the split of overhead costs between the two audit groups. We noted that there were some minor revisions to the current cost allocation model. Further work is being carried out by VAGO including using external advice. This exercise may require further revision following the recommendations 2.1- 2.3 in Section 2 of this report.

The budget is monitored by EMG through high level figures reported in the MMRs. The two audit groups also monitor elements of the budget through weekly dashboard reporting. A midyear budget review is performed and may require update of the budget to reflect any changes in activities.

High level budget results are reported externally to PAEC through quarterly acquittal reports and biannually to the Department of Treasury & Finance.

Recommendation

- Ensure that the cost allocation model for VAGO's overhead costs is adequately documented to ensure transparency and minimise the risk of cross subsidisation across the audit groups based on the current funding model.

Auditor-General response - Accepted

VAGO will continue to monitor the controls in place to ensure both accurate time recording and budget reporting. In addition, the full funding review will consider mitigating strategies for minimising cross subsidisation risk.

Responsible:

ED ASG

Timing:

Implemented

Terms of reference

- (f) the effectiveness of the Audit Committee in overseeing the scope, quality and effectiveness of the internal audit function within VAGO and in highlighting any risk management issues pertinent to the operations of the VAGO appointed Committee

Summary of observations

The Audit Committee is well established at VAGO and its membership is consistent with the requirements of the Victorian Financial Management Compliance Framework (FMCF). The Audit Committee meets at least 4 times per year and its Charter and scope of work are consistent with best practice and the FMCF. Minutes of meetings are documented and were reviewed for the three year period 2010 – 2013. The role of the Audit Committee includes oversight of the risk register and the internal audit program.

The Internal Audit function is fully outsourced to a professional services firm. This firm has been appointed since 2010 and was recently renewed for a further two years. The audit plan is updated annually, reflecting the risk register and key initiatives of VAGO and the internal audit plan is comprehensive and consistent with requirements of the FMCF and better practice.

In the past 3 years VAGO and the Audit Committee have undertaken work to improve the quality and content of the Risk Register. The current register was developed through an annual risk workshop at the EMG retreat in May 2013 and presented to the Audit Committee following endorsement by EMG.

Recommendation

There are no recommendations for this area.

Terms of reference

- (g) consider the extent of progress made and effectiveness of actions and measures implemented by VAGO to address the recommendations made in the 2010 Performance Audit report. Notwithstanding that the previous Auditor-General had not accepted 50 per cent of the recommendations made, consider the ongoing validity and application of these recommendations to VAGO

Summary of observations

VAGO accepted 10 of the 20 recommendation included in the August 2010 “Public Accounts and Estimate Committee (“PAEC”) Performance Audit of Victorian Auditor-General and Victorian Auditor-General’s Office Report”.

Recommendations accepted by VAGO were included in a continuous improvement register used to track progress against outstanding actions and recommendations. The February 2013 version of this register reported the implementation status of the 2010 actions as completed.

We considered actions taken to close out the 2010 recommendations accepted by VAGO and noted that the following recommendations are being actioned but remain in progress:

Recommendation 11- Performance Audits: Budgeted Costs vs. Published Costs

- VAGO to consider conducting a comprehensive review to identify ways to better manage costs/scope creep relating to Performance Audits.
- VAGO should also consider reviewing their budget setting practices to ensure more realistic budgets are prepared for Performance Audits.

While a comprehensive review was not conducted by VAGO, management have advised that the gap between budgeted and published costs is closing due to more accurate estimation of audit costs and closer monitoring of budgeted and published costs by EMG in the MMR. The June 2013 MMR highlighted that published costs for Performance Audit were marginally lower than budgeted costs but exceeded actual costs by \$271k/3%.

Going forward published costs will be reported through the Performance Audit Dashboard report and monitored in weekly Performance Audit meetings however we note that rationale for variances is not fully documented. In addition the FY13/14 dashboard report to date highlighted average variances of 4% (between actual and published costs) for reports tabled in August and September 2013, an increase since June 2013. VAGO should continue to review and monitor these costs closely.

Recommendation 17 – IT Audits

- We have been advised by VAGO that the IT strategy is being reviewed and will be incorporated into 2010-11 business plans.

- *We suggest that VAGO consider increasing the use of computerised techniques in future audits. An assessment of future IT staff audit requirements should be performed. From discussions with management, we understand that VAGO is considering outsourcing IT resources in future audits. We would encourage an expanded use of IT resources in future engagements and that more consideration of the use of IT specialist to included in audit strategies in future years.*

CAATs tools have been purchased by VAGO and additional staff IT staff have been hired but IT teams are only recently being included on Financial Audits. No data assurance or CAATs were used in 2012 audits reviewed but we understand such techniques are being employed for 2013 audits. Management advised that it will take time to fully embed the use of CAATs into the audit program.

In our Recommendation 2.8 in Section 2 of this report we have recommended that the technical capabilities of VAGO be an area of significant focus for the Office going forward.

Recommendation 18 – Evaluation of Private Audit Contractors and Consultants

- In order to meet the strategy of continuously improving VAGO's systems, methodologies and processes (Strategic Plan 2007 – 08 to 2009-10), we suggest that VAGO consider formalising a criteria scoring basis for evaluation of specialists engaged by Performance Audit and to further provide defined documentary evidence for sanctions or terminations against contractors, where appropriate;*
- We suggest the VAGO considers maintaining records of individual independent decisions of tender panel members prior to group decision, consensus agreement and final sign off. This may provide evidence that individual decision making was independently made before a consensus decision making is determine;*
- We suggest that VAGO consider further enhancing the key selection criteria scoring process for selection of Performance Audit tenders and that the process be aligned to the methodology used for Financial Audit tenders;*

ASP contracts include a clause that states the Auditor-General will conduct a performance review of the contractor, measured against performance standards outlined in a schedule to the contract, however current contract schedules do not contain performances standards. It is expected that the performance of contractors will align to the business objectives and targets set out in the VAGO annual plan, and the more detailed targets set out in the VAGO Financial Audit Business Plan.

- Results of current ASP monitoring are reported in an ASP Forum presentation. This is based on the result of ASP self assessment and VAGO assessment. Financial Audit has indicated that a business improvement project has been established to enhance the monitoring of ASP performance
- Performance Audit does not have a similar scoring process for the use of contractors. Management advised that there is only one relevant question in the audit debrief (where appropriate). Performance Audit is considering including a more formal evaluation in the procurement database to provide a more detailed assessment of the quality of their work with procurement staff and this is in the planning stage.

We considered that all other recommendations have been completed.

Recommendations

VAGO to continue to track 2010 Performance Audit recommendations 11, 17 and 18 as follows:

- Continue to monitor and report any gaps between the actual and published costs of Performance Audits and provide appropriate explanations/actions for any significant variances (Recommendation 11)
- Develop technology capabilities of VAGO for utilisation on audit programs to drive more efficient and effective audits (Recommendation 17)
- Ensure timely implementation of the proposed business improvement project for monitoring ASP performance (Recommendation 18)
- Performance Audit to develop a formal process for monitoring contractor performance to assess both effective and economic value to the audit (Recommendation 18).

Auditor-General response - Accepted

VAGO will continue to monitor audit costs with a view to continuing to decrease the percentage of audits that exceed their budgeted costs.

Responsible:

AAG PA

Timing:

Ongoing

Auditor-General response - Accepted

VAGO accepts this recommendation. Refer to response provided for Recommendation 2.8 above.

Responsible:

AAG ISA

Timing:

Commence early 2014

Auditor-General response - Accepted

The business improvement project to monitor ASP performance is under way.

Responsible:

AAG FA

Timing:

April 2014

Auditor-General response - Accepted

A process for formally assessing contractor performance is being developed. Work will be done on making the assessments available for use in overall contract assessment.

RESPONSIBLE

AAG PA / ED ASG

TIMING

September 2014

We considered the reasons why the remaining 10 of the 2010 recommendations were not accepted by VAGO. The rationale in most cases appears to be reasonable as we understand a change in legislation may have been required in order to fully implement the recommendation and/or VAGO considered current arrangements to be adequate. However one of the recommendations, Recommendation 6 not accepted in relation to the *Structure of Performance Audit Reports Tabled at Parliament* has also been raised in this report. (Refer Recommendation 2.5 in Section 2 of this report)

While we understand Recommendation 6 to consider reporting quantifiable measures relating to recommendations raised by VAGO in Performance Audits was not accepted due to a suite of other performance indicators being in place, another Audit Office in Australia does report on the specific impact Performance Audits has had on government investment and support in certain areas and sectors as a result of their reports. This may be an area that VAGO may wish to revisit.

Recommendations

- VAGO to review Recommendation 6 of the Performance Audit 2010 in regard to reporting the impact of Performance Audits on government activities. Such reporting could provide additional insights to the effectiveness of Performance Audits and set expectations for improvements in the public sector.

Auditor-General response - Accepted

The basis for assessing the impact of performance audits would be assisted by more comprehensive responses by agencies to audit recommendations as noted in Strategic Recommendation 5. This would be facilitated by amendments to the *Audit Act 1994*.

VAGO will initiate a discussion with other Australian audit offices on reporting the impact of performance audits on government activities.

Contingent on legislation changes

3.2 Human resource management

Terms of reference

Review and provide an assessment of VAGO's human resource management systems, policies and practices together with any recommendations for improvement, including but not limited to the following areas:

- (a) The appropriateness of the mix between specialist expertise, contractors and suitably qualified in house staff in undertaking particular financial and Performance Audits.

Summary of observations

Overall, VAGO has a highly educated and highly skilled workforce. In 2011-12, 87% of all employees had a bachelor degree or higher as compared to 66% for the VPS. It was observed that a total of 33 staff had professional qualifications in accounting including CA, ACCA, CPA and Master of Professional Accounting. 27 of these were within Financial Audit, reflecting the requirement for specialist accounting skills in this area.

Feedback from focus groups indicated that VAGO has a preference for using internal resources wherever possible to complete audit assignments, however, where specialist capability is required to complete an audit, VAGO will look to source that capability externally. It was felt from the groups that specialist external resources were brought in at appropriate times and that the preference towards internal resources provided more development opportunities for internal staff.

The selection of resources for each audit is completed during the planning stage based on the type of audit, complexity, skill sets required and staff availability. It is understood that this process is completed well in advance and issues around resource availability are managed ahead of time. In particular, focus groups indicated that contractors were deployed effectively at busy times, noting that the more complex or riskier audits appeared to be retained in house.

While not a direct indicator of capability, it was observed that VAGO has a considerably lower average tenure than VPS peers. Comparator organisations registered 55% of employees having 5 years or more of service, compared to 29% at VAGO. Only 21 employees had worked at VAGO for more than 10 years. Our understanding is that this is attributed to VAGO initiatives to refresh the leadership and culture of the organisation over the last 6 years.

VAGO maintains a continuous improvement register to measure and monitor progress against strategic and tactical initiatives across all parts of the business. From a HR management perspective, it was noted that the VAGO continuous improvement register contained an on-going action from the 2012 Parliamentary and Audit client survey to focus on staff continuity, professionalism and skills and knowledge of Financial Audit staff. This suggests that qualifications and skills of internal resources are an on-going high priority for VAGO.

Experience

The relatively low average tenure for VAGO could pose issues for knowledge retention within the organisation in the future, however this does not currently appear to be an issue and may be mitigated by currently low turnover levels.

Resourcing and skills

While resourcing of audit teams was not identified as a problem area during interviews or focus groups, it was observed from the audit completion reports that on two occasions there were instances of individuals being placed in roles without the requisite experience or capability. From the evidence available it is unlikely that this is a systemic issue across the organisation, rather these instances most likely reflect isolated instances in the resourcing process.

Recommendation

There are no recommendations for this area.

Terms of reference

- (b) the adequacy of performance and development strategies and succession planning in place to recruit and develop staff relevant to VAGO's objectives and operational needs.

Summary of observations

VAGO has a structured performance management process supported by a comprehensive policy. Performance is assessed over a 12 month period with reviews completed at 6 monthly intervals. The Performance and Development Plan (PDP) template is completed by all staff and is used to set, track and measure performance and development targets for the year.

VAGO also invest heavily in the professional development of staff. VAGO have learning and development capability embedded within Financial Audit and Performance Audit groups to ensure learning content is regularly reviewed and updated to reflect operational requirements. The professional development practices at VAGO are outlined in more detail in (f) and (g) of this section.

Feedback from staff on the 2013 engagement survey and during focus group sessions indicated that staff development is a strength area within VAGO and there was a general appreciation for the development opportunities and the way the process is managed within VAGO.

Succession planning at VAGO appears to be a largely informal process, with no evidence of documented succession plans for senior leadership or critical skill positions. It is understood through meetings with VAGO directors that some discussions have commenced on this topic recently.

Policy and process

VAGO's Performance Management Policy is comprehensive and clearly outlines key process steps (including associated dates), accountabilities throughout the process and guidelines that provide a clear and concise description of each step in the process.

While the performance management process is highly manual, there appears to be a solid level of rigour around the development and management of individual PDPs. In particular it was noted that the Manager People and Culture reviews all PDPs across the organisation for consistency and compliance purposes as well as to identify areas for improvement and professional development focus.

Focus groups also provided universally favourable feedback in relation to access to, and relevance of, development opportunities. It was also clear through these conversations that the policy was well understood across the organisation in terms of both process and associated guidelines and criteria.

Conversations with the Manager People and Culture and the focus groups suggested that VAGO managers are competent in having performance conversations with their staff. It was noted in focus groups that there is some variation in the quality of discussions across managers, although these comments reflected instances of exceptional managers as opposed to any below average.

Continuous improvement

An internal audit report on Performance Management was completed in February 2013. The audit was conducted by Moore Stephens. There were no areas of high or moderate risk identified during the course of this review.

Additionally, it is understood through focus group feedback and discussions with the Manager People and Culture that the PDP template has continually evolved over the past few years, suggesting a culture of continuous improvement is being applied to the process and that known issues are dealt with on a timely basis. An example of the improvements to the PDP template is the incorporation of learning and development feedback.

System support

The overall PDP process is highly manual, placing the onus on individuals to manage their own plan. Similarly, the review of PDPs for compliance and completeness is completed manually by the People and Culture team. Best practice organisations have an automated and integrated performance management system that provides greater control of data and process efficiency. While VAGO would benefit from a more automated process, this was not identified as a 'pain point' in discussions with VAGO staff or in survey results.

Succession planning

Succession planning for senior level roles is not currently formalised, and as a result, no documentation on succession plans has been reviewed, however, it was noted during meetings with the director group that the leadership team has commenced conversations around succession planning with the intent to formalise procedures. In discussions with the Manager People and Culture, it was confirmed that there is a level of informal succession planning currently in place at VAGO. Through this process, individuals are identified as part of the PDP process as being potential future leaders and these individuals may be given the opportunity to fulfil higher duty roles when the opportunities become available (ie. during leave, extended absence periods). It was noted however, that the majority of appointments over the past year have been internal appointments, suggesting that VAGO is providing career development opportunities.

Succession planning is not currently a high risk area for VAGO, however a perceived gap in experience levels between director and senior manager roles (noted in one of the focus groups) suggests an opportunity may exist for VAGO to further develop their succession plans for leadership roles. Our own observations from interaction with public sector departments and agencies support the need for a structured succession planning and shadowing of sector directors.

Recommendation

- Development of succession plans for senior leadership roles and leaders with critical skills/experience to ensure effective management of audits and development of staff and minimise disruption when senior staff leave the organisation.

Auditor-General response - Accepted

A new succession/career pathway model is being developed which will include transitional training programs at key points along the career paths for all staff at VAGO.

Responsible:

ED ASG

Timing:

January 2014

Terms of reference

- (c) Whether strategies are in place to assess and manage staff motivation across both financial and Performance Audit work areas.

Summary of observations

VAGO's HR capabilities are most aligned with the "Control and Compliance" level on the PwC HR maturity model with a focus on delivering HR services and providing governance and compliance around process. However, it was clear that VAGO is enhancing its HR capabilities, and there are elements of HR capabilities that fall within the higher levels of the maturity model such as training and development, and management of

employee engagement activities that are typically associated with larger organisations with more developed HR capability.

VAGO achieved very strong results across the most recent 2013 employee engagement survey suggesting high levels of engagement within the VAGO workforce. The results from the survey demonstrated consistent and substantial improvements year on year for engagement survey results. From the 2009 survey there were improvements across every measure ranging from 3-28%. Roles and Expectations (5.96/7) and Work/Life balance (5.94/7) both rated in the top 5 KPIs on the survey.

VAGO exceeded the overall mean score for the professional services sector, with only 'organisational cohesion' and 'policies, processes and procedures' falling more than 5% below the mean.

As part of regular HR processes, exit interviews are completed for all departing staff members and results from these interviews are assessed periodically for themes. Feedback from the Manager People and Culture indicated that no obvious themes had been observed from exit interviews to suggest systemic issues around people and culture.

Engagement survey results

The results from the recent survey demonstrated consistent and substantial improvements year on year for engagement survey results. From the 2009 survey there were improvements across every measure ranging from 3-28%. All 91 measures improved between the 2011 and 2013 surveys, and 78 of the 91 measures improved from the 2009 to 2011 surveys.

Continuous improvement

An example of a formal strategy to manage motivation and well-being of staff was specifically tabled: a staff consultation and development committee provides a channel of communication between staff and management. The focus group sessions suggested that this forum provided an effective means of communicating any issues to management.

Anecdotal evidence from interviews with the Manager People and Culture and focus groups indicates that VAGO is committed to managing staff engagement and motivation. In particular, where issues are identified, the organisation is quick to establish targeted initiatives to address the issues. The unanimously positive comments from focus groups, and consistent improvements in survey scores, suggest that these initiatives are generally effective.

Organisational cohesion

While engagement survey results were extremely positive overall, the Organisation Cohesion KPI had only a 20% positive rating which was the lowest by some margin across all KPIs. A 28% negative rating makes it the only KPI to have a larger net negative rating. This was further supported by a number of comments in the free text response section of the survey suggesting that collaboration and communication between groups was a challenge.

The topic of cohesion and collaboration was explored during focus groups and while it was noted that there is separation of business units, this was seen to be intentional and effective. It was also suggested that cross-team collaboration had improved significantly with numerous individual examples provided in the sessions.

Discussions with the Manager People and Culture indicated that improving organisational cohesion would be a focus area for the People and Culture team over the next 12 months.

Recommendation

- Assess the root cause of the low scores on organisation cohesion to ensure that any interventions developed to address the issue are practical and will drive improvement in the ways of working. Strong organisational cohesion will drive a more effective organisation and enable greater acceptance of any structural changes which may occur.

Auditor-General response - Accepted

A range of initiatives are underway to improve organisation cohesion including changing the overall structure of the office and management committee structures.

Responsible:

ED ASG /PCD

Timing:

Underway

Terms of reference

- (d) whether appropriate OH&S and human resource policies are in place to effectively monitor staff well-being related to areas such as, staff morale, job satisfaction and workplace stress, and to take appropriate action where necessary.

Summary of observations

A number of comprehensive policies are in place at VAGO covering all key HR processes. The ones most pertinent to this scope item are: Remuneration, Employee recognition, Flexible working, Providing flexibility, Learning and development, Secondment, OH&S, Recruitment.

The VAGO continuous improvement register is a means of identifying and tracking key initiatives for the organisation, and a number of HR related initiatives focused on improving employee well-being and job satisfaction have been included on this register.

As noted previously, the most recent employee engagement survey revealed high levels of engagement across the VAGO workforce. In relation to this scope item, Roles and Expectations (5.96/7) and Work/Life balance (5.94/7) both rated in the top 5 KPIs on the survey, while other KPIs such as Job Satisfaction, Engagement, OH&S, and Empowerment all scored above 5 out of 7. It was observed that employee engagement is trending higher in all areas and is already strong relative to benchmarks. This is consistent with feedback from focus groups. While the verbatim responses in the engagement survey indicated that there are clearly pockets of discontent with leadership skills and culture, these views are very much in the minority.

Policies

As noted above, VAGO maintains comprehensive HR management policies to support employees. These policies compare favourably to other organisations, even larger and better resourced ones. Consistently, each policy outlines a clear process, associated guidelines to support an employee working through the process, and accountabilities. Version and review dates are documented on each policy although there was no change history to identify any modifications from previous versions.

Alignment to staff preferences

From the most recent engagement survey it was noted that access to flexible work arrangements was rated as the most important factor working at VAGO. This is supported by a high score on work/life balance KPI in survey and strong workforce flexibility policy.

Anecdotal evidence from focus groups confirms that staff are very appreciative of the workplace policies around flexible working arrangements and that there is high uptake of these arrangements across the organisation.

Forward looking HR management

VAGO appears to be somewhat reactive in their approach to HR management, in that HR initiatives are put in place at VAGO as the result of identifying issues emerging from engagement surveys or other feedback

mechanisms (ie. using lagging indicators). While this approach has driven consistent improvement in HR management practices at VAGO, there may be an opportunity to take a more forward looking and strategic approach to achieving the desired culture and work environment. For example, VAGO could look to use the annual planning process to agree an integrated and forward-looking people strategy with goals that are aligned to the overall organisational strategy (Refer 3.2 (e) of this Section).

Recommendation

There are no recommendations for this area.

Terms of reference

- (e) whether human resource policies and strategies are in place to manage staff retention and reduce staff turnover.

Summary of observations

As noted in (d) of this section, a number of comprehensive policies are in place at VAGO. The policies directly related to staff retention and staff turnover are: Remuneration, Employee recognition, Flexible working, Providing flexibility, Learning and development, Managing and Developing Performance and Secondment.

In addition to these policies, the People and Culture team collects and manages workforce data across a number of common areas including workforce demographics, turnover, leave etc. This information is compiled in the Workforce Profile report. The report provides an historical view of the workforce using descriptive statistics and historical trend analysis. No scenario planning or forecasting is completed as part of this analysis.

VAGO has developed a set of organisational values that are aligned to the nature of work completed and to the people within the organisation. Focus groups spoke favourably about VAGO's values confirming that they resonate well with staff.

During the six months to 31 December 2012, 12 employees departed, compared with the 30 employees that departed in the corresponding period of the last financial year. The separation rate of 7% is VAGO's second lowest separation rate since Workforce Profile reporting began in 2007. While current economic conditions have likely played some role in staff retention, it is clear that VAGO has demonstrated consistent improvement over time in staff turnover, and that turnover is not currently a risk area for the organisation.

VAGO consistently monitors data and takes action to target problem areas. The most recent people survey showed that most KPI areas are viewed favourably by employees, with every question improving since the last survey. Regular and targeted internal surveys audits have been completed and documented (for example, a Performance Management audit was conducted in February 2013).

Workforce Data

VAGO consistently monitor and assess workforce data for potential risk areas around staff retention. While the most recent workforce profile report did not identify any areas of risk, it was noted that this data had been used in the past to identify risks around turnover rates in specific parts of the organisation and developed interventions as a result.

Policies

VAGO has a comprehensive set of policies in place to support staff retention. As mentioned in section 5d, policies such as flexible working demonstrate a high level of alignment with staff priorities as identified in the staff engagement survey. This was also reflected in focus group discussions where flexible working arrangements were identified as a key reason why people enjoy working at VAGO.

Risk management

Risks around maternity/family leave are being well managed through the workforce flexibility policy and a number of employees have taken up this method of working.

Forward looking HR management

There may be opportunities to take a more strategic view of workforce data analysis, focussing on measurement and tracking of leading indicators rather than waiting for an issue to surface before taking action. Examples of this include:

- Forecasting workforce requirements for the next 5 years (in terms of FTE, skills and experience) and assessing the gap against current workforce to identify potential risk areas for the business
- Forecasting staff turnover based on historical trends, predicted retirement age etc. to identify potential risk areas.

Recommendation

- Incorporate strategic workforce forecasting into annual planning process with a 12 monthly review cycle and 6 monthly validation to enable more efficient management of VAGO's budget requirements.

Auditor-General response - Accepted

The annual workforce profile and associated reporting will be revised to better equip VAGO resources planning.

Responsible:

ED ASG

Timing:

January 2014

Terms of reference

- (f) whether VAGO's professional development program adequately identifies and targets staff training needs

Summary of observations

Professional development is a key focus area for VAGO and a strong differentiator in terms of the employee value proposition that the organisation offers. The investment in learning and professional development at VAGO is significant and there is a high uptake. 80.5% of staff (137 employees) had participated in some form of Learning and Development in the 6 months to December 12.

A comprehensive learning and development handbook is maintained and provides a guide for learning and development opportunities by level and function. This is maintained by the People and Culture team and the annual program is developed based on individual inputs into PDPs in terms of career objectives, development targets and feedback on existing learning and development and through discussions with business units to identify technical capabilities and skills that require development.

Discussion with focus group members from both Performance Audit and Financial Audit indicated that there is significant focus on development of staff technical skills. This is reflected in the regular development of new training (for example, training on regulatory changes).

Each business unit manages its own learning and development program (from a technical learning perspective). This suggests that there may be some duplication of effort and there may be some efficiency to be gained through integration of this process with the overall learning and development process.

Continuous improvement

The embedded learning and development capability within the business units is focused on understanding new learning requirements from each business unit and developing training to address these needs. This process is continuous which helps to ensure that VAGO continues to provide targeted training relevant to the needs of staff and reflective of current business and government conditions.

Alignment to staff needs

Through the PDP process, staff provide inputs on their professional development objectives. This data is reviewed in line with the 6 monthly PDP review process to identify emerging areas of development focus and ensure that the offerings within the learning and development handbook stay relevant.

Co-ordinated management of learning and development

Learning and development is currently managed under a decentralised model where each business unit responsible for the development of a technical training program tailored to the needs of staff in that group. While the People and Culture team maintain a comprehensive learning and development handbook, there may be some duplication of effort and opportunities for efficiency to be gained through consolidation of learning and development activities such as course development and delivery.

Recommendation

- Consolidate learning and development capability within People and Culture team to ensure greater oversight of the various programs and drive efficiencies through one point of administration.

Auditor-General response - Accepted

People and Culture will continue to provide the logistical and administrative support for the specific technical training delivered in the business groups.

Responsible:

ED ASG

Timing:

February 2014

Terms of reference

- (g) whether processes are in place to evaluate the effectiveness of professional development activities undertaken by staff

Summary of observations

It was observed that VAGO has formal processes in place to evaluate the effectiveness of professional development at an individual level. Evaluation of professional development occurs formally through two routes:

- For courses run specifically for VAGO, staff are asked to complete a confidential survey
- Feedback on the learning and development section of the PDP is required at each 6 month review.

In addition to this, VAGO use the VESPA software system to maintain the necessary audit trail to demonstrate how staff professional development has been managed. Reports can be produced for management to provide an oversight of the professional development progress of each staff member over the years they have been employed at VAGO.

Measurement and action

It was confirmed through conversations with the Manager People and Culture that feedback on professional development is valued, and time is invested in reviewing all feedback to identify areas where change or improvements may be required.

Cost benefit analysis

While mechanisms are in place to evaluate the effectiveness of individual learning and development programs, there was no evidence found to suggest that any process is in place to assess overall effectiveness of professional development activities completed by staff. For example, is VAGO getting the expected return on investment from professional development? Is there a measureable difference in productivity and capability uplift as a result of professional development? Is there a correlation between professional development and career progression?

Recommendation

- Establish processes to measure the benefit delivered from professional development activities. This serves to optimise return on investment in training and balance costs to align with agreed benefits.

Auditor-General response - Accepted

VAGO will investigate monitoring and evaluation systems that can be used to measure returns on professional development investment.

Responsible:

ED ASG

Timing:

January 2014

3.3 Monitoring and measuring performance effectiveness

Terms of reference

Review and provide an assessment of key performance management systems and measures together with any recommendations for improvement, including but not limited to the following areas:

- (a) The adequacy and effectiveness of management information systems in place to measure and improve productivity including cost effectiveness and human resource management within VAGO

Summary of observations

Productivity and human resource management are monitored at the Executive Management Group meetings through the Monthly Management Report and through weekly management meetings.

As mentioned previously the format of the Monthly Management Report (“MMR”) has changed since September 2013. The previous report was quite lengthy and reported on expenditure against budget, performance targets included in the VAGO annual plan as well as progress on tabling reports, average cost and time to deliver Performance Audits, the costs to deliver reports tabled in parliament and productivity rates, leave balances and reports on certain high level balance sheet items.

The document included a lot of repetition and while comments were provided highlighting variances the rational or root cause behind the variances were generally not provided. The traffic light system used in the report provided limited value with no rationale provided on how results should be coded and some cases where positive results appeared to be coded as issues (e.g. less sick leave taken compared with budget noted as an issue).

The new MMR is a one page document which reports on YTD financials against prior years, performance targets included in the VAGO annual plan, overall staff productivity, YTD FTE numbers, sick leave hours and staff turnover. This MMR is supported by a Financial Audit and Performance Audit dashboard which is monitored by the Executive at business unit level and additional details such as flex leave and annual leave excesses are reported to the business units by HR. The one page MMR is also supported by an Executive Summary which provides comments on each of the areas reported. Similar to the previous MMR a traffic light system and again detailed definitions (e.g. what is considered to be an issue) are not provided.

Recommendation

- Management should provide greater clarity and definition around the traffic light system used in Monthly Management Reports to enable more effective discussions around results and any variances.

Auditor-General response - Accepted

The Monthly Management Report underwent significant review and a new format was introduced in September 2013.

Responsible:

ED ASG

Timing:

Complete

Terms of reference

- (b) the appropriateness and veracity of the performance indicators and benchmarks which VAGO uses to measure its performance in relation to the achievement of its strategic objectives

Summary of observations

The key performance indicators measured and reported by VAGO in the MMR are included in the Annual Plan and are reported under the following headings; Output 1: Parliamentary reports and services and Output 2: Audit reports on financial statements.

| <i>Output 1</i> | <i>Output 2</i> |
|---|--|
| <i>Quantity</i> | |
| <ul style="list-style-type: none"> • Auditor-General Reports | <ul style="list-style-type: none"> • Audit Opinions issued on non-financial performance indicators • Audit Opinions issued on the financial statements of agencies |
| <i>Quality</i> | |
| <ul style="list-style-type: none"> • Average score of audit reports by external/peer assessors | <ul style="list-style-type: none"> • External/peer reviews finding no material departures from professional or regulatory |

| | |
|---|---|
| <ul style="list-style-type: none"> Overall level of external satisfaction with audit reports and services – Parliamentarians | standards |
| <i>Timeliness</i> | |
| <ul style="list-style-type: none"> Inquiries for Members of Parliament and the public responded to within 28 days Reports completed on time | <ul style="list-style-type: none"> Audit opinions issued within statutory deadlines Management letters issued to agencies within established timeframes |
| <i>Cost</i> | <i>Cost</i> |
| <i>Total output cost</i> | <i>Total output cost</i> |

These measures are also included in VAGO's annual business plan and are reported in the quarterly PAEC acquittal reports and annual report.

While these measures are included in the annual business plans we noted however that further information on how the measure can be achieved and targets are only provided for some of the measures in the business plan. The “*average score of audit reports by external/peer assessors*” and “*reports completed on time*” are not included and while a breakdown of measures and 2011/12 and 2012/13 actual results are provided in relation to the “*overall level of satisfaction with audit reports and services*” targets have not been set for 2013/14. Furthermore no additional information is provided in relation to Output 2 quality and timeliness measures.

VAGOs 2010/11 -2014/15 Strategic plan includes the following measures in relation to strategic objectives:

- Audit reports completed on time
- Assessment of Parliamentary engagement
- Assessment of impact on accountability and performance
- Assessment of Parliamentarians' feedback on audit reports and services
- Assessment of audit client feedback
- Assessment of perceptions of alignment and assessment of feedback from staff satisfaction
- Performance against business plans

While a number of these do not form part of the annual business plan or MMR they are reported in the VAGO annual plan.

Recommendation

- Provide greater clarity and information around the performance measures across the Annual Plan and the Business Plan and alignment between the two Plans. This could promote more effective discussion of performance at EMG and where performance measures are not being achieved, with appropriate action plans agreed by EMG collectively.

Auditor-General response - Accepted

The next Strategic Plan will be developed in 2014 and there will be changes to the business plan and its measures.

Responsible:

PCD/ED ASG

Timing:

June 2014

Terms of reference

- (c) any initiatives or improvements which have flowed from VAGO's evaluation of its performance over the past three years

Summary of Observations

VAGO has a Continuous Improvement Register (the Register) which tracks the implementation of key initiatives from a number of sources, including internal audit reports and the recent SSA 2012 Review. The Register currently includes the implementation of initiatives from the following reviews:

- Actions arising from the 2012 Parliamentary and Audit Client survey results
- Performance Audit Cold review -2013
- VAGO Business Plan 2012-13
- Internal Audit reviews – Performance Audit Topic Selection Review (January 2013), Performance Management Review (February 2013) and Payroll Review (March 2013)
- Oakton Targeted Review of VAGO 2013

In addition the Risk Register that is presented at EMG and the Audit Committee monitors and focuses on the key strategic risks for VAGO. The areas of focus in the Risk Register are strategic and include such key risks as:

- Changes in Regulatory Environment affecting the audit mandate
- Quality of audit reports
- Stakeholder expectations
- Operational performance

Within each risk there are a number of sub risks and proposed treatment plans /tasks to manage these risks.

In addition improvements and initiatives related to financial and Performance Audit methodology audit planning are updated in IPSAM and AmP on a regular basis.

Recommendation

There are no recommendations for this area.

Terms of reference

- (d) the extent to which VAGO has reviewed or considered best practice public sector management and auditing in other relevant national and international jurisdictions over the past three years to evaluate its own performance and practices

There are a number of mechanisms by which VAGO utilises external resources to inform and improve their performance and practices:

- Membership of Australian Council of Auditor- Generals (ACAG) and their involvement in the research, benchmarking and subcommittees within ACAG. The cold review conducted by ACAG resources annually on selected Performance Audits inform the Performance Audit process and ensure compliance with relevant Auditing Standards

- both financial and Performance Audits through the Process Directory
- The Continuous Improvement Register is another mechanism to monitor improvements across VAGO (Refer ©above) VAGO's Quality Framework was developed to align the relevant Auditing Standards with VAGO's methodologies for
- The recent review by the State Services Authority of VAGO's business support activities to assess VAGO's structure and performance against better practice public sector
- Where appropriate Internal Audit may measure VAGO's activities and performance against better practices

In addition through VAGO's relationship with the Audit Office in British Columbia there has been sharing of ideas and audit approaches between these two jurisdictions.

Recommendation

There are no recommendations for this area.

Terms of reference

- (e) assess VAGO's use of the results of independent assessment of the quality of Performance Audits by the Australian Council of Auditors General (ACAG) over the past three years

ACAG has undertaken independent reviews of selected Performance Audits across VAGO since 2003. ACAG has developed the process for these reviews and the recent review was completed in February 2013 with Performance Auditor directors from Western Australia reviewing 4 audits. A detailed report was issued in April 2013 outlining detailed findings for each file and a number of systemic findings for the Performance Audit methodology. These findings have largely been agreed and an action plan was developed for implementation and these are now completed.

For the independent assessment in the previous years there is evidence of the findings being actioned and monitored through the Continuous Improvement Register at EMG in the period.

Recommendation

There are no recommendations for this area.

Terms of reference

- (f) assess VAGO's use of the results of peer reviews to assess the quality of Financial Audits over the past three years.

Summary of observations

VAGO has a number of review processes in place in order to identify areas of improvement and ensure the quality of audits performed is appropriate. Four of the main types of reviews are below:

- **Engagement Quality Control Reviewer (EQCR):** An EQCR is assigned to higher risk audits and this involvement is evidenced throughout the IPSAM audit file
- **Peer Review:** Periodically (and most recently in 2012), VAGO are subject to a Peer Review by other Audit Offices in which the findings are reported

- **Cold Review:** Twice annually, VAGO performed post-audit reviews in which a sample of Financial Audits selected for an in-house review in which findings are recorded
- **Triennial Performance Audit:** Every three years, a Performance Audit is undertaken and the results are considered, documented and the determination is made to accept or not accept each item.

The observations and results of the EQCR reviews are subject to ongoing discussions and captured within communications and forums held throughout the year. The results of the other three types of reviews are maintained by VAGO and captured within a continuous improvement register. Within this register, the recommendation is noted as well as relevant information and the status of the implementation.

We reviewed the continuous improvement register and noted that the relevant findings over the past three years are captured therein and the status of most appears to be completed. The register had been updated in July 2013 (with the previous update being performed in February 2013). Based on the information presented within the register, all information appears to be thoroughly considered and progress has been made.

Further, we reviewed VAGO's process directory and noted a number of processes in place that are based on the various types of reviews discussed herein. Through this review, it appears that these reviews are a cornerstone in VAGO's quality improvement program.

The table below presents items identified during the benchmarking we performed. Similar observations were noted in three instances, with other the themes not noted at VAGO during our review.

| Quality Observations noted through benchmarking of other audit offices | Similar Observation Noted at VAGO (and captured herein) |
|--|---|
| Improved telling the story of the audit | X |
| Improved documentation supporting the rotation of controls approach | |
| Increased assessment over reliability of internally generated reports | X |
| Improved documentation of controls testing findings | |
| Improved understanding of test of detail vs. test of control | |
| Improved testing approach to automated controls and/or calculations | |
| Consistent risk assessment documentation | X |

Recommendation

There are no recommendations for this area.

Terms of reference

- (g) assess the soundness and comprehensiveness of the processes followed by VAGO in undertaking periodic 'client' surveys (including those of Members of Parliament and audited agencies) and the uses made of these results to improve business processes and outputs. Consider whether an additional independent survey of the effectiveness of VAGO should be conducted

VAGO runs an extensive survey program across its key stakeholders, parliamentarians and auditees. The survey program is currently run by an independent organisation, Orima, and the current program was developed in 2011 and follows a three year program to survey a broad range of the stakeholders. The current program is as follows:

- 2011/12 and 2012/2013 - surveys were sent to Chief Financial Officers for Financial Audits, selected officers involved in Performance Audits and Parliamentarians

- 2012/13 - Audit Committee Chairs were surveyed, Department Secretaries were included in the survey, selected officers for Performance Audits were surveyed but not Chief Financial Officers and Parliamentarians were offered a face to face interview with the survey company

As part of our audit we interviewed a number of senior management at the departments and larger agencies to discuss their interactions and assessment of VAGO's financial and Performance Audits. (Refer Appendix C for list of interviewees). In addition we selected 100 agencies from VAGO's list of Financial Audit clients and independently surveyed the Chief Financial Officers in relation to their interactions with VAGO for Financial Audits and if relevant Performance Audits. We received 41 responses to the 100 surveys sent.

The findings from these interviews and surveys were for the most part consistent with the findings of the Orima surveys in recent years. They were some minor variations in our results with the Orima surveys which are noted below:

- More PwC respondents responded negatively to the question regarding VAGO's understanding of their organisation
- More PwC respondents responded negatively to the question regarding auditors demonstrating professional skills and knowledge required to conduct the audit
- Concerns over the basis for the Financial Audit fee and the clarity of the explanations provided
- An increase in concerns over the timeliness of the audit opinion being issued (Refer comment below).

Based on these results we do not believe that a further independent survey of the effectiveness of VAGO is required.

Recommendation

There are no recommendations for this area.

Terms of reference

(h) the extent and usefulness of processes and/or measures used by VAGO to assess the impact of its audit activities on operations and management practices across the Victorian public sector

Summary of observations

There is limited evidence that VAGO assesses the impact of its audits on operations across the public sector. However there are some activities that demonstrate that VAGO considers outcomes:

- For each Financial Audit, management letter recommendations are followed up each year to ensure that the department or agency has implemented the proposed recommendations. In addition the outcomes from the areas of Financial Audit focus are factored into the audit approach each year.
- There is some ad hoc follow up of Performance Audits where the department or agency may be subject to further audits but this is not a formal program and the AG has no formal mandate to require the department or agency to implement the recommendations.

The recent 2012-12 Annual Report included a section on "Impact of reports and services" which includes feedback and commentary from Parliamentarians and departments and agencies around the impact of certain audits. There were some quantitative measures also reported including increase in feedback from parliamentarians, acceptance of audit recommendations and inquiries from public for audit activity.

Recommendation

- With reference to Recommendation 2.7 in Section 2 of the report, VAGO to develop a formal follow up program for Performance Audits including prioritisation criteria, initial scopes etc. Reference is also made to this Report's recommendation to revisit Recommendation 6 from the 2010 Report around reporting the impact of Performance Audits on government activities (Refer Page 11).

Auditor-General response - Accepted

VAGO is currently developing a structured follow up program to provide maximum value to the public sector which will feed into any further assessment of indicators of audit impact. See also Strategic Recommendation 2.6.

Contingent on legislation changes

Terms of reference

- (i) the adequacy of time reporting and costing systems in identifying all recoverable costs and the appropriate allocations of costs to ensure there is no cross subsidisation between chargeable and non-chargeable activities or between performance and Financial Audits

Summary of observations

Each audit is set up on the MARS system and allocated a separate MARS code. Budgets are established and agreed for each audit and entered into MARS. Staff then use the MARS system to record productivity and time charged to individual audits, with timesheets completed weekly and approved by the individual's manager or director to ensure that they are accurate.

Overall staff hours and productivity are monitored by management using the Financial Audit and Performance Audit Dashboards and more detailed monitoring is carried out at a project level by the Audit Directors and Managers.

Recommendation

There are no recommendations for this area.

Terms of reference

- (j) the adequacy of systems and processes in place to: determine appropriate budgets across VAGO's operations; monitor costs against budget; and explain variances against budgets

Summary of observations

As previously noted in section 3 VAGO's annual budget is contained in the annual business plan document. The budget is established through consultation with business units and consideration of prior year results and known revenue and costs such as the annual appropriation, staff costs, ASP fees, rent and depreciation. Costs are either charged fully to one of the two output groups or split between the two groups based on special or base ratios. As noted in section 1 (e) while the ratio used to split costs is documented the rationale for splitting costs in this manner is not currently documented.

The budget is created using a number of excel models and tools before approved by the Executive Management Team and uploaded onto the MARS system.

The budget is monitored by the Executive Management Group through high level figures reported in the Monthly Management Reports. The Financial Audit and Performance Audit also monitor elements of the budget through weekly dashboard reporting.

A midyear budget review is also carried out to update the budget as required.

High level budget results are reported externally to PAEC through quarterly acquittal reports and biannually to the Department of Treasury and Finance.

Recommendation

There are no recommendations for this area.

4 Conduct and management of Financial Audits

Terms of reference

Review the efficiency and effectiveness of the management and conduct of Financial Audits undertaken by the Victorian Auditor-General's Office, considering but not limited to the following:

- (a) The adequacy of the audit methodology and quality control procedures to assist in the identification of any material or significant risks and to ensure that findings and conclusions arising from the Financial Audits are adequately supported.

Summary of observations

The audit methodology used by VAGO is based on Australian Auditing Standards and these standards are integrated into the IPSAM (Integrated Public Sector Audit Methodology) software, which was introduced in 2005. Additionally, VAGO employs a number of quality control practices and procedures to ensure the audit methodology is appropriate and the quality control procedures are sufficient in order to identify material risks and ensure audit conclusions are supported.

These procedures include the following:

- **Risk Identification tools and practices:** As part of the planning phase of Financial Audits, teams are required to perform a risk assessment which drives the audit strategy. The IPSAM audit file includes a number of required procedures to identify risks, including a review of issues from the prior period. The audit risks are identified, rated and captured within the Audit Risk view in IPSAM.
- **Response to risks:** The Audit Risk view enables teams to populate the Audit Strategy view which captures the planned controls and substantive audit response to mitigate each risk identified. An Audit Strategy Memo is prepared during this process and presented to the Audit Committee.
- **Reassessment of risks:** As part of the finalisation phase of the audits, teams are required to confirm that the assessment of the risks of material misstatement contained in the Audit Strategy view remains appropriate. This final conclusion is also captured within the Audit Committee report.
- **Review of IPSAM:** Periodically, VAGO engages an independent party to review IPSAM to ensure the policies and guidance are complete, appropriate and compatible with auditing standards. Most recently, this was performed by Grant Gay Consulting Pty Ltd in May 2010, after the release of the Clarity Auditing Standards. There have been limited changes to auditing standards and therefore to IPSAM since this time.
- **Continuous improvement register:** VAGO maintains a continuous improvement register which addresses potential improvements noted through various audit reviews performed. This register is maintained and updated periodically as new reviews are performed and as improvements are implemented.

We also note the IPSAM tailored procedures and guidance were appropriate in that they require teams to identify risks during the planning phase and ensure findings noted during the execution phase were considered during the reassessment of risks in the finalisation phase. By responding to these procedures, teams would demonstrate that the conclusions reached are adequately supported. Although we agree with the adequacy of the audit methodology and quality control procedures, we did note a number of findings as part of the Financial Audit IPSAM file reviews that related to the implementation of these policies (refer to (b) in this section).

Recommendation

There are no recommendations for this area.

Terms of reference

- (b) compliance with the relevant statutory requirements and Australian Auditing Standards for the conduct and reporting of Financial Audits.

Summary of observations

Compliance with relevant statutory requirements and Australian Auditing Standards is imperative for VAGO, and is reflected in the introduction of a new performance measure in 2011-12 to measure the quality of the Financial Audit activities: 'external/peer reviews finding no material departures from professional and regulatory standards'.

As noted above in (a) of this section Australian Auditing Standards are integrated into the IPSAM software used to structure and document the Financial Audits completed. Compliance with Australian Auditing Standards is evidenced within the individual IPSAM Financial Audit files through the audit work completed and reviewed by the Financial Audit engagement teams.

We tested compliance with Australian Auditing Standards through a review of a sample of IPSAM Financial Audit files for the period 2011-12. A total of 10 files were selected to form part of the review, with our targeted review focusing on compliance with significant aspects of the Australian Auditing Standards. Although our targeted review did not include the examination of all work papers, the procedures performed were designed to identify instances of material non-compliance with Australian Auditing Standards.

We also note the following in relation to conduct of Financial Audits:

- **High levels of sector knowledge of the engagement leaders:** It was clearly evident that the engagement leaders were very knowledgeable of the departments and agencies under audit as well as the audit risks and the overall audit strategy. It was clear that the engagement leaders were able to discuss in detail aspects of the work completed and had an appropriate level of knowledge to lead these engagements.
- **Culture of consultation and collaboration:** Through discussion with the engagement leaders and the Engagement Quality Control Reviewer (EQCR), it was clear that a culture of consultation is in place at VAGO. Specifically, the structure of the interactions between the EQCR and the engagement leaders facilitated the achievement of consistency in the application of accounting and audit judgments. We do note below, that the documentation of these consultations and discussions could be improved on the IPSAM files (refer below).
- **Depth of review by the EQCR:** The level of review of audit work papers by the EQCR was detailed and evidences the level of oversight and scrutiny of the IPSAM Financial Audit files which are designated as higher risk and thus require an EQCR.

Efficiency Opportunities

As part of the review of the IPSAM Financial Audit files we have identified areas where we consider that the efficiency of the audit could be improved while maintaining audit quality.

Use of the work of internal auditors

We identified as part of the IPSAM Financial Audit file reviews that a significant amount of time was invested in the review of the scope, competency and output of the internal audit teams of the various entities subject to audit. It was however noted that in almost all instances the use of internal audit was confined to issue identification only, rather than the VAGO audit team being able to place direct reliance on the work of internal audit, and as a result reduce the level of testing required to support the audit opinion. The engagement leaders were open and positive about the ability to place greater reliance on the work of internal audit, however highlighted a number of structural challenges including: appropriateness of sample sizes used by internal audit, the scope of some internal audits being operational rather than financial in nature and the timing of the release of internal audit reports. We recommend that for major departments and agencies, the engagement leaders work with the Audit Committees early to re-engage on the use of internal audit. To the extent there is willingness on the part of the Audit Committee to reduce duplication and better align internal and external audit, the hurdles identified by the engagement leaders may be overcome. Although this will involve time and effort in the planning and scoping stages of the audit, overall efficiency gains could be made during fieldwork.

Clearer identification of audit risks and responses

One of the most significant areas where efficiency gains could be made is by careful consideration of the identification and documentation of audit risks. If risks are identified too broadly, the result can be a number of audit tests covering a number of financial statement assertions performed at too high a level of precision. When risks are carefully defined, only those audit tests that mitigate the risky financial statement balances and assertions are required to be performed to a higher degree of precision. This outcome was discussed with the Methodology and Standards team who noted that this was already an area that was being considered further, specifically in relation to achieving better visibility of linking controls that address key risks, to those risks.

Introduction and development of data analytic procedures

Data analytics refers to computer based auditing techniques used to obtain audit comfort over large amounts of system generated data. The IPSAM Financial Audit files selected for review were all from the 2011-12 period. VAGO has noted that the first significant introduction of data analytics by the office is on the 2012-13 files where these techniques have been used to identify unusual transactions and balances for further review. Data analytics can be the most efficient way to test large volumes of data, typically millions of transactions which are individually of low value (traditional audit techniques can be ineffective or inefficient when dealing with transactions of this nature). Data analytics has been a relatively underutilised audit technique, both at VAGO and more generally across the profession. It can be used to scan large amounts of data for unusual characteristics (eg journal entries processed at night or weekends, sales transactions which are not recorded against cash or accounts receivable ledgers etc) which are then subject to manual follow up audit procedures. A more advanced use of data analytics is the move from identification of items with unusual characteristics to testing and obtaining audit comfort over large numbers of transactions eg testing that sales transactions were correctly recorded and matched against cash receipts. VAGO is on a journey to develop their ability to employ data analytics meaningfully and reduce audit effort. This should continue to be an area of focus for VAGO as the benefits of a well designed and utilised set of data analytic procedures is significant.

Use of templates to guide audit teams in documenting audit work efficiently

The use of more templates embedded into the IPSAM tool could be of benefit to the efficiency of the existing Financial Audits. Templates can be invaluable to standardise audit documentation and achieve consistency. Templates can also enable team members to document their work completely and in the correct format and reduce the need for any re-work if required audit documentation is not fully captured. It is important to note that templates are designed to aid the decision making process and not replace it. Auditor judgement is still an important component of any audit approach.

Efficiency opportunities

- The work of internal auditors to be used more effectively to optimise VAGO resource use where appropriate
- Identify audit risks and responses more clearly to ensure audit resources are optimised
- Greater use of templates to guide audit teams in documenting audit work more efficiently.

Auditor-General response - Accepted

VAGO assesses the work of internal auditors in all financial audits and where that work adequately addresses audit risks, is sound, and its use is cost-effective, relies upon that work in order to optimise use of VAGO resources.

VAGO is finalising a new version of IPSAM (version 4) that will better link risks and audit program responses to enhance the quality of planning by teams, and will address the findings underpinning this recommendation. The new version of IPSAM will be piloted on 2013-14 financial audits.

Responsible:

AAG FA

Timing:

June 2014

Areas for improvement

The Financial Audit file reviews identified instances where compliance with Australian Auditing Standards could be improved. These instances were not pervasive to all files, however after consideration of the nature and extent of the issues noted, we have collated the more common audit findings into the broader themes noted below. The themes have similarities to the issues identified internally by the Methodology and Standards group as part of its processes, and also have similarities to issues identified by other audit offices through the benchmarking we performed.

Documentation of overall approach and judgments made – ‘Telling the story of the audit’

Both through inspection of files selected for review and discussion with the engagement leaders it was noted that there is room for improvement in the documentation of key judgements and the audit approach on the IPSAM files. In a number of instances, the documentation of judgments made was not captured on the IPSAM file, however when discussed with the engagement leaders, the rationale for these judgments could be clearly articulated. As the IPSAM files should be a standalone repository for all audit evidence that supports the issuance of the audit opinion, further efforts should be made to ensure IPSAM files ‘tell the story of the audit’. Examples of this theme include the following:

- Meetings to discuss key judgements, audit approach and the application of professional scepticism are not always fully captured on file including: discussions between the Engagement Leader and EQCR relating to audit risks and strategy; and decisions made which require significant professional judgment (eg sufficiency of audit evidence, the thought process to validate judgments)
- The IPSAM file reflects the work that was completed, and the end result of the testing performed, but does not fully reflect the reasons why certain testing was/was not performed or what judgments were made in relation to areas such as sample selection or professional scepticism.

The robustness of substantive analytical review requires strengthening

Consistent with other State audit offices and the profession more generally, the robustness of substantive analytical review remains a challenge for VAGO. Substantive analytical review is an audit technique used to obtain audit evidence regarding a specific balance or transaction and requires the auditor to make an estimation of an account balance, independent from the accounting system and management’s view, and then to investigate any reasons for variances between the auditor’s expectation and the recorded balance. During the inspection of IPSAM files selected for targeted review, instances of the following issues were noted in relation to substantive analytical procedures:

- Insufficient documentation to support the relationship identified between the balance being tested and other independent information. In a number of instances, the prior year value was used as the expectation without sufficient documentation to support why this was appropriate. Independent information was not frequently used, and the IPSAM files did not include guidance regarding the requirement to consider and document the reliability of that other information (including system generated data).
- Insufficient corroboration of differences between the auditor's expectation and the recorded balance. Management's expectations were accepted without further corroboration or without documented application of professional scepticism.

Completeness and consistency of documentation regarding audit procedures designed to address the risk of fraud

The procedures required to be performed by the auditor in relation to fraud were noted as being well defined and clear in IPSAM. However, instances were noted where the documentation on the Financial Audit file did not fully address the IPSAM documentation requirements, or indeed all the considerations and judgments made by the engagement team in relation to fraud. Examples of this theme included:

- As part of the planning stage of the audit engagement, an assessment was not completed and documented to incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures as required by VAGO policy
- As part of the planning stage of the audit engagement, a retrospective review was not completed of management judgments and assumptions related to significant accounting estimates reflected in the prior year financial report as required by VAGO policy
- The judgements made regarding fraud were not consistent in all instances throughout the IPSAM Financial Audit files, and the linkage of the fraud assessment in planning to audit work completed in fieldwork was not always clear (eg the impact on management override of control considerations and fraud risks on journal entry testing)
- Insufficient documentation to address the completeness of journal entry listings which are then subsequently tested as part of the procedures designed to mitigate the risk of fraud.

File maintenance and documentation of audit evidence could be improved

The IPSAM audit files should stand alone as the repository of audit evidence to support the audit opinion issued by VAGO. Specific requirements are included in Australian Auditing Standards which mandate certain practices in relation to file maintenance, and these were not adhered to in all instances. Examples of areas that could be improved included:

- Archiving of Financial Audit files within 60 days of the issuance of the audit opinion, as mandated by Australia Auditing Standards, was not achieved in all instances.
- Electronic sign off of the concluding memorandum by the Engagement Leader and/or Engagement Quality Control Reviewer (EQCR) was not completed on the date of the issuance of the audit opinion in all instances.
- A number of files have 'deleted' work papers referenced in the IPSAM Financial Audit files. This occurs when a work paper is included in the engagement file, is referenced in another part of the IPSAM Financial Audit file, and then the original work paper is deleted. The presence of 'deleted' work papers resulted in required audit evidence not being included on the final archived IPSAM file. Similarly, one corrupted work paper was noted in the files selected for review, with the result that required audit evidence was not included on the final archived file.
- The IPSAM files are established with a number of mandatory processes which the auditor is required to complete under Australian Auditing Standards. The completion of these procedures was not fully performed in all instances (Refer to completeness of fraud observations noted previously for examples).

Consideration of untested balances and use of the sample testing guidance

The VAGO audit methodology set out in IPSAM includes guidance and references in relation to audit sampling and this provides guidance regarding the appropriate sample sizes to use both tests of controls and substantive tests. The appropriate sample size is based on the degree of planned reliance on the procedure (low, moderate or high) and the strength of the controls (low, moderate or high). IPSAM also outlines the instances when audit sampling is not appropriate and when other procedures should be considered such as significant items testing or substantive analytical review. Within the files selected for review, it was noted that:

- In some instances when the audit sampling methodology was not used and instead other testing was performed such as significant item reviews, the rationale for the sample size selected was not documented in detail
- In a number of instances, the value of the untested balance was above materiality and was not subject to further testing, and a consideration as to why no further audit procedures were required on the untested balance was not documented.

Recommendations

- Enhance documentation of overall approach and judgements made – “Telling the story” of the to ensure all the audit outcomes are fully supported by documented evidence
- The robustness of substantive analytical review requires strengthening to ensure adequate explanations included on the audit file
- The completeness and consistency of documentation regarding audit procedures designed to address the risk of fraud to be improved for consistency across files and in compliance with IPSAM
- File maintenance and documentation of audit evidence could be improved so that the audit evidence can stand alone as the repository for all audit evidence
- Consider documentation around rationale for no further audit procedures on untested balances and where variations from use of the sample testing guidance.

Auditor-General response - Accepted

The recommendation/s are consistent with VAGO methodology, and Financial Audit is developing a case study training intensive for all financial audit staff. This training builds on opportunities for improved practice identified by FA management and EQCRs during the recent year end cycle. It will provide the opportunity to strengthen knowledge and skills in the areas mentioned in this recommendation, and reiterate the requirements for compliance with established methodology. In particular, we will include sessions on documentation, audit evidence, analytical review and fraud.

The training will supplement the group’s established technical training program.

Responsible:

AAG FA/Assistant Auditor General Standards & Quality (AAG S&Q)

Timing:

March 2014

Auditor-General response - Accepted

Methodology and Standards are revising the policies and tools that guide VAGO on sampling. The revised policy and associated tools will be addressed in the case study intensive.

Responsible:

AAG S&Q

Timing:

February 2014

Terms of reference

(c) completion of Financial Audits on time and within budget

Summary of observations

In order to comply with the Audit Act 1994, VAGO is required to express an audit opinion within four weeks of receiving the financial statements from the respective authority. The evidence of the receipt of financial statements and the timely issuance of the opinion is captured within the VAGO Financial Audit file as milestones.

In order to track the actual time spent on audits against the original budget, VAGO utilise audit project detail reports which present the relevant information including actual time to date, original budget, revised budget and commitments. VAGO directors actively monitor progress and status to ensure the audits are completed within budget where practicable.

We note that the 2011/2012 annual report states that 99% of audits were completed within the statutory deadline. This information is consistent with our observations for the files we selected for review as 100% of the 10 Financial Audits selected were completed within the statutory deadline. The actual engagement team hours were, in aggregate, within 1% of the budgeted hours.

In the current year Financial Audit cycle there were some concerns expressed by auditees about VAGO's last minute stance on "correcting errors" and "late" adjustments to financial statements. Auditees reported inefficiencies attributed to this stance and that financial statements had been unreasonably delayed due to "minor" audit adjustments insisted on by VAGO which were not material and the rationale for the requirement to adjust the financial statements not being adequately explained by VAGO staff.

In one instance the adjustment was for \$25k and the adjustment related to revised "investment valuation estimates" in the financial statement components of the agency which were clearly not material. In this case external reporting (eg. to the Responsible Minister), Board packs had to be revised and additional Board meetings scheduled.

Recommendation

- Ensure that prior to year end there are clear guidelines issued to both VAGO auditors/ASPs and auditees on financial statement materiality thresholds on an agency by agency basis and requirements/protocols for late audit adjustments. This will avoid unnecessary rework, and demands on audit and management time during critical phases.

Auditor-General response - Accepted

Comment on, and clarity of, VAGO's expectations regarding adjustment of misstatements within financial statements identified during audits, will be made in upcoming reports to Parliament on the results of the 2012-13 financial audits.

Responsible:

AAG FA

Timing:

December 2013

Terms of reference

- (d) whether the selection techniques employed by VAGO to gather audit evidence comply with all relevant Australian auditing standards.

Summary of observations

In relation to audit sampling, the selection techniques to be employed by teams are based on guidance stated in IPSAM. The guidance in relation to selection techniques, and the substantive approach, is based on auditing standards. Teams are then expected to base audit sample sizes on the relevant IPSAM guidance.

We reviewed the relevant areas of the IPSAM and agree that the guidance is consistent with auditing methodology. Further, we reviewed the independent report provided to VAGO in May 2010 which supports IPSAM guidance and methodology being aligned with auditing standards.

Within the files reviewed, we noted a number of instances where the selection technique is not clearly documented by the engagement team, specifically when audit sampling is not utilised. This leads to a lack of clarity around the strength of audit evidence obtained and presents inconsistencies among different testing financial statement line items and also between different Financial Audits.

Recommendation

- The use of a template or practice aid during the gathering of evidence would prompt teams to more fully comply with the required elements of documentation and consider the selection technique and size prescribed within IPSAM.

Auditor-General response- Accepted

Refer to responses above regarding sampling policy and tools (IPSAM).

Responsible:

AAG S&Q

Timing:

February 2014

Terms of reference

- (e) the adequacy and appropriateness of the methodology used to determine focus areas for detailed internal control assessment in each of the Financial Audit sectors consistent with a risk-based approach to Financial Audit.

Summary of observations

Section 7A of the Audit Act 1994 requires the Auditor-General to prepare an Annual Plan before the beginning of each financial year. The plan includes the Office of the Auditor-Generals goals, audit priorities and the audit program for both Financial and Performance Audits. A four year rolling plan/program has been published for Performance Audits since 2007-08 and since 2010-11 for Financial Audits. The objective of providing four years advance notice is to provide public sector agencies the opportunity to improve their performance prior to the audit being conducted.

Areas of Financial Audit Focus

Part 3 of the Audit Act relates to Financial Audit. VAGO has a methodology on selection of areas of focus for Annual Plan document (developed in 2012) in place to provide guidance to the sector directors responsible for delivering the FA parliamentary reports, on how to select the areas of focus. Per these guidelines the following should be considered when selecting areas of Financial Audit focus:

- any public interest issues (i.e. probity, compliance or waste) identified internally or by ASPs
- fraud or irregularities reported by clients, particularly if there appears to be a common theme across the sector
- any issues raised through media articles
- similar control weaknesses' identified in the sector (this is generally identified through a review of the interim management letter)
- material balances/ transactions in the balance sheet and operating statement
- nature of operations of the sector (i.e. use of outsourcing)
- issues raised by clients or through sector forums, and
- areas of focus identified in other sectors.

Two to three areas of focus should be selected for each sector and areas should aim to cover the operating statement, balance sheet and internal controls. Performance Audits must also be considered when selecting areas of focus to ensure there is no unintentional overlap.

A Financial Audit database has been developed by VAGO to record Financial Audits' contribution to the Annual Plan including the team structure, draft and financial memos to the AG and detailed specifications and questionnaires supporting agreed Financial Audit topics.

The annual planning process may result in previously selected audit topics being replaced or being moved out to another financial year. A memo to the AG is prepared and highlights movements in audit topics. We compared one year of Financial Audit topics included in the 2012-13 plan to those included in the 2013-14 Plan to identify topics movement and all movements were reported in the memo to the AG.

Currently detailed questionnaires are only prepared for 2013/14 topics but questionnaires will be developed for all topics going forward. Questionnaires are provided to VAGO's own staff and ASPs to ensure that a consistent process is followed for all audits.

As discussed in (a) of this section VAGO has a thorough risk identification and assessment process. The classification of risks identified inherently leads to focus areas for the Financial Audit team, especially in relation to the engagement leader and EQCR.

Beginning with Financial Audits taking place in the current year, VAGO is implementing the use of data analytics in order to add efficiencies to procedures performed (where applicable).

Within the Financial Audit files selected for our review, we observed teams considering the focus areas through the audit planning phase, and documenting the outcomes in the 'Audit Risk' view and 'Audit Strategy' view in IPSAM. Specifically, the 'Audit Risk' view presents the team's response to the risks identified which appropriately highlights the areas of focus. However, as discussed in (b) of this section we noted instances where the work performed did not align with the response presented within the 'Audit Strategy' view. Although the work still appeared to be sufficient to address the risk, the inconsistency between these areas can be improved upon.

Also discussed within (b) of this section data analytics is a relatively new initiative in audits that relies heavily on computer based auditing techniques to obtain audit comfort over large amounts of system generated data. We understand this to be a focus area for VAGO and agree with this initiative. We have raised a strategic recommendation in support of this.

Lastly, as discussed within (b) of this section we further noted that the engagement leader's involvement was often not clearly documented on file. By increasing the audit evidence in this area, the clarity around the engagement leader involvement would increase and this would demonstrate the risk-based approach of teams given the nature of these meetings.

Recommendation

There are no recommendations for this area.

Terms of reference

- (e) whether any risks identified during the course of a Financial Audit, which were not originally anticipated in audit plans, are adequately and effectively considered and addressed in a timely manner.

Summary of observations

As part of the finalisation phase of the audit, VAGO considers risks identified during the audit, the audit coverage obtained and the appropriateness of the risk assessments performed during the planning phase. In doing so, VAGO demonstrates the consideration of, and responses to, due to new risks not originally anticipated in audit plans.

Through review of the files selected for our review, we noted that the audit teams consider additional risks identified during the audit as part of the 'Review of audit coverage' element of the IPSAM audit file which occurs at the finalisation phase of the audit. This assessment was included in each audit file reviewed.

Recommendation

There are no recommendations for this area.

Terms of reference

- (f) processes for the engagement of contracted Financial Audit services have considered relevant government purchasing policies and good practice and procedures and are conducted with due regard to probity and value for money.

Summary of observations

VAGO is responsible for carrying out approximately 550 audits each year and uses a mix of internal staff and outsourced service providers to deliver these audits in accordance with the provisions of the Audit Act 1994. 36 audit service providers were used during 2012-13 while 41 were used during 2011-12.

Audit service providers are generally appointed during an annual tender round and are appointed for a period of 3 years initially with an option to extend for a further two years (1 year plus 1 year).

As the ASP contract term comes to an end management reviews the current mix of audits before deciding whether to include the authority in the upcoming tender round or to bring the audit in house. Factors that are considered when deciding whether to bring to audit in-house or continue to outsource include the risk profile of the authority, issues that have come up in recent audits, skill sets required and VAGO staff development needs. VAGO aims to carry out a mix of audits in house from both geographic and complexity perspectives. Audits can also be grouped for tender rounds based on audits in an economic entity, audits within an industry section or audit groupings within a geographic area. In 2013 there were 19 groupings. Prior to issuing a request for tender, VAGO notifies the relevant authorities subject to the tender round.

VAGO has developed a tender round manual which sets out procedures that should be followed when appointing Financial Audit, ASPs. In accordance with these guidelines a Procurement Strategic Plan and a Procurement Conduct Plan is prepared for each tender round. The Procurement Strategic Plan includes details such as; the scope of procurement requirement, estimated cost, background information, business case, stakeholder expectations, evaluation criteria and methodology and procurement timeframes, while the Procurement Conduct Plan contains details of tender evaluation team, roles and responsibilities of tendering steering committee, evaluation team, project team, project manager and procurement officer plus key conduct requirements and record keeping requirements. These documents are approved by the Assistant Auditor-General and the AG.

Through a public request for tender, prospective ASPs are asked to prepare a tender proposal to cover eligibility criteria as well as broader tender requirements. The tender is only considered during the evaluation process if it meets the requirements set out in the eligibility criteria. VAGO's newly appointed Procurement and Contracts Officer carries out the initial eligibility assessment. In 2013 all tenders met the criteria and were included in the evaluation stage.

Evaluation teams typically include at least one director and one other person (at director or manager level) however audits which are estimated to exceed a fee of \$250k over a three year period are evaluated by a team of three individuals. Evaluations are carried out independently by the evaluation team before scores are combined and considered by the evaluation team as a whole. The evaluation process considers the capacity, capabilities and experience of the tender and does not consider the costs proposed by the tenderer as tenderers are asked to provide their costs in a separate envelope to their proposal.

Proposed costs are added to the evaluation sheets after the evaluation team has ranked the tenderers and a formula is used to compare proposed costs and score in order to come up with a value for money result.

Once a final decision is made by the evaluation team approval is required from the project sponsor, Accredited Purchasing Unit (who ensures that the approved process was followed) and the AG.

Recommendations

There are no recommendations for this area.

Terms of reference

- (h) the effectiveness of procedures in place to monitor the quality and performance of contracted Financial Audit services.

Summary of observations

A number of Financial Audits are performed by ASPs. In these instances, the requirements communicated by VAGO are integrated within IPSAM. Consistent with other areas of IPSAM discussed herein, these requirements align with Australian Auditing Standards. Updates to IPSAM are communicated throughout the year as well as at the annual forum for ASPs.

The VAGO engagement leaders are involved from the beginning to the end of each audit that is contracted out, beginning with the development of the audit plan through to the review of the financial statements and attendance at the Audit Committee meetings. The evidence of the VAGO engagement leader's involvement is documented through their review of the key deliverables prepared by the ASPs including an analytical review of the financial statement balances as well as draft financial statements. VAGO ultimately receives a contractor audit clearance report prior to placing reliance on the work and issuing an opinion.

At the completion of each audit, a scorecard is completed by VAGO in which they assess the quality and performance of the ASPs. In order to further monitor the quality and performance, cold reviews are performed twice a year in which a sample of audit files are chosen that ensures at least one material entity is reviewed each cycle, reasonably split between in-house and ASPs and ensures the appropriate rotation among engagement leaders. Additionally, VAGO utilises an audit quality checklist and examines work papers of selected ASPs subsequent to engagements being performed.

We selected two audits which were performed by audit service providers as part of our review. Through review of these files, review of peer reviews, review of scorecards and discussions with the relevant VAGO engagement leaders, we noted the following:

- The key deliverables were included on file, as well as analytical explanations for balances and transactions
- The VAGO engagement leaders demonstrated a robust familiarity with the risks, procedures and conclusions reached
- The scorecards reviewed were thorough in nature and the responses provided by VAGO appeared honest and constructive
- The peer reviews conducted as part of VAGO's quality management system included one audit performed by an audit service provider.

In relation to the two ASP files reviewed, the procedures in place to monitor the quality and performance of contracted Financial Audit services appears effective.

We reviewed the continuous improvement register and note that this also included considerations and improvements relating to audit service providers.

We also note that hard messages were communicated in the ASP scorecards when required which highlights the commitment by VAGO of holding ASPs to account.

Recommendation

There are no recommendations for this area.

5 Conduct and management of Performance Audits

Terms of reference

Review the efficiency and effectiveness of the management and conduct of Performance Audits (both broad scope and limited scope) undertaken by Victorian Auditor-General's Office, with particular attention to:

- (a) Whether VAGO's Performance Audit methodology provides comprehensive guidance for the conduct of Performance Audits and is regularly reviewed and updated to ensure it retains rigor and relevance
- (b) compliance with the relevant provisions of the Audit Act 1994 and Australian Auditing Standards for the conduct and reporting of Performance Audits.

The Performance Audit methodology tool Audit Method –Performance (AmP) was assessed against the Auditing Standards ASAE 3000, ASAE 3100 and ASAE 3500 and no significant gaps were identified with the methodology. The Performance Audit methodology is also consistent with the requirement of the Audit Act 1994 and the Auditing Standards.

AmP contains all guidance material, policies and procedures to complete a Performance Audit and is a Lotus Notes database available to all Performance Audit staff. AmP is comprehensive in its scope for the Performance Audit team.

AmP retains its currency through review by the users and the AmP Steering Committee having a regular agenda item to receive updates on the alignment of AmP with the Auditing Standards. The Steering Committee membership includes the Assistant Auditor-General, Performance Audit, Head of Methodology and Standards and Head of IT.

Additionally, VAGO employs a number of quality control practices and procedures to ensure the Performance Audit methodology is appropriate and the quality control procedures are sufficient in order ensure audit conclusions are supported. These procedures include the following:

- **Quality assurance framework** which includes:
 - Standard process steps and tasks to guide the auditor through the audit
 - Use of standard letters and documents
 - Review and oversight function
 - Use of engagement quality control reviewer
 - Processes to engage with audited agencies and the PAEC on audit objectives, scope and criteria.
- **Review of AmP:** Periodically, VAGO reviews AmP to ensure the policies and guidance are complete, appropriate and compatible with professional standards. Recommendations for improvements are provided to the AmP Steering Committee for consideration.

A total of 8 files were selected to form part of the review, with our targeted review focusing on compliance with significant aspects of the Standards. Although our targeted review did not include the examination of all work papers, the procedures performed were designed to identify instances of material non-compliance with the Standards. Some areas for improvement were identified and are included below.

Recommendations

- Clearer identification of risk, materiality and complexity within AmP of each Performance Audit. It would provide greater clarity and inform the level of staffing and expertise for an engagement, including involvement of senior management
- Ensure supporting documentation for monitoring of budget captured on the AmP file to enable review of budget outcomes
- Provide guidance on documentation to be included in the issues paper section to enable linkage of the final report to this section
- Streamline the number of key milestones in the AmP file to more accurately reflect the key dates to be completed and reduce focus of the audit on achieving milestones and greater focus on delivering quality report to stakeholders.

Auditor-General response - Accepted

Risk and materiality are related to the annual planning process which decides whether an audit should be listed on the work program. The complexity rating is assigned through the business planning process. Further work will be done to identify criteria that will inform the assignment of complexity rating for audits.

Responsible:

AAG PA / ED ASG

Timing:

March 2014

Auditor-General response - Accepted

VAGO will continue to monitor how managers are reporting program against budget in milestone briefs.

Responsible:

AAG PA

Timing:

Implemented

Auditor-General response - Accepted

VAGO will consider how better linkages between issues papers and the final report can be achieved.

Responsible:

AAG PA (via AmP user group)

Timing:

March 2014

Auditor-General response - Accepted

The ability to streamline the number of milestones requires changes to the performance audit mandate to allow more flexibility as noted in Strategic Recommendation 2.4.

Contingent on legislation changes

Terms of reference

- (c) Whether the selection of agencies for review is supported by an appropriate rationale (eg. such as risk, preliminary evidence/findings; materiality; or geographical/character representation)

Agency selection is driven by the development of the Annual Plan and the Performance Audit topics included in this Plan. The individual Performance Audit will include a detailed scope which is developed and confirmed with the key external stakeholders. Where the scope covers a number of agencies/departments this will be articulated in the scope.

In relation to the sampling methodology we noted in two of the files reviewed that there was some inconsistency with the samples proposed and the actual sample recorded in the audit files. There was limited explanation in the audit files for the rationale for amending the sample sizes from the initial audit scope and planning.

Recommendation

- Audit working papers to clearly document the rationale and approval for audit scope changes such as reduction in sample sizes or amendments to location or agencies included in the audit.

Auditor-General response - Accepted

Audit briefing papers contain this information and there has been increased emphasis on documenting sampling decisions.

Responsible:

AAG PA

Timing:

Implemented

Terms of reference

- (d) The adequacy and effectiveness of methodologies and/or processes in place for the development of realistic budgets (cost and time) for the conduct of Performance Audits and for monitoring Performance Audit budgets from the planning phase through to report tabling

Performance Audit budgets are developed during the audit scoping and planning phase and a weekly Performance Audit Scorecard is produced by ASG and provided to the Assistant Auditor-General for review and monitoring of each individual Performance Audits.

This scorecard includes the following details for each Performance Audit; target and actual costs to date, target and actual hours to date, forecasted and actual elapsed time (months) and target dates for various milestones that should be completed for each of the Performance Audits including sending initiation letter, target dates for drafting approving and finalising audit specifications and target dates for drafting finalising and tabling reports.

Recommendation

There are no recommendations for this area.

Terms of reference

- (e) Any instances of pressure in adhering to time and costs budgets resulting in curtailed planned audit activity and potentially impacting of the comprehensiveness of the issues reported to Parliament

For two of the files reviewed there were issues identified with the budgets initially developed.

Performance Audit – Procurement practices in the health sector

In the initial scoping of this audit it was envisaged that 8 health services would be audited, however only 4 health services were audited. It was indicated that this reduction was reduced due to budget issues and initial plan to utilise external consultants to assist with the audit. VAGO has indicated that the reduction of number of entities audited did not compromise the nature of the findings from the audit.

Performance Audit – Biotechnology in Victoria – The public sector's investment

There were significant delays in the delivery of this Performance Audit, it was scheduled to be completed in the 2010 Annual Plan but was not completed until June 2011. The initial budget was \$500k but the actual cost was approximately \$1m. In addition it was not clearly documented in the file the reasons for the delay and there was no evidence of formal communication with the relevant external stakeholders notifying them of the delay.

Resourcing issues were the major reason for the delays in the completion of the audit, with the team leader being absent for a 7 month period and during this period the audit did not continue. In addition there were significant discussions with finalising the issues in the report with the key stakeholders and these factors all added to the significant increase in costs for the completion of this Performance Audit.

Recommendation

- Significant delays in audit delivery should be formally communicated to relevant external stakeholders as soon as practicable. This will allow VAGO to respond promptly to any queries and provide learnings on reasons for delay to avoid similar situations occurring in the future.

Auditor-General response - Accepted

VAGO has focussed over the last five years on resourcing audits appropriately to deliver audits on time. In 2012-13 97% of reports to Parliament were completed on time. Should any significant delay occur there would be formal communication to external stakeholders.

Responsible:

AAG PA

Timing:

Implemented

Terms of reference

- (f) Whether significant issues arising during the course of a Performance Audit that were not identified in audit plans, are adequately and effectively considered and addressed in a timely manner

There are a number of stages in the Performance Audit process where issues identified throughout the audit are discussed with the key external stakeholders. These include:

- End of planning phase
- Late conduct phase
- Provisional draft findings.

From the files reviewed there was no evidence of significant issues identified that were not considered during the initial planning and scoping phase.

Recommendation

There are no recommendations for this area.

Terms of reference

- (f) The appropriateness of the mix between specialist expertise, contractors and suitability qualified in house in undertaking particular Performance Audits
- (h) Whether process for engagement of specialist services and/or consultants comply with relevant government procurement policies and procedures and are conducted with due regard to probity and value for money
- (i) Whether specialists skills engaged in relation to Performance Audits are evaluated in terms of the usefulness and value they have added to the conduct of the audit.

There is 55 audit staff in the Performance Audit team, with a diverse range of qualifications, including degrees in engineering, public policy, arts, science, law, commerce and accounting. There is no requirement for the staff to have an accounting qualification or an auditing qualification. The composition of a Performance Audit is determined during the planning phase and generally includes a team leader as the manager with 1 to 2 analysts

to assist with the fieldwork. Feedback from the auditees through the normal survey process and our discussion with senior external stakeholders identified that there was some concern over the experience of resources utilised on Performance Audits and a perception that senior VAGO staff were not involved closely enough with the audit fieldwork and engagement with auditees.

The use of external consultants to assist on Performance Audits is assessed at the planning phase and appropriate procurement activities are undertaken if a specialist resource is identified as being required. From the files reviewed external consultants were utilised across the Performance Audits for a range of services including:

- Resourcing gaps with the VAGO team
- Statistics and modelling expertise
- ICT expertise
- Investment management
- Skill augmentation and negotiation expertise.

Supporting documentation was available for the engagement of the external consultants across the audits. In addition there was evidence that the value of the external consultant was considered at the completion of the audit.

In order to make this process more efficient and reduce the administrative burden, VAGO established a “Performance Audit Panel” in 2013 with a formal tender process completed to identify panel members. Panel members can be quickly appointed for Performance Audit assignments with minimal administrative requirements.

Recommendation

There are no recommendations for this area.

Appendices

| | | |
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| Appendix C | List of interviewees | 75 |

Appendix A Review scope

| Stream | Data/information to be considered | Analysis and assessment | Identification, discussion and analysis of issues | Outputs and solutions |
|---|---|---|---|--|
| Stream 1 Office of the Auditor-General | Governance and planning <ul style="list-style-type: none"> Current organisation structure and overall governance Current strategy and related planning documentation and performance targets Key position descriptions for senior management Management meeting agenda, papers and minutes Internal monthly reporting and supporting documentation, including performance reporting Relevant management Committee charters and recent minutes of Committee meetings Audit Committee Charter and minutes of Audit Committee minutes (previous 3 years) Current Risk Register and associated treatment plans and other supporting documentation Internal Audit Charter and internal audit plans (previous 3 years) Management actions plan and supporting documentation from previous 2010 Performance Audit. Monitoring and measuring performance and effectiveness <ul style="list-style-type: none"> Obtain relevant documents relating to key performance management systems and measures. This may include: | <ul style="list-style-type: none"> Design stakeholder interview approach – Identify and arrange meetings with key stakeholders to be consulted and areas of interest. For example, PAEC, VAGO, Executive management and cross sections of teams Develop and confirm VAGO interview guide with VAGO Plan specific focus sessions with VAGO staff groups including managers, senior auditors and other staff Plan interviews with HR management Design and conduct surveys to collate data on performance/utilise existing surveys (client/internal employee surveys) Conduct interviews/surveys with key stakeholders including PAEC, Departmental Secretaries and Agency Chairs and CEOs Consider results from interviews with the relevant key stakeholders | Governance and planning VAGO strategy and planning <ul style="list-style-type: none"> VAGO Executive interviews to discuss the formulation of the strategic plan, environmental scanning, PAEC input, performance outcomes, budget and people strategy alignment Process undertaken to develop annual plan, with regard to internal and external stakeholders consulted and materials referenced to support the proposed Three Year Audit program Interviews with key stakeholders <ul style="list-style-type: none"> Analysis of interview/survey results from key stakeholder groups and workshop emerging themes Interview with the senior manager responsible for risk management, consideration of development of risk register and strategies for management of strategic risks Interview with Chair of Audit Committee to consider governance arrangements and function of the Audit Committee, Internal Audit and risk management activities Workshop with key management to consider: Process undertaken to develop strategic plan including any relevant supporting documentation or presentations | <ul style="list-style-type: none"> Conduct workshop to discuss findings and root cause analysis with VAGO management Engage with PAEC to provide insights, obtain feedback and explore recommendations and actions Develop options and agreed solutions and actions with VAGO management Draft summary of findings along with agreed solutions and actions with VAGO Final results and actions to be discussed with PAEC. |

| Stream | Data/information to be considered | Analysis and assessment | Identification, discussion and analysis of issues | Outputs and solutions |
|--------|--|---|---|-----------------------|
| | <ul style="list-style-type: none"> – VAGO strategic plan, budget and performance targets – Human resource management and performance systems – Process for setting, measuring and reporting of key performance indicators – Key performance indicators and benchmarks used to measure achievement of strategic objectives including the results for 2010 to 2013 – Recent improvements or initiatives implemented by VAGO to improve performance – VAGO's review and consideration of best practice public sector management and auditing in other relevant national and international jurisdictions to improve its performance – VAGO's use of the results of peer reviews over Financial Audits – Process for receiving, collating and actioning periodic client satisfaction surveys – Reports to Parliament and PAEC. <p>Human Resource management</p> <ul style="list-style-type: none"> • Obtain relevant documents relating to VAGO's human resource management systems, policies and practices. This may include: <ul style="list-style-type: none"> – Organisation strategy – HR & OHS policies and data – Competency framework – Development programs/framework – Performance management framework and reporting – Succession planning framework | <ul style="list-style-type: none"> • Benchmark VAGO to PwC Assurance and Consulting Practice as well as national and international Auditor-General functions and develop an initial gap analysis for consultation. | <ul style="list-style-type: none"> • Process undertaken to develop annual plan, with regard to internal and external stakeholders consulted and materials referenced to support the proposed Three Year Audit program <p>Monitoring and measuring performance and effectiveness</p> <ul style="list-style-type: none"> • Review the adequacy and effectiveness of the performance management systems including systems to manage costs and human resources • Consider the appropriateness and veracity of the performance indicators used by VAGO to measure its performance • Benchmark VAGO's performance in light of best practice public sector management in other national and international jurisdictions • Assess the effectiveness of recent improvement initiatives implemented by VAGO • Assess the soundness and comprehensiveness of the process for receiving and collating client feedback and the action plans in place to address key client concerns. <p>Human resource management</p> <ul style="list-style-type: none"> • Perform compliance assessment against identified benchmarks and processes including: <ul style="list-style-type: none"> – Risk and quality standards – Industry and general market insights. • Analysis of learnings from focus groups and workshops with VAGO Senior Management and HR Management | |

| Stream | Data/information to be considered | Analysis and assessment | Identification, discussion and analysis of issues | Outputs and solutions |
|--|--|--|---|---|
| | <ul style="list-style-type: none"> – Recognition programs – Motivation assessment tools/data – Workforce data – Turnover and recruitment data – Organisation and team structure – Job descriptions – Resource allocation to previous audits. • Perform a desktop review and assess the adequacy of key documents such as the policy framework and other relevant documentation • Obtain external data (for comparative and benchmarking purposes) • Perform a desktop review and assessment of relevant material including good practice models and practical approaches in other jurisdictions. | | <ul style="list-style-type: none"> • Assess the organisational culture through results from staff surveys, information gathered as part of the exit process. | |
| Stream 2 Conduct and management of Financial Audits | Governance and Planning <ul style="list-style-type: none"> • VAGO Audit methodology guide including any supporting templates. • VAGO risk management guide or equivalent. • VAGO quality control policies and procedures eg policy of maintaining currency of methodology guidance. • Any checklists, guides or other tools used by VAGO in quality reviews (or peer review) of VAGO files. • Obtain government purchasing policies. • Project scoping and planning, resource estimation and project management methodologies, frameworks and tools | <p>From the evidence obtained through a combination of materials sourced, discussions held and files selected for review we will perform the following procedures:</p> <p>Material or significant risks</p> <ul style="list-style-type: none"> • We will review audit methodology and quality control procedures against ASA and ISQC requirements respectively • We will ensure for reviewed files that the conclusions reached are adequately supported and in accordance with VAGO Policies and Procedures/Guidance. | Governance and Planning <ul style="list-style-type: none"> • Comparison of Financial Audit methodology in light of best practice public sector management in other national and international jurisdictions • Thematic analysis of unanticipated issues and risks emerging from the conduct of Financial Audits and a workshop with relevant VAGO stakeholder to assess/confirm how the methodology could be enhanced to address identified issues and risks • Analysis of budget v actual time, resources and cost and identification of drivers of variance from plan • Consideration of project scoping, planning and delivery practices in light of VAGO methodologies, policies, frameworks and tools | <ul style="list-style-type: none"> • Discuss and agree preliminary findings and root cause analysis with VAGO and other key stakeholders • Prepare a draft report for management comments and feedback • Collate agreed VAGO management actions • Engage with PAEC to provide insights, obtain feedback and explore recommendations and actions |

| Stream | Data/information to be considered | Analysis and assessment | Identification, discussion and analysis of issues | Outputs and solutions |
|--------|---|---|---|--|
| | <p>Monitoring and measuring performance and effectiveness</p> <ul style="list-style-type: none"> Current project management frameworks, processes and practices in relation to project monitoring, tracking and reporting, particularly in relation to planned v actual v forecast resources consumption and timelines Risk and issue management frameworks and processes, including resolution actions and reporting. <p>Human Resource management</p> <ul style="list-style-type: none"> Approach and processes to identify skills required for delivery of Financial Audits VAGO procurement policies, guidelines and standard operating procedures for outsourcing Financial Audits Through review and interview, understanding of current procurement practices for outsourcing Financial Audits. | <p>Compliance with relevant statutory requirements and Australian Auditing Standards</p> <ul style="list-style-type: none"> Consider outcomes of procedures performed to address 4 e) and 4 f) of RFT Part B – Specification Review process for maintaining and updating VAGO audit methodology guide During performance of other procedures outlined we will note any non compliance with statutory requirements (Audit Act 1994) and Australian Auditing Standards Consider key areas of current thinking around quality including: <ul style="list-style-type: none"> How the audit approach is documented in the planning phase to clearly demonstrate the judgements made How effectively the work of the IT/systems auditors is understood and integrated into the work of the financial statement auditors Whether use is being made of opportunities to enhance efficiency, for example, the rotation of testing non-critical controls | <p>Monitoring and measuring performance and effectiveness</p> <ul style="list-style-type: none"> Consider the appropriateness and veracity of the performance indicators used by VAGO to measure its performance in relation to Financial Audits Review the key themes/feedback from client satisfaction surveys for Financial Audits and assess the action plans implemented to address key client concerns. <p>Human Resource management</p> <ul style="list-style-type: none"> Consider the appropriateness of the mix between specialist expertise, contractors and suitably qualified in house staff in undertaking Financial Audits Analysis of value added by specialist expertise and comparison of this expected value identified during scoping Workshop with relevant stakeholders to review analysis and assessment of value added through specialist skills Consideration of engagement and procurement processes for specialist skills. | <ul style="list-style-type: none"> Finalise and distribute report within the required time line. Conclude on the overall effectiveness of the Office of the Auditor. Final results and actions to be discussed with PAEC. |

| Stream | Data/information to be considered | Analysis and assessment | Identification, discussion and analysis of issues | Outputs and solutions |
|--------|-----------------------------------|--|---|-----------------------|
| | | <ul style="list-style-type: none"> – How the use of professional scepticism and the judgement used by the auditors in gathering evidence is captured and documented in the audit files – The effective use of substantive analytics • The approach taken to address the risk of fraud, in particular procedures adopted for the testing of manual or non-routine journals. <p>Completion of Financial Audits on time and within budget</p> <ul style="list-style-type: none"> • Review management reports which summarise overall VAGO performance in this area and obtain supporting documentation. • For each file selected, review evidence of signing date, management letters and cost against deadlines and budget. <p>Selection techniques</p> <ul style="list-style-type: none"> • Compare VAGO audit methodology to ASA's • During the review of engagement files, ensure compliance with VAGO methodology. <p>Focus areas for detailed internal control assessment</p> <ul style="list-style-type: none"> • Compare VAGO audit methodology to ASA's | | |

| Stream | Data/information to be considered | Analysis and assessment | Identification, discussion and analysis of issues | Outputs and solutions |
|--|---|---|--|--|
| | | <ul style="list-style-type: none"> During the review of engagement files, ensure compliance with VAGO methodology. <p>Risks identified which were not originally anticipated</p> <ul style="list-style-type: none"> For each file selected, determine if risks not originally identified are addressed and documented in line with VAGO methodology and ASA's. Ensure each risk is adequately and timely addressed. <p>Contracted Financial Audit services</p> <ul style="list-style-type: none"> Compare VAGO process against government policies Select a sample of contracted Financial Audit services and review for compliance with the outlined process. Further, an assessment on the probity and value for money of the contract will be made. <p>Procedures in place to monitor the quality and performance</p> <ul style="list-style-type: none"> Review procedures and ensure operating effectively. | | |
| Stream 3 Conduct and management of Performance Audits | <p>Governance and Planning</p> <ul style="list-style-type: none"> Selection framework for Performance Audits Documentation relating to the application of the selection framework for Performance Audits | <ul style="list-style-type: none"> Design stakeholder interview approach – Identify and arrange meetings with key stakeholders to be consulted in relation to planning, delivery and assessment of Performance Audits | <p>Governance and Planning</p> <ul style="list-style-type: none"> Analysis and review of the application of the Performance Audit topic selection framework and analysis of rationale behind topics that were considered by VAGO <ul style="list-style-type: none"> – but not selected for Performance Audit | <ul style="list-style-type: none"> Workshop with key Performance Audit stakeholders to validate preliminary findings and root cause analysis Discuss and agree |

| Stream | Data/information to be considered | Analysis and assessment | Identification, discussion and analysis of issues | Outputs and solutions |
|--------|--|--|---|--|
| | <ul style="list-style-type: none"> Current Performance Audit methodology Findings from previous reviews of Performance Audit methodology and impacts/enhancements made as a result Project scoping and planning, resource estimation and project management methodologies, frameworks and tools. <p>Monitoring and measuring performance and effectiveness</p> <ul style="list-style-type: none"> Current processes and measures used by VAGO to assess the impact of Performance Audit activities Current project management frameworks, processes and practices in relation to project monitoring, tracking and reporting, particularly in relation to planned v actual v forecast resources consumption and timelines Risk and issue management frameworks and processes, including resolution actions and reporting <p>Human Resource management</p> <ul style="list-style-type: none"> Approach and processes to identify skills required for delivery of Performance Audits VAGO procurement policies, guidelines and standard operating procedures Through review and interview, understanding of current procurement practices Evaluation and assessment framework for value delivered by specialist skills engaged during delivery of Performance Audits. | <ul style="list-style-type: none"> Develop and confirm interview guide with VAGO Conduct interviews/workshops with relevant Performance Audit managers to identify and confirm their perspectives on <ul style="list-style-type: none"> strengths and concerns in relation to comprehensiveness of Performance Audit methodology and supporting project management methodologies and tools Current practice in relation to scoping, planning and estimating resources required for delivery of Performance Audits Potential impact of time and cost pressures on planned and actual Performance Audit activities Approaches to responding to unanticipated significant issues that arise during the course of Performance Audits Evaluation of specialist skills used during delivery of Performance Audits Conduct interviews/surveys with key stakeholders including PAEC, Departmental Secretaries and Agency Chairs and CEOs Conduct file reviews for a sample of Performance Audits | <ul style="list-style-type: none"> were not initially selected and subsequently have been subject to a Performance Audit considered by VAGO and selected for Performance Audit Comparison of Performance Audit methodology in light of best practice public sector management in other national and international jurisdictions Thematic analysis of unanticipated issues and risks emerging from the conduct of Performance Audits and a workshop with relevant VAGO stakeholder to assess/confirm how the methodology could be enhanced to address identified issues and risks Analysis of budget v actual time, resources and cost and identification of drivers of variance from plan Consideration of project scoping, planning and delivery practices in light of VAGO methodologies, policies, frameworks and tools <p>Monitoring and measuring performance and effectiveness</p> <ul style="list-style-type: none"> Consider the appropriateness and veracity of the performance indicators used by VAGO to measure its performance in relation to Performance Audits Review the key themes/feedback from client satisfaction surveys for Performance Audits and assess the action plans implemented to address key client concerns Analysis of the processes and measures used by VAGO to identify and assess the impacts of Performance Audits. <p>Human Resource management</p> | <p>preliminary findings with other key stakeholders as appropriate and required</p> <ul style="list-style-type: none"> Engage with PAEC to provide insights, obtain feedback and explore recommendations and actions Prepare a draft report for management comments and feedback Collate agreed VAGO management actions Finalise and distribute report within required timing <p>Conclude on overall conduct and management of Performance Audits</p> <ul style="list-style-type: none"> Final results and actions to be discussed with PAEC. |

| Stream | Data/information to be considered | Analysis and assessment | Identification, discussion and analysis of issues | Outputs and solutions |
|--------|-----------------------------------|--|--|-----------------------|
| | | <ul style="list-style-type: none"> – Target audits where high level of acceptance or high level of rejection of findings by Executive Government • Validate results from interviews with the relevant key stakeholders as appropriate. | <ul style="list-style-type: none"> • Consider the appropriateness of the mix between specialist expertise, contractors and suitably qualified in house staff in undertaking Performance Audits • Analysis of value added by specialist expertise and comparison of this expected value identified during scoping • Workshop with relevant stakeholders to review analysis and assessment of value added through specialist skills • Consideration of engagement and procurement processes for specialist skills. | |

Appendix B Approach and methodology

| | Phase 1 Planning and Review Preparation | Phase 2 Desktop review and workshops with VAGO management | Phase 3 Assessing the performance of VAGO | Phase 4 Collating findings from all streams | Phase 5 Reporting and presentation |
|---------------------------------|---|---|--|---|---|
| Objective | Confirm our proposal with PAEC to ensure the terms of reference and approach address the PAEC's objectives for this assignment | Perform desktop review and workshops to understand the objectives, strategies and relationships between VAGO and key stakeholders | Assess the performance of VAGO by interviewing key VAGO and stakeholder personnel and review of information and files | Collate and analyse the information collected in Phase 3 to enable comparison against best practice and synthesis of our assessment | Present our findings and potential improvements to key stakeholders nominated by PAEC |
| Key steps and activities | <ul style="list-style-type: none"> Conduct discussions with PAEC to confirm the terms of reference and PwC's proposed approach Discuss and agree key outcomes that will be of value Confirm engagement protocols including sample population selection and reporting timetable Identify and arrange meetings with key stakeholders to be consulted and obtain key documents and data Conduct current research on good practice across Australia and globally | <ul style="list-style-type: none"> Review <i>Audit Act 1994</i> to identify statutory responsibilities noting changes during the review period Review VAGO Annual Plan and other relevant documents which detail VAGO strategies, activities, structures and controls in place to meet statutory responsibilities Review prior performance reports Review relevant reports from other jurisdictions Identify performance measures and benchmarks utilised at present | <ul style="list-style-type: none"> Gather information in the following areas of VAGO operations and activities (streams): Office of the Auditor-General Conduct and management of Financial Audits Conduct and management of Performance Audits Our detailed approach to the above streams is provided on page 15. | <ul style="list-style-type: none"> Collate and analyse information obtained from Phase 3 Evaluate results to identify areas of compliance and deficiency Assess compliance with identified benchmarks and processes Identify opportunities for improvement Develop practical recommendations to improve on existing processes and practices Assess achievement of objectives set out in the annual plans, and identify gaps | <ul style="list-style-type: none"> Report findings from Phases 3 and 4 Conclude on overall assessment of VAGO's compliance with the <i>Audit Act 1994</i> Discuss and agree draft action plan and recommendations with VAGO and PAEC Finalise performance report after agreement with VAGO and PAEC Present to PAEC and other nominated parties key opinions, findings and conclusions, along with agreed solutions and actions. |

| | Phase 1 Planning and Review Preparation | Phase 2 Desktop review and workshops with VAGO management | Phase 3 Assessing the performance of VAGO | Phase 4 Collating findings from all streams | Phase 5 Reporting and presentation |
|-------------------------------------|--|--|---|---|---|
| | | <ul style="list-style-type: none"> Identify stakeholder groups PAEC, VAGO, Departmental Agencies and develop an engagement plan to understand feedback. | | <ul style="list-style-type: none"> Develop an action plan to address improvement opportunities and reflect recommendations. | |
| Outcomes/ Key milestones | <ul style="list-style-type: none"> Agreed terms of reference and confirmation of approach Agreement on expected outcome areas and coverage of any specific PAEC concerns Agreed stakeholder engagement plan, including PAEC contact throughout the review Confirmation of engagement protocols including sample population and selection Strategy and timetable for meetings with key stakeholders Relevant data, key documents and results from research to consider in preparation for the next phase. | <ul style="list-style-type: none"> A detailed understanding of VAGO, its stakeholders and activities so as to ensure our work is focused on key risk areas Established baseline performance measures and benchmarks. | <ul style="list-style-type: none"> Collection of stakeholder views of VAGO performance Assessment of VAGO Performance for the above areas and benchmarking against good practice and relevant benchmarks. | <ul style="list-style-type: none"> Identification of areas where best practice and benchmarks are being achieved Workshop a set of options for improvement with VAGO Identification of recommendations where improvements can be made to provide enhanced value to Parliament. | <ul style="list-style-type: none"> Opinion on compliance with Audit Act 1994 Presentation to key stakeholders Final report to PAEC |

Appendix C List of interviewees

| Department of Premier & Cabinet | Department of Education & Early Childhood Development |
|---|--|
| Jo De Morton – Deputy Secretary | Richard Bolt – Secretary |
| Mark Duckworth- Executive Director | Jim Miles – Deputy Secretary |
| Ann Hodder – Director | Clare Britchford – Chief Financial Officer |
| Ryan Phillips- Director | James Kelly – Executive Director |
| Department of Treasury & Finance | Department of Human Services |
| Grant Hehir – Secretary | Gill Callister – Secretary |
| Steve Mitsas – Director | Katie Haire – Deputy Secretary |
| | Peter Neilson – Chief Finance Officer |
| Department of Justice | Victorian Managed Insurance Authority |
| Greg Wilson – Secretary | Warren Hutcheon – Chief Executive Officer |
| Shaun Condron – Chief Finance Officer | Victor Martindale – Executive General Manager, Finance |
| Jacinthe Galpin – Director Risk and Audit | |
| Victorian Funds Management Corporation | Melbourne University |
| Warren Lee – Chief Executive Officer | Allan Tait – Chief Finance Officer |
| Marc Pizzichetta – Head of Finance & IT | |
| Independent Audit Committee Member | Department of Transport, Planning & Local Infrastructure |
| Frank King | Dean Yates – Secretary |

