

PUBLIC ACCOUNTS COMMITTEE

FINANCIAL MANAGEMENT BILL 2005 AUDITOR GENERAL BILL 2005

**TRANSCRIPT OF EVIDENCE TAKEN
AT PERTH
MONDAY, 27 FEBRUARY 2006**

SESSION ONE

Members

**Mr J.R. Quigley (Chairman)
Mr D.T. Redman
Mr A.D. McRae
Dr S.C. Thomas**

Participating Member

Mr P.B. Watson

Hearing commenced at 9.30 am

PEARSON, MR DESMOND
Auditor General, examined:

CUNNINGHAME, MR DONALD JOHN
Acting Assistant Auditor General, examined:

STEPANOFF, MS JACQUELINE ADELE
Executive Officer, Planning and Coordination, Office of the Auditor General, examined:

The CHAIRMAN: Welcome. Before we can commence this part of the hearing I am required to advise you that the committee hearing is a proceeding of Parliament and warrants the same respect that the proceedings of the house itself demand. Even though you are not required to give evidence under oath, any deliberate misleading of the committee may be regarded as contempt of Parliament. Have you completed the "Details of Witness" form?

The Witnesses: We have.

The CHAIRMAN: Do you understand the notes attached to it?

The Witnesses: We do.

The CHAIRMAN: Have you read the information for witnesses form regarding giving evidence before committees?

The Witnesses: We have.

The CHAIRMAN: On behalf of the committee I take this opportunity to thank you for taking the time to appear before us today. As you are aware the committee is conducting a review of the Financial Management Bill 2005 and the Auditor General Bill 2005. I particularly thank you for the very detailed and informative answers you provided to the questions we asked you prior to this hearing. I appreciate that they would have caused you to divert valuable resources from other significant responsibilities. Are there any particular issues you would like to bring to the committee's attention?

Mr Watson is attending this hearing as a member of the Legislative Assembly. He has not been elected by the Assembly to sit on the Public Accounts Committee; he has been nominated as a Labor Party nominee to sit on the committee to fill the position vacated by Mr Marlborough following his appointment to the ministry. Mr Watson can ask questions but he cannot vote today. He will be able to vote on the report after next week after the Assembly has elected him.

The Auditor General Bill has fewer contentious issues for members of the Legislative Assembly committee than does the Financial Management Bill. Those issues relate to the timing of the three per cent overs and the reporting of them. The committee has met every week and after discussing the legislation we sent you some indicative questions to which we will direct today's questions.

Mr Pearson: We appreciate receiving an indication of the areas of interest to help us prepare our responses and we hope we are ready to answer your questions.

The CHAIRMAN: Did you prepare any written responses to these indicative questions or are you happy for them to go straight to transcript?

Mr Pearson: We are prepared to put them straight to transcript.

The CHAIRMAN: Does your jurisdiction cover all the bodies defined in the Government Financial Responsibility Act 2000?

Mr Pearson: That is our understanding. We are aware that some parties have raised that issue. However, on reflection, we are fortunate in Western Australia given the amendments to the FAAA in about 1989 or 1990 that introduced universal coverage of all entities subject to control of departments or authorities. We have not experienced any exceptions in the past decade so we are as confident as we can be that the bill adequately provides that cover.

The CHAIRMAN: We were concerned about corporate entities established under the control of ministers.

Mr Pearson: They are in the same category. In our view, the bill requires any entity to exercise control by appointing the Auditor General as auditor.

Dr S.C. THOMAS: Do you have concerns that any subentities within departments might not be covered under the Auditor General Bill?

Mr Pearson: No.

Dr S.C. THOMAS: So far you have not discovered any that might be at risk.

Mr Pearson: That is right.

The CHAIRMAN: Some of the auditors in town asked whether a private company to which an agency has outsourced one of its functions would be covered.

Mr Pearson: I recall some discussions following the Commission on Government that highlighted this sort of concern. It is a matter of the definition of the audit. I consider that the bill allows the Auditor General to track the dollar into the private entities' accounts. However, the bill does not empower the Auditor General to externally audit that private sector organisation. That is the area in which some confusion lies.

Dr S.C. THOMAS: I suspect that will be a fairly contentious issue among the private sector. To allay any concerns, what can you recommend to enable the Auditor General's office to probe deals? This could cut across a number of payments that might be questionable under the audit act but are quite common in business.

Mr Pearson: The first step in allaying any fear would require an exceptional power. However, on the other hand I firmly believe the power is required to protect the public dollar. The issue of whether a transaction might be acceptable in the private sector but not under the act would need to be considered on its merits on a case-by-case basis. I am not aware that during my time as Auditor General we have followed a dollar into a private sector organisation. However, one I can think of now has involved the full cooperation of a private sector contractor. At the contractor's behest my staff were asked to check controls within that organisation to provide assurance to the entity with which it is contracting that the revenue due is fully accounted for.

The CHAIRMAN: So there is an incentive for the contractor to demonstrate to the agency that it enjoys the confidence of your office.

Mr Pearson: Yes.

Dr S.C. THOMAS: Can you see that section being outsourced or is that exclusively the purview of your department?

Mr Pearson: I can certainly see it being outsourced. For example, I envisage that a highly complex financial deal might prompt the Auditor General to invoke that power. However, I would appoint a private firm to undertake that part of the audit. It is akin to some audits that we tend to contract out. I could upskill my staff to do it but it would not be cost effective for a single client. We would contract out that sort of audit and review the work of the private provider. It works as a very cooperative and complementary operation in practice.

The CHAIRMAN: Do you envisage that it would track the dollar into the company's account only to make sure it went to the right company?

Mr Pearson: Yes. If the company were contracted to deliver a service, the audit would ensure it was provided for that particular service or outcome.

The CHAIRMAN: Concern was expressed in a submission that the bill will enable you to start trawling through a company's books. What do you say to that proposition?

Mr Pearson: That is an extremely difficult question. First, we are too task-oriented and busy to go on a general trawl. I do not have an answer to that. We would have a specific purpose for doing anything.

The CHAIRMAN: I do not think your office has that power.

Mr Pearson: We do not have the power and if we did, what would we do with it? Conversely, it is one of those things that could raise our suspicion. If an organisation did not want to show us something that we would routinely expect the organisation to be on top of and proud of, I suppose it would raise a query.

The CHAIRMAN: I refer to Parliament's role. The questions arose from recommendations made some time ago by COG. We have had a conservative administration in the state for eight years since then - probably six since the establishment of the COG - and a Labor administration for about the same time. Some of these have not been picked up. Why does the Auditor General Bill give only two parliamentary committees - the PAC and the Standing Committee on Estimates and Financial Operations - the power to request audits? I do not have a particular concern with that, but are you happy with that?

Mr Pearson: Yes. As you say, it picks up the recommendations of COG and recognises the terms of reference in the PAC and the Standing Committee on Estimates and Financial Operations of the Legislative Council, which specifically refer to the relationship with the Auditor General. My reading is that while that gives primary responsibility to those committees, given the close relationship we have with committees, it does not stop other committees engaging with the Auditor General nor does it stop the Parliament as a whole requesting the Auditor General undertake an audit.

The CHAIRMAN: It does not prevent those committees writing to the Chairman of the PAC.

[9.40 am]

Mr Pearson: I would have to defer to parliamentary advice there. I am not sure whether they would necessarily have to write to the Public Accounts Committee, but it is an explicit provision for the PAC.

The CHAIRMAN: They could work through the PAC or seek the PAC's assistance and persuasiveness in requesting assistance.

Mr Pearson: Yes. I point out that I think it was the sale of the Dampier to Bunbury pipeline legislation in which the Parliament inserted a clause requesting the Auditor General to review the sale document and make a specific report. It is really formalising a power that has been there and providing some structure to it.

Dr S.C. THOMAS: Does that work reasonably well?

Mr Pearson: Yes. I understand that in the informal arrangements it has worked well to mutual advantage.

The CHAIRMAN: Question 2 refers to consulting the parliamentary leader of each party regarding the appointment of an Auditor General. I do not know whether it is a question for you. There are two definitions of what is a political party under the Electoral Act or what the Legislative

Assembly and the Legislative Council recognise as a party by reason of the numbers they hold in the chamber.

Mr Pearson: I would have to refer to legal advice on that.

The CHAIRMAN: You are probably indifferent as to whom they consult.

Mr Pearson: Effectively, yes, but I imagine the Electoral Act would be more authoritative. I would have to seek legal advice.

The CHAIRMAN: A provision in the bill gives the PAC the power to initiate the removing or suspending of an Auditor General. The question has been asked whether it should be limited to the PAC. This legislation seems to give the Public Accounts Committee an enhanced role.

Mr Pearson: It recognises that primary relationship between the Public Accounts Committee and the Auditor General, as I read it. Under the Westminster system the Legislative Assembly is the chamber of the government, and from my lay understanding of the separation of powers and the parliamentary process, in the normal course of events things should be initiated in the Assembly and reviewed in the Council.

The CHAIRMAN: By having the PAC initiate the process of making a recommendation for the removal, is it the appropriate committee to look at that?

Mr Pearson: In principle, the PAC should be the most relevant and informed committee if there is an issue.

The CHAIRMAN: The final issue is: why does the bill give power only to the PAC to make recommendations concerning your budget?

Mr Pearson: Again, that is a separation of powers between the legislature and the executive, unless the Auditor General's Office became part of the Parliament. At the moment it sits off the side somewhere between the executive and the Parliament. This recommendation power seems to be a happy balance that provides the check and balance in the process between the executive and the office.

The CHAIRMAN: Thank you. Why does the Auditor General's bill not give Parliament or one of its committees the power to either recommend or determine the application for additional funding to cover the costs requested by a parliamentary committee? When a committee requests you to do an audit, should it make a recommendation for additional funding?

Mr Pearson: It is the degree to which it is explicit in the act. My expectation would be that if there is a request to do a significant audit that involved significant funds, it would become a recommendation when we went to the Treasury to get the resources to do that task. Again, it comes back to the separation of powers.

The CHAIRMAN: Are you satisfied with that arrangement?

Mr Pearson: Yes and, again, it worked very well with the Dampier to Bunbury pipeline audit, which was a significant task. It was on the basis of the parliamentary request that went to Treasury, and it allocated resources to do the task.

Dr S.C. THOMAS: There are other operating systems in terms of the amount of work that is referred to an Auditor General's Office by a Parliament versus self-generated funds. I am thinking of the eastern states, particularly New South Wales and Victoria, where a lot of it is generated through the Parliament. Obviously, you interact with other Auditors General's offices. If additional work is pushed through, does that have a financial and budgetary impact that is adequately taken care of under those systems or does it tend to strain resources? Do those systems then have a system whereby the Public Accounts Committee or the Auditor General's Office can seek additional funding?

Mr Pearson: In essence it is working. I would see the extent to which parliamentary committees or the Parliament asks for, it is to be done. If it is the rare exception, our current arrangements would work. If it became a stream of requests, that is when we would have to negotiate a mutual agreement on the direction of the office, what it needs to cover and what the parliamentary committees want covered. We would then look at whether there are sufficient resources to do that or there is a need for supplementation.

Dr S.C. THOMAS: Are those mechanisms sufficiently covered in the proposed bill?

Mr Pearson: I think so. We cannot foreshadow the future. I can point to one case in what is arguably one of the largest democracies in the world where it got out of hand; that is, the American Congress and its Government Accountability Office, which is equivalent to the Auditor General's Office. A stage was reached in the late 1980s where Congress's requests were coming faster than the audit office could acquit them. They had a meeting of minds and got it back into balance. In the normal course of events, my short answer is that, yes, the provisions should be adequate.

The CHAIRMAN: We were asked to ask you about the appointment of an external auditor to your own office. How does that arrangement stand at the moment? Do you appoint the external auditor to your office?

Mr Pearson: No, the Governor appoints the external auditor. At the moment, the arm of executive government that initiates that is the Department of Treasury and Finance. It provides the advice in consultation with us.

The CHAIRMAN: To the Governor?

Mr Pearson: Yes.

The CHAIRMAN: To appoint an external officer?

Mr Pearson: Yes.

The CHAIRMAN: And that works at reasonable arm's length from you?

Mr Pearson: Yes.

The CHAIRMAN: Do you think we need to look at the provision that provides that the committee can determine, in camera, whether a minister's decision not to provide certain information to the Parliament is appropriate? I am talking about commercial confidentiality and disclosing it to the PAC committee. I trust that I am on the right subject.

Mr Pearson: Yes. I cannot think of a better arrangement to provide adequate review of such a decision.

The CHAIRMAN: Which essentially is a confidential decision.

Mr Pearson: Yes.

The CHAIRMAN: It has to have some accountability.

Mr Pearson: Yes, there has to be some accountability for the committee to meet in camera. If they concur with the minister, there is not a problem. If they disagree with the minister, then I imagine that, in camera, that can be negotiated and at the end of the day democracy has to work.

The CHAIRMAN: That is right and the report can be made.

Mr Pearson: Yes.

The CHAIRMAN: The opposition can dissent to that report.

Dr S.C. THOMAS: That is right, but potentially there are dangers involved. Whatever system of review we have has some inherent dangers. I do not see that there is a better one floating around.

Mr Pearson: I am not aware of one.

The CHAIRMAN: As the Auditor General of Western Australia, are you happy with that provision?

Mr Pearson: Yes.

The CHAIRMAN: The next subject is Parliament's access to information. We dealt with clause 82 of the Financial Management Bill. There are occasions when the Treasurer has the ability not to provide certain information to Parliament; nonetheless, ultimately he has to advise the committee.

Mr Pearson: Yes.

The CHAIRMAN: What is your view of those provisions?

Mr Pearson: In today's world you have got to have them.

The CHAIRMAN: When you say "you have got to have them", the confidentiality -

Mr Pearson: There will always be a case for an exception, and you need a due process to process that exception. I cannot give a specific example, but I can think of a circumstance that could arise where there was particularly sensitive information regarding, for example, state security and very sensitive personal information -

The CHAIRMAN: Commercial contracts?

Mr Pearson: Yes. The other category would be exceptional and true - I stress "true" - commercial in confidence, not just the first-curtain charade.

The CHAIRMAN: No, but where you will impact on another person's commercial enterprise.

Mr Pearson: Yes. I draw the analogy with the government tendering process. There might be just a window of time that needs to be kept sensitive. When I think of procurement - during the closing of tenders and the evaluation process - it is not appropriate to make public the various tenders received. Normally, once the decision is made and the contract is let, there is not a problem with the confidentiality of the bids. It needs to be worked through in a reasonable and rational manner.

Dr S.C. THOMAS: The fact that this information is not being released relates to both houses of Parliament and the Auditor General's Office. Often information that lies in both houses of Parliament tends to be ignored on occasions. What avenue is there for the Office of the Auditor General to take? What is its next step in that process if it feels there is an issue?

[9.50 am]

Mr Pearson: I read an obligation that if it is coming to us, we should run the rule over it and essentially agree that it should remain confidential, in which case there would be an added assurance that it was justified or, if we ran the rule over it and found a problem, it would be a question of going back to the minister and challenging the proposal. It is not always easy, but that is the role of the auditor.

The CHAIRMAN: I want to interpolate here over the run of the questions as set out in the indicative questions. My friend from Capel will not be with us all morning, because in 20 minutes he has to go. I want to ask him a question outside the flow of the indicative questions. Do you have any other questions you want to fit in before you go?

Dr S.C. THOMAS: No, I do not think so. The Auditor General's Office has been intimately involved in the preparation of the green paper. Obviously we have raised some of the areas of issue, but are there any areas that the Auditor General's office feels have not been addressed or have been inappropriately addressed within the green paper that you would have done differently had you had carte blanche?

Mr Pearson: Effectively, no. This bill has been a long time in its gestation. In most respects our operational procedures are quite satisfactory. I am not trying to put down what the bill is covering, but in many respects it is formalising approaches that are already operating. In other respects it is

shoring up the operational independence of the office, and that is where, to me, the key aspects of it are a statutory deputy and the proposal for the committee to make recommendations in relation to the budget resourcing and organisational structural aspects of the office that impact on our operational independence.

Dr S.C. THOMAS: On the question of the parliamentary input to the Auditor General's office, which will be increased under this process, are you comfortable with that process?

Mr Pearson: Yes, I think it is important because that helps focus the operations of the office, and really we are there to serve the Parliament. I see it as very positive.

The CHAIRMAN: This was raised in our indicative questions. What other roles is the Auditor General currently carrying out in the public sector? I do not know what precipitated that question.

Mr Pearson: We are down to one other statutory appointment now, which is that, ex officio, the Auditor General is a State Records Commissioner. Previously the Auditor General was the chair of the Premium Rates Committee under the Workers' Compensation and Rehabilitation Act, but that has been overtaken by -

The CHAIRMAN: The state archives legislation?

Mr Pearson: Yes, the State Records Act.

Dr S.C. THOMAS: Are the paid positions in the accountability of the Auditor General's roles? If they are paid positions, is there no conflict of interest going on with the ability to audit as well as -

Mr Pearson: No. In fact, the Premium Rates Committee one has now been superseded and finished, so it does not exist, but that was just the total. It was chairing a committee that oversights an actuary reviewing rates, charges and workers' compensation insurance. It was removed from the audit role. I understand the antecedence were for an independent person to chair that committee. There is no remuneration specifically for the State Records Commissioner. Clearly, I have drawn it to the attention of the Salaries and Allowances Tribunal that, aside from the Auditor General function, you are also doing that other job. There is no fee or remuneration for that. You just get your Auditor General's salary, and that is it.

Dr S.C. THOMAS: I was just thinking of avoiding a conflict of interest, if your office happened to audit another office in which you were employed.

Mr Pearson: No. The State Records Commission has been set up with that specifically in mind. The commission is effectively only four people - the Ombudsman, the Information Commissioner, the Auditor General and a person with expertise in archival and records management. Effectively that commission has no resources. It has a requirement to make a report to the Parliament, which we do annually, but it is serviced and victualled by the State Records Office from within the Department of Culture and the Arts, so there are no resources per se that it is accountable for.

The CHAIRMAN: A question was raised by members of the committee, and unfortunately not all members of the committee are here this morning because of other commitments, as to the appropriateness of the controls and accountability in relation to the Treasury's power to transfer excess amounts out of an agency's special purpose account to consolidated accounts. You are aware of that position in the financial management bill, where there has to be an annual notification, as I recall. Is that not the case?

Mr Pearson: That is my understanding of it, yes.

The CHAIRMAN: Someone raised the question of whether this should happen in real time; in other words, that there should be notification in real time. I pointed out to them that often your reports are in anything but real time because the audit report might not come down until 18 months or maybe two years after the actual event had occurred, but your report still attracts a lot of publicity.

Mr Pearson: Clearly, timeliness is important. It is the role of executive government to do things, and it is primarily accountable for doing them properly. I am very reluctant for the auditor or some other review person to be brought into the mainstream, because it would muddy the accountability. The audit can get in the way.

The CHAIRMAN: The audit can get in the way?

Mr Pearson: If you are in there auditing before a transaction has finished, I do not see that as appropriate. I see clear rules needing to be established. When we are talking about transfers such as that, there will always be a range of views, but if there is a clear rationale for it, that is documented and reported and there is a trail left. In the normal circumstances I would expect the executive to be able to explain what they have done, and the rationale would be self-evident.

The CHAIRMAN: And notify Parliament in a ministerial statement?

Mr Pearson: That is right. For me, it is appropriate for the auditor then to survey all those issues. If there was an anomaly, we would draw it to Parliament's attention.

Dr S.C. THOMAS: On a slightly different tangent, on the question of the ability of the Treasury to transfer three per cent of the budget for expenditure can you comment on the appropriateness of that particular proposal?

Mr Pearson: I will declare my background as a resource manager in a former life. A three per cent flexibility, responsibly administered, I see as a positive thing. I would hate us in the public sector to go back to the very old days when money was appropriated for a particular, narrow, finite purpose and you had to go back through Parliament to get additional funds for something else within a jurisdiction. I think it is a far more mature and responsible approach to have the global allocation, a clear purpose and management accountable for the management of those funds. In that respect, in general, I would have thought that three per cent is moderate.

Dr S.C. THOMAS: Pretty reasonable?

Mr Pearson: Yes, a modestly reasonable discretionary element, and they have got to be accountable for the exercise of it.

The CHAIRMAN: We have raised the question of subdepartments. We couched it in terms that perhaps there is some inconsistency. I do not know whether there is or not. In your submission dated 20 February 2006 you noted that the revised arrangements of subdepartments in this bill will require the directors general to identify and transfer responsibility and accountability for financial administration of a service of a subdepartment, separately from all other aspects of responsibility and accountability, which will remain with the directors general. The DTF has advised this committee that the appointed accountable authority is solely responsible for the operations of the subdepartment, and discharges his or her accountability by submitting an annual report, through the appropriate minister, to Parliament. Consequently, the CEO is no longer responsible for the operations of the subdepartment. Is that how you see it?

[10.00 am]

Mr Pearson: That is literally how it works. We raised this issue because of the normal auditor caution that there needs to be clarity of responsibility. As the saying goes, you can delegate responsibility but not accountability. Too often people have delegated responsibility and think that it is someone else's. We, as auditors, come along and say, "No, they did that". Legally, the person who delegated it cannot delegate responsibility.

The CHAIRMAN: I will just tease this out for a moment. The Department of Treasury and Finance has advised that once that is delegated to the subdepartment, the head of that subdepartment will be responsible, through the minister, to the Parliament.

Mr Pearson: That is how I understand it.

The CHAIRMAN: Okay. I refer to something you said in your submission. I do not think this is an inconsistency, although we may have couched it as one. In your submission you said that the revised arrangements of the subdepartments require the director general to identify and transfer responsibility and accountability to a subdepartment -

Mr Pearson: Yes.

The CHAIRMAN: - separately from all other aspects of responsibility and accountability, which will remain with the director general. So, once he identifies a part going to a subdepartment, he remains responsible for the balance. Is that what you are saying?

Mr Pearson: Yes. It comes down to us wanting a clear delineation. When there is a clear delineation, people know where they stand.

The CHAIRMAN: You want to see on whose desk the buck is stopping.

Mr Pearson: Yes, very clearly.

The CHAIRMAN: That is right. So long as that is identified.

Mr Pearson: We appreciate that the world is not perfect, but we do not like any fuzziness around the edge.

The CHAIRMAN: No, but in terms of the responsibility and accountability arrangements of subdepartments, are you satisfied with the provisions of the Financial Management Bill?

Mr Pearson: Yes.

The CHAIRMAN: Thank you. I welcome the member for Riverton, Mr Tony McRae, to the meeting.

Mr A.D. McRAE: Thank you, Mr Chairman.

The CHAIRMAN: We have asked some indicative questions and we are working through those. Our friend from Capel, Dr Thomas, has to leave at a quarter past 10. I asked him whether there was anything outside these indicative questions that he wanted to ask, and for about 10 minutes he directed some questions to the Auditor General. They will appear in the transcript. Otherwise, he is pretty happy with the format. We are just working our way through that. We are halfway down page 2 of the prepared questions on accountability of the Auditor General. I refer to clause 14(2) of the Auditor General Bill. In what circumstances would you envisage waiving audits? Would that be for only non-functional entities?

Mr Pearson: Yes. Really this is one of the ones where we are trying to clarify existing practice and to ensure that it is specifically covered by legislation. At the moment, the only audits that we do not do are about three company audits of dormant subsidiary companies. In practice, we have not been auditing them, but on review there is a question mark about whether we have the authority to do that. It is common practice within commerce and industry, but within the public sector -

The CHAIRMAN: When it is a dormant company with no transactions?

Mr Pearson: Yes.

The CHAIRMAN: Under clause 36, you have the discretion to advise this committee about whether you have waived that.

Mr Pearson: Yes.

The CHAIRMAN: Do you think you should do that as a matter of form, so that there is accountability by outlining that these are the ones you are not bothering to audit, rather than that being discretionary?

Mr Pearson: Yes, we probably should. I would have to check whether we cover that under section 95 of the Financial Administration and Audit Act.

The CHAIRMAN: That would mean that there would be something on the public record; that is, that a letter had been delivered to the Public Accounts Committee setting out the ones that had not been audited.

Mr Pearson: That is right. I see the Public Accounts Committee as being like an audit committee of a company.

The CHAIRMAN: If we came up with that recommendation, would that upset the applecart?

Mr Pearson: No. In fact, it would help me and my neat accountant mind.

The CHAIRMAN: We will make a note of that one.

Mr Pearson: Sorry, Ms Stepanoff has just drawn my attention to the provision under clause 14(4) that already covers that.

The CHAIRMAN: Sorry; yes, it does.

Mr Pearson: We strive, in our section 95 reports to Parliament, to acquit all entities and provide a separate index to their audit.

The CHAIRMAN: Someone had a question about clause 24(2)(b). My friend from Capel is now excused. This comes under the heading "Reporting to Parliament" and "Reports on performance of functions generally". Clause 24(2) states -

Without limiting subsection (1), in a report under that subsection the Auditor General -

...

(b) is to include particulars of any major change of approach made by the Auditor General in relation to the extent or character of the audit function.

I do not know what would cause a major change. I suppose the evolution -

Mr Pearson: It concerns the evolution of accounting standards and of the methodology we use. Auditing, by nature, is subjective, so in some respects I value the opportunity to draw Parliament's attention to the discretion or approach I have adopted. If somebody had an issue with that, I would prefer that it be drawn to notice sooner rather than later. I would argue that we have done it reasonably well to date in our audit results reports to Parliament. We put in an audit practice statement that summarised our approach. With the implementation of the international financial reporting standards, we have signalled in the past two or three reports any developments in our approach. The object is to keep Parliament appraised of how it is being addressed.

The CHAIRMAN: Clause 27 covers the powers and duties of the Auditor General. It sets out your duties. Subclause (2) does not mention auditing and assurance standards. Having regard to subclause (1)(a) -

Mr Pearson: Clause 27(1) does.

The CHAIRMAN: Clause 27(1) does.

Mr Pearson: Yes.

The CHAIRMAN: Subclause (2) states -

In carrying out an audit the Auditor General is to consider whether the requirements of relevant enactments have been complied with.

It does not specifically spell out that it should be an audit to the standard of the auditing and assurance standards.

Mr Pearson: No. I suppose I read that as meaning that subclause (1) deals with the application of the accounting and assurance standards. Subclause (2) comes down to our legal compliance. That is a particular requirement of public sector auditors. It uses the term "relevant enactments". An extreme example is that when we are doing an annual financial statement audit, we have regard to

the Public Sector Management Act, the supply act and, clearly, the financial management act; that is, to those acts that guide the financial administration and program administration. However, it would not extend, for instance, to checking whether the agency was complying with traffic laws. We would say that while that is sort of relevant, it is remote from financial management.

The CHAIRMAN: I raised that point because I recalled from your earlier submission that you wanted a bit more specificity on the Australian assurance standards.

Mr Pearson: No, we wanted to have regard to the standards. The approach is that, in normal circumstances, we would apply the Australian accounting and auditing standards.

The CHAIRMAN: I see. I am sorry; I picked up the wrong submission. It was the Australasian Council of Auditors General that really wanted more specificity about the standard you are auditing to. I refer to clause 27(1)(a). You would be hard-pressed to be more specific than that, would you not?

[10.10 am]

Mr Pearson: Yes. To be honest I suppose you could say that you will follow Australian auditing and assurance standards, whereas my strong view is that the inclusion of the words “having regard to” makes us accountable for either following them or, if we have not followed them, explaining why we have not followed them. I think that respects the jurisdiction of the Western Australian Parliament, because they are not legislation, but they are standards made under the Corporations Act.

The CHAIRMAN: The difficulty with regard to the other party that has made a submission to us is that if in the future those standards are amended or varied and it is a requirement that you follow them, you are locked into something when you may not know what a professional body or some other person might prescribe as the appropriate standard.

Mr Pearson: That is correct.

The CHAIRMAN: Whereas as the Auditor General you have a legal obligation to carry out an audit “in such manner as the Auditor General thinks fit, having regard to”.

Mr Pearson: To me that makes the Auditor General more accountable to the Western Australian Parliament for either following them or explaining why we have not followed them. To be honest, it would be very much the exception that we would not do that. Mr Cunninghame might remember a situation in the mid-1990s when we ended up having to give a two-part opinion on financial statements. I think it was when net appropriations were introduced, and there was an issue of control. We gave a clear opinion under the FAAA, and a qualified opinion under the standards. In that sort of situation, I think with hindsight we might advise the Parliament of the circumstances and set an approach and give a straightforward opinion.

The CHAIRMAN: Thank you for that. That enables us to deal with that submission that has been made to us.

Mr Cunninghame: I want to emphasise the point that Mr Pearson made about the mechanism for informing the Parliament if there is a divergence from the standards. I think the other party that has made a submission might be suggesting that there should be a mechanism for doing that.

The CHAIRMAN: Are you saying that you should inform the Parliament -

Mr Cunninghame: Yes, if we have diverged from the standards.

The CHAIRMAN: But that is not required here, is it? It states only that you are to have regard to the standards as you think fit.

Mr Pearson: Yes, but I suggest it is a major change of approach, because our approach is to follow the standards.

The CHAIRMAN: You are not suggesting this bill is a major change of approach?

Mr Pearson: No. I am saying if we chose not to follow the standards.

The CHAIRMAN: It requires you to have regard to the standards as you think fit.

Mr Pearson: Yes. My interpretation is if we saw fit not to follow an aspect of the standards, it would be something that we should explain to the Parliament.

Mr A.D. McRAE: But you are not obliged to do that.

Mr Pearson: It might depend on the interpretation. I am not specifically obliged to, but I think it would depend on the interpretation of clause 24(2)(b), which states “any major change of approach made by the Auditor General in relation to the extent or character of the audit function”.

The CHAIRMAN: Yes.

Mr Pearson: That is the one we dealt with earlier.

Mr A.D. McRAE: It would depend on your interpretation of major variation. You could say it was not a major variation, therefore you saw fit to depart from the standards; in other words, you were of the view that it was not major, so you did not report it.

The CHAIRMAN: That might be okay in theory. However, if a piece of legislation required you to have regard to a particular standard and you did not have regard to that standard, that would be a major change of approach, because it would be at variance with what the legislation required, would it not?

Mr Pearson: That is how I come at it. However, equally, even though I can point to one case in the past 10 years in which it would have been helpful and a lot more straightforward for the sector, I must confess that as an auditor if I had regard to the standards and decided that an aspect of them did not apply, that would be pretty major.

Mr A.D. McRAE: Why would you not prescribe a scheme that said as Auditor General this is the standard that I think should apply? In other words, why not declare what the specifications are going to be, and in that declaration identify those areas that you are not going to use as a standard because you do not regard them as applicable in the circumstances? If you did that, everyone would know precisely what you were using and what you were not using, and that clause would make some sense to me, because if you made any variation from what you had indicated publicly, you would be obliged to notify the Parliament about that variation. It seems to me that the scheme does not require you to publicly inform everybody of the standards that you are going to apply, because it is assumed that you will apply the national standards as they exist from time to time, and you will decide which standards do not apply.

Mr Pearson: I would argue that I am already doing that. I do not have an audit practice statement with me, but we table our audit practice statement in the Parliament, and right up front it says that when we do the audit we apply the Australian auditing and assurance standards.

Mr A.D. McRAE: I know it says you apply the Australian standards, but it does not say which aspects of the standards you are not going to apply because the circumstances do not fit.

Mr Pearson: At the moment per se there is none that we are not applying. I see this provision about having regard to the standards as meaning that if in the future the standards were amended in a way that was not appropriate to the public sector or -

Mr A.D. McRAE: Let us use a practical example. What do the audit standards say about public sector companies that are non-operational?

Mr Pearson: I think they are silent on that.

Mr A.D. McRAE: So what do you say about them?

Mr Pearson: We follow commercial practice, and if they are dormant and there are no transactions, we do not do an audit.

Mr A.D. McRAE: That is an example of a variation from the national standards.

Mr Pearson: No. The standards do not say anything about that.

Mr A.D. McRAE: So you have introduced a new standard - a commercial one.

Mr Pearson: I think there is a difference between a practice and a standard. The standards are all about how to do an audit and the considerations to take into account in reaching conclusions.

The CHAIRMAN: Are you saying it is not the practice to apply these standards to non-operational entities?

Mr Pearson: Yes. It is a bit like dividing by zero.

Mr A.D. McRAE: Mathematicians do do that, actually!

The CHAIRMAN: Can we move now to the independent auditing of your office? Clause 37(2) provides that the Governor may appoint an independent auditor to carry out audits of the Office of Auditor General. Does that include efficiency and effectiveness audits of your office?

Mr Pearson: It is not my understanding that it does. It provides for the standard annual attest audit.

The CHAIRMAN: But your office does efficiency and effectiveness tests of the other agencies?

Mr Pearson: It does. That is correct.

The CHAIRMAN: Is there any reason that your office is not subjected to effectiveness and efficiency audits?

Mr Pearson: Not specifically. There are two approaches that I have observed nationally. From memory, the external auditor of the Australian National Audit Office has the power to do efficiency and effectiveness audits per a mandate. However, in other jurisdictions, generally speaking, the external auditor does only a financial attest audit, and they have either compulsory or voluntary peer reviews in which the operation of the office is reviewed by an outside authority, and a report is provided to the public accounts committee of the Parliament.

The CHAIRMAN: Anyway, it is clear that it does not include that, so that is a policy issue. Do you have a view against an effectiveness and efficiency audit?

Mr Pearson: Not specifically. If anything - I am getting into personal views here - it is a hard call. There is a strong argument for the external auditor having the same powers as the Auditor General. However, if the external auditor has those powers, then it is probably an overkill to have an external peer review.

The CHAIRMAN: Yes. That is right.

Mr Pearson: It should be one or the other, because I have observed in some other jurisdictions in which they have an external review once every three years that on a number of occasions the subsequent review has started before the first one has finished.

The CHAIRMAN: When was the external peer review of your office last carried out?

Mr Pearson: Our last one would have been in 2004.

The CHAIRMAN: Who carries out that review?

Mr Pearson: There is not a specific requirement in my office, so we have done it voluntarily. In the past we have used the standard Council of Auditors General terms of reference. We have sought PAC input to those terms of reference, engaged the panel, had the report done, and then provided a copy of the report to the PAC. In practical respects we have mirrored the compulsory ones elsewhere.

[10.20 am]

The CHAIRMAN: In relation to the compliance by your office with the principles set out in sections 8 and 9 of the Public Sector Management Act - a copy of which I will have before me in a moment - who do you envisage will submit a report upon your compliance with those provisions? They refer to the general principles of human resource management and the general principles of efficient conduct. They would normally come up in an efficiency and effectiveness audit, would they not?

Mr Pearson: Not normally, no.

The CHAIRMAN: Okay. Where do we look for an audit trail for your office, for your compliance with that?

Mr Pearson: I am not sure. I would put this provision in a similar context to sustaining the operational independence of the audit office, in the sense that the office is not covered by the Ombudsman, the Freedom of Information Act or the State Supply Commission Act. I have just taken this provision as a parallel one there. Clearly, in operations we follow the requirements or principles of those other pieces of legislation - we see ourselves as being part of the public sector and needing to perform at an appropriate level - but in terms of someone explicitly reviewing an audit -

The CHAIRMAN: I can think of another agency, now disbanded, where the human resources area was a disaster. It was the Anti-Corruption Commission. Someone in the Office of the Commissioner for Public Sector Standards had a look at it and found there had been some exploitation of some female staff there. It is a fair issue. How do you see your office assuring the public that it is complying with sections 8 and 9?

Mr A.D. McRAE: It could be a bit Pythonesque, could it not? You do not have any complaints, but you do not have a complaints department either.

The CHAIRMAN: Would you like a little more time to mull that one over and do a follow-up letter? That is, unless anyone else has any suggestions.

Mr A.D. McRAE: Do you use the public sector standards people at all? Do they come in at all to do HR, or to discuss the agency or act as a service agent?

Mr Pearson: I cannot recall; no.

Mr Cunninghame: All the rules of the public sector apply to our staff, and they therefore have the protection of those rules. They also therefore have to comply with them. That all applies; there is no exemption in that regard at all, as to the actual compliance with all the requirements. It is just the review function. It brings about the quandary in which one organisation is reviewing another organisation which in its turn is auditing that organisation. That is where the independence of either party can be impaired, and it could affect the opinion or the report.

Mr A.D. McRAE: Who checks the checker?

Mr Pearson: Yes.

The CHAIRMAN: You suggested in your original answer that no alternative mechanisms are proposed to monitor and report on this general principle of the office of the Auditor General and its code of conduct, but the Auditor General remains accountable to Parliament and must provide Parliament with any information it may require about the operations of his office, including the current code of conduct. That requires parliament to go on some sort of probe, rather than just be reassured. Is that how you see it occurring?

Ms Stepanoff: On a pragmatic level, the regular compliance reporting we are talking about here is currently provided on an annual basis in a spreadsheet to the Public Sector Standards Commissioner, and information on HR practices - the HR make-up of our office - is also provided

in our annual report. In real terms, there is no reason we could not continue to provide exactly that information to the Parliament in our annual report. However, we will do it without having to go through an agency that we audit. I guess we had not gone to the step of developing alternative mechanisms for the Parliament's consideration. What we are saying is that Parliament could continue to require us to report with exactly the same list of headings. However, we would be doing that in a more appropriate way, through the parliamentary relationship, rather than through a part of the public sector, which we are external to.

The CHAIRMAN: Thank you, Ms Stepanoff. Do you have something you can hand up to us? Do you have an example of that with you today?

Ms Stepanoff: No, but I can refer you to the appropriate sections of our annual report for the current year.

The CHAIRMAN: Thank you; we will touch on that in our report. I will flip over the page now, because we have covered two of the three pages of indicative questions. I do not think this one will take quite the same amount of time. When the term "accounts" is used in the Auditor General Bill 2005, rather than "financial report", is there any magic in this?

Mr Cunninghame: I would have a view that "accounts" is probably broader than "financial report". To me, "financial report" has a connotation of the actual financial statement, whereas "accounts", to me, extends beyond the financial statements to the underpinning ledgers and records. It is a more all-embracing term.

The CHAIRMAN: The next question is: why is "financial statements" used rather than "financial reports" in some parts of the bill?

Mr Cunninghame: This is another semantic matter. Basically, "financial statements" and "financial reports" are synonymous.

The CHAIRMAN: So they are synonymous, but you would see "accounts" as being more widely embracing?

Mr Cunninghame: Yes.

Mr A.D. McRAE: So why the variance? Is it just a drafting thing?

Mr Cunninghame: One of the reasons "financial statements" was used is that there are a number of other references to other reports in the bill. There are annual reports and the reports we table in Parliament. The term "financial statements" was therefore used. In actual fact, in the accounting standards, in some instances the term "financial report" is used and in other instances "financial statement" is used. At the moment they are quite interchangeable, but I feel that "financial report" is becoming the contemporary terminology. It is certainly what they use in the private sector.

Mr A.D. McRAE: I guess the Chairman's question goes to why we would have that variation in a new bill. Why persist with the interchangeability and why not just establish an expression that is meaningful and consistent in the way that we want it to be and that differentiates itself from those other activities that you just talked about?

Mr Pearson: I agree with that. I think we should look at using the standard term.

The CHAIRMAN: Thank you. In relation to terminology, the final question is: in relation to the definition of a "subsidiary body", are we applying the outdated definition of "control" for accounting purposes? Let us get to that definition of "subsidiary body".

Mr Pearson: That is one thing that, on it being raised, we have found that an outdated definition has been used, and we now propose that the definition of "subsidiary body" in clause 4 be amended at paragraph (a)(ii) to read "over which the agency exerts control, consistent with the definition of control in Australian accounting standards AASB 127 - Consolidated and Separate Financial Statements".

The CHAIRMAN: That is what you propose as the amendment?

Mr Pearson: Yes.

The CHAIRMAN: What is in the bill at the moment?

Mr Pearson: Paragraph (a)(ii) of the definition of “subsidiary body” reads -

in respect of which the agency has the capacity to dominate decision making, directly or indirectly, in relation to the financial and operating policies of the body so as to enable the body to operate with the agency in pursuing the agency’s objectives;

The amendment picks up a cross-reference to the standards.

Mr Cunninghame: The standards are amended from time to time, and this is what has happened since we picked up that reading. In order to avoid having to amend the legislation every time the standards change, that wording was suggested. Basically, it was to have the wording refer to the particular accounting standard AASB 127, “Consolidated and Separate Financial Statements”, so that it links in.

The CHAIRMAN: To effect that change?

Mr Cunninghame: Yes; to effect that change. That is an appropriate thing to export to the standards, because that is something that will change from time to time.

The CHAIRMAN: We are clear on that. I have not had a look at this. I should have looked at it on the weekend. Can they claim legal-professional privilege against your office? They must be able to.

[10.30 am]

Mr Pearson: The proposal is that they should not because it is for the purpose of an audit and to get the information. That was a recommendation of, I think, COG, if not the royal commission.

The CHAIRMAN: Okay.

Mr A.D. McRAE: That is a great idea, if that is the thinking, Mr Chairman.

The CHAIRMAN: In relation to the administration of public accounts, it is. Under this legislation, do you think you have the right to cabinet documents?

Mr Pearson: I believe so. We have been given access to date, and this clause is probably marginally tighter.

Ms Stepanoff: The drafting instructions and the cabinet submission that I understand started this all happening specifically directed that the bill give this kind of access to information; that is, a power that would override both cabinet and legal confidentiality provisions. Whether or not it in fact does, we understand that it does.

Mr A.D. McRAE: Does access mean disclosure authority as well? If you have access, does that mean that all other responsibilities flow from that as well?

The CHAIRMAN: I do not know that access casts upon them the responsibility to disclose.

Mr A.D. McRAE: That is what I am asking. If you have access to information, do all other rights and responsibilities for audit flow from that access right? In other words, if in the course of doing that you find something, does that mean you are obliged to disclose?

Mr Pearson: I think if we found something, we would be obliged to disclose, but in disclosing you would have regard to the source of the information.

Mr A.D. McRAE: That is what I am trying to understand.

Mr Pearson: I am just trying to think now. It is difficult to say how it is to be used, but without access to the information, you cannot effect the audit. Nine times out of 10, access to the

information confirms the authority, so you do not need to disclose other than to say there is appropriate authority.

Mr A.D. McRAE: The decision was made with the -

Mr Pearson: With the appropriate authority.

Mr A.D. McRAE: - authority to make that decision, and that is all you need to know.

Mr Pearson: Yes. We might need to see that it was cabinet decision number such and such of a certain date or something, but in terms of reporting the detail of the decision -

Mr A.D. McRAE: That is what I am trying to understand.

Mr Pearson: - we put ourselves in a position to say that it is appropriately approved at an appropriate level, or that appropriate information went into informing the decision, but this is the audit. We do not question the decision unless there is a defect in the information leading to that decision. If there were a material defect, we would query not so much the decision but the lack of adequate basis for the decision.

Mr A.D. McRAE: That then becomes a value judgment.

Mr Pearson: Yes.

Mr A.D. McRAE: Whereas the other one is an audit of process and authority.

Mr Pearson: That is straightforward. It is hard to have an example, but what would you expect the auditor to do if he asked what was the authority for something and he saw it and realised it was blatant that only half the story was put? What would you expect the auditor to do?

Mr A.D. McRAE: I think that is the question I am rummaging around with.

Mr Pearson: It has to be a judgment. It would have to be a material and obvious flaw that you are aware of. My natural intuition, if I saw that sort of gross anomaly, would be to draw it to the attention of the decision maker and give him to chance to revisit it.

Mr A.D. McRAE: Let us take a slightly controversial historical example. This one was publicly disclosed so it is not a matter of whether there should have been disclosure. A grant was given to the Global Dance Foundation by the previous government. It was a cabinet decision to award that contract. I am not using this example simply because all members present at the moment are of the "red team", Mr Chairman. It is historical enough and it has been rummaged over enough to not be a real concern. The question of authority was never challenged.

Mr Pearson: In that case, it was okay as long as there was accountability for the decision, because that is a value judgment decision.

Mr A.D. McRAE: That is right.

Mr Pearson: We have had cases in the past where -

Mr A.D. McRAE: There was never any suggestion that the contract was awarded inappropriately -

Mr Pearson: No.

Mr A.D. McRAE: - and nothing in your audit would have suggested that? Even if you or any of your officers personally hated dance companies, that is not material?

Mr Pearson: No. I agree with you a hundred per cent there. I am not sure if the PAC looked at that particular one.

Mr A.D. McRAE: I do not know; I was not here then.

Mr Pearson: There was a parallel example of financial assistance to industry. We did an audit and found problems with the process, but that sort of led to the question of whether the assistance was

being directed in the right direction. Then the PAC picked up our report, and held an inquiry and looked at the policy considerations of the direction.

Mr A.D. McRAE: What did it pick up? You said that these are the issues with the decision-making process -

Mr Pearson: No; we found issues with the process for approvals and acquittals and that sort of stuff. The PAC then looked at it and said that, moreover, it did not necessarily agree with the direction in which the assistance was going.

Mr A.D. McRAE: Did it pick that up because of some comment you made in your report?

Mr Pearson: No, it was not a lead from us, but was just a coincidental follow-on from that report. I am really looking at the mechanical side of it, but - I expect these are real exceptions - if we looked at a decision and saw that there was an obvious flaw or hole in what went up, I would probably, prima facie, see an obligation to say that is an obvious flaw and ask whether it was addressed. If the answer was that the decision maker -

Mr A.D. McRAE: Is it not true that if something does not perform how people were told it would perform, there must have been a gap in the information that went forward as a basis for making the decision? That is nearly a truism, is it not?

Mr Pearson: No. We are very much of the process side it.

Mr A.D. McRAE: If something fails, you have to be able to go back and find the hole, or gap, in the information.

Mr Pearson: Audits tend to look at the deficiencies in controls or applications of criteria or guidelines, and tend not to revisit the guidelines or the content of it.

The CHAIRMAN: In the indicative questions that we forwarded to you, Mr Auditor General, there were two points taken from submissions we received on which we would appreciate your comments. They are in the middle of the third page -

What is the Auditor General's view on the following submissions:

1. That the AG should have regard to all audit and assurance standards including those relating to section 227B of the Australian Securities and Investments Commission Act 2001 and the Auditing and Assurance Standards Board standards?

I have a view that you can be confused with too much, but you are required to go by the Australian -

Mr Pearson: That is the reference. We must have regard to that.

The CHAIRMAN: Section 24?

Mr Pearson: Yes.

The CHAIRMAN: Another submission has come in to say that you should have regard to more than that; you should have regard to this as well. What do you say to the person making this submission?

[10.40 am]

Mr Pearson: We agree, because we certainly have regard to the audit and assurance standards.

The CHAIRMAN: That is a legislative requirement of section 24(1).

Mr Pearson: Yes. Then section 227B of the ASIC Act - I think they are extensions or explanations of it.

The CHAIRMAN: The Auditing and Assurance Standards Board standards?

Mr Pearson: Yes. They are Australian auditing and assurance standards.

The CHAIRMAN: In other words, by reason of section 27(1), the Parliament will require the auditor to carry out his audit in such a manner as the auditor thinks fit, having regard to the auditing and assurance standards.

Mr Pearson: Yes.

The CHAIRMAN: Are we getting any more by putting it in there as well as in the Australian Securities and Investments Commission Act?

Mr Pearson: Yes. I have an extract from the Australian Securities and Investments Commission Act, and section 227B deals with the Australian Auditing and Assurance Standards Board's functions and powers. Section 227B(1)(a) is to make auditing standards under section 336 of the Corporations Act for the purposes of the corporations legislation. That is the corporate section. Then paragraph (b) is to formulate auditing and assurance standards for other purposes; paragraph (c) is to formulate guidance on auditing and assurance matters; and paragraph (d) is to participate in and contribute to the development of a single set of auditing standards for worldwide use.

The CHAIRMAN: Or (b)?

Mr Pearson: Paragraph (b) is to formulate auditing assurance standards for other purposes.

The CHAIRMAN: That could be the public sector?

Mr Pearson: Yes. To me it is just an entrance door to what is available. You go to the extent you need to do your job.

The CHAIRMAN: The person making the submission thinks that we also should be reporting, that we should include the ASIC requirement as well. This is what the person making the submission to us submits, and we are just seeking your response. He states that under section 27(1) the Auditor General is to carry out his audit in such a manner as he thinks fit having regard to (a) auditing and assurance standards and (b) ASIC. Do you see what I am saying?

Mr Pearson: Yes. My initial reaction is that I think that is a bit of an overkill, because in the public sector the auditing and assurance standards are the predominant reference and in Western Australia the corporatised entities are not established under corporations law like they are in some other jurisdictions, but they draw in corporations law. I think it would almost be not applicable. Even if you put it in, it would not be applicable.

The CHAIRMAN: Because ASIC is dealing with corporations?

Mr Pearson: Yes.

The CHAIRMAN: You are dealing with the public sector?

Mr Pearson: Yes.

The CHAIRMAN: Even those corporations which come within your purview are not formed under the corporations law?

Mr Pearson: That is correct.

The CHAIRMAN: But some of their accounting -

Mr Pearson: Draws out of corporations law. We follow it via the -

The CHAIRMAN: That is your response to that submission, anyway.

Mr Pearson: Yes.

The CHAIRMAN: Another concern of an auditing body - this is not my challenge or criticism of you, but a submission we have received - is that your practice of making a report to the Parliament that reports on financial, control and performance information all in the same audit document may confuse the users. That is not my criticism. How do you feel about that?

Mr Pearson: I personally do not think it would confuse the users any more than the two separate opinions. At the moment, in the course of drafting this or working through it, we did it out of practice. That is because when the FAAA came in, we continued to give opinions on financial statements but it was honoured in the breach with no opinions on performance indicators until the early to mid-1990s. It just evolved that we developed a second opinion. In talking with parliamentary draftsmen it came to note that the reading in of the FAAA is that it should be a single opinion and not two separate opinions. We sort of merged them in. I think the Western Australian public sector is familiar with financial statement and control and performance reporting.

The CHAIRMAN: Do you have any feedback - I am not concerned with the public sector - on how the public itself views your reports?

Mr Pearson: No, I am not aware of any.

The CHAIRMAN: So you are happy with the way that -

Mr Pearson: With the way it is proposed. The only time I could see it becoming any sort of issue, but it always is, is if there is a qualification.

The CHAIRMAN: But in these reports you are required to include the agency's comments concerning the performance examination?

Mr Pearson: Yes. Sorry, that is not on opinions. That question is about the opinion on financial statements and performance indicators.

The CHAIRMAN: Correct.

Mr Pearson: But in reports -

The CHAIRMAN: I was trying to seamlessly move on to the next topic and you picked it. In reports you are now required to include any agency comments on your comments of performance of that agency.

Mr Pearson: Yes. That is a natural progression. In fact we go through a very exhaustive what we call procedural fairness process with agencies now and by and large I would expect in their current circumstances their comment would be that we generally concur with the conclusion.

The CHAIRMAN: Or if they do not concur, say so?

Mr Pearson: Yes. If they do not concur, we get to add a section in where they say what they think, whereas to date we have effectively managed to -

The CHAIRMAN: Silence them?

Mr Pearson: Well, I hope not. If anybody says that -

The CHAIRMAN: I am joking, if there are any members of the press present.

Mr Pearson: A director general has come to me and say that a report was terrible; look what happened in the media and look at the questions in the Parliament. You sort of say that we went through procedural fairness and here is the letter you signed saying you agreed with the conclusions. His reaction to the conclusion is another matter.

The CHAIRMAN: My experience as a legal practitioner is that many commissions of inquiry now include the comments of the person about whom you are making an adverse finding against or making an adverse comment about.

Mr Pearson: That is right.

The CHAIRMAN: If we could include it in the same volume -

Mr Pearson: It is more transparent.

The CHAIRMAN: Capital user charges have by and large gone by the way, have they not?

Mr Pearson: Yes. Again for capital user charges to work -

The CHAIRMAN: Just for those following the transcript, we have been asked at committee level at least to provide more detail regarding the risk you have mentioned of agencies manipulating the cash balances to minimise their exposure to this charge, because as we see it these have now been largely put aside by the government, have they not?

Mr Pearson: I am not -

Mr Cunninghame: I suppose in the course of this year they have been put aside, yes, but we were asked for our views on whether that was an appropriate move, because that is one of the issues in the Financial Management Bill. We commented that it does create a bit of a risk of agencies manipulating cash balances, and to answer that part of the question, there is a risk that you can do things at year end, such as increase your prepayments to your suppliers and pay your suppliers further out into the future, thereby reducing your cash balance at the reporting date and then your net assets at that point in time are lower. It is just a cash flow thing. They are lower and therefore you pay a lower capital user charge. The capital user charge system has that inherent weakness. We do not have any strong evidence of that happening. However, it does create that risk.

[10.50 am]

The CHAIRMAN: Has the capital user charge not been put aside as of this year?

Mr Cunninghame: Yes.

The CHAIRMAN: Will it be an ongoing concern?

Mr Cunninghame: No. From an audit perspective it seems to be a good move to reduce that risk.

The CHAIRMAN: So do we not see that as an ongoing risk because it is a dead issue?

Mr Cunninghame: It is a dead issue.

The CHAIRMAN: It was an historical concern rather than a concern today?

Mr Cunninghame: That is right.

The CHAIRMAN: Should the Auditor General be required to provide copies of audit certificates and report on them to the Parliament or to the PAC?

Mr Pearson: We report on them to Parliament in our audit results report. A section at the back of the report lists a summary of the certificates issued.

The CHAIRMAN: The question is a bit silly because you say you already do it.

Mr Pearson: We already give a summary of the certificates issued. I would probably counsel against tabling the actual certificate because I see them as an operation acquittal between an agency and the funder.

The CHAIRMAN: An audit trail of certificates issued is published in the Auditor General's report.

Mr Pearson: That is right; it is covered in the report, so if a member of Parliament or anyone else wants to know more about it -

The CHAIRMAN: They can ask a question of the Treasurer.

Mr Pearson: Yes; they can pursue it. I am suggesting a lead is given.

The CHAIRMAN: The public can pursue it through either the Parliament or the media. The final question, concerning your resources, is one I do not want to ask you.

Mr Pearson: Oh, yes.

The CHAIRMAN: This is the lollypop question I suppose. The committee is aware of a number of recent changes to your mandate - specifically FALAA - and the new international accounting

standards being introduced in agencies' financial statements. Do you see the new arrangements under this bill increasing the workload of your office?

Mr Pearson: Under FALAA, a new annual report on state finances is required. By the same token, the Treasurer's annual statement is removed. It will probably mean a marginal increase. The international financial reporting standards are a hurdle that will create extra work in the transition. However, they should settle at the same level.

The CHAIRMAN: Once you get over the hump.

Mr Pearson: Once we get over the hump they should settle. There is a similar issue at the moment with early reporting under FALAA requirements for agencies to report within 90 days.

The CHAIRMAN: Once again, it is a matter of getting over the hump.

Mr Pearson: I have a slight reservation on that because it is a question of how much we can fit into the window of 90 days. There is a physical limit. Indications are that it will create a bit of an impost.

The CHAIRMAN: It is a matter of suck it and see.

Mr Pearson: Very much. We have to work it through.

The CHAIRMAN: You cannot anticipate what extra resources you might need until you have worked it through.

Mr Pearson: We will do an estimate.

The CHAIRMAN: You are satisfied you have the resources at the moment.

Mr Pearson: We are negotiating on the final resources required for that.

The CHAIRMAN: With the Department of Treasury and Finance?

Mr Pearson: Yes.

Mr A.D. McRAE: In any case, it is clear these are quite specific and intense periods of resource demand on people and people's time.

Mr Pearson: An issue is developing because of the booming economy. Our staff are well trained and are therefore very attractive to other parts of the public service and to the private sector.

The CHAIRMAN: I was going to come to that. At a human resources level -

Mr A.D. McRAE: It is a good problem to have.

Mr Pearson: Unless you are the recruiter and trainer.

Mr A.D. McRAE: Everybody has the problem.

The CHAIRMAN: It is a good problem in private enterprise; it is not necessarily a great problem in public sector auditing because not all resources are available. We have heard submissions about a dearth of really good, competent auditors in the city. Is that right?

Mr Pearson: There is a great shortage.

The CHAIRMAN: Are there any concerns at human resources level - I suppose at a financial level also - about your office's capacity to meet its new responsibilities under the Auditor General Bill once it is enacted?

Mr Pearson: Some challenges exist at the moment. From October to February we have lost about 15 per cent of our field staff. Effectively, since the end of the last cycle - October through to February - we have lost about 15 out of 45 staff.

Mr A.D. McRAE: It extrapolates out at about a 45 per cent turnover rate.

Mr Cunninghame: Yes.

Mr Pearson: Based on a straight pro rata basis.

Mr A.D. McRAE: That is spooky.

Mr Pearson: It is. Hopefully, it will not be that bad. Our people tend to be busy until October and then staff turnover and recruitment occurs.

The CHAIRMAN: People might stay with you for an audit season.

Mr Pearson: Yes, following which they move. That is worrying. About three years ago we had a similar run and 18 or 20 of our staff had fewer than three years' experience. Although they now have the experience, they are very marketable. The problem is that we are losing them when they come on stream.

The CHAIRMAN: That is happening in all professions. Law firms find it difficult to keep staff for longer than three to five years, as do accounting professions.

Mr A.D. McRAE: It is happening among not only professions workers, but also tradespeople.

Mr Pearson: In light of public service pay rates, we lose about half our staff within the public sector and half to the private sector. It is not a lot of assurance, but the big accounting practices down the street have the same problem because they are losing staff to the mining companies. That will put more pressure on us because the fundamental issue is that we cannot get auditors off the street and put them on the job tomorrow. They require training and working up. We will have to rely a lot more on contract firms in the near future, which is a dearer way of providing services.

The CHAIRMAN: Your answer is that you have the present capacity; you are concerned about how it will unfold over the next six months as you go into the audit season, but you do not see the AG bill foisting so much extra responsibility on you that your current human resources cannot handle it.

Mr Pearson: That is right. The problem is due to the Western Australian labour market, not the legislation.

Mr A.D. McRAE: The Treasurer will be alarmed!

The CHAIRMAN: I invite you to make any other comments on the legislation. You forwarded us a submission, we previously forwarded written questions to which you responded, and we have asked additional questions today and we are satisfied with your answers. Do you have any other comments to make before I conclude the hearing this morning?

Mr Pearson: I thank you for the opportunity to speak to the questions. We think the Auditor General Bill is an important development. It has been a long time coming and we hope the momentum will continue.

The CHAIRMAN: Thank you, Mr Auditor General. This concludes your part in today's hearing. The committee will send you a transcript of the evidence you have presented today along with a letter that explains the process for making any corrections. Alterations must be confined to only corrections of errors. If there are points you have made in your evidence that you think may need clarification or you have inadvertently admitted, you may if you wish forward this additional information in writing to the committee. This will be incorporated into our records as a supplementary submission. You will have 10 working days to return your corrected transcript to the committee office. If the transcript is not returned within this time, it will be deemed to be correct. Thank you.

Hearing concluded at 10.58 am
