Leadership and influence in the public sector
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About CPA Australia

Founded in 1886, CPA Australia is one of the world’s largest professional accounting bodies, representing more than 139,000 members in 114 countries.

The organisation advances its members’ interests through its focus on education and knowledge exchange, the development of professional networks, advocacy in relation to policy, standards and regulation and the promotion of the value of CPAs to employers, government, regulators and the public.

At the heart of the accounting profession is a commitment to serve and protect the public interest and act with ethical conduct. CPA Australia serves the public interest by enforcing a strict professional code of conduct with members, including an obligation to undertake continuous professional development to ensure that the highest of professional standards are met. This commitment is critical, as accounting professionals are placed in a position of trust by the various national and international communities they serve.

The CPA designation is recognised and valued throughout the world.

To access CPA Australia’s public sector page visit cpaaustralia.com.au/publicsector
This paper outlines CPA Australia’s views in relation to significant areas of interest for the public sector.

For our organisation, the public sector constitutes an important part of our 139,000 strong global membership, with 9 per cent of members working in the public sector across all levels of government.

As stewards of public finances that account for a significant percentage of GDP in most countries, members working in government play a vital role in promoting accountability, effective financial management and good governance.

CPA Australia as an organisation, and through its highly qualified members brings leadership and expertise to enhance integrity, effectiveness and efficiency. This is increasingly vital as public sector professionals grapple with increased scrutiny, reduced funding and large-scale reforms.

With more than 125 years behind us, we see ourselves as a thought and practice leader for the profession and our vision is to transform business and create value for the communities in which we operate.

We also assist countries in our region to develop an awareness and understanding of Australia’s experience of developing public sector accounting and look to share the breadth of knowledge and significant experience of our members.

CPA Australia will continue to seek to advance the profession of accountancy in the public sector, especially in relation to the maintenance and strengthening of certification and continuing professional development training standards; development and sharing of better practice guidance and research; high quality and relevant member service and facilitate the mobility of the profession.

Alex Malley FCPA
Chief Executive Officer
CPA Australia

Acknowledgements

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The nature and significance of the public sector

The composition of the public sector varies by country, but in most countries the public sector includes such services as the police, military, public roads, public transit, primary education, healthcare, delivering social security and administering urban planning (Starling, 2008). The public sector is the part of the economy concerned with providing basic government services. It provides services that non-payers cannot be excluded from, such as street lighting and public parks, i.e. public goods (International Public Sector Accounting Standards Board, 2011). Governments also provide merit goods, which benefit all of society and encourage equal opportunity, such as public education, health and fire services (InvestWords.com, 2011).

The United Nations defines the public sector as including “general government and public corporations” (United Nations, 2008). In Australia, the total public sector includes the total non-financial public sector, comprised of the general government sector and the public non-financial corporations sector, and the public financial corporations sector for the Australian Government and state / local levels of government (Australian Government, 2005).

There are many ways to measure the size of the public sector, such as by government consumption expenditure and number of employees. According to the World Bank (2010) government consumption expenditure, as a percentage of gross domestic product (GDP), is made up of cash payments for operating activities aimed at providing goods and services. The payments include compensation of employees, such as wages and salaries, interest and subsidies, grants, social benefits and other expenses such as rent and dividends. Illustrative data of public sector expenses is provided in Figure 1.

**Figure 1 Public sector expense (percentage of GDP)**

<table>
<thead>
<tr>
<th></th>
<th>2006 (%)</th>
<th>2007 (%)</th>
<th>2008 (%)</th>
<th>2009 (%)</th>
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<tr>
<td>Australia</td>
<td>24.9</td>
<td>24.4</td>
<td>24.3</td>
<td>26.6</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>16.7</td>
<td>16.3</td>
<td>18.9</td>
<td>N/A</td>
</tr>
<tr>
<td>Malaysia</td>
<td>18.4</td>
<td>18.8</td>
<td>20.3</td>
<td>22.7</td>
</tr>
<tr>
<td>Singapore</td>
<td>13.4</td>
<td>12.4</td>
<td>14.5</td>
<td>15.2</td>
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Note: China (PRC) data unavailable.

Government and public sector employment are often reported as either a percentage of the total population, or a percentage of total employment. According to the United Nations Secretariat (2000), the employment figures suffer from lack of comparability in addition to their limited availability.

Public sector employment data varies greatly. For example, the Singapore Public Service is the country’s largest employer, with 120,000 officers (Public Service Division, 2011), constituting approximately 4 per cent of the labour force. In Australia, the total public sector employs approximately 16 per cent of wage and salary earners (Australian Bureau of Statistics, 2010).

The public sector employment in China is difficult to estimate due to the size of economy and the changing role of government in business. However, the government maintains a major role in the urban economy, with “all but a few of the more than 100 ministries, commissions, administrations, bureaus, academies, and corporations under the State Council … concerned with economic matters” (Hsu, 2007). Similarly, the Malaysian Government has a strong presence in the economy (Australian Government Department of Foreign Affairs and Trade, 2005).

In recent years, the production and provision of public and merit goods has been transferred to a range of interdependent public, private and not-for-profit organisations (Shergold, 2008), motivated by the desire to reduce costs and increase efficiency, focus on core competitive advantage, introduce workforce flexibility and manage industrial relations problems (Young, 2004).

The extent of outsourcing in the public sector is often partial and limited to internal functions, such as IT services, security, payroll and catering. However, the outsourcing of delivery of publicly funded programs has expanded into areas such as labour market placement, skills training, provision of welfare and provision of health and housing services (Shergold, 2008).

The organisation of the public sector commonly includes publicly or government-owned corporations (GOCs), which may be fully or partially owned by government. GOCs may be organised as semi-autonomous corporate entities, operating according to commercial criteria, with limited decisions taken by government. Such entities are often listed on stock exchanges, with complex governance provisions to accommodate for a mixture of public and private interests and goals. Examples illustrating the variety
of mixed ownership GOCs are numerous. Singapore has a highly developed state capitalist mixed economy, where the state owns stakes in firms through entities such as the sovereign wealth fund Temasek (Forshaw, 2011).

In China, different corporate forms result in a combination of public and private capital, and the industrial system contains a complex mixture of relationships (Hsu, 2007). While 30 per cent of total assets of the industrial and service sectors in 2008 was held by GOCs (Office of the Leading Group of the State Council for the Second National Economic Census, 2009) many companies, such as subsidiaries of GOCs and partially privatised GOCs “fall into a grey area” (Woetzel, 2008). Similarly, government-linked companies (GLCs) may be private or public, with the government controlling the GLCs using a holding company. For example, the Malaysian government oversaw 40 listed GLCs (Australian Government Department of Foreign Affairs and Trade, 2005), including Petronas and Proton.
Accrual accounting: the Australian approach

The past 30 or so years have seen significant reforms to the Australian public sector and the introduction and implementation of the accrual basis of accounting in place of the cash basis of accounting. This can be seen as the impetus for broader changes to the public sector that included the use of a corporatised model very much informed by private sector practices.

Some commentators trace the history of the implementation of accrual accounting back to the Royal Commission on Australian Government Administration in 1976, which called for more accountability, devolved management and better performance measurement in the Australian public sector. During the next five years, reports from the Senate Standing Committee on Finance and Government Operations and similar committees in New South Wales and Victoria recommended accrual accounting. At about the same time, the Public Sector Accounting Standards Board was established to improve the quality of financial reporting in the public sector and the development of accounting standards for the public sector, which can be seen as a means of promoting the use of accrual accounting standards. Later, the implementation of a policy of transaction-neutral standards saw the activities and responsibilities of the Public Sector Accounting Standards Board absorbed by the Australian Accounting Standards Board.

Today, commentators acknowledge the significance of the contribution accrual accounting has made to public sector reforms in that its adoption has facilitated greater transparency in public sector activities, strengthened the accountability of governments and improved the quality of decision-making within government. Further, the breadth of knowledge and experience of accountants in the Australian public sector positions Australia as an important partner and resource for those jurisdictions that are contemplating the development of, or are in the process of putting in place, public sector financial management, reporting and budgeting initiatives.

CPA Australia has a significant public sector accounting membership and, as such, has long been acutely aware of that membership segment’s unique experiences and needs. In the face of the significant reforms to the Australian public sector described above, CPA Australia has continued to advocate for reforms that are in the public interest.

Transaction neutral standards

Initially, the Public Sector Accounting Standards Board worked on the development of a conceptual framework, as well as early drafts of what was to become AAS 27 Financial Reporting by Local Governments (1996) and later AASs 29 and 31 (1998). In recognition of their substantially common agendas, the Public Sector Accounting Standards Board merged with the Australian Accounting Standards Board (AASB) in 2000. The Australian Accounting Standards Board has a transaction neutrality policy, which means similar transactions and events should be accounted for in a similar manner by all types of entities, whether in the for-profit sector, the not-for-profit private sector or the public sector – unless there is a sound reason to be different in particular circumstances. The AASB considers the specific needs of not-for-profit entities in the private and public sectors when preparing new and revised International Financial Reporting Standards (IFRS) for adoption in Australia. When appropriate, this policy will lead to the publication of accounting standards specific to the public sector. AASB 1049 Whole of Government and General Government Sector Financial Reporting (2007), AASB 1050 Administered Items (2007), AASB 1051 Land Under Roads (2007) and AASB 1052 Disaggregated Disclosures (2007) are examples of accounting standards specific to the public sector.

CPA Australia supports the transaction neutral approach as a laudable objective from a theoretical standpoint. However, we have questioned whether it remains a practical approach as it is not the approach adopted internationally or used by other jurisdictions. It is against this background that CPA Australia supported New Zealand in its proposals to consider embracing public sector-specific standards, particularly where they have international acceptance outside of those entities for which IFRS are developed.

Example evolution of accrual accounting in practice

Malaysia’s initiatives for economic transformation include the public sector. As quoted in The Malaysian Institute of Accountants Accounting Today Prime Minister Dato’ Sri Najib Tun Razak said, “We need a government that enables and empowers the private sector. This means re-shaping and energising the public sector to be more responsive and accountable to the needs of private citizens and businesses” (June 2011). The proposal, developed
in Malaysia, is for the national government to switch from cash-based accounting to accrual-based accounting.

CPA Australia has encouraged Malaysia in this development and support has been provided through direct participation in a series of week-long government meetings on the adoption of accrual accounting and the accounting standards of the International Public Sector Accounting Standards Board.

Long-term fiscal sustainability reporting

The International Public Sector Accounting Standards Board describes long-term fiscal sustainability as the ability of a government to meet its service delivery and financial commitments both now and in the future. Separate reports providing information about the anticipated long-term financial consequences of governmental programs have recently become a feature of public sector reporting in a number of jurisdictions.

For example, in the Intergenerational Report 2010 the Australian Government provided a comprehensive analysis of the challenges that Australia will face over the next 40 years. The key conclusion is that an ageing population and climate change present significant long-term risks for the economy and the sustainability of government finances in that forward projections forecast an increase in total government spending from 22.4 per cent of GDP in 2015-16 to 27.1 per cent of GDP by 2049-50. As a consequence, spending is projected to exceed revenue by 2.75 per cent of GDP in 40 years.

The forecast demographic changes mean that future policies will need to continue to address the anticipated growth in government spending and the anticipated decline in economic growth. As noted in the Intergenerational Report 2010, real GDP per person is affected by the “three Ps”, being:

- Population – the share of the population that is of working age (i.e. age 15 or more)
- Participation – the share of the working age population that is employed (i.e. not unemployed or retired) and the average hours worked
- Productivity – the average value of the output (i.e. goods and services) produced per hour worked

The government has indicated its intention to address the three Ps by allowing higher net immigration levels, encouraging older Australians to stay in the workforce longer and initiatives to boost labour force participation.

Some commentators have described the benefit of the Intergenerational Report 2010 as a valuable benchmark for assessing the intergenerational affordability of government spending and other programs.

The International Public Sector Accounting Standards Board (IPSASB) (2009) has opined that such long-term fiscal sustainability information for national governments has the potential to enhance both the historically based information provided in the traditional general purpose financial statements (GPFSs) and the additional information provided in general purpose financial reports (GPFRs). The IPSASB has therefore concluded that the presentation of information on long-term fiscal sustainability is necessary to meet the accountability and decision-making objectives of financial reporting and that the ideal outcome would be the presentation of additional statements in GPFRs providing details of projections on future government spending and receipts to best satisfy users’ needs. In the interim, the IPSASB believes a discussion of long-term fiscal sustainability issues and indicators as part of narrative reporting appropriate.

CPA Australia considers that the presentation of information on long-term fiscal sustainability at least every five years, or more often as required, is necessary to meet the objective of financial reporting and that the option to choose between additional statements in GPFRs – providing details of projections and summarised projections in narrative – reporting appropriate. CPA Australia believes the proposed requirements should apply to each level of government but not as a requirement to be pushed down to individual entities.
Sustainability reporting in the public sector

The public sector provides many examples of high-quality leadership in sustainability reporting. Significant contributors can be identified in local government, water utilities and government business enterprises (GBEs). CPA Australia’s survey of Australian sustainability reporting practices (2005) identified more than 50 discrete public sector sustainability reports. If trends in the private sector can be drawn upon, it can be anticipated that current levels of sustainability reporting have doubled since 2005. The compelling reasons for such leadership can be explained by a range of factors which relate directly to public sector entities’ core purpose for existing, and thus a rationale for reporting to stakeholders. These include such diverse responsibilities as delivery of community services, provision of essential services, maintenance of vital infrastructure and oversight of critical natural resources. This said, adoption of these reporting practices is in no way universal and the quality of reporting is highly variable.

Parallels can be drawn between challenges which confront private sector entities and those encountered within the public sector in the pursuit of better penetration and quality of sustainability reporting. This includes issues around embedding sustainability in decision-making, confusion over organisational ownership and responsibility, absence of information integration and the disconnect between external rhetoric and internal reality.

Government departments, both Commonwealth and state, are the more significant areas where the argument or “business case” for sustainability reporting needs better development and articulation. Similar to the private sector, transition and development in the measurement of economic and business externalities will have an impact upon the scope and content of public sector sustainability reporting. Areas where potential impact can be anticipated is in state of the environment (SoE) reporting, intergenerational impacts and environmental stewardship.

Standards

As with the private sector, the growth in penetration of sustainability reporting has been underpinned by the maturing of reporting frameworks, particularly the Global Reporting Initiative’s (GRI) sustainability reporting guidelines (G4) (2011), particularly given the foreshadowed shift to greater orientation around the needs of the investment community. The Australian Government has not adopted, and would seem unlikely to adopt, sustainability reporting in the foreseeable future. The direction taken by some European governments has been to compel agencies and GBEs to report using the GRI Guidelines. Short of this type of prescription, it remains unclear what will drive comprehensive adoption of sustainability reporting across the public sector.

Integrated reporting in the public sector

The initial articulation by the International Integrated Reporting Committee (IIRC) of the Integrated Reporting Framework (2011) is that it will be initially oriented to investors as the primary target audience. This said, it is foreshadowed that integrated reporting will eventually be applicable to public sector entities. Challenges can be anticipated in describing the public sector entity’s business model and components of core capital which are the basic “building blocks” of integrated reporting. Further challenges may be around defining the stakeholder constituency to which integrated reporting is targeted.
Governance is concerned with how organisations are directed, controlled and held to account. There are several theoretical perspectives on corporate governance such as agency, stewardship, stakeholder, transaction cost economics and resource dependence (see Clarke & Clegg 1998, Psaros, 2009) but “no single model of good corporate governance” (OECD 2004:14). This view is shared by the ASX Corporate Governance Council which articulates the “Principles and Recommendations of Corporate Governance” in Australia and continually asserts that there is no single model of good corporate governance.

The fundamental questions of governance are: who has control and for whom is control exercised (Clarke & Clegg, 1998). Governance in the public sector is concerned with how organisations are managed and includes strategy, values, structures, processes and policies. While the main emphasis of governance is internal and covers issues such as who manages, for whose benefit and how (Epstein, 1999), in the public sector there are no shareholders whose interests need to be balanced against those of other stakeholders. Instead, public sector entities are required to act in the best interest of the public. The World Bank (2007) mentions the characteristics of accountability, transparency, efficiency, rule of law and ordered political interactions as desirable in public sector governance. Similarly, the United Nations Development Programme (UNDP) describes good public sector governance as participatory, transparent, accountable, effective, equitable and promoting the rule of law.

Stewardship is a fundamental principle of public sector governance. Stewardship is based on the premise that the public sector organisations’ power and resources are held in trust for the benefit of all citizens. The officials of public sector organisations are the stewards of the resources. The objective of public sector organisations is the public good reflected in the ability of public sector organisations to serve the public interest. In Australia, public sector governance is defined by the Australian National Audit Office (ANAO) and the Department of the Prime Minister and Cabinet (2006: 13) as “the set of responsibilities and practices, policies and procedures, exercised by an agency’s executive, to provide strategic direction, ensure objectives are achieved, manage risks and use resources responsibly and with accountability”.

“Good public sector governance is important to provide adequate accountability to its many stakeholders, including taxpayers, and to encourage performance improvement while satisfying control and compliance requirements.”

(ANAO, 2003: iii) Governance principles to achieve good public sector governance have been developed for Commonwealth and state public sector entities. The ANAO (2003) includes accountability, transparency, integrity, stewardship, leadership and efficiency as the principles that can support better governance in Commonwealth public sector entities, and state public sector entities have similar values. The Public Administration Act 2004 (Vic), for example, includes the values of responsiveness, integrity, impartiality, accountability, respect and leadership for the Victorian public sector.

Good governance of public entities helps them meet regulatory obligations and societal expectations and needs that include accountability and effectiveness. The ANAO (2003:6) explains that good governance generally focuses on two main requirements:

- “performance, whereby the organisation uses its governance arrangements to contribute to its overall performance and the delivery of its goods, services or programs; and
- conformance, whereby the organisation uses its governance arrangements to ensure it meets the requirements of the law, regulations, published standards and community expectations of probity, accountability and openness.”

Good governance is achieved through the hard (structures, frameworks, regulations, policies) and soft (people, values) elements of public governance. While traditionally the emphasis has been on the hard elements, recently calls to better understand the softer issues of governance have been made. Edwards and Clough (2005) for example cite the HIH Royal Commission report which states that “systems and structures can provide an environment conducive to good corporate governance practices, but at the end of the day it is the acts or omissions of the people charged with relevant responsibilities that will determine whether governance objectives are in fact achieved”.

The organisational and process elements that constitute good public sector governance are described by ANAO (2003) as the house of public sector governance (see Figure 2):

**Figure 2**

1. **Leadership, ethics and a culture committed to good public sector governance** provides the foundation upon which a well-governed public organisation can be developed based on the behaviours and values of the organisation’s leaders and the overall culture of the organisation.

2. **Stakeholder relationships (internal and external)** influence the success and effectiveness of internal compliance and accountability, planning and performance monitoring, and external compliance and accountability. Governance arrangements should ensure that the legitimate interests of stakeholders are considered.

3. **Risk management** provides flexibility as well as control and ensures that risks are identified and managed appropriately within the model’s three central components.

4. **Internal conformance and accountability** are related to **external conformance and accountability** in that information reported externally would normally reflect the information generated internally to manage the organisation. This is both efficient (by reducing reworking of similar material) and effective (by establishing internal arrangements on the basis of broader standards and expectations).

5. **Planning and performance monitoring** ensures the organisation performs as well as possible in meeting its policy and operational objectives.

6. **External compliance and accountability** relates to compliance with applicable laws and regulatory mandates while at the same time having a transparent system of decision-making and responsibility.

7. **Information and decision support** must satisfy both performance and conformance requirements and must be provided judiciously to support major decisions.

8. **Review and evaluation of governance arrangements** is an ongoing process. Its goal is to continuously improve the organisation’s governance structure and processes.
Governance enables accountability and improves transparency, the areas that have been identified as needing attention in the public sector. There is also a need for consistency and comparability between and within the different levels of the public sector in the absence of a one model fits all.

While private sector organisations may be forced to address any potential governance problems through the market mechanism, public sector organisations have to ensure that such problems are identified and resolved either internally or through overseeing arrangements and legislation. Internally, a values approach may address any potential problems with the development of an ethical culture, supported by congruent policies and reward structures. The absence of the market mechanism to motivate public organisations to address possible governance deficiencies makes the role of internal and external auditors more important. External audits are undertaken by auditors-general and focus not only on the financial statements of public entities but on their efficiency, effectiveness, probity and compliance.

A number of legislations affect public sector governance and create obligations that increase complexity. The complexity of the regulatory framework may create inefficiencies and focuses mainly on the hard aspects of governance. It may also encourage the abdication of responsibility and potentially promote a minimum compliance culture that will lack innovation and improvements. The complexity of the regulatory framework also imposes multiple accountabilities to public sector organisations.

The public sector is under increasing pressure to improve outcomes and increase outputs while simultaneously improving efficiencies and effectiveness (Barber et al., 2007).

As noted by Curristine (2011), these initiatives are driven by increasing claims on public expenditure, such as pensions, healthcare and education, and a reluctance on the part of citizens to pay ever-higher taxes. Performance management is crucial in government organisations faced with reductions in funding with increased community demand for quality services by multiple internal and external constituencies, such as media, community, politicians and employees (Hoque and Adams, 2008). Governments also have to be more competitive to match other potential suppliers in areas like transport, communications and energy (Curristine, 2011).

Effective performance management is crucial to achieve sustainable and stable public finances and to gain the public’s confidence that tax revenues are being used effectively (CIMA, 2010).

These developments have motivated governments to modernise their accountability and control procedures, shifting the emphasis of government management and budgeting away from how much money to spend towards what is actually being achieved (Curristine, 2011). Technological innovation and changes in the size and structure of government, reflecting privatisation and decentralisation, also play an important role in these developments.

Performance management is an essential component of a corporate governance framework, allowing boards, ministers and committees to lead, monitor and respond to how an organisation delivers against its goals, mission and the outcomes required of it by the government (Hoque and Adams, 2008).

The objectives of performance management can be identified as:
• managing government efficiency and effectiveness
• improving decision-making with regard to resource allocation and budgeting
• improving external transparency and accountability
• achieving budgetary savings (Curristine, 2011)

Performance management has been defined in the Australian Public Service context as the use of interrelated strategies and activities to improve the performance of individuals, teams and organisations. Its purpose is to enhance the achievement of agency organisational goals and outcomes for the government (Management Advisory Committee Report, 2001).

In Australia, the public sector has developed fairly comprehensive sets of formal indicators and reporting requirements. The framework encompassing the components and structure of performance management is depicted in Figure 3.
The public sector in Australia has recently adopted a number of new frameworks aimed at increasing productivity and financial accountability, as well as improving public sector budget transparency and financial accountability and promoting good governance, such as Operation Sunlight, with a commitment to “a practical suite of measures to enhance Budget transparency” (Murray, 2011).
Risk management in the Australian public service

Every organisation faces a variety of risks. Identifying, assessing, managing and reporting these risks is at the heart of corporate governance and organisational performance (Victorian Auditor-General, 2007).

Risk is defined in terms of the effect of uncertainties on objectives (International Organization for Standardization, 2009). Uncertainties include events, which may or not happen, and uncertainties caused by a lack of information or ambiguity. This definition includes both negative and positive impacts on objectives (Riskex, 2010). In the public sector, risks can be categorised according to the goals, objectives or outcomes in the agency’s corporate, strategic or business plans. At the highest level, these represent risks to the agency’s ability to implement government policy (Auditor-General Victoria, 2004).

There are several distinct areas and sources where risk can arise, as illustrated in Figure 4.

**Figure 4: Categories of risk**

- **Market**
  - Financial risks
    - Investment
    - Interest rate
    - Foreign exchange
    - Energy / commodity
  - Non-market
    - Liquidity
    - Credit
    - Superannuation liability
    - Insurance claims
    - Reporting risk
    - Budget / fiscal risk
    - Resource management risk
- **Strategic risks**
  - Strategic planning
  - Governance
  - Demographic risk
  - Emergency / catastrophes risk
  - Economic risk
  - Energy / water security
  - Actions of other governments
  - Technology changes
- **Operations**
  - Infrastructure risk
  - Project management
  - Occupational health and safety
  - Pandemic risk
  - Procurement
  - Service delivery risk
- **People and culture**
  - Human resources
  - Culture
- **Natural environment**
  - Climate change
- **Knowledge and system management**
  - Risk of system (IT) failure
  - Security
  - Fraud
  - Intellectual property
  - Information management
- **Other**
  - Reputational risk
  - Legal
  - Physical security

Source: Department of Treasury and Finance, 2011, p.25
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Many risks can be avoided, reduced or eliminated through good risk management, defined as “… the systematic application of management policies, procedures and practices to the task of identifying, analysing, assessing, treating and monitoring risk” (Management Advisory Board’s Management Improvement Advisory Committee, 1996:3).

Risk management is a comprehensive process, supported by appropriate strategies and frameworks that are designed to identify, analyse, evaluate, treat and monitor those risks that could prevent a department or agency from achieving its objectives. It covers strategic, operational, financial and compliance risks.

According to the Victorian Auditor-General (2007), effective risk management is even more important where the public sector is facing greater scrutiny and adopting new models of service delivery.

The risk management framework should govern risk management at all levels of the public sector and it should include key roles and responsibilities for risk management (Victorian Auditor-General, 2007), as illustrated in the model below.

**Figure 5: Victoria’s governance and risk management model**

Source: Department of Treasury and Finance, 2011, p.7

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Audit in the public sector

Multiple compelling needs shape audit in the public sector: transparency in the use of public funds, the need for effectiveness and efficiency and management of risks with far-reaching consequences all demand strong audit responses. The fundamentals of strong audit, including independence and objectivity are ubiquitous. Technical and subject matter competence are requisite to audit in any context, and particularly within the wide scope of public sector activities.

Standards

International audit and professional ethical standards have been widely adopted by public sector auditors. CPA Australia firmly supports this and believes that the foundation and overarching ethical imperatives of audit are consistent across the public and private sector. International auditing and assurance standards are the appropriate basis for developing standards in the public sector.

Adopting international standards as a base provides several benefits. The international standards have evolved to address issues that arise in audit over a wide range of applications. With appropriate consideration of, and adjustment for, matters unique to the public sector these standards provide the most complete basis of pronouncement. In addition, consistent standards in the public and private sector enable more effective resourcing from the broader audit profession. Finally, consistency allows the public better clarity in the meaning of an audit.

An effective two-way exchange of knowledge and experience between public and private sector audit exists in Australia. The Australian National Audit Office (ANAO) and most auditors-general have adopted a suite of standards based on international auditing standards. There is active representation on the Australian Auditing and Assurance Standards Board from state auditors-general. This has enabled the board to be cognisant of, and provide guidance and pronouncement for, the public sector; for example, ASAE 3500 Performance Engagements (2008) states how performance audit in the public sector is undertaken in harmony with existing standards on assurance. The unique perspective that auditors-general bring to the board’s deliberations serves the whole assurance profession.

More than just the numbers

Western Australian Auditor-General, Colin Murphy (2011), says that his role is more than just ensuring that public money is spent according to the rules; it is about ensuring that the community receives value for its tax dollars.

The scope of public sector audit activities in Australia has evolved to cover a broad mandate in addition to financial audit, including performance audit, control assessment and risk. Performance auditing has reached a mature stage where it is now integrated into wider audit activities, allowing auditors-general to deliver reports that cover their client’s activities and the interests of stakeholders broadly. For example, in addition to financial and other audit opinions, the ANAO’s reports contain detailed findings on both positive aspects and areas of improvement for the execution of government programs.

The audit profession and government

Private sector auditors are often called on to provide their services for specific public sector purposes outside their normal role in the financial reporting supply chain, such as compliance audits for specific legislative reasons, grant acquittal or other assurance services such as reports on greenhouse gas emissions.

It is crucial that consistency with established audit and assurance standards is preserved in these situations. This enables auditors to carry out their work and fully comply with their professional obligations. The existing framework also allows for a more efficient and effective use of audit and assurance services by the public sector. To facilitate this, CPA Australia works directly with governments and regulators and is active in the consultation process that accompanies new laws and regulations.
Audit committees

Audit committees have a valuable contribution to make in improving the governance, and subsequently the performance and accountability, of public entities. In public entities with a governing body, an audit committee helps the governing body carry out its governance duties. In government departments, an audit committee provides the chief executive with independent advice on strategic, performance, assurance, and/or compliance matters.

There are four main principles that support the effective operation of an audit committee (Controller and Auditor-General, 2008):

1. independence – most of the members of an audit committee need to be independent of the management team to provide objective and impartial advice
2. competence – audit committee members need to have relevant experience and expertise to bring valuable insights and perspectives to the areas of audit committee interest
3. clarity of purpose – an audit committee needs to be clear about its mandate, purpose and role in the organisation and within the governance structure as a whole
4. open and effective relationships – the audit committee needs to encourage open and transparent communication and effective ways of working with stakeholders

According to Queensland Treasury (2009:34) “the audit committee acts as a forum for the internal audit function in respect of its planning, monitoring and reporting processes. It is part of the means for ensuring that the agency’s internal audit function operates effectively, efficiently and economically”.

An audit committee can involve all or a combination of the following duties and responsibilities (Institute of Internal Auditors Australia, 2008:9):

- obtaining assurance from management that all financial and non-financial internal control and risk management functions are operating effectively and reliably
- providing an independent review of an agency’s reporting functions to ensure the integrity of financial reports
- monitoring the effectiveness of the agency’s performance management and performance information
- providing strong and effective oversight of an agency’s internal audit function
- providing effective liaison and facilitating communication between management and external audit
- providing oversight of the implementation of accepted audit recommendations
- ensuring the agency effectively monitors compliance with legislative and regulatory requirements and promoting a culture committed to lawful and ethical behaviour

Audit committee members provide the public entity with a helpful range of experience and expertise and tend to act in more of an advisory and improver role for the governing body or chief executive, with more of a focus on performance improvement, financial and compliance matters (Controller and Auditor-General, 2008:8).

The audit committee could be said to have a guiding role in relation to the effective operation of corporate governance within an agency, and should at least provide assurance about the overall control environment and the financial reporting of the agency (Barrett, 1997).

A strong relationship between the audit committee and the entity’s internal auditors enables the committee to meet its responsibilities and carry out its functions. Internal audit should be a major source of information to the audit committee on the performance of the entity. To maximise the value of an internal audit, it is important that open lines of communication are established and maintained between the internal audit and the audit committee (Australian National Audit Office, 2005:8).

Internal audit

Internal audit has long been recognised as a valuable resource and entities have given the internal audit function a key role in their governance arrangements (Australian National Audit Office, 2007).

The Institute of Internal Auditors (2006:1) defines internal audit as “an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes”.

The responsibilities of internal audit vary considerably across public sector entities, as do internal audit organisational arrangements and the way internal audit services are delivered (Barrett, 1997).
Audit activities consist of:

- **internal audits**: including reviews of entity policies, programs, operations, internal controls, management information, governance frameworks and IT systems
- **advisory services**: including advice to management regarding existing, new or revised processes, procedures and IT systems, risk management and fraud control facilitation
- **coordination and training, observer status on management committees and the provision of other formal or informal advice**

Internal audit support activities are activities associated with internal audit or managing the internal audit function including:

- developing the internal audit strategic business plan and internal audit annual work plan
- providing support services to the audit committee
- monitoring the implementation of agreed internal and external audit report recommendations and those of Parliamentary committees and other bodies

- **internal audit staff management and training and liaison with the external auditor**

According to the Australian National Audit Office (2007:2) non-audit activities are activities where internal audit undertakes management responsibilities including:

- membership of management committees
- the formulation of risk management and fraud control plans
- the conduct of fraud investigations

Organisations recognise that internal audit is one of a number of internal assurance and business review type activities that should operate in a coordinated and complementary manner to the benefit of the organisation, as depicted in Figure 6 below. These other activities include management monitoring, evaluations, quality assurance and controlled self-assessment arrangements, that are all designed to provide confidence and assurance to chief executives and / or boards that management is meeting its responsibilities and the entity is achieving its objectives (Controller and Auditor-General, 2008).

**Figure 6: Internal and external assurance and review framework**

![Diagram of internal and external assurance and review framework](image)

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Internal audit provides an independent and objective review and advisory service to the chief executive and / or board that the entity's financial and operational controls are operating in an efficient, effective and ethical manner, and assist management in improving the entity's business performance (Australian National Audit Office, 2007:4).
Fraud and corruption

As economic conditions worsen around the globe, fraud risks for both public and private sector organisations appear to be on the rise. Fraud trends experienced during previous economic downturns show that a slowing economy increases financial pressure on both individuals and businesses (Deloitte, 2009:3). Falling state revenues, freezes on headcount and other restrictions are placing increasing pressure on public sector staff to deal with an increasingly financially stressed community (Deloitte, 2009:3). The composition of economic fraud is shown in Figure 7 below.

**Figure 7: Types of economic crime experienced by government and state-owned enterprises that reported experiencing fraud in the past 12 months**

<table>
<thead>
<tr>
<th>Type of economic crime</th>
<th>Percentage of organisations reporting each type of fraud (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset misappropriation</td>
<td>69</td>
</tr>
<tr>
<td>Financial statement fraud</td>
<td>28</td>
</tr>
<tr>
<td>Bribery and corruption</td>
<td>22</td>
</tr>
<tr>
<td>IP infringement, including theft of data</td>
<td>6</td>
</tr>
<tr>
<td>Illegal insider trading</td>
<td>5</td>
</tr>
<tr>
<td>Espionage</td>
<td>5</td>
</tr>
<tr>
<td>Money laundering</td>
<td>3</td>
</tr>
<tr>
<td>Tax fraud</td>
<td>3</td>
</tr>
<tr>
<td>Market fraud involving cartels</td>
<td>2</td>
</tr>
<tr>
<td>Other</td>
<td>3</td>
</tr>
</tbody>
</table>


Fraud against the Commonwealth takes many forms, and may target (Australian Government, 2011):

- revenue, such as income tax, GST fraud, customs duties
- benefits, such as social security, health, child care, education/training, visas or grant of citizenship
- property, such as cash, computers, stationery and other portable and attractive items
- information and intelligence, such as personal information or classified material
- Commonwealth program funding and grants, such as education, child care and employment
- entitlements, such as expenses, leave, travel allowances, attendance records
- facilities, such as unauthorised use of vehicles, information technology and telecommunication systems
- money or property held in trust or confiscated

At the Australian Government level, the Attorney-General’s Department is responsible for coordinating fraud control policy. The Department works closely with the Australian Federal Police on all fraud control issues. The functions of the Department’s fraud control policy area include (Mazurski and Johnson, 2007):

- implementation of the Commonwealth Fraud Control Guidelines
- promoting the use of risk management techniques within Commonwealth departments and agencies to minimise fraud against their programs
- promoting best practice in fraud control, including the development of fraud standards
- providing advice on fraud control to government

Responsibility for managing the risk of fraud, like responsibility for managing all risks, rests with management as part of its ongoing responsibilities. Contemporary management in the Australian public sector is underpinned by managers and senior executives who are familiar with the key elements of a robust fraud control framework, shown in Figure 8, including policy, legal and governance requirements (Australian National Audit Office, 2011:1).

Fraud against the Commonwealth is defined as “dishonestly obtaining a benefit, or causing a loss, by deception or other means” (Australian Government, 2011). Commonwealth agencies reported losses due to external fraud of approximately A$600 million in 2008-09 (Australian Government, 2011).

According to CPA Australia (2011:1), fraudulent activity is usually motivated by one or more of three main factors:

1. pressures
2. opportunity
3. rationalisation

The risk of fraud can come from inside an organisation, that is, from its employees or contractors, or from outside an organisation, that is, external parties such as clients, consultants, service providers or other members of the public (Australian National Audit Office, 2011:1).
Forensic accounting

The increasing sophistication of certain crimes requires that forensic accounting be added to the tools necessary to bring about the successful investigation and prosecution of those individuals involved in criminal activities such as bribery, money laundering, non-compliance with existing laws and regulations and other crimes that “leave a paper trail”.

According to Bologna and Lindquist (1987:38) “… forensic and investigative accounting is the application of financial skills and an investigative mentality to unresolved issues, conducted within the context of the rules of evidence. As a discipline, it encompasses financial expertise, fraud knowledge, and a sound knowledge and understanding of business reality and the working of the legal system. Its development has been primarily achieved through on-the-job training as well as experience with investigating officers and legal counsel”.

Knowledge of forensic accounting by investigators will be a powerful addition to the arsenal of investigating officers and will enhance their ability to combat those crimes, and will be especially valuable in the fight against white-collar crimes such as fraud, corruption and other illegal activities (Ahmad, 2005).

Problems and structures in South-East Asian countries

Detailed rules and norms of behaviour govern the behaviour of civil servants in developing countries, with corruption control being the principle instrument to build an integrity system. The results of anti-corruption initiatives in developing and developed South-East Asian countries have been mixed. Despite knowledge of the fact that there is widespread corruption in government departments, state audit has not played any effective role to forestall it, except in a few developing countries, notably China (Dye, 2007).

In Indonesia, the anti-corruption program consists primarily of moves to introduce monitoring and sanctioning mechanisms that are external to particular government organisations. Internal reforms that aim to improve organisational self-discipline have received much less attention (Hamilton-Hart, 2001:65).

The Malaysian Anti-Corruption Commission and the MARA University of Technology model for developing expertise in forensic accounting is an attempt to enhance the capabilities of its investigating officers (Ahmad, 2005).

Hong Kong has a dedicated anti-corruption agency bearing the name of Independent Commission Against Corruption. A public opinion survey has confirmed that the people of Hong Kong no longer consider corruption to be a serious problem (Tong, 2007:2).


Malaysian Institute of Accounting, 2011, Accounting Today.


Management Advisory Board’s Management Improvement Advisory Committee, 1996, Guidelines for Managing Risk in the Australian Public Service, Report No. 22, Canberra, October.


