Report to the Local Government Association of South Australia

Who Should Audit Local Governments in South Australia?
A Consideration of the Costs and Benefits of Alternative Arrangements

By Dr Sabine Schührer
Acknowledgement

This report summarises research undertaken based on funding received from the Local Government Association of South Australia’s Research and Development Scheme. I would like to express my gratitude to the Local Government Association of South Australia for funding this research. I would also like to thank the individuals who agreed to participate in this research project, the individuals who were prepared to support this project with their expertise and insights and the members of the South Australian Local Government Finance Management Group, who supported me throughout this project. Lastly, I would like to thank my research assistants, Yuki Wei and Hui Situ, for their excellent contribution.
# Table of Contents

1. Executive Summary ........................................................................................................... 2

2. Background, Methodology and Limitations of the Report .............................................. 3

3. Current arrangements and developments in Australia, New Zealand and the UK. ........ 5
   a. South Australia ................................................................................................................. 5
   b. Australian Capital Territory ........................................................................................... 6
   c. New South Wales .......................................................................................................... 6
   d. Northern Territory ......................................................................................................... 6
   e. Queensland .................................................................................................................... 6
   f. Tasmania ....................................................................................................................... 6
   g. Victoria .......................................................................................................................... 7
   h. Western Australia ......................................................................................................... 7
   i. New Zealand .................................................................................................................. 7
   j. UK .................................................................................................................................. 7

4. Costs and benefits of alternative audit arrangements for Local Governments in South Australia 8
   a. Appointing Local Government auditors ......................................................................... 8
   b. Alternative Local Government audit arrangements ...................................................... 8
   c. Quality and scope of audit ............................................................................................. 10
      i. Consistency of accepted treatments of financial information by auditors .............. 10
      ii. Quality of the auditors and their work ..................................................................... 11
      iii. Auditor independence ............................................................................................... 14
      iv. Audit oversight and the role of the Auditor-General ............................................... 16
      v. Timeliness of audit opinion ....................................................................................... 17
      vi. Number of adverse or qualified opinions over time ................................................ 20
      vii. Transparency ........................................................................................................... 21
   d. Audit fees ..................................................................................................................... 22

5. Other matters arising from this research project ............................................................... 28

6. Summary and discussion ................................................................................................... 28
1. Executive Summary

This research found that many interviewees are generally satisfied with the current audit arrangements, in which Local Government audits are provided by private sector auditors. In particular, many interviewees were generally satisfied with the quality of the work provided in their own organisation and the fees charged for these services.

At the same time, a larger number of interviewees raised concerns about the current audit arrangements. The main issues arising from this research project are that there:

- Is a lack of consistency of what auditors accept with regard to interpretation and application of accounting standards
- Are concerns about the quality of some audit work
- Are concerns about auditor independence
- Is currently no oversight over Local Government audits in South Australia
- Appears to be a threat to audit quality due to the low audit fees being paid in South Australia.

These issues were further supported by the analysis of additional archival data. While there are a number of ways these issues could be addressed, the data collected and analysed for this report suggest that a mandate for Local Government audits by the Auditor-General should be a serious consideration.
2. **Background, Methodology and Limitations of the Report**

The purpose of this research project was to investigate the costs and benefits of alternative Local Government audit arrangements, in particular audits by private sector auditors versus the Auditor-General. Ethics approval for the research project was obtained by the Human Research Ethics committee of the University of Adelaide. The main data sources were interviews, financial statements of Local Governments across Australia and other relevant archival documents.

A call for participants for the project was made directly to the members of the South Australian Local Government Finance Management Group and a Circular by the Local Government Association of South Australia. Overall, 27 individuals directly involved with Local Government audits were interviewed. They represented the following groups as shown in Table 1.

**Table 1 Interviewees**

<table>
<thead>
<tr>
<th>Group</th>
<th>Number of interviewees</th>
<th>Number of represented entities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Finance Managers/CFOs</td>
<td>9</td>
<td>9 councils</td>
</tr>
<tr>
<td>CEOs</td>
<td>2</td>
<td>2 councils</td>
</tr>
<tr>
<td>Auditors</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private sector audit partners</td>
<td>6</td>
<td>6 audit firms</td>
</tr>
<tr>
<td>Auditor-General/Auditor-General staff across Australia</td>
<td>4</td>
<td>3 Auditor-General’s Departments and 1 Auditor-General’s organisation</td>
</tr>
<tr>
<td>Managers Internal Audit</td>
<td>3</td>
<td>3 councils</td>
</tr>
<tr>
<td>Audit committee members</td>
<td>6</td>
<td>Minimum of 9 local councils and 5 entities controlled by local councils</td>
</tr>
<tr>
<td>Consultants</td>
<td>3</td>
<td>n/a</td>
</tr>
<tr>
<td><strong>Total representations</strong></td>
<td><strong>33</strong></td>
<td></td>
</tr>
</tbody>
</table>

The higher number of representation (33 as compared to 27 actual individuals) arises as some individuals represented more than one group. More specifically, most audit partners and consultants are also audit committee members at Local Government councils or Local Government controlled entities.

Interviewees were asked about the tendering process of their auditors and their thoughts on current and alternative audit arrangements. When interviewees noted their preference for one alternative (e.g. Local Governments should be audited by private sector auditors), they were asked about their reasoning. They were then confronted with alternative arguments and asked their thoughts about these. The interviewees were further asked about their thoughts on whether it would matter to citizens, council members or audit committee members who is the auditor of the Local Government’s financial statements. Lastly, the interviewees were asked whether there were any other issues they thought was relevant to the topic to ensure that all relevant arguments were heard.
To provide a better context, data from Australian States and Territories, as well as New Zealand and the UK was collated and analysed. This included financial statements, data from grants commissions, parliamentary reports and reports of Local Governments by Auditor-Generals.

At this stage, I would like to highlight a number of limitations of this report which should be considered when interpreting and using the information provided. The interviews present a qualitative aspect of this research project. As with any qualitative research, caution must be taken when collecting, analysing, presenting and interpreting the information. For example, there may be a self-selection bias during the collection phase, i.e., individuals with strong opinions or confidence might be more willing to participate than others. A proportionately large number of audit committee members were from rural or smaller councils, which should also be considered in the interpretation of the presented data. During the analysis and presentation phase, care needs to be taken to ensure that the views are understood and presented in a manner that reflects the content in an appropriate manner not to distort the intended meaning. Here, it is important to present a balanced and complete picture of the issues discussed during the interviews. It is not necessarily appropriate to suggest that an issue that was only raised by one interviewee is less important or valid than an issue that was raised by many interviewees.

To supplement the shortcomings of the interview data, data from archival documents were considered. However, these data too, have limitations. For example, to put Local Government audit fees into perspective in section 4.d., ‘total expense’ data from grants commissions across Australia were used. These data are, however, not collected in the same basis across Australian jurisdictions. For example, some jurisdictions provide expenses as presented in the financial statements, whereas other jurisdictions present modified ‘standardised’ or ‘assessed’ figures. Where this is the case, it has been noted in the report. In addition, the use of ‘total expense’ as a basis for the analyses presents further limitations, which should be kept in mind when interpreting the results. The size of total expense might not necessarily reflect the size and complexity of the organisation as a basis for comparisons as, for example, reflected in the case of Queensland Local Governments (for more detail, please refer to p. 26). Additional alternative ways of analysing data might result in different findings. For example, audit fee could have been investigated as a percentage of the budget, total revenue, based on rateable properties or the population of councils. Total expenses were selected because it appeared to be the best fit for the analysis in the current circumstances. Revenue figures were unreliable across jurisdictions, mostly due to the fact that there was no easy way to assess how Federal Assistance Grants were treated. Analysis based on population or rateable properties did not provide valuable insights for our purposes as some councils have a comparatively small population, but very complex and large council activities (e.g., the main city councils), whereas others are the opposite (e.g., very small rural councils). We performed a regression analysis of audit fees based on the population of councils, but the results were less significant. We were not able to hand-collect budget figures from all councils due to a limitation of resources.

When comparing data from Local Governments across Australia, it is important to keep in mind that there are often significant differences in the respective regulatory, socio-economic or geographic environment. I have attempted to highlight these where relevant, but as the focus of this project is on South Australia, there might be other factors that have not been taken into account due to the time and resource limitations of this project.
3. Current arrangements and developments in Australia, New Zealand and the UK.

a. South Australia

Currently, Local Governments in South Australia are audited by private sector auditors and Local Governments can chose their auditor. There has been an ongoing debate about the audit arrangements of Local Governments in Australia.

The LGA produced a number of documents on this issue. In 2005, the LGA commissioned an independent inquiry into the financial sustainability of Local Government in South Australia. The inquiry was commissioned “pursuant to a resolution of the LGA State Executive Committee and mindful of a motion being debated in the SA House of Assembly calling on the LGA to establish such an inquiry”.

In 2007, the LGA produced a discussion paper on Local Government Audits. The paper noted that the “Auditor-General [noted] that Local Government Act provisions related to auditing were not as robust as that required under the Public Finance and Audit Act”\(^1\).

In 2009, the Local Government (accountability framework) Amendment Act 2009 introduced the audit of internal controls of Local Governments. The legislation was rolled out over a number of years, with the first opinion on internal controls to be required for urban councils for the financial year 2014/15 and for rural councils for financial year 2015/16.

In 2013, the Public Finance and Audit Act 1987 (SA) was amended to expand the powers of the Auditor General in relation to Local Governments. The amendments allow the Auditor General to examine the accounts, efficiency and economy of Local Governments or Local Government projects on their own volition, whereas such were examinations had previously been conducted by request of the Treasurer only.

To date, the Auditor General has presented one report relating to Local Governments, i.e. the report on the Local Government indemnity scheme. In the financial year 2015/2016, the Auditor General’s office implemented a Local Government review methodology for planning, executing and reporting on Local Government examinations.\(^2\) Currently, examinations into the Brown Hill and Keswick Creeks Stormwater Management Project and the governance arrangements in Local Government are conducted.\(^3\)

In 2013, the South Australian Local Excellence Expert Panel recommended in its report Strengthening South Australian Communities in a Changing World “that the Auditor General assumes responsibility for Local Government auditing on a basis to be agreed between the LGASA and the State Government.”\(^4\)

In June 2016, the Economic and Finance Committee of the Parliament of South Australia tabled its Final Report on the Inquiry into Local Government Rate Capping Policies. The report recommended

that “Councils be subject to a thorough auditing process under the auspices of the Auditor-General, consistent with section 36 of the Public Finance and Audit Act 1987.”

b. Australian Capital Territory
Not applicable.

c. New South Wales
The NSW government passed the Local Government Amendment (Governance and Planning) Bill 2016 on 25 August 2016, which stipulates that the Auditor General will be the auditor of Local Governments from this financial year. The amendments include the power for the Auditor General to conduct sector wide performance audits.

The changes came as a result of an inquiry by the Independent Local Government Review Panel, which was appointed by the NSW government in 2012 “to formulate options for governance models, structures and boundary change”. The Panel released a final report of its review Revitalising Local Government in October 2013. The report states:

“The Panel is convinced that NSW should follow the example of Queensland and Victoria in placing Local Government audits firmly under the aegis of the Auditor General. This is the best way to ensure consistency of approach and provision of reliable data that can be used for sustainability assessments and benchmarking. Most audits would continue to be carried out by private firms, but under the supervision of the Auditor General, who would also prepare an annual overview report to Parliament, providing an independent assessment of the financial health of the Local Government system. The Panel sees this as a major step forward for the sector.”

d. Northern Territory
Local Governments are currently audited by private sector auditor. The Auditor General does not have a mandate for Local Governments.

e. Queensland
In accordance with the Local Government Act 2009 (QLD), the Auditor-General is the external auditor for Local Governments in Queensland. Since 2011, the mandate includes performance audits.

A significant amount of the Queensland Auditor Office’s audits, including audits of Local Governments, are outsourced. According to the 2015/2016 financial statements of the Queensland Audit Office, payments to contract (supplies and services) auditors were approximately $14 123 million compared to approximately $20 838 million spent on employee related expenses.

f. Tasmania
In accordance with the Tasmanian Audit Act 2008, the Auditor-General is the external auditor for Local Governments in Tasmania. The mandate includes performance audits.

---

In Tasmania, a smaller percentage of audits is outsourced compared to Queensland and Victoria. According to the 2015/2016 financial statements of the Tasmanian Audit Office, payments to contract (supplies and services) auditors were approximately $1 321 million compared to approximately $4 964 million spent on employee related expenses.

g. Victoria

In accordance with the Audit Act 1994 (VIC), the Auditor-General is the external auditor for Local Governments in Victoria since 1995. The mandate includes performance audits.

A large amount of audits are performed by private sector auditors. According to the 2015/2016 financial statements of the Victorian Auditor-General’s Office, payments to contract auditors were approximately $11 893 million compared to approximately $23 238 million spent on employee related expenses.

h. Western Australia

The Liberal National Government introduced the Local Government Amendment (Auditing) Bill 2016 to improve accountability and transparency in the sector. The Bill proposes that Local Government audits requiring all audits to be done under the supervision of the Office of the Auditor-General of Western Australia from 1 July 2017 onwards. It also introduces a requirement for performance audits. The Bill is currently before the Legislative Assembly.

The Office of the Auditor General Western Australian outsources some of their audit work. According to the 2015/2016 financial statements of the Office of the Auditor General (Western Australia), payments to contract auditors were approximately $4 601 million compared to approximately $15 330 million spent on employee related expenses.

One interviewee noted that it is the intention that much of the Local Government audit work will be outsourced, but no further detail was available.

i. New Zealand

As per paragraph 14 (1) of the Public Audit Act 2001 (New Zealand), the “Auditor-General is the auditor of every public entity”, including Local Governments. The Auditor General’s mandate includes performance audits and a consideration of the long-term strategic plans of Local Governments.

Audits are conducted by staff of the Auditor-General (more specifically, a business unit of the Controller and Auditor-General which operates like a business unit, with the objective to break even, rather than profit making), as well as private auditors (Big 4, as well as small and medium size audit firms). According to the 2015/2016 financial statements of the Controller and Auditor-General (Tumuaki o te Mana Arotake), payments to contract auditors were approximately $34 705 million compared to approximately $40 875 million spent on employee related expenses.

j. UK

The UK Local Government audit environment has been subject to a number of significant changes over the last decades. From the early 1980s, the Audit Commission (a statutory corporation) was responsible to appoint auditors to Local Governments. In 2010, it was announced that the Audit Commission was to be abolished. From 2017 onwards, Local Governments will be able to appoint
auditors themselves. The oversight for Local Government audits will move to the Financial Reporting Council, a private sector body that also overseas audit quality for the private sector.

4. Costs and benefits of alternative audit arrangements for Local Governments in South Australia

a. Appointing Local Government auditors

Interviewees were first asked about the tendering process of auditors. More specifically, they were asked what factors determined the selection of their auditors and what determined the price of an audit. The analysis of the interviews highlighted a number of matters of interest. For example, most interviewees refer to price as a main determining factor of the decision-making process. While some Finance Managers and Audit committee members suggested that they did not “go with the cheapest” tender, they suggested that if they viewed that the quality of the auditor (reputation) as similar, the cheaper offer was selected. It appears that there is a select group of audit firms who are viewed as experienced Local Government auditors in South Australia.

Some interviewees expressed disappointment of the lack of Big 4\(^7\) audit firms in the South Australian Local Government audit market. The analysis of financial statements confirmed the absence of Big 4 auditors in South Australian Local Governments, where only one council was audited by a Big 4 audit firm. In other states currently audited by private sector firms, there is a larger representation of Big 4 audit firms (in particular, PwC, Deloitte and KPMG) and larger second-tier audit firms (such as BDO, Pitcher Partners, Moore Stephens, Grant Thornton). Some interviewees suggested that the absence of larger audit firms was due to the small profit margins available in South Australian Local Government audits. It is not known which firms undertake contract work for the Auditor Generals in Queensland, Victoria or Tasmania.

Interview data also suggest that smaller rural councils are more price-sensitive than larger councils. Interviewees suggested that this might be because smaller councils are under-resourced, both financially as well as in relation to accounting and finance staff. As a result, the potential value of a good quality audit might not be fully explored and appreciated and is instead be seen as a necessary ‘tick-off’ item.

b. Alternative Local Government audit arrangements

Interviewees were then asked about their thoughts on the current auditing arrangements of Local Governments as well as potential alternatives. The alternative arrangements discussed were as follows:

Alternative 1: Retain current system (Local Government audits conducted by private sector audit firms)

Alternative 2: More formalised oversight body

Alternative 3: Auditor-General as auditor for Local Government, portion of audit work outsourced

Alternative 4: Auditor-General as auditor for Local Government, does not outsource any work

---

\(^7\) The Big 4 audit firms are Deloitte, Ernst & Young, KPMG and PwC.
The distribution of preferences for alternative audit arrangements is presented in Table 2.

Alternative 4, the Auditor-General to have mandate of Local Government audits and to conduct audits with their own staff, was not seen as a valid alternative, as respondents suggested that the Auditor-General would not have the resources to conduct Local Government audits with their own staff. Interviewees also highlighted the importance of this work for the local business community.

Table 2: Distribution of preferences for alternative audit arrangements by Interviewees

<table>
<thead>
<tr>
<th>Group</th>
<th>Alt 1</th>
<th>Alt 2</th>
<th>Alt 3</th>
<th>Alt 4</th>
<th>Total number of interviewees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Finance Managers/CFOs</td>
<td>4</td>
<td>3</td>
<td>3</td>
<td></td>
<td>9</td>
</tr>
<tr>
<td>CEOs</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td>1</td>
</tr>
<tr>
<td>Auditors</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>5</td>
</tr>
<tr>
<td>• Private sector audit partners</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td></td>
<td>5</td>
</tr>
<tr>
<td>• Auditor-General/Auditor-General staff across Australia</td>
<td>1</td>
<td>3</td>
<td></td>
<td>4</td>
<td></td>
</tr>
<tr>
<td>Managers Internal Audit</td>
<td>1</td>
<td>1</td>
<td>2</td>
<td></td>
<td>3</td>
</tr>
<tr>
<td>Audit committee members</td>
<td>1</td>
<td></td>
<td>4</td>
<td></td>
<td>4</td>
</tr>
<tr>
<td>Consultants</td>
<td></td>
<td></td>
<td></td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Total representations</td>
<td>10</td>
<td>5⁸</td>
<td>15⁹</td>
<td>0</td>
<td>27</td>
</tr>
</tbody>
</table>

Alternative 2, a formalised authority which would provide advise/direction/oversight for Local Government audits, was an acceptable alternative by five interviewees, three of who also saw Alternative 3 as a valid option. Suggestions for initiatives for increased oversight and external quality assurance included increasing the responsibilities of local government audit committees (for example to give audit committees responsibilities for the tender process of audit services) or making auditors of Local Governments subject to oversight by the South Australian Auditor-General or the Australian Securities and Investments Commission. Another alternative that was mentioned that an South Australian oversight body could be created, which would comprise of representatives from the Auditor-General’s Department, the Local Government Association and Councils.

Alternative 1, retain the current system, and Alternative 3, Auditor-General with mandate for Local Government audits, outsourcing a large proportion of work to private sector auditors, were the two alternatives which were preferred by the largest number of interviewees. These alternatives are discussed in the remainder of this section.

In essence, the research project investigates the balance of value for money of the two alternatives. As a result, the following paragraphs consider quality and scope of Local Government audits versus the price of the audits of the two alternatives.

⁸ This number includes three individuals who suggested a preference for either Alternative 2 or Alternative 3.
⁹ This number includes three individuals who suggested a preference for either Alternative 2 or Alternative 3.
c. Quality and scope of audit

The quality of audits has many aspects and is not straightforward to assess. While many interviewees were generally satisfied with the services provided by their current auditors, a majority also raised issues related to the quality or scope of current audits.

In relation to the scope of the audit, interviewees highlighted the Local Governments’ objectives for effective and efficient delivery of public services and, hence, the need for respective performance audits. This matter was mainly raised by interviewees who had prior experiences at the State/Territory or Federal Government level. One interviewee representing the Auditors-General’s group noted:

“Local Government because they strike their rates, and they spend within their revenue broadly speaking, but that doesn’t tell you anything about their efficiency and effectiveness.

So I think there’s two dimensions to assessing efficiency and effectiveness: one is comparison or benchmarking of similar jurisdictions, similar Local Governments, and the other one is you’ve got to do a performance audit.”

Performance audits are currently only regularly performed in jurisdictions where the Auditor-General has the mandate for Local Government audits. The costs of sector wide performance audits are at least in some jurisdictions charged to government, rather than the local councils.

Some indicators of quality arose from interviews, including consistency across the financial statements of Local Governments, quality of the auditor and their work, auditor independence and the current lack of an oversight function. In addition, indicators informed by academic and other literature (e.g. reports by standard setting or oversight bodies) were investigated. These included the timeliness of the audit, the number of qualifications of audit reports over time and transparency of audited financial statement information.

i. Consistency of accepted treatments of financial information by auditors

Consistency in relation to what auditors would accept in relation to the application and interpretation of accounting standards was mentioned by almost all interviewees. Only three individuals did not mention this issue and noted that they were not aware of consistency issues in Local Government. Specific examples of concern included the initial and subsequent valuation of non-current assets in accordance with AASB 13 Fair Value Measurement and the recognition of grants revenue under AASB 1004 Contributions. AASB 13 suggests that a relevant asset should be valued at its highest and best use. There was some debate among the profession across Australia as to how this requirement should be interpreted. At least one audit firm interpreted AASB 13 to mean that the current use of a Local Government asset was not its highest and best use. As a result, the asset was valued at zero, despite being valued at a multi-million dollar amount by the external valuers. Most other South Australian audit firms, however, assumed that the current use of the asset was the highest and best use.

In relation to the recognition of grant revenue, AASB 1004 requires grants that are untied (i.e., the organisation can determine on what and when to spent the grant monies) to be recognised in the financial year it is received. In some years, grants for a financial year are, however,
received several days before the start of the respective financial year. For some councils, these grants are a main source of revenue and the early receipt of the grants can present major volatility in the results of the financial statements. While this effect is acknowledged in the industry, AASB 1004 does require the recognition of income at receipt. At least one audit firm, however, allowed the recognition of these grants as a liability (revenue received in advance). This led to an adverse audit opinion in the following financial year, when a new auditor was appointed to the organisation.

Some interviewees suggested that the lack of consistency is something that is a normal aspect of the profession and that such issues occur, in particular when new regulatory requirements are implemented. Most participants, however, expressed a desire for an authority to consult with and to provide clear directives as to what was acceptable and what not. Interviewees noted the work that was undertaken by the South Australian Local Government Auditors Group (SALGAG), but suggested a preference for the Auditor-General as an independent body (refer to Table 1 above).

ii. Quality of the auditors and their work

Most interviewees acknowledged that the work currently performed by private sector auditors is generally of high quality. One interviewee highlighted that private sector auditors would bring valuable insights from the private sector, which an Auditor-General would not be able to provide. Interviewees suggested that current audit firms have a developed a deep understanding of the complex and specific Local Government environment. Concerns were raised as to whether the Auditor-General would have the expertise required to investigate Local Governments. Interviewees acknowledged that the Auditor-General would need time and resources to gain an appropriate level of local government expertise. With the amendments to section 32 of the Public Finance and Audit Act 1987 (SA), the Auditor-General of South Australia is arguably in the process of deepening their understanding of the sector.

Some interviewees noted that it would be an advantage of the Auditor-General to have a public sector perspective. One interviewee explained:

“So the private sector has as a real driver, they’re very concerned about the prospect of litigation if they haven’t followed the auditing standards in terms of making sure that everything’s got a true and fair view. So they’re very driven; they know exactly that they’re doing and what they’re looking for. We are, I mean equally we’re concerned about the auditing standards, but we’re also concerned about reporting to Parliament on any shortcomings that need to be drawn to people’s attention. If I could give you some examples that if credit card spending of a few thousand dollars is inappropriate in a public corporation, that’s not an issue that would feature in an audit report at all because it’s not material and it doesn’t impact on the fair presentation of the financial statements, whereas in the world I audit, inappropriate use of credit cards is a major issue and the Parliament wants to know about it and they expect me to be looking at it. So we’re looking at a whole lot of issues to do with accountability for what I always call “other people’s money”, but it is looking after the interests of the
tax payer and reporting to the Parliament on what the government agencies are doing with the resources that the taxpayers have provided to them.”

An additional benefit of an Auditor-General mandate was their potential to offer a sector-wider perspective. This would enable better benchmarking and comparisons across the sector. Another benefit of this aspect would be that the Auditor-General would have to prepare a Local Government sector report for parliament. This would arguably focus the attention or parliament and the public on Local Government issues more than is currently the case. One interviewee said:

“An Auditor General has a view across the sector and is able to identify good practice, poor practice, and able to actually look holistically across the whole sector, which any individual auditor can’t do.”

Some interviewees raised concerns in relation to the quality of Local Government audits in relation to fees paid by councils. While Local Government finance managers saw current prices mostly as an advantage, concerns were raised mostly by representatives of the private sector auditors themselves and representatives from the Auditor-General’s group, as well as other individuals with State or Federal Government Background:

“There’s audits being done for $9,000 – you can’t do a proper audit for that price and actually make money off it, even if you’ve got scale and volume.”

“Time is money is what it comes down to at the end of the day, and if the money’s not there someone is not going to spend the time. Or, they’ll put the time but the wrong level of resources, and I think that could be the other issue. But that all relates to quality.”

“Indicative of my concerns I think the private sector has the ability to fly under the radar of any quality regulator. Which means there is concern, I have a concern that there are providers out there that are not... it’s hard for me to categorically say that they’re not doing a good job. I don’t know. But I am concerned that they are cutting corners to just win work, which is not providing the best outcome or advice for the sector. I certainly hope that’s not the case, but that is a concern I think with private, with it being a privatised kind of sector in the local market.”

Regulators in the U.S, U.K and Australia have raised fears that pressures on audit fees lead to reduced quality of financial statements in the private sector. For example, Paul Beswick, Chief Accountant at the U.S. Securities and Exchange Commission, suggested that fee cuts can put “pressure on the nature of the services”. 10

In 2012, the U.K Financial Reporting Council, the oversight body for the auditing profession, found that, amid pressures from the market, auditing firms had engaged in cost-cutting measures “putting audit quality at risk” 11. Paul George, executive director of conduct at the

---

10 The Wall Street Journal, SEC Grows Suspicion of Declining Auditor Fees, 24 February 2014
11 AccountancyAge, FRC fires warning shot over audit quality, 13 June 2012.
U.K Financial Reporting Council, was quoted as saying that “audit needs to represent value for money but there needs to be appropriate controls to ensure that giving significant fee reductions doesn’t undermine the quality of work being performed.”

The Australian Securities and Investments Commission issued Report 461: Audit Inspection Program Report for 2014-15 and found more room for improvement in smaller audit firms compared to the larger audit firms, in particular in relation to their quality control systems.

The quality of the work of Auditors-General is subject to a number of quality assurance tools. For example, the Victorian Auditor-General lists a number of systems which are employed to ensure they audit quality, including:

- “Surveys of MPs—MPs are surveyed annually on the usefulness of VAGO’s reports and their satisfaction with our work.
- ‘Cold’ and ‘hot’ reviews—process reviews of individual audits.
- Report quality reviews—independent external reviewers assess the quality of a report and whether it is clear and understandable to readers.
- Surveys of agencies—regular surveys of audited agencies, including those involved in the conduct of audits, departmental secretaries and audit committee chairs.
- Benchmarking—against other audit offices in Australia.
- Parliamentary accountability measures—VAGO is subject to an annual financial audit and a triennial performance audit conducted on behalf of Parliament, and also consultation requirements for aspects of our practices.”

As Auditor-General’s Departments are subject to a rigorous regulatory environment and heightened public scrutiny, their quality can be assumed to be of high standard. This was reflected in comments made by interviewees who confirmed that there is a general perception that the Auditor-General’s work is of high standard. Only three interviewees suggested that they had adverse experiences with Auditor-Generals. A finance manager suggested that his experience with the Auditor-General was that they were much more concerned with procedures and processes, rather than efficiency and effectiveness. A private sector auditor said:

“I’ve never ever seen a situation where the Auditor General either carrying out the audit or supervising who’s carrying out the audit, has smoothed and facilitated the process. He generally slowed it down, made it much pricklier, much less comfortable.”

On the other hand, a private sector auditor said that:

“[having the Auditor-General as the responsible auditor] adds an extra layer of quality assurance I suppose. To be honest, it’s been really good for us as a firm. We’ve certainly lifted our quality over that time. I mean, part of that is just the natural

---

12 Ibid.
passing of time and our quest for continuous improvement but certainly, having that extra layer of scrutiny over the top definitely sort of forced us to increase our quality even further or perhaps faster than we might otherwise have done it. Yeah, I mean, the Auditor General has a bit of a different focus to what’s required under the Auditing Standards.”

iii. Auditor independence

An important aspect of audit quality is their independence. APES 110 Code of Ethics for Professional Accountants describes independence to be to be of mind and in appearance. K. F. Brigden, AO, the tenth Auditor-General for Australia, wrote in a report to parliament:

“Audit independence and audit effectiveness can amount to much the same thing. If an auditor does not enjoy independence from the bodies subject to audit it will be only a matter of time before some measure of control by auditees becomes apparent. When that happens, the effectiveness of the audit process will inevitably suffer. In practical terms, impairment of the auditor’s independence is synonymous with impairment of audit effectiveness.”

Nine interviewees raised issues relating to audit independence under the current arrangements. For example, an audit committee member said:

“The basic problem is [the auditor’s] conflict: They are appointed by councils and are reluctant, in my view, to push hard on issues that might jeopardise their commercial relationship with the council.”

Another auditor who is also an audit committee member recalled the following:

“Council members want an auditor who doesn’t qualify them. [...] We also had a chair who was very concerned about getting an auditor who wouldn’t qualify the council, and I did raise that that’s not actually what you’re after; you’re after an auditor who does the job. If there’s a qualification, then you need to know that, you don’t want an auditor who is frightened of telling you the bad news. [...] If an auditor is very open with the audit committee and council about issues, they tend not to get the job when the round comes around again. External auditors are interested in getting non-external audit work when their turn is over”

An audit committee member16 said:

“Particularly larger firms where you’ve got multiple partners, and they just swap it from partner to partner, because the Chinese wall has to be rigid and has to go all the way down the organisation, you can’t have the same junior audit clerk auditing receipts for two different partners, so I’m not in favour of Chinese walls. [...] The audit

15 Parliament of Australia, Papers on Parliament No 26, August 1995
16 An earlier version of this report misattributed this comment to a local government auditor.
committees I’m on have only just joined in the last six months, have recently had three internal audit assignments undertaken by their external auditors, and it’s permitted”

17 A representative from the Auditors-General’s group highlighted the issue of audit independence for rural councils:

“When everybody knows everybody in a small community, and the service provider’s sitting on the council and all the rest of it, quite often the auditor’s in a similar situation, so it’s not best practice independence.”

In a related issue, interviewees emphasised that they expected a certain ‘value-add’ from their auditors. They explained that ‘value-add’ meant that they could call the auditors for technical advice on accounting issues outside the actual audits and the ability to ‘talk through issues’. Some individuals were concerned that these aspects of ‘value-add’ would reduce or disappear if the Auditor-General would be the auditor for Local Governments. One auditor noted:

“If the Auditor-General would come in[,] flexibility goes out the window: Under the Auditor General, under the way the Auditor General operates in other states, not allowed to set foot in the place, and so you have the Auditor General ringing up and writing letters to the council, “Where’s your statements, where’s your draft statements?” No assistance, no one’s helping the poor bugger in the small country council, and getting them on the right track, and it does make the whole process so much more rigid, and feedback that I’ve had from auditors and from staff is that it just doesn’t help the client-audit relationship at all.”

On the other hand, a representative from the Auditors-General group emphasised the importance of a good working-relationship with local governments. The representative said the following about the potential implementation of the move to the Auditor-General for Local Government audits:

“And one element of the implementation process] is just engagement with the local governments ourselves. So I’ve just started very, very slowly with that because it’s a bit tricky; until the legislation is actually law it’s a bit hard to step in and start doing work with the local governments themselves. But I have met with the head of the Local Government Association here; [they] arranged a couple of functions […] to meet with and talk with Chief Executive Officers of local government, and that process has started and will be ongoing. But we will later in the year look to recruit auditors, either ones who have worked in the local government sector and who have skills and knowledge in that area, or alternatively recruit some auditors and run them through some training in the sector and get them up to speed so that we can actually hit the ground running”.

A good working-relationship between Local Governments and their auditors is seen as an important part of audit arrangements by most interviewees. The difficulty is in ensuring that

17 A comment from a previous version of this report was removed to avoid misinterpretation as the full context of the comment could not be provided.
there is no threat to auditor independence while maintaining an efficient and effective relationship and addressing the limitations of the current arrangements.

iv. Audit oversight and the role of the Auditor-General

An external oversight body is often seen as a quality assurance tool. There is currently no external control system or oversight body over Local Government audit arrangements in South Australia. This is arguably a main shortcoming of the current Local Government audit arrangements.

In the U.K., private sector auditors of Local Government audits were subject to the oversight of the Audit Commission, a statutory corporation. From 2017 onwards, the oversight function will be transferred to the U.K. Financial Reporting Council, the equivalent to the Australian Securities and Investments Commission. In some Australian jurisdictions, Departments of Local Government might be involved with oversight. This is, however, not the case in South Australia. A representative of the Auditors-General groups noted:

“In the private sector you’ve got to be honest and things like that, but they’ve got a marketplace to keep them honest, and they’ve got ASIC and if they’re a financial institution they’ve got APRA, they’ve got regulators looking at them. In the public sector the Department of Local Government’s all things to all people, it’s advising the Minister, and it’s probably as close as you come to a regulator in Local Government but they’re not set up to regulate generally speaking. They’ve got, usually got an under resourced inspectorate that reacts to complaints and allegations of improper behaviour. It’s not a true regulatory regime in the sense of ASIC or APRA.”

Auditors-General are independent auditors of public sectors and report directly to parliament. In a paper to parliament, John Taylor, AO, Australian Auditor General from 1988 to 1995 discussed the role of the Auditors-General:

“If the Parliament wants to keep an effective interest in what is being done with power or resources provided by it to the government in the interests of the community as a whole,[23] it must have a clear and formally independent and accountable channel through which it is advised regularly, consistently across programmes, by an official who is independent and apolitical and who can report ‘without fear or favour’; who has a clear, unambiguous, legal requirement to look across the public sector as a whole; who has power to allocate available resources according to assessment of risk; who has command of appropriate resources which are independent of the executive, with wide powers of access; and who has the power to report to the Parliament and others relevant as necessary/appropriate. This position or official cannot, in practice and by definition, be privatized; the accounting profession takes a similar view as have the independent auditors of the ANAO.”

A representative from the Auditors-General groups explained their reasoning for why Auditors-General should have the mandate for Local Governments:
“Local Government is a creation of State parliaments. Local Government comes from the Local Government Act, and effectively everything else created by a parliament is subject to audit by the Auditor General so why shouldn’t Local Government. And I take it at the next level: Local Government is using public resources. Now they don’t like terming it this way but they extract the revenue by force, they strike a rate and you get no option, you have to pay it. But as a public sector entity they carry with them the public trust obligations that they should manage resources available to them in the public interest and for the common good. And that’s a very subjective remit but a fundamentally important one.

So from the principle point of view I think there’s a very strong case that there’s, in my mind, there is no question [Local Government] should be subject to audit by the Auditor General. […] They impose rates which are effectively taxes. They’ve the power to resume land. They’ve got the power to regulate parking and things like that. All the public sector things that aren’t embraced by a financial statement audit. And probably just rounding that out: the citizen has little choice. Once you buy your house or your block of land within a municipal area, you’re not in a marketplace. You have limited choice. In the private sector you can pick which supermarket you’re going to deal with. And it’s relatively easy to shift from one to another. But in Local Government, as with State and Federal, most of us don’t have much choice about changing jurisdictions.”

Auditors-General are themselves subject to audit and are commonly under public scrutiny. The Australasian Council of Auditors-General (ACAG) collated a set of fundamental principles that underpin the role of Auditors-General. The accountability principle is as follows:

“The Auditor-General must be fully accountable for the performance and use of public resources in discharging the mandate of the office.

The Auditor-General must be primarily accountable to Parliament (not the Executive Government) in a manner consistent with the office’s independence.”

A representative from the Auditors-General group explained the oversight environment of Auditors-General as follows:

“Effectively all offices are subjected to oversight, and they’re either subjected to an external strategic review or performance audit every three to four years, or if they’re not they tend to do it of their own volition for their own protection.”

Auditor independence and audit oversight are closely connected. The current lack of oversight over Local Government audits is a main shortcoming of the current arrangements, which should be addressed.

v. Timeliness of audit opinion

Timeliness of financial statement information is generally seen as a positive sign, as information is more useful to users the more timely it is provided. Timeliness of audit opinions

18 Australasian Council of Auditors-General, Role of the Auditor-General.
can be seen as a proxy of audit efficiency, provided that the outcome of the audits does not reduce in quality.\textsuperscript{19} The Queensland Audit Office notes that “timely reporting is an indicator of the robustness of each individual entity's governance and financial management processes.” \textsuperscript{20} The Queensland Audit Office publishes information about the timely preparation of financial statements in its report about local governments. For example, the report presents information about timely reporting over time presented in figure 1 below.

The interview data suggests that the quality of the audits by Auditors-General is perceived to be at least as good as audits provided by private sector auditors. At the same time, the scope of audits by Auditors-Generals is often broader than that by private sector auditors, for example, because it includes performance audits or regulatory compliance audits. Hence, if Auditors-General are able to provide their audits faster, this would suggest that they are more efficient.

Figure 1: Reporting on timeliness of financial statements by Queensland Audit Office\textsuperscript{21}

For the purpose of this project, we collected the dates of when the audit opinion was signed and calculated the amount of days since year-end for the financial years ending 30 June 2013, 2014 and 2015. The audit opinion is typically signed after the report is ratified by the audit


\textsuperscript{20} Queensland Audit Office, Results of audit: Local government entities 2014–15. p. 34.

\textsuperscript{21} Queensland Audit Office, Results of audit: Local government entities 2014–15. p. 35.
committee. Hence, there is a time lag between the finalisation of the audit and the signature. This treatment is, however, arguably the same across all jurisdictions. The findings are as follows:

Table 3: Days between end of financial year and signature on audit opinion

<table>
<thead>
<tr>
<th></th>
<th>NSW</th>
<th>NT</th>
<th>QLD</th>
<th>SA</th>
<th>TAS</th>
<th>VIC</th>
<th>WA</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012-13</td>
<td>113</td>
<td>117</td>
<td>143</td>
<td>110</td>
<td>87</td>
<td>80</td>
<td>163</td>
</tr>
<tr>
<td>2013-14</td>
<td>113</td>
<td>124</td>
<td>160</td>
<td>112</td>
<td>85</td>
<td>79</td>
<td>161</td>
</tr>
<tr>
<td>2014-15</td>
<td>113</td>
<td>130</td>
<td>120</td>
<td>113</td>
<td>86</td>
<td>81</td>
<td>145</td>
</tr>
<tr>
<td>Average days</td>
<td>113</td>
<td>124</td>
<td>141</td>
<td>112</td>
<td>86</td>
<td>80</td>
<td>156</td>
</tr>
<tr>
<td>Required by legislation</td>
<td>123 (31/10)</td>
<td>138 (15/11)</td>
<td>123 (31/10)</td>
<td>153 (30/11)</td>
<td>92 (30/09)</td>
<td>92 (30/09)</td>
<td>184 (31/12)</td>
</tr>
</tbody>
</table>

Figure 2 presents the data in chart format

Figure 2: Average days\textsuperscript{23} between end of financial year and signature on audit opinion - Chart

The results show that the jurisdictions where the Auditor-General has the mandate for Local Governments have stricter deadlines for the submissions of audited financial statements than the other jurisdictions, except for New South Wales, where the requirements are equal to Queensland. As a result, the audited financial statements are signed almost a month earlier in Victoria and Tasmania than in the next State, which is South Australia. All States and Territories’ financial statements had their financial statements audit opinion signed before the due date. The exception is Queensland. While many councils submitted within the legislated period, a small number of councils were excessively late, which influenced the average time

\textsuperscript{22} Councils are required to submit their financial statements to the auditor no later than 30 September. The auditor then has until 31 December to examine the financial statements and sign off on the audit report. The local governments are required to send a copy of their statements to the Department of Local Government within 30 days of audit sign off.

\textsuperscript{23} The table considers the average days between the end-of-financial year and the date of the audit opinion for three financial years, i.e., 2012-13, 2013-14 and 2014-15, as also presented in Table 3.
lag of the audit opinion. Since the financial year 2015, the situation has improved and the average dates of signatures on the audit opinions are within the timeframe required by legislation.

Out of the jurisdictions where Local Government audits are performed by private sector auditors, South Australia has the most efficient audit time. The findings suggest that audits undertaken by Auditors-General might be more efficient than those undertaken by private sector audit firms.

vi. **Number of adverse or qualified opinions over time**

The number of adverse or qualified opinion can be used to examine the impact of audit. Arguably, the audit should influence or improve financial reporting over time. Continued qualifications would, therefore, suggest that the audits do not have the desired effect.

For the purpose of this report, we collected the audit opinions from Local Governments across Australia for the financial years ending 30 June 2013, 2014 and 2015 if available on the website. This means that the number of adverse or qualified opinions presented in Table 4 represents the minimum amount of adverse or qualified opinions.

<table>
<thead>
<tr>
<th></th>
<th>NSW</th>
<th>NT</th>
<th>QLD</th>
<th>SA</th>
<th>TAS</th>
<th>VIC</th>
<th>WA</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>9</td>
<td>41</td>
<td>6</td>
<td>4</td>
<td>0</td>
<td>5</td>
<td></td>
</tr>
<tr>
<td>2014</td>
<td>9</td>
<td>18</td>
<td>5</td>
<td>7</td>
<td>0</td>
<td>1</td>
<td>7</td>
</tr>
<tr>
<td>2015</td>
<td>4</td>
<td>41</td>
<td>4</td>
<td>9</td>
<td>0</td>
<td>0</td>
<td>12</td>
</tr>
<tr>
<td>Average</td>
<td>7</td>
<td>33</td>
<td>5</td>
<td>6</td>
<td>0</td>
<td>0</td>
<td>8</td>
</tr>
</tbody>
</table>

The findings show that almost no Local Governments received a qualified audit opinion in two jurisdictions where the Auditor-General has the mandate for Local Government audits (VIC and TAS). Queensland also has also a comparatively low rate of qualified audit opinions.

Out of the jurisdictions where Local Government audits are performed by private sector auditors, South Australia a comparatively low level of qualified opinions. This finding should, however, be interpreted with regard to the availability of financial statements on council’s website as presented below as well as issues surrounding auditor independence discussed above, i.e., issues that are raised in management letters, rather than in the audit opinion. Due to limitations of resources, we were unable to hand-collect relevant data from management letters.

When interpreting the results, one should keep in mind that some States and Territories have a comparatively larger number of very remote councils with small population bases. In these councils, there might be limitations to the available accounting and/or auditing expertise needed to prepare financial statements.

Most recently, an audit assurance is also required for the internal control system of South Australian Local Governments. For urban councils, the first audit assurance was required for
the financial year 2014-15, for rural councils the first audit assurance will be for the financial year 2015-16. One urban council received a qualified opinion for its internal control system, at the time of writing, the results for the rural councils was not available yet. In addition, it is possible that issues relating to internal controls systems might have been outlined in the management letters to councils. To obtain a sector wide picture of the internal controls systems requires a significant amount of time and resources. In contrast, such information is often provided in sector reports to parliament in those jurisdictions where the Auditor-General is responsible for Local Government Audits. An example can be found on page 5 of Queensland Audit Office Results of audit: Local government entities 2014–15.

Another metric for assessing the quality of or issues with the financial statement information prepared by Local Governments is to consider adjustments made because of audit findings prior to issuing the audit opinion. While such information is not available for South Australia, an example of a jurisdiction where this is reported on is Queensland. Relevant information can be found on page 3 of the Queensland Audit Office Results of audit: Local government entities 2014–15.

vii. Transparency

Transparency might not be directly related to the quality of audit, it is, however, an important instrument of good governance and best practice in the public sector. To investigate transparency, we looked at the availability of Local Government financial statements on their respective websites. The findings are presented in Table 5.

<table>
<thead>
<tr>
<th></th>
<th>NSW</th>
<th>NT</th>
<th>QLD</th>
<th>SA</th>
<th>TAS</th>
<th>VIC</th>
<th>WA</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>88</td>
<td>76</td>
<td>78</td>
<td>81</td>
<td>90</td>
<td>87</td>
<td>74</td>
</tr>
<tr>
<td>2014</td>
<td>95</td>
<td>94</td>
<td>92</td>
<td>86</td>
<td>86</td>
<td>90</td>
<td>86</td>
</tr>
<tr>
<td>2015</td>
<td>98</td>
<td>100</td>
<td>85</td>
<td>90</td>
<td>93</td>
<td>100</td>
<td>92</td>
</tr>
<tr>
<td>Average</td>
<td>94</td>
<td>90</td>
<td>85</td>
<td>86</td>
<td>90</td>
<td>93</td>
<td>84</td>
</tr>
</tbody>
</table>

The results show that there is a high percentage of financial statements are available on the Councils’ websites, but not all of them. When looking for these financial statements, we faced a number of challenges. Firstly, not all financial statements are easy to find. We initially looked for older financial statements and found that the availability of these statements decreases significantly. In States and Territories where private sector conduct the audits, it is difficult to compare statements and it is almost impossible to obtain a sector-wide perspective on the financial state and performance without investing significant time and having a high level of expertise. A representative from the Auditors-General group explained this point as follows:

“There is a much higher level of transparency in the auditing that [the Auditors-General] do. We report on a sector, we let the Parliament know who’s got a good score, who’s got an ordinary score, what some of our findings are. And at the moment there is no transparency at all, and I mean I’ve endeavoured to try and have a look at audit reports or financial reports from our local government authorities, and it’s impossible; you
can’t find them, even though the local government legislation says they must make documents publicly available, “publicly available” means sending somebody one when they ring up, or pinning it up on the noticeboard in the council office. So for the average person to try and get a look at an individual council, local government authority is problematic, but to get a view across the whole sector is just impossible. So transparency’s really, really important.

In States and Territories where the Auditor-General has the mandate for Local Government Audits, a sector report is prepared on an annual basis. These reports are tabled at the respective parliaments and are available on the respective Auditors-General’s websites for several years. In addition to reports on financial statements, these jurisdictions also provide sector wide reports on selected matters such as sustainability, asset management plans, tendering and contracting or performance reports.

d. Audit fees
The relatively low prices of current audits was mentioned as an advantage by many interviewees, and a large number of interviewees noted that they were generally satisfied with the audit services they received in exchange for the price. Only five out of 23 interviewees (four interviewees did not mention anything on this issue), however, noted that they did not see a reason to change anything. On the other hand, a large number of interviewees see current prices as problematic. Interviewees suggested that there was a history of low-balling of audit fees in South Australian Local Governments, presenting a potential thread to audit quality as discussed above.

An audit committee member said:

“When I first started the fee was $10,000 or something, and there’s no way that you can do a proper audit for that. We’re now, mid 30’s is probably not too bad. I think perhaps my biggest disappointment is that it doesn’t attract the interest of the big four firms.”

One private sector auditor noted:

A Local Government is [...] half the market rate really for the level of complexity and the size and the revenue that they’re earning. [...]”

Another private sector auditor said:

“We have mainly withdrawn from Local Government audits because there is not enough profit. [...] We know how much time we need to spend on a job to do it properly and the sort of recovery that we think we need to get out of it from a professional point of view with the risk that you take on and with the other work that you do and if you are working in a sector where it doesn’t provide that, you cut your losses.”

Most interviewees recognised the importance of price to council members. For example, one interviewee who is an auditor as well as audit committee member noted:
“And it’s difficult for councils to, you know, because I’m on the other side as well; I’m on Audit Committees and I know how cost-sensitive councils are, how Local Government is and for, you know, very valid reasons – it’s public money, they need to be careful how they spend it and, if they can get it... audit is often seen as a box-tick. It’s a legislative requirement that you have an audit done so we’ll get it done for as cheaply as we can and the people making the decision about that often aren’t the people who get the benefit from a good audit. [...] If we’re the cheapest, we’ll get the job – not 100% of the time but 80% of the time, if we’re the cheapest, we get the job. And that might only be $500, $1,000 because we’re all seen to be experts in Local Government so we would score very similarly in terms of experience and expertise, quality of staff, methodology, all that sort of side of things and yeah, often if you don’t have some sort of pre-existing relationship with a client where they know you and know how you operate and they like you, then it essentially comes down to price.”

Almost all interviewees suspect that the price of audits would increase if the Auditor-General would take over the mandate for Local Government audits in South Australia. The majority of interviewees (15 out of 23) suggested, however, that they would not be too concerned by a certain level of price increase provided they saw a reason or benefit for the increase.

A variety of potential reasons for this price increase were suggested, including a difference in scope of audit, a higher level of scrutiny, additional administration costs (contracting out and oversight function), as well as initial training and set-up cost. In addition, a small number of interviewees suggested that Auditors-Generals are comparatively higher because they are in a monopoly position.

A representatives from the Auditors-General group suggested that there should not be a significant price difference between the audit of private sector firms and the Auditor-General:

“It shouldn’t have a costing impact, because audit offices are pretty cost competitive. If it does have a cost impact I would query if quality of the audit that was previously being delivered. Because the private sector auditor, audit’s under the same standards, so for a financial statement audit they should be, as professionals they should be pretty much the same audit. The firm is paying general market rates and it has to turn a profit. Public sector audit offices would be paying at the lower end of market rates for salaries and it’s a break even operation.”

A second representative from the Auditors-General group explained the costing by the Auditor-General as follows:

“Local Government won’t like it, they don’t like spending money that they don’t need to. So I will be explaining that our costs are what they are because of the level of work; we certainly don’t charge them more per hour than the private sector. Our hourly rates are less, but we’ll be doing more hours of work, we’ll be looking at more things.”

The Queensland Audit Office publishes its charge-out rate on its website:

“Our approved charge out rates are:

<table>
<thead>
<tr>
<th>Position</th>
<th>Rate per hour 2015-16 $</th>
<th>Rate per hour 2016-17 $</th>
</tr>
</thead>
</table>
In jurisdictions where the Auditor-General has the mandate for Local Government audits, they also have the mandate for undertaking performance audits, as is typical for the State/Territory and Federal level. One representative of the Auditors-General group summarised the reasoning for performance audits at the Local Government level:

“A simple audit of the financial statements to my mind doesn’t go far enough. It’s a good stewardship tool but without the performance audit overlay the analogy I like to draw is in the private sector the financial statements tell you both the how much and how well in broad terms. [...] In the public sector, Local Government because they strike their rates, and they spend within their revenue broadly speaking, but that doesn’t tell you anything about their efficiency and effectiveness.

So I think there’s two dimensions to assessing efficiency and effectiveness: one is comparison or benchmarking of similar jurisdictions, similar Local Governments, and the other one is you’ve got to do a performance audit.”

The financing of performance audits can vary across jurisdictions. In some jurisdictions, the costs for performance audits might be carried by Local Governments, in others, an Auditor-General might negotiate additional budgets for sector wide performance audit with parliament.

Performance audits could also be legislated to be performed by private sector auditors, similarly to the requirement to issue opinions on internal controls of South Australian Local Governments. The advantages and disadvantages presented in this section for who should perform financial statement audits equally apply to performance audits.

Due to their role and independence, Auditors-General might engage in higher levels of scrutiny. A private sector auditor who performs contract work for an Auditor-General said:

“So, the Auditor General [...] essentially follow the Auditing Standards but go above and beyond in certain areas and they are much more likely to follow a rabbit down a hole if you like. So, we might stumble across what’s a relatively minor issue and in terms of the Auditing Standards’ perspective, it’s something which would be clearly immaterial and you wouldn’t progress it any further. [...] However, our experience has been that often the Auditor General’s department will want to investigate it. They don’t like loose ends and

---

they don’t have the same profit focus; they don’t need to make a profit on jobs, they don’t need to keep the clients happy because they’ve got a guaranteed client base so, you know, sometimes investigating these minor little things can be an annoyance to people who understand that it’s minor and a waste of time [laughing] from their perspective. The Auditor General doesn’t have that problem.

A lot of the prices, actually, a lot of the additional cost would be taken by the Auditor General, because they add this extra layer of quality control; they do a significant amount of work. It’s not just a case of a quick five minute review of the file and “Oh yep, that’s all fine”. They actually invest quite a significant amount of time in reviewing the files in great detail.”

A number of interviewees suggested that there might be additional costs if the Auditor-General would have the mandate for Local Government audits due to additional administration costs, including the tendering of audit work to private sector auditors. Representative from the Auditors-General group suggested that some Auditors-General are already contracting out large amount of audit work to private sector firms and have become very efficient and effective in doing so.

The New Zealand Audit Office states on its website:

“Audit contracts are reviewed every three years, with most audits to be continuing “with limited recourse to tendering”. Audit fees are based on “a range of techniques to monitor audit fees at the point of negotiation, and to provide a comparative analysis to help resolve concerns about proposed audit fees. Our overall objective is to ensure that audit fees are fair to the public entities subject to audit, and provide a level of return to the auditors commensurate with the auditing standards that public entities, the Auditor-General, and Parliament expect. The Auditor General monitors audit fees to ensure “realistic hours (that is, hours reflecting the nature and extent of work required), an appropriate audit team mix, and charge-out rates in line with market rates.”

The transition period of moving from private sector audits to a mandate by the Auditor-General would come at a cost. The experiences from New South Wales and Western Australia might provide relevant insights over the next few years.

To provide a better context of audit fees across the Australian Local Government sector, we collected the audit fees for councils for the financial years ending 30 June 2013, 2014 and 2015 when financial statements were available on the website. We undertook a simple linear regression analysis based on total expenditures of Local Governments for different states. We used the numbers provided by the respective grants commissions. It should be noted here, that different grants commissions use different bases to calculate the expenses shown in their table. Therefore, the results are not 100% comparable. They do provide, however, insights into general trends. The results are as follows:

Table 6: Regression Analysis of the Relationship between Audit Fees and Expense

25 (http://www.oag.govt.nz/about-us/audit-allocation)
26 There were no significant results for NT, i.e. there is no correlation between the audit fee and the amount of expense.
All results were significant, which means that the audit fee depends on the amount of expenses. This makes sense, as the amount of expenditure can be seen as a proxy for size and complexity of a Local Government. The results can be interpreted as follows: The intercept presents the minimal cost of an audit, i.e., even if the Local Government had no expenses, the fix costs of the audit would, equate to the amount of the intercept. The slope presents the additional cost (in $) for every $ of Expense.

To offer a different perspective, Local Governments were divided into five groups based in the amount of total expenses: Very large (total expense larger than $227,223,636), Large (total expense between $170,586,272 and $227,223,635), Medium (total expense between $113,948,909 and $170,586,271), Small (total expense between $57,311,545 and $113,948,908) and very small (total expense smaller than $57,311,544). These groups were determined by taking the largest total expense amount of all councils and the smallest total expense amount of all councils and divided the difference into five same size groups.  

Table 7: Average audit fee for similar sized councils based on amount of total expense in $ for the financial year 2014-15

<table>
<thead>
<tr>
<th></th>
<th>NSW</th>
<th>NT</th>
<th>QLD</th>
<th>SA</th>
<th>TAS</th>
<th>VIC</th>
<th>WA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very</td>
<td>121,800.00</td>
<td>270,057.14</td>
<td>191,420.00</td>
<td>127,500.00</td>
<td>29,409.67</td>
<td>40,827.97</td>
<td>22,614.42</td>
</tr>
<tr>
<td>Large</td>
<td>78,833.33</td>
<td>191,420.00</td>
<td>127,500.00</td>
<td>46,000.00</td>
<td>49,000.00</td>
<td>69,800.00</td>
<td>69,800.00</td>
</tr>
<tr>
<td>Medium</td>
<td>74,000.00</td>
<td>127,500.00</td>
<td>46,000.00</td>
<td>49,000.00</td>
<td>69,800.00</td>
<td>69,800.00</td>
<td>69,800.00</td>
</tr>
<tr>
<td>Small</td>
<td>56,135.14</td>
<td>136,468.91</td>
<td>54,672.43</td>
<td>47,553.33</td>
<td>47,553.33</td>
<td>58,835.07</td>
<td>58,835.07</td>
</tr>
<tr>
<td>Very</td>
<td>32,541.67</td>
<td>69,167.10</td>
<td>17,041.87</td>
<td>29,409.67</td>
<td>40,827.97</td>
<td>40,827.97</td>
<td>22,614.42</td>
</tr>
<tr>
<td>Small</td>
<td>32,541.67</td>
<td>69,167.10</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The data presented in Tables 6 and 7 show significant differences in audit fees across Australian Local Governments. Audit fees in relation to total expense of Local Governments are not necessarily higher in jurisdictions where the Auditor-General has a mandate compared to audit fees in other jurisdictions. For example, in relation to total expense, audit fees in New South Wales and Northern Territory are more expensive than in Victoria and Tasmania.

Local Government audit fees in Queensland are the highest in Australia. The reasons for this are related to extended requirements of the audit in Queensland as well as political and socio-economic and geographic reasons. In addition to following the Australian Accounting Standards, the Auditor-General of Queensland Audit Standards also require the investigation of the probity and propriety of

---

*IC = Intercept

27 An alternative approach would be to differentiate groups based on socio-geographic areas, e.g. city, city fringe, large rural, small rural, etc.

28 This number is distorted by the high audit fees paid for one particular council.
matters associated with the management of public sector entities, acts or omissions that have given rise to a waste of public resources and compliance with relevant acts, regulations, government policies and other prescribed requirements. In addition, the Queensland Audit Office is required to investigate current year financial sustainability, any grant acquittals, as well as referrals from the Crime and Corruption Commission. Regarding political and socio-economic reasons, Queensland councils were subjected to a series of amalgamations and de-amalgamations since 2008. As a consequence, Queensland has some of the largest councils in Australia, sometimes with multiple town centres. For example, Brisbane City Council and the City of Gold Cost council are the two largest councils in Australia (based on total expense), triple and respectively double the size of the next largest council, i.e. the City of Sydney Council, and six of the largest eight councils are in Queensland. The geographic reasons relate to the undertaking of the audit itself as well as challenges that councils face due to their geographic location. With regard to the undertaking of audits, Queensland’s councils are distributed across a large land mass and with some councils located in very remote areas. This has a significant impact on travel costs for auditors. Further, much of Queensland has been subjected to major catastrophic weather events over the recent years, leading to significant impact on Federal, State and Local Government Finances. In many instances, these events have impacted long-term assets of Local Governments. As asset management poses a major element of Local Government audits, this might also have impacted the costs of audits. Major infrastructure investments are, however, typically capitalised, i.e., recognised as assets and depreciated over time, rather than expensed or they might be refunded by other levels of Government. In this regard, an analysis of audit fees based on budgets or revenue might have been more appropriate, but were not undertaken for the reasons explained in section 2. For the interpretation of the information provided in Tables 6, 7 and 8, these aspects should, however, be considered.

The results show that Local Government audit fees in South Australia comparatively low. Table 6 shows that the fixed cost of a South Australian Local Government audit is almost 40% lower than the cost of the second lowest cost State, Tasmania. Table 7 shows that the costs are also low when comparing similar sized councils based on their total expenses. The lowest and highest percentage of audit fee expense are highlighted in green and red respectively

<table>
<thead>
<tr>
<th></th>
<th>NSW</th>
<th>NT</th>
<th>QLD</th>
<th>SA</th>
<th>TAS</th>
<th>VIC</th>
<th>WA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very Large</td>
<td>0.00044</td>
<td></td>
<td>0.00054</td>
<td></td>
<td></td>
<td>0.00025</td>
<td></td>
</tr>
<tr>
<td>Large</td>
<td>0.00039</td>
<td>0.00102</td>
<td></td>
<td>0.00025</td>
<td></td>
<td>0.00034</td>
<td></td>
</tr>
<tr>
<td>Medium</td>
<td>0.00052</td>
<td>0.00084</td>
<td>0.00031</td>
<td></td>
<td>0.00042</td>
<td>0.00050</td>
<td></td>
</tr>
<tr>
<td>Small</td>
<td>0.00068</td>
<td>0.00103</td>
<td>0.00178</td>
<td>0.00062</td>
<td>0.00057</td>
<td>0.00066</td>
<td></td>
</tr>
<tr>
<td>Very Small</td>
<td>0.00155</td>
<td>0.00286</td>
<td>0.00317</td>
<td>0.00113</td>
<td>0.00218</td>
<td>0.00134</td>
<td>0.00455</td>
</tr>
</tbody>
</table>

Table 8: Audit fees as a percentage of total expense for similar sized councils based on amount of total expense for the financial year 2014-15

30 This number is distorted by the high audit fees paid for one particular council.
Table 8 expresses audit fees as a percentage of total expense for the same group of councils. The findings show that audit fees are a very small percentage of the total expenses of councils, ranging from 0.00025% to 0.00317%. The table also shows that the audit fees use up a larger portion of the total expense the smaller the council is. This makes sense, as the fixed cost component of an audit is comparatively larger in smaller councils than the variable audit fee component. In other words, certain audit activities need to be performed irrespective of the size of the council, whereas other audit activities are dependent on the size of the council, as presented in Table 6. The data also show that relative to total expense (as a proxy for size and complexity of an organisation), the Auditor-General is very efficient, as the percentage of audit fee is low in Tasmania and Victoria. As these data are based on the same information used in Table 6, the relationships between the council groups across States and Territories are the same.

5. Other matters arising from this research project

Due to the time and resource limitation, a number of issues found during the research process could not be further investigated or analysed. They included concerns about the financial management of rural councils, the implementation and audit of the internal control system, sustainability of councils and issues relating to the management of councils long-term assets. In particular, the data suggest that many of the issues presented above are be exacerbated in rural councils.

One topic of main interest to this report relates to the implementation and audit of Local Governments Internal Control systems. The main observations relate to difficulties in the development and implementation process of the newly legislated requirements. While the South Australian Finance Managers Group provided a central forum in which the requirements were discussed and developed, issues of consistency in the implementation of the systems as well as the audit of the systems were mentioned by interviewees. At the time of writing, only urban councils had been audited with regard to internal control, with one council being qualified. A few interviewees suggested that, again, issues related to internal control might be more significant in rural councils. The respective audited statements and management letters for the financial year ended 2015-2016 will provide further insights.

6. Summary and discussion

The research project investigated the costs and benefits of alternative Local Government audit arrangements for South Australia. The main data sources were interviews, financial statements from Local Governments and other relevant archival documents.

The research found that many interviewees are generally satisfied with the current audit arrangements, where Local Government audits are provide by private sector auditors. In particular, many interviewees were satisfied with the quality of the work provided and the fees charged for these services.

The main issues raised with were:

- the consistency of interpretation and application of accounting standards by auditors
- the quality of some audit work
- auditor independence
To address these issues, four alternatives were proposed. They were:

Alternative 1: Retain current system (Local Government audits conducted by private sector audit firms)
Alternative 2: More formalised oversight body
Alternative 3: Auditor-General as auditor for Local Government, portion of audit work outsourced
Alternative 4: Auditor-General as auditor for Local Government, does not outsource any work

Alternatives 1 and 3 received the vast majority of support and were, therefore, further considered.

With regard to issues of consistency, proponents of Alternative 1 suggested that differences in new accounting or auditing requirements are normal and typically allowed for. They also suggested that differences would decrease over time and treatment would then become more consistent.

Proponents of Alternative 3 suggested that the Auditor-General would be the obvious choice to address issues of consistency, as the independent auditing authority with a sector-wide mandate. This would also avoid confusion when new accounting or auditing requirements are introduced.

While many interviewees expressed satisfactory levels of audit quality by current auditors, issues were raised about the quality of audit work by ‘others’. In particular, interviewees questioned the ability to perform good quality audits for some of the fees that were charged.

Interviewees suggested that current Local Government auditors had developed deep industry knowledge of the sector and concerns were raised in this regard for Alternative 3. Proponents of Alternative 3 suggested that the Auditor-General could develop this understanding over time and would have the advantage of a sector-wide perspective. In addition, they suggested that the public sector expertise of the Auditor-General would add to the value of the audit of Local Governments.

A number of interviewees suggested that some auditors allowed the treatment of financial statement elements which was not in accordance with accounting standards (e.g., the recognition of revenue grants as a liability, rather than income) or that auditors were not stringent enough and would refer to issues with audits in management letters rather than include it in the audit opinion.

The latter issue is directly related to the concerns that were raised with regard to auditor independence. Interviewees also suggested that there was a threat to auditor independence because auditors might be interested in securing non-audit work after their audit contract has finished.

Proponents of Alternative 3 suggested that audit independence issues could be addressed by giving the Auditor-General the mandate for Local Government audits.

---

31 While many finance managers expressed satisfaction with current fees and raised the importance of low fees with respect for council members and tax payers, other interviewees highlighted the potential risks of pressures on audit fees to audit quality.
The current lack of audit oversight is arguably a main shortcoming of the current Local Government Audit arrangements in South Australia. Again, proponents of Alternative 3 suggested that this issue could be addressed by giving the mandate over Local Government audits to the Auditor-General.

Audit fees were a major theme of the interviews. Finance managers in particular stated the desire for audit fees to stay low. Interviewees also mentioned that this was a particularly important issue for council members. On the other hand, many interviewees suggested that they would not be too concerned by some increase in audit fees, provided they could see the additional benefits. Interviewees suggested that there might be a need for education in this area, as council members and citizens might not see the benefits of a good quality audit, but instead, see it as a necessary ‘tick-off’ item.

The analysis of Local Government audit fees across Australia suggests that audit fees in South Australia are the lowest in the nation. Interview data suggests that this is partially due to a history of low-balling of prices in the sector. As argued, the low costs might present a risk to audit quality. Potential adjustments of audit fees to the levels in other jurisdictions might prove difficult if they are not addressed centrally.

If the mandate for Local Government audits was given to the Auditor-General, fees might indeed increase. The research suggests that the charge-out rate by Auditor-Generals is typically below those of private sector auditors. The reasons might instead come from adjustments to market prices across Australia, an extended scope of the audit, additional expertise needed, costs associated with a transition phase, as well as costs of the administration of the additional mandate. Experiences from other jurisdictions suggest that additional costs for the administration of contracting-out of audit work can become more efficient and effective over time, when the organisation becomes more experienced with the arrangements. It is important that decision-makers are aware of a potential increase in cost and are prepared to ensure that such a move would be appropriately funded in both the short- and longer-term.

Overall, this research highlighted that while many interviewees were generally satisfied with current audit arrangements, a larger number of interviewees raised issues which should be addressed. To do so, transferring Local Government audits under the auspices of the Auditor-General should be considered as a serious alternative. Such a consideration should include an extensive consultative process with all affected key constituents. I hope that the information provided in this report will be helpful for decision-makers and other constituents in the Local Government audit space.