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The practice of probity audits in one Australian jurisdiction

ABSTRACT

"Probity audits" are a new type of audit gaining some popularity in the Australian public sector. Probity audits refer to independent reviews of government privatisations, contracting out projects (government procurements), and expression of interests to ascertain whether procedures followed are consistent with appropriate regulations, guidelines and best practice principles of openness and transparency.

In recent times probity audits have been used by Australian public sector agencies in such activities as procurement, disposal of assets and contracting out of services. They provide one means of demonstrating open and accountable government processes, and assuring taxpayers that they are receiving value for money.

However, there is scant empirical evidence on this topic. Surveys government departments in one Australian jurisdiction on their practices in relation to probity audits. Concludes that, while many have conducted probity audits, the concept is not fully understood. Further, the majority of the audits conducted were "real-time" and performed by parties outside the public sector. Concludes by suggesting areas for further research.

Keywords: Audits, Contracting out, Contracts, Public sector, Tendering, Value-for-money audit

1.0 Introduction

The Australian public sector has undergone tremendous changes in the last two decades. The introduction of managerialist philosophies has necessitated an increased emphasis on efficiency, effectiveness and value for money of operations (Gray and Jenkins, 1985). It is a current expectation that public sector agencies demonstrate that best value for money is being achieved when public sector moneys are spent (Guthrie, 1998). Moreover, increasingly, the private sector is becoming involved in public sector activities as agencies contract out services, and enter partnerships to provide infrastructure (Industry Commission, 1997). Contracting out is now a significant activity in the Australian public sector (ICAC, 1995). Indeed, a 1994 survey of the NSW public sector revealed that in 1993-1994 alone, over 82,000 contracts were awarded, with a combined value of $1.064 billion. Alongside these changes in philosophy, and the partnerships with the private sector, have come the exposure of corrupt or unethical practices in many Australian jurisdictions (ICAC, 1993). Calls for open and accountable government, and transparency of operations have been a feature of Australian public administration throughout the 1980s and 1990s (O'Faircheallaigh *et al.*, 1999). A new type of audit, commonly referred to as a "probity audit", has been promoted as one means of contributing to an open and accountable government, demonstrating the transparency of operations and ensuring the best possible value for public money (ICAC, 1993, 1995, 1996), particularly with respect to sustaining public confidence in government privatisations and the competitive tendering and contracting process (Industry Commission, 1996).

The Macquarie Dictionary defines the word "probity" to mean "integrity, uprightness or honesty". A probity auditor's task is to examine and evaluate information and processes, to provide advice on the management of probity issues that may arise, and to report and make recommendations to the management or Parliament (ICAC, 1996). Probity auditors provide an independent professional service which improves the quality of information for decision makers. Thus, probity auditing is one type of assurance service [1] as identified by the Elliott Report (AICPA, 1997) and the AICPA Future Issues Committee (1989). As the role of probity auditors suggests, probity audits can be employed in both the private and public sectors. However, the focus of this paper is on public sector probity audits.

In relation to public sector probity audits, the Independent Commission Against Corruption (ICAC) describes a probity auditor as:

typically an individual (or organisation) who is engaged to observe and review a complex government project, generally in relation to a procurement process (for example, lease or tender) (ICAC 1996, p. 2).

ICAC's definition is confined to government procurements. For the purpose of this paper, probity audits[2] refer to independent reviews of government privatisations, contracting out projects (government procurements), and expression of interests to ascertain whether procedures followed are consistent with appropriate regulations, guidelines and best practice principles of openness and transparency.

Probity auditing in the public sector evolves from the need for government agencies and relevant stakeholders to have assurance that applicable laws, regulations, policies and procedures are adhered to in government privatisations and tendering and contracting processes. The early policy guidelines emanated from ICAC in its 1993, 1995 and 1996 documents. These have provided the basis for subsequent policy guidelines both at a central agency and departmental level (see, for example, VGPB, 1998; Victorian Department of Treasury and Finance, 1997; Queensland Treasury 1997; Queensland Department of Main Roads, 1998; Queensland Transport, 1998). However, there is little, if any, reference to this kind of assurance service in the academic literature. Moreover, there is little empirical evidence on the many aspects of public sector probity audits: for example, their frequency of use; the circumstances in which probity audits are conducted; who conducts them; or their costs.

This paper aims to contribute to the probity auditing literature by providing some empirical evidence of the current practice of probity audits conducted by the Queensland public sector between 1994 and 1998. This paper is structured as follows. The next section describes the themes emerging from the literature. The section following provides a description of the survey conducted and the analysis of the results. The final section provides a conclusion and suggests areas for future research.

2.0 Themes emerging from the literature on probity auditing

The study of probity auditing is a new and emerging area. Based on the early works of ICAC (1993, 1995 and 1996), there are two consistent themes which emerge from the literature: the first centres on the nature of probity audits; and the second on who can conduct these activities.

In relation to the former theme, it is generally agreed that probity audits differ from traditional financial statement audits in a number of ways. The decision to conduct a probity audit is entirely at the discretion of the agency involved, as are the parameters for the audit which are usually contained in an "engagement letter". To date, no Australian government, State or Federal, has mandated the use of probity audits in particular circumstances. In fact, it is argued that the use of probity auditors should be the exception rather than the rule (ICAC, 1996). Moreover, it is argued that their use should be confined to situations where: the integrity of the project may be questioned; the project may be seen as politically sensitive and vulnerable to controversy; or there are high stakes involved for bidders (ICAC, 1996).

The crucial element of this is that it assumes that the decision that a probity audit be conducted is made prior to the particular event occurring (i.e. at the outset of the bidding or contracting out process) (ICAC, 1996). In this paper, audits of this type, where a decision is made to appoint a probity auditor to oversee the process prior to the event occurring, will be referred to as "real-time" probity audits. While management would normally initiate the audit (ICAC, 1996), it is noted that it is possible that Parliament or the relevant Minister could decide on the need for an audit as was witnessed in the recent Queensland TAB initial public share offer. For "real-time" audits, audit comments and recommendations are likely to be more forward-looking and more relevant for "real-time" decision making. While "real-time" probity audits would have the advantage of ensuring stakeholders that all the required processes are fully adhered to, and that all parties are treated fairly, it is possible that some probity audits may be conducted after the event. In this paper these audits will be termed "after-event" audits. "After-event" probity audits generally take place as a result of complaints from unsuccessful parties in the bidding or contracting out processes. In an earlier document (ICAC, 1995) it was argued that, although ideally performance should be evaluated throughout projects, there are circumstances where it may be appropriate for an independent review to be carried out after the event to ensure proper functioning of activities within an agency. However, as has been indicated in the introduction to this paper, there have been no empirical studies conducted into probity audits, and so the type of audits being conducted and the relative frequency of these audits is unknown.

The second theme in the literature concerns who is to conduct the probity audit. The crucial element in this section of literature concerns the independence and objectivity of the probity auditor. ICAC (1996) argues that not only does management have to be satisfied of the independence of the process, but also the probity auditor must be perceived as being independent by stakeholders external to the organisation. In recognition of the high cost of engaging probity auditors, ICAC (1996) argues that it is possible for someone completely external to the organisation, or someone from within the public sector or the internal auditor of the organisation to conduct such an audit.

If agencies choose a probity auditor from outside the public sector, either an auditor with traditional accounting qualifications, or professionals without accounting training could be chosen. The Joint Standing Committee of the Institute of Chartered Accountants in Australia, and the Australian Society of Certified Practising Accountants (JSC, 1997), has noted that most assurance services, including probity auditing, are emerging in areas where accountants have no regulatory protection that grants them "ownership" of the service (as they do for traditional financial statement audits). Consequently, it is likely that probity audits may be conducted by non-accountants, albeit without necessarily the protection of a system of professional ethics.

On the other hand, if agencies choose a probity auditor from within the public sector, either internal auditors (from within that agency, or another agency), or the Auditor-General could be chosen. However, conducting a "real-time" probity audit in government agencies could raise potential problems of perceived independence for Auditors-General. If the Auditor-General is involved in a "real-time" probity audit of a complex government project (for example, procurement, disposal of assets or contracting out), and it subsequently becomes the subject of a "performance audit", then it might be argued that the independence of the Auditor-General is compromised through having to report on the probity of the processes that they initially helped to formulate. There is no empirical evidence on just who is conducting probity audits within the public sector, or on the fees being paid.

In summary, in recent years, there has been an increased emphasis on the issue of probity in the public sector where the benefits of using probity audits in certain circumstances have been recognised. For example, the Queensland Treasury policy framework for private sector involvement in public infrastructure and service delivery (Queensland Treasury, 1997) includes the consideration of engaging a probity auditor to assist with the development of a probity plan and to ensure adherence with it. However, there is little academic evidence on the current practice of probity auditing. The following section describes a survey conducted of Queensland public sector departments to ascertain information on the frequency of use; the circumstances in which probity audits are conducted; who conducts them; and their cost.

3.0 Method

The Australian public sector comprises eight separate jurisdictions – Queensland, New South Wales, Victoria, Australian Capital Territory, Tasmania, South Australia, Western Australia, and Northern Territory. Owing to the availability of data, the Queensland public sector was chosen as the site for this study. The Queensland public sector comprises 26 departments of State Government, 244 statutory bodies/authorities and 26 government owned corporations as at 30 June 1999 (Queensland Audit Office, 1999). Owing to the exploratory nature of the study, it was decided to confine the study to the 26 government departments. While the government departments in only one jurisdiction were chosen, there is no reason to believe that the nature of audits conducted in government departments in other jurisdictions would differ to any great extent from those in Queensland. As such, it is argued that the results are generalisable to government departments in the Australian public sector.

The research was conducted in collaboration with the Queensland Audit Office (QAO). The involvement of the QAO ensured a high response rate to the survey, as by law all government agencies must respond to the queries of the Auditor-General. It also enabled the researchers to access the relevant files in each department if supplementary information was needed. Details on probity audits conducted by each department between 1 July 1994 and the 30 June 1998 were requested. A letter was issued by the QAO and signed by the Auditor-General. The letter was sent to the Director-General of each of the 26 Queensland government departments. The information collected included the number of probity audits undertaken during the period, the nature and scope of each audit, the terms of reference of each audit, a copy of the engagement letter, the names of the auditor, the audit fees, and a copy of the audit report issued. Directors-General were asked to nominate a contact person to liaise with one of the researchers during this information gathering process.

4.0 Analysis of results

From the total of 26 departments, 22 responded to the survey. This is a response rate of 85 per cent. An analysis of the non-responses indicates that these agencies are relatively small and would probably not be involved in substantial capital projects in which probity is an issue. Amongst those who responded to the survey, 11 (or 50 per cent) have conducted one or more probity audits during the period. The information on the frequency of probity audits conducted is contained in Table I.

As expected, some government agencies, including Queensland Health, the Department of Main Roads, Queensland Transport, Queensland Treasury and the Department of State Development, have undertaken several probity audits. This seems to confirm the current anecdotal picture emerging that the use of probity audits is increasing. It should be pointed out that, despite an increased focus on the issue of probity in the public sector in recent years, many agencies have shown a lack of knowledge of the nature of probity audits. The researchers received many queries from departmental agency representatives as to what constitutes a probity audit. The most common question concerned the treatment of internal auditors' routine compliance review of procurement procedures. Many were inclined to treat these as probity audits.

A second feature which is well documented in the literature concerns the nature of probity audits, and the fact that ideally, to achieve effective outcomes, probity auditors must be engaged from the beginning of the selection process. It is envisaged that part of an effective planning of a process is to ensure that probity audits were "real-time". Table II classifies the audits conducted according to their type. An analysis of Table II shows that 24 out of the 32 probity audits (or 75 per cent) during this period were "real-time" probity audits. "After-event" probity audits were generally conducted after complaints were lodged by unsuccessful bidders. This kind of probity audit is likely to be initiated either by the Minister responsible for the portfolio or the Parliament.

A further area which arises in the literature, concerns the question of who conducts probity audits. Table III summarises details of probity auditors used by agencies. It shows that 75 per cent of audits (i.e. 24 out of 32 audits) were conducted by organisations outside the public sector. Of these, 50 per cent of the probity audits performed during 1994 to 1998 were conducted by either the Big 5 or Second Tier accounting firms. It is interesting to note that, of a total of 32 probity audits, eight were performed by non-accounting firms. This result supports the claim made by the Joint Standing Committee of the ICAA and the ASCPA (JSC, 1997) that assurance services may be performed by people other than accountants. While 16 per cent of probity audits were performed by internal auditors, audit operational review committees, or another government department, just under 10 per cent were carried out by the QAO. Further examination of the three probity audits conducted by the QAO shows that all of the probity audits were "real-time" audits. This result raises the problem of the "perceived" independence of the QAO. As the QAO is an independent agency which is responsible solely to the Parliament, there may be some concerns that the independence of QAO is compromised if they get involved in this kind of assurance service. This is especially the case if they are involved in a "real-time" probity audit, and then find themselves in the situation of having to audit some aspect of the process which they helped to set up in a "performance audit/systems audit"[3] later in time.

The other area raised in the literature concerned the cost of probity audits. Table IV summarises the audit fees paid by government agencies during the period of the study.

From the information presented in Table IV, it can be seen that, in two of the cases, no specific audit fee was able to be identified as the engagement of the probity auditor formed part of a broader contract for general management consultancies. Of the remaining 30 probity audits conducted, a total of five probity audits (or 17 per cent) incurred no monetary cost to external parties. Most of these audits were carried out by either audit and operational review committees or internal auditors (within and between government agencies). This supports the contention of ICAC (1996) which argues, on the basis of cost, that parties internal to the public sector can conduct probity audits. Nineteen of the audits, or 64 per cent, had fees of less than $30,000. At the other end of the spectrum, three out of a total of 30 probity audits (approximately 10 per cent) conducted during the period cost more than $60,000.

Table I
Number of probity audits performed by Queensland Government Departments between 1 July 1994 and 30 June 1998

Name of agency	Number of probity audits conducted
Queensland Health	11
Treasury Department	4
Department of Main Roads	4
Department of State Development	3
Queensland Transport	3
Department of Communication, Information, Local Government and Planning	2
Department of Natural Resources	1
Department of Housing	1
Queensland Corrective Service Commission	1
Department of Primary Industries	1
Department of Tourism, Sports and Racing	1
Department of Education	None
Department of Emergency Services	None
Department of Employment, Training and Industrial Relations	None
Department of Environment and Heritage	None
Department of Equity and Fair Trading	None
Department of Families, Youth and Community Care	None
Department of Public Works	None
Department of Justice and Attorney-General	None
Department of Mines and Energy	None
Queensland Police Service	None
Department of Aboriginal & Torres Strait Islander Policy and Development	None
Total probity audits conducted	32

Table II
Number and type of probity audits conducted by Queensland Government Departments between 1 July 1994 and 30 June 1998

		Types of probity audit	
Number of probit audits	Number of agencies	Real time audit	After-event audit
None	11	Not applicable	Not applicable
1	5	4	1
2	1	1	1
3	2	5	1
4	2	5	3
5 or more	1	9	2
Total	22	24	8

Table III
Summary of probity auditors used by Queensland Government agencies

Probity auditor	Number	Percentage
Big 5 (dominated by KPMG and Ernst & Young)	11	34
Non-accounting firms	8	25
Second tier firms	5	16
(Conducted by firms external to the public sector	24	75)
Internal probity auditor, within the agency or from other government agency	5	16
Queensland Audit Office	3	9
Total	32	100

Table IV
Probity audit fee structures

Audit fee range (A$)	Probity auditor		Number of probity audits	Percentage of those with identified audit fee
Fee not able to	Non-accounting firms	(1)		
be identified	Big 5 firms	(1)	2	n/a
0	Internal auditor	(3)		
	Audit and operational review committee	(2)	5	17
< 5,000	Non-accounting firms	(6)	6	20
5,001 – 10,000	Non-accounting firms	(1)		
	QAO	(1)		
	Big 5 firms	(1)		
	Second tier firms	(2)	5	17
10,001 – 20,000	QAO	(2)	2	7
20,001 – 30,000	Big 5 firms	(4)		
	Second tier firms	(2)	6	20
30,001 – 40,000	Big 5 firms	(2)	2	7
40,001 – 50,000	0		0	0
50,001 – 60,000	Big 5 firms	(1)	1	2
> 60,000	Big 5 firms	(2)		
	Second tier firms	(1)	3	10
Total			32	100

Based on the information collected in the study, it would appear as if the non-accounting consulting firms were primarily engaged to perform the smaller projects. From Table III it was established that the non-accounting firms conducted 25 per cent of the audits. However, from Table IV, it can be seen that all of the audits conducted were < $10,000. Likewise the second tier firms predominantly provided services in the middle ranges of the fee structures. The Big 5 accounting firms dominated the larger audits.

5.0 Conclusions, limitations, future research directions

The Australian public sector is embracing mechanisms which allow it to demonstrate that the activities it undertakes provide value for money for the taxpayer and that its activities are undertaken with the upmost honesty. Probity auditing is a new mechanism that is being used by some agencies to demonstrate, either, or both of these features. However, the literature on public sector probity auditing, both the policy aspects and empirical studies, is scant. This paper provided an empirical examination into the role and features of probity audits within the public sector by surveying the probity auditing practices of 26 government departments in one Australian jurisdiction.

There are a number of conclusions that can be drawn from the study. First, it appears that the concept of a probity audit was not well defined in many agencies; indeed, some respondents had trouble differentiating it from an internal audit. Second, the conduct of probity audits appears to be relatively widespread; with over one half of the agencies surveyed conducting a probity audit in the four-year period. Third, the majority of audits conducted were “real-time”, although “after-event” audits were also relatively frequently conducted. Further, the majority of audits were conducted by parties outside the public sector, with accountants conducting the most audits. However, specialist consulting firms also held a fair share of the market. The cost of the audits was found to vary markedly with the Big 5 accounting firms conducting the larger probity audits.

This study has some limitations. As with any survey research, the results included in the paper are very much dependent upon the responses of government agencies in the study. Although the study attempts to be as complete as possible, there is a possibility that some probity audits might not be included in the analysis. First, because of changes to personnel, it is possible that the current officer might not be fully aware of all the probity audits undertaken during the period. Further, a change in department structure (e.g. abolition or establishment of a department) could also affect the data collected. Nevertheless, this paper provides empirical evidence on some of the key features of probity auditing in the public sector and provides future research directions. In particular, the issues of the involvement of Auditors-General in conducting probity audits for government agencies and its ramifications are worthy of further research.

Notes

1. Assurance services are "independent professional services that improve the quality of information, or its context, for decision makers" (AICPA, 1997).
2. The Victorian Department of Treasury and Finance (1997) call these "process audits".
3. QAO currently does not have a mandate to do performance audits, but can do system audits (Scanlan, 1999).

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