

THE VALUE OF PUBLIC AUDIT

Investigations conducted by David Hay, Kevin Simpkins and Carolyn Cordery

Advisers: David Emanuel, W. Robert Knechel, Tony van Zijl

OAG Participants: Karen Smith

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Introduction and overall programme objectives

Overall question: An assessment of the value of public audit in New Zealand in the current environment.

Research Objective: A set of investigations that analyse existing information and develop a detailed plan for conducting further research on the value of auditing in the New Zealand public sector.

Terms of Reference

To carry out research on the Value of Public Audit. The following investigations explore issues and report on the value of public audit in New Zealand.

Investigation 1: an extended literature review of research on the value of auditing in general, including public sector auditing research and private sector auditing research that is relevant to the public sector, and making comparisons between them.

Investigation 2: an investigation of what is being done to examine similar issues in other countries.

Investigation 3: an independent investigation using existing published reports and other means of communication to examine who are the stakeholders affected by the most important parts of public information; who are their representatives who use public information; and how information is used and relied on. This investigation should recognize how the environment of public information is changing.

Investigation 4: an analysis of whether it is useful to obtain further information by way of interviews or surveys of users and other parties, or by archival examination of reports.

Outcomes:

Research papers that promote improved understanding of:

- the need for public auditing and assurance;
- the users of information;
- the changing context in which public auditing occurs;
- the changing nature of public audit and assurance.

The research papers will lead to publications for dissemination of the results to users of public sector information in New Zealand via the Office of the Auditor-General, and to more academic publications as working papers and articles in leading academic journals.

Importance and Benefits:

There is comparatively little recent research on the value of public audit in general, and on its value in New Zealand in particular. It is timely to examine the issue because of the rapidly changing environment in which information is produced and used. Assessing the value of public audit in New Zealand is also in accordance with ISSAI 12 (INTOSAI, 2012). ISSAI 12 explains that public sector auditing makes a difference to the lives of citizens; that an independent, effective and credible Supreme Audit Institution is an essential component in a democratic system; and that Supreme Audit Institutions have a responsibility to demonstrate their ongoing relevance to citizens, Parliament and other stakeholders. ISSAI 12 includes an objective that Supreme Audit Institutions “should periodically assess whether stakeholders believe the SAI is communicating effectively” (Principle 7, part 4, page 9). ISSAI 12 (INTOSAI, 2012) also includes a set of statements describing expectations for "Demonstrating ongoing relevance to citizens, Parliament and other stakeholders".

Motivation:

The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements (IAASB, 2012). These functions are very important, but the benefits can be indirect, so that studying the value of audit can be a complex task. In the public sector, this issue is particularly complex. Some of the benefits of auditing and assurance accrue to the user of information; but in addition, the provider of information benefits from increased credibility; and there can be information intermediaries who receive or provide benefits (such as media, interest groups, or other official bodies). In New Zealand, recent publications of the Office of the Auditor-General show that public sector accounting is world class but there is a continuing need for improvement (OAG, 2015, p. 8). In addition, there is a growing expectation gap in New Zealand between community views of the role of auditing and its actual role (Porter, 2014, p. 46) and this is likely to extend to public sector auditing.

The services provided by the Office of the Auditor-General includes providing assurance over financial statements, including in many cases service performance information. The Office also carries out performance audits, and inquiries (OAG, 2015). New Zealand's public audit function is held in high regard internationally. The Auditor-General personally recently

received an award from Chartered Accountants Australia New Zealand for outstanding leadership in the public sector. New Zealand has always ranked highly for lack of corruption in the Transparency International Index. The Open Budget Partnership Survey (International Budget Partnership, 2015) also rates New Zealand favourably compared to most other countries. The Auditor-General has been of major influence on the political system in the 1980s (regarding advertising of public programmes) and in the first decade of the twenty-first century (regarding advertising by political parties).

The changing environment includes new developments such as Integrated Reporting, developments in information technology, and expanding data from new types of information (e.g., health statistics by DHBs reported through newspaper announcements). In addition, there are increased opportunities for engagement by external stakeholders, and the focus internationally of engagement with Supreme Audit Institutions has changed to recognize two-way flows of information, both to and from citizens (using methods for gathering feedback)¹ (INTOSAI, 2014, p. 6). The changing environment also includes fewer resources available to news media organizations around the world and less interest in investigative journalism. “Investigative journalists are a vanishing species” according to a recent article in the *American Journalism Review* (Walton, 2010).

The research is also relevant to the strategic objectives of the OAG, specifically, citizen focus and position for the future (OAG, 2014, p. 7). Research of this nature is specifically referred to under documents explaining the latter goal. The OAG’s Strategic Intentions document also sets out an objective to address fundamental questions and issues about the future of auditing and accountability in the public sector (OAG, 2014, p. 14).

Investigation 1 reviews the research literature and the history of public audit. The confirmation hypothesis implies some relevant issues for possible investigation. Recent changes to private sector auditing, including independent regulation and oversight, and the greater importance given to corporate governance in recent years also indicate issues that are worth investigating further. Investigation 2 looked at what is done in other countries, in order to examine whether there are other practices that could be used in New Zealand. We found very few. Investigation 3 included interviews, focus groups, observation of Select Committee meetings and examination of documents. We have made several recommendations based on

¹ For example, by opening financial reporting information to greater public scrutiny in the hope that citizens will become “armchair auditors” (Gainsbury & Neville, 2015; O’Leary, 2015).

Investigation 3 and the other Investigations, many of which relate to internal control. They include reporting more details of internal control weaknesses found, and whether or not they have been remediated. The recommendations go so far as to suggest considering whether large public sector entities should be required to report on the effectiveness of their internal control, with the audits giving an opinion attesting to internal control effectiveness.

Investigation 4 is a short discussion of some other research opportunities that are likely to be useful. These include investigating the impact on stakeholders of modified audit opinions, and whether they would value reports attesting to internal controls; tests of the confirmation hypothesis; a more substantiated measure of public trust and confidence; and further tests of the proposed explanations for auditing, this time obtaining more information from stakeholders.

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