

# Chapter One BACKGROUND

## Introduction

This is the thirty-first and thirty-second Auditor-General's reports in terms of Section 19 of the Organic Law on Certain Constitutional Office Holders. The reports also accords with the requirements of Section 27(2) of the *Audit Act, 1989*, which requires me to furnish a report on the operations of the Office of the Auditor-General annually.

This is my second report since my appointment in early 2005. The report contains information about the operations and the financial statements of my Office for the years ended 31 December 2006 and 2007.

Future reports will be issued annually and will cover the operations of the Office for the previous year.

## Office of the Auditor-General

The Office of the Auditor-General is responsible for the audit of the financial affairs and activities of the Government in accordance with Section 214 of the Constitution of the Independent State of Papua New Guinea (see Figure 1)

**Figure 1. Section 214 of the Constitution – The Functions of the Auditor-General**

- (1) The primary functions of the Auditor-General are to inspect and audit, and to report at least once in every fiscal year (as provided by an Act of the Parliament) to the Parliament on the public accounts of Papua New Guinea, and on the control of and on transactions with or concerning the public moneys and property of Papua New Guinea, and such other functions as are prescribed by or under a Constitutional Law.
- (2) Unless other provision is made by law in respect of the inspection and audit of them, Subsection (1) extends to the accounts, finances and property of—
  - (a) all arms, departments, agencies and instrumentalities of the National Government; and
  - (b) all bodies set up by an Act of the Parliament, or by executive or administrative act of the National Executive, for governmental or official purposes.
- (3) Notwithstanding that other provision for inspection or audit is made as provided for by subsection (2), the Auditor-General may, if he thinks it proper to do so, inspect and audit, and report to the Parliament on, any accounts, finances or property of an institution referred to in that subsection, insofar as they relate to, or consist of or are derived from, public moneys or property of Papua New Guinea.
- (4) An Act of the Parliament may expand, and may provide in more detail for, the functions of the Auditor-General under subsections (1), (2) and (3), and may confer on the Auditor-General additional functions and duties not inconsistent with the performance of the functions and duties conferred and imposed by those subsections.

The audits conducted by the Auditor-General are an independent review of the state of affairs of public sector entities on behalf of Parliament with a view to provide assurance that the entity managements have discharged their responsibilities in terms of financial and operational performance.

## **Audit Mandate**

The Audit Act, in supporting the Constitution, provides the legal authority for the functions and powers of the Auditor-General, and governs the operations of the Office of the Auditor-General.

In particular, Section 3(1) of the Act mirrors the requirements of the Constitution, and states that “The primary functions of the Auditor-General are to inspect and audit, and to report at least once in every fiscal year to the Parliament on the public accounts of Papua New Guinea, and on the control of and on transaction with or concerning the public money and properties of Papua New Guinea and such other functions as are prescribed by or under a law of Papua New Guinea”.

More specifically, the Auditor-General is mandated to undertake audits of National Government, Provincial and Local Level Government and Statutory Authorities, as follows:

**National Government** - to inspect and audit the accounts, finances and properties of all National Government Departments, Arms, Agencies, and Instrumentalities as well as bodies established for governmental or official purposes by Constitutional law, Act of Parliament, Executive or Administrative Act of National Executive, and the subsidiary corporations of such bodies. In 2007, the National Government’s mandate included audits of the Public Accounts, 33 National Government Departments, and 25 other entities, which included 19 Treasury Offices located in the Provinces. It also included audit of National Government functions in the Provinces, for example the Department of Works and Internal Revenue Commission.

**Provincial Government** – to inspect and audit the accounts, moneys and properties of Provincial Government, Local Level Government, Subsidiary Corporation of Provincial Government, Provincial Government Associations, Provincial Government owned companies and Public projects and bodies established by Provincial Law and Executive or Administrative Act of Provincial Executive. In 2007, the Provincial Government’s mandate included 19 Provincial Governments, 303 Local Level Governments, including 19 Urban Local Level Governments and their business arms.

**Statutory Bodies** – to inspect and audit the accounts, records, financial transactions, assets and liabilities of all public bodies and subsidiary corporations. In 2007, the Statutory Bodies’ mandate included 116 Statutory Bodies and Government Owned Companies.

## The Audit Coverage and Process

The audit coverage includes the attestation of financial statements, examination of compliance with legal and administrative regulation, and assessment of the economy, efficiency and effectiveness of the operations of entities being audited.

The audit process relies on effective planning, co-ordination, implementation and reporting in line with the best audit practices as stipulated in auditing standards. All audits are conducted in accordance with International Standards on Auditing as promulgated by the International Federation of Accountants. The audit process begins with the planning phase in July and ends with the preparation of the Auditor-General's audit report to Parliament by June the following year.

## Reporting Requirements

Section 214 of the Constitution requires me to report at least once every fiscal year to the Parliament on the public accounts of PNG and on the control of and on transactions with or concerning the public monies and property of PNG.

The Public Finances (Management) Act requires a Public Body, before 30 June each year, to provide the Minister with a performance and management report, together with financial statements, of its operations for the year ending 31 December preceding. The Public Finances (Management) Act also requires the Public Body to submit the financial statements to the Auditor-General before providing them to the Minister.

Section 123(8) of the Organic Law on Provincial Government and Local Level Government requires me to furnish before 30 April of the following year, audit reports on the previous year's accounts of Provincial Government and Local Level Government to the Minister for Provincial Government and Local Level Government Affairs, the Minister responsible for Finance matters, the Provincial and Local Level Governments concerned, and the National Economic and Fiscal Commission.

In addition to meeting the specific legislative requirements for reporting to Parliament, I am also required by the Constitution to report on project funding co-funded by the Government in partnership with international donors on identified projects approved by the Executive Government.

I fulfill the reporting responsibilities required by the Audit Act by preparing four Auditor-General's compendium reports annually, as follows:

**Part I – Public Accounts.** The Part 1 Report provides an audit opinion on the Public Accounts, which represent the financial statements of the Government of Papua New Guinea. It also contains observations on the Government's financial statements.

---

<sup>2</sup> The types of audit opinions that can be expressed are unqualified, qualified, adverse and disclaimer.

**Part II – National Government Departments and Provincial Treasury Offices.** The Part II Report provides the audit findings, conclusions, and recommendations from my audit of National Government Departments, Instrumentalities and Agencies. The audits of the National Government Departments provide information on the reliability and accuracy of the reported expenditure and revenue, which in aggregate are reported in the Public Accounts.

**Part III – Provincial and Local-Level Government.** The Part III Report deals with the status of audits of Provincial Governments, their public bodies and subsidiary corporations, Urban Local-Level Governments, Hospital Boards and some Trust Funds.

**Part IV - Public Bodies and their Subsidiaries.** The Part IV Report covers the financial statement audits of Public Bodies and their Subsidiaries, National Government-Owned Companies and National Government's shareholdings in Other Companies.

## **Organisational Structure**

In the period covered by this Report, the Office of the Auditor-General was organized into three operational audit branches headed by First Assistant Auditors-General who reported to the Deputy Auditor-General. The roles of the audit branches are discussed briefly in the following paragraphs with more detail provided in Chapter 2.

### **The National Government Branch**

The National Government Branch was responsible for the audits of the Public Accounts of Papua New Guinea, and of the accounts and records of all National Government Departments and agencies.

### **The Provincial Government and Local-Level Government Branch**

The Provincial and Local-Level Government Branch assisted the Auditor-General carry out his responsibilities to maintain an effective and efficient audit service within the provinces and audit the accounts, monies and properties of Provincial Government and Local-Level Governments, including their subsidiary bodies, Hospital Boards, Provincial Authorities and Trusts. Although there is a requirement under Organic Law for the AGO to have offices in all Provinces, only four have been established.

### **The Statutory Bodies and Special Audits Branch**

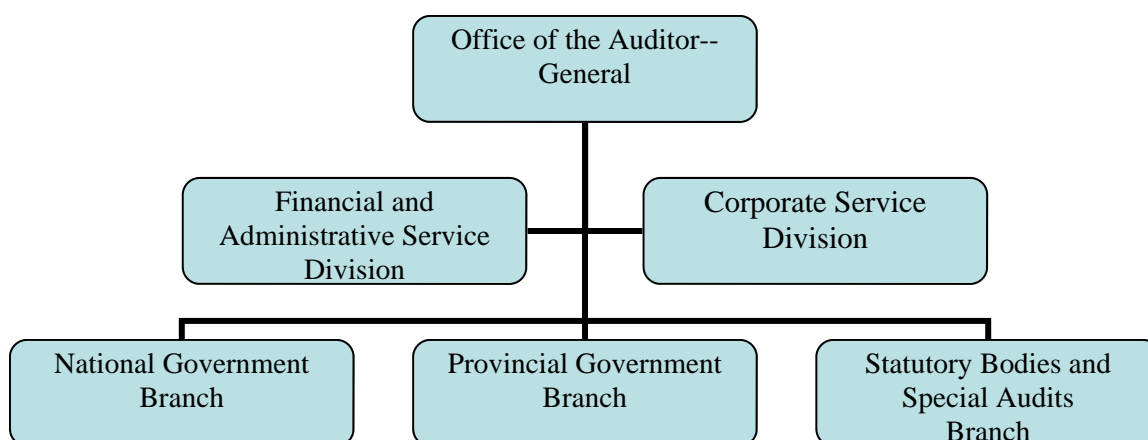
The Statutory Bodies and Special Audits Branch was responsible for the audits of the accounts and records of all Public Bodies and subsidiary corporations to ascertain whether the financial statements are based on proper accounts and records, and whether these statements show fairly the financial operations for the period which they cover and the state of affairs at the end of the period. Special reviews and performance audits were undertaken by this Branch as well.

The Statutory Bodies Branch also undertakes audits of Donor and State co-funded development projects as approved by the Executive Government through Certified Loan Agreements.

## Support Services

The operational audit branches are supported by a Corporate Services Division Finance and Administrative Services Division (See Figure 2).

**Figure 2. Structure of the Auditor-General's Office**



## Resourcing of the Auditor-General's Office

The Parliament provided the financial resources to the AGO in 2006 and 2007 as follows:

2006      K8.9 million

2007      K11.0 million

Although, there was a K2 million increase in the 2007 Budget compared with the 2006 Budget, this level of funding was not sufficient for the AGO to carry out its audit mandate as will be shown later in this Chapter and in Chapter 2.

A fundamental principle of the democratic process is that, for it to be effective, an Audit Office must be adequately resourced so that it is, and is seen to be, operationally independent of Government. Section 20B of the Audit Act provides this resourcing independence as it requires the Auditor-General to:

*'...prepare annually estimates of the sums that will be required for the payment of salaries, allowances and expenses of his office during the next ensuing financial year for consideration by the Permanent Parliamentary Committee on Public Accounts for recommendation to the Prime Minister for approval in accordance with Section 225 of the Constitution'.*

In practice this has not happened, and the AGO funding is determined by Government officials as part of the annual Government Budget process. This process does not involve the Public Accounts Committee (PAC).

I recognize the important role the Department of Treasury plays in the Budget process and that the Government has the ability to decide how the country's resources should be allocated. However, I believe that the PAC should play a role in determining the Office of the Auditor-General's resourcing requirements as provided for in the Audit Act. I have been following this up with the Department of Treasury in 2008.

Our annual budget provided through appropriations is supplemented by internally generated audit fees from fee-paying clients.

## **CORPORATE PLAN 2007-2010**

Immediately after my appointment as Auditor-General, I embarked on developing a new Corporate Plan for the Office. The Plan, which covered the period 2007-2010, was completed in March 2007.

The Office's vision is "auditing for impact" because I believe that the achievement of the objectives of the Plan will have an impact on transparency, accountability and good governance in government entities, and allow the Office of the Auditor-General to be a key player in public sector accountability and integrity.

The Office's long term objectives are to promote effective leadership and management so that it can address its mandate by developing close relationships with its stakeholders and delivering quality audit reports with a workforce that has the capacity to undertake audits with professionalism and integrity.

The Office requires adequate resources to meet the needs of a modern day professional audit practice and to allow us to continually review our processes and procedures so that the Office can deliver cost-effective and efficient audits.

The Office's intention is to align its audits with the National Government development aspirations. With this in mind, my preamble in the Corporate Plan states that the Office would strive to provide opinions on the effectiveness of the public sector's delivery, of government policies and programs, and their contribution to Nation Building through the service delivery objectives of the Medium Term Development Strategies (MTDS).

## **Constraints on the efficient operations of the Office of the Auditor-General**

The Office of the Auditor-General is constrained in carrying out its audits in a comprehensive, efficient and timely way by inadequate resourcing and the poor state of entity financial management.

---

<sup>3</sup> The Auditor-General's resourcing independence is also provided by the Audit Act, which provides for the Auditor-General to make a special report to the Parliament if he is...of the opinion that the amounts provided for the Auditor-General in the estimates submitted to the Parliament are not sufficiently adequate to enable him to fulfill his responsibilities.

## **Resourcing**

As mentioned earlier, the resourcing of the Office is not sufficient for it to meet its audit mandate, the effect of which is that a number of government entities have not been audited for some time or have not been audited at all. Put simply, I require more staff to carry-out more audits, in particular in the Provinces where to date we have not been able to audit a large number of Local-Level Governments. I addressed this in late 2007 in a submission to the Salaries and Conditions Monitoring Committee to increase the number of staff from 128 to 183 over three years. The Committee agreed to the additional positions subject to funding being available.

The resource constraints also prevented me from venturing into full-scale information systems audits and performance audits. Performance audits in particular, would allow me to examine the less than effective delivery of services by responsible state agencies. The resource constraints may also mean that I will have to use my discretion to dispense with some audits in 2008 onwards.

## **Poor state of entity financial management**

After observing the financial management of the public sector in the three years I have been the Auditor-General, I believe the financial capability of staff in a number of public sector entities is not adequate to deal with the complexities of a modern day public sector environment. The audit function is constrained because often there are no records to audit, and the entities' systems do not support the financial management functions. Often the internal controls that are supposed to prevent breakdowns in financial administration are non-existence.

Examples of poor financial management include:

- Lack of bank reconciliations;
- Poor documentation supporting the transactions;
- Lack of physical stock takes;
- Non acquittal of advances and allowances;
- Non payment of taxes on allowances; and
- Ineffective budget controls.

This poor state of financial management has forced me to issue many qualified audit opinions. This means that I have disagreed with the treatment or disclosure of information in financial statements, or cannot express an opinion on whether the financial statements are based on proper accounts and records.

One of the issues faced by the Office is the non-submission of financial statements by public bodies within the legislative timeframe, which leads to audits being in arrears as the financial statements are not audited in the current year. This reduces the relevance of the financial statements to decision makers and is contrary to the principles of accountability and transparency.

I believe that there needs to be a coordinated approach by the central agencies, and one which involves my Office, to develop a remediation plan to correct the financial management deficiencies in public sector entities. Unless this happens I cannot envisage my audit opinions improving, and I will continue to qualify accounts for the same reasons that I qualify them now. I will discuss this with the Secretary of the Department of Finance in 2008.