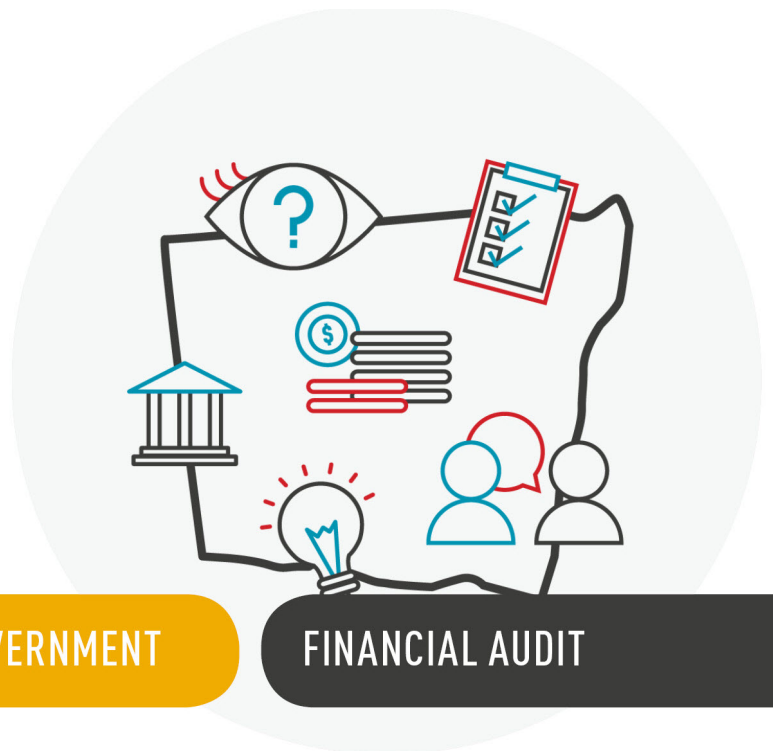


Audit Office of New South Wales

Financial Audit Pricing Approach

June 2021



INSIGHTS FOR BETTER GOVERNMENT

FINANCIAL AUDIT

Auditor-General's pricing statement

Like our auditees, we must live within our means

Introduction

The Audit Office of New South Wales is a statutory authority, established under the *Government Sector Audit Act 1983*, that conducts audits for the Auditor-General. The Auditor-General helps parliament hold government accountable for its use of public resources.

Our auditees pay us fees for the work we do. As with any public sector agency, it is incumbent on us to demonstrate we are using public resources as efficiently and effectively as possible.

This document is fundamental to achieving transparency in the way we set our prices. It explains our pricing model, including how we set our prices for the work we do. It details the multi-layered benchmarking that is performed, and how we promote accountability for our use of public resources.

Our pricing

'Any necessary growth in our revenue from audit fees will be consistent with expenditure constraints placed on agencies.'

The Auditor-General's pricing statement (above) establishes a clear expectation that we manage the impact we have on our auditees' finances.

The pricing statement is the foundation of our pricing model. Its premise is that, like our auditees, we must live within our means and provide value to the public.



The pricing model

Our pricing model sets the benchmark price for audit

Our pricing model is known as the 'benchmark pricing model'. The model prices our audits based on the relative size, nature, and complexity of an audit. Using a series of decision inputs, we categorise our audits into 'benchmark price ranges'. The price

we charge should sit within that range. The 'benchmark price' is based on the most optimal team (resource) mix for the audit, a set of hourly charge-out rates for each role in the team, and an estimate of the total hours required to complete the audit.

Key components of the model

Series of decision inputs

Decision inputs are objective factors that can significantly affect resourcing required to complete an audit. These resourcing decisions relate to both the mix of resources and the time required to complete an audit.

The more significant factors that affect our resourcing decisions are listed in Appendix One.

Optimal team mix

An outcome of the series of decision inputs is the recommended optimal team mix.

The optimal team mix reflects the ideal team mix required to complete an audit. Each separate 'benchmark price range' has a different mix. This acknowledges that different types of audits require different levels of senior team member involvement compared to other engagements.

The availability of resources within the Audit Office is not a pricing factor.

That is, the availability or otherwise of particular resources will not

change our optimal team mix used to determine the price we charge. We do tailor team mixes for certain audits if auditee-specific factors mean a different mix is considered more appropriate.

For example, if the auditee has a complex business model or significant and complex transactions.

Hourly charge-out rates

We calculate hourly charge-out rates for each role in the team. The rates are based on the average 'direct' costs (such as salaries and wages) of the role, and 'indirect and support' costs (such as IT equipment, domestic travel, office rental expenses and utilities, and corporate services staff salaries).

Our 2019-20 charge-out rates are listed separately on our website.

Estimate of total hours

An outcome of the decision inputs is the recommended estimate of total hours.

The estimate of total hours reflects our expectations of completing a standard audit based on the series of decision inputs. Auditee-specific factors that can't be appropriately reflected in the decision inputs mean we may deviate from the recommended estimate.

Setting the 'benchmark price'

The 'benchmark price' is a function of the optimal team mix, the set of charge-out rates, and the estimate of total hours.

The 'benchmark price' is intended as a guide, subject to engagement-specific factors unable to be reliably included in the decision inputs.

Engagement prices that deviate from the benchmark price by a set percentage are subject to review and approval by the Deputy Auditor-General.

Direct expenses (such as external specialist services) will be added to the 'benchmark price' to arrive at the final engagement price.

There will be times when circumstances arise during our audit that weren't expected or factored into the engagement price. These can include new transactions or events, or a higher than expected number of issues, complications, or misstatements. Where these result in additional work, we will discuss the impact on our engagement price with auditee management.

Establishing the cost

A core requirement to setting our hourly charge-out rates is establishing the cost required to sustainably fulfil our mandate.

Our 'benchmark prices' are calculated based on historical costs for the work we do. Over time, greater levels of benchmarking data will be incorporated into the 'benchmark price'.

Benchmarking our prices

Benchmarking gives us the evidence to demonstrate our efficiency

Benchmarking our prices is an important aspect in demonstrating our efficiency. We perform a range of benchmarking exercises to give us the evidence we need.

External benchmarking

External benchmarking involves comparing our costs against our peers. We participate in annual macro benchmarking surveys with other audit offices throughout Australia and disclose the results in our annual report. We compare our costs against our peers on a range of measures including:

- Total audit costs (excluding payroll tax) per \$'000 of public sector transactions
- Total audit costs (excluding payroll tax) per \$'000 of public sector assets
- Cost per financial audit opinion.

We also benchmark our prices with external accounting firms which perform audits on our behalf (known as 'Audit Service Providers').

Contracting out audits provides important data for benchmarking the fees we charge against those of private sector accounting firms. Through the selection of audits to be contracted out, the Auditor-General looks to gather enough data by auditee type and sector to enable meaningful benchmarking.

Internal benchmarking

Internal benchmarking involves the analysis of engagement prices for comparable audits. This analysis aims to look at trends in engagement prices, and identifies prices that appear outside a reasonable range.

In addition to the macro analysis, a representative sample of audits is selected for quality review each year. Among other things, the review considers whether the audits were conducted efficiently.



Holding us to account

We must be transparent and allow ourselves to be held to account

In order to demonstrate we are using public resources as efficiently and effectively as possible, we must be transparent and allow ourselves to be held to account.

Reporting actual results

A cornerstone to demonstrating transparency in our pricing approach is reporting actual results against our targets. We acquit compliance with our pricing approach via our annual report.

Quadrennial review by the Public Accounts Committee

The Public Accounts Committee of the NSW Parliament commissions a review of the Audit Office of New South Wales every four years. The reviews, amongst other things, look at our value for money. The reviews are an important source of public

accountability for the work we do. The Public Accounts Committee's reports are available at: www.parliament.nsw.gov.au/publicaccounts.



Significant factors that impact our price

1 Appendix one

Many factors can impact the price we charge for the work we do. The pricing model identifies the more significant factors that can impact the price. There will always be factors that are more significant for particular auditees, or auditee-specific factors that aren't accommodated in the standard model. We overcome this by allowing teams the flexibility to tailor the price we charge. Where we significantly tailor the price, the Deputy Auditor-General reviews and approves the price.

The significant factors that impact our price include:

Factor	Impact on price/audit effort
What is the overall engagement risk?	Engagement risk is, broadly speaking, the risk of our exposure to financial loss and damage to our professional reputation. Engagements with higher engagement risk generally require more time by senior team members, and more time overall responding to the higher risk.
Does the entity have a strong governance and internal control environment?	Strong governance and internal control environments allow us to place more reliance on these elements as part of our engagement approach. Placing more reliance on these elements generally reduces the time we have to spend on testing transactions and balances in the financial statements.
Does the entity have a history of misstatements?	If an entity has a history of misstatements, unless we can assess otherwise, we have to assume a similar level of misstatements will occur in the future. The more misstatements we expect overall will generally increase the amount of work we have to do. A greater number of misstatements also generally requires more time to assess the impact of the misstatements in the financial statements, and to discuss the misstatements with management.
Does the entity have a strong focus on reliable financial reporting and respond quickly (and accurately) to our requests for information?	A strong focus on reliable financial reporting and responsiveness to our requests for information will generally reduce the time spent on the engagement. The strong focus generally means management provide timely and accurate information in response to our requests – reducing the time spent following up information that was previously requested, or requesting more accurate information where the information originally provided was incomplete or not accurate.
Is the entity experiencing significant change in its operations?	An entity experiencing significant changes in its operations generally requires more involvement of senior team members, and more time overall reviewing the financial reporting impact. This involves assessing the appropriateness of the accounting treatment through our engagement procedures.
Does the entity have complex computer processing environments that impact the engagement?	Complex computer processing (IT) environments generally require involvement by Information Systems audit specialists. They specialise in reviewing complex IT environments to ensure we can rely on the systems as part of our engagement approach. Less complex IT environments will generally require less time spent by our audit specialists in reviewing the structure of the environments and the controls implemented to support reliable processing of information.
Does the engagement include a large number of revenue, expense, asset, and liability streams?	The larger number of revenue, expense, asset, and liability streams an entity has will generally increase the time spent on the engagement. This time is required to understand and assess the controls within each of the significant streams, perform engagement procedures to test the streams, and evaluate any issues identified through our procedures.

Factor	Impact on price/audit effort
Does the entity operate financially significant components that require a decentralised engagement approach?	Having centralised financial reporting responsibilities generally reduces the time spent on the engagement. With decentralised responsibilities, time is required to understand the extent of decentralisation, assess the controls in place at the significant components (sites), perform engagement procedures to test the sites, and evaluate any issues identified through our procedures.
Does the entity have shared services (outsourcing) arrangements?	<p>Shared services (outsourcing) arrangements can have a range of impacts depending on the nature and extent of the arrangements. Key factors include:</p> <ul style="list-style-type: none"> ○ the complexity of arrangements with the shared service provider ○ the pervasiveness of outsourced functions affecting the entity's financial reporting ○ whether the shared service provider receives an independent audit report over the design, implementation and operating effectiveness of its internal controls ○ the nature and extent of issues identified in the shared service provider's controls ○ the nature, extent, and significance of procedures and controls the entity is required to implement to support the shared service provider's controls.
Does the engagement contain significant accounting estimates or judgements?	<p>Significant accounting estimates and judgements generally require involvement by senior team members to review the financial reporting impact. Estimates and judgements are, by their nature, at greater risk of fraud and error. Senior team members use their experience to assess the appropriateness of management's estimates and judgements against accounting standards, relevant laws and regulations, and other authoritative pronouncements (such as those issued by The Treasury).</p> <p>The impact on price and audit effort can vary significantly from one year to the next. For example, a desktop asset indexation or annual assessment of fair value requires less time spent on the engagement compared to a full asset revaluation.</p>
Does the engagement contain complex accounting transactions?	<p>Complex accounting transactions generally require more involvement of senior team members, and more time overall reviewing the financial reporting impact. More senior team members use their experience to understand and assess the appropriateness of the accounting transactions, design engagement procedures to validate key aspects of the transactions, and evaluate any issues arising from our procedures.</p> <p>The complex nature of these accounting transactions may also require involvement of technical experts (below).</p>
Does the engagement contain accounts subject to technical expert involvement (tax, superannuation, financial instruments)?	Significant accounts that are subject to technical expert involvement will generally require involvement of senior team members to review the financial reporting impact. We may use our own technical experts (or engage external experts) to review the appropriateness/reasonableness of any methodologies, inputs, assumptions, or judgements used.
Does the entity form part of a group engagement and require completion of group auditor documentation?	<p>An entity will sometimes form part of a consolidated group of entities. As a result, it is likely management are required to provide the preparers of the group financial statements information to help with their preparation. Similar arrangements exist for group assurance engagements. The group auditor generally requires an entity's auditors to provide documentation about their engagement, including any misstatements or issues identified. The time spent completing this documentation will vary depending on the significance of the entity to the group's financial statements.</p> <p>The time spent completing this documentation is generally charged to the entity (unless specific arrangements are established between the group and entity management).</p>

OUR VISION

Our insights inform and challenge government to improve outcomes for citizens.

OUR PURPOSE

To help parliament hold government accountable for its use of public resources.