

**Pacific Studies Series**

# **Toward a New Pacific Regionalism**

An Asian Development Bank—Commonwealth Secretariat  
Joint Report to the Pacific Islands Forum Secretariat

**VOLUME 3: WORKING PAPERS**

Working Paper No. 8

## **A Pacific Regional Panel of Auditors: Cost-Benefit Analysis**

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# Preface

This report was prepared for the Pacific Islands Forum Secretariat (PFIS) in Suva, Fiji Islands. The report is one output of an Asian Development Bank (ADB) technical assistance project (TA 6226 REG): “Developing and Implementing the Pacific Plan for Strengthening Regional Cooperation and Integration.” The Commonwealth Secretariat provided funding to the project.

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The report is published in three volumes. Volume 1 is the Executive Summary. Volume 2 is the main report. Volume 3 contains the working papers commissioned for the report—a series of independent studies assessing potential benefits and costs of implementing a variety of possible regional initiatives. Volume 3 has been printed in hard copy in only limited numbers. However, it is available on the websites of ADB ([www.adb.org](http://www.adb.org)) and at [www.pacificplan.org](http://www.pacificplan.org).

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## CONTENTS

	Page
PREFACE	ii
ACKNOWLEDGEMENT	iv
EXECUTIVE SUMMARY	v
I. BACKGROUND	1
II. INSTITUTIONAL CAPACITIES – MEETING THE OBJECTIVE: A PHASED APPROACH	2
A. Phase 1: Strengthening SPASAI – Developing Co-operation while OAGs Operating Environments are Converged	
B. Phase 2: Establishing a Federation of Offices of Auditor Generals. A Convergence of Institutional Expatriates	
C. Phase 3: Establishing a Regional Panel of Public Sector Auditors	

## **Acknowledgement**

I am pleased to acknowledge the kind assistance of the following in compiling this report:

Johann Janzy, OAG Victoria  
Sasha Silva, Commonwealth Secretariat  
Jacqueline Schieff, OAG Noumea  
Barry Underwood, OAG New South Wales  
Eroni Vatuloka, OAG Fiji Islands

Audit Office of New Zealand  
Audit Office of Samoa  
Public Audit Office, Federated States of Micronesia

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## EXECUTIVE SUMMARY

Establishing a regional panel of auditors for the public sectors of the Forum Island countries requires far more than simply making adequate budgetary provision. This paper considers the differences in institutional frameworks that the island countries offices of Auditor General (OAG) operate under and demonstrates that these will need to converge prior to the effective establishment of a regional panel of auditors.

There are substantial difference in the operating capacities of the OAG's. These too will need to be addressed if the work of the national offices are to be merged.

This paper seeks to address these development needs. It suggests a phased approach. The initial phase is to involve an empowerment of the South Pacific Association so Supreme Audit Institutions (SPASAI), an embryonic federation of OAG's by funding training and secondment programmes through its operations. The costing of these programmes is estimated at some Fiji dollars (F\$)2.35 million and is entirely exclusive of the budget provisions already made for the national OAG's by the individual Forum Island countries.

This phase would last until such time as the appropriate action had been taken to establish a common institutional environment under which OAG's operate in the Forum Island countries. It would then seem feasible to establish a full federation of Forum Island OAG's, which could establish a regional approach to audit issues and possibly directly take on the audit role for regional institutions. It is accepted that operational capacities would need to continue to develop firstly to establish a common standard and ultimately to develop further.

The federal arrangement is costed at a minimum of F\$29 million with an ideal budget set at F\$39 million. These figures are inclusive of the budget provisions already made for the individual Forum Island countries for their national OAG's. It is expected that the annual budget will be set at a figure close to the minimum initially rising to the ideal figure eventually as the operating capacities of the constituent members continue to develop.

Once operating capacities of the national OAG's approach convergence establishing a fully integrated regional panel of auditors is seen as feasible. Establishing such a regional facility is seen as a possible third phase in the development of public sector audit capacities in the Forum Island countries. Certain advantages for a Regional Panel of Auditors over what can be secured from a federal system are identified. However, these are not seen as being so substantial to justify any material increase in the upper limit in the proposed budget provision of F\$39 million, identified as appropriate under the federal system.

## I. BACKGROUND

An office of the Auditor General (OAG), or its equivalent, exists in each of the Pacific Islands jurisdictions. These offices have already established a network through the South Pacific Association of Supreme Audit Institutions (SPASAI), which includes the New Zealand OAG and some of the State offices of Australia among its members. (The constitution of SPASAI is attached). Its role is primarily that of providing a forum for senior members of staff to identify common issues and problems and consider appropriate strategies to deal with them. It also performs a training function, ensuring that the developments in international regulations are disseminated and understood. This work is primarily funded by the European Union.

Practical limits are imposed on collaboration between various offices, quite apart from considering their formal integration. This is due to the following:

- (a) Different jurisdictions use different regulatory frameworks. The Federated States of Micronesia (FSM) employs United States generally accepted accounting practices. Fiji Island's point of reference is the Fiji Accounting Standards, although adoption of the International Public Sector Accounting Standards developed the International Federation of Accountants is under active consideration. Other jurisdictions refer to International Financial Reporting Standards. However, a number of these standards either have no relevance to the Pacific Island economies, or are impossible to apply in these economies undeveloped and thin markets. The actual application will therefore vary from jurisdiction to jurisdiction.
- (b) The responsibilities of the offices of the Auditor Generals varies from jurisdiction to jurisdiction. For example the office in Fiji Islands is charged with the audits of local authorities. This task is generally understood to be outside the jurisdiction of an OAG. Additionally, despite constitutional provisions, not all public agencies are "accountable" directly to parliament or its equivalent, because the mandate and scope of the Audit Office are incomplete. For example, the audit of commercial statutory authorities and government commercial companies is undertaken by private sector auditors that do not have a mechanism to report directly to Parliament except via the minister. (ADB:2004)
- (c) The status of the OAG's office will also differ among jurisdictions. For example the office of the Auditor General is not completely independent of the executive government, because its budget appropriations and staff appointments are subject to executive government decisions, such as those of the Ministry of Finance and the Public Service Commission.
- (d) Anomalies in the legislative framework can also create operating conditions which are likely to be unique to a particular jurisdiction. For example, Vanuatu's Comprehensive Reform Program, launched in 1998 and supported by the ADB, was premised on the enactment of legislation to improve public service administration and public financial management, and to commercialize/corporatize statutory authorities. Thus, Parliament enacted all the 8 pieces of legislation very quickly as required under the program loan, with little consideration being given to implementation. However, after consultants departed in December 2002, few changes can be seen in the way the Government operates or the way public finances are managed. (ADB: ibid).
- (e) The effectiveness of the OAG's also varies because of:
  - (i) The status of the office. Some report to their country's parliament or congress, while others report to the government. (ADB: ibid)
  - (ii) The disposition to act on the report of the OAG varies. Even where the OAG reports to the parliament its observations and recommendations may be largely ignored.

- (iii) Institutional capacities vary.
- (f) A further fundamental difficulty exists to the establishment of a fully effective regional count of auditors. The regional almost certainly does not possess the appropriately qualified accountants to staff it!

These limitations are not insurmountable. Internationally the accounting profession is working towards a worldwide harmonized regulatory framework. Other regional initiatives to be fostered by the Pacific Plan can be expected to move Forum countries towards a common framework for governance. However, given the substantial differences in the environments under which OAG's operate establishing a regional panel of public sector auditors must be considered a medium to long-term objective. Added to the difficulties already identified, OAG's are generally perceived as performing an oversight role of government on behalf of the population that funds it, through its parliamentary, or equivalent, representatives. The role is therefore very much a national rather than a regional one. Surrendering what is essentially a national role to a regional body is not likely to be well received.

This argument does however serve to suggest that regional institutions might appropriately be audited by a regional panel of auditors. This may serve as the basis for establishing such a panel which could expand its role overtime. While the establishment of a regional panel of auditors may serve to strengthen both the capacity and independence of the public sector audit function, it would seem appropriate to consider other means of working towards these objectives in the medium term.

## **II. INSTITUTIONAL CAPACITIES – MEETING THE OBJECTIVE: A PHASED APPROACH**

As has been already noted and can be expected, the capacities of OAGs in the different jurisdictions varies. However no office is capable of providing all audit functions. The OAG in Fiji Islands is perhaps the best resourced of the region's auditor generals. It succeeds in completing the most troublesome of audit exercises within eight months. Audits in other Forum Island jurisdictions may take more than a year to complete. However, while it carries out annual compliance audits, risk management assessments and special investigations, it does not conduct value for money, or environmental audits. The Fiji Islands government processes of accounting do not enable the former, although this is currently being addressed. The OAG, does not possess the expertise to deal with the latter.

Establishing a fully effective regional panel of auditors goes beyond making an appropriate financial provision. Provision will have to be made to:

- (a) Establishing a training provision to ensure that audit expertise is maintained and developed to meet existing audit regulations and to keep pace with change.
- (b) Ensure the independence of OAGs offices.
- (c) Eliminate anomalies in legislation that pertain to work of the OAG.
- (d) Establish a common regulatory framework.
- (e) Establish a mechanism to ensure the active consideration of the OAG's annual report, with appropriate action taken where necessary.
- (f) The adoption of a common regulatory framework (accounting system).

These issues have to be addressed in tandem with the provision of appropriate resources to enable all aspects of the audit function to be carried out effectively in the Forum Island countries.

In developing a regional panel of auditors consideration could also usefully be given to:

- (g) promoting understanding and co-operation among national OAG offices, until such time that the establishment of a fully integrated regional panel of auditors becomes feasible.
- (h) establishing a center for the accumulation and dissemination of information pertinent to the field of public audit in the region.
- (i) provision of technical assistance and the exchange of expertise among OAG's in Forum Island countries. (SAPASAI: 1988)

Of the issues raised above items (c), (d), (e), (f) and (g), have no real budgetary implications. While they are necessary developments they lie outside the work of this paper. As such they are not discussed further, other than to note that the development of this paper proceeds on the assumption that these issues will be addressed as necessary by the Forum Island jurisdictions. This requires legislative reviews and reorganization, which cannot be reasonably be expected to be completed in less than two years at a minimum. During this time steps need to be taken to develop capacities of the individual OAG's to a common level.

#### **A. Phase 1: Strengthening SPASAI – Developing Co-operation while OAGs Operating Environments are Converged**

SPASAI (1988) already has the remit to facilitate training, act as a clearing house for technical information and provide for inter member office assistance. However, SPASAI's administration is sustained largely by the goodwill of its better resourced member bodies. Currently SPASAI's role is effectively limited to making provision for the most senior staff to confer and undertake training. This work is funded by the European Union. It is assumed that this kind of financial support will continue. While provision for training of all but the most senior staff may be considered a national, rather than a regional responsibility, the quality of training available at the national level will vary substantially from jurisdiction to jurisdiction. Some countries are simply too small to sustain an entity, which would provide such training. A regional provision is therefore needed to ensure that the necessary training is available and that the training seeks to establish a common quality in the public sector audit function in Forum Island countries. Financial provision therefore needs to be made for:

- (a) The establishment of a secretariat for SPASAI that can provide a clearing house for operations.
- (b) The establishment of a wider training function.
- (c) Provision for secondments between offices, to provide assistance and facilitate an exchange of expertise.

The secretariat at least initially, need only be a modest operation. As it would function as an information base and a means of co-ordination SPASAI activities, it might reasonably be headed by the equivalent of a senior librarian with secretarial assistance. Office space and equipment would be required. USP senior librarian and secretary compensation packages have been assumed and rental charges in Suva's central business district taken to assess office costs. Suva given its location at the hub of the Forum Islands is taken as the appropriate place to establish the secretariat. Alternative locations could of course be considered.

USP is currently offering training programmes at a charge of Fiji dollars (F\$)2800 per day, plus travel associated costs where pertinent. Given the acute need for upgrading each officer may need to undertake ten person days of training per annum. Quite possibly training will have to be conducted for senior and intermediate staff as a separate exercise. These two levels are likely to incorporate the greater part of the staff. There is limited scope for employing junior staff in

audit activities. Training required by junior staff should be undertaken through established tertiary programmes.

Given the limited resources available in the Forum Island nations secondments will almost certainly have to be drawn from Australia and New Zealand. Initially secondees may have to be sought from the United States in the case of the Federated States of Micronesia, the Marshall Islands, and Palau, and possibly France in the case of Vanuatu. The average salary of audit staff at the New South Wales office is Australian dollars (A\$)8,000 ([www.audit.nsw.gov.au](http://www.audit.nsw.gov.au)) (F\$64,000).

Staff seconded may also require compensation for dislocation effects. A one third premium is factored into the costing, giving a cost of F\$85,000 per secondee. Relocation costs will also have to be considered. Airfares for a family of four, (4xF\$1000=F\$4000), movement of personal possessions (\$F2000) and settling and out allowances (\$F3000) have been allowed for.(Comperable allowances are made by USP) As all OAG's in the Forum Islands could undoubtedly benefit from one such secondment, it has been assumed that an annual secondment will be made to each office.

Annual costs associated with this upgrade in SPASAI's operations can therefore be estimated as follows:

	<u>F\$</u>
<b>Secondments</b> fourteen senior staff at F\$85000 per annum	1 190 000
Relocation Costs	126 000
<b>Training</b>	
20 person days per jurisdiction for 14 jurisdictions at F\$2800 per day	784 000
Travel costs (taken to be F\$1000 per travel exercise in an average) for 14 jurisdictions	14 000
Living allowances (taken to be F\$200 per day for 28 days assuming that Senior and Intermediate training is undertaken consecutively) for 14 jurisdictions	78 400
<b>Secretarial Costs</b>	
Executive officer	90 800
Secretary	21 200
Officer operating costs	20 000
<u>Office rental</u>	<u>24 000</u>
<b>Total</b>	<b><u>2 348 400</u></b>

An additional one off charge to equip the office would also be required, say F\$20 000.

## **B. Phase 2: Establishing a Federation of Offices of Auditor Generals. A Convergence of Institutional Expatriates**

A federation of OAG's might reasonably be considered when convergence of the offices standing as instruments of governance is achieved and a common system of accounting adapted. At this point staff could move from one jurisdiction to another without their effectiveness being limited by having to operate in a context different to that which they are used to. This is not to suggest that institutional capacities will converge at the same time or the

same rate as operating environments. The current capacities of OAGs in the different jurisdictions vary drastically. The OAG in Fiji Islands is perhaps the best resourced of the region's auditor generals. It succeeds in completing the most troublesome of audit exercises within eight months. Audits in other jurisdictions may take more than a year to complete.

Fiji Island's OAG reports that 92% of the audit staff hold a relevant first degree qualification, at a minimum. 14% of staff in this office are studying to secure further academic and/or professional qualifications. Staff in this jurisdiction are required to complete a minimum of 30 hours continuing professional development work per annum. All audits are currently conducted per annum, with 29 contracted out. The office in question conducts compliance and risk management audits. Audits are completed on a reasonably timely basis, completion times being between four to eight months.

However, while environmental audits and value for money audits are part of the office's scope of work, Parliament has yet to determine a commencement date for these activities. Implementation of these responsibilities will inevitably require additional resourcing and substantial training.

At the other end of the spectrum OAG's exist in the region which have one or two staff members with a degree or profession qualification only. (One French territory reports that the equivalent office is staffed only with paraprofessionals.) Employment carries no professional development requirement and no staff members are undertaking advanced studies. In some cases audits take in excess of twelve months from balance day to complete.

Clearly if the relatively well resourced office does not currently carry out the full range of audit functions it cannot be regarded as having more than the minimum acceptable resourcing. Clearly considerable inputs have to be made in other jurisdictions to provide an effective OAG.

While training programmes provided under phase I should do something to address the disparity in institutional capacities, these can be expected to persist when the convergence of operational environments have been achieved. Phase 2 would continue with the secondment arrangements, which may even grow under a federal arrangement. A federation of OAG's should serve to address the issue of institutional capacities. A formal federation of offices may be established by strengthening SAPSAI, or by superseding it by establishing a new institution. If the latter option is adopted it is presumed that the federal organisation will subsume the work of SPASAI and therefore require the resources identified in the costing already for phase 1 as well as the costs for additional functions that it will undertake.

The role of the federation could be seen to be:

- (a) Continue training programmes established in phase I.
- (b) Establish resourcing at the national level to enable common operating capacities across jurisdictions
- (c) Consider the merits and drawbacks of establishing a panel of public sector auditors as a single regional entity.

In addressing point (b) it is necessary to consider at what level of operations convergence should be sought.

Given the effectiveness of the operations of the OAG in Fiji Islands its budget may be regarded as providing an initial indicator of the resourcing required to provide an effective public sector audit facility in the region. It must however be born in mind that this level of funding does not resource Fiji Island's OAG to conduct either environmental or value-for-money audits. It should

therefore be regarded as the minimum benchmark in identifying the resourcing required to provided an effective public sector audit facility in the region.

**SUMMARY BUDGET FOR THE OFFICE OF THE AUDITOR GENERAL  
IN FIJI ISLANDS, 2004**

<b><u>Total</u></b>	<b><u>F\$3,281,900</u></b>
Payroll:	
Audit Staff	2,246,626
Non Audit Staff	120,074
Training	50,000
Travel	40,000
Office operating expense other than personnel	735,200
Capital outlays	90,000
<u>Special investigations</u>	<u>Not shown separately</u>

Source: Office of the Auditor General, Fiji Islands (2004)

The ideal, would be reflected by an office, or a federation of offices, which is capable of executing the full range of audit functions efficiently and effectively. Given concerns expressed in many quarters regarding the extent of corruption in the public sectors, (ADB, ibid) resourcing equivalent to that available to an OAG in a developed economy may be required. A summary of the 2004-5 budget for New South Wales OAG may be regarded as an indicator of the desirable level of resourcing for the public sector audit function in the region.

	<b><u>A\$'000</u></b>	<b><u>F\$'000</u></b>
<b><u>Total</u></b>	<b><u>27,714</u></b>	<b><u>37,085</u></b>
Payroll:		
Audit Staff	17,912*	23,784
Non Audit Staff	2,725	3,632
Training	599	899
Travel	283	374
Office operating expense other than personnel	6,195	8,260
Capital outlays	1,048#	1,357
Special investigations	Nil	
<hr/>		
* Financial Report Audit Staff		15,581
Performance Audit (Value for Money) Staff		2,331
# Not included in total expenses		
Exchange rate F\$1 = A\$0.75		

The difference in the minimal acceptable and the ideal capacities are also reflected in the qualitative differences between the staff in the OAG in New South Wales and in Fiji Islands. This is reflected by the qualifications held by the personnel.

<b>Qualifications of Audit Staff</b>	<b>New South Wales</b>	<b>Fiji Islands</b>
Holding a professional qualification and a relevant degree	89 (35%)	6 (9%)
Holding a professional qualification only	92 (37%)	6 (9%)
Holding a relevant Degree only	67 (27%)	49 (74%)
Holding a para Professional Qualification	3 ( 1%)	5 (8%)

Upgrading the quality of staff from within the region's own resources will prove difficult. Fiji Islands of the Forum Island countries has by far the strongest accounting profession, but only had a little over 300 accountants holding a full professional qualification, although there are many more accounting graduates. A qualitative increase in the capacity of the regional OAG's will clearly require introducing expatriate accountants in the short term, notwithstanding the concerted training programme to be put in place in phase I. It is worth noting at this point that USP graduating students in seeking employment regard training opportunities as an important factor in identifying a preferred employer. While their motives may well be to increase their career mobility, rather than out of a sense of professionalism, introducing a higher profile training programme may serve to attract good graduates into the OAG's. Their long-term commitment may be secured by offering better compensation packages than those currently available.

Transposing to a costing from both the minimum acceptable indicator offered by the budget of the OAG in Fiji Islands and the desirable indicator offered by the budget of the OAG for New South Wales is problematic. The collective population of the island states of SPASAI as at 1999 approximates to 6.5 million, which is comparable to the population of New South Wales. Fiji Island's population is a little over 800,000. Adjusting the indicative figures of Fiji Islands by a value of 8.125 and simply accepting the indicative figures for NSW without adjustments to obtain an appropriate costing is simplistic. This does not allow for the size of the economies, or the size of the public sector within the economies. The capacity to contract out audits will also vary from jurisdiction to jurisdiction. While per capita incomes in Forum Island countries are lower than in NSW, the public sector in the island countries will be a relatively larger part of the economy than in NSW. Adjusting the budget of the OAG for Fiji Islands by a factor of 8.125, while simplistic, may therefore be regarded as as good an approximation to a minimum acceptable budget that can be made. This would yield the following summary costing:

<b><u>Total</u></b>	<b><u>F\$26,675,400</u></b>
Payroll:	
Audit Staff	18,235,800
Non Audit Staff	975,600
Training	400,600
Travel	320,500
Other operating expenses	5,972,400
Capital outlays	101,200

An 8.125 fold increase in staff would require a total payroll of 536. This compares with the staffing level at the New South Wales office of 251. A figure of 536 staff in total may be seen as high, but not unrealistically so when the following are born in mind.

- (a) The New South Wales office will be able to enjoy economies of scale that are not to be found in the Forum Island countries.
- (b) In general the NSW office staff are better qualified than those in the Forum Island countries
- (c) The public sector is relatively larger in the Forum Island countries than in New South Wales.

A real problem with regard to the Forum Island countries capacity to utilize such a budget can be expected to persist simply because the required number of accountants are not available in the local market. Providing resources to even the minimum acceptable level to the OAGs may well prove impossible unless non-regionals are recruited. As has already been noted such personnel will require premium salaries to attract them. These additional costs may be broadly offset by accepting a total payroll of less than the 536 staff indicated.

The training element in the costing as stated above would also prove to be lamentably inadequate as this has been demonstrated in the costing for an upgrading of SPASAI in phase I.

The issue of employee retention also needs to be addressed. The OAG in NSW lost 26 of its current staff base of the last three years to retirement or movement to other employment. The loss in the Fiji Islands office was 33%. Given the demographics of NSW and Fiji Islands a greater proportion of the staff losses would be due to retirement than in Fiji Islands. The lower staff retention in Fiji Islands was certainly due in part to staff opting to leave Fiji Islands subsequent to the 2000 political crises and in part to the greater relative shortage of accountants in the economy generating more possibilities for career development by switching employers.

This latter factor can be expected to persist and be found in all jurisdictions. It is reinforced by the regions accountants disposition to migrate to economies which are seen to offer more attractive living and working conditions. To counter this, OAG's must ultimately be in a position to offer a compensation package to staff that is sufficient to limit staff migration to manageable levels. This may well approximate to the terms and conditions currently offered to staff in the OAG in NSW.

The federation's operations would clearly require oversight and direction, particularly with regard to the need to address the issue of establishing a fully integrated regional panel of auditors. SPASAI/Federation administration would require upgrading, with at least one experienced accountant to be appointed to write position/policy papers on issues the federation would have to address. Such an individual might be expected to command a compensation package well in excess of \$100 000. One further secretary at least would be required. Office operating costs

would rise. SPASAI's congress currently meets every second year. A fully fledged federation could be expected to meet annually. Executive meetings would also have to be budgeted for. The costing of a federation's operations will therefore incorporate the following elements:

	<u>F\$</u>
Operations to be established in SPASAI in phase I	2348 400
Operations of national offices within the federation	26 075 400
	to 37 085 000
Additional costs of an expanded federation office	
Policy advisor	F\$120 000
Secretary	21 200
Additional office operating costs	30 000
Additional rental	<u>12 000</u>
	183 200

Costing of a federal system of offices of auditor generals can therefore be anticipated to be in the range F\$29 million to F\$40 million. As the lower end of the range represents the costing for minimum acceptable institutional capacities and costing at the top of the range the ideal operating capacity it may be appropriate to set a budget at the low end of the range initially and move to the upper end as offices demonstrate the ability to increase the range and effectiveness of their operations.

It must be stressed that these costings reflect the totality of the public sector audit operations. They are therefore already funded in part by the Forum Island countries by way of the financial provision they are currently making to the OAG's operations. The cost of implementing this aspect of the Pacific Plan will therefore be the sums indicated above net of the amounts Forum Islands already provide to resource their respective OAG's.

To summarise it would seem inappropriate to recommend a budget for a federation of Forum Island countries OAGs that is less than that derived by adjusting the current budget for the Fiji Islands OAG by 8.125. As capacities are progressively upgraded over time it will become desirable to expand the roles of the OAG and to stabilize the work forces by offering compensation packages comparable to these, which can be secured elsewhere. This will require a resourcing of the order currently available to the OAG in NSW.

### **C. Phase 3: Establishing a Regional Panel of Public Sector Auditors**

In moving to phase 3 it will be necessary to consider whether a regional panel of auditors can achieve more than a federal system, or can achieve the same objectives, more efficiently.

The clear advantages that would seem to present themselves from a regional arrangement are as follows:

- (a) That the independence of the public sector of the audit function from national governments that contribute in part to its funding is strengthened.
- (b) It would seem natural that regional institutions be audited by a regional audit body. If regional institutions are to develop/emerge under the Pacific Plan this may prove to be a significant activity in itself. However it would seem difficult to sustain an argument for a significantly increased budget over and above the upper costing limit of \$40 million

identified for phase 2 on the basis of these two benefits. If there is a desire under the Pacific Plan to set up a regional court of auditors it might be most appropriate to establish a time frame under which this is to be achieved and a financial ceiling to its operations. The analysis offered here suggests that the establishment of a regional panel of auditors should be seen as a medium to long term objective and will require a total budget in the order of \$40 million per annum.

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