



**Report of the  
Controller and  
Auditor-General**  
*Tumuaki o te Mana Arotake*

**on**

**Central Government:  
Results of the  
2000-01 Audits**

Presented to the House of Representatives pursuant  
to section 20 of the Public Audit Act 2001





Rt Hon Jonathan Hunt  
Speaker  
House of Representatives  
WELLINGTON

Mr Speaker

I am pleased to forward this report to you for presentation to the House of Representatives pursuant to section 20 of the Public Audit Act 2001.

Yours sincerely

A handwritten signature in blue ink, reading 'D J D Macdonald'.

D J D Macdonald  
Controller and Auditor-General

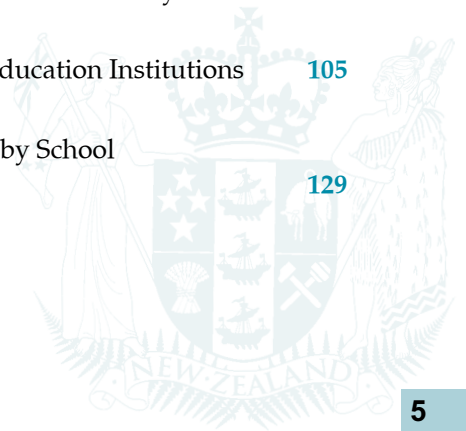
Wellington  
7 December 2001





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# Introduction

This report serves two broad purposes:

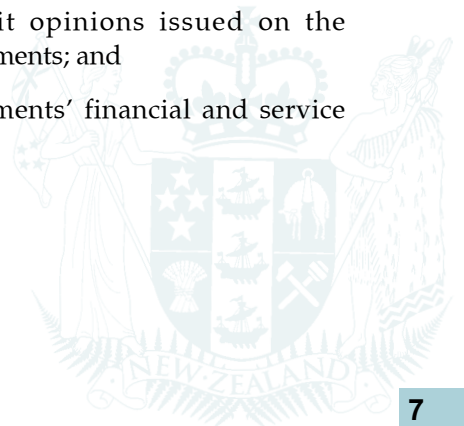
- it constitutes our “annual report” on the audits for 2000-01 of the Crown and its sub-entities – mainly as reflected in the *Financial Statements of the Government of New Zealand for the Year Ended 30 June 2001* (parliamentary paper B.11, 2001); and
- it brings to attention a number of other matters (related both directly and indirectly to events occurring in the financial year 2000-01) that we believe warrant consideration by Parliament.

**Part One** deals with the Government’s *Financial Statements* as audited and presented to the House (pages 9-15). Specific topics addressed include:

- recognition of urban state highways as an asset;
- valuation of student loan debt;
- recognition of certain assets of the conservation estate;
- new financial reporting standards; and
- preparation for full consolidation.

**Part Two** deals with the results of our audits of government departments for the year ended 30 June 2001 (pages 17-26). We include our usual:

- commentary on the audit opinions issued on the departments’ financial statements; and
- assessments of the departments’ financial and service performance management.



The other parts of the report deal with a variety of topics, relating to subject areas such as:

- Parliamentary control of expenditure –
  - **Part Three** on forecasting capital expenditure (pages 27-33);
  - **Part Seven** on accountability for health sector expenditure (pages 69-79); and
  - **Part Eight** on adjustments to appropriations and estimates (pages 81-87).
- Departmental and Crown entity management –
  - **Part Four** on risk management policies and practices in government departments (pages 35-46);
  - **Part Five** on the Accident Compensation Corporation's investment policies and practices (pages 47-61); and
  - **Part Six** on purchase agreements between departmental chief executives and their responsible ministers (pages 63-68).
- Governance and accountability issues affecting the Maori Trustee (**Part Nine**, pages 89-103).
- The financial condition of tertiary education institutions (**Part Ten**, pages 105-127).
- Certain arrangements being entered into by school boards of trustees with professional fund-raisers (**Part Eleven**, pages 129-136).





One

B.29[01b]

# The 2000-01 Audited Financial Statements of the Government





- 1.1 The Audit Office issued its audit report on the Financial Statements of the Government of New Zealand for the Year Ended 30 June 2001 (the *Financial Statements*) on 7 September 2001. This is the same date on which the Treasurer and Minister of Finance, and the Secretary to the Treasury, signed their Statement of Responsibility for the Financial Statements.

## Unqualified Opinion Issued

- 1.2 The audit report appears on pages 18-19 of the *Financial Statements*. The report includes our unqualified opinion that those statements:
- *comply with generally accepted accounting practice; and*
  - *fairly reflect –*
    - *the results of operations and cash flows for the year ended 30 June 2001; and*
    - *the financial position as at 30 June 2001.*
- 1.3 As in previous years, the Treasury has provided a comprehensive commentary on the financial performance and position, which is presented on pages 6-16 of the *Financial Statements*.
- 1.4 In addition to that commentary, we draw attention to the following significant items reflected in the reported results.



## Recognition of Urban State Highways

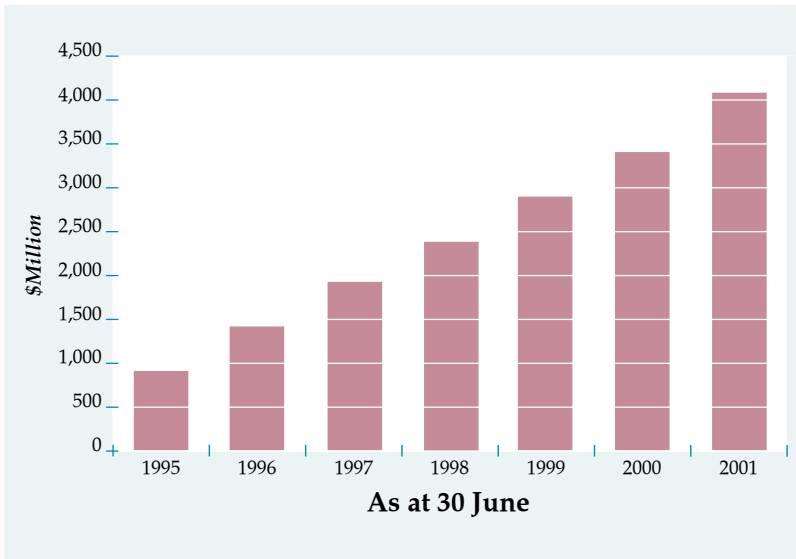
- 1.5 Urban state highways have been recognised in the *Financial Statements* at a depreciated replacement cost of \$1,650 million. This initial recognition (with which we concur) has been made with effect from 1 July 2000 and treated as an adjustment to the opening equity balance in accordance with the transitional provisions of Financial Reporting Standard Number 3: *Accounting for Property, Plant and Equipment* (FRS-3). (See pages 24 and 77 of the *Financial Statements*.)
- 1.6 Before this recognition, urban state highways were not accounted for in the *Financial Statements*, nor accounted for by local authorities. The local authorities' view was that the Crown should have accounted for urban state highways because Transit New Zealand fully funds the state highway network and has control of the asset.<sup>1</sup>

## Valuation of Student Loan Debt

- 1.7 For several years we have raised concerns about the methodology for valuing the outstanding balance of student loan debt.
- 1.8 An inter-departmental working group, including Treasury representatives, has considered this matter recently. While we are pleased to report that some progress has been made, it is disappointing that the work was not fully completed in time for any potential consequential adjustment to be included in the *Financial Statements*.
- 1.9 We understand that this matter will be resolved before 30 June 2002 and a revised methodology will be used as a basis for the financial information in the 2001-02 Financial Statements. It is essential that this milestone is achieved in order to avoid any reconsideration of our audit opinion in 2002.
- 1.10 Outstanding student loan debt is a significant asset for the Crown that has grown rapidly, as illustrated in Figure 1.1 on the opposite page.

<sup>1</sup> We reported on this subject in our *Fifth Report for 1999* (parliamentary paper B.29[99e], pages 13-14) and our report *Central Government: Results of the 1999-2000 Audits* (parliamentary paper B.29[00c], 2000, pages 11-12).

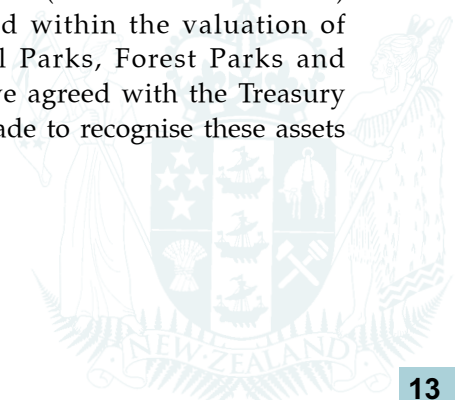
Figure 1.1  
Student Loan Debt 1995-2001



- 1.11 Figure 1.1 above presents student loan debt in net terms, after providing for bad and doubtful debts. Total loans outstanding at 30 June 2001 were \$4,655 million and provisions were \$512 million – giving a net loan asset value of \$4,143 million.
- 1.12 The movement in the debt and further information on the provisions is outlined on page 64 of the *Financial Statements*.

## Conservation Estate

- 1.13 A large number of ‘visitor assets’ (such as tracks and huts) are not currently recognised within the valuation of \$1,507 million for National Parks, Forest Parks and Conservation Areas. We have agreed with the Treasury that an adjustment will be made to recognise these assets as at 30 June 2002.



- 1.14 The transitional provisions of FRS-3 can be used to report the adjustment through the Statement of Movements in Equity – the same approach as for the initial recognition of the urban state highways (see paragraph 1.5 on page 12).

## New Financial Reporting Standards

- 1.15 We reviewed the *Financial Statements* against recently issued financial reporting standards that will apply to the 30 June 2002 financial statements for the first time. The new standards are:

- FRS-3: *Accounting for Property, Plant and Equipment*; and
- FRS-15: *Provisions, Contingent Liabilities and Contingent Assets*.

- 1.16 In relation to FRS-3, we believe that a number of issues need to be resolved – both in the context of FRS-3 and in the adoption of full line-by-line consolidation of SOEs and Crown entities. A review of valuation issues has been in train for some time, but they will now need to be resolved by 30 June 2002 in order to ensure compliance with FRS-3. The issues include:

- the different bases of valuation being applied throughout the Crown reporting entity;
- the new requirement for capitalisation of borrowing costs; and
- valuation of heritage assets.

- 1.17 In relation to FRS-15, before the end of the financial year we carried out a review to satisfy ourselves that individual entities:

- understood the implications of FRS-15 (not just as it pertains to environmental obligations but all provisions, contingent liabilities, and contingent assets); and
- would be in a position to comply with the standard when it takes effect for the financial statements for the year ending 30 June 2002.

- 1.18 As a result of our review, we recommend that proper consideration be given to potential environmental liabilities faced by the Crown. We believe that entities in the Crown estate have given insufficient consideration to this issue. We will now focus particularly on entities that are more likely to have environmental liabilities and we recommend that the Treasury also gives consideration to a similar approach to this problem – which must also be resolved by 30 June 2002.

## Preparation for Full Consolidation

- 1.19 The Financial Statements of the Government will be prepared on a fully consolidated basis for the year ending 30 June 2003. The Budget for 2002-03 will also be prepared on a fully consolidated basis. The Treasury is making good progress in working through the issues arising and establishing the mechanics of how it will be done.







Two

B.29[01b]

# Government Departments – Results of the 2000-01 Audits





## Introduction

- 2.1 This article reports on the results of the 2000-01 audits of 44 government departments.<sup>1</sup> Its purpose is to inform Parliament of the assurance given by the audits in relation to:
- the quality of financial reports; and
  - the financial and performance management of departments.

## Audit Opinions Issued

- 2.2 The Public Finance Act 1989 (the Act) specifies departments' responsibilities in fulfilling the requirements for general purpose financial reporting. Sections 34A(3) and 35(3) of the Act require departments to prepare their financial statements in accordance with generally accepted accounting practice.<sup>2</sup>
- 2.3 The Act also sets out the responsibility of the Audit Office to issue an audit opinion on the financial statements of each department (section 38).
- 2.4 To form an opinion on the financial statements of departments, we conduct our audits in accordance with generally accepted auditing standards together with our own additional standards appropriate to public sector audits. We plan and perform the audits so as to obtain all the information and explanations we consider necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material mis-statements, whether caused by fraud or error. In forming our opinion, we also evaluate the overall adequacy of the presentation of information in the financial statements.

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1 Comprising the 47 Offices of Parliament and Departments listed on page 96 of the *Financial Statements*, excluding the Audit Office (which does not audit itself) and the two Security and Intelligence Departments.

2 "Generally accepted accounting practice" is defined in section 2(1) of the Public Finance Act 1989.

2.5 All of the 44 government departments received audit reports containing an unqualified audit opinion. See Figure 2.1 below.

*Figure 2.1  
Analysis of Audit Opinions 1997-2001*

Year Ended 30 June	2001	2000	1999	1998	1997
Unqualified opinions	44	43	42	44	42
Qualifications regarding statements of service performance	-	-	-	-	1
Qualifications regarding other issues	-	-	-	-	3
<b>Total audit opinions issued</b>	<b>44</b>	<b>43</b>	<b>42</b>	<b>44</b>	<b>46</b>

2.6 This is the fourth successive year of unqualified opinions for all departments – a pleasing situation for all concerned.

## Financial and Service Performance Management

2.7 In 1994, we began reporting our assessments of certain aspects of management to the chief executive and to stakeholders in each department (such as the responsible minister and the select committee which conducts the financial review of the department).

2.8 While conducting the annual audit, our auditors examine aspects of financial management and service performance management. The purpose of this exercise is to identify specific areas of management where there are weaknesses, and to make recommendations to eliminate those weaknesses.

### Financial Management

- 2.9 We assess the following aspects of financial management:
- *Financial control systems* – the systems for monitoring expenditure and the management of assets.
  - *Financial management information systems* – the systems for recording, reporting and protecting financial information.
  - *Financial management control environment* – management’s attitude, policies and practices for overseeing and controlling financial performance.

### Service Performance Management

- 2.10 Aspects of the management of service performance that we assess and report fall into two broad areas:
- *Service performance information and information systems* – This covers the adequacy of monitoring and control systems for service performance information, the accuracy of the information produced by those systems, and whether the performance measures in the statement of service performance are being used as a management tool.
  - *Service performance management control environment* – This covers the existence of quality assurance procedures, the adequacy of operational policies and decisions, and the extent to which self-review of non-financial performance is taking place.



*The Rating System*

2.11 The rating system we use is as follows:

<b>Assessment Term</b>	<b>Further Explanation</b>
<b>Excellent</b>	Works very well. No scope for cost-beneficial improvement identified.
<b>Good</b>	Works well; few or minor improvements only needed to rate as excellent. We would have recommended improvements only where benefits exceeded costs.
<b>Satisfactory</b>	Works well enough, but improvements desirable. We would have recommended improvements (while having regard for costs and benefits) to be made during the coming year.
<b>Just Adequate</b>	Does work, but not at all well. We would have recommended improvements to be made as soon as possible.
<b>Not Adequate</b>	Does not work; needs complete review. We would have recommended major improvements to be made urgently.
<b>Not Applicable</b>	Not examined or assessed. Comments should explain why.



## *The Results*

- 2.12 We assessed management in each of the 44 departments. A summary of the assessments (220 in total – 5 for each department) is given in Figure 2.2 on the next page.
- 2.13 The 85 assessments of “Excellent” (39%) show a continuation of improvement in recent years, and indicate commendable achievement by the departments concerned.
- 2.14 However, the combined total of 186 assessments (84%) that were either “Excellent” or “Good” is almost identical with the previous year. This could indicate that, after marked improvements in 1998-99 and 1999-2000, the standards of management and performance being assessed are approaching a level from which further improvement will be slight.
- 2.15 Four assessments of “Just Adequate” were issued. This was a little disappointing, after there had been none in the previous year. The two assessments relating to Financial Control Systems and Financial Management Control Environment reflect shortcomings that are capable of being remedied quickly. In respect of the other two assessments, relating to Service Performance Information Systems, our auditors have specified what needs to be done to improve these assessments.
- 2.16 We compared our assessments for 2000 and 2001 for each of the 43 departments where the comparison is possible. The overall results for those 43 departments are summarised in Figure 2.3 on page 25.



**Figure 2.2**  
*Summary of Assessments of Aspects of Financial Management and Service Performance Management  
in Departments for 2000-01*

Aspects Assessed	Excellent		Good		Satisfactory		Just Adequate		Not Adequate		Total
	No.	%	No.	%	No.	%	No.	%	No.	%	
FCS	19	43	20	45	4	9	1	2	0	0	44
FMIS	18	41	24	55	2	5	0	0	0	0	44
FMCE	20	45	17	39	6	14	1	2	0	0	44
SPIS	10	23	21	48	11	25	2	5	0	0	44
SPMCE	18	41	19	43	7	16	0	0	0	0	44
<b>Totals</b>	<b>85</b>	<b>39</b>	<b>101</b>	<b>46</b>	<b>30</b>	<b>14</b>	<b>4</b>	<b>2</b>	<b>0</b>	<b>0</b>	<b>220</b>
2000	74	34	107	50	34	16	0	0	0	0	215
1999	52	25	115	55	42	20	1	0	0	0	210

**Key**

- Financial Control Systems
- Financial Management Information Systems
- Financial Management Control Environment
- Service Performance Information Systems
- Service Performance Management Control Environment



*Figure 2.3*  
*Assessments for 2001 Compared to 2000*

Aspects Assessed <sup>1</sup>	Higher	Same	Lower	Total
FCS	5	37	1	43
FMIS	6	35	2	43
FMCE	5	37	1	43
SPIS	4	35	4	43
SPMCE	3	39	1	43
<b>Totals</b>	<b>23</b>	<b>183</b>	<b>9</b>	<b>215</b>
%	11	85	4	100

1 See Figure 2.2 for key to abbreviations.

2.17 The noteworthy features of the results shown in Figure 2.3 are:

- A significant majority (85%) of the assessments were maintained at the level of the previous year. This mirrors the virtually unchanged proportion of assessments that were either “Excellent” or “Good” referred to in paragraph 2.14 on page 23.
- 23 of the assessments (11%) were higher in 2001 than in 2000.
- 9 of the assessments (4%) were lower than in 2000.

2.18 The fact that 23 assessments got better in the 2000-01 year compared with 9 that were lower points to overall improvement in departments. As we observed last year, the ongoing trend to higher assessments restricts the scope for improvements of the same magnitude as previously.

2.19 The theoretical possibility of all departments attaining an assessment of “Excellent” for all aspects assessed, for a variety of reasons, is a practical impossibility. Such reasons may include:

- periodic restructuring;
- complexity of departmental operations; and
- sheer size of operations.

- 2.20 Our auditors will nevertheless be continuing to assist and encourage departments to make improvements, through recommendations made in management letters. For their part, chief executives and their staff will no doubt be motivated to continue striving for improvements.
- 2.21 We have now reported our assessments of management performance to Parliament and its select committees for each of the past eight years. Our assessments have often been of considerable interest to select committees when conducting their financial reviews of departments.
- 2.22 Departments vary greatly in terms of size and organisational structure. When we first reported results of the assessments to select committees, we took care to alert committees to those differences and urged them not to make comparisons between departments without being mindful of considerations (such as those mentioned in paragraph 2.19 on page 25) which could explain reported differences in performance. Caution should continue to be exercised in using the assessments.



Three

B.29[01b]

# Forecasting Capital Expenditure



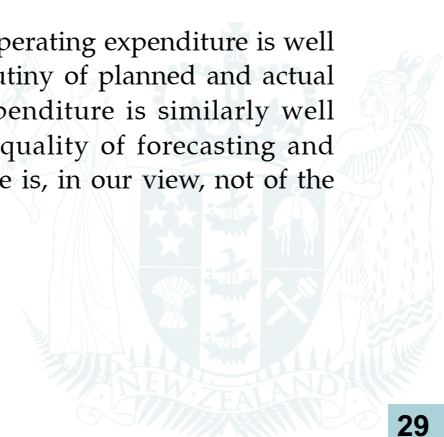


*For several years, we have expressed the view that Parliament needs better information about demands and forecasts for capital expenditure.*

*Demands for capital expenditure continue to grow – with changing demographics, ageing or obsolete equipment and the impact of new technologies. In addition, the Government is making strategic investment decisions – which involve new capital needs.*

*Effective parliamentary scrutiny of capital expenditure forecasts will only be achieved when the Government improves the scope and reliability of its long-term financial planning for capital.*

- 3.1 The Public Finance Act 1989 currently refers to seven different categories of expenditure, which comprise operating expenditure and capital expenditure.
- 3.2 **Operating Expenditure** consists of expenditure on:
- outputs;
  - benefits and other unrequited expenses;
  - borrowing expenses; and
  - other expenses.
- 3.3 **Capital Expenditure** consists of expenditure on:
- capital contributions;
  - purchase or development of capital assets; and
  - repayment of debt.
- 3.4 The quality of forecasting for operating expenditure is well developed. Parliamentary scrutiny of planned and actual performance of operating expenditure is similarly well developed. By contrast, the quality of forecasting and reporting of capital expenditure is, in our view, not of the same standard.



3.5 We have commented on the quality of capital forecasting on three occasions recently:

- *Third Report for 1999: The Accountability of Executive Government to Parliament*<sup>1</sup>

In that report we advocated the need for better information on capability expenditure and risk and risk management. We defined capability expenditure to be that which the Government must incur in order to establish or extend an entity's ability to produce outputs.

- *Central Government: Results of the 1999-2000 Audits*<sup>2</sup>

In that report we said that, in order for Parliament to properly consider appropriations for defence capital equipment, it needs information about:

- the capability of the New Zealand Defence Force – especially in relation to its capital equipment needs;
  - the fiscal risks attaching to capital equipment purchases; and
  - the funding requirements (in the form of appropriations) to pay for the purchases.
- *Ministry of Defence: Acquisition of Light Armoured Vehicles and Light Operational Vehicles*<sup>3</sup>

In that report we stated that the Defence Planning System (DPS – which underpins planning of defence capability) needs improvement. An output of the DPS is the Defence Long-term Development Plan, which in turn results in 5-, 10- and 20-year estimates of capital expenditure.

1 Parliamentary paper B.29[99c].

2 Parliamentary paper B.29[00c], 2000.

3 August 2001, ISBN 0 477 02883 7.

## The Crown's Competing Demands for Cash

3.6 All expenditure – whether operating or capital – requires funding. The various means of funding available to the Government are:

- operating revenues –
  - direct and indirect taxation;
  - interest;
  - profits and dividends from SOEs and Crown entities; and
  - sales of goods and services;
- proceeds of asset sales;
- domestic or foreign debt financing; and
- off-balance-sheet financing – lease deals for capital assets.

3.7 Since 1994, there has been a consistent pattern of fiscal surpluses which, together with the proceeds of asset sales, have enabled the Crown to fund both capital acquisitions and the repayment of debt (resulting in a declining net debt position).

3.8 This pattern seems likely to change. Pressures on the Government's operating expenditure remain as strong as always, but a range of capital expenditure requirements<sup>4</sup> is now apparent. Some examples are:

- new prisons;
- changing demographics and new technologies affecting health and education;
- new transport infrastructure – particularly roads, but now also railways;
- capital equipment to meet the Government's new defence priorities;
- building an innovative society – e.g. the Government's new \$100 million venture capital fund and funding e-government initiatives;

4 For which appropriations will be needed to the first two categories listed in paragraph 3.3.

- refinancing Housing Corporation of New Zealand and District Health Board debt from the private sector to the public sector;
- contributions to the Government's proposed New Zealand Superannuation Fund;
- student loans; and
- investing in Air New Zealand Limited.

3.9 These examples contain a number of common threads:

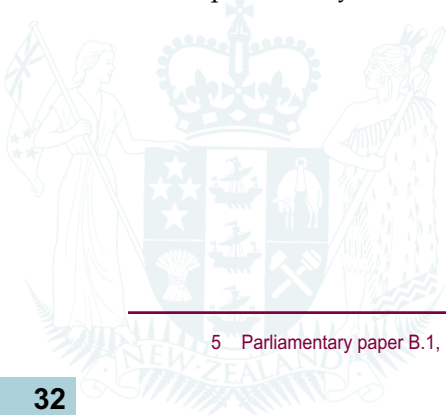
- responding to changing demographics;
- replacing old or obsolete equipment;
- the impact of new technologies; and
- strategic investment decisions by the Government.

3.10 In order to fund these capital demands, the Crown is reliant on cash from either:

- operating cashflows;
- borrowing; or
- asset sales.

3.11 Alternatively, the Crown may consider leasing or other private sector financing arrangements for the provision of assets or services.

3.12 The 2001 *Budget Policy Statement* states that *there are a number of issues we need to address to improve the Government's framework for capital expenditure decisions*.<sup>5</sup> We also acknowledge that the Treasury has undertaken preliminary work to address these issues.



<sup>5</sup> Parliamentary paper B.1, 19 December 2000, page 8.



- 3.13 However, in our view, Parliament needs better information on these emerging capital expenditure needs and the options available to fund them (particularly to the extent that funds are not available from accumulated depreciation). In order to achieve this, there need to be more comprehensive and reliable forecasts of capital requirements, so that Ministers have the information on which to base choices. This will necessarily require enhanced long-term financial planning capability (with an emphasis on capital), which in our view requires a central initiative as the most realistic means of achieving progress.
- 3.14 Capital expenditure provisions in the Budget have been increasing over the last three years. While some information on the emerging pressures for capital expenditure is presented in the Budget, we believe there should be better linkage between these pressures and the amounts provided for capital expenditure. The competing demands for capital invariably result in trade-offs being made – which are the prerogative of the Government. However, we see potential for Parliament to be also better informed – in terms of future demands and actual trade-offs made.





Four

B.29[01b]

# Risk Management Policies and Practices





*The quality of risk management varies between government departments and (generally) needs to improve. Some departments have not identified the scope of their risks to encompass the full range of stakeholders and breadth of issues.*

*Departments are experiencing practical difficulties in communicating within their organisation the need to be aware of risks, and in monitoring and managing risks. Balancing risk and innovation takes careful management. As discussed at the recent Public Service Senior Managers' Conference, departments need to be 'risk aware', not 'risk averse'.*

## Background

- 4.1 The management of risk in government departments is of critical importance to the Government. In our 1999 report *The Accountability of Executive Government to Parliament*<sup>1</sup>, we identified the need for departments to provide better information on risks and risk management to Parliament.
- 4.2 Earlier – in 1997 – to promote risk management by government departments the State Services Commission (SSC) developed a set of expectations based on the risk standard AS/NZS 4360. The SSC communicated these expectations to departmental chief executives in a June 1997 document entitled *Responsibility and Accountability Standards Expected of Public Service Chief Executives*.
- 4.3 As part of our 2000-01 annual audit of government departments, we asked each department six questions (based on the SSC letter) relating to their current risk management policies and practices, with the aim of:
- obtaining a stock-take of departments' risk management policies and practices; and
  - assessing the extent to which departments had met the expectations set out by the SSC.

1 *Third Report for 1999, parliamentary paper B.29[99c]*.

## What We Asked

- 4.4 We asked each of 44 departments whether:
- it had a current risk management policy statement issued by the Chief Executive;
  - the need for awareness of risks and risk management was incorporated into regular communication with all staff in the department;
  - risk management was integrated within strategic and operational planning and decision making throughout the department;
  - it adopted a positive and forward-looking approach to risk management which involved identification and ongoing review of risks;
  - it had a communications framework – comprising strategies for consultation and communication with different stakeholders; and
  - its senior management reviewed the risk management policy.

## Current Chief Executive Risk Management Policy Statement

- 4.5 Of the 44 departments:
- 37 had a current risk management policy statement signed by the Chief Executive;
  - 6 had no such policy statement; and
  - 1 had a “draft” that was not yet finalised.
- 4.6 The 37 policy statements varied widely in scope. One of the more exhaustive was 34 pages long and included:
- definitions of risk and risk management;
  - key elements of the risk management framework;
  - the categories of risk;
  - the ownership of risk management;

- a process for identifying risks;
  - a risk response strategy; and
  - a summary of roles and responsibilities.
- 4.7 By contrast, another policy statement simply recorded the Chief Executive's commitment to reducing risk.
- 4.8 Financial risks were the most common type of risk covered, but that was not always the case. For example, one statement covered strategic, operational, financial, infrastructure, human resource, reputational, and political risks. At the other extreme, one policy statement was limited to reducing the risk of injury and loss to personnel, visitors, and the department itself.
- 4.9 Departments obtained commitment to their policy statements in varying ways:
- Most commonly, the Chief Executive signed the statement.
  - One Chief Executive required all General Managers to also sign the statement.
  - In another instance, responsibility was delegated to General Managers to develop their own risk management policy statements that were then incorporated into their performance agreements.
- 4.10 There was no universal form for the statements. Some were separate documents; some were incorporated in business plans or in strategic documents; and at least one was included in documents articulating the role and values associated with the department.
- 4.11 There was also variation in how frequently departments reviewed the policy statement. Some were reviewed every year and many were subject to biennial reviews. In some cases the statements had become outdated because they had never been reviewed.

### 4.12 In summary, we found that:

- most government departments had a policy statement on risk management;
- the scope of the statements varied, as did the risks covered;
- Chief Executives used various ways to obtain wider commitment to the statements;
- there was no universal form of policy statement; and
- there were varying degrees of review of the statements.

4.13 Clearly, departments generally need to put more effort into developing a comprehensive and broadly based risk management policy statement.

## Risk Management Culture

4.14 We were interested to find out departments' views on whether:

- they had established a risk awareness culture;
- risk management was a feature of regular communication with staff;
- and, if so, to what extent, they had developed a sense of commitment to staff managing risks – including raising awareness of risks and risk management.

4.15 All departments said that they had established a culture of risk management, but some identified impediments to the establishment of such a culture:

- individual employees were sometimes reluctant to take responsibility for risks and to embrace the risk management concept;
- establishing an appropriate culture was more difficult in larger departments – suggesting that larger departments need to work harder to establish the appropriate culture;
- it was sometimes difficult to get employees to concentrate on non-financial risks; and



- it was hard to get employees to concentrate on risks that they may not be directly responsible for, but that could adversely affect the department.
- 4.16 Departments agreed that regular communication of risks and risk management processes was important, and they used a variety of means to do so – including through:
- an intranet;
  - project briefings and de-briefings;
  - branch/division meetings;
  - senior management briefings;
  - monthly reports; and
  - targeted risk management training.
- 4.17 However, communication was not always reliable in practice. For example, one department posted risk management policies and procedures on its intranet but not all employees read and/or applied them.
- 4.18 Other problems we observed were:
- communication of risk was limited to senior managers and managers, with other staff having only a compliance role;
  - communication did not always filter downwards and was not always reliably transferred upwards;
  - systems were not always in place to consolidate risks; and
  - there was no co-ordination of risks across groups within the department.
- 4.19 **In summary, we found that:**
- **departments believed that they had established a culture of risk management, but that there were some impediments to the establishment of such a culture; and**
  - **departments communicated risks by a variety of methods – which cannot be assumed always to be reliable.**

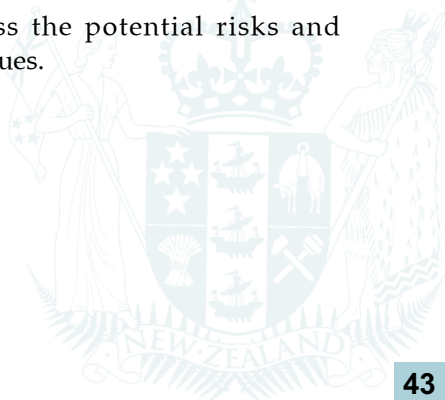
### Positive Approach to Risk Management

- 4.20 All but two departments said that they adopted a positive approach to risk management.
- 4.21 There were clearly varying degrees of development in departments' approaches to managing risks. For example, one department:
- undertook an annual risk management exercise that included describing the risk, establishing the means to manage the risk, and assessing the probability of the risk occurring and the potential impact on the department's business; and
  - produced quarterly monitoring reports for the management group and identified new risks during the year as they arose or were identified.
- 4.22 One department had no formal process for identifying, monitoring and managing risks.
- 4.23 Three other trends were apparent. First, risk identification was generally a department-wide exercise. This occurred in a variety of ways – including:
- business unit meetings;
  - project reviews;
  - strategic and annual planning exercises;
  - department-wide risk assessment;
  - communication plans; and
  - regular updating of risk registers.
- 4.24 However, it was clear that not all risks were considered or reviewed. For example, some departments limited risk reviews to risks associated with particular projects, and others limited reviews to financial risks.
- 4.25 Secondly, there was an increasing use of audit and risk committees and corporate and assurance boards to oversee the strategic monitoring of risks. This was not always the case, with some departments devolving this responsibility to discrete business units.

- 4.26 Thirdly, some of the larger departments have dedicated risk managers to monitor and manage risks.
- 4.27 In summary, we found that:
- departments believed they adopted a positive approach to risk management;
  - some departments had well-developed processes to manage risks;
  - risk identification was generally a department-wide exercise; and
  - there was an increased use of specialists to identify risk and oversee risk management.

## Risk Management Communications Framework

- 4.28 Departments had a communications framework that comprised strategies for consultation and consultation with different stakeholders. Internal stakeholders and the Responsible Minister were seen as the two most important stakeholders, but stakeholders were not limited to these two. Other stakeholders mentioned were external agencies and the wider community.
- 4.29 Departments saw clear advantages in having an effective risk communications framework, including:
- strengthening relationships;
  - mitigating a particular risk;
  - obtaining a better understanding of the risks; and
  - being able to better assess the potential risks and opportunities in strategic issues.



4.30 There was clear focus on having a specific communications framework for major projects. This was seen as a key strategy which supported the underlying project and allowed the department to:

- address issues of concern that its staff had about the project; and
- deliver to those concerned about the project the key messages of the organisation.

4.31 It was also noteworthy that at least one department had established a communications planning group to co-ordinate the risk communications strategy.

4.32 Problems identified with communications strategies were:

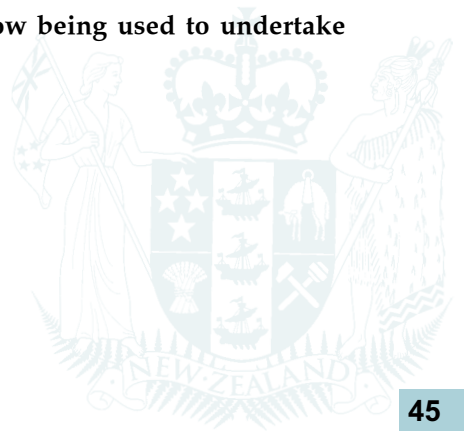
- internal communication on risks was not always effective – risk notification did not always flow up or down in the department;
- internal and external communication was not always co-ordinated;
- inconsistency existed between the communication strategy and actual implementation; and
- communications were not always consistent with the department's goals.

4.33 **In summary, we found that:**

- **many departments had a risk communications framework;**
- **there was a clear focus on having a communications framework for specific projects; and**
- **some problems with communications strategies existed that may undermine the effectiveness of the communication.**

## Senior Management Review of Policies

- 4.34 We were interested to know whether senior management regularly reviewed risk management policies to ensure the policies' effectiveness.
- 4.35 All departments except one said they carried out regular review of policies. However, some departments indicated that, although they had implemented risk management policies, they had not formally reviewed them.
- 4.36 Review processes took many forms – including:
- reviews by the senior management team at regular intervals throughout the year;
  - reviews as part of business or strategic planning;
  - reviews by an internal auditor or designated risk manager; or
  - reviews by audit and risk committees and/or advisory boards.
- 4.37 The advisory board concept is an interesting one. For example, its role is to assist the chief executive to ensure that the department's risk management policies are operating effectively. The board provides an ongoing review mechanism as to the effectiveness of the risk management policies.
- 4.38 **In summary, we found that:**
- **departments generally reviewed their risk management policies and procedures as well as regularly updated their risk profiles; and**
  - **specialised bodies were now being used to undertake the reviews.**



### Conclusions

4.39 Asking the questions was a useful exercise in that it allowed us to obtain a better understanding of how departments were approaching risk management. The answers showed that:

- Risk management practices varied between departments. Some (but not many) departments had extremely well-developed risk management strategies and plans, whereas others carried out very little risk management.
- Some departments are making more use of specialised boards and managers to monitor their risk profile and strategies – such as audit committees, advisory boards, and risk managers. However, other departments manage risk on an unstructured or informal basis.
- Generally, in our opinion, departments need to do more to develop their risk management strategies and to manage their risks.



# Accident Compensation Corporation – Investment Policies and Practices







*This article describes the arrangements under which ACC manages its investments.*

*ACC's investments earned \$223 million of income in 2000-01, and ACC had \$3,400 million invested as at 30 June 2001. The amount of investments is expected to increase significantly over the next few years (to over \$8,000 million) as ACC moves to fully fund its long-term claims liabilities.*

*It is important that:*

- *the risks associated with ACC's management of its funds are mitigated;*
- *the Responsible Minister is fully informed of the funds' performance and any policy changes; and*
- *the ACC Board explicitly acknowledges the Crown's interests.*

*Sound arrangements are currently in place to ensure that this happens.*

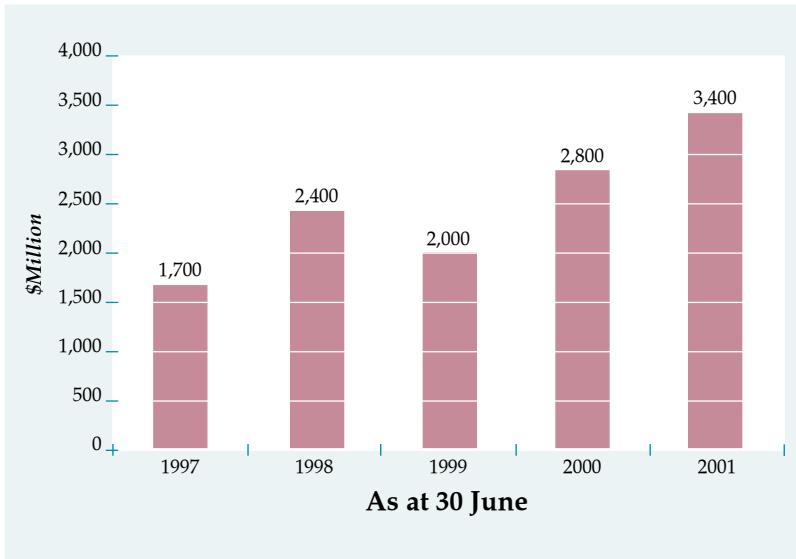
## How Much Is Invested

### Current Investments

- 5.1 As at 30 June 2001, the Accident Compensation Corporation (ACC) had \$3,400 million worth of investments, and it generated \$223 million of investment income (after investment expenses of \$4 million) during the year to that date.
- 5.2 Figure 5.1 on the next page shows the growth in ACC's investments over the last five years.



Figure 5.1  
Total Investments 1997–2001



5.3 Figure 5.1 shows that investments have increased from \$1,700 million at 30 June 1997 to \$3,400 million at 30 June 2001. The decrease in 1999 was due to closure of the Employers' Account for 12 months as a result of the Accident Insurance Act 1998 that removed ACC from the provision of accident insurance in the workplace.

### Future Growth

5.4 ACC's investments are expected to increase significantly over the next 10 years – to over \$8,000 million. There are three reasons for this projected increase:

- ACC cover is a time-related form of insurance. That is, rather than paying all claims out as lump sums, many claims result in payments over future years – for example, rehabilitation, medical care, and earnings replacement costs. Accordingly, ACC premiums cover the costs of an accident in the year it occurs and the future costs arising from the accident. ACC invests the proceeds of premiums not immediately required to help fund those future costs.

- ACC now collects sufficient premiums each year to pay for all costs associated with injuries – regardless of whether the costs of the injury are incurred in the short or long-term. This is known as a fully-funded regime.
- ACC is collecting a residual levy to bring the previous schemes to a fully-funded position by 2014.

## Comparative Fund Size

5.5 The amount of ACC’s investments is comparable with other major New Zealand institutional investors, as shown in Figure 5.2 below.

*Figure 5.2  
Comparable Institutional Investors*

Institution	Total Investments \$million
AMP Henderson	9,500
Tower Asset Management	5,000
Armstrong Jones	4,000
<b>ACC</b>	<b>3,400</b>
AXA Insurance	3,100
Bank of New Zealand	2,500
Bankers Trust	2,400
Arcus Investments	1,800

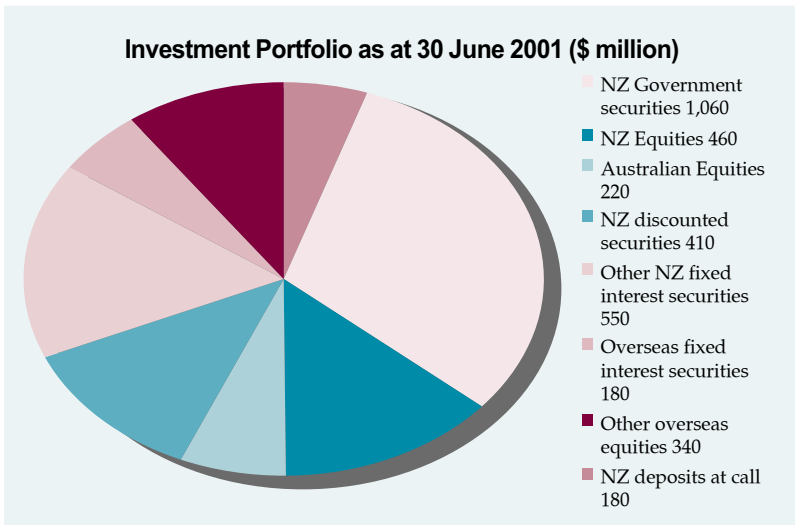
Source: ACC



## Where the Funds Are Invested

5.6 Figure 5.3 below sets out where ACC has invested its funds.

*Figure 5.3  
Investment Portfolio*



5.7 Compared to other institutions, ACC invests a larger portion of its funds in New Zealand investment markets. ACC's 2000-01 Annual Report (page 71) cites four reasons for this approach:

- New Zealand investment markets match ACC's claims liabilities better than offshore markets (i.e. New Zealand domestic bonds and equities are more sensitive to New Zealand interest rates than offshore investments and provide a better natural hedge to ACC's claims liability).
- Internal management and custody costs of ACC's New Zealand investments are lower than management and custody costs for offshore investments.
- ACC expects slightly greater long-term returns from New Zealand markets than from offshore (due to higher yields).

- ACC has greater confidence of outperforming market benchmarks in the New Zealand market than offshore.

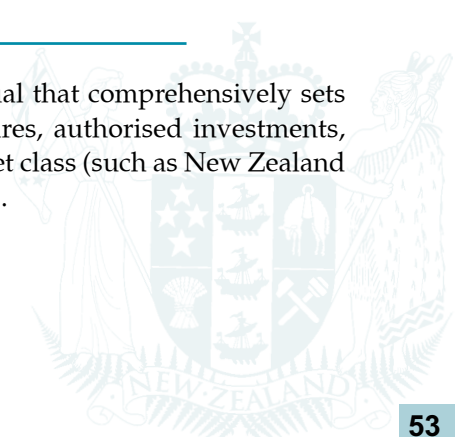
## How Investments Are Chosen

### *Liquidity and Reserve Accounts*

- 5.8 ACC chooses investments to meet both short and longer-term liquidity requirements.
- 5.9 Funds of the Liquidity Account are for short-term cash flow requirements and are invested in a cash portfolio. Funds not expected to be required in the short-term (i.e. to meet the future costs of claims) are held in Reserve Accounts and are invested in reserves portfolios.
- 5.10 From 1999, ACC changed from having one reserve account for all funding accounts (Motor Vehicle, Earners, Residual, Self-employed, Employers, and Medical Misadventure) to a dedicated reserve account for each funding account.
- 5.11 Investments chosen for the Reserve Accounts are tailored to the specific future funding requirements of the related funding account. For example, ACC can take into account the different funding positions, different projected growth rates, and different claims liability characteristics of the funding account when making investment decisions. In this way, ACC aims to match the future income and liabilities of each funding account.

### *Choosing Individual Investments within an Asset Class*

- 5.12 ACC has an Investment Manual that comprehensively sets out the objectives, risk measures, authorised investments, and dealing limits for each asset class (such as New Zealand equities or Australian equities).



- 5.13 For example, the objective of the ACC manager responsible for managing the New Zealand equity portfolio is to match or better the performance of the NZSE-40 Gross Index. The Investment Manual also sets out a series of rules within which the New Zealand equity manager must make investments.

## The Returns from Investment

- 5.14 Given that investment markets are volatile and unpredictable, ACC's practice is not to set a specific monetary level of return on investments. Rather, relative performance is measured by reference to a recognised market benchmark.
- 5.15 Broadly, a market benchmark gives a nominal return for a selected group of investments. The aim of the fund manager is to match or better the returns achieved by the market benchmark. For example, ACC measures actual returns of the New Zealand equity portfolio by reference to the NZSE-40 Gross Index benchmark.
- 5.16 Figure 5.4 on the opposite page sets out ACC's investment returns measured against the relevant benchmarks.
- 5.17 ACC's investment returns have generally exceeded benchmark rates of return.
- 5.18 ACC's target was to achieve at least benchmark rates for returns for 2000-01 and for the average of the previous three years. Returns exceeded target for nine out of ten benchmarks for the current year, and for six out of eight benchmarks for the average of the last three years.
- 5.19 Of note are ACC's returns on the New Zealand equity portfolio. In 2000-01 the New Zealand equity portfolio returned 17.72%, exceeding the market benchmark of 4.92%. The portfolio also returned an average of 19.84% for the previous three years compared to the market benchmark of 6.6%.
- 5.20 ACC attributes that performance to holding higher-than-index weights in companies that performed better than the NZSE-40 Gross Index, and holding lower-than-index weights in companies that performed worse than the NZSE-40 Gross Index.

Figure 5.4  
Returns from Investments

	2000-01			Average 1998-99 to 2000-01		
	Return %	Benchmark %		Return %	Benchmark %	
NZ Cash Portfolio	6.91	6.69	✓	6.22	5.70	✓
NZ Equity Portfolio	17.72	4.92	✓	19.84	6.60	✓
Australian Equity Portfolio	11.89	10.04	✓	n/a	n/a	
Reserves Cash	6.70	6.63	✓	5.69	5.64	✓
NZ Bonds	8.11	7.09	✓	7.31	6.02	✓
NZ Listed Property	14.39	11.61	✓	n/a	n/a	
NZ Index Linked Bond Portfolio	10.41	10.78	x	6.43	6.65	x
Offshore Bonds	11.60	10.41	✓	6.22	6.95	x
Offshore Equity – Developed	(10.48)	(13.74)	✓	7.71	5.36	✓
Offshore Equity – Emerging	(4.62)	(13.22)	✓	11.94	10.48	✓

✓ = Actual return has met or exceeded ACC's benchmark rate of return.

x = Actual return was less than ACC's benchmark rate of return.

n/a = not applicable

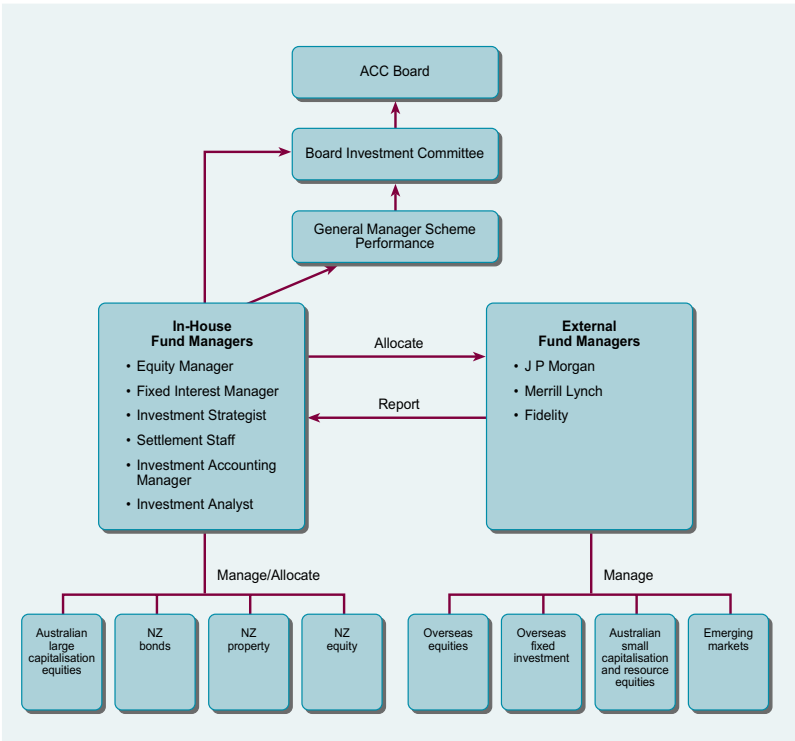
The source for the data is ACC's 2000-01 Annual Report.

## Managing the Investments

### *Management Structure*

5.21 Figure 5.5 below shows ACC’s internal and external investment management structure.

*Figure 5.5  
Investment Management Structure*



5.22 ACC’s in-house investment unit directly manages its investments in New Zealand investment markets. An equity manager is responsible for the \$466 million New Zealand share portfolio, while a fixed interest manager is responsible for the New Zealand fixed interest portfolios worth \$2,100 million.



- 5.23 An investment strategist provides advice on benchmark asset allocation (what amount of funds should be invested in New Zealand equities, New Zealand bonds, overseas equities, or other securities) and allocates funds within a range around these benchmarks.
- 5.24 ACC cites the following reasons for managing its New Zealand investments in-house:
- it has sufficient economies of scale to achieve a lower internal management cost than would be charged by external fund managers;
  - internal management ensures that the investment process is closely aligned with ACC’s investment objectives, rather than the business objectives of an external fund manager; and
  - there is no reason why ACC should not be able to at least match the performance of external fund managers, so long as high-quality staff can be employed.
- 5.25 ACC does not have the necessary expertise to manage non-Australasian investments, so it gives the job to overseas sector specialists. For example, ACC has contracts with:
- J P Morgan and Co, and Fidelity and Co, to manage overseas equity investments; and
  - Merrill Lynch Mercury Asset Management, to manage overseas fixed interest investments.
- 5.26 Australian equity investments are managed by a combination of in-house investment staff (who are responsible for investments in large capitalisation companies in the industrial sector) and external fund managers (who are responsible for investments in small capitalisation companies and companies in the resources sector).



### *How External Fund Managers Are Selected and Reviewed*

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- 5.27 ACC selects external fund managers based on its assessment of who is most likely to achieve the best returns for any type of investment.
- 5.28 External fund managers are reviewed every two years. The review covers:
- the achieved returns relative to the appropriate benchmarks and a comparison to other comparable managers;
  - an outline of the decision-making process of the manager; and
  - an update on the investment methodology of the manager, including an attempt to ascertain whether ACC's performance and positions have been consistent with the stated investment strategy.
- 5.29 In addition to these two-yearly reviews, an external fund manager is reviewed whenever its ownership changes, senior managers leave, or the portfolio it manages underperforms over a four-quarter period.

## Governance

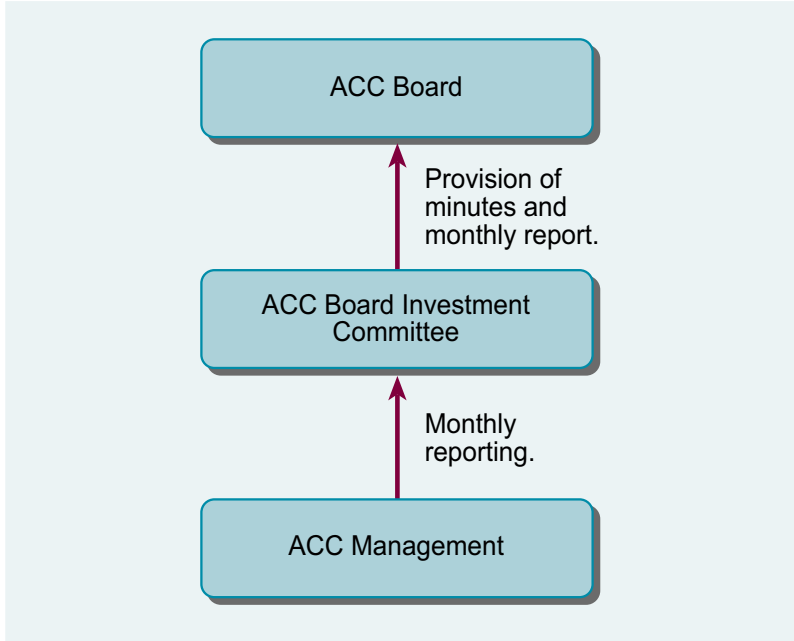
- 5.30 Figure 5.6 on the opposite page shows ACC's internal reporting and governance arrangements.

### *Board Oversight*

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- 5.31 ACC's Board of Directors has established an Investment Committee (comprising a number of members of the Board) and delegated certain responsibilities to the Committee. The Investment Committee's primary responsibilities are:
- setting investment strategy;
  - monitoring and reporting on fund performance;
  - setting and monitoring trading limits; and
  - appointing managers, bankers and consultants.
- 5.32 The Investment Committee meets monthly and provides its minutes to the ACC Board. There is a standard ACC Board agenda item covering the investment of funds.

Figure 5.6  
*Internal Reporting and Governance Arrangements*



### *Reporting to the Investment Committee*

5.33 ACC managers provide the Investment Committee with the following information each month:

- investment activity report;
- investment portfolio as at the end of the month;
- details of daily exception reports;
- monthly performance figures;
- transaction summary;
- brokerage figures; and
- any other significant matters.

5.34 The investment unit produces a daily compliance report, and any breaches of the Investment Manual are immediately reported to the Chief Executive and the Chairperson of the Investment Committee.

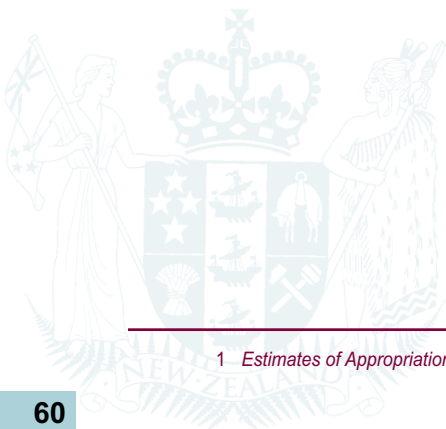
## Reporting to the Department of Labour and the Minister of Accident Insurance

5.35 For 2001-02, Parliament is being asked to appropriate \$3.438 million to enable the Department of Labour to provide the Minister of Accident Insurance with policy advice, analysis, evaluation, research, monitoring, and purchase advice in respect of the ACC.<sup>1</sup>

5.36 ACC provides both financial and non-financial information to the Department of Labour on a monthly and quarterly basis.

- Monthly financial information on funds management includes:
  - year-to-date net investment income;
  - performance (for the month and the year to date) of particular investments classes (New Zealand equities, NZ bonds, etc); and
  - brief explanations clarifying any trends or variations.
- Quarterly reports (required under the Service Agreement with the Minister of Accident Insurance) provide further detail about ACC's funds management.

5.37 The Department of Labour reports quarterly to the Minister of Accident Insurance, summarising the information provided by ACC. This information is usually limited to a description of how investment returns compare to their relevant benchmarks over a one-year and a three-year period.



<sup>1</sup> *Estimates of Appropriations*, parliamentary paper B.5 Vol.1, page 10.

## Our Overall Observations

- 5.38 ACC's investments are a significant asset of the Crown. The funds will continue to increase over the next ten years (from \$3,400 million to, perhaps, over \$8,000 million) as ACC moves to fully fund its future claims liabilities. ACC has a very active approach to managing investment of its funds, compared to other funds held by the Crown – for example, the Earthquake Commission or the Government Superannuation Fund.
- 5.39 ACC's active approach has resulted in strong investment returns over the last four years. The pursuit of higher returns through an active approach invariably presents greater risks. To date, ACC appears to have managed these risks well, and has provided good information on invested funds and their performance to the Department of Labour and to the Minister of Accident Insurance.
- 5.40 We note that the Crown is now moving to a more active approach to investment management in two other funds:
- the Earthquake Commission – by allowing a portion of its funds to be invested in overseas equities; and
  - the Government's proposed New Zealand Superannuation Fund.
- 5.41 These new, growing, and more actively managed funds will present greater challenges for their managers and monitors. As their auditor, we will maintain an active interest in how they are managed.





Six

B.29[01b]

# Timing of Purchase Agreements



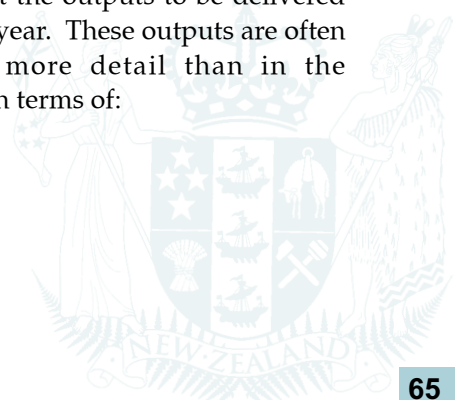




*Purchase agreements are a well-established part of the accountability relationship between a minister and a departmental chief executive. To be most effective, a purchase agreement should be agreed and signed by both parties before the start of the financial year to which it relates.*

*Of the 49 purchase agreements for the 2001-02 year that we looked at, 24 had not been signed before 1 July 2001, and some had not been signed three months into the 2001-02 year.*

- 6.1 Purchase agreements have been a key document for intra-executive accountability since 1993, when they were incorporated into the performance agreements between ministers and chief executives of government departments for the 1993-94 year.
- 6.2 Purchase agreements are an administrative rather than a statutory requirement. Their use was an outcome of a Cabinet decision following the recommendations of an interdepartmental working party on output definition in 1992. The working party recommended that:
- a clear purchase phase be incorporated into the budget process;
  - decisions by Ministers on the outputs to be purchased be documented in a purchase agreement with each chief executive; and
  - the agreement be updated regularly if what was agreed between the Minister and the chief executive changed.
- 6.3 A purchase agreement sets out the outputs to be delivered by the department during the year. These outputs are often specified in considerably more detail than in the department's forecast report, in terms of:
- volume;
  - price;
  - timeliness; and
  - quality.



- 6.4 A chief executive generally provides the Minister with quarterly reports of achievements against the targets specified in the purchase agreement. The agreement may also provide the basis of the work programme that drives individual employee performance agreements in the department.

### An Alternative to the Purchase Agreement

- 6.5 More recently, in the Capability, Accountability and Performance pilot project (CAP pilot) being led by the State Services Commission, a small number of departments have replaced:

- the purchase agreement with an output agreement; and
- the forecast report with a statement of intent (some departments have incorporated the output agreement into the statement of intent).

- 6.6 The CAP pilot draft evaluation paper notes that purchase agreements had previously suffered from a lack of impetus and central agency attention. Incomplete coverage and weak performance measures have been part of the problem.

- 6.7 One aim of the output agreement in the CAP pilot was to provide more of a context for outputs – thereby helping to link outputs with outcomes and strengthening accountability for outputs actually delivered.

### Timeliness of Reaching Agreement

- 6.8 The purchase agreements are documents that set the basis of accountability for actual performance compared with intended performance. Consequently, the agreements should be completed and signed before the start of the year to which they apply. They can be altered throughout the course of the year, as long as they continue to align with the output class appropriations in the department's forecast report.

- 6.9 We looked at the 2001-02 purchase agreements or output agreements for all departments (including some with multiple agreements for multiple votes) and found in only 25 cases out of 49 that the Minister had signed the agreement before 1 July 2001. Some were still not signed by 30 September 2001. We are concerned that many of these agreements are not being prepared in a timely way – that is, agreed with the Minister and signed before the beginning of the financial year.
- 6.10 Several departments said that their as-yet-unsigned agreements were the same as their forecast report or statement of intent, which meant (in effect) that they had a purchase agreement in all but name. One department (which was participating in the CAP pilot) said that it had neither a purchase agreement nor an output agreement, but what would have been in the output agreement was included in its statement of intent that had been signed. We counted this department as “signed”.
- 6.11 Use of the purchase agreement as a management tool – as a basis for work planning and performance agreements with staff – is made inefficient by lateness.
- 6.12 Select committees routinely ask to see a department’s purchase agreement – often because of paucity of information in the department’s forecast report. But purchase agreements are not always available as a source of fuller information because they are not prepared in a timely way.
- 6.13 In our view, while the present arrangements continue, departments (and their ministers) should strive to have a signed purchase agreement or output agreement in place before the beginning of the financial year to which it relates.



### Future Direction

- 6.14 As we have described, accountability documents are evolving and changing form. We understand that, at a more fundamental level, the practical value of a purchase or output agreement is being questioned. Particular considerations are:
- the compliance costs involved in preparing and reporting against the agreement; and
  - the utility of the agreement – especially to the minister (and the Government) whose concern is more appropriately directed at the outcomes that the underlying policies are attempting to achieve.
- 6.15 A statement of intent may well be a better vehicle for ‘agreement’ between a minister and chief executive, with its greater focus on outcomes and how outputs are intended to contribute to them. A document equivalent to a purchase agreement could act more as a departmental management tool, and still be available to the minister and the select committee if they want that information.



Seven

B.29[01b]

# Accountability to Parliament for Health Sector Expenditure





*The health sector is going through significant change, with the establishment of District Health Boards (previously Crown Health Enterprises and Hospital and Health Services) and the absorption of the Health Funding Authority into the Ministry of Health. A number of significant issues affecting funding, financial condition, and financial planning in the sector need urgent attention.*

- 7.1 We have a number of concerns about the quality of the accountability to Parliament for health sector expenditure – including:
- a lack of information about health activities funded through non-departmental output classes in Vote Health;
  - poor alignment between the financial planning cycles of the Government and District Health Boards (DHBs) – leading to problems in producing planning information on a timely basis;
  - the use of ‘deficit funding’ – that is, meeting part of the cost of health services by DHBs running down their equity or borrowing – leading to a need for future capital appropriations to redress the problem;
  - the re-emergence of the need for the Crown to give letters of support to enable DHBs in poor financial condition to satisfy us that they have correctly prepared their annual financial statements using the ‘going concern assumption’.



## Lack of Information About Health Activities Funded Through Non-departmental Output Classes

- 7.2 The total of appropriations for non-departmental output classes in Vote Health for 2001-02 is \$7,104 million. That total is approximately 95% of all appropriations for Vote Health.<sup>1</sup>
- 7.3 Many of the appropriations for the non-departmental output classes are described in terms that are high-level or vague, and do not meet the requirements for output class appropriations – that the output classes are groupings of homogeneous sets of outputs. The Cabinet has been advised that this is the case, but has accepted the explanation that there is no better alternative appropriation class. In December 2000, it agreed to one non-departmental output class for each DHB.
- 7.4 Under new funding arrangements for the health sector, responsibility for allocating funds for most personal health services and some disability support services is devolved to the DHBs. The single appropriation for each DHB (output classes O1-O21) is entitled *Health and Disability Support Services – [name] DHB*.<sup>2</sup>
- 7.5 The common description for those output classes says that the personal and disability services to be provided may include, but are not limited to:
- *primary care;*
  - *pregnancy and childbirth services;*
  - *primary diagnostic and therapeutic support services (including laboratory and pharmacy services);*
  - *dental health services;*
  - *secondary surgical and medical services;*
  - *tertiary services;*

1 *Estimates of Appropriations*, parliamentary paper B.5 Vol 1, pages 588-591.

2 *Ibid.*



- *mental health services;*
- *forensic services; and*
- *services for individuals with psychiatric disabilities.*<sup>3</sup>

- 7.6 However, no information is provided on how much funding is allocated to each of these services, either nationally or by district – although they are services at which budget initiatives are targeted.
- 7.7 The Ministry of Health (the Ministry) forecasts and records expenditure on public health and disability services that are not separately appropriated – at service levels such as elective surgery, mental health, services to Maori, and a range of primary care items (e.g. pharmaceuticals, laboratory costs, and payments to general practitioners). However, such expenditure categories are neither forecast nor reported in public accountability documents, with the result that Parliament’s oversight of the largest part of Vote Health is severely limited.
- 7.8 Notwithstanding an environment of devolution of funding to DHBs, the Ministry still needs to collect this type of service-level information for policy purposes.
- 7.9 The Ministry has told us that it intends to provide information on expenditure within the health sector in an annual report to Parliament. This report will be based on information provided by DHBs in their monthly financial returns to the Ministry. The Ministry’s information will indicate actual expenditure by service category, as proposed, and will be a helpful additional source of information about actual expenditure – thus addressing part of our concern.
- 7.10 However, in December 2000 the Cabinet decided that, with effect from 2001-02, the Minister of Health will make an annual report to Parliament of consolidated DHB expenditure, based on the audited expenditure figures in DHB annual reports. But those figures are not broken down into the different services on which the expenditure has been made.

<sup>3</sup> Ibid., page 602.

- 7.11 The Ministry comments that the new arrangements involve DHBs being given funding with which they have discretion to fund services in various ways – as long as they comply with service coverage requirements. Notwithstanding that discretion, in our view information on how DHBs expect to spend the funding that they are given should be available at the time of the *Estimates*, in order to enable more thorough scrutiny of the appropriations sought.
- 7.12 For instance, when a new initiative is announced in mental health, it should be possible to see what difference that new expenditure is expected to make to the expenditure trend in mental health. If new funding in mental health results in DHBs switching existing mental health funding to other activities (as happened with additional funding for elective surgery services some years ago), Parliament will want to know that this is happening. It will want to see a national picture in relation to national policy issues, rather than 21 individual district pictures.
- 7.13 The Ministry points out that the New Zealand Public Health and Disability Act 2000 requires that DHBs' Statements of Intent (SOIs) are to be with the Minister by 31 May each year (although see comments in paragraph 7.19 on page 76), and that this is too late for aggregation of information for the *Estimates*. We agree that this is so, but this does not preclude higher-level forecasting information being provided – which may indeed vary from the aggregate planning information subsequently supplied by the DHBs.
- 7.14 **In our view, the Ministry needs to make public – in an easily understood form – how it expects health service funding to be spent. The figures should be the Ministry's best estimate at the time of the *Estimates*. When the Government announces in the Budget more funding for, say, mental health, elective services, or primary health care, Parliament should be able to see how much was spent in that area previously and what difference the new funding is likely to make. This is not possible with current arrangements.**

- 7.15 Given the Government's policy document *The New Zealand Health Strategy*,<sup>4</sup> we would expect there to be some means of monitoring how funding may be changing in pursuit of the strategy and its objectives. Parliament needs to see how a strategy is given effect, and the way that the funding follows the strategy.
- 7.16 We applaud current intentions to focus on achievement of health outcomes and to measure indicators that are likely to relate to those health outcomes. But we also advocate more complete reporting of performance – including inputs, activities, and outputs. Our July 2001 publication *Reporting Public Sector Performance* explains the comprehensive model of performance reporting more fully.<sup>5</sup>
- 7.17 The Health Committee's report on the estimates of Vote Health for 2001-02 noted that:

*We have encountered difficulties in scrutinising this vote. There is a lack of clarity as to what is being provided by the appropriations. There is insufficient information about which health services are provided by particular appropriations. Funding for health services is now voted either by DHB or centrally funded, such as some public health and disability services. It would be helpful to have these funding streams clearly defined. Information has been provided regarding new funding initiatives although no specific information regarding how these funds are spent on these services across the nation are provided.*

- 7.18 The Ministry should make available sufficient information to enable our and the Health Committee's concerns to be addressed at the time of the *Estimates* examination.

4 Available on the Ministry's web site [www.moh.govt.nz](http://www.moh.govt.nz)

5 ISBN 0 477 02877 2 – available on our web site [www.oag.govt.nz](http://www.oag.govt.nz)

## DHB Planning – Information and Timelines

- 7.19 The Ministry's 2001-02 national-level planning for DHBs, and planning by individual DHBs, has been delayed. At the end of September 2001, no DHB's annual plan had been finalised; nor (consequently) their SOIs – which summarise the annual plan and must be presented to the House. The Minister initially granted an extension until 30 September 2001 for receipt of the SOIs, but has since agreed that the deadline for receipt from each DHB is two weeks after the annual plan has been agreed with the Ministry.
- 7.20 Experience to date with finalising annual plans suggests that the House is likely to see many 2001-02 SOIs well into the financial year and (possibly) some after the year has ended. The causes of this situation could lie in both the Ministry and the particular DHB – where there may be a reluctance to amend plans in line with central requirements.
- 7.21 DHBs have not received information about their future funding in a timely way to enable them to plan for the 2001-02 year. The Health Funding Authority used to receive advice in October of the likely funding to be appropriated in the following year's Budget, and was able to pursue purchase negotiations accordingly. For 2001-02, DHBs did not receive information from the Ministry about funding for their hospital services until March 2001. We understand that this was the earliest that the Ministry was permitted to give the DHBs the information, but in our view that is too late for sound planning.
- 7.22 The DHBs have been receiving from the Ministry further information about their newly acquired contracts with regional health service providers as late as September 2001 (for implementation in October 2001). Some DHBs are still negotiating with the Ministry on details of funding for current service delivery contracts, although the Ministry tells us that there are only a limited number of issues being worked through.
- 7.23 The 2001-02 year has been one of transition – with decisions about devolution of contracts requiring Cabinet approval – which has suffered a number of delays. However, what needs to be recognised is that a much longer planning horizon is required for DHBs to function efficiently and effectively.

- 7.24 During 2001-02, DHBs are required to undertake five-year strategic planning – similar to local government long-term planning. However, unlike local government, DHBs have limited prospective funding information in order to engage in meaningful consultation about their plans. We understand that the Ministry is currently preparing strategic planning guidelines for DHBs, which will include a set of common assumptions to be used.
- 7.25 **We recommend that the Ministry carry out advance planning and forecasting for the needs of the health sector, so that DHBs are in a position to consult their communities on a meaningful basis. The forecasts should have some status and national consistency – even though they may not be binding.**
- 7.26 Multi-year appropriations (which are permissible under the Public Finance Act 1989) would be a way of giving DHBs firm indication of future funding that are reliable enough to work with. Alternatively, DHBs could be given (at the time of the Budget) the three-year forecasts of their funding.

## ‘Deficit Funding’

- 7.27 A number of DHBs are in a situation of ‘deficit funding’, whereby they are meeting part of the costs of the services that they are providing out of their own or borrowed capital in order to make up the difference between those costs and the funding received from the Ministry.
- 7.28 We discussed this issue in our *Second Report for 1998* under the heading *The Financial Condition of Crown Health Enterprises*.<sup>6</sup> Crown Health Enterprises (CHEs) needed capital contributions from the Crown to redress their deteriorating equity position that resulted from accumulated operating deficits. Thus, the contributions were being used not to expand the Crown’s investments in the CHEs, but to provide working capital. This meant that Government expenditure on health was understated because the capital contributions were not part of Vote Health.

6 Parliamentary paper B.29[98b], pages 11-36.

- 7.29 The aggregate of DHBs' operating results for 2000-01 is not yet publicly available. (The Ministry has given us an unaudited figure of a deficit of \$61.8 million. And we cannot provide the information because – at the time of writing – three DHBs had not presented their financial statements to us for audit.) No firm forecast is available but figures as high as \$200 million are being mentioned for the aggregate deficits that DHBs expect to incur in the 2001-02 year.
- 7.30 The Ministry has told us that additional funding available to DHBs for their hospital services in the current year is “very small”. DHBs have been unable to restrain costs to manage within their funding. The Ministry is working with DHBs to bring down deficits to the extent possible through the annual planning processes. The Ministry's aim is to reduce the proposed DHB deficits without reducing the levels of service to be provided, and it will be looking to eliminate deficits over time. (This does not always mean that previous deficits are recovered – rather, the DHB will plan for a break-even result in two or three years time.)
- 7.31 A reliable forecast of aggregate deficits for 2001-02 will not be available until the Minister has approved all SOIs. As we have already observed in paragraphs 7.19 and 7.20, finalisation of an SOI is dependent on agreement between the DHB and the Ministry on the annual plan, and all SOIs might not be approved until near the end of the financial year.
- 7.32 **Our concern is that the deficits that have occurred in 2000-01 and the prospect of larger deficits in 2001-02 mean a return of:**
- the ‘deficit funding’ issue; and
  - greater expenditure on health services than the amount reported as charged against the appropriations provided in Vote Health by Parliament for the purpose.

## Letters of Support

- 7.33 Another consequence of the poor financial condition of a number of CHEs that we reported on in 1998 was the need for letters of support from the shareholding Ministers so that the CHEs' financial statements could be prepared on the basis of the 'going concern assumption'.<sup>7</sup>
- 7.34 The need has reappeared for the year ended 30 June 2001. Letters of support have been required for (so far) 12 of the 21 DHBs so that the board members were able to prepare the financial statements on a going concern basis.
- 7.35 Letters of support were in common usage between 1995-96 and 1997-98. In 1998-99 and 1999-2000 they were needed less because of timely agreements about purchase contracts, business plans, and (in some instances) new equity contributions.
- 7.36 Re-emergence of the need for letters of support may also reflect problems with the former policy of *sustainable funding path*<sup>8</sup> – by which the Ministry had been pursuing an approach to sector funding that took account of likely cost increases and changing demographics. The Ministry has told us that for 2001-02 there is no “sustainable funding path” agreed within the health sector.
- 7.37 There has been an adjustment for the changing demographic profile of the population, but funding for hospital services was essentially unchanged between 2000-01 and 2001-02 – despite considerable cost pressures and the need to maintain service levels. While some efficiency gains should always be sought, there are limits to the extent that a funding shortfall can be expected to be met by efficiency gains.

<sup>7</sup> Ibid., pages 22-25. The 'going concern assumption' is explained in paragraphs 10.13-10.14 on page 114.

<sup>8</sup> *Sustainable Funding for the Health and Disability Sector – An Overview*: Ministry of Health, April 1997.





# Forecasting and Control – Appropriations and Adjustments to Estimates





*When Parliament is asked to agree to adjustments to appropriations that it has already agreed to, it has a right to expect proper explanation of why the adjustments are necessary.*

*In our view, the quality of the explanations being provided is variable. Where the underlying reason for the adjustment rests with the reliability of the forecast of the original appropriation, or the quality of the controls over the expenditure incurred against the appropriation, or both, this needs to be recognised and addressed by the department responsible.*

- 8.1 The purpose of this article is to discuss:
- the kind of information that we believe Parliament should be given about the reasons for the need to make adjustments (up or down) to estimates of appropriations; and
  - the circumstances that may give rise to the adjustments.

## Providing Proper Explanations

- 8.2 When changes to appropriations are being sought, it would be helpful to Parliament if the explanations provided for variances matched the circumstances that caused them. The Appendix on pages 86-87 sets out a number of possible causes of variance.
- 8.3 Unless Parliament is provided with explanations for variances that reflect the circumstances that gave rise to them, Parliament cannot form a view about what action, if any, it is appropriate to take in response. There is a significant difference in the gravity of situations where an appropriation breach resulted from an unforeseeable forecast error and where it arose from a conscious decision to disregard the terms of the appropriation.
- 8.4 In the context of the 2000-01 *Supplementary Estimates*, we have observed that often there was a considerable range in the quality of explanations provided to Parliament by departments seeking adjustments in appropriations. In our

view, not all of the descriptions given of the “Purpose of and Reasons for Change” in the appropriations actually did so in clear and understandable terms.

- 8.5 In future, we will be seeking to encourage a better standard of explanations for adjustments to appropriations.

## Adjustment Mechanisms

- 8.6 It is a truism that all forecasts, including financial forecasts, are made in the context of some uncertainty about the future. It follows that they may need to be adjusted in the light of actual events. This truism is reflected in the existence of pragmatic mechanisms for adjusting appropriations:

- Supplementary Estimates;
- the use of sections 5 (transfer of resources between output classes) and 12 (unappropriated expenditure, expenses, and liabilities) of the Public Finance Act 1989; and
- the Appropriation (Financial Review) Acts.

- 8.7 However, these mechanisms for adjusting appropriations should not be thought of as convenient methods for “fixing up” actual expenditure whenever and for whatever reason that expenditure does not accord with appropriations. To do so would tend to subvert Parliament’s control over supply. When adjustments to appropriations are needed, Parliament should receive sufficient information to justify them.

## Forecasts and Control

- 8.8 Forecasts are generally inter-related with controls. At one extreme, a forecast may be made of events over which there can be no effective control. At the other extreme, a forecast may be made of events that are absolutely controllable – in which case, the forecast is actually a statement of intention. Most forecasts are made in circumstances that fall somewhere in between.

- 8.9 Where the events subject to forecast are not controllable, the accuracy of the forecast depends on the quality of the forecast model and the quality of the data applied in the model. Where the events subject to forecast are completely controllable, any variances will reflect either a failure of control or an intentional deviation.

## Reliability of Forecasts

- 8.10 Forecasts are generally made using:
- a model that reflects the way in which the world behaves; and
  - data that describes the state of the world at the time of the forecast.
- 8.11 Forecast models are developed having regard to event histories. They are an attempt to understand the way in which the world will behave in the future based on observations of how it did behave in the past. There is an inescapable uncertainty in this – forecasters can never be sure that the world will behave the same way in the future.
- 8.12 Indeed, in relation to social and economic behaviour, it very often doesn't. As well, actual events may manifest an element of “randomness”, which may be recognised in the best available model but which nonetheless may see actual events differing unpredictably from forecasts derived from that model.
- 8.13 Like most activities, building a forecast model can be done either well or badly. Both the Government and Parliament are entitled to expect the job to be done well. If forecasts are erroneously high, scarce resources may be appropriated for a purpose for which they are not needed and other worthwhile expenditure may not occur. If forecasts are erroneously low, both the Government and Parliament will be faced with having to provide for expenditure that they did not expect.

## Appendix

### Why Estimates May Need Adjusting

#### *Government Decision*

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- At a point in time after the enactment of the most recent Appropriation Act, the Government makes a decision that requires a new or an amended appropriation. *This is neither a forecast nor a control fault.*

#### *Pure Forecast Errors*

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- The forecast model did not adequately reflect the behaviour of the real world. *This is a forecast fault. The remedy is to improve the forecast model.*
- The forecast model was adequate, but the data applied in the model was inaccurate or lacking. *This is a data quality fault. The remedy is to obtain more, or more reliable, data.*
- The forecast model and data were both adequate, but actual events differed from forecasts in a way that could not have been foreseen. *This is neither a forecast nor a data fault. If the unexpected events were not simply attributable to “randomness”, the forecast model should be revised in the light of the new information.*

#### *Forecast and Control Errors*

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- The forecast model and/or the data were inadequate, so actual events differed from expectations. Controls available to the department were exercised in a way that responded appropriately to actual events but differed from forecasts. *This is either a forecast model or a data fault (or both), but not a failure of control. The remedy is to revise the model and/or improve data reliability.*

- The forecast model and data were both adequate, but actual events differed from expectations. Controls available to the department were exercised in a way that responded appropriately to actual events but differed from forecasts. *This is not a forecast or a data fault or a failure of control. If the unexpected events were not simply attributable to “randomness”, the forecast model should be revised in the light of the new information.*
- The forecast model and data were both adequate, but actual events differed from expectations. Controls available to the department were not exercised in a way that responded appropriately to actual events. *This is not a forecast or a data fault, but a failure of control. The deficiency in controls should be remedied. Also, if the unexpected events were not attributable to “randomness”, the forecast model should be revised in the light of the new information.*
- The forecast model and/or the data were inadequate, so actual events differed from expectations. Controls available to the department were not exercised in a way that responded appropriately to actual events. *This is either a forecast model or a data fault (or both) and also a failure of control. The remedy is to revise the model and/or improve data reliability and remedy the deficiency in controls.*

### Control Errors

- The forecast model and data were both adequate but controls available to the department proved inadequate or were not exercised appropriately. *This is a control fault and the remedy is to improve the controls or the way in which they are applied.*
- The forecast model and data were both adequate, and actual events did not differ from expectations, but controls available to the department were exercised deliberately to pursue an outcome that differed from the forecast. *This is a decision fault, and represents a fundamental and illegal breach of appropriation.*





Nine

B.29[01b]

# Maori Trustee – Governance and Accountability



OFFICE OF THE MĀORI TRUSTEE



*In 2001 we assisted the Maori Affairs Committee in its inquiry into the performance and current operations of the Maori Trustee. Here we discuss further the issues affecting the Maori Trustee that we raised with the Committee.*

*We consider that it is important – for both the clients of the Maori Trustee and the Crown – that the issues of governance, accountability, and accumulated liability to the Crown are resolved.*

## Who is the Maori Trustee?

- 9.1 The Maori Trustee is a statutory body, constituted as a corporation sole under the Maori Trustee Act 1953 (the Act). Under the Act, the Chief Executive of Te Puni Kokiri (the Ministry) must carry out the role of Maori Trustee.
- 9.2 The Chief Executive of the Ministry can confer the position on another officer of the Ministry with the prior consent of the State Services Commissioner.<sup>1</sup> Since 1995, the position of Maori Trustee has been conferred on the Ministry officer holding the position of General Manager of the Maori Trust Office. Currently, that officer is also the Deputy Chief Executive of the Ministry.

## What does the Maori Trustee do?

- 9.3 The Maori Trustee (the Trustee) can:
- on behalf of Maori individuals or groups, hold land or other property in trust and manage it on their behalf; and
  - manage estates of deceased Maori.
- 9.4 Given these powers, the Trustee's clients comprise Maori individuals, hapu, iwi, trusts, and incorporations whose assets the Trustee administers. In exercising those powers, the Trustee's role is to manage the assets to the clients' best advantage.

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<sup>1</sup> Section 4(2) of the Act.

- 9.5 Management of Maori land is a major activity for the Trustee.<sup>2</sup> This is as a result of the multiple ownership regime applying to Maori land, which can lead to Maori land having many different owners. Because any descendent of an owner is able to succeed to a share of their ancestor's land interests, the number of owners can increase over time.
- 9.6 This fragmentation of land title creates administrative difficulties, as beneficial owners can become dispersed and difficult to locate. In addition, as the number of owners increases, the size of individual land interests – and (hence) an owner's share of any income from the land – decreases. This can create a disincentive for many owners to maintain an active interest in management of their land.
- 9.7 Where these circumstances arise, the owners may prefer to have the Trustee manage their land interests for them. As at 31 March 2001, the Trustee was responsible for managing around 105,000 hectares of Maori land (7% of all land owned by Maori), with an associated annual rental income of \$8.3 million.
- 9.8 The Trustee provides a variety of client services:
- **Property Management Services** – including, among other things:
    - arranging for clients' land to be leased or utilised – which might require calling meetings of owners to make decisions on the future of the land;
    - collecting rental income from people who lease Maori land, or who may use other resources associated with Maori land (for example, minerals or forestry cutting rights); and
    - monitoring lessees' compliance with the terms of the lease.

<sup>2</sup> In the context of this article the term "Maori land" refers to Maori freehold land. Te Ture Whenua Maori/Maori Land Act 1993 governs the management of Maori land.

- **Client Funds Management** – involving the investing of clients’ funds either in the Common Fund or in Special Investment Accounts to earn interest (see paragraphs 9.9 and 9.10).
- **Other Management and Administration Services** – involving responsibility managing several trusts and funds for the benefit of Maori, including –
  - the Maori Soldiers Trust;
  - the Ngarimu VC 28<sup>th</sup> Maori Battalion Scholarship Fund;
  - the Maori Purposes Fund; and
  - residual estates and disabilities trusts.

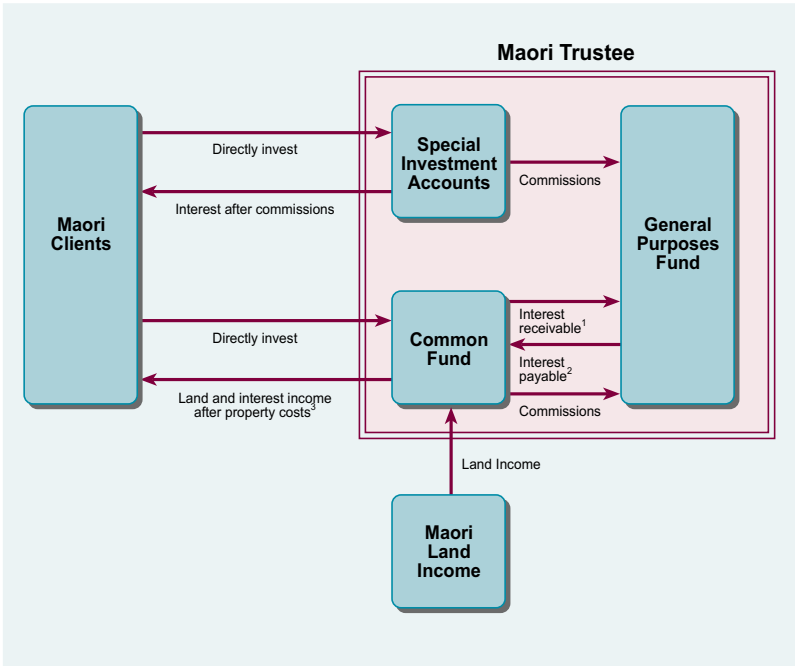
9.9 The Trustee manages the following separate funds or accounts:

- **General Purposes Fund** – the Trustee’s own account containing all revenue earned by the Trustee, which is to be used for certain purposes prescribed by the Act.
- **Common Fund** – comprising all money held by the Trustee in trust for clients.
- **Special Investment Accounts** – the funds held by the Trustee in Special Investments that enable the Trustee to provide clients with access to wholesale financial markets. The Trustee invests the clients’ funds under their direction.

9.10 Figure 9.1 on the next page shows the funds and services administered by the Trustee.



Figure 9.1  
Funds and Services Administered by the Maori Trustee



**Notes**

- 1 Under section 28(3) of the Act, all interest received from the investment of money in the Common Fund is to be paid into the General Purposes Fund.
- 2 Common Fund investments earn interest at market rates. The Maori Trust Office Regulations 1954 specify the interest to be paid to clients on Common Fund investments. The Trustee retains in the General Purposes Fund the margin between interest earned and interest paid, and pays the level of interest specified by regulation to the clients through the Common Fund.
- 3 Property costs include commissions, rates, inspection fees, and taxes.

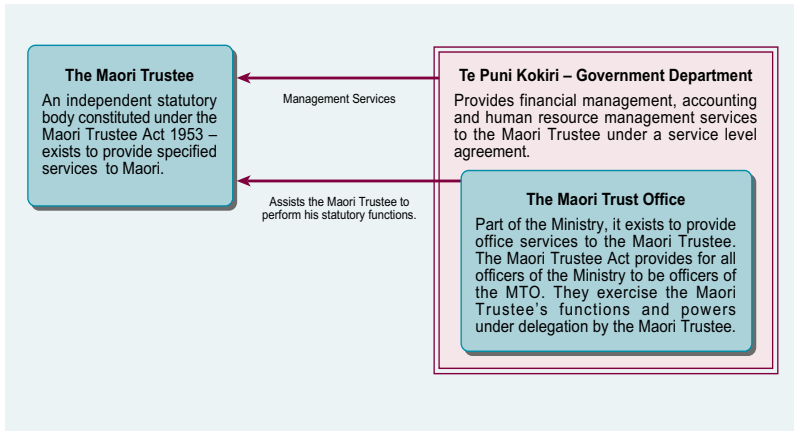


## How are the Trustee's functions carried out?

- 9.11 The Trustee's statutory functions can be performed by:
- the Trustee himself, acting as a corporation sole;
  - the Deputy Trustee, acting under the control of the Trustee; and
  - staff of the Maori Trust Office (MTO), acting under written delegation by the Trustee.
- 9.12 The MTO is *an office of the Public Service*, which exists within the Ministry. All staff of the Ministry are also officers of the MTO.
- 9.13 The Ministry provides – through the MTO – full office support services, including financial and human resource management services. These services were originally provided under a service level agreement that took effect on 1 July 1994, but the agreement expired on 30 June 1995. There has been no subsequent formal agreement, although the terms of the 1994 agreement have been adhered to.
- 9.14 Figure 9.2 on the next page depicts the nature of the relationships between the Ministry, the MTO, and the Trustee.



Figure 9.2  
Organisational Relationships



## How is the Maori Trust Office funded?

- 9.15 The cost of the services provided by the MTO is funded by an appropriation through Vote Maori Affairs, *Output Class D6: Services to the Maori Trustee*. The appropriation for 2001-02 is \$4.2 million (GST inclusive).<sup>3</sup>
- 9.16 The Act prescribes the various purposes for which the Trustee can disburse money. However, these purposes do not include the costs of the services provided by the MTO.<sup>4</sup> Instead, the Act provides for the Minister of Finance to *requisition* the Trustee to pay an amount into the Crown Bank Account (out of the General Purposes Fund) *for the purpose of recouping ... money paid out ... for salaries and other expenses of the [MTO]*.<sup>5</sup>

<sup>3</sup> *Estimates of Appropriations*, parliamentary paper B.5 Vol. II, page 789.

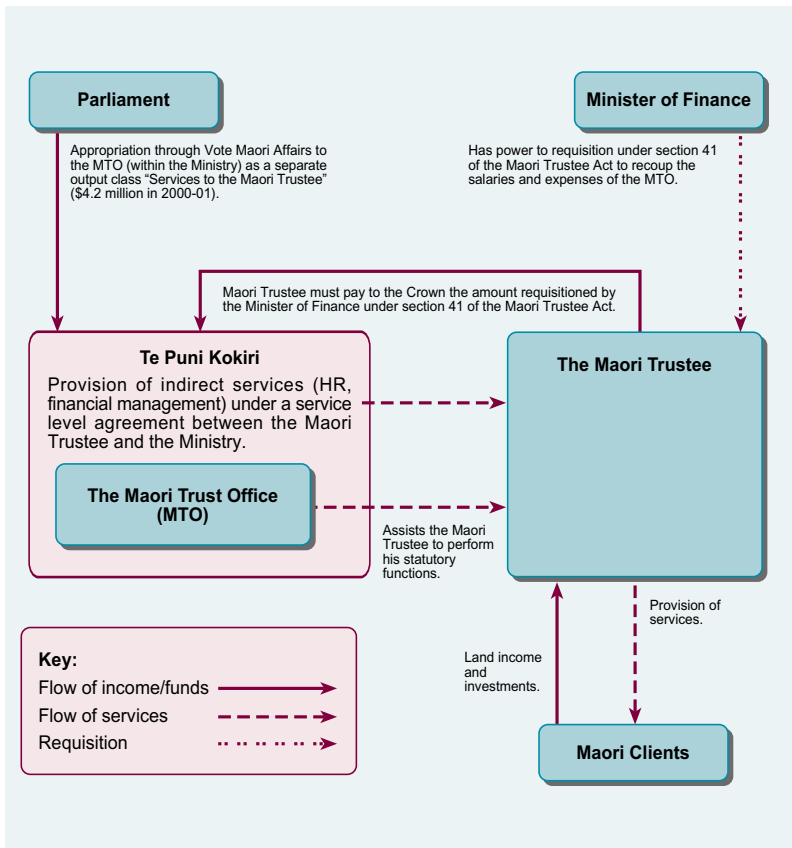
<sup>4</sup> Section 17(3) of the Act.

<sup>5</sup> Section 41 of the Act.



9.17 To expand on the relationships depicted in Figure 9.2 on the opposite page, Figure 9.3 below illustrates the sources of income generally and the flow of services between the Ministry, the Minister of Finance, the Trustee, the MTO, and Maori clients.

Figure 9.3  
Financial and Service Relationships



### *Issues Arising from These Relationships*

- 9.18 Three main issues arise as a result of these financial and service relationships:
- the governance and accountability arrangements surrounding the Trustee, the MTO, and the Ministry;
  - the Trustee’s accumulated liability to the Crown; and
  - the long-running review of the role and functions of the Trustee.

## Governance and Accountability Arrangements

- 9.19 Given the role, legal status, and financial/service relationships affecting the Trustee, in our view the Trustee should be:
- independent of influence from the Crown or other parties that could affect the Trustee’s ability to act in the best interests of clients;
  - accountable to:
    - clients, for the activities carried out on their behalf; and
    - Parliament and the Crown, for the costs of the MTO that are met out of public money.

### *Governance*

9.20 Because the Chief Executive of the Ministry is the Trustee, potential conflicts of interest arise. Each role has a different set of obligations to the Crown and to the clients of the Trustee.

9.21 The Ministry is responsible for the proper administration of the Act. In this role, the Chief Executive and Ministry staff must provide free and frank advice to the Minister of Maori Affairs on the appropriateness or otherwise of the role, functions, powers and accountabilities of the Trustee, as provided by the Act.

- 9.22 The Chief Executive of the Ministry is also governed by the State Sector Act 1988 and is therefore ultimately responsible to the Minister of Maori Affairs.
- 9.23 In addition, the Government has indicated a focus on addressing issues of Maori land fragmentation, multiple ownership, and uneconomic interests. These are issues that the Ministry advises on and are of concern to the Trustee.
- 9.24 However, the Trustee's primary responsibility is to the Maori clients whose assets the Trustee manages. In discharging this responsibility, the Trustee must act independently of the Ministry in such things as:
- the acquisition of land;
  - investments and divestments;
  - the administration of estates; and
  - advocacy on behalf of clients.
- 9.25 The Act attempts to manage these potential conflicts by providing for the Chief Executive to confer the position of Trustee on another Ministry employee (see paragraph 9.2).
- 9.26 However, this approach to managing the potential conflict of interest is reliant on the person given the position of Trustee having no involvement in the management of the Ministry's policy and operations. As already observed (in paragraph 9.2), the current Trustee is the Deputy Chief Executive of the Ministry.

### Accountability

- 9.27 The arrangements described in paragraphs 9.11 to 9.13 mean that:
- the sole source of administrative resources for the Trustee is the MTO; and
  - the value of the services that the MTO can provide is the amount appropriated for the purpose (paragraph 9.15); but
  - the discharge of the Trustee's functions determines the level of demand for the MTO's services.

- 9.28 The Act does not require the Trustee to prepare an annual report and annual financial statements. Consequently, there is no statutory requirement for presenting to the House an annual report including audited financial statements. However, the Trustee does present those things to the House, and has done so for a number of years.
- 9.29 The annual financial statements include an amount for the Trustee’s operating costs that includes the costs of the services provided by the MTO. The Trustee does not provide any other basis of accountability for either financial or service performance in respect of this Crown support.
- 9.30 The information in the Trustee’s annual report and financial statements predominantly reflects the Trustee’s accountability to clients for the activities of the Common Fund and the activities of the Trustees’ General Purposes Fund.
- 9.31 The Ministry, rather than the Trustee, is accountable to Parliament for the Crown funding used by the MTO in supporting the Trustee.

### Accumulated Liability to the Crown

- 9.32 As at 30 June 2001, the Crown recognised a liability from the Trustee of \$34.8 million (GST-inclusive). The liability is currently increasing by approximately \$300,000 to \$350,000 a month.
- 9.33 The liability is based on the Crown’s expectation that the Trustee will reimburse the Crown for the expenditure of the appropriation for services provided by the Ministry – through the MTO – to the Trustee (see paragraphs 9.11 to 9.16). The expectation arises through past practice and the existence of a legislative mechanism for obtaining reimbursement.
- 9.34 The Trustee is of the view that the Crown’s expectation is unrealistic, given the limited funds available to the Trustee. There is also a question whether the liability amounts to a debt in the legal sense.

### *History of the Liability*

- 9.35 Until 1990, the revenue earned by the Trustee was sufficient to meet the expenses of the MTO. However, since that time, the Trustee has not been in a position to fully reimburse the Crown for those expenses.
- 9.36 In 1993, the Minister of Finance requisitioned \$7.4 million from the Trustee under section 41 of the Act (see paragraph 9.16).
- 9.37 In 1995, the Trustee and the Crown signed a Memorandum of Understanding to clarify the arrangements relating to the appropriated funds made available to the Trustee through the Ministry. The Memorandum records that the accumulated amounts of funds made available:
- before 30 June 1994 (totalling \$10,038,795, after writing off \$4.144 million in 1992-93) were to be reimbursed to the Crown once the proposed review of the Trustee was completed and the future role and financial structure of the Trustee ascertained;
  - between 1 January 1995 and 31 March 1995 (totalling \$1,020,279) were to be reimbursed to the Crown in two instalments, in April and May 1995; and
  - after 31 March 1995, were to be reimbursed to the Crown if the Trustee – using best endeavours – could do so.

### *Comment*

- 9.38 Irrespective of whether the accumulated liability is a debt recoverable by the Crown from the Trustee, the position is unsatisfactory and needs to be addressed.
- 9.39 Clearly, the 1995 Memorandum of Understanding anticipated that the issue would be addressed as part of the arrangements to implement a new governance and funding structure for the MTO following completion of the review. However, the review has not been completed – and the longer it remains uncompleted, the longer the matter remains outstanding and the accumulated liability continues to increase.

## Review of the Maori Trustee

9.40 Past Governments have intended to deal with the issues we have outlined as part of a review of the role and functions of the Trustee. A review started in 1992. The key agencies currently involved in the review are the Ministry, the State Services Commission, and the Treasury. The Crown Law Office has provided legal advice from time to time.

9.41 These agencies have spent considerable effort in defining policy and legal positions. However, little tangible progress has been made. This appears to be due to a variety of factors – including the complexity of the issues, staff turnover in the agencies, and other competing policy and legislative priorities.

9.42 We understand that there are two broad options currently being considered to address the issues affecting the Trustee:

- **The Trustee and MTO could become a Crown Entity** – Under this option the Trustee would become a Crown Entity with statutorily independent functions. The role of the Trustee would transfer to the new entity and be vested in the entity's board. The entity would be established as a statutory corporation. The Trustee would be subject to the Public Finance Act 1989.
- **The Trustee could remain a corporation sole, but with enhanced governance and accountability arrangements** – Under this option the Trustee would remain a corporation sole, and the General Manager of the MTO would also be the Trustee. However, the Trustee would not be able to hold any post in the Ministry. The Trustee would –
  - be directly funded by appropriation through a non-departmental output class in Vote Maori Affairs;
  - have a funding agreement with the Minister of Maori Affairs; and
  - have a service agreement with the Ministry for the services provided by the MTO.

- 9.43 These options focus on governance and accountability issues. However, as noted above, resolution of the funding issue is dependent on the outcome of the review.

## Maori Affairs Committee Inquiry

- 9.44 The Maori Affairs Committee inquired into the performance and current operations of the Trustee in April 2001. In its report, the Committee expressed its concern that no obvious progress had been achieved by the review. The Committee also raised a number of issues – including (among other things) the governance and accountability issues outlined in paragraphs 9.19 to 9.31, and the accumulated liability discussed in paragraphs 9.32 to 9.39.
- 9.45 The Committee recommended that the Government instruct the agencies involved in the review to complete it by 31 December 2001. The Government, in response, agreed to the recommendation of the Committee and instructed the agencies to complete the review by 30 November 2001, within the current priorities and resources of the Government.
- 9.46 At the time of writing, we understand that the agencies have completed the review and the Government is considering their recommendations.

## Comment

- 9.47 In our view, it is important for both the clients of the Trustee and the Crown, that the governance, accountability and accumulated debt issues outlined above are resolved as quickly as possible.







Ten

B.29[01b]

# Financial Condition of Tertiary Education Institutions

Capital injection will  
meet desperate need

Investment vital to  
rebuild universities

Polytech layoffs

**Plea for funds  
by university**

Mixed fortunes for  
beleaguered polytechs

Tertiary profitability low



*The overall financial condition of the tertiary education sector has deteriorated since we last reported. A number of the tertiary education institutions are under particular financial stress. For various reasons, some struggle to maintain operating surpluses, have poor financial positions, or have inadequate working capital resources. As a consequence, we have seen delays in statutory reporting and a range of costly measures as the Crown works through options for the future of the institutions under stress.*

## Trends in Financial Performance

### Past Experience (1994-1997)

- 10.1 In 1998, we reported on the financial performance of tertiary education institutions (TEIs) from 1994 to 1997.<sup>1</sup> We observed that the Crown’s principal expectation of TEIs, rather than being centred on financial performance, is that each TEI will deliver quality education. Nevertheless, we believed that *a TEI’s continuing ability to demonstrate financial security and to offer high-grade facilities can be an indicator of its success*. In our opinion, the operating results, working capital and equity position are key indicators of a TEI’s financial performance – with operating results probably being the most critical of these.<sup>2</sup>
- 10.2 We reported that the 1997 financial statements of all TEIs complied with generally accepted accounting practice (GAAP), and that aggregate operating results reflected increased surpluses and improved equity positions. Despite the aggregate operating surplus for 1997, however, individual TEI results ranged from a deficit equal to 6.9% of income to a surplus of 6.2% of income. Such variations occurred within each of the sector subgroups: universities, polytechnics, colleges of education, and wananga.

1 *Tertiary Education Institutions: Financial Performance 1994 to 1997*, Report of the Controller and Auditor-General: *Third Report for 1998*, parliamentary paper B.29[98c], pages 39-47.

2 *Ibid*, page 40.

10.3 We found that *all* [39] *TEIs were assessed as going concerns in accordance with GAAP*. However, *19 had negative working capital at the end of the financial year*.<sup>3</sup> Our analysis indicated that TEIs had been funding building programmes from working capital, rather than financing the cost of infrastructural assets by selling longer-term investments or raising long-term debt. (One TEI has since suggested to us that some TEIs did not have the latter options readily available to them – having little by way of longer-term investments that could be realised, or the ability to arrange debt security.)

### Current Picture (1999 and 2000)

10.4 Since our 1998 report, the Ministry of Education (MoE) has produced two reports on the tertiary sector.<sup>4</sup> The MoE's Tertiary Advisory Monitoring Unit (TAMU)<sup>5</sup> has also recently presented to the Education and Science Committee an overview of the tertiary sector.<sup>6</sup> TAMU reported that (in aggregate) overall financial performance of the TEIs was “relatively marginal”, although each sector subgroup had a mix of strong and weak performances. For the year ended 31 December 2000, TAMU reported a number of key trends:

- negative working capital among polytechnics and universities;
- inadequate cash cover in polytechnics – that is, cash balances below TAMU's recommended threshold of 8% of operational outgoings (one month's cover);
- inadequate operating surpluses of universities and polytechnics – that is, surpluses below TAMU's recommended threshold of 3% of income; and
- about one-third of all TEIs recording a net operating deficit for 2000.

3 Ibid, page 47.

4 *New Zealand's Tertiary Education Sector Profile and Trends 1998 and 1999*.

5 Previously named (and referred to in our previous report as) the Tertiary Ownership Monitoring Unit.

6 *TEI Performance Trends 1996-2000, and Financial Trends and Performance in Tertiary Education Institutions*, Tertiary Advisory Monitoring Unit, 1 August 2001.

10.5 The current picture is one of deteriorating financial performance, more particularly in polytechnics. Table 10.1 on pages 124-125 shows the key information from TEI annual financial statements for 1999 and 2000 (the audits of which we are currently reporting on). The five figures on pages 110-112 show our analysis of that information for 2000 compared with 1997 (the last year on which we reported):

- There is an increasing incidence of operating deficits in 2000 compared with 1997.<sup>7</sup> Operating deficits were incurred by 10 of 39 TEIs for the year ended 31 December 1997, 10 of 38 TEIs<sup>8</sup> for the year ended 31 December 1999, and 14 of 38 TEIs for the year ended 31 December 2000. (See also Figures 10.1A and 10.1B on page 110.)
- In 2000 fewer universities and polytechnics recorded operating surpluses that were above TAMU's recommended 3% of income. For 1997, three universities, nine polytechnics, two of the four colleges of education, and one of the three wananga had a surplus greater than 3% of income for the year.<sup>9</sup> The figures for 2000 have further deteriorated – two universities, six polytechnics, three colleges of education, and one wananga. (See also Figure 10.2 on page 111.)
- There were continuing instances of negative working capital – 19 in 1997, 20 in 1999, and 17 in 2000. (See also Figure 10.4 on page 112.)

10.6 Key issues associated with TEIs' deteriorating financial performance are:

- Statutory reporting requirements have not been met, with a considerable delay in the information about the deteriorating situation being publicly available in some cases.

7 It should be kept in mind that deficits can arise (as in the case of Waikato Institute of Technology in 2000) because of a once-only circumstance, such as a write-down in the value of fixed assets.

8 The number of TEIs decreased by one, due to the merger of Wellington Polytechnic and Massey University.

9 B.29[98c], pages 51 and 52.

# FINANCIAL CONDITION OF TERTIARY EDUCATION INSTITUTIONS

Figure 10.1A  
Operating Results (all TEIs)

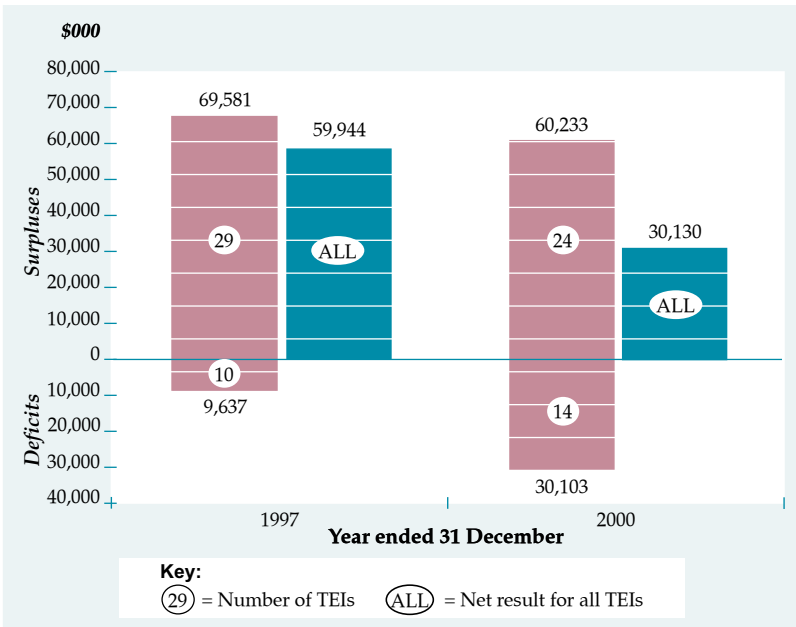
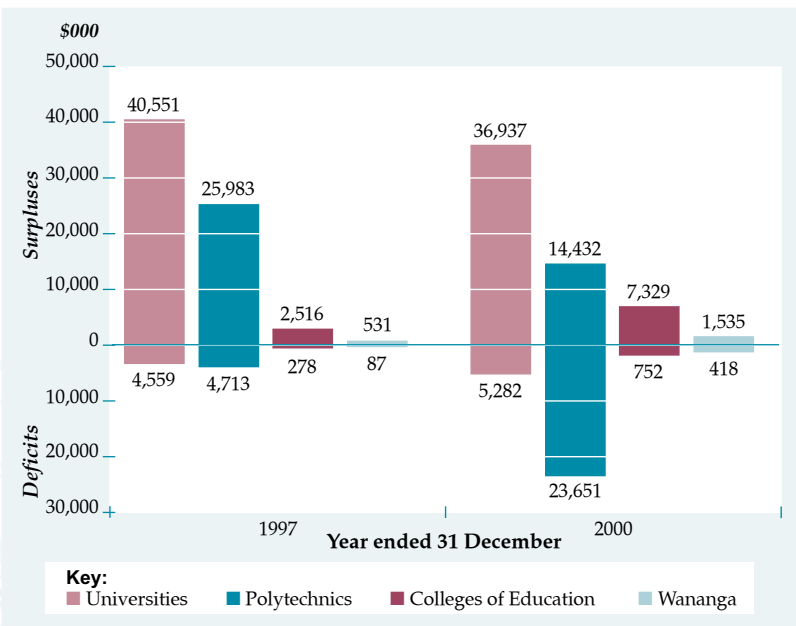


Figure 10.1B  
Operating Results (by type of TEI)



TEN

Figure 10.2  
Achievement of Recommended Operating Surplus of 3% of Income

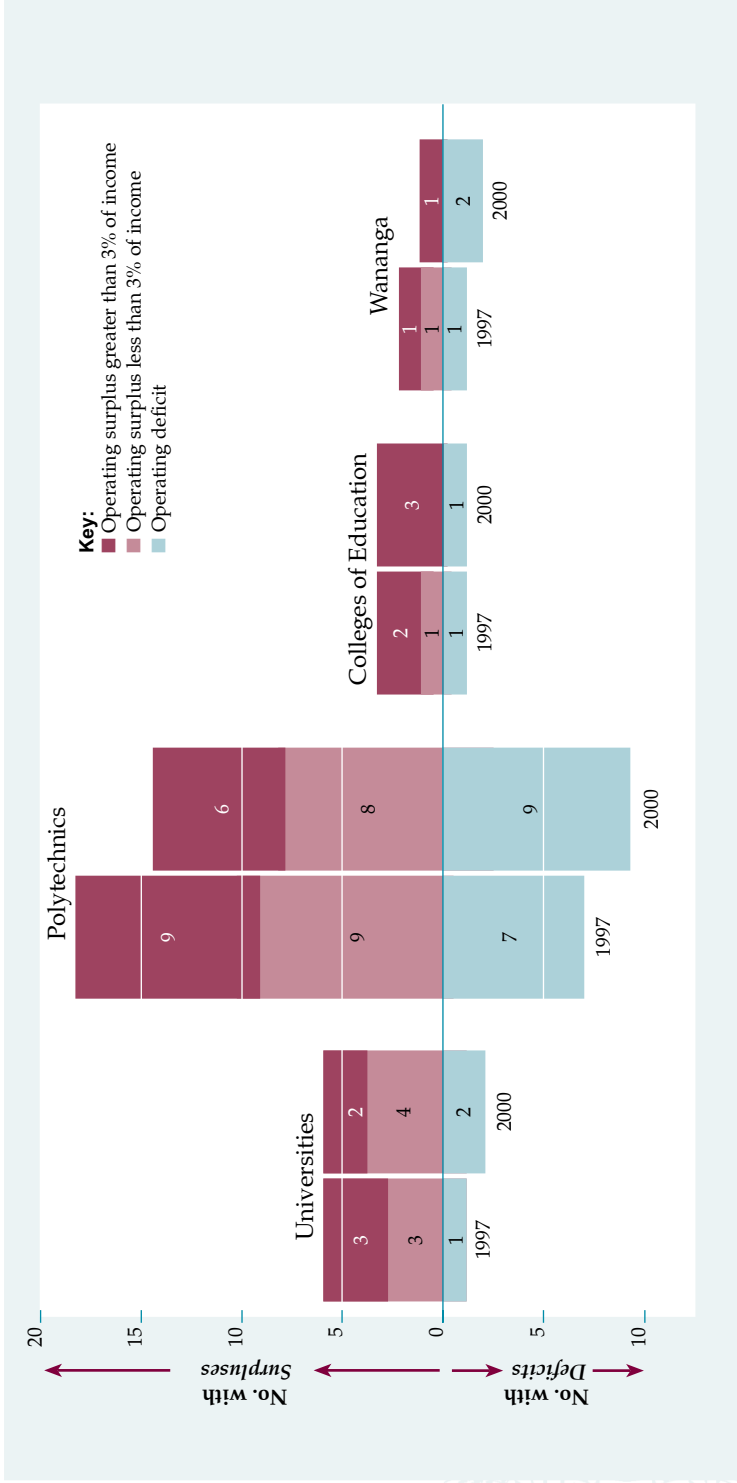


Figure 10.3  
Equity (by type of TEI)

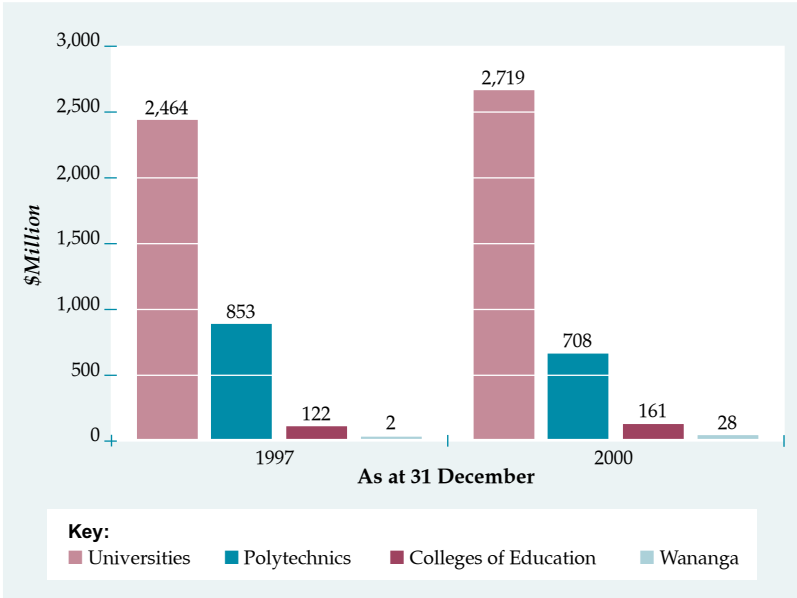
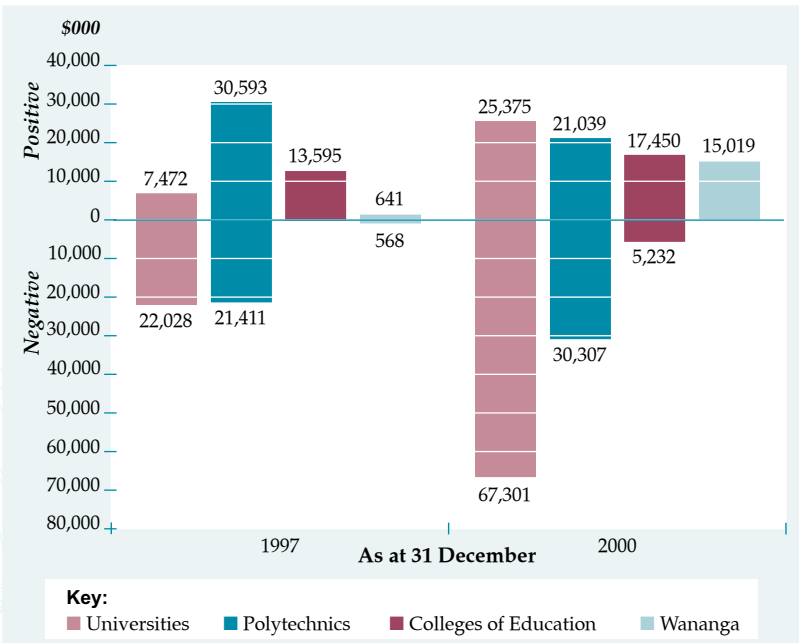


Figure 10.4  
Working Capital (by type of TEI)





- There has been significant financial stress in the most critical cases – three involving the disestablishment/merger of the TEI, and in all cases requiring significant additional expenditure to effect adequate oversight.

## Breach of Statutory Reporting Requirements

- 10.7 The annual reporting requirements for TEIs are specified in the Education Act 1989 (the Act) and the Public Finance Act 1989 (the PFA):
- each TEI is required to present its financial statements for audit within 90 days of the end of the financial year;
  - the audit is required to be completed within 30 days of receipt of the financial statements; and
  - audited financial statements are required to be presented to the House of Representatives within six sitting days of being returned by the auditor.
- 10.8 When TEIs meet these deadlines, the users of financial statements are aware of the performance of the individual TEIs and the sector as a whole, in a timely fashion.
- 10.9 For the year ended 31 December 1997 (when we last reported), three TEIs failed to present financial statements for audit within 90 days.
- 10.10 Table 10.2 on pages 126-127 sets out the date of receipt of the financial statements for audit, in an auditable form, and the date of the audit report for each of the TEIs for the 1999 and 2000 audits. It indicates that there were a high number of breaches of either or both of the first two requirements set out in paragraph 10.7 above, both in 1999 and in 2000. Six of the TEIs were involved in breaches in both years.
- 10.11 The breaches were usually related to the financial condition of the TEIs. In most cases the financial statements were received late and/or the issuing of the audit report was delayed while serious consideration was given to whether or not the TEI was a going concern. In three cases, it was over 12 months before audited financial statements for 1999 were available.

- 10.12 There are still two TEIs for which the 2000 audited financial statements are not available. In one case the financial statements have only recently been presented for audit. In the other, the statements were presented, incomplete, in April 2001, but with matters still to be resolved.

### *What is the 'Going Concern Assumption'?*

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- 10.13 An entity is assumed to be a going concern if it would continue in existence for the foreseeable future and there was no intention or necessity to liquidate or significantly curtail the scale of its operations.<sup>10</sup>
- 10.14 GAAP requires an entity to prepare its financial statements on the appropriate basis, depending on whether or not the going concern assumption is valid. If we are not satisfied that the assumption is valid, we expect the financial statements to be prepared on the basis that the entity is *not* a going concern – that is, on a disestablishment basis. In the event that the entity does not do so, it receives an adverse audit opinion.
- 10.15 Public entities can run into financial difficulties from time to time. Without Government support beyond that provided for the production of outputs (which in the case of TEIs is provided as a grant toward the costs of delivering courses to students), the entity may have to cease operating or significantly curtail its operations.
- 10.16 While it *may* be unusual that the Government would allow a public entity to fail financially, it is not the auditor's role to anticipate the Government's response to a public entity in financial difficulty. If there is insufficient clarity about the support that is available (from the Government, financiers, or other parties), then it would not be appropriate for the entity to prepare its financial statements on the basis of the going concern assumption.

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<sup>10</sup> Institute of Chartered Accountants of New Zealand: Auditing Standard No. 520, 1998.

### *Some TEIs Failed to Satisfy the Going Concern Assumption*

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- 10.17 During March and April 2000, as the audits for the year ended 31 December 1999 were in progress, our auditors gave serious consideration to the going concern status of six TEIs.
- 10.18 In one case, the TEI had made a significant loss, had a significant working capital deficit, and was subject to high overhead costs in proportion to turnover. However, there were plans in place to manage these difficulties, sufficient to conclude that the TEI was a going concern.
- 10.19 In a second case, there was a 4.3% deficit as a percentage of revenue, and deteriorating working capital. There were sufficient assurances of support and improvement of the situation in place to warrant the use of the going concern assumption.
- 10.20 In the other four cases – given the seriousness of the financial situation and the lack of a plan that could satisfy us that the TEI would be able to continue operating – we considered that the TEI was not a going concern, without some assurance of support from the Government. The four TEIs were:
- Central Institute of Technology;
  - Taranaki Polytechnic (now the Western Institute of Technology at Taranaki);
  - Wairarapa Community Polytechnic; and
  - Wanganui Regional Community Polytechnic.

### *What Caused the Delays?*

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- 10.21 The Ministers of Education and Finance declined to provide an explicit guarantee of Government support to the four TEIs without viable business cases. We received the Ministers' response to this effect on 16 May 2000.

## Central Institute of Technology

- 10.22 The Central Institute of Technology (CIT) decided at that point that it was unable to continue operating into the foreseeable future. It presented its 31 December 1999 financial statements for audit on 5 June 2000 – just over two months late. However, CIT was unable to prepare its financial statements on a disestablishment basis, so an adverse audit opinion was issued on 22 June 2000.
- 10.23 The decision to disestablish CIT and merge it with Hutt Valley Polytechnic – to take effect on 1 July 2001 – was announced by the Minister of Education on 10 April 2001. Because of uncertainties around the valuation of assets and possible exit costs, CIT was also unable to prepare its 31 December 2000 financial statements on a disestablishment basis, so an adverse audit opinion was issued on 4 May 2001.

## The Other Polytechnics

- 10.24 There were lengthy delays in the other three cases. The other three TEIs believed that they *were* going concerns, and would be able to produce viable business cases that would satisfy the Government, elicit the required support, and guarantee continuing operations in the coming year. Interim approvals for Crown loans were given in June 2000 to cover the immediate cashflow difficulties, until options for dealing with the medium-term viability of the three polytechnics could be developed.
- 10.25 Considerable delays were experienced throughout this process. Not the least delay was in each TEI obtaining assurance as to whether the Government regarded the business case it had submitted as viable, at least in the medium-term. Without such assurance, none of the TEIs was willing to submit its financial statements for audit, knowing that they might be qualified on the basis that it was inappropriate to prepare the financial statements using the going concern assumption.

- 10.26 The former Chairperson of Wairarapa Community Polytechnic believes that some of the fault for the delays rests with the slowness of the MoE's responses to business plan proposals. The MoE, however, says that the business plans as originally received from the TEIs were insufficiently robust to be viable from the Government's viewpoint.
- 10.27 We acknowledge that Ministers – in initially refusing to provide assurance of support to TEIs – were focusing on TEIs producing a sound business case. The Government was nevertheless providing several other forms of assistance.<sup>11</sup>
- 10.28 Aspects of poor management and governance have been implicated in the institutions' failure. The MoE has told us that, in all such cases to date, there has been a significant element of management and governance failure. Indeed, Crown Observers<sup>12</sup> and a Crown Manager<sup>13</sup> were put in place because of this.
- 10.29 The delays and outcomes varied in each of the three TEIs.

## Taranaki Polytechnic

- 10.30 The 31 December 1999 financial statements of Taranaki Polytechnic (TP) were originally presented for audit in February 2000. TP presented a business case in June 2000. A loan of \$900,000 was approved in June 2000 to meet immediate cashflow difficulties. The loan was subsumed into the \$7.5 million Crown injection package – notified to TP on 20 November 2000 – that was developed to ensure its medium-term viability.
- 10.31 The appropriateness of TP preparing its financial statements on the basis of the going concern assumption was still at issue. It was not until April 2001 that we received sufficient assurances that TP's expected performance would see it still able to continue operating into the foreseeable future.

11 Letter from the Ministers of Education and Finance to the Auditor-General, 16 May 2000.

12 Independent adviser to the TEI's Council and management, appointed by the Minister of Education to represent the Crown's interests.

13 A manager appointed by the Crown, with functions and powers similar to those of a receiver, as a condition of the additional financial support provided to the TEI.

Even then, there were fundamental uncertainties about the projected proceeds from the sale of assets, and TP's ability to repay the loan elements of the Crown capital injection package as they fell due.

- 10.32 TP's 1999 financial statements received an unqualified audit opinion issued on 30 April 2001, but with an "explanatory paragraph" included in the audit report relating to those fundamental uncertainties. As the issues of going concern had been resolved, an unqualified opinion for the 31 December 2000 year was also issued on the same date.

### **Wairarapa Community Polytechnic**

- 10.33 Wairarapa Community Polytechnic (WCP) believed, as 1999 drew to a close, that it required further support from the Crown to be able to continue operating. WCP found itself unable to present its 31 December 1999 financial statements until the future options had been clarified, and it proceeded to investigate merger options.
- 10.34 Early negotiations about merger options were unsuccessful. After lengthy discussions an Order in Council determined – on 2 October 2000 – that WCP would be disestablished, and that its operations would be absorbed on 1 January 2001 into the Universal College of Learning (UCOL).
- 10.35 WCP's financial statements for the year ended 31 December 1999 were not presented for audit until 13 February 2001. The statements had by that stage been re-prepared on a disestablishment basis – as was appropriate – and an unqualified audit opinion was issued on 16 February 2001.
- 10.36 WCP's financial statements for the year ended 31 December 2000 – when it ceased operations – were presented for audit in September 2001. The audit report for 2000 has still not been issued, because of valuation and severance payment issues that require resolution.

## Wanganui Regional Community Polytechnic

- 10.37 Wanganui Regional Community Polytechnic (WRCP) originally presented its 31 December 1999 financial statements for audit on 14 April 2000, prepared on the basis of the going concern assumption. We did not accept the going concern assumption as an appropriate basis.
- 10.38 Over 2000 and 2001, WRCP's Council and management, and the Crown Manager who was subsequently appointed, attempted to put together a recovery package that would provide WRCP with a demonstrable path to financial viability. However, the recovery package did not eventuate, and the financial situation deteriorated over the period.
- 10.39 The Crown Manager reported in March 2001 that a substantial input would be required if WRCP was to be sustained. The Government provided interim cash cover. A working party report proposed options, and the Minister of Education (in consultation with the community) considered these. The Crown Manager and the MoE agreed that WRCP was not viable in the long-term.
- 10.40 As WRCP had presented its 1999 financial statements for audit prepared on the basis of the going concern assumption, an adverse audit opinion<sup>14</sup> was issued on 27 June 2001.
- 10.41 WRCP's financial statements for the 31 December 2000 year were presented for audit on 27 April 2001, but the audit opinion has still not been issued because of liability and valuation issues that require resolution.
- 10.42 UCOL will assume responsibility for public tertiary education in Wanganui from late-March 2002, in a community partnership with WRCP.<sup>15</sup>

<sup>14</sup> Adverse, as the financial statements had been wrongly prepared using the going concern assumption.

<sup>15</sup> Announcement by the Associate Minister of Education (Tertiary Education), 4 December 2001.

## Costs Associated with Poor Financial Condition

### *Costs of Developing Long-term Financial Solutions*

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- 10.43 Much of the delay centred on the failure of these TEIs to produce business plans that could satisfy Ministers about their medium-term viability. When there has been a serious deterioration in the financial position of the TEI, there may well be management issues that make it a lengthy matter to prepare a business case or recovery package to support the going concern assumption. That was so in these cases.
- 10.44 During the last two years, the Crown has had to seek the following extra appropriations to keep TEIs functioning:
- An additional \$2.950 million was appropriated in 2000-01 for Central Institute of Technology, to address its cash flow problems.
  - There was an appropriation of \$7.9 million in 2000-01 for Wanganui for the same reason,<sup>16</sup> and another loan of \$1.315 million made without appropriation, under section 12(1) of the PFA in 2000-01. A further loan of \$3.965 million was authorised for 2001-02.
  - In the case of Taranaki Polytechnic, there was an appropriation of \$8.4 million in 2000-01 for *financial assistance to the polytechnic by way of a Crown loan and new capital to assist with restructuring its operations*.<sup>17</sup>

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16 *Supplementary Estimates of Appropriations for the year ending 30 June 2001*, B.7 Vol. 1, page 149. We understand this was in the form of a loan of \$7.5 million, \$2.5 million of which was due and payable by 31 January 2002, at an interest rate of 9% – which is above commercial rates. The additional \$900,000 was provided previously as a loan, to be subsumed into the \$7.5 million.

17 *Ibid*, page 149.



### *Costs of Oversight*

- 10.45 No statutory oversight mechanism was available at the time these TEIs were in difficulty. Each – including CIT – has needed the oversight of Crown Observers (or in one case, a Crown Manager) for some time. Though we have to date been unable to obtain from the MoE an accurate account of the costs of this oversight for each TEI, the MoE acknowledges them to have been significant. Some costs have been incurred directly by the Crown, and others by the TEI.
- 10.46 The Crown Observers or Managers are still in place where the TEI is still operating. Where it is not – for example, in CIT and Wairarapa Community Polytechnic – a residual but very limited role exists.<sup>18</sup>
- 10.47 As well as this additional oversight, TAMU has substantially stepped up the frequency and extent of its own monitoring.
- 10.48 In our opinion the MoE needs to examine its mechanisms for business planning support for TEIs at risk, because there are benefits to the Crown in providing oversight and early intervention. We note that:
- The Government has recently appointed Crown Observers to a number of poorly performing TEIs to address institutional failure at an earlier stage.
  - The recently enacted Education Standards Act 2001 provides for improved accountability and support mechanisms for TEIs at risk. In our submission to the Education and Science Committee on the Bill we suggested that mechanisms for appointment of a “limited statutory manager” should be considered as an option for TEIs at risk – just as had been proposed for the compulsory education sector. The Committee did not adopt this suggestion. However, the Act makes provision for the appointment of Crown Observers or Commissioners for TEIs in appropriate circumstances.

<sup>18</sup> The residual role relates solely to the provision of assistance to the former Council in terms of the preparation of the final set of financial statements for the disestablished institution.

## *Costs of Replacement of Services*

10.49 Where a TEI fails financially, the educational services that it delivers may still be of high quality and sought after. Development of alternative services (including the costs to the new service provider) is costly. During the MoE's 2000-01 financial year, there were appropriations of:

- \$8 million *for assistance with the costs involved in disestablishing the Central Institute of Technology* – which had a total revenue of around \$17 million – *and incorporating it within the Hutt Valley Polytechnic*, now known as the Wellington Institute of Technology.<sup>19</sup> Further possible costs of \$17 million were envisaged and provided for.
- *\$4.6 million to meet the costs of the disestablishment of Wairarapa Community Polytechnic* – which, incidentally, had \$4.6 million total revenue in 1999<sup>20</sup> – *and its incorporation into the Universal College of Learning.*<sup>21</sup> Of this \$4.6 million, UCOL received \$2.56 million.

10.50 Other costs are expected to materialise in 2001-02 and 2002-03 relating to the restructuring of tertiary education provisions for the Wanganui district. The recent decision of a partnership with UCOL “brings with it an investment in the Wanganui community of up to \$48 million.”<sup>22</sup>

## *Other Costs and Risks*

10.51 As well as these costs, there are other commitments and risks that may crystallise when a TEI is disestablished. Two issues in particular that have come to our attention in the context of the audits referred to earlier are severance payments and lease commitments.

19 *Supplementary Estimates of Appropriations for the year ending 30 June 2001*, B.7 Vol.1, page 148.

20 *Annual Report*, page 17.

21 *Supplementary Estimates of Appropriations for the year ending 30 June 2001*, B.7 Vol.1, page 149.

22 See footnote 15 on page 119.

- 10.52 Severance payment procedures have caused concern in the case of two TEIs. Similar problems have been evident in other sectors, resulting in public complaints about “golden handshakes”. In the next few months we will be looking more generally at how public entities manage the risks involved in entering into severance agreements with senior employees.
- 10.53 Current and long-term lease liabilities may significantly add to the costs and the difficulty of disestablishing the TEI’s business.
- 10.54 There is also the risk of costs associated with legal action which students may take as a result of the (costs associated with) the disruption to their education. Former students of CIT, for example, are suing for the costs involved in their course being relocated to Auckland next year.<sup>23</sup>

## Conclusion

- 10.55 This report presents a deteriorating picture of the overall financial condition of the tertiary education sector. Three TEIs (Central Institute of Technology, Wanganui Regional Community Polytechnic, and Wairarapa Community Polytechnic) have had to be merged with another polytechnic, and another (Taranaki Polytechnic) is under severe financial stress. Other TEIs are also struggling financially to varying degrees.
- 10.56 With the end of another financial year approaching, we will continue to keep a close watch on the financial condition of TEIs and the measures taken by the MoE to control the situation.
- 10.57 We intend to report again on the subject next year.

Table 10.1  
TEI Financial Performance Indicators for 1999 and 2000 Financial Years

Institution	Operating Surplus/ (Deficit) as % of Income		Operating Surplus/ (Deficit) \$000		Equity \$000		Working Capital \$000	
	2000	1999	2000	1999	2000	1999	2000	1999
University of Auckland	2.4	6,270	9,802	615,101	626,678	4,915	17,606	
University of Canterbury	1.4	6,206	2,021	439,155	433,485	(3,347)	(11,481)	
Lincoln University	(2.0)	1,577	(1,151)	76,231	75,080	1,991	360	
Massey University	2.2	(11,985)	5,718	504,160	494,720	(3,965)	(29,025)	
University of Otago	2.5	12,393	7,064	461,696	468,862	(3,274)	(18,232)	
Victoria University of Wellington	(3.1)	19,458	(4,131)	347,107	286,673	6,959	5,271	
University of Waikato	3.8	2,047	5,360	226,174	216,054	6,508	2,138	
Auckland University of Technology	6.1	5,813	6,972	110,253	117,225	(5,355)	(8,563)	
Aoraki Polytechnic	(3.0)	(1,914)	(268)	11,319	10,790	(876)	(173)	
Bay of Plenty Polytechnic	5.1	1,873	894	32,570	33,464	1,745	717	
Central Institute of Technology	(27.0)	(1,899)	(4,621)	37,444	32,526	577	(3,105)	
Christchurch Polytechnic	(1.8)	668	(981)	81,348	81,152	(886)	(2,543)	
Eastern Institute of Technology	10.5	1,739	2,505	28,344	30,849	62	2,157	
Wellington Institute of Technology	1.5	232	249	24,059	24,308	5,187	2,984	
Universal College of Learning	1.8	421	474	39,657	45,601	(2,940)	(3,159)	
Manukau Institute of Technology	2.0	1,453	1,153	74,039	74,887	(2,952)	(2,505)	
Nelson/Marlborough Institute of Technology	(3.9)	(2,859)	(776)	16,519	15,743	(2,991)	(1,856)	
Northland Polytechnic	4.0	433	421	19,339	20,179	243	799	
The Open Polytechnic of New Zealand	11.3	3,883	4,822	24,689	30,294	228	3,926	
Otago Polytechnic	0.6	474	221	39,418	47,212	(575)	(839)	
Southern Institute of Technology	1.1	723	196	23,986	24,250	3,390	2,792	
Tai Poutini Polytechnic	4.7	267	276	4,324	4,600	861	915	
Tairāwhiti Polytechnic	(4.3)	(150)	(448)	12,149	12,635	(277)	(446)	

# FINANCIAL CONDITION OF TERTIARY EDUCATION INSTITUTIONS

B.29[01b]

Institution	Operating Surplus/ (Deficit) as % of Income		Operating Surplus/ (Deficit) \$000		Equity \$000		Working Capital \$000	
	2000		1999	2000	1999	2000	1999	2000
Telford Rural Polytechnic	1.6	26	3,188	3,229	(3)	40	(3)	40
Unitec Institute of Technology	3.3	2,988	63,600	66,555	(4,666)	(7,844)	(4,666)	(7,844)
Waiariki Polytechnic	2.3	464	22,055	22,343	3,868	(482)	3,868	(482)
Waikato Institute of Technology	(12.6)	(254)	(6,183)	90,201	5,609	6,598	5,609	6,598
Wairarapa Community Polytechnic(1)(2)	(67.3)	(480)	(2,730)	1,016	(1,054)	2	(1,054)	2
Wanganui Regional Community Polytechnic(1)	(14.9)	(1,982)	(2,389)	3,078	(3,796)	(6,418)	(3,796)	(6,418)
Western Institute of Technology at Taranaki	(30.7)	(1,495)	(5,255)	13,128	(1,881)	(937)	(1,881)	(937)
Whitireia Community Polytechnic	2.1	445	19,828	20,204	(374)	109	(374)	109
Auckland College of Education	12.6	1,305	4,753	57,302	9,379	9,182	9,379	9,182
Christchurch College of Education	4.7	1,192	1,587	42,894	(2,339)	(5,232)	(2,339)	(5,232)
Dunedin College of Education	5.6	637	989	36,825	4,618	5,845	4,618	5,845
Wellington College of Education	(4.5)	(125)	(752)	23,970	2,566	2,423	2,566	2,423
Te Wananga O Raukawa	18.7	1,090	1,535	13,063	(62)	8,507	(62)	8,507
Te Wananga O Aotearoa	(1.1)	30	(149)	12,082	(456)	5,540	(456)	5,540
Te Whare Wananga O Awanuiarangi	(10.2)	436	(269)	2,460	2,084	972	2,084	972

**Notes:**

- 1 Data for 2000 is unaudited.
- 2 The 2000 financial statements were prepared on a disestablishment basis, with fixed assets reclassified as current assets. To enable proper comparison, we have removed these assets from the calculation of working capital.

**Table 10.2**  
*Dates of Receiving Financial Statements and Completing Audits*

Institution	1999		2000	
	Statements Received	Audit Completed	Statements Received	Audit Completed
University of Auckland	17/02/00	20/04/00	1/03/01	28/03/01
University of Canterbury	13/03/00	24/03/00	16/02/01	10/04/01
Lincoln University	28/02/00	11/04/00	26/02/01	27/04/01
Massey University	11/04/00	28/04/00	19/03/01	23/04/01
University of Otago	16/02/00	22/02/00	20/01/01	22/02/01
Victoria University of Wellington	24/03/00	27/03/00	15/02/01	22/02/01
University of Waikato	3/03/00	24/03/00	16/02/01	28/02/01
Auckland University of Technology	6/03/00	28/04/00	1/03/01	27/04/01
Aoraki Polytechnic	21/02/00	9/05/00	19/03/01	10/04/01
Bay of Plenty Polytechnic	14/02/00	17/03/00	26/02/01	21/03/01
Central Institute of Technology	5/06/00	22/06/00	30/03/01	4/05/01
Christchurch Polytechnic	20/03/00	10/04/00	19/03/01	27/04/01
Eastern Institute of Technology	7/02/00	3/03/00	12/02/01	9/03/01
Wellington Institute of Technology	18/03/00	17/04/00	21/03/01	26/04/01
Universal College of Learning	24/02/00	20/04/00	10/10/01 (final)	7/11/01
Manukau Institute of Technology	7/02/00	1/03/00	12/02/01	28/02/01
Nelson/Marlborough Institute of Technology	19/04/00	28/04/00	16/04/01	30/04/01
Northland Polytechnic	23/02/00	30/04/00	28/02/01	30/04/01
The Open Polytechnic of New Zealand	28/01/00	25/02/00	28/01/01	23/02/01

# FINANCIAL CONDITION OF TERTIARY EDUCATION INSTITUTIONS

B.29[01b]

Institution	1999		2000	
	Statements Received	Audit Completed	Statements Received	Audit Completed
Otago Polytechnic	21/02/00	30/03/00	12/02/01	29/03/01
Southern Institute of Technology	15/03/00	27/04/00	12/03/01	12/04/01
Tai Poutini Polytechnic	8/03/00	30/03/00	12/03/01	17/04/01
Tairāwhiti Polytechnic	6/03/00	19/04/00	5/03/01	27/04/01
Telford Rural Polytechnic	23/02/00	6/03/00	12/03/01	6/04/01
Unitec Institute of Technology	3/04/00	28/04/00	30/03/01	27/04/01
Waianiki Polytechnic	13/04/00	8/05/00	14/03/01	22/05/01
Waikato Institute of Technology	6/03/00	17/03/00	9/03/01	2/04/01
Wairarapa Community Polytechnic	13/02/01	16/02/01	28/09/01	N.C.
Wanganui Regional Community Polytechnic	14/04/00	27/06/01	27/04/01	N.C.
Western Institute of Technology at Taranaki	29/02/00	30/04/01	26/03/01	30/04/01
Whitireia Community Polytechnic	28/02/00	30/03/00	26/02/01	2/04/01
Auckland College of Education	24/02/00	31/03/00	23/02/01	30/03/01
Christchurch College of Education	8/02/00	21/02/00	5/03/01	20/04/01
Dunedin College of Education	17/02/00	2/03/00	22/02/01	29/03/01
Wellington College of Education	15/02/00	24/03/00	20/02/01	29/03/01
Te Wananga O Raukawa	28/02/00	28/04/00	13/03/01	30/04/01
Te Wananga O Aotearoa	6/03/00	8/05/00	26/03/01	8/05/01
Te Whare Wananga O Awanuiarangi	27/03/00	28/04/00	23/03/01	30/05/01

**Note:**

N.C. = not completed.





Eleven

B.29[01b]

# Use of Professional Fund-raisers by School Boards of Trustees





*School boards of trustees (boards) engage in fund-raising for a variety of purposes – usually capital projects such as buildings or sports facilities. This might be regarded as a normal and legitimate activity of boards.*

*Some boards that we know of have entered into a type of contract with a professional fund-raising company that, in our view, involves making an unlawful investment by the board and puts the board's funds at risk.*

*The Minister of Education needs to consider whether a fund-raising arrangement that involves making an investment is an appropriate use of a board's funds, given the risks involved.*

*Before entering into any formal relationship with a professional fund-raiser, a board needs to make a careful assessment (after seeking appropriate advice) of what it is letting itself in for, whether it is likely to produce the outcome intended, and whether it needs the Minister's consent.*

11.1 In April 2001 we became aware of five school boards of trustees (boards) that had entered into a particular type of contract with a professional fund-raising company to raise funds for the benefit of their school. We do not know how widespread this type of contract is, or whether similar arrangements are being entered into by other public entities that engage in fund-raising.<sup>1</sup>

11.2 We examined all five of those contracts. Although varying in some detail, typically they involve:

- the board paying to the fund-raising company a set fee (in the region of \$100,000-\$200,000);
- the fee being paid in monthly instalments over a 12-18 month period; and

<sup>1</sup> Members of the Fundraising Institute of New Zealand, who we consulted in the preparation of this report, indicated to us that similar fund-raising schemes are being run by other schools and other public entities – including hospitals, tertiary education institutions and museums.

- in return, the fund-raising company undertaking a fund-raising campaign on behalf of the school in an effort to raise a “target” amount.<sup>2</sup>
- 11.3 The target amount specified in the five contracts ranged between \$2 million and \$5 million. However, there was no requirement in the contracts for the fund-raising company to achieve the fund-raising target, even when a “Plan of Action” was mentioned in the contract.
- 11.4 The types of fund-raising activities undertaken include:
- approaching former pupils of the school seeking donations or pledges of donations;
  - approaching other community organisations – such as the Lions, local community trusts, and the Lotteries Grants Board – for grants or donations; and
  - holding specific events where invited guests pay an entry fee or buy goods.
- 11.5 All money raised from those activities would be paid to the board.
- 11.6 We have two main concerns with this type of contract:
- in our view, it may involve making an unlawful investment by the board; and
  - it places the board’s funds at risk.

### Unlawful Investment?

- 11.7 Under the Education Act 1989 (the Act) the fund-raising contract appears to involve making an unlawful investment by the board. Section 73 of the Act regulates the way in which boards can invest money. In short, it allows boards to invest money only in “safe investments” – a registered bank or a public security.<sup>3</sup>

2 In addition, all five contracts provide either party with the right to terminate the contract on one month’s notice for any reason.

3 “Public securities” include securities issued under section 53 of the Public Finance Act 1989 or any provision of any other Act; and any loan or credit agreement, guarantee, indemnity, bond, note, debenture, bill of exchange, Treasury bill, Government stock, and any other security representing part of the public debt of New Zealand.

- 11.8 The object of section 73 is to protect boards' funds and to ensure that the inherent risks in investing their funds are properly addressed and limited. If a board wants to invest in anything other than a bank or public security, it must obtain the consent of the Minister of Education (the Minister).
- 11.9 The Act does not define what an "investment" is. In order to determine whether a certain type of expenditure constitutes an investment, we have adopted – in consultation with the Ministry of Education (the MoE) – an approach that looks at the *purpose* of the expenditure:
- if the primary purpose of the expenditure is to **discharge the functions of the board**, the expenditure is not an investment; but
  - if it is to **make more money** (whether or not that money would then be used to discharge the functions of the board) the expenditure constitutes an investment.
- 11.10 On that basis, in our opinion the five fund-raising contracts involve making investments, because the boards are spending money by way of a set fee for the sole purpose of making more money.
- 11.11 The Minister has given no consent that covers any of the five contracts and, consequently, the contracts appear to be unlawful. We have discussed the matter with the MoE, which concurs with our opinion.

## Funds at Risk

- 11.12 In none of the five contracts was there an obligation on the company to achieve the fund-raising target in order to be paid the agreed fee. Nor was there an obligation to follow a "Plan of Action" devised for the fund-raising campaign.
- 11.13 The absence of such safeguards does little to ensure that the board is likely to receive the expected return on its money.

### *Should Boards Make Fund-raising Investments?*

- 11.14 A board may lawfully enter into a contract for fund-raising. But, before doing so, a board should understand the nature and financial implications of the contract and (if required) obtain the Minister's consent.
- 11.15 The Minister needs to consider whether a fund-raising arrangement that involves making an investment is an appropriate use of the board's funds, given the risks involved. If the Minister decides that it is, we would expect that consent to any particular fund-raising investment would be preceded by demonstration that:
- the board has given the proposal sufficient consideration; and
  - the contract contains adequate safeguards for the board and minimises the risks to its funds.
- 11.16 Sufficient consideration by a board of a fund-raising proposal would include:
- enquiring about alternative proposals that might be available;
  - assessing the feasibility of the related fund-raising campaign;
  - establishing the board's liability for expenses and whether the expenses are justifiable; and
  - obtaining legal advice on the acceptability of the terms and conditions of the proposed contract.
- 11.17 Because of the inherent risks in fund-raising schemes, even the safeguards suggested in paragraph 11.16 may not be adequate to provide assurance that the board will obtain funds sufficient to:
- cover its outlays (especially the fee paid to, or retainable by, the fund-raiser); and
  - make the exercise worthwhile in terms of the objective of the fund-raising.

- 11.18 A board should not engage in a fund-raising scheme unless it is satisfied that the scheme is:
- likely to achieve a ‘success threshold’ that will meet or exceed an acceptable margin over the extent of risk involved; and
  - not unnecessarily putting its funds at risk.

## Action Required

- 11.19 We understand that the MoE intends to include a section on fund-raising contracts in its updated booklet *Financial Information for Schools*, which is to be published on its web site at the end of 2001 or the beginning of 2002.
- 11.20 In our opinion, the Minister should first consider the advisability of boards fund-raising by way of “investment” in the manner described in paragraph 11.2. If the Minister considers such a type of investment to be appropriate, the MoE should formulate and promulgate the preconditions that a board will need to meet before the Minister’s consent can be expected.
- 11.21 In respect of the contracts currently in force, more urgent action is required – because:
- There may be other boards involved in, or at risk of becoming involved in, similar fund-raising contracts.
  - A board that remains a party to one of these fund-raising contracts appears to be acting unlawfully and putting its funds at risk. Boards in this position need to take immediate action to either terminate the contract or gain the Minister’s consent.
- 11.22 The MoE has told us that such contracts cannot gain the Minister’s consent as they stand. It also says that – in addition to its general advice to boards on the matter – it will discuss the issue with the boards that have to date been identified, with a view to the contract being terminated or amended.

- 11.23 If a contract is to be amended, the amendments should result in a better balance between the risk and return to the board (as described in paragraphs 11.17 and 11.18).
- 11.24 We will keep the situation under review.

