

Australasian Council Of Auditors General

Peer Review

of the

New Zealand Audit Office

August 2001

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1.0 Introduction

- 1.1 The Australasian Council of Auditors-General (ACAG) was established following the 19th Bicentennial Conference of Australasian Area Auditors-General in Perth in 1993. ACAG provides consultative arrangements for the structured sharing of pertinent information and intelligence between Auditors-General. Membership of ACAG is open to the Auditors-General of all audit jurisdictions within Australia, New Zealand, Fiji and Papua New Guinea.
- 1.2 The objectives of ACAG are to foster and promote the development of Public Sector Auditing in the Australasian Region. Promoting the development of a professional quality assurance peer review programme for participating Offices is included among these objectives.
- 1.3 This report describes the findings of the first such peer review of the New Zealand Audit Office, conducted between 26 February and 10 March 2001.

Review Team Members

- 1.4 Review Team members were:
 - Dr Gordon Robertson, retired Deputy Auditor-General for Western Australia;
 - Mr Phil Thomas, Assistant Auditor-General, New South Wales Audit Office;
 - Mr Russell Walker, Assistant Auditor-General, Victorian Audit Office; and
 - Mr David McKean, Executive Director, Australian National Audit Office.

Scope and Approach

- 1.5 A significant difference between the New Zealand Audit Office and those of other jurisdictions is the division of the Audit Office into two separate business units:
 - the **Office of the Auditor-General (OAG)**, which provides technical advice and oversight of all audit activities; and
 - **Audit New Zealand**, which is a quasi-independent business unit that undertakes audit assurance work on the Auditor-General's behalf along with private sector audit service providers.
- 1.6 The ACAG review addressed the Audit Office, most aspects of the Office of the Auditor-General and aspects of Audit New Zealand.
- 1.7 The approach included
 - Extensive briefings from and interviews of senior staff;
 - Interviews of key external stakeholders; and
 - Review of documents and files.

- 1.8 The Controller functions of the Controller and Auditor-General were not addressed by this review.

Structure of the Report

- 1.9 The report is split into two parts:
- Office of the Auditor-General (sections 2 and 3); and
 - Audit New Zealand (sections 4 and 5).
- 1.10 Both parts have an individual Executive Summary and a Detailed Review.
- 1.11 In addition, the responses of the Office of the Auditor-General and Audit New Zealand to the '*Opportunities for Improvement*' set out in the report are detailed in Section 6.

2.0 Office of the Auditor-General (OAG) – Executive Summary

Effectiveness of the Auditor-General

- 2.1 The Auditor-General operates as a constitutional safeguard to maintain the financial integrity of New Zealand's parliamentary system of government. The Auditor-General has no executive power. However, he provides assurance that the 3,900 public entities he audits are operating in a manner consistent with Parliament's intentions, and can report publicly where this is not the case or where he sees room for improvement. The perceptions of stakeholders, especially the Members of the Parliament to whom he reports and the leaders of the sectors with whom he interacts, are therefore of vital importance to the effectiveness of his function.
- 2.2 The review found that the Auditor-General is effectively meeting the needs of key stakeholders.

Parliament

- 2.3 The Auditor-General is highly regarded by Members of the New Zealand Parliament and his integrity, credibility and authority were described as being without question. The Members interviewed perceive him to be unbiased and fair, and indicated that they place great reliance on his work. His Reports to Parliament are widely read by both government and agencies and are seen to contribute to improvement in public administration. Briefings provided to Parliamentary Committees by the Auditor-General's staff are well received and highly valued and the quality of explanations in the briefs was described as exceptional. Inquiries conducted by the Auditor-General are also well regarded, with Members expressing the view that the integrity of his Inquiries is without question.

Local Government

- 2.4 Representatives of local government similarly hold the Auditor-General in high regard. Both the OAG and Audit New Zealand have a reputation within the local government sector for being incorruptible and are regarded as being measured, sensitive and balanced when dealing with local government issues. Management of local authorities value the assistance provided by the OAG when implementing changes arising from new legislation. They are particularly appreciative of the OAG's good practice guides.

Central Government Agencies

- 2.5 Central government agencies described their relationship with the Auditor-General as satisfactory and the level of consultation taking place as appropriate. There was reluctant acceptance by central agencies of the role for the Auditor-General's staff in providing advice to Parliamentary Committees, although the view was expressed that auditors should be more cautious when framing questions in that environment. Nonetheless the credibility of the Auditor-General is high and his ability to conduct Inquiries, particularly those involving questions of probity, is seen by central agencies to be very important. Central agencies also view the Auditor-General's Reports as making a useful contribution to debates on finance and accountability but felt that the Auditor-General needs to be more transparent about how special studies are chosen. They have a high level of confidence in the financial accounting expertise, professional astuteness and competence within the OAG, and its activities are seen as being proactive and useful in financial matters.

Auditing Non-financial Information

- 2.6 While financial audit opinions are well regarded by all stakeholders, the audit of non-financial information may need some attention. Some reservations were expressed as to the competence of auditors to adequately address non-financial matters.

Operation of the Auditor-General's Office

Legislative Base

- 2.7 The new Public Audit Act, which will take effect from 1 July, 2001 is of great significance as it will give a firm base upon which the Auditor-General will be able to achieve his purpose. The legislation strengthens the independence of the Auditor-General and expands his mandate to include every public entity in New Zealand. The legislation also regularises customary reporting relationships by enabling the Auditor-General to report to Parliament or its Committees, Ministers, public entities or any person.

Funding

- 2.8 Under the New Zealand system of Output Based Management, the Audit Office is funded to produce four Output Classes. Reports and Advice includes undertaking and reporting on special audits of public entities as well as reporting to and advising parliamentarians on results of audits and investigations; Controller Certifications of authority to release funds from the Crown bank account; Non-Contested Audit Services to approximately 500

public entities where the audit is not allocated by contestable process; and Contested Audit and Assurance Services where the audit is allocated by contestable process. The last of these Output Classes is funded on the Mode B Net basis, enabling costs to be incurred up to the amount of revenue generated, which the review team recognised as essential in the contestable environment.

Structure

- 2.9 The OAG has been structured along sectoral and functional lines that are appropriate for the legislative and environmental framework within which it operates. These comprise a Parliamentary Group, which deals with the central government sector; a Local Government Group which deals with the local government sector; and groups that deal with Special Audits and Studies, Accounting and Auditing Policy, Legal, and Corporate Support functions.
- 2.10 The review team concluded that the structure is appropriate for the legislative and environmental framework within which the OAG operates.

Audit Process

- 2.11 The OAG has in place a comprehensive strategic audit-planning framework that enables it to gather and distil intelligence on all aspects of public sector activities. From this it develops detailed rolling three-year Strategic Audit Plans for both its Parliamentary and Local Government Groups. These plans are used to support decisions to proceed with selected audit interventions such as special studies; a focus incorporated into annual assurance audit work; or best practice guides.
- 2.12 Overall, the review team was impressed by the comprehensiveness and quality of these plans. However, the review team has suggested improving the criteria for selecting audit interventions and improving reporting of the rationale behind selection, thereby satisfying the desire expressed by a number of stakeholders to have a better understanding of how special audit studies in particular are selected.

Special Audits and Studies

- 2.13 Topics for special audits can arise from the Strategic Audit Plans, the OAG policy of following up previous studies, topics emerging from other studies or from special investigations for Parliament on behalf of Select Committees. The Special Audits and Studies Group conducts 7-9 of the special audits undertaken by OAG each year. Other OAG staff, Audit New Zealand, or external consultants, undertake 3-4 of the special audits each year.
- 2.14 Once an audit proposal is formally approved, the methodology followed by the Special Audits and Studies Group in conducting a special audit is sound,

containing sufficient guidance to be useful whilst avoiding excessive prescription. In the files examined by the review team the methodology was closely followed and appropriately documented. The evidential standards underpinning the special audit studies were good and internal quality assurance was satisfactory. The review team identified some opportunities for improvements in the areas of project management and report writing.

Enquiries, Complaints and Inquiries

- 2.15 The Auditor-General may inquire, either on request or on his own initiative, into any matter concerning a public entity's use of its resources. Approximately 20 per cent of enquiries originate from Members of Parliament. Taxpayers account for a further 20 per cent, while ratepayer enquiries account for 60 per cent. A number of enquiries lead to major inquiries or special studies separately reported to the Parliament by the Auditor-General.
- 2.16 Inquiries undertaken by the Special Audit and Studies group follow their procedure manual. However, there are no established procedures for inquiries undertaken by other groups within the Office. An examination of a limited number of inquiry files showed adequate documentation of the process followed but did not record approvals for the inquiry to proceed. The review team identified an opportunity to improve the procedures surrounding enquiries and complaints.

Contestability

- 2.17 While the New Zealand public sector was undergoing extensive reform in 1992, the then Auditor-General introduced a system of contestability for public sector auditing. The private sector is now involved in about 39 per cent of the audit effort and further expansion of contestable audits is planned. The OAG has detailed procedures in place for managing the contestability process, which include oversight of the tendering process by an independent evaluator, the provision of highly regarded Auditing Standards and Guidelines and a number of quality assurance checks.
- 2.18 The review team examined the contestability model in some detail and concluded that it is working as designed. However, monitoring of the outcomes of the contestability regime would be improved by introducing more comprehensive management metrics and it is timely for a formal evaluation of the benefits and costs of the regime to be undertaken. The review team was also of the view that a retendering policy is needed to limit the duration of the association between individual entities and audit service providers, while addressing equity and fairness to market place participants.

Administration

- 2.19 The OAG has in place a comprehensive strategic business plan that addresses its overall operational capacity and links its goals with strategies for all deliverables for both external and internal deliverables. It also has a “Board of Management”, which meets regularly, making decisions on all significant matters, effectively tracking progress against targets and monitoring financial and other aspects of performance.
- 2.20 The review team concluded that the overall management control framework is both strong and effective and saw only minor areas for improvement.
- 2.21 The corporate support framework provides a comprehensive system of information management and, although there is some room for improvement in the integration of data systems, the information technology, financial, human resources and asset management systems are appropriate for the OAG’s needs.

3.0 Office of the Auditor-General – Detailed Findings

Effectiveness of the Auditor-General

- 3.1 The Auditor-General operates as a constitutional safeguard to maintain the financial integrity of New Zealand’s parliamentary system of government. Apart from the limited power embodied in the Controller function, certain statutory functions under the Local Authorities (Members’ Interest) Act 1968, and (an inappropriate and soon to be removed) power to surcharge members of local authorities, the Auditor-General has no executive power. However, he provides assurance that the 3,900 public entities he audits are operating in a manner consistent with Parliament’s intentions, and can report publicly where this is not the case or where he sees room for improvement.
- 3.2 To be effective therefore, the Auditor-General must be perceived as independent, credible, competent, authoritative and fair by those he seeks to influence. The review team interviewed a number of key external stakeholders to gauge the nature of these perceptions and concluded that the Auditor-General is effectively meeting the needs of key stakeholders.

Parliament

- 3.3 The review team met with the following Members of Parliament (MP):
- Rt Hon. Jonathan Hunt, Speaker of the House of Representatives and Chairperson of the Officers of Parliament Committee;
 - Mr Mark Peck, Chairperson and Mr Rodney Hide, Member of the Finance and Expenditure Committee;
 - Mr Damien O’Connor, Chairperson of the Primary Production Committee; and
 - Ms Jeanette Fitzsimons, Chairperson of the Local Government and Environment Committee.
- 3.4 The MPs were unanimous in their praise of the Auditor-General and his Office. The Auditor-General’s integrity, credibility and authority were described as being without question. He is highly regarded by MPs in all political parties and perceived as being unbiased and fair. All of the MPs place great reliance on the Auditor-General and expressed total confidence in his work. Several MPs commented favourably on the achievement of the present Auditor-General in overcoming the difficulties created by his predecessor.

Committee Briefings

- 3.5 All MPs interviewed indicated that Committee briefings are very well received and highly valued. The Audit Office is helpful in achieving a sense of how well a department is run. MPs were generally comfortable with the analyses given in briefings and subject matter is also considered to be good. The advice from the Auditor-General’s staff is perceived as authoritative, sound, well prepared and well supported by facts and is therefore rarely subject to attack.
- 3.6 Advice received from the Auditor-General whenever requested by Committees has been timely and valued. The quality of explanation in OAG briefs was described as exceptional.
- 3.7 OAG staff attending briefings are perceived as being unbiased – which is important to Committee members – and a number of individual OAG staff were frequently singled out for praise.
- 3.8 Several MPs commented that within the Committee there is a balance between the battleground of politics and objective information. This is well managed by OAG staff, who are well aware of political boundaries.

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| 3.9 | However, several MPs commented that OAG advice in Committee Briefings tends to be focused on audit interests. Financial analysis was described as “great” but non-financial performance information was “not so good”. Some MPs expressed reservations about the competence of the Audit Office in non-financial areas. |
| 3.10 | At least one MP confused the Office of the Auditor-General with Audit New Zealand, suggesting that the distinction between the OAG and its service providers is not yet fully understood. |
| 3.11 | <i>Opportunities for Improvement:</i> <ul style="list-style-type: none">• <i>The OAG should address MPs’ concerns about its competence in non-financial areas.</i>• <i>The OAG should take steps to ensure that it is not confused with its service providers.</i> |

Reports

- 3.12 Because of their different interests, MPs do not read all reports from the Auditor-General. However, all MPs were familiar with reports, describing them as highly relevant, useful, impartial, forthright, well directed and of high standing.
- 3.13 MPs believe that reports are widely read by both government and agencies and that they do improve public administration – their impact was described as medium to high. The impact is expected to improve now that the Finance and Expenditure Committee is following up reports.

- 3.14 MPs believe that the Auditor-General is careful of what is written and is generally successful in avoiding entering into the policy debate.
- 3.15 Report presentation has improved significantly over recent time and the quality was variously described as "perfectly adequate" or "excellent". All MPs considered that the reports were easy to read, businesslike, and did not embellish the subject matter. Tables and graphs are helpful, recommendations are clear, chapter construction is good and MPs found it easy to find their way around the reports.

- 3.16 ***Opportunities for Improvement:***
- *One MP suggested that it would be helpful if the Auditor-General explained how an audit works. This process is "interesting in the forensic sense" but remains a mystery to many MPs.*
 - *One MP expressed the view that the Auditor-General should "stick to dollars". A contrary view was also expressed but with the caveat that the Auditor-General should ensure that relevant expertise was engaged when commenting on non-financial matters.*
 - *One MP expressed the view that reports should be more focused on current issues. Although they should take lessons from the past, little was gained by simply raking over old coals.*
 - *Some MPs believed that the accessibility of reports could be improved by (more consistent) use of executive summaries and summaries of recommendations.*

Inquiries

- 3.17 The Auditor-General's inquiries are well regarded and the priority given to inquiries is appropriately high. MPs expressed the view that the integrity of inquiries was without question and that they had high confidence in the outcome of any Auditor-General inquiry. *"The Auditor-General can be relied upon to play a straight bat."*
- 3.18 One MP expressed the view that it would be valuable if the Auditor-General became involved in Committee inquiries but recognised that the Auditor-General should not be directed by Parliament.

Local Government

- 3.19 The review team met with a senior staff member of Local Government New Zealand and three representatives of the Society of Local Government Managers.
- 3.20 The quote *"if only our relationship with all parts of government were as good as they are with the OAG"* fairly sums up the positive perceptions of those interviewed.

- 3.21 According to those interviewed, Council Members and management both hold the Auditor-General in high regard, seeing him as fair and even-handed in his dealings with local government authorities. Both the OAG and Audit New Zealand have a reputation with the local government sector for being incorruptible.
- 3.22 The OAG has regular contact with both the sector-wide bodies and individual local government authorities. There is good public consultation and communication between the OAG and local government was described by those interviewed as exceptionally good. *“The OAG are particularly good at talking through issues and are also prepared to listen to local authority points of view.”*
- 3.23 Overall local government is very pleased with the way the Auditor-General has worked, describing it as:
- Measured;
 - Sensitive; and
 - Balanced.
- 3.24 The OAG is seen as being especially helpful on major issues that affect the broad range of local authorities and works closely with local government to resolve difficulties. It has been useful in drawing attention to obsolete or unworkable legislation, thereby facilitating change.
- 3.25 Local authorities particularly value assistance provided by the OAG when changes arising from new legislation are being implemented. Both groups described the "road shows" comprising the OAG, local government and other government agencies as vital to effective implementation. Reference was made to the relatively new financial accountability legislation in which the OAG played a pivotal role in disseminating information and providing guidance on appropriate responses to the legislation.
- 3.26 The audit approach is seen as positive, working with the sector to bring about improvement rather than against it. The OAG approach of using effective communication and persuasion rather than “clobbering” an authority is greatly appreciated. *“Audit does not kick you unless you are recalcitrant.”*

Reports and Good Practice Guides

- 3.27 The OAG is seen to be proactive, good at sizing up the situation, then effective in developing guidelines and reports. The OAG evaluations conducted of new approaches to service delivery were described as helpful in identifying emerging issues.
- 3.28 Reports are highly valued and, since they are also put out for consultation, they effectively match the reality of the situation. The language of the Auditor-General's publications was described as good, with the reports described as accessible, clear, and understandable.
- 3.29 The OAG approach of soliciting feedback on fact and nuances within the Auditor-General's annual report to Parliament on the sector was described as

highly successful and very effective. They have gained a reputation for listening and adjusting accordingly.

Public Complaints

- 3.30 The OAG's response to public complaints was described as thorough. They are seen as:
- Willing to take each complaint seriously;
 - Capable of investigating hard issues;
 - Prepared to dismiss spurious complaints; and
 - Applying appropriate sanctions by naming the authority in a Report to Parliament and/or advising the Minister.
- 3.31 The demarcation line between the OAG and Audit New Zealand is blurred. In practical terms issues raised at the local level are referred to Audit New Zealand and thence to the OAG.

Other Matters Raised

- 3.32 Most local government authorities have a preference for Audit New Zealand as opposed to other audit service providers because of their better understanding of the sector. Rotation of auditors is working satisfactorily and they generally have a consistent approach.
- 3.33 Local government managers also see the OAG and Audit New Zealand as a good source of well-trained staff.
- 3.34 Auditors lack the expertise to make meaningful comment in non-financial technical areas and should make greater use of expert advice.
- 3.35 When commenting on emerging approaches to Council service delivery the Auditor-General has, on occasion, been insufficiently critical of specific examples of poor management practices, which can by inference reflect badly on management practices of Councils generally.

- 3.36 ***Opportunities for Improvement:***
- *Auditors should ensure that they have sufficient expertise, including relying on the work of experts, to make meaningful comments on non-financial matters.*
 - *At times the Auditor-General should state his views on the management of emerging approaches to Council service delivery more strongly.*

Central Government Agencies

- 3.37 The review team met with:
- Mr Mike Wintringham, State Services Commissioner;

- Mr Mark Prebble, Chief Executive, Department of the Prime Minister and Cabinet; and
- Messrs Geoff Dangerfield (Deputy Secretary), Ken Warren, David Galt, and Luke Peacocke of the Treasury.

3.38 Although the perspectives of each central agency varied, the views expressed are synthesised below.

Relationship with Central Agencies

3.39 The Auditor-General is seen as an important constitutional safeguard. This role automatically creates a degree of tension with central agencies, but for the most part this is managed in a satisfactory manner. The liaison between central agencies and the Auditor-General was also described as satisfactory with appropriate consultation taking place. There have been instances in the past where the Auditor-General has been criticised for intruding into policy, but not recently.

Committee Briefings

3.40 There was reluctant acceptance of this role for the Auditor-General's staff. The advice provided when Departmental Annual Reports are reviewed is seen to be entirely within the audit role, but there is a perception that auditors are out of their depth in non-financial matters and struggle with issues associated with priorities for policy direction when committees deal with Departmental Forecast Reports. There is also a view that auditors should be more cautious when framing questions for committees.

Inquiries

3.41 The credibility of the Auditor-General is high, and his ability to conduct inquiries, particularly those involving questions of probity, is seen to be very important.

Reports

3.42 The high status of the Auditor-General means that his reports carry considerable weight. The process followed in the production of reports is good with appropriate exposure of drafts for comment. However, the reports are of variable quality and there are general concerns that feedback from central agencies is not listened to.

3.43 The reports can make a useful contribution to debates on finance and accountability, but some of the reports are too idealistic and make impracticable recommendations. In contrast, others expressed the view that the Auditor-General was insufficiently firm when reporting adverse findings.

- 3.44 A view was also expressed that the Auditor-General needs to be more transparent about how special studies are chosen.

Accounting Standards and Auditing Standards

- 3.45 The OAG has a very high level of financial accounting expertise, professional astuteness and competence. The confidence in OAG comment on accounting matters is high – on a par with the big five accounting firms or better – and it is seen as proactive and useful.

Audit Opinions

- 3.46 While financial audit opinions were well regarded, the audit of non-financial information received some criticism. Following the introduction of non-financial reporting, the OAG took an active role. At present they are seen to have been relatively quiet, which has had the effect of slowing developments. Greater scrutiny by audit might stimulate agencies to do better in this area.
- 3.47 A view was expressed that the “appropriateness” of non-financial information should be reported upon by audit. However, some doubt was expressed as to the capability of auditors to fully understand the business they were analysing and whether even cost and quantity indicators are being adequately addressed.

- 3.48 ***Opportunities for Improvement:***
- *The transparency of topics selection for special audits could be improved;*
 - *The Auditor-General could be more firm when reporting adverse findings; and*
 - *More attention could be paid to the audit of non-financial information.*

Operation of the Auditor-General’s Office

Legislative Base

- 3.49 At the time of the review, the Auditor-General was operating under the Public Finance Act (1977). However, a new Public Audit Bill was before the New Zealand Parliament and has now passed into law, with effect from 1 July 2001. The new legislation reforms and restates the law relating to the auditing of public sector organisations. It:
- Establishes the Auditor-General as an Officer of Parliament thereby assuring independence from Executive Government;
 - Abolishes the Audit Department so that the Auditor-General no longer employs staff as a Departmental Chief Executive;

- Expands the Auditor-General’s mandate to include every public entity in New Zealand, and apply it consistently to most entities.
- 3.50 The ‘legislative audit model’ adopted by the Auditor-General is encompassed in the new legislation in that he is required to audit the financial statements and accounts of public entities and (for most public entities) is able to examine:
- Effectiveness, efficiency (within the bounds of government or local government policy);
 - Compliance with statutory obligations;
 - Waste; and/or
 - Probity.
- 3.51 In addition to reports to the House of Representatives on matters arising out of the performance and exercise of the Auditor-General's functions, duties, and powers, the legislation also regularises customary reporting relationships, enabling the Auditor-General to report on any matter to:
- A Minister;
 - A committee of the House of Representatives;
 - A public entity; or
 - Any person.
- 3.52 The legislation also enables the Auditor-General to provide other assurance services to public entities of a kind that it is reasonable and appropriate for an auditor to perform.
- 3.53 The new legislation is of great significance as it gives a firm base upon which the Auditor-General will be able to achieve his desired outcomes which are:
- Parliament and the Public will be confident that public entities:*
- *Are delivering what they have been asked to;*
 - *Have operated lawfully, honestly, and have not been wasteful;*
 - *Have fairly reported their performance;*
- and know that if this is not the case [the Auditor-General] will tell them.*
- And:
- Government and public entities will effect improvements in public sector performance and accountability in areas [the Auditor-General has] advised that there is potential for improvement.*

Funding

- 3.54 Under the New Zealand system of Output Based Management, the Audit Office is funded to produce four Output Classes.

Reports and Advice

- 3.55 This includes:
- Undertaking and reporting on special audits of public entities' performance, accountability and probity, resulting in 8-10 reports per year (\$2.353 million);
 - Reporting to and advising parliamentarians, either in Select Committees or as Ministers or individual Members, on the results of audits and investigations (\$0.640 million); and
 - Responding to about 300 enquiries from taxpayers, ratepayers and individual Members of Parliament on matters that the Auditor-General thinks it appropriate to investigate (\$0.300 million).

Controller Certifications

- 3.56 Certification of authority to release funds from the Crown Bank account – checking that warrants issued by the Governor General and amounts released to departments are supported by appropriation.

Non-Contested Audit Services

- 3.57 Provision of audit and assurance services to approximately 500 public entities where the audit is not allocated by a contestable process.

Contested Audit and Assurance Services

- 3.58 Provision of audit and assurance services to approximately 3,300 entities (including 2,600 schools) where the audit is allocated by a contestable process. This last class is funded on a Mode B Net basis, which means that without further appropriation costs may be incurred up to but not exceeding the amount of revenue generated.

Structure

- 3.59 To deliver its outputs, the OAG has been structured along sectoral and functional lines, each group being headed by an Assistant Auditor-General.
- 3.60 The two sectoral groups are:
- **Parliamentary Group** (all entities in central government, education, health, primary production, social services etc); and
 - **Local Government Group** (all local authorities, airports, ports and energy companies and other local entities).
- 3.61 The four functional groups are:
- **Special Audits and Studies** (conducts special audits at the request of Sector Managers in either the Parliamentary or Local Government Group. It undertakes inter-agency and cross sectoral reviews, performance and

value-for-money audits, special investigations and other major studies. It also provides assistance and analytical support to the other groups);

- **Accounting and Auditing Policy** (develops and promulgates accounting and auditing policy, undertakes audit quality assurance, conducts tendering for audit services, and manages audit contracts with audit service providers);
- **Legal** (provides legal advice to the Auditor-General and the OAG as a whole); and
- **Corporate Services** (undertakes strategic and corporate planning, finalises publications, and provides support functions in finance, payroll, information technology and human resources management).

3.62 The review team concluded that the structure is appropriate given the legislative and environmental framework within which the OAG operates.

3.63 The strong focus on sectors is also appropriate for the planning and delivery of services, and the extensive interaction which occurs between the Office and New Zealand's system of Parliamentary Committees, which are also structured along sectoral lines.

Audit Process

Strategic Planning

3.64 The OAG has a great need to keep abreast of issues arising within the public sector. To this end it has developed a comprehensive system of gathering and distilling intelligence on all aspects of public entity activities from which it develops detailed rolling three-year Strategic Audit Plans (SAP) for the Parliamentary and Local Government Groups. These plans are updated annually.

3.65 The Parliamentary SAP is supported by information drawn from a wide range of sources including analysis of Hansard, changes in legislation, published reports, statistical information and forecasts, intelligence from auditors and other sources. Strategic Audit Plans are prepared for each sector as well as from a whole of government viewpoint. The individual sector plans are used as the source to develop the Strategic Audit Plan of the Parliamentary Group. From this process issues and possible audit interventions are identified.

3.66 Until recently, the ranking method used for Parliamentary Group interventions was governed by a socio-economic model, which essentially aimed at identifying the audit intervention that would have the greatest long-term impact on reducing an expected loss in public welfare against the expected payoff from the proposed intervention. This model proved too complex and has now been abandoned. As a result the individual sector plans do not have a basis of project prioritisation – that is, selection criteria – and Sector Managers now assess the value of possible interventions. The Parliamentary SAP also does not take account of the limited resources available to undertake special studies, outline past audit coverage (say over

the past 10 years) or outline the spread of the projects over the 3 years of the plan. In addition, it is difficult to link the individual sector plans with the overall plan of the Parliamentary Group.

- 3.67 Because of the different legislative framework and operational environment, the Local Government SAP is derived somewhat differently. It is also more comprehensive. It commences with an analysis of the high-level generic risk to the local government sector under the key legislative audit model elements of performance, waste, accountability, probity and authority. The identified risks are then set against the legislative environment in which local government operates and the OAG goals for the current year. Information is then gathered from liaison with the sector and other parts of the OAG, and an analysis of ratepayer enquiries. From this, issues and possible audit interventions are identified and the scale of intervention assessed. These are then weighted on a judgement basis against the criteria of:
- Alignment with OAG operating goals and strategies;
 - Whether the OAG is the best party to carry out the work;
 - Cost/benefit to local government; and
 - Cost/benefit to OAG.
- 3.68 Possible timing, products and resources are also assessed. High-ranking interventions are then prioritised and allocated to a possible time schedule.
- 3.69 SAPs are supplemented by biannual environmental scans conducted by working groups within the OAG to identify emerging issues in accountability, government and auditing. These documents cover a wide range of topics with observations about their potential impact on the public sector and an assessment of what the OAG needs to do about it.
- 3.70 The Sectoral SAPs are also supported by two Subject SAPs – Environment and E-government.
- 3.71 The end result of the SAP process is a decision to proceed with selected interventions. This may be a special audit; a focus incorporated in the annual Audit Brief to audit service providers; a best practice guide; or other means of raising the profile of the issue.
- 3.72 The review team was impressed by the comprehensiveness and quality of these plans. They clearly demonstrate the success of the OAG’s intelligence gathering and provide a sound base for future directions.

3.73 *Opportunities for Improvement:*

The selection criteria for audit interventions should be more specific and cover a range of issues such as:

- *Risk – social, environmental and economic;*
- *Materiality;*
- *Public Interest;*
- *Improvement in resource management; and*
- *Enhancing accountability,*

with immediacy being a key determinant when prioritising projects.

The plans would be more informative and useful for decision making if they outlined past interventions, say over the past 10 years. Transparency could be improved by better reporting of the rationale behind selection, thereby satisfying the desire expressed by a number of stakeholders to have a better understanding of how special studies in particular are selected.

Special Audits and Studies (Performance Audits)

- 3.74 Topics for special audits and studies can arise from the Strategic Audit Plans, the OAG policy of following up previous studies, topics emerging from other studies, or from special investigations for Parliament on behalf of Select Committees. Sector Groups recommend priorities for approval by the Board of Management and the Auditor-General.
- 3.75 The Special Audits and Studies Group (SAS) conducts 7-9 of the special studies undertaken by the OAG each year. Other OAG staff, Audit New Zealand, or external consultants, undertake 2-3 of the special studies each year.
- 3.76 In addition to special studies, SAS is also involved in research or in response to enquiries and complaints. This consumes about 20 per cent of the SAS resource.
- 3.77 Following the selection of a topic for further study, the relevant Sector Manager may commission SAS to develop the topic into a study proposal. This involves considerable background research and results in a detailed document describing issues to be addressed, risks and benefits, scope and approach, and reporting objectives.
- 3.78 Once a proposal is formally approved, the methodology and standards followed by SAS in conducting a special study are sound. Because, unlike audit assurance work, each special project is likely to be unique, it is not feasible to adopt a prescriptive methodology. The review team formed the view that the methodology used by SAS contains sufficient guidance to be useful whilst avoiding excessive prescription. In essence, the methodology requires:
- The development of a detailed **audit plan** addressing scope, criteria to be used in assessment, method to be used in testing performance, fieldwork to be undertaken, and the role and credentials of proposed technical or other external advisors. A project budget is prepared which includes estimated timeframes and resources. Formal approval by a Project Steering Committee¹ is required before the plan can be put into effect.
 - A **value added plan** is developed which assesses the scope of interest of the likely report, determines the appropriate format, and determines an effective follow up process.

¹ Each special study is overseen by a Project Steering Committee comprising, as a minimum, the Sector Manager, the SAS team member(s) working on the study, the Assistant Auditor-General SAS and the sector Assistant Auditor-General.

- *Fieldwork* is undertaken and results are analysed by the method appropriate to the study determined by the plan.
 - A *Summary of Findings Report* is produced that covers key findings and preliminary conclusions. The report is subject to review by the Assistant Auditor-General Special Audits and Studies Group, Special Audits and Studies Group peers, the advisors (if applicable) and the Sector Manager. It is approved by the Project Steering Committee. A full *draft report* is then produced on the basis of the Summary of Findings report.
 - A *substantiation* file is prepared which ensures that key evidence is readily to hand should the report be challenged.
 - A *clearance process* is undertaken with the audited entity, the purpose being to agree the facts. Care is taken to preserve confidentiality and to minimise the risk of leakage of the report at this time.
 - A separate OAG *Reports Group edits the report* to the OAG style and standard.
 - The *report is finalised* with OAG management and *published*.
- 3.79 A *post project review* is undertaken with the objective of using the experience gained to develop improved approaches for the future.
- 3.80 The methodology was fairly closely followed and appropriately documented in the files examined by the peer review team. Files were well structured and comprehensive.

Early Project Development

- 3.81 The information contained in some topic descriptions can be very brief and SAS has, on occasion, had difficulty capturing the essence of the topic in the highly specific study proposal it develops. Although OAG policy indicates that the proposal should be developed in liaison with the sector manager, breakdown in communication has resulted in unnecessary or ill-directed research and rework has been required to refine the proposal to meet the OAG's needs. In some cases, the early misunderstanding has not been clarified, resulting in the production of a draft report that fails to meet OAG expectations and requires extensive rewriting at the publication stage.
- 3.82 This problem has recently been partly overcome by the earlier establishment of the Project Steering Committee, chaired by the relevant sector Assistant Auditor-General and comprising the Sector Manager, Assistant Auditor-General SAS and members of SAS, which has improved communication – and there was evidence of active involvement of the Project Steering Committee at key points in the files examined. The recent decision to give earlier attention to the development of a ‘value added’ (marketing) plan should also assist in developing a common understanding of the purpose for which a special study is being conducted. However, communication in the early stage of project development remains an area for further improvement.
- 3.83 The review team suggests that the risk of miscommunication could be reduced if the Sector Manager clearly specified the outcomes desired of the study in a comprehensive “project brief”. An “options paper” could then be

developed by SAS in consultation with the relevant sector manager, which would explore alternative approaches before resources are committed to the development of a more detailed project proposal.

3.84 ***Opportunities for Improvement:***

- *Sector Managers should clearly specify the outcomes desired of a special study in a comprehensive “project brief”.*
- *Options papers should be developed in response to the brief that enable more informed consideration by management of alternative courses of action.*

Choice of Audit Criteria

3.85 The review of files showed that audit plans developed are of variable standard. It is to be expected that plans should build in some flexibility because in many cases a special study will be a voyage of discovery and it will be impossible to predict the findings at the planning stage. In this respect, the development of excessively rigid “audit criteria” may present a hazard if they do not relate well to the real world. There may be an opportunity for improvement in the criteria chosen.

3.86 ***Opportunity for Improvement:***

- *Criteria chosen for special audits and studies should be kept to a high level of principle rather than prescribing expected management behaviour in detail.*

Project Management

3.87 Project management of special studies remains an area for improvement. A significant number of studies have run over time or over budget. The files reviewed showed that plans include charts of project timing and milestones (produced in Microsoft Project) but only the initial plan was produced, apparently for budgeting and resource planning purposes. Management progress reports were produced showing month to date and year to date costs but, in the files reviewed, these were not set against budget or elapsed time projections. However, the Board receives monthly reports on global project outturn against budget, together with a brief narrative on progress. The system reports used to produce this schedule provide outturn against project milestones, but these are not routinely monitored against the milestone budgets.

3.88 Within the files reviewed no evidence was found of the use of critical path analysis or of monitoring progress against a critical path. Critical path analysis could assist the project team to identify areas where time slippage will impact on completion date, and assist in prioritising audit effort.

- 3.89 In files reviewed, the evidential standards underpinning the special studies were good. The substantiation review in particular is worthy of praise as it brings key evidence together in a readily accessible form.
- 3.90 Internal quality assurance is satisfactory, and may be augmented by external advisory panels when such a panel is considered necessary. However, projects may benefit from a rigorous “challenge review” undertaken by individuals external to the office (hence not imbued with audit culture) and not party to the audit, or its advisory panel (hence not limited by over-familiarity with the subject area). Challenge reviewers can provide a useful ‘reality check’ – identifying areas within a report that may be unclear or inadequately substantiated in the eyes of the broader readership, and weaknesses that may not be apparent to those close to the subject matter.

- 3.91 ***Opportunities for Improvement:***
- *Project management tools should be better used to monitor and report on progress against project milestones, elapsed time and budgets;*
 - *Critical path analysis should be used to identify project vulnerabilities and develop contingencies to minimise project slippage; and*
 - *A challenge review process external to both the project subject matter and the OAG should be considered as a means of assessing public and Parliamentary reaction to special studies.*

Reporting Phase

- 3.92 The ***reporting phase of special audits remains an area for improvement.*** Long delays are sometimes encountered between the production of the Draft Report and the report that is finally released. Delays in finalising reports of special studies are common to many other jurisdictions. Contributory factors within the OAG include:
- Delays in receiving input from the various parties within OAG that are involved in signing off a Draft Report;
 - Bottlenecks within the Reports Group with a number of reports from several sources queued for final editing;
 - Extensive editing of reports in order to meet the Auditor-General’s reporting standards and style; and
 - Delays in the clearance process as entities react to the context, nuances and tone apparent in the final report.
- 3.93 The review team observed substantial improvement between the presentation of information in a draft report and the report finally cleared for publication, indicating that the final editing process adds significant value. However, the present editor is approaching retirement age and the OAG is vulnerable to the loss of writing skills. The OAG has conducted a number of writing courses for staff, but has not yet succeeded in developing the skills it requires.
- 3.94 The present system of handing a report to Reports Group for editing may be perpetuating the problem because project managers can place reliance on their product being ‘fixed’ elsewhere.

3.95 During the review, comments were received from some staff that attempts by project managers to produce a report in close-to-final format was a waste of time because “Reports Group would change the final report anyway”. This may be so, but in view of the importance of context, nuance and tone in the reports, it may be beneficial if the tack were taken of encouraging project managers to produce a product entirely consistent with the OAG requirement.

3.96 ***Opportunities for Improvement:***

- *Draft Reports should follow the OAG publication standards, in language, style, tone and format;*
- *Word template that mimics the fonts and format to be used in the final document should be developed for use by project leaders, so that a similar ‘feel’ is present as the documents are created; and*
- *The role of the Publication Officer should be recast to that of critic and teacher (supplemented by academic support if necessary), so that editing is done for illustrative purpose only with the remainder of the document being given back to the primary author to fix.*

3.97 In the short term, this approach may cause some further delays to reports already underway. In the longer term, it offers the prospect of broadening the OAG’s writer base and reducing reliance on a single final editor.

Enquiries, Complaints and Inquiries

3.98 The current legislation (s 28) enables the Auditor-General to inquire into any matter relating to an audit. The new Public Audit Act states that the Auditor-General may inquire, either on request or on the Auditor-General's own initiative, into any matter concerning a public entity's use of its resources. These powers, along with the profile of the Auditor-General and the high public regard in which his Office is held, have seen a rising number of enquiries and complaints from Members of Parliament and the public. The number of enquiries is likely to increase further as the Auditor-General’s mandate is widened under the new legislation.

3.99 Approximately 20 per cent of enquiries originate from Members of Parliament. Taxpayers account for a further 20 per cent, while ratepayer enquiries account for 60 per cent.

3.100 The Office has a register system to monitor enquiries and has established benchmarks as a means of ensuring that there are timely responses, with the status of such enquiries being reported to the Board of Management. All enquiries that are estimated to take more than four hours are separately tracked.

3.101 A number of enquiries lead to major inquiries or special studies separately reported to the Parliament by the Auditor-General. This number has increased since 1998-99. Because of the ad hoc nature of these enquiries, the

resources required cannot be anticipated when appropriations are made and funding of extensive inquiries can present problems. For this reason the OAG has recently introduced a resource threshold (\$20,000) beyond which an inquiry requires Board of Management approval.

- 3.102 Most enquiries are responded to individually, and file reviews showed that these responses are comprehensive.
- 3.103 Inquiries undertaken by the Special Audits and Studies Group follow the methodology outlined in the Special Audits and Studies Group procedure manual. However, there are no established procedures for inquiries undertaken by other groups within the Office. A draft procedure has been developed within the OAG but has not yet been considered by the Board of Management. Moreover, the draft procedure is not specific in relation to the processes to be followed – such as outlining the objectives, scope and the issues to be pursued, maintaining adequate audit files, and undertaking quality assurance processes.
- 3.104 An examination of a limited number of enquiry files showed adequate documentation of the process followed but did not record approvals for the inquiry to proceed. Moreover, the working papers supporting one enquiry could not be located in a timely manner. However, the review team observed that the Local Government Group has developed a planning cover sheet, which covers the planning, reporting and peer review elements. The form is appropriately signed off by another member of the Local Government team or, if legal issues are involved, by a member of the Legal team.
- 3.105 It should be noted that the work undertaken on enquiries is not subject to quality assurance by the group that provides quality assurance over audit opinions. The files examined showed no evidence of other quality control processes.

3.106 *Opportunity for Improvement:*

- *Standard procedures for enquiries should be consolidated across the OAG, which could be a cut down version of those in the Special Audits and Studies Group procedure manual.*

Financial Report Audits

The Contestable Audit

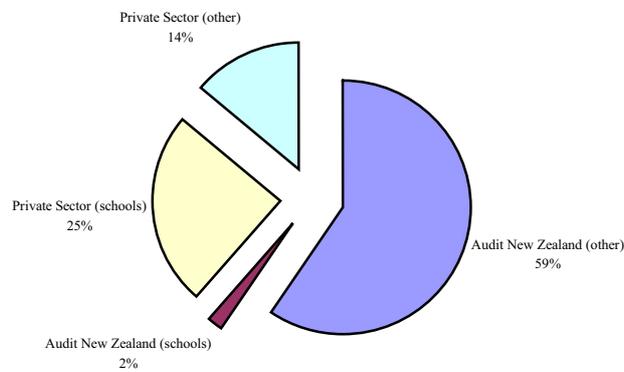
- 3.107 In 1992, as New Zealand was undergoing extensive public sector reform, the then Auditor-General introduced a system of contestability for public sector auditing. Audit New Zealand was separated and ‘ring fenced’ from the Office of the Auditor-General and was required to compete for audit assurance work with private sector audit service providers. However, at that time, the Auditor-General signalled his intention to retain some in-house capacity to undertake audit assurance work and reserved the right to withhold the audit of some public entities from the contestable model.

- 3.108 In essence, under the contestability model:
- The Auditor-General decides which entities will be able to opt for a contestable audit; and
 - The selected entities are asked to decide if they wish their audit to be contested. (If not, a contract is agreed with the existing Audit Service provider – under the same terms as described below for a “tendered” audit.)
- 3.109 If the audit is tendered:
- Expressions of Interest are sought from ‘Audit Service Providers’;
 - Tenders are sought from at least three ‘Audit Service Providers’ who are pre-qualified by the Auditor-General;
 - A Selection Panel (comprising a representative of the entity, a representative of the Auditor-General, and an independent chairperson) examine the tenders on a ‘double envelope’ system whereby the tender is assessed and weighted for quality, before price is considered;
 - A contract is issued to the selected provider, usually for a period of three years with renewal expected for a further three years if the entity and the OAG are satisfied with the service provided. This contract delegates the signing of the opinion to the Approved Auditor;
 - At the end of a six year contract period and every three years thereafter, the entity is given the opportunity to retender the audit or to negotiate with the provider for a further period;
 - An independent evaluator oversees the contestability process.
 - All audit service providers are required to audit in accordance with the Standards published by the Auditor-General; and
 - The OAG applies a quality assurance review process to each Approved Auditor, aiming to review each within a three-year term.
- 3.110 In addition, a comprehensive audit brief is prepared annually for each significant sector. This brief directs audit effort to areas of strategic interest to the OAG.

Contestability Outcomes

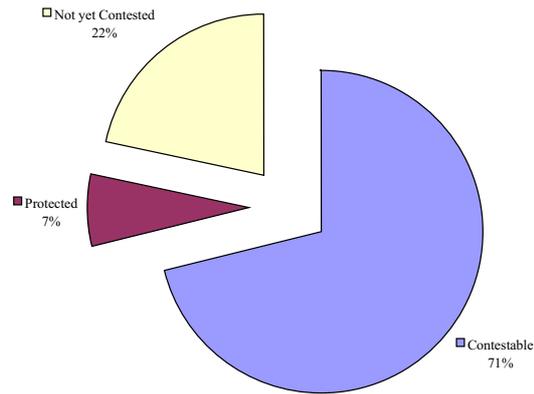
- 3.111 Based on briefings, interviews with key staff, a limited review of policy papers, Board of Management papers and other files, the review team concluded that the contestability model is working as designed.
- 3.112 The following chart illustrates the present overall division of work (in hours) between Audit New Zealand and the private sector. Schools are shown separately because the large number of individual school entities is an unusual feature of the New Zealand system. All school audits are tendered and the private sector dominates school audits.

Division of Work (Hours)



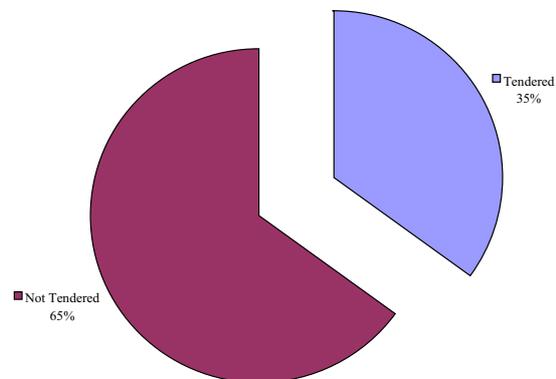
3.113 An analysis of contestability outcomes indicates the following in respect of the remaining (non-school) audit population:

The Contestable Audit (Hours)

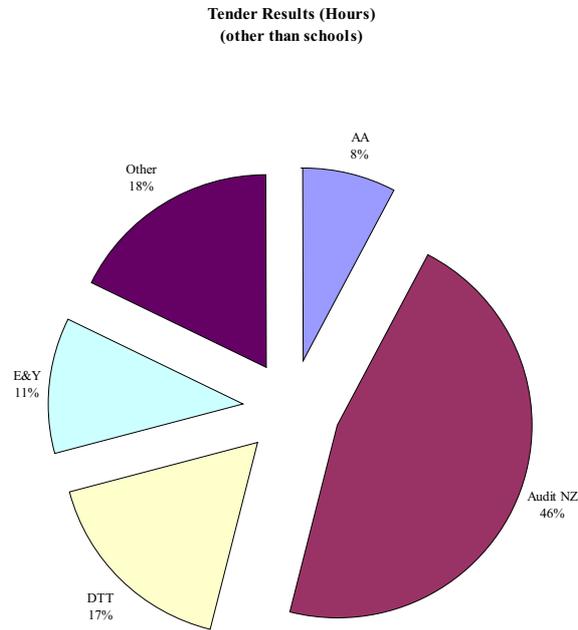


3.114 The following chart shows the quantum of audits that have actually been tendered:

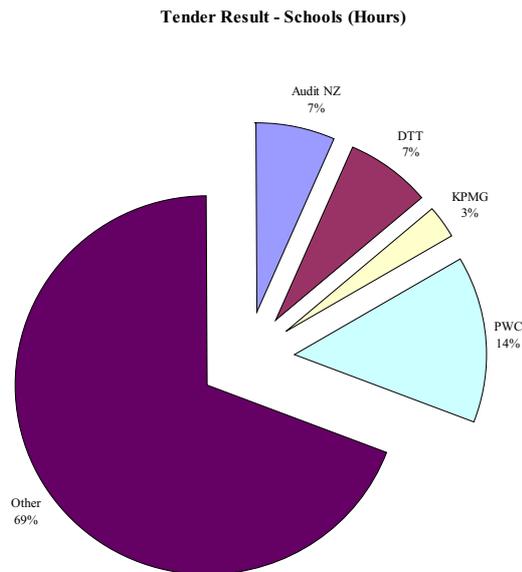
Contested (Hours)



3.115 Of those that have been tendered, the outcomes in terms of successful firms is demonstrated in the following chart (excluding schools):



3.116 Similarly for schools, all of which have been tendered, the outcome is as follows:



- 3.117 As a consequence, it can be demonstrated that some 35 per cent of the audit population (other than schools) has been tendered in an open market situation, with Audit New Zealand being successful in some 46 per cent of those cases. It is understood that the target population to be offered the opportunity for market testing is in the order of 93 per cent.

Benefits of Contestability

- 3.118 In a number of discussions and in papers reviewed it has been suggested that this regime of contestability has resulted in a reduction in audit costs/fees and an enhanced quality outcome. While the anecdotal evidence may seem strong in both cases, the OAG has not been able to demonstrate that this is the case. As the programme has been in place for some eight years it seems timely to undertake a formal evaluation of the benefits/costs of the regime.

3.119 *Opportunity for Improvement:*

- *The Office of the Auditor-General should undertake a formal analysis of the cost/benefit of the contestability regime.*

- 3.120 In addition, given the lack of availability of a number of statistics associated with the regime, it would seem management of the activity could be enhanced if a small number of management metrics were established to monitor performance and/or achievement of activities which could be regularly reported against targets to the Board of Management.

3.121 *Opportunity for Improvement:*

- *Management metrics should be developed to monitor performance of audit service providers and should be regularly reported against targets to the Board of Management (where appropriate). Metrics that can be considered include:*
 - *Audited entities – total by category and hours;*
 - *Audited entities not to be subject to contestability – total by category and hours;*
 - *Audited entities invited to tender – total by category and hours;*
 - *Audited entities that elected to roll over audit service providers – total by category and hours;*
 - *Tender outcome in terms of change: in audit service provider, no change in audit service provider;*
 - *Number of audit service providers and approved auditors disqualified/cancelled at OAG initiative;*
 - *Number of contracts terminated due to quality issues;*
 - *Staff mix used by audit service provider;*
 - *Fee/price outcomes of contested audits;*
 - *Measure of other assurance services undertaken by audit service providers;*

Tendering

- 3.122 The tendering process is thorough and is followed with some rigour – although the following specific matters are highlighted for management consideration and, as appropriate, attention.
- 3.123 There are a significant number of audits that have not been subject to the rigour of the market place as a consequence of:
- The nature of the audited entity, some of which will never be exposed to the market;
 - Audited entities that were destined to be subject to market testing but, because of particular circumstances, have not progressed to that stage in the first eight years of the regime; or
 - Audited entities that have been offered the opportunity of tendering but elected to stay with their current audit service provider.
- 3.124 For audited entities that had their audits tested in the market place, the length of time between being retested (apart from quality concerns) can be considerable, and recent developments are likely to further extend this period to 12 years or more. It is understood that approximately 20 per cent are re-tendered within six years and that no target has been established of the quantum that should be re-tendered after nine years. A maximum period in the order of five to six years before re-tendering may be appropriate in retesting the market and developments therein, and in equity and fairness to the market place participants.

3.125 ***Opportunity for Improvement:***

- *A re-tendering policy should be developed that addresses equity and fairness to market place participants.*

Risk Assessment

- 3.126 Audited entities are risk rated for the purpose of requiring audit service providers to undertake second partner review of the audit. Audited entities are rated on a number of factors including: that the audit is in excess of 500 hours per annum; that they fall within a particular category of audited entities; or individually they are assessed as high risk. This is a broad-brush approach – a more discriminating methodology may lead to a better outcome and a more appropriate utilisation of resources.

3.127 ***Opportunity for Improvement:***

- *A more discriminating risk-based approach to the requirement for second partner reviews of audits should be developed.*

Perceptions of Audited Entities

- 3.128 While the OAG have frequent contact with their major audited entities and regular contact with others, the absence of a formal structured audited entity survey (undertaken at periodic intervals) may result in the OAG failing to identify and respond to significant audited entity service issues that may emerge across the audited entity base and/or in respect of particular service providers. It is understood the last survey was in 1998. While recognising that ‘survey fatigue’ can occur if surveys are conducted too frequently, it would seem appropriate to initiate a new audited entity survey in the near future.

3.129 *Opportunity for Improvement:*

- *Structured, independent surveys should be conducted of audited entity perceptions at intervals of approximately three years.*

Perceptions of Audit Service Providers

- 3.130 The review team met with representatives of two of the large chartered accounting firms involved in provision of audit services to the Auditor-General.
- 3.131 They described the OAG as having:
- Good solid respect;
 - Good solid rules, which are followed;
 - Good technical people; and
 - Very good quality briefs and manuals.
- 3.132 Although the firms did not necessarily agree with all the processes they recognised that they were probably quite effective from the OAG side.
- 3.133 There was one comment that the tender process – with its focus on listing audit issues – may not result in the best outcome. Similarly, one firm expressed the view that the tender process unduly focuses on hours as a determinant of quality.
- 3.134 The fee cap imposed by the OAG (which limits the value of non-audit work that can be done by the provider) created some tension, being described as not necessarily good commercial sense and more appropriately spread over the life of a contract rather than per annum.
- 3.135 The review team concluded that the current relationship with audit service providers is satisfactory. The review team also concluded that the fee cap should remain so that the integrity of audit independence within the contestability model is preserved.
- 3.136 One issue associated with audit service providers that arose as a result of the review team’s other enquiries, relates to that of the timely transmission of audit intelligence from the provider to the OAG. On at least one occasion a provider was aware of a serious problem within an entity that reached the

public domain before the OAG was informed. This illustrates the potential for a lack of communication to embarrass the Auditor-General.

3.137 ***Opportunity for Improvement:***

- *Mechanisms should be developed to ensure capture of intelligence about audited entities from audit service providers.*

The Independent Evaluator

- 3.138 The Independent Evaluator oversees the contestability process from a probity point of view. His report to the Auditor-General is published.
- 3.139 During the team's meeting with the Evaluator, he ***explained*** his role and how the contestability policy has emerged and developed over time, recognising that the cost of perfection was too high. The Evaluator believes from his observations that firms are generally comfortable with the process as it currently operates. He is not involved in determining what to contract.
- 3.140 The review team is of the view that the Independent Evaluator fulfils an important role in providing assurance on the integrity of the contestability model. This role should be continued. However, the team also noted that the same individual has been in this role since the inception of the contestability model and suggest that rotation of the individual should be considered by the OAG in the near future in accordance with principles of maintaining independence.

Auditing Standards

- 3.141 All audit service providers are required to adhere to the comprehensive Auditing Standards published by the Auditor-General. Although in all areas at least equivalent to those issued by the New Zealand Institute of Chartered Accountants, the Standards are tailored for the unique requirements of public sector auditing. Under the new Public Audit Act this capacity for the Auditor-General to adopt Standards that in his view are appropriate will be preserved, and the Auditor-General will be obliged to publish these Standards at intervals of not less than three years.
- 3.142 The review found that audit service providers hold the Standards and associated guidelines in high regard. In recognition of the difficulty of keeping such material constantly up to date in a printed form, the Auditor-General has scheduled the production of an on-line version of these manuals for the near future. This initiative also is likely to be well regarded by audit service providers.
- 3.143 The review team noted that the audit opinions issued under delegation from the Auditor-General do not, at present, make explicit reference to these Standards. It would be appropriate if this were done.

3.144 ***Opportunity for Improvement:***

- *Audit opinions issued under delegation from the Auditor-General should make explicit reference to the Auditor-General's published Auditing Standards.*

The Quality Assurance Process

- 3.145 The OAG maintains a quality assurance process to provide the Auditor-General assurance that the audit service providers working on his behalf are undertaking work of a suitable standard.
- 3.146 The quality assurance process as reviewed focused solely on the review of the ongoing quality of 'Approved Auditors', by undertaking a mix of site visits and desktop reviews of files. Current policy provides for a review to be undertaken of each Approved Auditor once during each three-year period.
- 3.147 In selecting Approved Auditors for review, weight is given to:
- Those in the first year of a contract;
 - Those in the final year of a contract who have not been previously reviewed;
 - Comments from sector managers; and
 - Reviewing a mix of providers by size and location.
- 3.148 Following the selection of an Approved Auditor for review, a selection of a small number of their audits is made, which become the subject of review.
- 3.149 Reviews undertaken by OAG staff generally take about a half-day for each audit. Effective guidance notes exist to assist in the preparation for and the undertaking of quality assurance reviews. While reviews are intended to be comprehensive, some focus is said to be given to those aspects of the annual audit that might be seen as being a 'unique' part of the OAG requirement. However, in the files reviewed, the review team observed that the primary focus was on the audit of financial statements – with a disproportionately small part of the resource being directed at auditing non-financial information.
- 3.150 Initial findings of each review are discussed with the Approved Auditor and followed up with a letter.
- 3.151 A summary of issues identified in a number of reviews (where the incidence is greater than 30 per cent) is provided to all Approved Auditors. Other actions include scheduling a review in the following year or seeking termination of a contract either by resignation or termination. Metrics in relation to the latter were not routinely maintained.
- 3.152 Recent issues identified include:
- For Schools:
- Presentation errors in audit reports;
 - Presentation errors in financial statements;
 - Lack of evidence of reviews of other information;

- Lack of engagement letters;
- Materiality not calculated or calculated by reference to an inappropriate base;
- Audit of compliance with laws and regulations not performed to a satisfactory standard;
- Lack of bank confirmations; and/or
- Inadequate or inappropriate cross referencing of final accounts.

For other than Schools:

- Presentation errors in audit reports;
- Presentation errors and inconsistencies in financial statements;
- Lack of engagement letters;
- Audit of compliance with laws and regulations not performed to a satisfactory standard;
- Inadequate audit of bank reconciliations;
- Inadequate or inappropriate cross referencing of final accounts; and/or
- Inadequate documentation to support audit conclusions (re material items).

3.153 Given the nature of some of these items, and that these items were observed in over 30 per cent of the Approved Auditors subject to review, it may be appropriate to reconsider the nature of the actions taken and assess the impact on the credibility of information being reported to Parliament and other ‘owners’.

3.154 It is noted that present OAG policy normally does not require any “hot” reviews to be undertaken by the OAG, seeing this as a matter for the Approved Auditor to determine in the context of their own operating procedures. However the OAG does undertake some hot reviews when the need arises from significant changes to legislation or accounting policies.

3.155 *Opportunity for Improvement:*

- *The quality assurance process could be enhanced by adoption of some or all of the following:*
 - *Formalising a more risk-based approach to the quality assurance process, with both audited entities and approved auditors being tasked on a risk basis;*
 - *Exploring the suitability of using the quality assurance processes of Audit Service Providers as a more efficient means of seeking the assurance sought through the quality assurance process;*
 - *Establishing rights of access to the outcomes of quality assurance reviews of OAG audits undertaken by Audit Service Providers and the Institute of Chartered Accountants;*
 - *Establishing a similar quality assurance process in respect of audits directly undertaken by the OAG;*
 - *Establishing an appropriate quality assurance process over other assurance work undertaken by Audit Service Providers and the full range of other products of the OAG;*

- *Determining the extent to which the quality assurance process has provided sufficient focus on the audit of non-financial information; and*
- *Improving the focus on understanding and addressing business risks and processes within the audited entity.*

Administration

Board of Management

- 3.156 The OAG has a “Board of Management” which meets regularly – making decisions on all significant matters, tracking progress against targets, and monitoring financial and other aspects of performance.
- 3.157 The Board comprises the Auditor-General, the Deputy Auditor-General, all Assistant Auditors General and the Executive Director of Audit New Zealand. The last is excluded from the Board when “section E” agenda items – those relating to contestability are being considered.
- 3.158 Items covered regularly in the agenda include:
- Progress against the Departmental Forecast Report, including performance targets in terms of quality, quantity, timeliness and cost;
 - Progress of projects, both external and internal;
 - Financial status and forecasts; as well as
 - Plans for future action and consequential monitoring against plans.
- 3.159 The quality of most submissions to the Board is high (particularly for major decisions on changes to OAG policy or plans), informing the Board while offering alternative courses of action and potential consequences. Linkage to previous decisions is readily tracked.

- 3.160 The review team concluded that the overall management control framework is both strong and effective. Two minor areas for possible improvement were noted during the review of Board Minutes:
- Financial information is largely focused on a line item (input) basis that does not transparently reconcile in an ongoing way with outputs. This could make it difficult for the Board to address outputs when deciding on corrective action.
 - Projects are monitored largely by due completion date, with explanations focusing on variations to the timeline. Although budgeted costs and actual expenditure on major projects are included in the report, information is not routinely presented on progress against project milestones or milestone expenditure against budget. Similarly, at the detailed level, a ‘deliverables due’ report provides elapsed time but not cost information. Although project management is seen to be primarily the responsibility of individual Project Steering Committees, the current information provided may mean that the Board may not have sufficient warning of serious departures from plans to enable timely corrective action.

Business Planning

- 3.161 A strategic business plan, incorporating operating unit (OAG and Audit New Zealand) business plans 2000 to 2004, was produced.
- 3.162 The Business Plan, together with the various sector plans, forms the basis upon which the annual Departmental Forecast Report is produced. The plan was also utilised to support a business case for additional funding.
- 3.163 The plan is comprehensive, and in relation to the OAG outlines its strengths and weaknesses, implications and strategies in relation to the following elements:
- Research and Planning;
 - Purchasing and Quality Assurance;
 - Operational Capacity;
 - Reporting and Advice;
 - Technical Support Services;
 - Organisation and Management Structure; and
 - Administrative and Corporate Support.
- 3.164 The plan also incorporates the OAG's Human Resource Plan, an Information Technology Plan, and an Asset Management Plan.
- 3.165 A template is used to assist in the development of cost centre work plans and budgets. This is a very positive process.
- 3.166 The template facilitates input from the various groups in the Office to ensure the development of the Internal Business Plan on the P&M (Planning and Monitoring) database (including all deliverables with people assigned responsibility for delivery, with due dates also assigned). The Plan links outputs/goals with strategies and all related deliverables.
- 3.167 The Cost Centre Workplan by due date can be extracted from the P&M data base, which provides up to date information on each deliverable, especially in relation to any variance from the expected completion date. It also discloses the budgeted hours but, because it does not interface with the time recording system, it does not disclose budgeted cost, actual hours and actual cost.

3.168 Linked to the internal business plan should be individual staff performance agreements. However, according to the 31 January 2001 report to the Management Committee, over 25 per cent of such agreements had not been completed.
- 3.169 The Monthly Monitoring Reports presented to the Board of Management are very comprehensive and disclose how deliverables are tracking, and what is due at the particular meeting and what is due at the next meeting. In relation to major studies, the reports disclose any variance from due dates and actual

cost compared with budgeted cost. However, in relation to enquiries, budgeted hours and costs are not disclosed (but all of the enquiries will not be material by size).

- 3.170 In relation to the OAG's costing models, the charge-out rates need to be reviewed by management against actual costs (including overhead out-turns) to determine their appropriateness.

3.171 In addition, work needs to be undertaken by management on the reality of the cost allocation process, especially in relation to output groups 1, 2 and 3.

Corporate Support

Information Technology

- 3.172 The OAG operates central servers running Microsoft NT operating system and uses NT4 Workstation on all personal computers within the Office. The OAG is currently testing Windows 2000. There is a standard operating environment achieved by cloning a template and establishing operating system profiles, which prevent other software from being loaded on to Office computers. Other Office software includes Office 97, Outlook 2000, intranet/Internet software, and access to OAG Systems software. Dialup access is available for checking emails via a web interface. A direct remote area dial-up service is not available.
- 3.173 OAG systems include:
- **Microsoft Exchange** – email and resource scheduling program.
 - **Time Discipline** – a time recording system which operates from a proprietary front end on an SQL database. This has a facility for drag and drop time recording and is considered by the OAG to be very user-friendly. All time recording is mapped to output classes for the Office, then to a project and task within each class. The system records hours that are journaled into the finance system (the Sun system), which converts hours for each individual to banded charge-out rates. Although the system has the capacity to record hourly charge-out rates, it does not do so at present and there is no link backwards to the system from the finance system to enable online calculation in dollar terms. Similarly, the system does not record disbursements. A separate module is provided to supervisors for time approval.
 - **Sun Financial System** (which is SQL based) and a Microsoft Access viewing platform "Vision 5". Vision 5 mostly produces predetermined reports, although these can be structured across a date range and confined to any output class, projects or task. It was noted that the results produced from Vision 5 queries had a line-item approach rather than a project cost-oriented approach. Personal Assistants to Cost Centre Managers have Vision 5. It is not available to General staff.
 - **Audit Status Database** – this SQL database tracks the status of financial audits. It also contains key audited entity information which is captured

from the two information packs that audit service providers are required to submit to the OAG – the first at the time the opinion is issued, the second (the “closure pack”) which contains the management letter. The information captured includes the proper name of the entity, postal address and details of key contacts within the entity.

A Contracts Module within this database contains information on budgeted versus actual fees and OAG overhead contribution and hours – which data are captured at the time the auditor is approved. Fees can be classified as “contracted” (where the fee is fixed) or “purchase agreement” (where the hourly rate is fixed). Most audits are contracted for a fixed fee but new audits (where the complexity has yet to be established) may use a purchase agreement, which governs the hourly rate rather than the overall cost.

The Audit Status Database is the source of a quarterly Statement of Service Performance (audits due, received, completed, and variations) that is reported to the Board of Management. It also has a range of exception reports and data validity checks built into the software. The Audit Status Database is a tailor-made system to OAG design. It is about 5 years old. The OAG is currently developing a Web-based interface “ASD on-line”, which will be used to devolve data entry to audit service providers. About 18 key pieces of key information will be captured via the Web, initially supplemented by hard-copy service packs.

(Note: the Audit Status Database appears to be incompatible with the Windows 2000 operating system.)
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- ***SilentOne***, an electronic document management system, which integrates well with Microsoft Office documents as well as emails, portable document format files and images. It currently contains about 37,000 files. It has a free text search engine on both title and content of documents, allowing limited Boolean operators as well as structured keyword classification and interrelationship of meta data information. Meta data uses a matrix of the OAG Output Classes and sub classes with a key business related cross-indexing. SilentOne draws some key data from the Audit Status Database but this is not a fully integrated link. Publications Branch currently has responsibility for ensuring final copy of each Report is captured within SilentOne. SilentOne has good document security features, although these were not tested during the review. It also has a document control feature – a document “checked out” of SilentOne to undergo editing by the author cannot be checked out by another user, although read-only copies remain available from the system.
- ***CHRIS Personnel and payroll system (SQL database)***. A web interface is planned to enable electronic leave applications, etc. Currently access to this system is confined to relevant administrative staff. CHRIS prepares the payroll for both Audit New Zealand and OAG.
- ***Technical Advice Register*** – this is basically a website with an SQL back-end. It is used internally by the Accounting and Auditing Policy

group to capture precedent-setting advice to auditors. It also has analysis capabilities that can help determine the frequency with which advice is requested and thereby assist with training. It has some links to SilentOne but these are not fully integrated. Data is entered manually into the technical advice register via a Web interface and manual pointers to SilentOne documents are incorporated. The Technical Advice Register has workflow software built-in to ensure appropriate review and updating of advice entries.

- ***Inmagic*** – electronic indexing of records in the manual filing system. This comprises file tracking, archive tracking, retention and disposal schedules, library catalogue, journal distribution lists, etc. It links to the SilentOne SQL environment.
- ***An online policy and procedures manual***, which is written in a Microsoft Help file format. This is acknowledged to be out of date and poorly maintained. It is scheduled to be migrated to SilentOne.
- ***CAGNet***, the OAG's intranet, which provides a convenient means of accessing other systems, as well as news items, etc. CAGNet is progressively being used more extensively to draw data from other databases.
- In addition to the major systems, ***small Microsoft Access databases*** provide monitoring and management information (e.g. the Planning and Monitoring Database, which contains some 200 records on current deliverable projects, processes and reports). The Planning and Monitoring Database will be integrated into the Performance Management System, which covers individual performance.

3.174 Under development or planned OAG systems are:

- ***Making Online audit manual*** accessible to audit service providers as well as OAG and Audit New Zealand staff, which will improve timeliness of access to changes to Auditing Standards and policies.
- ***Migrating the On-line HTML-based policy and procedures manual to SilentOne***, which will be easier to maintain and update. This will be accessible through CAGNet.

3.175 The present information technology environment imposes a number of constraints on the OAG:

Hardware

- Only four laptop computers are available to staff. This limits work that OAG staff can do on site in the field.
- The absence of a remote area server, and/or more extensive Web interface, limits the extent to which staff can make use of OAG information sources while away from the Office.

Software

- Since most databases are written in SQL there is potential for much better integration of data available from each, by use of a more sophisticated viewing platform either within CAGNet (HTML), Microsoft Access, or some other viewing platform – for example, better integration of the time

recording system with the financial system would improve the focus of timeliness and cost. Improved integration of systems is already planned.

- A current and acknowledged issue with SilentOne is the extent to which documents are captured by the system. More extensive staff uptake of SilentOne and reduced reliance on paper-based information may require a change in the working habits of senior management to make clear their intention to replace paper documentation with EDMS material. Senior management may need to demonstrate that they are placing reliance on data within SilentOne to motivate staff to use the system (for example the Auditor-General currently monitors a hard copy “letters file” which should be extracted exclusively from SilentOne).
- Extending the proposed online data capture for the Audit Status Database. Capturing additional entity information in the Audit Status Database would enable analysis of audit costs against key entity data such as expenditure, assets, and/or audit risk (various models are available which correlate well with audit fees).

3.176 *Opportunity for Improvement:*

- *The information technology environment and management practices should be upgraded to:*
 - *Enable greater capacity for staff to work away from the OAG by improving the availability of laptop computers and providing a remote area service to OAG databases;*
 - *Better integrate data from existing systems;*
 - *Encourage greater use of the electronic document management system; and*
 - *Extend the proposed online data capture for the Audit Status Database to enable analysis of audit costs against key entity data such as expenditure, assets, and/or audit risk.*

Finance

3.177 OAG has sound financial management in place. Budgets are well structured and clearly linked to the Departmental Forecast Report, Business Plan, and individual cost centre work plans.

3.178 The Finance Branch produces timely and comprehensive reports to the Board of Management showing progress against budget, as well as realistically based forecasts with options for corrective action. Detailed reports are also available for cost centre managers and on individual projects.

3.179 The introduction of Mode B Net appropriation for audit services has alleviated an incongruity between fixed appropriation and variable revenue and expenditure. However, the OAG has had an ongoing problem with cash flow, caused largely by timing differences between audit revenue and expenditure. The present appropriation mechanism for funding the Audit Office has prevented the OAG from borrowing to bridge these timing differences. This issue has been resolved by the new legislation, which will

enable the Auditor-General to borrow (subject to approval by the Minister of Finance).

- 3.180 The internal transparency of the cost allocation process used to assign costs to outputs and output groups, particularly the application of charge-out rates, needs improvement. The review team acknowledges that this has passed Treasury scrutiny, and from their perspective is functioning effectively. However, it is insufficiently integrated with other OAG systems to be of significant value to project oriented staff. The present system encourages project managers to focus on hours as opposed to cost, which could differ significantly if disparate staff are involved.

3.181 ***Opportunity for Improvement:***

- *The transparency of the cost allocation model should be improved, and cost allocation data should be incorporated into other relevant systems.*

Human Resources

- 3.182 The OAG has undertaken a comprehensive human resources capability assessment, which has revealed a heavy reliance on key individuals within the organisation and a shortage of skills in key areas (notably report-writing/report finalisation skills, and limitations in capacity to deal with the emerging risks associated with e-commerce). A capability action plan has been developed to reduce the risks posed by these shortfalls.
- 3.183 The capability plan aims to ensure that the OAG will have access to a combination of resources and systems, which are fit for the purposes of:
- Delivering outputs and results to current specification and customer satisfaction; and
 - Maintaining capacity to identify and cope with likely future requirements.
- 3.184 At the time of the review, the OAG had already made some progress in implementing the capability plan, although more work is needed before the plan's objectives can be met.
- 3.185 The OAG also has an outcome-focused staff ***performance management system***, which assigns clear responsibilities and accountabilities within the Office. As mentioned earlier, the performance assessments against these plans has lagged, with some assessments outstanding.

Asset Management

- 3.186 The OAG has only a small asset base, but has in place a satisfactory ***asset management plan***.
- 3.187 The review team concluded that, overall, the corporate support maintained is appropriate to support OAG functions and effectively manage its resources.

4.0 Audit New Zealand – Executive Summary

Overview

- 4.1 Audit New Zealand is a business unit within the Audit Office, which carries out audits that it has won the right to conduct on behalf of the Auditor-General in competition with private sector auditors, as well as those audits not awarded under the contestable audit arrangements. It also offers additional assurance services to public entities.
- 4.2 In 2000-2001, Audit New Zealand had an annual operating budget of \$21.4 million, and about 220 staff operating from 10 locations. Audit New Zealand is currently of sufficient size to maintain the critical mass needed to support adequate technical capability and development. However, the review team was advised that significant further reduction in its audit base could jeopardise its future viability.

Management Practices

- 4.3 Essentially, Audit New Zealand is market-driven, and its performance measures relate primarily to bottom-line results. However, Audit New Zealand is currently introducing a Balanced Scorecard approach to management reporting, which should improve its focus on audit clients, staff and internal processes.
- 4.4 There are satisfactory procedures in place to enable Audit New Zealand to actively pursue continuous improvement in its management practice. Innovation is part of its strategic plan.
- 4.5 The administrative support structure is adequate to service Audit New Zealand's needs. The time recording system is closely linked to billings and tracks actual time and cost versus budget. There have, however, been examples of budget overruns and the review team found indications of under-recording of time. We recommended that Audit New Zealand develop a culture that actively discourages non-recording of time.
- 4.6 Under the prevailing highly competitive labour market conditions for auditors, Audit New Zealand has been experiencing a 25 per cent staff turnover per annum. Losses have been mostly within its junior ranks and in the regions. Current staffing numbers are, however, adequate to meet current needs.
- 4.7 The development of the strategic plan provides direction for aligning policies and procedures and promoting staff innovation. However, the review team observed numerous instances where there were contradictions between desired behaviour and current procedures. We recommended that greater attention be paid developing a common sense of purpose in staff.

Quality Control

- 4.8 Audit New Zealand undertakes suitable assessments of risks associated with its client base. The review team noted that introduction of regular client satisfaction surveys, linked to mechanisms to respond to client concerns, would improve Audit New Zealand's ability to maintain its position in the marketplace.
- 4.9 Audit New Zealand has suitable processes to give it assurance that staff maintain professional independence and the necessary levels of skill and competence to conduct audits. It is currently developing a competency-based human resource model that should integrate strategic direction, recruitment, training and performance assessment.

Audit Policies and Procedures

- 4.10 Audit New Zealand has documented quality control procedures and these are effectively monitored. It also has a professional policies manual that ensures each audit is adequately reviewed. Audit files include comprehensive information about the entity and all relevant correspondence, and also record advice provided to the entity.
- 4.11 Audit New Zealand has suitable systems for determining its personnel requirements, assigning staff to audit engagements and scheduling its work. Staff supervision within assignments is satisfactory.
- 4.12 Audit New Zealand's workflow has a pronounced seasonal variation, with large peaks of effort occurring after the end of the financial year. Greater use of interim audit work could significantly reduce the seasonal peaks in audit workload and associated resource requirements.

Examination of Audit Engagements

- 4.13 The review team examined a number of audit engagements in detail.
- 4.14 There was a high level of compliance with OAG Standards and with Audit New Zealand's methodology. However, the review team gained the impression that methodology is seen as the law, rather than as a tool to support professional judgement.
- 4.15 Audit New Zealand's unit costs are low, but the hours expended are high. There was some evidence that more realistic assessments of risk may have reduced the audit effort, and in particular the assessment of sample sizes for substantive testing.
- 4.16 We recommended that audit effort be reviewed, to identify areas for improvements in efficiency, and that the methodology be adapted to

incorporate better risk assessment, and place greater reliance on client systems, computer audit assurance and internal audit.

- 4.17 The review team had reservations about the relatively low audit effort directed to the audit of non-financial information in comparison to that directed to the audit of financial statements.
- 4.18 The review team also examined a special audit of payroll and expenditure that had been conducted by Audit New Zealand for the OAG. It was satisfactorily planned and executed. The Auditor-General should consider arranging a further review of other assurance services provided by Audit New Zealand, as these were not adequately addressed in this review.

5.0 Audit New Zealand – Detailed Findings

Overview

- 5.1 Audit New Zealand is a business unit within the Audit Office, which has been ‘ring fenced’ so that it operates on a transparently commercial basis, with the Auditor-General as its “owner”. Audit New Zealand carries out audits that it has won the right to conduct on behalf of the Auditor-General in competition with private sector auditors, as well as those audits not awarded under the contestable audit arrangements. It also offers additional assurance services to public entities and is the Auditor-General’s ‘auditor of last resort’ in the event of market failure. A number of the issues observed in the course of this review arise because of the apparent difficulties of Audit New Zealand seeking to operate solely on a commercial basis on the one hand and the Auditor-General enjoying the benefits of ownership on the other.
- 5.2 In 2000-2001, Audit New Zealand had an annual operating budget of \$21.4 million. Approximately \$16.5 million of its revenue is derived from audits, with the remainder derived from other assurance services it performs for public entities. It is expected to return an annual operating surplus to the Crown, which has totalled to approximately \$2.5 million over the last five years, but it has recently negotiated a reduction in the expected rate of return to more realistic levels.
- 5.3 Despite its commercial orientation, Audit New Zealand is currently subject to the funding constraints applicable to government departments. These have had significant implications for its cash flow and its capacity to re-invest its earnings to stay abreast of current developments and remain competitive. However, it has recently been successful in obtaining significant capital and other funding to upgrade its information systems. The new Public Audit Act will also provide greater financial flexibility for Audit New Zealand in the future.
- 5.4 Audit New Zealand currently has about 780 of New Zealand’s public sector entities as audit clients. It sees its major sector strengths as being in central government, local government, health and tertiary education, and it aims to maintain dominance in these sectors. Although a large proportion of the public entities it audits have been offered the opportunity to have their audits market tested, many entities have chosen not to exercise this option. This means that most of Audit New Zealand’s “contestable” work has been retained (under the continuing threat of contestability) rather than won in the open market place.
- 5.5 Differences also arise in terms of the legislative constraint on its services, in that it has no discretion regarding whether to not undertake certain audits. There has been cross subsidisation of free audits and audits of last resort but the Auditor-General has recently bid for and received Crown funding for the “no fee” audits.

- 5.6 At the time of the review, Audit New Zealand had about 220 staff operating from 10 locations. The regional structure is satisfactory, giving it a “local presence” appreciated by some clients, although the viability of some regional centres is currently being threatened by loss of audits to competitors.
- 5.7 Audit New Zealand is currently of sufficient size to maintain the critical mass needed to support adequate technical capability and development. However, the review team was advised that significant further reduction in its audit base could jeopardise its future viability.

Review of Management Practices

- 5.8 Essentially, Audit New Zealand is market-driven and its performance measures relate primarily to bottom-line results. However, Audit New Zealand is currently in the process of introducing a Balanced Scorecard approach to management reporting, which should improve its focus on audit clients, staff and internal processes.
- 5.9 There are satisfactory procedures in place to enable Audit New Zealand to actively pursue continuous improvement in its management practice. Innovation is part of its strategic plan.

Administration

- 5.10 The overall organisational structure of Audit New Zealand is fairly standard for an audit practice and is appropriate to the nature of its activities. An independent Advisory Board appointed by the Auditor-General provides guidance to Audit New Zealand’s management.
- 5.11 Audit New Zealand works under the OAG system of “Approved Auditors” and has satisfactory delegations of authority for the required level of autonomy necessary to conduct assigned work.
- 5.12 The administrative support structure is adequate to service its needs. Audit New Zealand:
- Prepares a strategic plan and a business plan, which are presented to the "owner" annually. Progress is reported against these plans on a quarterly basis.
 - Has satisfactory accommodation and security over confidential information.
 - Has satisfactory communication facilities, and an overall information technology strategy that is designed to improve productivity. It has recently introduced a computerised audit support tool known as "Team Mate".
 - Has a satisfactory time recording system that is closely linked to billings and tracks actual time and cost versus budget. There have, however, been examples of budget overruns on a number of audits that have resulted in

significant “write-offs”. Moreover, the review team found indications of under-recording of time, which impacts adversely on realistic workloads as well as on budget forecasts for future work.

5.13 ***Opportunity for Improvement:***

- *Audit New Zealand should develop a culture that actively discourages non-recording of time.*

Human Resources

- 5.14 Under the prevailing highly competitive labour market conditions for auditors, Audit New Zealand has been experiencing a 25 per cent staff turnover per annum. Losses have been mostly within its junior ranks and in the regions.
- 5.15 The current staffing numbers are, however, adequate to meet audit resource needs. Audit New Zealand schedules staff leave and accumulates time in lieu to accommodate the seasonal busy periods, and also uses temporary staff where available. It also has policies and procedures in place to engage additional qualified staff for casual employment on technical assignments where required.
- 5.16 The present skills and experience of staff are satisfactorily matched with the technical complexity of the audits undertaken, and Audit New Zealand has developed in-house specialist skills appropriate for specific audit activities.
- 5.17 Appropriate attention has been given to assessing future requirements based on personnel turnover and anticipated changes in audit responsibilities, notably in the event of winning or losing contestable audits.
- 5.18 Current recruitment policies, terms and conditions of employment, staff appraisal schemes and professional programmes are satisfactory, although (as noted earlier) Audit New Zealand has an ongoing problem with staff retention. Its remuneration at senior levels is less than in the private sector, but there is a view in Audit New Zealand that this is fair (an aspect of “serving the public”). Whether this view is held by competent people in sufficient number for Audit New Zealand to maintain properly its operations was not examined by the review team
- 5.19 Broadening its activities into assurance services other than attest audit, and recent moves to establish reciprocal staffing arrangements with audit offices overseas, are expected to assist in providing more attractive career opportunities for staff. A staff survey underway at the time of the review may identify further areas for improvement.
- 5.20 Working relationships between operating divisions are encouraged, but the review team encountered some “us and them” attitudes between the National Office and the regions.
- 5.21 The development of the strategic plan provides direction for aligning policies and procedures and promoting staff innovation. However, the review team

observed numerous instances where contradictions between desired behaviour and current procedures were evident.

- 5.22 There is a bipolar cultural impact arising from conflict between traditional and commercial approaches, with a traditional risk-averse tendency to focus on process rather than how to do things smarter. The review team gained the impression that the environment does not reward positive behaviour or punish negative behaviour and this produces contradictory messages for staff.
- 5.23 The use of the 360-degree feedback obtained as part of the staff appraisal process should assist management in understanding where policies and procedures are not being properly performed, but there remains a need to align strategic directions with performance assessment and appropriate rewards.

- 5.24 ***Opportunity for Improvement:***
- *Greater attention to developing a common sense of purpose in staff could improve overall effectiveness. This may involve developing a system of rewards and sanctions directed at encouraging desired behaviour.*

General Quality Control

Client Evaluation

- 5.25 Audit New Zealand considers whether its client base is consistent with its strategic direction and its skills.
- 5.26 It also has procedures in place to assess whether an audit client represents an unusual risk to Audit New Zealand, and whether it has or can acquire the necessary skills and competencies to provide required audit services. Assessments are made to determine if all risks are apparent and properly dealt with.
- 5.27 However, Audit New Zealand has no discretion regarding whether to undertake certain audits (“core audits”, audits with no fee, auditor of last resort). The Auditor-General, as owner and having statutory responsibility, may direct Audit New Zealand to undertake an audit in exceptional circumstances. Advice received from the Auditor-General’s Office indicated that at the time of this report the extent of such work was not large but, because many of these audits are small, the start-up cost is usually high and they have a disruptive impact on audit resources that impacts on Audit New Zealand’s competitiveness in other areas.

Client Relationships

- 5.28 Audit New Zealand does not currently undertake comprehensive client surveys on the public entities it audits – the assessment of satisfaction being undertaken through discussions with client agencies by the Managing Director. However, a pilot client satisfaction survey has been undertaken by the Auckland Office, with the intention of a later rollout for Audit New Zealand as a whole. And it has recently conducted a survey of the Office of the Auditor-General as its primary client, which showed a high level of satisfaction with its performance.
- 5.29 The introduction of the Balanced Scorecard is improving Audit New Zealand's focus on customer relationships – but a number of measures, including those of audit client satisfaction, have yet to be put into place.

5.30 ***Opportunity for Improvement:***

- *The introduction of regular client satisfaction surveys, linked to mechanisms to respond to client concerns, would improve Audit New Zealand's ability to maintain its position in the marketplace.*

Professional Independence

- 5.31 Audit New Zealand has in place processes and procedures which enable it to gain reasonable assurance that all persons maintain professional independence. All staff are required to make a comprehensive declaration of any interests that may conflict with Audit New Zealand's work.

Professional Development

- 5.32 Suitable procedures are in place to ensure that Audit New Zealand maintains the necessary level of skill and competence to conduct audits. It is developing a competency-based human resource model that should integrate strategic direction, recruitment, training and performance assessment.
- 5.33 Each position has a job description form which is kept up to date. Competency based performance criteria have been established for each position within the Office. Staff appraisals are conducted six-monthly using Job Assessment Reports and 360 degree feedback.
- 5.34 Potential employees are given practical tests in addition to interviews and an appropriate staff member checks references. There are established guidelines for the training and professional development of new staff.
- 5.35 Audit New Zealand has procedures in place to ensure that it can adequately assess the level of on-the-job training. The extent of supervision that is required is assessed on a six-monthly basis and Audit New Zealand also has in place a mentor process to assist new staff.

- 5.36 However, cutting back on “investment” (eg training of senior staff) – an expedient consequence of not achieving the necessary surplus – is likely to affect competence of Audit New Zealand in the longer term.
- 5.37 Audit New Zealand does not maintain a record of staff compliance with professional development requirements of the accounting body as they see this to be a personal responsibility. However, the review team is of the view that such information would assist Audit New Zealand in determining its staff development position.

5.38 ***Opportunity for Improvement:***

- *Audit New Zealand should maintain a record of compliance by staff with professional development requirements of the accounting body.*

Audit Policies and Procedures

Quality Control

- 5.39 Audit New Zealand has documented quality control procedures and these are effectively monitored. It also has a professional policies manual that ensures that each audit is adequately reviewed.

Documentation and Records

- 5.40 Audit New Zealand maintains audit files that include comprehensive information about the entity, all correspondence with the entity, and also record any advice provided by its staff to the entity. Evidential standards are in accordance with its methodology.
- 5.41 Files are retained for 10 years (which is consistent with OAG policy) and archived material is stored in secure facilities provided by a private sector organisation. Access to files is restricted by floor security and password security on networked documents.

Assignment of Personnel

- 5.42 Audit New Zealand has a scheduling system that assists it in determining its personnel requirements. It has appropriate criteria to assign personnel to audit engagements and schedules its work to ensure that appropriate personnel are available when required. There is a procedure in place to rotate assignments and personnel every six years to maintain independence and to mitigate the risks of over-familiarity and loss of objectivity. Staff supervision within assignments is satisfactory.
- 5.43 Audit New Zealand makes negligible use of independent contractors but has satisfactory review procedures in place to ensure that their work is adequate.

Examination of Audit Engagements

- 5.44 The review team examined a number of audit engagements in detail. Annual audit and assurance files were selected for review from the Auckland and Wellington Offices.
- 5.45 There was a high level of compliance with OAG Standards and with Audit New Zealand’s methodology. Audit reports comply with requirements and satisfactory attention was paid to ensuring that financial statements were presented in accordance with generally accepted accounting practice. There was evidence that the audits were planned, executed and reviewed in accordance with the methodology.
- 5.46 However, the review team gained the impression that methodology is seen as the law, rather than as a tool to support professional judgement. At present there seems to be a focus on process not outcomes. This encourages a transaction-based approach which is labour intensive and which does not assist in making findings relevant to management. This also contradicts the values that Audit New Zealand is trying to establish.

Audit Efficiency

- 5.47 Audit New Zealand’s unit costs are low, but the hours expended are high. The review team encountered a view that manifests itself in a manner described by some as Audit New Zealand being “holier than thou”. That is, some people within Audit New Zealand consider that they know what the OAG needs better than the OAG itself. One effect of this may be that Audit New Zealand over-delivers, or alternatively prices itself out from tenders.
- 5.48 There was some evidence that more realistic assessment of risk may have reduced the audit effort, and in particular the assessment of sample sizes for substantive testing. In the review team’s view, there should be a less passive approach to risk assessment, resulting in smarter audit techniques and lower levels of testing. Greater reliance could be placed on client systems, computer audit assurance and internal audit, and this work could be better integrated into the overall audit product. Audit New Zealand is aware of and is addressing the computer audit integration issue, but this may require developing mechanisms and enhancing the methodology so that people are encouraged to exercise greater professional judgement.

5.49 ***Opportunities for Improvement:***

- *Management review of audit effort may identify areas for improvements in efficiency without prejudicing audit effectiveness.*
- *Adapting the methodology to incorporate better risk assessment, and place greater reliance on client systems, computer audit assurance and internal audit, may reduce audit effort and increase Audit New Zealand's competitiveness.*

Other Observations

Audit of Non-Financial Information

- 5.50 The review team had reservations about the relatively low audit effort directed to the audit of non-financial information in comparison to that directed to the audit of financial statements. This may be a result of the strong traditional focus on financial statements, or of competitive budget pressures. The team was unable to reach a conclusion on the adequacy of the work performed in this area but suggests that it warrants further review.

5.51 ***Opportunity for Improvement:***

- *The resources applied to the audit of non-financial information should be further reviewed.*

Interim Audit Work

- 5.52 Audit New Zealand's workflow has a pronounced seasonal variation, with large peaks of effort occurring after the end of the financial year. Currently these peaks are accommodated by: overall staffing levels; leave management; management of time in lieu; and by engagement of contract staff. Other forms of assurance work are also used to take up surplus capacity in off-peak periods.
- 5.53 Decisions to not perform interim audit work may make sense at the individual audit level, when there is a narrow focus on charge rates. However, from a whole-of-office perspective, greater use of interim audit work could significantly reduce the seasonal peaks in audit workload and associated resource requirements.

5.54 ***Opportunity for Improvement:***

- *More strategic use of interim audit work may be of benefit to Audit New Zealand's resource requirements.*

Special Audit Work and Other Assurance Services

- 5.55 The review team examined a special audit of payroll and expenditure that had been conducted by Audit New Zealand for the OAG. It was satisfactorily planned and executed, sufficient evidence was recorded to support the conclusions, and documentation of the work undertaken was also satisfactory. Project management was found to be acceptable, with satisfactory monitoring of actual resources used against budgets.
- 5.56 The development of other assurance work has benefits to clients as well as to Audit New Zealand's financial position. The legal constraints on other assurance services provided for the benefit of client entities are somewhat unclear at present but may be clarified under the new legislation. The Auditor-General should consider arranging a further review of other assurance services provided by Audit New Zealand, as these were not adequately addressed in this review.
- 5.57 Some staff report that special audit work and assurance services add interest and job satisfaction. Other staff consider that other assurance work is not relevant to the Auditor-General's statutory responsibilities to Parliament.

6.0 OAG/Audit New Zealand Responses to “Opportunities for Improvement”

<i>Ref</i>	<i>Opportunities for Improvement</i>	<i>OAG Responses</i>	<i>Timeframe</i>
3.9	<p><i>OFFICE OF THE AUDITOR-GENERAL PARLIAMENT – COMMITTEE BRIEFINGS</i></p> <p><i>... several MPs commented that OAG advice in Committee Briefings tends to be focused on audit interests. Financial analysis was described as “great” but non-financial performance information was “not so good”. Some MPs expressed reservations about the competence of the Audit Office in non-financial areas.</i></p>	<p>Our briefings to Select Committees are balanced between “results of audits” (which predominantly looks at reporting, compliance, and general control environment issues) and “other advice”. Other advice is always based on evidence or research of accountability and other information on the public entity under scrutiny. Both types of advice are subject to peer review. We intend to maintain the current balance of evidence and advice. We have evaluated the consistency of our advice recently and will ensure this exercise is completed at least annually.</p> <p>In addition, we plan to have an external review of our Select Committee products, probably undertaken by staff of the Treasury and the State Services Commission.</p>	<p>Annual</p> <p>30/06/02</p>

Ref	Opportunities for Improvement	OAG Responses	Timeframe
3.10	<i>At least one MP confused the Office of the Auditor-General with Audit New Zealand, suggesting that the distinction between the OAG and its service providers is not yet fully understood.</i>	This is an inevitable consequence of our institutional arrangements. However, it is not an endemic problem and it does not interfere with our operations. We also monitor Audit New Zealand publications and promotional material with this potential issue in mind.	
3.11	<i>The OAG should address MPs' concerns about its competence in non-financial areas.</i> <i>The OAG should take steps to ensure that it is not confused with its service providers.</i>	See comments on 3.48. See comments on 3.10.	
3.16	PARLIAMENT – REPORTS <i>One MP suggested that it would be helpful if the Auditor-General explained how an audit works. This process is “interesting in the forensic sense” but remains a mystery to many MPs.</i>	We intend to publish an explanation of auditing processes as part of the publication of our Auditing Standards later this year. This explanation may also be useful in briefings to Select Committees. Special Audits and Studies reports will explain the methodology used.	30/09/01 Ongoing Ongoing

Ref	Opportunities for Improvement	OAG Responses	Timeframe
	<p><i>One MP expressed the view that the Auditor-General should “stick to dollars”. A contrary view was also expressed but with the caveat that the Auditor-General should ensure that relevant expertise was engaged when commenting on non-financial matters.</i></p> <p><i>One MP expressed the view that reports should be more focused on current issues. Although they should take lessons from the past, little was gained by simply raking over old coals.</i></p> <p><i>Some MPs believed that the accessibility of reports could be improved by (more consistent) use of executive summaries and summaries of recommendations.</i></p>	<p>See comments on 3.48.</p> <p>View noted – however, financial reviews are an important part of the accountability process. This is a question of balance – our reports do include a focus on current issues.</p> <p>Feedback noted – we are now using ‘flyers’ and summary reports more frequently.</p>	
3.36	<p>LOCAL GOVERNMENT – OTHER MATTERS RAISED</p> <p><i>Auditors should ensure that they have sufficient expertise, including relying on the work of experts, to make meaningful comments on non-financial matters.</i></p>	<p>Auditing standards require auditors to seek appropriate expert advice when carrying out the audit function, and our quality assurance process ensures these standards are adhered to. See also comments on 3.48.</p>	

Ref	Opportunities for Improvement	OAG Responses	Timeframe
	<i>At times the Auditor-General should state his views on the management of emerging approaches to Council service delivery more strongly</i>	This comment was directly related to our approach in one performance audit. In that instance the decision was deliberate on our part based on what was likely in the long-term to produce the best results for the community. The approach we took may not have met the needs of some individuals or Councils. These are always going to be difficult decisions and we have to call it as we see it. We stand by the judgement call made in this instance.	
3.48	<p><i>CENTRAL GOVERNMENT AGENCIES</i></p> <p><i>The transparency of topics selection for special audits could be improved;</i></p> <p><i>The Auditor-General could be more firm when reporting adverse findings</i></p>	<p>Our 2001/02 DFR has an expanded commentary on planned work. This will be expanded further in our first Annual Plan under Section 36 of the Public Audit Act (2002/03) and will include details of how we select topics and prioritise them.</p> <p>We are acutely aware of the need for our reports to be balanced and to reflect our process of fairness, equity and natural justice. See also our comments on 3.36.</p>	30/11/01

Ref	Opportunities for Improvement	OAG Responses	Timeframe
	<i>More attention could be paid to the audit of non-financial information.</i>	<p>We are conscious of the need to make further progress in this regard. We have tabled a report on performance reporting which should stimulate debate and refocus on this issue.</p> <p>The question of how we tackle the “appropriateness” of performance measures remains outstanding – we will develop a strategy to progress. See also our comments on 3.155 – 6th bullet point.</p>	
3.73	<p><i>AUDIT PROCESS – STRATEGIC PLANNING</i></p> <p><i>The selection criteria for audit interventions should be more specific and cover a range of issues such as:</i></p> <p><i>Risk – social, environmental and economic;</i></p> <ul style="list-style-type: none"> • <i>Materiality;</i> • <i>Public Interest;</i> • <i>Improvement in resource management; and</i> • <i>Enhancing accountability,</i> <p><i>with immediacy being a key determinant when prioritising projects.</i></p>	<p>Agreed – we will review the audit intervention criteria as part of the 2001/02 strategic planning update. The range of issues suggested are currently considered in our plans, however we need a more robust and transparent approach to record our consideration of these issues.</p>	31/08/01

Ref	Opportunities for Improvement	OAG Responses	Timeframe
	<p><i>The plans would be more informative and useful for decision making if they outlined past interventions, say over the past 10 years.</i></p> <p><i>Transparency could be improved by better reporting of the rationale behind selection, thereby satisfying the desire expressed by a number of stakeholders to have a better understanding of how special studies in particular are selected.</i></p>	<p>Agreed – see above.</p> <p>Agreed – see above</p>	
3.84	<p>SPECIAL AUDITS AND STUDIES – EARLY PROJECT DEVELOPMENT</p> <p><i>Sector Managers should clearly specify the outcomes desired of a special study in a comprehensive “project brief”.</i></p>	<p>We now have a high emphasis on face-to-face interactions, whereby:</p> <ul style="list-style-type: none"> • a short description of the study idea is produced before it is approved for inclusion in the Strategic Audit Plan; • an early Project Steering Committee meeting is held (before scoping work commences), involving Sector Manager, SAS team member, AAG/SAS and any other key party (e.g. legal or sector AAG) to discuss and agree preliminary scope – the meeting is minuted and the minutes agreed; • scoping work is agreed with the Sector Manager and AAG/SAS; 	All in progress

<i>Ref</i>	<i>Opportunities for Improvement</i>	<i>OAG Responses</i>	<i>Timeframe</i>
	<p><i>Options papers should be developed in response to the brief that enable more informed consideration by management of alternative courses of action.</i></p>	<ul style="list-style-type: none"> • there is regular communication with the Sector Manager and AAG/SAS as scoping work proceeds; • for larger studies – particularly where the audit field is not well known – the Project Steering Committee commissions and considers interim products (e.g. information and discussion papers) before moving to production of the proposal; and • where it is envisaged that costs up to proposal submission will exceed \$30,000, Board approval is sought for the additional scoping work. <p>As above, this practice is already in place for studies that are anticipated to be large and/or where the audit field requires more than the usual level of basic research. Informed consideration is by the Project Steering Committee for projects that can be scoped within \$30,000. The Board sees options papers where the expenditure is likely to exceed this amount.</p>	<p>In progress</p>

<i>Ref</i>	<i>Opportunities for Improvement</i>	<i>OAG Responses</i>	<i>Timeframe</i>
3.86	<p><i>SPECIAL AUDITS AND STUDIES – CHOICE OF AUDIT CRITERIA</i></p> <p><i>Criteria chosen for special audits and studies should be kept to a high level of principle rather than prescribing expected management behaviour in detail.</i></p>	<p>Agreed. Detailed criteria are becoming increasingly difficult to apply effectively on some of the studies we are currently undertaking in complex environments such as health and defence. For example, on our study of Primary Health Care, expectations have been kept to a high level. This will now be our usual practice for effectiveness and efficiency type studies. However, it will still be appropriate to use fairly detailed criteria on some studies – for example, on narrower audits of compliance.</p>	<p>In progress for all studies from now on.</p>
3.91	<p><i>SPECIAL AUDITS AND STUDIES – PROJECT MANAGEMENT</i></p> <p><i>Project management tools should be better used to monitor and report on progress against project milestones, elapsed time and budgets;</i></p>	<p>We consider that detailed project management tools that are not linked to our time recording system are unwieldy and inappropriate for our projects. For new projects, budgets for milestones will be recorded within the OAG time recording system, so that we need to record time once only and monitor using a single report.</p>	<p>Systems changes in progress. Budgets in time recording system from 1 July 2001.</p>

Ref	Opportunities for Improvement	OAG Responses	Timeframe
	<p><i>Critical path analysis should be used to identify project vulnerabilities and develop contingencies to minimise project slippage;</i></p> <p><i>A challenge review process external to both the project subject matter and the OAG should be considered as a means of assessing public and Parliamentary reaction to special studies</i></p>	<p>Critical path is considered when we schedule our fieldwork. However, we consider that most of the improvements suggested in the report are best achieved through improved management of the process as described above – for example, by better scoping and monitoring of milestones. The actions in respect of the work of Reports Group (below) are also relevant to addressing recent delays in publication.</p> <p>We are planning to pilot external “cold reviews” of our reports. Depending on the outcome of the pilot, we will consider commissioning reviews of all our reports against standard criteria so that lessons can be transferred and so that we can track whether our products are improving.</p>	<p>Exploratory work June/July 2001. Pilot using two recent reports August/September 2001.</p>
3.96	<p>SPECIAL AUDITS AND STUDIES – REPORTING PHASE</p> <p><i>Draft Reports should follow the OAG publication standards, in language, style, tone and format;</i></p>	<p>Agreed. However, there are times when the standards will not suit a particular product. And we are currently innovating by varying our products, e.g. Procurement Guidelines will be web-based to facilitate occasional updates.</p>	<p>In progress</p>

Ref	Opportunities for Improvement	OAG Responses	Timeframe
	<p><i>Word template that mimics the fonts and format to be used in the final document should be developed for use by project leaders, so that a similar 'feel' is present as the documents are created;</i></p> <p><i>The role of the Publication Officer should be recast to that of critic and teacher (supplemented by academic support if necessary), so that editing is done for illustrative purpose only with the remainder of the document being given back to the primary author to fix.</i></p>	<p>Agreed – this will be done.</p> <p>The report on which the team observed a substantial improvement had mainly been worked on by SAS, as suggested. This is already our preferred approach, but we acknowledge it has not been adopted on every report. We agree that all editing of reports should be done in this way in future.</p> <p>We are reviewing the role of the Reports Group, and expect to substantively implement this recommendation.</p>	<p>Timing subject to discussion with Corporate Services 30/6/01 In progress</p> <p>31/08/01</p>
3.106	<p>ENQUIRIES, COMPLAINTS AND INQUIRIES</p> <p><i>Standard procedures for enquiries should be consolidated across the OAG, which could be a cut down version of those in the Special Audits and Studies Group procedure manual.</i></p>	<p>Agreed – will be done. See also our comments on 3.16.</p>	<p>30/09/01</p>

Ref	Opportunities for Improvement	OAG Responses	Timeframe
3.119	<p><i>FINANCIAL REPORT AUDITS – BENEFITS OF CONTESTABILITY</i></p> <p><i>The Office of the Auditor-General should undertake a formal analysis of the cost/benefit of the contestability regime.</i></p>	<p>This is scheduled in 2001/02.</p>	<p>31/03/02</p>
3.121	<p><i>Management metrics should be developed to monitor performance of audit service providers and should be regularly reported against targets to the Board of Management (where appropriate). Metrics that can be considered include:</i></p> <ul style="list-style-type: none"> - <i>Audited entities – total by category and hours;</i> - <i>Audited entities not to be subject to contestability – total by category and hours;</i> - <i>Audited entities invited to tender – total by category and hours;</i> - <i>Audited entities that elected to roll over audit service providers – total by category and hours;</i> - <i>Tender outcome in terms of change: in audit service provider, no change in audit service provider;</i> - <i>Number of audit service providers and approved auditors disqualified/cancelled at OAG initiative;</i> - <i>Number of contracts terminated due to quality issues;</i> - <i>Staff mix used by audit service provider;</i> - <i>Fee/price outcomes of contested audits;</i> 	<p>Some of this information has been available to OAG management in the past – for example, results for each tender round and the results for the tender rounds in each year (reported in the annual report). We agree that more consistent reporting to the OAG Board of some of the metrics proposed would be of value. The Board’s views will be sought on:</p> <ul style="list-style-type: none"> • which metrics would be of value; • how frequently information should be reported; and • appropriate targets for certain metrics. <p>Following the Board’s advice, reporting will be commenced.</p>	<p>30/09/01</p>

<i>Ref</i>	<i>Opportunities for Improvement</i>	<i>OAG Responses</i>	<i>Timeframe</i>
	<ul style="list-style-type: none"> - <i>Measure of other assurance services undertaken by audit service providers;</i> - <i>Measure of other work undertaken by audit service providers.</i> 		
3.125	<p><i>FINANCIAL REPORT AUDITS – TENDERING</i></p> <p><i>A retendering policy should be developed that addresses equity and fairness to market place participants</i></p>	<p>We do not agree with the inference that tendering every 5-6 years is necessary to ensure equity and fairness to market place participants. First, the costs of such a policy would be very high for all participants. Secondly, our currently policy has been strongly supported by almost all Audit Service Providers, who are regularly consulted.</p>	
3.127	<p><i>FINANCIAL REPORT AUDITS – RISK ASSESSMENT</i></p> <p><i>A more discriminating risk-based approach to the requirement for second partner reviews of audits should be developed.</i></p>	<p>Prior to 1999, all audits greater than 200 hours were required to have a second partner review. The current policy is broadly risk-based but we accept that it is timely to consider a more discriminating approach.</p>	By 31/12/01

<i>Ref</i>	<i>Opportunities for Improvement</i>	<i>OAG Responses</i>	<i>Timeframe</i>
3.129	<p><i>FINANCIAL REPORT AUDITS – PERCEPTIONS OF AUDITED ENTITIES</i></p> <p><i>Structured, independent surveys should be conducted of audited entity perceptions at intervals of approximately three years.</i></p>	<p>This is being considered as part of a current project on outcomes measurement.</p>	31/03/02
3.137	<p><i>FINANCIAL REPORT AUDITS – PERCEPTIONS OF AUDIT SERVICE PROVIDERS</i></p> <p><i>Mechanisms should be developed to ensure capture of intelligence about audited entities from audit service providers.</i></p>	<p>Discussions have been had with Audit NZ on our information needs and will be extended to other audit service providers. We also recognise the need to give better feedback on “good” and “poor” performance in this regard.</p>	30/09/01
3.144	<p><i>FINANCIAL REPORT AUDITS – AUDITING STANDARDS</i></p> <p><i>Audit opinions issued under delegation from the Auditor-General should make explicit reference to the Auditor-General’s published Auditing Standards.</i></p>	<p>Prior to enactment of the Public Audit Act 2001, our Auditing Standards had no statutory backing. Under that Act, the Standards are intended to be published by 30 September 2001. We will consider making explicit reference to the Auditing Standards as part of the process of review leading up to publication.</p>	By 30/09/01

Ref	Opportunities for Improvement	OAG Responses	Timeframe
3.155	<p><i>FINANCIAL REPORT AUDITS – THE QUALITY ASSURANCE PROCESS</i></p> <p><i>The quality assurance process could be enhanced by adoption of some or all of the following:</i></p> <ul style="list-style-type: none"> - <i>Formalising a more risk-based approach to the quality assurance process, with both audited entities and approved auditors being tasked on a risk basis;</i> - <i>Exploring the suitability of using the quality assurance processes of Audit Service Providers as a more efficient means of seeking the assurance sought through the quality assurance process;</i> - <i>Establishing rights of access to the outcomes of quality assurance reviews of OAG audits undertaken by Audit Service Providers and the Institute of Chartered Accountants;</i> - <i>Establishing a similar quality assurance process in respect of audits directly undertaken by the OAG;</i> 	<p>The approach in recent years has been responsive to risks but would benefit from being formalised.</p> <p>We had preliminary discussions with Audit Service Providers in 1999 and plan to explore this further in 2001/02.</p> <p>Establishing rights of access to reviews of OAG audits by ASPs is integral to the recommendation above. This has been discussed with liaison partners and will be progressed as part of the above recommendation. In relation to ICANZ Practice Review, we are able to obtain reports and do so prior to approving auditor to undertake audits.</p> <p>Agreed – there are only 3 or 4 financial report audits undertaken in the OAG each year.</p>	<p>By 31/12/01</p> <p>By 30/06/02</p> <p>By 30/06/02</p> <p>Immediate</p>

Ref	Opportunities for Improvement	OAG Responses	Timeframe
	<ul style="list-style-type: none"> - <i>Establishing an appropriate quality assurance process over other assurance work undertaken by Audit Service Providers and the full range of other products of the OAG;</i> - <i>Determining the extent to which the quality assurance process has provided sufficient focus on the audit of non-financial information;</i> - <i>Improving the focus on understanding and addressing business risks and processes within the audited entity</i> 	<p>It is only appropriate to review work done in the name of the Auditor-General. Where such work is done for an entity selected for review, that work is also subject to review. We will review our approach to ensure it gives adequate coverage and make any changes as appropriate.</p> <p>Planning for a QA process over special audits and studies was initiated earlier in the year. The first review is expected to take place before the end of 2001. We also intend to extend QA processes to cover OAG inquiries.</p> <p>We will review the focus of our reviews to increase the emphasis on these aspects.</p> <p>See above</p>	<p>By 30/09/01</p> <p>By 31/12/01</p> <p>Immediate</p> <p>Immediate</p>
3.160	<p><i>ADMINISTRATION – BOARD OF MANAGEMENT</i></p> <p><i>Financial information is largely focused on a line item (input) basis that does not transparently reconcile in an ongoing way with outputs. This could make it difficult for the Board to address outputs when deciding on corrective action.</i></p>	<p>We are reviewing our financial and performance reporting systems in 20001/02 and expect to substantively address this issue.</p>	<p>24/12/01</p>

<i>Ref</i>	<i>Opportunities for Improvement</i>	<i>OAG Responses</i>	<i>Timeframe</i>
	<i>Projects are monitored largely by due completion date, with explanations focusing on variations to the timeline. Although budgeted costs and actual expenditure on major projects are included in the report, information is not routinely presented on progress against project milestones or milestone expenditure against budget. Similarly, at the detailed level, a 'deliverables due' report provides elapsed time but not cost information. Although project management is seen to be primarily the responsibility of individual Project Steering Committees, the current information provided may mean that the Board may not have sufficient warning of serious departures from plans to enable timely corrective action.</i>	See previous response	24/12/01

Ref	Opportunities for Improvement	OAG Responses	Timeframe
	<i>ADMINISTRATION – BUSINESS PLANNING</i>		24/12/01
3.167	<i>The Cost Centre Workplan by due date can be extracted from the P&M data base, which provides up to date information on each deliverable, especially in relation to any variance from the expected completion date. It also discloses the budgeted hours but, because it does not interface with the time recording system, it does not disclose budgeted cost, actual hours and actual cost.</i>	See previous response	
3.168	<i>Linked to the internal business plan should be individual staff performance agreements. However, according to the 31 January 2001 report to the Management Committee, over 25 per cent of such agreements had not been completed</i>	All performance agreements have now been completed. Continued emphasis will be placed on having these agreements and the corresponding performance reviews completed on a timely basis.	Ongoing
3.171	<i>In addition, work needs to be undertaken by management on the reality of the cost allocation process, especially in relation to output groups 1, 2 and 3.</i>	See comments on 3.160.	
	<i>CORPORATE SUPPORT – INFORMATION TECHNOLOGY</i>		
3.173	<i>The Audit Status Database appears to be incompatible with the Windows 2000 operating system.</i>	Only 3 users are currently on Windows 2000, and the issue will be easily resolved if the rest of the OAG go to Windows 2000.	

Ref	Opportunities for Improvement	OAG Responses	Timeframe
3.176	<p><i>The information technology environment and management practices should be upgraded to:</i></p> <ul style="list-style-type: none"> - <i>Enable greater capacity for staff to work away from the OAG by improving the availability of laptop computers and providing a remote area service to OAG databases;</i> - <i>Better integrate data from existing systems</i> - <i>Encourage greater use of the electronic document management system;</i> - <i>Extend the proposed online data capture for the Audit Status Database to enable analysis of audit costs against key entity data such as expenditure, assets, and/or audit risk.</i> 	<p>Current laptops only have 40% utilisation so availability is not a high priority. Our development programme includes improving remote access.</p> <p>See response to 3.160 re review of systems.</p> <p>This is an important part of our knowledge management strategy. We will actively seek ways to maximise use of the EDMS (which was introduced in April 2000).</p> <p>This will be considered after ASD on-line is fully implemented and the review of contestability is completed.</p>	<p>Ongoing</p> <p>24/12/01</p> <p>Ongoing</p> <p>2002/03 financial year</p>
3.181	<p><i>CORPORATE SUPPORT – FINANCE</i></p> <p><i>The transparency of the cost allocation model should be improved, and cost allocation data should be incorporated into other relevant systems.</i></p>	<p>See response to 3.160 re review of systems.</p>	<p>24/12/01</p>

<i>Ref</i>	<i>Opportunities for Improvement</i>	<i>Audit New Zealand Responses</i>	<i>Timeframe</i>
5.13	<p><i>AUDIT NEW ZEALAND REVIEW OF MANAGEMENT PRACTICES – ADMINISTRATION</i></p> <p><i>Audit New Zealand should develop a culture that actively discourages non-recording of time.</i></p>	<p>Audit New Zealand constantly reinforces the need to accurately capture time spent in delivering our services so that business decisions can be made based on the best information available. During the 2001/02 we plan to introduce electronic timesheets and improved business information systems that will facilitate this activity.</p>	
5.24	<p><i>REVIEW OF MANAGEMENT PRACTICES – HUMAN RESOURCES</i></p> <p><i>Greater attention to developing a common sense of purpose in staff could improve overall effectiveness. This may involve developing a system of rewards and sanctions directed at encouraging desired behaviour.</i></p>	<p>As part of the next phase in creating our strategic vision for Audit New Zealand we have established “Project Enable”. This project is designed to address a number of areas, including a revised performance and remuneration system that is aligned to our strategic direction for the organisation.</p>	

<i>Ref</i>	<i>Opportunities for Improvement</i>	<i>Audit New Zealand Responses</i>	<i>Timeframe</i>
5.30	<p><i>GENERAL QUALITY CONTROL – CLIENT RELATIONSHIPS</i></p> <p><i>The introduction of regular client satisfaction surveys, linked to mechanisms to respond to client concerns, would improve Audit New Zealand’s ability to maintain its position in the marketplace.</i></p>	<p>Agreed. In December 2000, following the successful completion of a client survey trial in the Auckland Region, approval was given to introduce regular client surveys for all our key clients (including the Office of the Auditor-General). This programme has commenced with the OAG survey in February 2001 and the Wellington Region is to be surveyed in June 2001.</p>	
5.38	<p><i>GENERAL QUALITY CONTROL – PROFESSIONAL DEVELOPMENT</i></p> <p><i>Audit New Zealand should maintain a record of compliance by staff with professional development requirements of the accounting body.</i></p>	<p>While Audit New Zealand considers it is an individual’s responsibility to maintain their professional continuing education requirements (which the organisation makes a significant contribution to funding) we will consider whether to record this as a part of any future upgrades to our Human Resource Information Systems.</p>	

<i>Ref</i>	<i>Opportunities for Improvement</i>	<i>Audit New Zealand Responses</i>	<i>Timeframe</i>
5.49	<p><i>EXAMINATION OF AUDIT ENGAGEMENTS – AUDIT EFFICIENCY</i></p> <p><i>Management review of audit effort may identify areas for improvements in efficiency without prejudicing audit effectiveness.</i></p>	<p>Agreed. As discussed under 5.24, we have established “Project Enable”. This project is designed to address a number of areas, including developing a refocused audit approach. This involves taking a risk-based approach to our audit and reducing or removing low value/no value audit work. Increased emphasis on the strategic risk assessment of the audited entity at the planning stage plus adding value to the audited entity will be key outcomes of this project that commenced in April 2001.</p>	
5.51	<p><i>OTHER OBSERVATIONS – AUDIT OF NON-FINANCIAL INFORMATION</i></p> <p><i>The resources applied to the audit of non-financial information should be further reviewed.</i></p>	<p>Agreed. The level of work put into this area will be reviewed as a part of Project Enable and our refocused audit approach. Non-financial reporting is a growing area in the public sector and we will need to constantly review and revise our work programmes as developments emerge.</p>	

<i>Ref</i>	<i>Opportunities for Improvement</i>	<i>Audit New Zealand Responses</i>	<i>Timeframe</i>
5.54	<p><i>OTHER OBSERVATIONS – INTERIM AUDIT WORK</i></p> <p><i>More strategic use of interim audit work may be of benefit to Audit New Zealand’s resource requirements.</i></p>	<p>Again, as a part of our project to refocus our audit approach, the use of interim audit visits will be considered as a tool to manage the resourcing impacts of our workload. Where cost effective, greater use of pre- balance date work will be utilised</p>	