

A close-up, black and white photograph of a fountain pen nib. The nib is positioned diagonally across the frame, pointing towards the bottom left. It is resting on a document that features a grid of dotted lines and several rows of numbers. The numbers are slightly out of focus, but some are clearly legible: 6644, 33213, 654, 644666, 6436, and 5466. The pen nib has intricate engravings and the words 'MONTBLANC' and '785 K' are visible on its barrel. The background is a soft, out-of-focus grid pattern.

**The Controller and
Auditor-General**

Tumuaki o te Mana Arotake

**Annual Report
2002-03**

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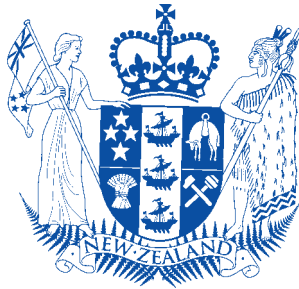
The Controller and Auditor-General

Tumuaki o te Mana Arotake

Annual Report

for the Year Ended 30 June 2003

Presented to the House of Representatives
as required by section 37 of the Public Audit Act 2001



Rt Hon Jonathan Hunt
Speaker
House of Representatives
WELLINGTON

Mr Speaker

This report has been prepared pursuant to the requirements of section 37 of the Public Audit Act 2001. It covers the operations of the Audit Office for the year ended 30 June 2003.

Yours sincerely

A handwritten signature in blue ink, consisting of a long horizontal stroke followed by a large loop.

K B Brady
Controller and Auditor-General

Wellington
30 September 2003

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The Year's Highlights



I have much pleasure in presenting my annual report on the Audit Office's performance for the 2002-03 financial year.

The environment in which we operate continues to change – bringing new challenges. This annual report confirms that we have adapted well to those challenges and have produced high-quality work for Parliament and the people of New Zealand.

Public Audit Act 2001

The passing of the Public Audit Act 2001, and subsequent changes to accounting standards, have resulted in a number of new entities coming under our mandate and subject to our audit. The application of the 'control test', which determines whether an entity is a public entity within our mandate, is in many cases quite complex.

We have spent considerable time reviewing entity documentation, such as Trust Deeds, to ascertain whether entities do indeed fall within our mandate. As a result, approximately 350-400 additional entities have been identified since the Public Audit Act was passed. Many of these will report for the first time under the new regime for the year ended 30 June 2003.





THE YEAR'S HIGHLIGHTS

At the same time, we have undertaken a complete review of all our work – especially those areas of additional work undertaken at the request of public entities – to ensure that it falls within our mandate.

Attest Audit

Giving assurance on the annual financial reports prepared by public entities continues to be the largest part of our work. This year, our auditors issued a total of 4192 audit reports compared with 3650 in the previous year.

While it does not always have the high profile of our inquiry and performance audit work, the audit of annual financial reports is a critical part of the accountability process. In the past year, the number of entities that have not produced financial reports for audit has fallen. Production of the financial report is the entity's responsibility, not ours. Nevertheless, we have used our influence to encourage those that are in arrears to be accountable to their communities. We have had some success, but there is still a way to go.

At the same time, we have continued to ensure that those in a governance role, including Select Committees, are aware of the issues that have come to our attention as part of the annual audit process. We have produced a record number of reviews and estimates examinations through the year. Feedback from Select Committees and other stakeholders confirms that our efforts are highly valued.

Performance Audits and Inquiries

Each year, after widely consulting with Select Committees and other stakeholders, and based on our own Strategic Audit Planning and stakeholder feedback, we prioritise and allocate resources to a number of performance audits.

In our Statement of Objectives for 2002-03, we said we would complete at least 10 performance audits. We were not able to complete all those planned audits, for two main reasons:

- the complex nature of the projects and the corresponding time taken to complete them; and
- the number of enquiries we have been asked to undertake.



In many instances, there is no-one other than the Auditor-General who can provide the independence and level of assurance to the public in relation to the concerns that they have. However, the resources we have are limited and the inquiry work has to be undertaken from the same pool of resources used for our performance audits. While the number of inquiries has not grown, the complexity of them has. Consequently, we have had to reprioritise the allocation of our resources to cope with the inquiry work. A number of inquiries have not been resolved as quickly as we would have liked.

I intend, through our strategic planning, to identify what might be an appropriate resource base. I will then ask Parliament what level of output is required, and to provide for greater resource in the future for this important element of our work.

Audit Service Providers

During 2002-03, we continued to ensure that all of our effort is properly focused. One key step was to ensure that the two business units of the Audit Office – the Office of the Auditor-General and Audit New Zealand – work closer together to produce the best audit results.

Audit New Zealand has played a much greater role in our strategic planning to ensure that its front-line experience is better used. Similarly, we have signified a need for a much closer working relationship with the private sector auditing firms that undertake work on our behalf.

An impediment to working collaboratively with our Audit Service Providers has been the contestability regime that we have operated for the last 10 years. I have decided that we should now move towards an allocation model for audits in the core public sector (government departments, local authorities, Crown entities, the health sector, and the tertiary education sector) to remove that impediment. The new process will be introduced in 2003-04.

Internal Governance

In order to improve our internal governance, I established an Audit Committee – made up predominantly of people from outside the Audit Office. The committee will provide me with independent advice on the quality of the activities of management, internal controls, responsible resource use, and risk management.





THE YEAR'S HIGHLIGHTS

I have also established an internal audit function to support the Audit Committee in conjunction with our independent external auditor.

Financial Results

Our total spending for the year was \$39,548,000, compared with \$36,808,000 in 2001-02. All expenditure was within appropriation, and we will return an operating surplus of \$151,000 to the Crown, compared to a forecast surplus of \$61,000.

Our working capital situation, which is subject to seasonal fluctuations, meant that we had to make use of the available overdraft facility of \$0.5 million through the period March to July 2003. This facility, together with our careful management of accounts payable and receivable, has enabled us to better manage a very difficult cashflow situation in the later part of the financial year.

Looking Forward to 2003-04

Our *Annual Plan 2003-04*¹ sets out our work programme and other plans for achievement for the current year. As well as continuing our statutory functions of conducting and reporting on audits, some particular areas of focus will be:

- preparing our Strategic Business Plan for 2004-07;
- implementing our governance and risk management framework;
- planning to provide the required capability for changes in our operating environment, particularly in the local government area; and
- implementing changes as a result of the proposed audit allocation regime.

¹ Parliamentary paper B.28AP(03), 2003.



Appreciation

In conclusion, I would like to thank the staff of the Office of the Auditor-General and Audit New Zealand, those in the private sector auditing firms that work for us, and the Audit Committee for their professionalism and excellence during the last 12 months. We have a highly competent and dedicated staff and audit service providers and their efforts have been appreciated.



Kevin Brady



A close-up, black and white photograph of a fountain pen nib writing the number '2003' on a document. The pen is positioned diagonally from the top right towards the bottom left. The nib is in contact with the paper, and the number '2003' is being formed. The paper has a dotted line running parallel to the pen's path. The background is slightly blurred, showing more of the same number '2003' written on the paper. A semi-transparent blue and white graphic element is overlaid on the top left corner of the image.

Part One

Organisation, Purpose, Outcomes, and Outputs

Contents

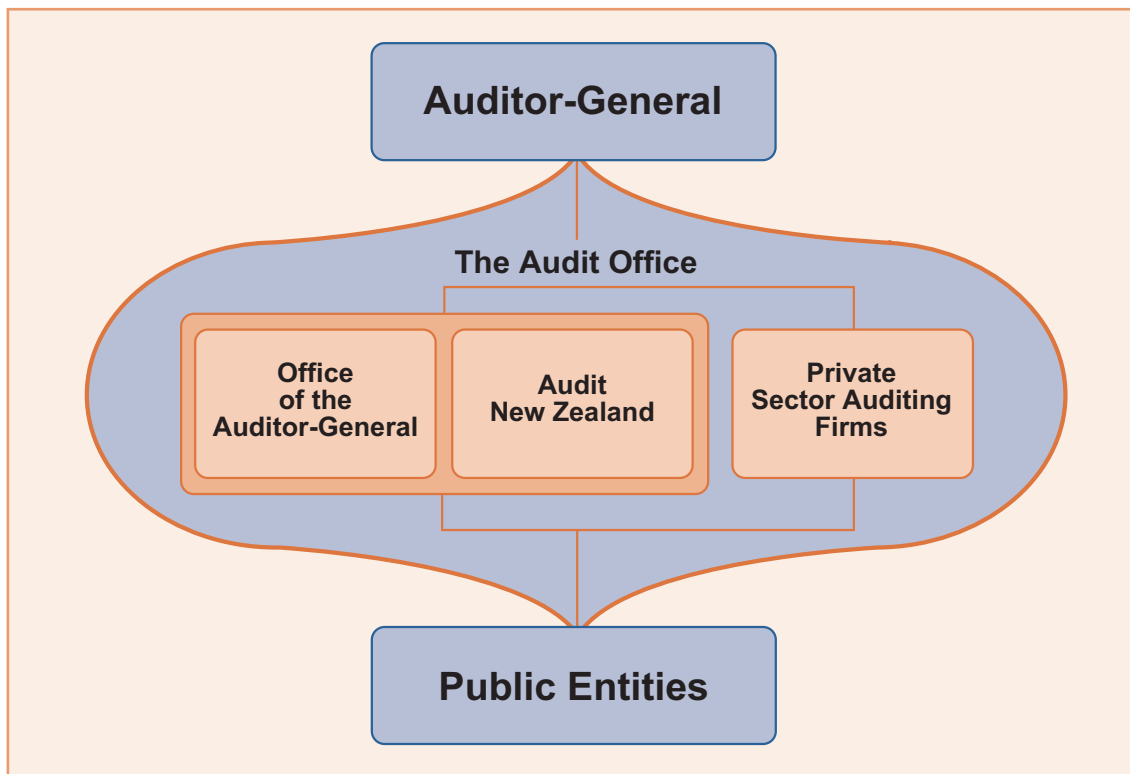
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Organisation

The office of Auditor-General is a statutory office created by Parliament in the Public Audit Act 2001.

The Auditor-General is an officer of Parliament, and in that capacity is independent of executive government and answerable to Parliament.

The Auditor-General employs staff in two business units and engages private sector auditing firms to carry out his functions in relation to public entities. This combination of internal and external resources we refer to as “the Audit Office”, as illustrated in the diagram below.



ORGANISATION, PURPOSE, OUTCOMES, AND OUTPUTS

Organisation

The roles of the two business units are as follows:

- *The Office of the Auditor-General (OAG)* – is responsible for strategic planning, setting standards, determining who will undertake audits, overseeing auditor performance, carrying out performance audits (in the form of special audits and studies), and parliamentary reporting and advice.
- *Audit New Zealand* – carries out audits that it has won the right to conduct, and offers additional assurance services to public entities.

A fuller description of who we are and what we do can be found in our publication *All about ... the Controller and Auditor-General*, available on our web site www.oag.govt.nz.



Purpose

The Audit Office exists as a constitutional safeguard to maintain the financial integrity of New Zealand's parliamentary system of government.

In New Zealand's system of government, Parliament is supreme – all authority for governmental activity ultimately stems from Parliament. Public sector organisations are therefore accountable to Parliament for their use of the public resources and powers that it has conferred on them.

Parliament also seeks independent assurance that public sector organisations are operating, and accounting for their performance, in accordance with Parliament's intentions. There is also a need for independent assurance at the local level. Local authorities are accountable to the public for using the resources they fund through rates.

The Auditor-General provides this independent assurance to both Parliament and the public.

Our Key Concerns

Our five key concerns are a reflection of the mandate given to us in the Public Audit Act 2001 and, therefore, are central to the way in which all our auditors undertake any work.

The first four concerns listed below derive from section 16 of the Act, which states that the Auditor-General may examine such matters at any time through a performance audit. The fifth, our concern for accountability, is derived from section 15, which requires the Auditor-General to audit every public entity's financial statements, accounts, and other information that a public entity is required to have audited.

- **Performance:** Have public entities undertaken activities in accordance with Parliament's intentions, and in an effective and efficient manner?
- **Authority:** Have activities, resourcing and accountability requirements been undertaken within the authority granted by Parliament?
- **Waste:** Have resources been obtained and applied in an economical manner? That is, taxpayers' dollars are not being wasted.



ORGANISATION, PURPOSE, OUTCOMES, AND OUTPUTS

Purpose

- ***Probity and Financial Prudence:*** Are entities meeting parliamentary and public expectations of an appropriate standard of behaviour in the public sector?
- ***Accountability:*** Have entities given full and accurate accounts of their activities, and of their compliance with Parliament's intentions, through the annual reporting cycle? Are governance and management arrangements suitable to address the concerns identified above?



Desired Outcomes

If the Audit Office has done a good job –

- *Parliament and the public will be confident* that public entities:
 - are delivering what they have been asked to;
 - have operated lawfully and honestly, and have not been wasteful;
 - have fairly reported their performance;and know that, if this is not the case, we will tell them.
- The Government and public entities will effect *improvements* in public sector performance and accountability in areas where we have advised that there is potential for improvement.

We discuss the measurement and reporting of our outcomes for 2002-03 in Part Four on pages 81-87.



Outputs

Our outputs fall into two broad categories:

- assurance products; and
- advice.

Assurance products take the form of:

- *Parliamentary and Public Reports* – which contain those matters arising from audits that warrant the attention of Parliament or other constituencies.
- *Controller Certifications* – which ensure that funds released from the Crown Bank Account are for purposes consistent with Parliament's intentions.
- *Audit and Assurance Reports* – which express opinions on the financial statements and results of the audit of the public entities within our portfolio, and also provide further assurance on aspects of management performance at the request of the entities.

Flowing from the conduct of audits, we provide **advice** to:

- Parliamentary Select Committees
- Taxpayers and ratepayers
- The Government
- Audited entities
- Related professional bodies.

We discuss our outputs for 2002-03 in Part Three on pages 48-67.



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Achievement of Our Goals and Strategies

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Operating Goals and Strategies of the Audit Office

Part Two of our *Annual Plan 2002-03* set out our three goals for the year and the strategies we considered appropriate for achieving those goals². This part of this report describes what we achieved.

Our operating goals and strategies for 2002-03 continued to be primarily directed towards:

- ensuring that we deliver excellent audit services;
- adjusting the emphasis of our audit work, our organisation, and our methods, to reflect our changing environment; and
- being a leading example of a public entity in terms of performance, financial management and accountability.

Goal 1: To ensure that we continue to deliver excellent audit services.

Strategy 1: *We will continue to plan and conduct all audits professionally, and having regard to the full mandate of the Office.*

The Auditor-General's Auditing Standards

The *Auditor-General's Auditing Standards* (the *Standards*) were published, as required by section 23 of the Public Audit Act 2001, by way of a report to the House of Representatives in May 2002. The *Standards* consist of the Institute of Chartered Accountants of New Zealand's (ICANZ) ethical and professional standards, supplemented by the Auditor-General's Statements and (where an ICANZ standard does not exist) the Auditor-General's Specific Standards.

2 Parliamentary paper B.28AP(02), pages 29-31.

ACHIEVEMENT OF OUR GOALS AND STRATEGIES

Goal 1: Delivering Excellent Audit Services

The *Standards* establish the minimum standards to be applied to annual audits conducted on behalf of the Auditor-General. The *Standards* can be seen on our web site www.oag.govt.nz.

In April 2003, we amended the *Standards* to reflect changes on the following two matters.

Engagements Other Than the Annual Audit

Audit Service Providers³ are now required to consult with the OAG before accepting any engagements (other than the annual audit) involving matters of possible media or political interest, or of a sensitive nature.

Often, engagements of this nature have an impact on the wider interests of the Auditor-General, as well as implications for the wider public sector.

Quality Control

We changed our auditing standard on quality control to place the responsibility on Appointed Auditors to identify audits of less than 500 hours that should be subject to independent peer review by a second partner or director of the Appointed Auditor's firm. Previously, the OAG made this determination.

We consider that Appointed Auditors, supported by their firms' internal procedures, are better placed to make decisions on whether an independent peer review is needed for audits of less than 500 hours.

The change does not apply to those audits where an independent peer review is required by the terms of the audit engagement agreement.

3 An "Audit Service Provider" is the firm in which an "Appointed Auditor" practises – either Audit New Zealand or a private sector auditing firm. An "Appointed Auditor" is the person formally appointed by the Auditor-General under section 32 or section 33 of the Public Audit Act 2001 to carry out a particular audit.



Training and Support for Our Auditors

Manual for Audit Service Providers

Our primary vehicle for formally communicating with Appointed Auditors is our *Manual for Audit Service Providers*. The *Manual* was first published in 1993 and includes:

- background information to assist auditors;
- the *Auditor-General's Auditing Standards*; and
- annual audit plans (known as “audit briefs”) issued by the Auditor-General for all major sectors, together with sector information where appropriate.

The *Manual* also contains guidance for auditors in the form of statements of general policy on matters that, for example, affect entities in more than one sector or are unique to the public sector. Audit Service Providers contribute to these statements by reporting issues that they encounter during audits. The *Manual* is available to our Audit Service Providers in electronic form.

Support for Appointed Auditors

During 2002-03, we continued to provide advice and support to Appointed Auditors – both individually on request and collectively – on a range of accounting and auditing issues. We conducted seven seminars for school auditors throughout the country, 12 seminars for auditors carrying out local government audits, and three special seminars for auditors carrying out Crown Reporting Entity audits.

We keep in touch with Appointed Auditors in a less formal way through a periodic newsletter – *The Watchdog* – four editions of which were published in 2002-03.



Reviewing Our Auditors' Performance

We aim to review each Appointed Auditor's performance once during each three-year term of appointment. Follow-up reviews may be initiated if we identify a need for improvement.

Our quality assurance programme:

- aims to ensure that auditors fulfil the requirements of the *Auditor-General's Auditing Standards* and relevant audit briefs;
- is part of the continuous improvement programme within the Office; and
- provides feedback to the Office's policy, sector, and technical managers.

We undertake desk reviews of audit files, and also visit Appointed Auditors in their offices to:

- review the systems they have put in place to ensure compliance with the standards set; and
- review working paper files for evidence of compliance with those standards.

We proposed during 2002-03 to review the quality of the work of 45 Appointed Auditors, and we completed 50 reviews (2001-02: 45 reviews).

We visited 38 auditors (2001-02: 38 visits) to review their work, and we conducted desk reviews on a further 12 auditors (2001-02: 7 desk reviews) involved primarily in the audit of schools. Consistent with previous years, the work we reviewed was, with only a few exceptions, of good quality. For the exceptions, we took appropriate follow-up action.

Another way of reviewing the quality of auditor performance is in the process of issuing a non-standard audit report.⁴ If an Appointed Auditor is considering modifying the audit report because of a major issue (for example, where there are doubts that the going concern assumption is appropriate), they submit the matter to the OAG, stating the grounds for the proposed modification. Thirty-five such submissions were made and responded to during the year (2001-02: 38).

⁴ See Part Three on pages 66-67.



Review of Our Quality Assurance Procedures

We have begun a review of the means by which we assure ourselves that all the products of the Audit Office meet the necessary standards of quality. This review is being carried out using Audit Office staff.

External Peer Review of Our Performance Audit Reports

In 2002-03, we adopted a policy of selecting two reports of performance audits a year to be reviewed by external reviewers – a New Zealand academic and a group based at the London School of Economics (LSE). The criteria for these reviews are based on those that the LSE devised for the same purpose with the United Kingdom National Audit Office.

The two reports selected for review in 2002-03 were *Bringing Down the Road Toll: The Speed Camera Programme* and *Purchasing Primary Health Care Provided in General Practice*. We selected these two reports for a range of reasons – including the different presentation of the two reports and the relatively ambitious nature of the *Primary Health Care* report, which endeavoured to cover a very broad and complex area of the health sector in a single report.

Both external reviewers provided positive comments on the reports as well as valuable suggestions for improvement that can be applied to future work. The LSE ratings for our reports (on the same scale used for the UK National Audit Office) suggest that our two reports comfortably met international benchmarks.

For 2003-04, we have selected for review two recently published reports, mainly on the basis that we particularly wish to have external comments on the methodologies we are using and how well we are using them. For future years, we intend to discuss with our Audit Committee whether we should ask members of the committee or some other independent group to select the reports that will be subject to external review.



ACHIEVEMENT OF OUR GOALS AND STRATEGIES

Goal 1: Delivering Excellent Audit Services

Strategy 2: *We will continue to target our audits at critical areas of performance and accountability in the public sector.*

We target our audits on the basis of assessments made at three progressively refined levels:

- sector-based strategic audit plans;
- audit briefs for classes of entity; and
- subject-based special audits and studies.

In addition, the objectives of specific audits and/or inquiries can be determined as the result of enquiries made to us.

Strategic Audit Plans

Information to prepare a strategic audit plan (SAP) for each broad sector group of our audit portfolio is gathered from the results of previous audits, developments in different parts of the public sector, changes in legislation, and other environmental factors. We supplement this information with formal papers on environmental and E-Government issues.

The SAPs cover a period of three years, and are updated annually. They are subject to internal critical review so that priorities can be determined – given the limited resources we have available to do discretionary work. We publish planned and likely projects annually for scrutiny by parliamentarians and other interested stakeholders.

In the local government sector (as in previous years) we consulted widely with individual councils, sector groups, and a number of organisations with an interest in local government. We analysed the issues raised through consultation as well as the complaints that had been made to us, to ensure that we directed our attention to areas where we are able to add the greatest benefit. Our local government SAP was also subject to review by the Auditor-General's Local Government Advisory Group.



Audits of Annual Financial Reports

Some 85% of our work relates to conducting audits of annual financial reports. Aspects of those audits are subject to explicit direction by way of audit briefs issued by the Auditor-General.

The prime objective of each audit is to perform the work necessary to form an opinion and issue an audit report on the financial report. In addition, however, audit briefs may identify matters of particular interest that we require the Appointed Auditor to look into and report on. The major matters we asked auditors to focus on during 2002-03 were the Statements of Intent in central government, management of separate funds and investments, and collection of money at remote sites in local government.

Special Audits and Studies

Apart from any additional coverage required as part of the annual financial report audits, we draw up a programme of special audits and studies from our office-wide and sector strategic audit planning processes.

Parliament funds the costs of special audits and studies. The results are reported either in one of our general reports to Parliament⁵ or in a separate report (which is usually also presented to the House).

The areas we looked at in 2002-03 are set out in Part Three on pages 50-54.

Enquiries

We receive numerous unsolicited enquiries from members of Parliament, taxpayers, and ratepayers about issues in public entities. If these issues raise questions which fall within our mandate, we may investigate them. Our choice of whether or not to investigate is based on the nature and scale of the issue raised, and our assessment of the public benefit of pursuing it at the expense of other (programmed) work. We report on the work done, to the enquirer, or to the entity concerned, or publicly, depending on the nature of the issue.

5 Those bearing the shoulder number series B.29.



ACHIEVEMENT OF OUR GOALS AND STRATEGIES

Goal 1: Delivering Excellent Audit Services

The extent of the inquiry work (in terms of the number of inquiries and their size and complexity) is now such that it has imposed a major burden on our staff and has affected the extent of programmed work that can be undertaken.

Commentary on inquiry work undertaken during the year appears on pages 48-50, and the reports issued are listed in Appendix 2 on pages 150-151.

Each year, when preparing our Strategic Audit Plans, we consider the nature of enquiries we have responded to, to assess whether there are themes or issues emerging that we should look at more systematically.

Strategy 3: *We will place particular emphasis on making effective arrangements for audits and public reporting on new entities in our portfolio, and the use of our broader powers to conduct performance audits under the Public Audit Act.*

Making Arrangements for New Audits

Implementation of the Public Audit Act 2001

Our new legislation – the Public Audit Act 2001 (the Act) – has continued to bed down well. It provides a modern and workable basis for our activities. Ongoing implementation of the Act has been limited to three main activities:

- identifying the scope of our auditing portfolio – in particular, “controlled” entities;
- considering requests from non-public entities to accept appointment as their auditor by arrangement; and
- ensuring that all of our activities comply with the scope of our statutory mandate.



The Scope of Our Audit Portfolio: “Controlled” Entities

The Act makes the Auditor-General the auditor of every “public entity”. It defines the term by:

- using schedules to identify public entities either by type or individually; and
- providing that an entity which is “controlled” by one or more scheduled entities is also a public entity.

The test of “control” draws on both the Companies Act 1993 and relevant approved financial reporting standards.

Identifying every controlled entity has proved to be no easy task. We have had to assess hundreds of entities across the central and local government sectors. In many cases the test has been straightforward to apply – for example, in the case of majority-owned companies. It has been more difficult in others, because a new financial reporting standard (FRS-37: *Consolidating Investments in Subsidiaries*) often turns on the exercise of professional judgement as to whether the substance of arrangements between two entities is sufficient to establish control. A wide range of trusts and similar entities has had to be assessed using such judgements.

In most cases we have received full co-operation from affected entities and their advisers. But we have been disappointed at a tendency of some entities to resist the application of FRS-37 and take an adversarial position, usually after referral to lawyers.

In several cases, this has resulted in a situation where we have made our professional judgement that a public entity “controls” other entities under FRS-37, but neither the public entity nor the entities concerned have accepted the position and the entities have refused to provide financial statements for audit. In other cases, the public entity has agreed with our judgement but the “controlled” entities disagreed. This has placed us in the invidious position of being unable to discharge what we consider to be our statutory auditing duties. We will continue our efforts to resolve the issues with the entities concerned, and will report further to Parliament as necessary.



ACHIEVEMENT OF OUR GOALS AND STRATEGIES

Goal 1: Delivering Excellent Audit Services

Identification of the full extent of our portfolio carried on throughout the financial year, and was largely completed by year's end. The results are set out in the table below. Remaining assessments will be made in time for consolidation issues to be taken into account in annual audits to 30 June 2003 (in respect of which FRS-37 applies).

New Entities Considered for Adding to Our Audit Portfolio as a Result of the "Control Test"

	Local Government Sector	Parliamentary Sector	Total
New public entities	106	192	298
Awaiting review, decision, or further information	60	35	95
Considered but not public entities	36	71	107
Total entities considered	202	298	500

Audits by Arrangement

Section 19 of the Public Audit Act allows the Auditor-General to accept appointment as the auditor of an entity that is not a "public entity", for limited purposes and subject to a set of statutory criteria being met.

We received 25 requests under section 19 during the financial year. Section 37(2)(c) of the Act also requires us to report the full list of the entities subject to arrangements under section 19 (see Appendix 3 on pages 152-153).

The Scope of Our Mandate

We reviewed all of our products and services to ensure that they are consistent with our statutory mandate. A particular focus of the review was on section 17 of the Act, which provides the authority for a range of assurance services to public entities – most of which are provided by Audit New Zealand.



The review resulted in comprehensive internal guidelines on the Auditor-General's mandate and how it is to be applied in particular situations.

All the services offered by Audit New Zealand were assessed against these guidelines. (See page 78.)

Using Our Powers to Conduct Performance Audits More Widely

As from 1 July 2001 the Public Audit Act has given us the ability to conduct performance audits in Crown entities and State-owned enterprises. Our Strategic Audit Plans have been broadened to include potential new work under our new mandate.

In our 2002-03 *Annual Plan*, we stated our intention to start work on seven performance audits, based on the extension of our mandate under the Public Audit Act, on the subjects of:

- Infection control in publicly owned hospitals;
- Housing New Zealand Limited;
- Case management by ACC;
- Fee-setting in tertiary education institutions;
- Health care waste management in hospitals;
- Infectious diseases in at-risk communities; and
- Funding secondary and tertiary health care.

We discuss progress made on these audits in Part Three on pages 52-55.



ACHIEVEMENT OF OUR GOALS AND STRATEGIES

Goal 1: Delivering Excellent Audit Services

Strategy 4: *We will complete all audits that we are required to perform, and report on the results in a timely way.*

Audits Completed

See the commentary in Part Four on page 65 and the information in Part Five on pages 117-124.

Audits Outstanding

See the commentary in Part Four on page 65 and the information in Part Five on pages 117-124.

Strategy 5: *We will place particular emphasis on communicating effectively with those who have a key interest in the results of our work.*

Emphasis on Communication

We place great emphasis on effective communication with our various audiences. Liaison arrangements with stakeholders (such as select committees and sector groups), and operating on a professional “no surprises” basis with public entities when we are reporting on them, take significant effort and time.



Results of Annual Audits

Government Departments, Crown Entities, and State-owned Enterprises

We reported the results of our audits of the 2001-02 *Financial Statements of the Government* and the financial reports of government departments in *Central Government: Results of the 2001-2002 Audits*.⁶ The latter report also contained the results of the following audit examinations carried out during 2001-02:

- Non-standard Audit Reports Issued;
- Accountability for the Crown's Investment in Air New Zealand Limited;
- Accident Compensation Corporation's Investment Policies and Practices;
- Reducing Social Inequalities: Monitoring of Funding for Capacity Building;
- Accountability Information on Student Loans – Has It Improved?; and
- Status of Follow-up Action on Previous Reports.

Local Government

We reported the results of our audits of the 2001-02 financial reports of regional and territorial local authorities in *Local Government: Results of the 2001-02 Audits*.⁷ The report was issued after the end of the 2003 financial year, but reference to it is included here to maintain the currency of the information. The report also contained the results of other audit examinations carried out, or issues identified, during the 2001-02 audits:

- Accounting Issues – Heritage Assets, Infrastructural Assets, Land Under Roads, Environmental Obligations, and Leaky Buildings;
- Separate Properties and Rating Apportionments;
- Collection of Money at Remote Sites;
- Management of Separate Funds and Investments;

6 Parliamentary paper B.29[03a], 2003.

7 Parliamentary paper B29[03b], 2003.



ACHIEVEMENT OF OUR GOALS AND STRATEGIES

Goal 1: Delivering Excellent Audit Services

- Local Authorities (Members' Interests) Act 1968 – Discussing and Voting When Interested; and
- Review of Licensing Trusts.

Communications Strategy

We initiated a two-phase Communications Strategy in March 2003.

- The first phase included analysis of our existing approach to communications with a range of stakeholders, embracing communications methods and internal processes. We made a number of immediate improvements as a result, such as the introduction of a web site subscription service for better access to our reports.
- The second phase – to address areas identified for improvement and to draw up a Communications Plan – began in July 2003.



Goal 2: To adjust the emphasis of our audit work, our organisation, and our methods, to reflect our changing environment.

Strategy 1: *We will maintain sound awareness of developments and changes in the public sector.*

The Local Government and Parliamentary Groups in the OAG obtain and process a large amount of intelligence about developments and changes in the public sector, from public entities and from our field auditors, as a core part of their business. This intelligence forms the basis for our strategic audit planning process, referred to earlier in this report. The Auditor-General's Local Government Advisory Group also provides us with an excellent sounding board for developments in the sector.

In 2002-03, we complemented this ongoing effort by:

- continuing to put effort into developing relationships with central agencies through a series of regular meetings between CEOs of the respective organisations;
- maintaining an interest in, and contributing to, the work of the State Services Commission and the Treasury on Managing for Outcomes and the Review of the Centre;
- maintaining an in-house E-Government Group, participating in the State Services Commission's E-Government Agency Leaders Forum and contributing to the Go Procure project, to provide intelligence on developments in this area; and
- working closely with sector groups – such as district health boards, and education and social services organisations.



ACHIEVEMENT OF OUR GOALS AND STRATEGIES

Goal 2: Adjusting to Our Changing Environment

On a slightly different note, the Office often finds itself in a unique position, because of its independence and knowledge, to contribute to areas of reform in the public sector. Over the past year, we have made contributions in a number of areas of reform. We comment on these on pages 55-56.

Strategy 2: *We will improve the ways we learn as an organisation.*

In order to improve our mechanisms for learning, we have undertaken a number of initiatives in the OAG and Audit New Zealand – including:

- completing the first of two projects to improve access by Appointed Auditors to key information held by the OAG (the database of audits and the *Manual for Audit Service Providers*), and to obtain returns from auditors electronically rather than in paper form;
- undertaking a series of discussions on how to improve our internal communications and our capacity for innovation and learning, and starting to carry out the consequent action plans;
- aligning corporate policies and developing common systems, where that would enhance the benefits to the OAG and Audit New Zealand;
- reviewing and updating our intranet as a tool for informing and sharing common information and ideas;
- holding regular staff communications meetings, helping the flow of information between management and staff; and
- involving staff in project steering committees and task groups, to tap into their capability and to provide them with development opportunities.

The OAG and Audit New Zealand have been working closer together for the mutual benefit of the wider Audit Office through sharing of resources and knowledge. In particular, sector and technical expertise, and corporate service functions have been shared more readily between the OAG and Audit New Zealand over the past year.

We expect this sharing to increase in the future and to extend to all audit service providers (where practicable and desirable) under the new audit resourcing model. This will add to the learning ability of the Audit Office as a whole.



The Auditor-General has established a regular pattern of visits to Audit New Zealand offices in order to maintain communication with staff.

Strategy 3: *We will undertake projects targeted at increasing our understanding of specific areas or issues in the public sector, and at developing suitable audit products for the changing needs of the sector.*

In pursuit of this strategy, during 2002-03 we prepared and considered internal issues papers on the following subjects:

- review of the ‘five management aspects’⁸;
- accounting for IT equipment leases;
- provision of assurance on public entity web sites;
- possible options for future work on public sector performance reporting; and
- guidance to assist Appointed Auditors to review the Departmental Statement of Intent.

The OAG will continue to prepare a small number of issues papers on these and similar topics each year.

We completed our participation in a series of pilot workshops on triple bottom line reporting run by the Ministry for the Environment.

8 See Part Four on pages 85-87.



Goal 3: To be a leading example of a public entity in terms of performance, financial management and accountability.

Strategy 1: *We will fulfil a leadership role where it is appropriate to do so, particularly in the development of public sector accountability arrangements and performance reporting.*

During 2002-03, we pursued this strategy in a number of ways:

- by undertaking speaking engagements on a range of subjects in a range of forums – particularly on general accountability arrangements, the development of public sector performance reporting, and the impact of the Public Audit Act;
- through advising the Local Government and Environment Committee during its deliberations on the Local Government (Rating) Bill and the Local Government Bill;
- by liaising with our national and international peers and professional organisations;
- by consulting with the State Services Commission and the Treasury on the “Managing for Outcomes” and the “Review of the Centre” programmes and contributing to their evaluation of those initiatives; and
- by our involvement in other areas of policy and law reform (see pages 55-56).



Strategies 2 and 3: *We will continue to practise what we preach to others, and operate under a philosophy of continuous improvement.*

We take seriously the proposition that, to lead by example, we must practise what we preach.

This year, we again followed up a review of our own policies and procedures in the light of relevant reports we have issued over the last decade. The review identified some areas where the OAG needed to make modifications, such as IT project management and compliance with E-government Standards. Audit New Zealand revised its policies in relation to financial delegations, credit cards, motor vehicles, cell phones, accounting for work in progress, and acceptable use of IT systems.

Three particular developments should be reported:

- We established an Audit Committee for the Audit Office. The committee has four members, three of whom are from outside the Office. The fourth member is the Deputy Auditor-General. The Committee plays a vital role in the Office's governance arrangements.⁹ It plans to meet 4 times a year.
- We reviewed the kinds of work that we might undertake in terms of section 17 of the Public Audit Act in the light of –
 - our mandate under the Act; and
 - the independence requirements of the Institute of Chartered Accountants of New Zealand.¹⁰
- We established an internal interest group on looking at sustainable development in our audit work. The group's purpose is to plan, implement, and monitor targets for the Office's sustainable development programme for the future.

We also undertook a wide range of minor improvement or development projects, each too minor to report here, but cumulatively significant in terms of how we operate. We continually look for ways to improve our performance – both externally and internally – and to report on our activities in a comprehensive and open manner.

⁹ We described these arrangements on pages 10-13 of our *Annual Plan 2003-04* (parliamentary paper B.28AP(03), 2003).

¹⁰ See also page 30.



ACHIEVEMENT OF OUR GOALS AND STRATEGIES

Goal 3: Being a Leading Example

Strategy 4: *We will maintain a capability which delivers excellent administrative, corporate and technical support to the Office.*

The Auditor-General has been particularly keen to see a closer working relationship between the OAG and Audit New Zealand. This has been considered particularly sensible in the area of corporate and technical support functions in both the OAG and Audit New Zealand in Wellington, the only city where both are located. As a result, administrative, financial and human resource policies are being reviewed and aligned where appropriate, and a common form of employment agreement has also been adopted.

The Office's Reports Group, which is responsible for editing and publishing all Office publications, was given an increase in resources to an appropriate level to enable it to cope with the increased workload being experienced over recent years.

We had planned to complete an Information Systems Strategic plan and an Executive Reporting System, both of which will now be completed in the current year.

Microsoft Windows and Office 2000 software was installed on all of the Office's PCs and servers and an enhanced firewall installed, our document management system was upgraded, and creation of a new intranet started.

A Business Continuity Plan for the whole of the Audit Office was finalised, published, and communicated to staff toward the end of the year. It has yet to be tested which will be completed early in the new financial year.

In the OAG, the corporate services group surveyed users to determine the adequacy of the service provided in each of the functions of finance, human resources, information systems and services, and planning. This was the third such survey over the past six years. Overall, 90% of respondents rated the level and quality of service as "good" or "excellent", compared with 81% in the previous survey.

Audit New Zealand has continued its focus on improving its business and personnel planning for recruitment and retention, and budgeting and accountability systems, to support its new governance framework. (See pages 78-80.)



Strategy 5: *We will place additional emphasis on measuring and reporting achievement of our goals and desired outcomes.*

A core part of our role is advocacy of improved measurement and reporting of results by public entities. With this in mind, we need to comply with the reporting standards that we are required to report on in other organisations, if they are relevant to the Office.

One of our objectives in 2002-03 was to further enhance our management, measurement, and reporting of outcomes, capability, and risk. Over the last three years, we have applied considerable effort to the measurement of outcomes and capability, and some effort to risk. We have also improved the planning and reporting of these activities in keeping with the “Managing for Outcomes Model” implemented in government departments for the first time this year.

Earlier this year, as part of our Annual Plan for 2003-04 (required under the Public Audit Act 2001), we produced a Statement of Intent (SOI) in line with the Managing for Outcomes Model. For some years now we have been developing measures that demonstrate the impact we make on achieving our desired outcomes – described in our SOI as “the desired situation” – and also in terms of our own capability as an Office.

The SOI identified a possible series of measures that are not dissimilar to those we have committed to reporting in our last Annual Plan. These measures will continue to be developed and refined over time as we decide appropriate ways to collect data to make the measures more meaningful. The results of work to date, including some direct measurement of outcomes and capability, are described on Part Four pages 81-95.



ACHIEVEMENT OF OUR GOALS AND STRATEGIES

Goal 3: Being a Leading Example

Strategy 6: *We will successfully respond to the findings of a review of the impact of contestability conducted late in the 2001-02 year.*

Following the recommendation of an external review of the activities of the Audit Office by a team representing the Australasian Council of Auditors-General conducted in 2001-02, we reviewed the contestable audit arrangements used for the last 10 years to select most of the auditors we appoint to carry out annual audits on behalf of the Auditor-General. That review examined the impact that contestability had on:

- audit price;
- audit quality;
- the capability of the Audit Office; and
- the strategic and operational risks.

The review found that overall the gains made by contestability, in terms of audit quality and price, appear to have largely been realised. However, the regime may now be producing diminishing returns for the Audit Office in relation to those gains, and may be causing some unintended and perverse behaviours in the auditor/auditee relationship.

The review will result in a major change to the model for selecting and appointing auditors. The change has also taken account of:

- the major changes expected to occur in the public sector over the next few years that will require new skills and relationships between auditors of public sector entities; and
- the need to ensure that our auditors work more closely together to strengthen their skills and relationships.

After consultation with interested parties we will be in a position to implement the new model from the end of 2003 on a phased basis that ensures a smooth transition as changes in audit arrangements occur.



Strategy 7: *We will successfully manage the transition process on appointment of a new Auditor-General.*

Kevin Brady was appointed to the position of Auditor-General in May 2002. Kevin had previously had a long history with the Audit Office and was fully familiar with its functions and operations.

As a consequence, transition issues have been minimal and the organisation has moved on during the year under his leadership. At the start of his term, Kevin set out seven areas of performance and development for the Office that he wishes to focus on during his tenure:

- maintaining a viable and strong Audit New Zealand;
- maintaining an attest audit function that stakeholders can have confidence in;
- continuing to practise what we preach, particularly in terms of our own capability;
- maintaining our credibility and independence;
- being seen as an essential part of the system of government;
- engendering real change and improvement in the public sector; and
- making a major contribution to improving public sector accountability.

In addition, Kevin has initiated a strategic planning process to consolidate his goals into strategies to be implemented during his term.

These focus areas will form the basis for the Office's Strategic Plan covering at least the next three years, which is due to be finalised early in 2004.



A close-up, black and white photograph of a fountain pen nib. The nib is positioned diagonally across the frame, pointing towards the bottom left. It rests on a document that features a large, stylized number '3' in the upper left corner. The background of the document is filled with a repeating pattern of the year '2003' in a cursive font, arranged in a grid-like fashion. The pen nib has intricate engravings, including the number '1971' and a signature. The overall composition is artistic and symbolic, representing achievement and progress.

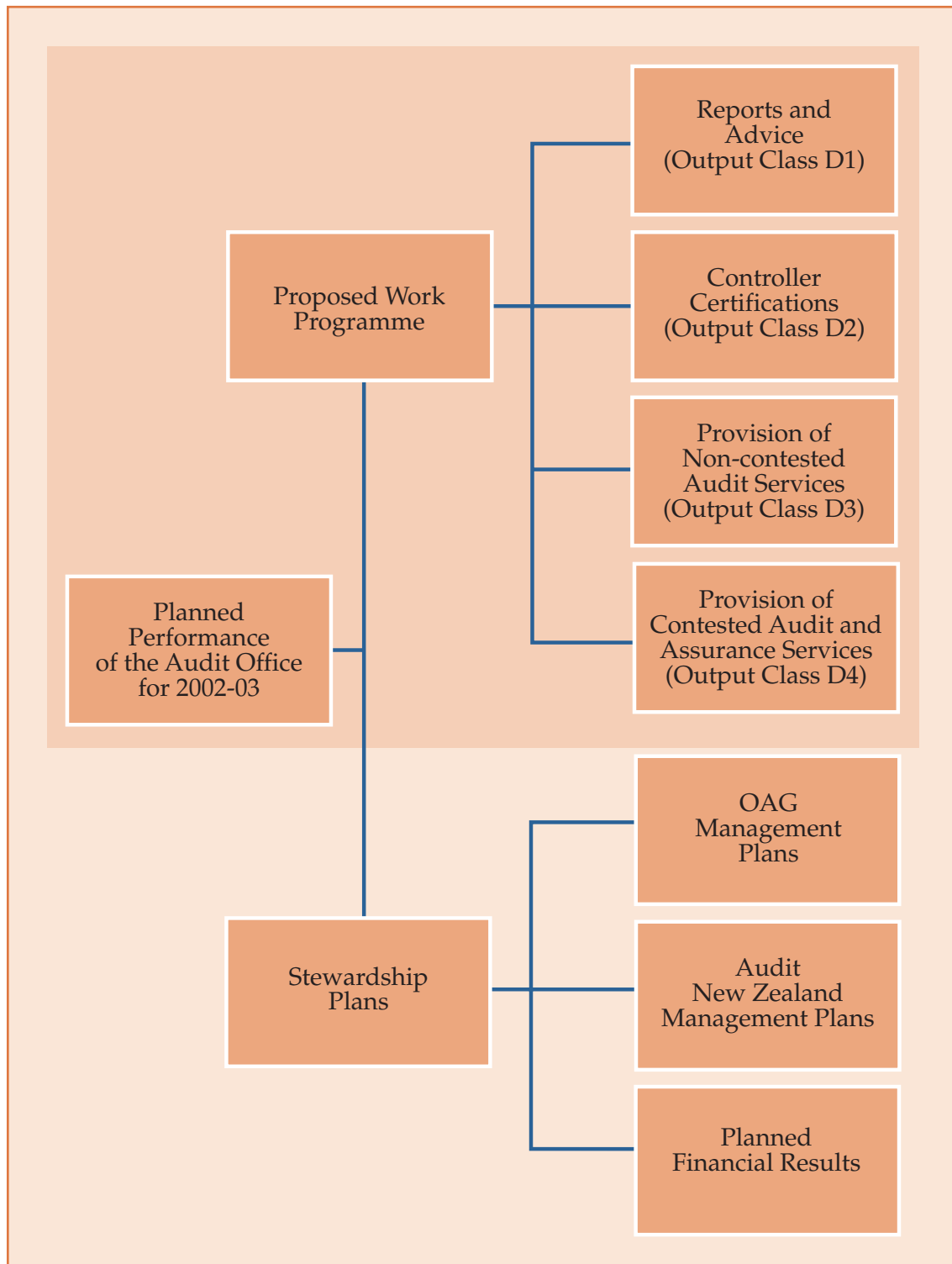
Part Three

Achievement of Our Work Programme

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Elements of the Performance of the Audit Office for 2002-03



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Advice to Parliamentarians

This activity comprises mostly contributing to the work of Select Committees in their conduct of Estimates examinations and financial reviews. Particulars of the contributions made are set out in the Statement of Service Performance in Part Five on pages 108-109.

Sometimes we make people available to assist a Select Committee in its other work, such as an inquiry. One such example during the year was an officer made available to assist the Primary Production Committee in its inquiry into the management of the scampi fishery. The inquiry is a lengthy one – starting in January 2003 and yet to be concluded.

Responding to Enquiries

We responded to requests from a number of stakeholders in the public sector, including Ministers of the Crown, members of Parliament, taxpayers, ratepayers, and other members of the public. For the most part, our response consisted of a letter to the enquirer, written after making our own enquiries with the organisation concerned. In some cases, we were prompted to instigate a more formal inquiry. The following are the major inquiries that we pursued during 2002-03, not all of which we have yet reported on.

Certain Matters Arising from Allegations of Impropriety at Transend Worldwide Limited

Following its 2000-01 financial review of New Zealand Post, the Finance and Expenditure Committee recommended that we provide assurance that Transend has made improvements to its policies and procedures, following allegations about its operation. The Committee's concerns related primarily to the adequacy of the process that the Board had followed to investigate the allegations and whether any problems identified had been fixed. We decided to enquire into certain aspects of Transend operations and their oversight by New Zealand Post. We reported on the results of our enquiry in December 2002.



Department of Conservation: Administration of the Conservation Services Programme

We decided to conduct an inquiry as a result of a complaint from a body that represents the interests of its shareholding fishing companies in association. The complaint was supported by specific case studies illustrating the body's concerns about the way that the Department of Conservation manages the Conservation Services Programme.

ACT Parliamentary Party Wellington Out-of-Parliament Offices

We received requests that we conduct an inquiry into certain electorate and out-of-Parliament offices in Wellington run by the ACT Parliamentary Party. After making enquiries and obtaining preliminary information, we wrote to the Speaker as the Chairperson of the Parliamentary Service Commission outlining our decisions as to why we would not conduct a full inquiry.

Report on the Disposal of 17 Kelly Street by Institute of Environmental Science and Research Limited

This report was in response to a request from the Minister responsible for Crown Research Institutes to audit the process by which Institute of Environmental Science and Research Limited disposed of a property in Auckland.

Allegations Involving Dr Ross Armstrong

In December 2002, we decided to undertake an inquiry into the expenses incurred by Dr Ross Armstrong during his tenure as Chairperson of Television New Zealand Limited, New Zealand Post Limited, and Industrial Research Limited. We said at the outset that the work necessary to gather and analyse the required information would take some time.



Public Funding of Organisations Associated with Donna Awatere Huata MP

In February 2003, we began an inquiry into certain matters concerning Donna Awatere Huata MP. The inquiry was prompted by allegations made in the news media that funds paid by the Ministry of Education to the Pipi Foundation (which Mrs Awatere Huata had established) for the purposes of a reading programme had been misappropriated. The Serious Fraud Office is investigating those specific allegations.

Consistent with our role as the public sector auditor, we directed our inquiry at the arrangements under which the public funding had been made available to the Pipi Foundation. However, we extended the scope of the inquiry to include public funding paid to other organisations with which Mrs Awatere Huata had been associated.

We said at the outset that the inquiry would be time-consuming, and it has been.

Special Audits and Studies

We completed work from our *Annual Plan* for 2002-03 and earlier years on the following subjects:

Managing the Relationship Between a Local Authority's Elected Members and its Chief Executive

We examined how elected members and their chief executive manage their relationship in the grey area between governance and administration. Difficulties in managing that part of the relationship appeared to be a common cause of problems between councils and their chief executive. We suggested ways in which this situation might be improved.



Local Authority Involvement in Economic Development Initiatives

We undertook this study prompted by concerns about potential liabilities and risks associated with local authorities' endorsement of, and (often) tangible support for, a wide range of economic development initiatives. This report is based on information and experiences obtained from interviews with mayors, councillors, chief executives and staff of 11 local authorities. We also spoke to a selection of economic development agencies.

Ministry of Agriculture and Forestry: Management of Biosecurity Risks

In this report we assessed how MAF manages terrestrial biosecurity risks. We also examined seven case studies as illustrations of MAF's application of biosecurity risk policies and procedures, and identified areas where we believed improvements could be made. One case study, on the management of the southern saltmarsh mosquito incursion, examined the role of the Ministry of Health.

New Zealand Defence Force: Deployment to East Timor – *Performance of the Helicopter Detachment*

In November 2001 we issued a report on the New Zealand Defence Force's deployment to East Timor. That report looked at how the NZDF planned for the East Timor operation, prepared a joint force, and subsequently deployed that force to East Timor. We undertook two further examinations of the roles performed by two particular elements of the New Zealand force in East Timor – helicopters and medical support. This report looked at the contribution of the Royal New Zealand Air Force's helicopter detachment – mainly at planning for deployment during early- to mid-1999, and operations from September 1999 to February 2000.



New Zealand Defence Force: Deployment to East Timor – Performance of the Health Support Services

Our report on health support to the East Timor deployment considered the medical preparations that were necessary for the deployment, how military personnel were supported while in East Timor, and what procedures and services were necessary in getting them back to New Zealand at the end of a tour of duty.

Management of Hospital-acquired Infection

Infection control is an essential element of good clinical practice and is vital for patient safety. The purpose of our performance audit was to describe and assess systems for managing hospital-acquired infection in public hospitals. The report covered both governance and clinical aspects of infection control – including how District Health Boards (DHBs) manage infection control, the specific policies that DHBs have in place, and internal arrangements for monitoring infection rates. We provided specific feedback to all DHBs on issues arising with their current policies and practices. We also intend to work with the Ministry of Health to improve infection control practices.

We made good progress on the following subjects indicated in our *Annual Plan 2002-03*:

Inland Revenue Department – Taxpayer Audit

The audit examined how the Inland Revenue Department uses taxpayer audit as part of its overall compliance improvement strategy. The report was presented to the House in August 2003.

Accuracy of Benefit Payments

We are examining the accuracy with which the Department of Work and Income processes claims for social security benefits, and reviewing the methods that the Department uses to measure and report processing accuracy. We have made good progress, and our report is in the course of preparation.



The State Services Commission's Effectiveness for Māori

This review involves the application to the State Service Commission of our model for assessing the capability of departments to deliver effective outcomes for Māori. Although the review was initiated in 1999-2000, it was postponed. We intend to complete and report on the review in 2003-04.

Co-ordination in the Justice Sector

This study examines the effectiveness and efficiency of the arrangements that have been put in place to facilitate co-ordination within the criminal justice sector, including the information systems that support both co-ordination and the operations of individual agencies.

ACC Case Management

This audit is reviewing the effectiveness and efficiency of ACC's case management processes and procedures. It looks at ACC's rehabilitation policy and practice, claims streaming and claims payment accuracy.

The Māori Trustee and the Māori Land Court

This audit is examining the effectiveness of the Māori Trustee and the Māori Land Court in assisting the administration and management of Māori land by its owners.

Hazardous Waste Management

This audit is examining the effectiveness and efficiency with which central and local government are delivering safe hazardous waste management for communities and their environments.



Shared Services in Local Authorities

The purpose of this study is to assess shared services arrangements against a set of high-level expectations with the objective of providing guidance to local government. The study will identify the potential benefits from the sharing of services and obstacles to such collaboration, drawing on the experiences of shared services initiatives in a range of local authorities.

Managing Threats to National Security

This study examines the management of threats to national security, especially from organised terrorist activity. There is a wide range of agencies involved in assessing and managing such threats, including the security agencies – the Security Intelligence Service; the Government Communications Security Bureau; External Assessments Bureau (within the Department of the Prime Minister and Cabinet); Police; Foreign Affairs; Defence; Immigration; and Customs. The report will be presented to the House shortly.

Human Resource Management in the Public Sector

This study examines in some depth how well departments individually – and the public sector generally – are performing a strategic human resource management function. Failures of strategic human resource planning can result in the inefficient delivery of public services, or in serious service failures, especially in areas which are potentially of high cost to the economy and society.

We made limited progress on, have deferred, or do not intend to pursue in the meantime, the following subjects indicated in our *Annual Plan 2002-03*:

A – Covered by 2003-04 Annual Plan:

- Civil Aviation Authority
- Information Requirements for the Sustainable Management of Fisheries
- Housing New Zealand
- Training in the New Zealand Defence Force



- Fines Collections by Courts
- Immigration Policies and Practices
- Economic Development Initiatives
- Department of Conservation's Land Holding and Purchasing Policies.

B – Not being pursued in the meantime:

- Information on Site Risks
- Costing and Pricing of Student Fees in Tertiary Education Institutions
- Infectious Diseases in At-risk Communities
- Effectiveness of Compensatory Funding Mechanisms in Education
- Funding Secondary and Tertiary Healthcare
- Illegal Drug Prevention and Detection
- Health Care Waste Management in Hospitals.

Involvement in Policy and Law Reform

We have continued to play a role in the development of policy and new legislation concerning matters of public sector finance, governance, and accountability. The Auditor-General is not part of the public service, and has no direct responsibility for policy development. Our role is therefore limited, and is moreover constrained by the need to maintain our independence from the Executive. Nevertheless, we are often well placed to contribute because of the experience and expertise of our staff and our public sector-wide perspective.

Our contributions over the past year included:

- extensive advice and assistance to the Local Government and Environment Select Committee on the Local Government Bill;
- comment to the Cabinet Office on proposed legislation requiring members of Parliament to disclose financial interests;
- comment to the State Services Commission on the financial, governance and accountability provisions of the draft Crown Entities Bill; and



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- comment on a number of policy papers prepared by the Treasury on the proposed Public Management Bill.

Advertising Guidelines

Government departments often ask for assurance about whether proposed advertising and publicity material complies with the *Cabinet Guidelines on Government Advertising* – for example, in relation to party political content. We also sometimes receive complaints about alleged breaches of the *Guidelines*.

During the past year we discussed with the Secretary of the Cabinet the currency of the *Guidelines* (which date from 1989) and the possibility of an update.

In the local government sector, we published our own *Suggested Guidelines for Advertising and Publicity by Local Authorities* in 1996 and updated them in 1999. We are currently working on a further revision, and have been consulting extensively within the sector. Completion of the revised version is scheduled for late-2003.

Local Authorities (Members' Interests) Act 1968

This important piece of legislation imposes controls in respect of financial conflicts of interest of members of local authorities and several other statutory bodies. It uses an outdated and complex drafting style, is in places ambiguous and hard to understand, and has been without major revision for 35 years. Members of local authorities rely substantially on our plain English booklet on the Act for guidance as to compliance. The booklet also contains large amounts of supplementary material, which we use as a basis for making rulings and giving exemptions in appropriate cases.

Enforcement of the Act has become problematic. We have twice recently reported our concerns to Parliament about the rising number of complaints about breaches of the rule against Councillors participating in meetings when they have a pecuniary interest. Yet the only enforcement function under the Act involves summary prosecution – for which we are the sole prosecuting authority. In May 2003 the first prosecution for many years was heard in the Christchurch District Court. Although we proved a pecuniary interest, the case resulted in an acquittal because of a statutory defence, the scope of which had been unclear.



The case demonstrated the difficulties in administering and enforcing legislation of this age and uncertainty, with prosecution the only enforcement function. There is in our view an urgent need for the Act to be reformed, and we have reported this view both to the Department of Internal Affairs and to the House¹¹.

Changes in Accounting and Auditing Practice

The Office continues to monitor and play a leading role in changes in accounting and auditing practice – both locally and internationally. The Accounting and Auditing Policy Group of the OAG deals with the large amount of information attaching to that role.

One major emerging issue for public sector accounting that the Office is confronting and has taken a lead on is the future of New Zealand Financial Reporting Standards, as they will affect the public sector.

The Accounting Standards Review Board (ASRB) has decided, after consultation with various interested parties, that New Zealand reporting entities will adopt International Financial Reporting Standards (IFRS) as the basis for financial reporting from 2007. Reporting entities can however choose to adopt IFRS from 2005.

The issue that arises from this decision is that IFRS are developed for profit-oriented entities and the ASRB has a responsibility to approve financial reporting standards that apply to all sectors in New Zealand. During the year we became concerned that the interests of users, preparers, and auditors in the public sector were not being given sufficient consideration. We raised our concerns with the ASRB and are now hopeful that these interests will be appropriately considered.

To accommodate service-oriented entities in the public sector and voluntary sector entities (referred to as public benefit entities) the New Zealand IFRS (NZ IFRS) will now incorporate additional material so that the standards are relevant and appropriate to all New Zealand reporting entities.

11 See our report *Local Government: Results of 2001-02 Audits*, parliamentary paper B.29[03b], 2003, pages 51-52.



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Additional material in the NZ IFRS will include:

- requirements on measurement and recognition that will be applicable only to “public benefit” entities;
- guidance that is applicable only to “public benefit” entities; and
- other disclosure requirements that will be applicable either to “public benefit” entities or all entities.

We expect that much of the additional material will be sourced from International Public Sector Accounting Standards that are relevant to the particular topic.

In addition, some of the options in IFRS will be eliminated where current New Zealand standards require one of those options to be applied and there is no good reason for permitting the other option.

Adoption of new standards based on IFRS will result in changes to financial reporting by public sector entities. It is too early to know exactly what NZ IFRS will require for public sector entities. Nevertheless, based on current IFRS, we know that there will be new standards dealing with financial instruments, intangible assets and agriculture, which New Zealand has not had in the past.

As exposure drafts (EDs) of NZ IFRS are issued, we will be reviewing them to see that public sector issues are appropriately dealt with. Where appropriate we will make submissions on the EDs.

The Professional Practices Board of ICANZ has recently decided to adopt International Standards on Auditing (ISAs), subject to a consultation process. At present, New Zealand standards are based on international standards but have broader application and are framed to reflect more fully the public sector aspects.

The timing of this change and its impact on auditing standards for the public sector are not yet known, but we will be monitoring developments and seeking to ensure that auditing standards continue to be relevant to the public sector.

International Relations

We continue to receive a wide range of visitors from countries who have an interest in New Zealand public sector reform, particularly our legislative, accountability and audit arrangements. We have also continued to expand our links with Australia, contributing to a number of forums on financial management, E-Government, and auditing matters.

We have continued to play a major role in the International Organisation of Supreme Audit Institutions (INTOSAI) Working Group on Environmental Auditing, particularly as a member of the group's steering committee. This has involved contributing to the development of a work plan for the group, disseminating information to other audit offices in the South Pacific region, and preparing papers on waste management and sustainable development. We also organised and ran the first of two ACAG/SPASAI (see below) regional workshops in Melbourne in August 2002 (we organised and chaired the second in Brisbane in August 2003).

South Pacific Association of Supreme Audit Institutions

The Controller and Auditor-General of New Zealand is also the Secretary-General to the South Pacific Association of Supreme Audit Institutions (SPASAI), and during the year we have continued to carry out various activities associated with this role.

SPASAI is one of the seven regional working groups of INTOSAI.

The membership of SPASAI currently consists of the Office of the Auditor-General – or its equivalent – from 21 countries and states in the Pacific region.

The objective of SPASAI is to “*encourage, promote and advance co-operation among members in the field of Public Audit*”.¹²

By far the most significant part of our role as Secretary-General to SPASAI is the organisation of training programmes in the Pacific in conjunction with the Asian Development Bank (ADB)¹³ and the INTOSAI Development Initiative (IDI)¹⁴ which provide funding and other support to the provision of these programmes.

Over the last financial year, two programmes have been held:

- a five-week workshop on performance auditing and instructional techniques (also known as train-the-trainer) which was hosted by the Government of Samoa Audit Office from 4 November to 6 December 2002; and

¹² From SPASAI Constitution – available at www.oag.govt.nz.

¹³ The ADB is a multilateral development finance institution dedicated to reducing poverty in Asia and the Pacific. The ADB was established in 1966 and is now owned by 61 members, mostly from within the Asia-Pacific region. The ADB is headquartered in Manila, Philippines.

¹⁴ The IDI has been the training arm of INTOSAI since 1986. The IDI's mission is to help Audit Offices, especially in developing and emerging nations, to improve their audit capacity and effectively address emerging audit issues through training and information sharing. The IDI is based in Oslo, Norway.

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Output Class D1

- a two-week workshop on performance auditing which was hosted by the Audit Department of Tonga from 12 May to 23 May 2003.

Approximately 30 participants from around the Pacific attended each workshop. Prior to each workshop, a planning meeting was held to prepare for the workshop.

These workshops were an important part of establishing and developing performance auditing in the SPASAI region. As a result of the workshops there is now a pool of skilled people, not only knowledgeable in performance auditing, but who also have the skills to present this material to their colleagues back in their Offices.

The Regional Institutional Strengthening Committee (RISC) identifies the training needs of the region. RISC is a sub-committee of SPASAI. The membership of RISC is the Auditor-General – or equivalent – of the Cook Islands, Fiji, Kiribati, New Zealand, Palau, and Papua New Guinea.

The purpose of RISC includes:

- agreeing on the training needs of the region;
- evaluating the effectiveness of training programmes;
- assisting in the development of training programmes; and
- identifying other institutional strengthening activities.

The last meeting of RISC was held in Nadi, Fiji in March 2003.

We are currently planning for a two-week workshop on financial auditing. The workshop is to be funded by the IDI and will be hosted by the Office of the Auditor-General of Fiji in November 2003.

The ongoing support of the ADB and IDI to the region is gratefully acknowledged, as well as those SPASAI members who provide ongoing support through the provision of trainers and the hosting of workshops.

Further information about SPASAI is available from our web site www.oag.govt.nz.



Output Class D2

Controller Function

The Controller function is a statutory function carried out in accordance with section 22 of the Public Finance Act 1989. Its purpose is to act as a monitor, on behalf of Parliament, to control the issue of funds from the Crown Bank Account.

Operationally, this includes monitoring departmental and Crown financial reporting systems to ensure that releases of funds are supported by Parliamentary appropriations and are for lawful purposes.

A key part of this activity is checking that warrants issued by the Governor-General for the release of funds, and daily amounts released to departments to fund their activities, are supported by appropriations. Particulars of our performance are included in the Statement of Service Performance in Part Five on pages 115-116.



Output Classes D3 and D4

Provision of Audit and Other Assurance Services

The Audit Engagement Policy

As at 30 June 2003, 142 individual Appointed Auditors from 71 private sector firms and Audit New Zealand were conducting audits and signing audit reports on behalf of the Auditor-General. Of these, 68 Appointed Auditors and 61 firms audit only schools or other small organisations.

From 1993 to 2002 we progressively applied a policy of exposing a significant part of our audit portfolio to competitive tendering. By 2003, entities comprising approximately 88% (by audit hours) of the portfolio had been invited to participate in the contestability arrangements.

Audit Tenders Completed in 2002-03

During 2002-03, we suspended tendering of audits (for entities where existing contracts had been completed, and for the few audits not previously subjected to contestability) pending the outcome of the review of contestability (see page 42). We took this step because any tender outcomes would have locked us into ongoing audit arrangements for a further six years, limiting the scope for new policy implementation. The only exceptions were:

- two District Health Boards, for which offers to tender audits were made prior to the policy suspension;
- a State-owned Enterprise, for which an independence issue (arising from the merger of two auditing firms) led to the resignation of the appointed auditor; and
- the three-yearly audit engagement process for school auditors, because tenders initiated in the previous financial year were completed in November 2002.



For 163 entities for which the audit contract was at the point of reconsideration, the existing auditor was appointed for a further year. We put in place a process for the auditors to negotiate fees for the audit of the 2002-03 financial year, subject to the approval of the outcome by the Auditor-General. In those cases where negotiations reached stalemate, and in the absence of a tender option, we provided comparative information about relevant fee levels and fee movements to the entity and the auditor. That assistance enabled agreement to be reached in four of those cases.

The results of the tenders that were concluded in 2002-03 are set out in the table below.

Audit Tender Outcomes 2002-03

Tender Timing	Entity Type	Tendered	Tenders Won by	
			Audit NZ	Other
May-November 2002	Schools	370	6	364
September-November 2002	State-owned Enterprise	1	-	1
August-December 2002	District Health Boards	2	-	2

Report of the Independent Evaluator

Mr David Gascoigne has completed his first year as independent evaluator to assist in ensuring that any tendering performed by the Audit Office is seen to be rigorous, objective, and unbiased. Mr Gascoigne's report on the integrity of the process for the tenders completed during the year is reproduced on the next page.



ACHIEVEMENT OF OUR WORK PROGRAMME

Output Classes D3 and D4

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29 July 2003

The Controller and Auditor-General
PO Box 3928
WELLINGTON

ANNUAL REPORT OF THE INDEPENDENT REVIEWER OF AUDIT TENDER PROCESSES

1. You have retained me as an independent evaluator of the process for the tendering of audits by the Office of the Auditor-General ("OAG"). I took up that position on 27 September 2002. Prior to my being retained, the role of independent evaluator had been held by Mr Anthony N. Frankham. I confirm that I am independent of the OAG and Audit New Zealand and all tendering audit firms.
2. My instructions require me to evaluate the audit tender process and to report on its probity and objectivity. During the past financial year, only four tenders for audits were carried out. I participated in two panel meetings, once as an observer, and once by telephone connection for the duration of the meeting. I considered the relevant papers for those two tenders and for a third, in which I judged it unnecessary to take part. The fourth tender took place prior to my engagement in this present role. On that occasion, I acted as chair of the panel.
3. I have also considered the process by which the contracts for 160 existing audit engagements have been renewed during the past financial year.
4. Further, I have reviewed the basis upon which new audit contracts were allocated – either by an agreed re-appointment of existing service providers or by means of a competitive tender process for that allocation – for 2,581 schools.
5. In my opinion, the processes that have been followed – for each of the areas of activity I have referred to in paragraphs 2, 3 and 4 – for the period to 30 June 2003 were fairly, properly and appropriately dealt with, having regard to the rights, interests and obligations of the parties involved. That opinion is based upon the documents I have examined, the discussions I have held, and my observation of the processes involved.
6. The number of audits tendered by the OAG over the past year has been much less than in previous years. The reason is that the OAG has been making an assessment of the contestable audit appointment process and its current validity and effectiveness. Because the assessment, when completed, may result in substantial change to the system as it now stands, it has been sensible, in most cases, to renew or roll over existing audit arrangements.
7. I have read papers arising from this review. It is proceeding cautiously, with extensive consultation. On the basis of my own experience of the system (both as independent reviewer and, previously, as a panel chair), I support the case for a review and for some consequent modification of the system. I consider that the review is warranted and that it is proceeding carefully and appropriately.

Yours faithfully



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Audits Completed and Outstanding

We completed 4192 audits of public entities in 2002-03 (3650 in 2001-02). The overall increase in audits can be accounted for by two main reasons:

- the result of the increase in controlled entities subject to our audit (see pages 29-30); and
- the reduction in audits in arrears.

Apart from school boards, audit reports and management reports have been issued in as timely a way as in the previous year – in most sectors and overall.

The tables on page 118 for Output Class D3 and on page 122 for Output Class D4 show the results on a sector basis.

The audits outstanding (i.e. in arrears) at the end of the year decreased from 543 to 372 at 30 June 2003. The decrease is attributable primarily to a reduction in the number of School Boards of Trustees' audits outstanding. The large number of School Board audits in arrears the previous year arose partly because many of them had difficulty finalising their financial statements in compliance with a new financial reporting standard, which required them to change their methods of providing for cyclical maintenance. The current figure of 180 outstanding audits is more consistent with previous years.

The outstanding audits were made up as shown in the table below.

Audits Outstanding at 30 June 2003

	As at 30 June		
	2003	2002	2001
Major Statutory Bodies	5	5	6
Other Local Authorities	43	21	38
School Boards of Trustees	180	326	153
Miscellaneous Public Bodies	73	82	74
Audits without fees	71	109	124
TOTAL	372	543	395



ACHIEVEMENT OF OUR WORK PROGRAMME

Output Classes D3 and D4

Non-standard Audit Reports Issued

The following table gives an analysis of all non-standard audit reports¹⁵ issued in the 2001-02 and 2002-03 years.

2001-02				2002-03		
Schools	Other	Total		Schools	Other	Total
64	46	110	Unqualified Opinion, with explanatory paragraph or reference to a breach of law	112	46	158
1	1	2	Full Disclaimer of Opinion	1	6	7
-	-	-	Partial Disclaimer of Opinion	2	-	2
-	17	17	Adverse Opinion	1	21	22
256	42	298	Except-for Opinion	99	44	143
321	106	427	Total non-standard audit reports	215	117	332
2,449	1,201	3,650	Total all audit reports	2,900	1,292	4,192

Commentary on Non-standard Audit Reports Issued in 2002-03

There has been a decrease in non-standard audit reports as a proportion of all audit reports issued during the year – from 11.7% in 2001-02 to 7.9% in 2002-03.

The decrease can be attributed to fewer School Boards than in the previous year having difficulty in complying with FRS-15: *Provisions, Contingent Liabilities and Contingent Assets*, resulting in less “Except-for” audit reports for non-compliance in 2002-03. FRS-15 requires the inclusion of a provision in the Boards’ financial report for their legal obligation to the Ministry of Education to maintain the properties from which they operate in “good order and repair”.

¹⁵ A non-standard audit report is issued in accordance with the Institute of Chartered Accountants of New Zealand Auditing Standard No. 702: *The Audit Report on an Attest Audit (AS-702)*. For a description of the types of non-standard audit reports see our report *Local Government: Results of the 2001-02 Audits*, parliamentary paper B.29[03b], 2003, pages 12-14.



ACHIEVEMENT OF OUR WORK PROGRAMME

Output Classes D3 and D4

B.28

There has been an increase in our reporting of breaches of statutory deadline, which we disclose in the audit report only if there is no disclosure of the breach in the financial statements of the School Board. In addition, there has been a small increase in the number of School Boards breaching their borrowing authority.



A close-up, black and white photograph of a fountain pen nib resting on a document. The nib is positioned diagonally, pointing towards the bottom left. The document features a large, stylized number '4' in the upper left corner, which is partially overlaid by a semi-transparent blue and white graphic. Below the '4', there is a grid of numbers, with '2003' being prominent in the foreground. The background is filled with a pattern of smaller numbers and dashed lines, suggesting a financial or accounting document. The lighting is dramatic, highlighting the metallic texture of the pen nib and the sharp edges of the numbers.

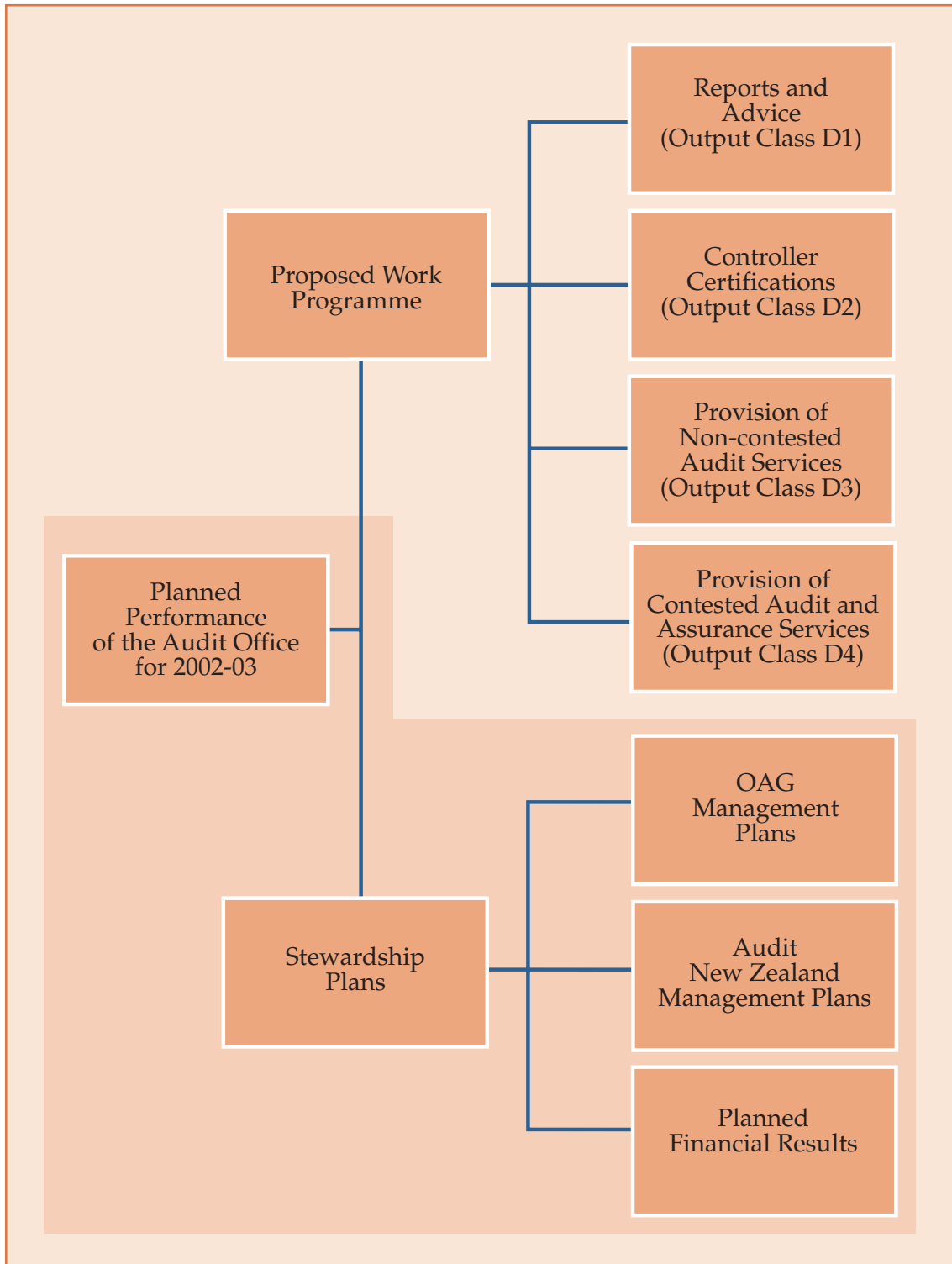
Part Four

Our Stewardship of the Organisation and Its Resources

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Elements of the Performance of the Audit Office for 2002-03



OUR STEWARDSHIP OF THE ORGANISATION AND ITS RESOURCES

Highlights of Planned Stewardship Performance

The “stewardship” of the Office is concerned with how we ensure that we are a progressive, viable and well-managed public sector organisation. To achieve this, we prepare management and development plans for each of the two business units of the Office:

The Office of the Auditor-General –

Which is responsible for assisting the Audit Office in strategic audit planning, setting standards, determining who will undertake audits, overseeing auditor performance, carrying out performance audits and special studies, and parliamentary reporting and advice.

Audit New Zealand –

Which carries out audits that it has won the right to conduct on behalf of the Audit Office in competition with private sector auditors, as well as those audits not awarded under the contestable audit arrangements.

We supplement this by identifying *key indicators of financial performance* which will demonstrate effective stewardship of our financial resources.

Plans for each of these three areas of stewardship are presented on the following pages.

We are also required to publish an *equal employment opportunities* (EEO) programme, under Schedule 3 to the Public Audit Act 2001. This programme is available on our web sites (www.oag.govt.nz and www.auditnz.govt.nz), and is reflected in the business unit plans in this section to the extent that it is significant to them. The EEO programme is accompanied by a programme to improve our *effectiveness for Māori*.



Objectives for the Management and Development of the Office of the Auditor-General

The key objectives in managing the OAG during 2002-03 were to:

Respond effectively to Parliamentary developments, in particular to:

- build sound relationships with new Select Committees after the 2002 general election; and
- be ready to respond if the current review of services to Select Committees proposes significant changes.

We readily responded to the needs of the new Parliament, where Select Committees were faced with having to deal with Estimates examinations for the 2002-03 Budget, which had been deferred from the previous Parliament. Since then we have been through further rounds of financial reviews and Estimates examinations for the 2003-04 budget. The Auditor-General has met with the Chairperson of every Committee, and in all cases they expressed a high degree of satisfaction with the quality of service that had been provided.

The review of services provided to Select Committees has not indicated any need to change the type and level of services.

Continue to implement the Public Audit Act, paying particular attention to the need to:

- clearly identify all entities which are now subject to the Act, and make audit arrangements for them (see page 28);
- extend our performance audit and inquiry role in new sectors effectively, to give full effect to Parliament's intentions in extending our coverage; and
- make the Annual Plan process work, through a higher level of engagement with relevant Select Committees.

Our report on the management of hospital-acquired infection is the first major performance audit undertaken using our extended mandate that enables us to undertake performance audits in the health and other sectors. In addition, we were able to effectively respond to the Finance and Expenditure Committee's recommendation that we undertake an audit into matters arising from allegations of impropriety at Transend Worldwide Limited, a subsidiary of New Zealand Post Limited – which is a State-owned enterprise, where, before the Public Audit Act, we had no mandate to undertake this kind of work.



OUR STEWARDSHIP OF THE ORGANISATION AND ITS RESOURCES

We further refined our Annual Plan process whereby we are required to consult with Parliament over our Annual Plan, particularly our discretionary work programme. Following consultation with the Clerk of the House of Representatives, we agreed a process with the Finance and Expenditure Committee (FEC) – this process was subsequently reported back to the House by the FEC. Under that process, we engaged with all members of Parliament on our preliminary draft Annual Plan before presenting the statutory draft Annual Plan to the Speaker. We were delighted with the level of engagement and feedback that we received from this consultation process and look forward to developing the process further over the coming years.

Continue to work on improving the use made of our public reports, by:

- working with the FEC sub-committee, other Select Committees, and senior public servants;
- exposing the reports in suitable forums; and
- improving our measurement and reporting of the impacts of the reports.

The FEC has not re-established its sub-committee to deal with Auditor-General reports. While we have had good uptake by other Select Committees on our reports, we will continue to ensure that our reports have impact with the entities and officials who are directly responsible for implementing the recommendations that we have made.

Continue to work on improving the timeliness of the audit reports and management reports provided to public entities by our audit service providers.

We report on this in detail in the Statement of Service Performance in Part Five on pages 119 and 123. Overall, our performance on the issue of audit reports and management reports has improved compared to past years. This is significant given the growth in the audit portfolio since the Public Audit Act came into effect in 2001.



Contribute to improvements in entity reporting to Parliament and the public, by working with relevant groups on:

- making reports more *understandable*, through methods such as summary financial statements, and plain language financial reporting; and
- making reports more *relevant*, by reporting on matters such as outcomes (including the “triple bottom line”), capability, strategy and risk.

We produced a Statement of Intent in line with the Managing for Outcomes requirements for the first time in our *Annual Plan 2003-04*. We discuss this more fully on pages 96-97.

Continue to develop our internal management and capability, in particular by:

- Extending our use of electronic facilities for interacting with audit service providers.

Good progress was made during the year on upgrading our Audit Status Database (ASD) to make it available on-line to auditors. The *Manual for Audit Service Providers* was also made accessible on-line for the first time in October 2002.

The first stage of the two-phase project to upgrade the ASD was completed at 30 June and has now gone live. This will allow faster availability of audit summary information, including dates – e.g. date of audit report, non-standard audit reports, fees charged, additional work performed by auditors, entity changes, and monitoring of uncompleted audits.

We had planned to complete the specifications for Phase 2 during the year but, because of the complexity and issues encountered in Phase 1, it was decided to stabilise this phase and have auditors trained, familiarised, and utilising it before embarking on the next phase. We hope to complete the specification for Phase 2 during the 2003-04 year. This will enable auditors to file all returns and interact with the Office entirely electronically.



OUR STEWARDSHIP OF THE ORGANISATION AND ITS RESOURCES

- Continuing implementation of a capability action plan developed over the last two years, focusing in particular on creating a better environment for learning and innovation.

The action plan has been promulgated through the management team and much activity is being generated. This includes:

- The Auditor-General's monthly staff communications meeting has been highly successful at imparting knowledge throughout the Office, and provides a forum to recognise and reward achievements.
 - Regular cross-departments/teams discussions have taken place.
 - Formal post-implementation reviews of performance audits completed have allowed sharing and learning from the experiences gained.
 - Formation of interest groups – such as on sustainable development (see page 39) – have allowed input on common issues. Outside speakers of interest to all staff have informed us on topics such as sustainable development, energy efficiency and conservation, and E- Government.
 - Membership of project steering groups allows wider participation by staff in development opportunities.
 - Staff are encouraged to put forward ideas and suggestions through the electronic suggestion box which are reviewed and feed-back is given at least monthly.
- Implementing a plan to improve our effectiveness for Māori.

The Audit Office's Effectiveness for Māori Plan was launched last year with steady progress being made. We are disappointed that not all of our intended strategies were fully implemented but, on reflection, we are happy with where we have got. The 2002-03 Plan has now been reviewed and extended through to 2004. One significant step we have taken is to form a specific Māori Sector Group whose responsibilities include Annual and Strategic Planning and monitoring of the plans. We are confident this will provide a better focus for the organisation.

A number of key initiatives were achieved – including a national staff hui in October 2002, the completion of the pilot schools visits programme, a number of staff have attended Wananga, a pilot set of questions was developed and tested in the scoping study for the Criminal Justice performance audit, a study of the Māori Trust Board sector was completed and five Boards targeted for assistance.

The Auditor-General has met with kaumatua and administrators of three Māori Trust Boards to identify areas where the Office and the boards can enhance the understandings and relationship for both parties. The Office's Māori Scholarship Scheme continues, with a further two scholarships awarded in 2002-03.

Specific performance audits in the Māori sector currently are:

- Māori land administration services by the Māori Trustee and the Māori Land Court (currently being completed); and
- Effectiveness for Māori in the State Services Commission (currently at the field work stage).

Both will be reported on in 2003-04.

- Responding effectively to our evaluation of the impact of contestability.

We completed the review of contestability during the year and have introduced a revised selection model for future appointments of audit service providers (see page 42).

- Effectively managing the transition to the new Auditor-General (see page 43).



Objectives for the Management and Development of Audit New Zealand

Audit New Zealand is the largest provider of audit services to the Auditor-General. During the year, Audit New Zealand:

- Was required to issue 995 audit reports on public entity annual financial reports audited under appointment from the Auditor-General. The timeliness of issuing the audit reports (other than for school boards of trustees) improved from 58% on time in 2001-02 to 69% on time in 2002-03.
- Was required to issue 1007 management reports on public entities audited under appointment from the Auditor-General.
- Reduced its number of audits in arrears from 222 in 2001-02 to 150 in 2002-03.
- Responded to changes in the Auditor-General's mandate under the Public Audit Act 2001 by establishing a policy framework by which to determine the consistency of existing and future services with the revised mandate.

The key objectives in managing Audit New Zealand during 2002-03 were to:

- *Grow the business* by:
 - retaining audit clients and extending assurance services which add real value;
 - efficient business processes that are aligned to and support our strategic direction;
 - continuing to improve the capability of the organisation through targeted recruitment, retention and development strategies; and
 - implementing our new Leadership/Governance and Accountability Frameworks.

During the year, Audit New Zealand:

- *Assessed all its existing service lines against the new policy framework mentioned above and made the necessary adjustments.*
- *Established new ways of working, with strategic partnerships in the areas of sustainable development and taxation.*
- *Reviewed and implemented a new tax audit approach.*



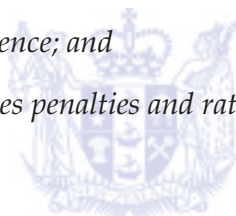
- *Increased its information systems audit and assurance capability.*
- *Held successful client seminars for the local government, health, and central government sectors.*
- **Deliver seamless services** to our clients by:
 - operating as “one team” of audit, assurance and tax experts working together across the country;
 - completing implementation of our refocused audit approach; and
 - extending client service planning to ensure we are providing the best team from Audit New Zealand no matter where the client resides.

During the year, Audit New Zealand:

- *Continued to integrate its Specialist Assurance Services team into the core audit service, particularly in the management control environment assessment.*
- *Continued to reinforce the application of our refocused audit approach.*
- **Share learning** through:
 - sharing knowledge and experience across the organisation by the appropriate use of staff training sessions and knowledge management technologies;
 - implementing a plan to improve our effectiveness for Māori; and
 - strengthening the role of our Sector Groups in facilitating knowledge sharing.

During the year, Audit New Zealand:

- *Undertook a number of initiatives to facilitate shared learning.*
- *Through its sector groups, issued nine client newsletters covering a range of topics, including –*
 - *the impact of Financial Reporting Standard No. 3: Accounting for Property, Plant and Equipment;*
 - *areas of audit focus in relation to the Local Government (Rating) Act 2002;*
 - *valuation of District Health Board land and buildings;*
 - *fees and allowances paid to District Health Board members;*
 - *auditor independence; and*
 - *tax update on rates penalties and rates remissions.*



OUR STEWARDSHIP OF THE ORGANISATION AND ITS RESOURCES

- *Held its annual Directors and Managers conference with the theme “Building Depth”.*
- *Released its fifth key leadership message of “Strengthen our core audit capability”.*
- *Introduced self-paced workbooks that allow Assistant Auditors, Auditors, and Supervisors to gain the necessary skills to do their job.*
- *Implemented a new leadership development programme, attended by 16 people from across the organisation.*
- ***Celebrate our success*** by:
 - *implementing a new remuneration and reward system that recognises achievement and excellence in our staff;*
 - *recognising our staff everyday for their contributions and achievements no matter how small; and*
 - *completing implementation of a Talent Management System to retain and attract the skills and talents required to be a successful business.*

During the year, Audit New Zealand:

- *Continued to recognise staff for their successes – through formal and informal communications.*
- *Completed performance and remuneration reviews for directors, managers and staff using the new performance management system.*
- *Refined its talent management system, including the addition of a targeted Employee Value Proposition (EVP) designed to reflect those areas of development that are important to the individual.*



Measuring and Reporting Our Outcomes, Capability and Risk

One of the objectives in our 2002-03 Annual Plan was to develop our management, measurement and reporting of outcomes, capability and risk. Over the last three years, we have done a lot of work on the measurement of outcomes and capability, and some work on risk. We have also developed the planning and reporting of these activities in keeping with the “Statement of Intent” model currently being implemented by 16 government departments.

We report here on measures we have so far considered and will continue to develop.

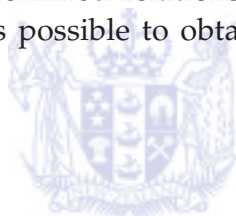
Measuring and Reporting Our Outcomes

We said we would continue to work and report on the following possibilities for better outcome measurement:

- measuring trends in Audit Office credibility and stakeholder understanding, assurance, and confidence;
- measuring the use of Audit Office briefing material and recommendations by stakeholders – in particular, Select Committee examinations and reports;
- recording implementation of audit recommendations by public entities; and
- recording changes in financial systems and practices, and in public entity outcomes, which were the result of (or influenced by) Audit Office recommendations.

Measuring Stakeholder Trends in Office Credibility, Understanding and Assurance, and Confidence in the Audit Office

As stakeholders’ interests are varied and complex, and assurance is also a complex concept, for the OAG we have decided that there was little information value at this stage in broad-based surveys of stakeholders. However, for the more confined relationship with clients associated with Audit New Zealand, it is possible to obtain relevant and meaningful data from customer surveys.



OUR STEWARDSHIP OF THE ORGANISATION AND ITS RESOURCES

In the OAG, we have found that a useful means of assessing stakeholder feedback is through using a focus group with a professional facilitator – asking group members to tell us what assurance meant to them, and how the Audit Office contributes to this. The latest group was drawn from a range of our stakeholders covering most sectors we work in. We have not yet finished considering the wealth of material and commentary provided, but the key things we have learned so far are:

- The participants valued outcomes centred on the integrity of the government system, performance (value for money) audits, helping government agencies make improvements, and the Office’s ability to report on “what’s going on”. However, the emphasis varied depending on the particular interest the participant had in the Office’s work.
- They valued the neutrality and independence of the Office, and the competence and professionalism of staff. They also noted the pleasing change in the Office’s approach over the past 10 years from just ‘watchdog’ to the more worthwhile role of contributing and adding considerable value to the organisation under audit – and confirmed that this changed approach was crucial to achieving the desired outcomes.
- They valued those Audit Office products which were most visible to them – in particular, financial report audits, the use of the inquiry function, and advice to Select Committees.
- Some issues were raised that we will be able to address quickly – such as the confusion between our role and that of the Ombudsmen, and the relationship management roles between Audit New Zealand and the OAG – but others raised are of strategic significance for the Office and need some careful thinking as to how we might address them. For example –
 - our role in auditing and measuring performance under Managing for Outcomes;
 - how we can make auditing real-time;
 - reporting on an organisation’s adequacy in capability and resource to do the job; and
 - providing entities with better access to information on best practice.



The group provided feedback on areas in which the Office could improve performance – most significantly to the critical need for timely reporting on issues of public concern and for the Office to maintain its capability and capacity to ensure that its reputation remains intact.

We also set up a system to record the results of the liaison discussions we have with other specific stakeholders in the normal course of relationship management. This has taken the form mainly of one-on-one meetings between the Auditor-General and the Deputy Auditor-General and the chairpersons of Select Committees and chief executives of audited entities. In general, the feedback from these meetings has been very positive of the Office's work, especially our contribution to the work of Select Committees. Some Select Committee chairpersons suggested that it was unfortunate that their committee did not have enough time to pursue in depth all the issues we raised with them.

Audit New Zealand Client Satisfaction

Audit New Zealand is the largest provider of audit services to the Auditor-General. It is therefore important that the entities audited by Audit New Zealand regard it as, among other things, a qualified and respected provider. To assess this, Audit New Zealand undertakes an annual independent client survey. In 2003, 80 interviews were conducted on 48 clients spread across the country to measure from their perspective how well Audit New Zealand conducted its relationships and performed the core financial audit, and the quality of the staff on the audit team. The overall client satisfaction rate was 77%, which is slightly lower than the target of 80% but not considered to be significant.

Select Committee Use of Our Material

A measure of how our work is regarded is the extent to which Select Committees use the briefing material we provide to them – not only to review public entities, but also to report and make recommendations to the Government on issues.

The table on the next page indicates the rate of take-up over the past three years, based on a sample of the reports provided to Select Committees. We believe that the average take-up rate of 72% for 2002-03 is satisfactory.



OUR STEWARDSHIP OF THE ORGANISATION AND ITS RESOURCES

	2002-03	2001-02	2000-01
Number of reports examined	33	20	6
Proportion of suggested issues taken up*	72%	70%	70%
Range of take-up rates	33-100%	0-100%	56-88%

* "Take-up" means the number of issues we suggested that are referred to in the Committees' reports to the House.

Outcomes of Annual Audits

In 2000-01 and 2001-02 we piloted an approach to assessing the effects that our annual audits have – i.e. the recommendations that are implemented, the changes in financial practice that result, and the outcomes in terms of more effective and efficient use of public money.

However, we found little that was quantifiable, and nothing worth reporting, with respect to the impact we were having. During 2002-03 we did not pursue such a measure any further. However, we consider that there is value in measuring our impact and have included some measurements for 2003-04 in our Statement of Intent. We will be pursuing the development of a useful measure that will demonstrate over time any trends in the matters raised by auditors.

Outcomes of Performance Audits

During 2000-01 we considered how we could improve our approach to performance audits to ensure that we were better placed to monitor impacts and outcomes after the audit had been completed. The requirements we identified have been incorporated into our processes for designing performance audits, reporting the results, making recommendations and following them up within an appropriate time. Information collected as a result of this is fed into future reporting about impacts.



The 'Five Management Aspects'

A further measure by which we can gauge the extent of our impact on achieving our outcomes is by analysing trends in the assessments our auditors make each year for five particular aspects of financial management and service performance management¹⁶ in certain groups of public sector entities.

The purpose of making these assessments is to identify specific areas of management where there are weaknesses, and to make recommendations to eliminate those weaknesses. For each entity, we report these assessments to the Chief Executive and Responsible Minister, and also to the select committee, which conducts the financial review of the entity. If our recommendations are adopted we should (over time) see an overall improvement in management.

Since 1994, we have published an analysis of these assessments in respect of government departments, in our reports on the results of annual audits in central government.¹⁷ However, for a more comprehensive view of whether we have effected improvement in the public sector, we have now extended this analysis to include our assessments of the five management aspects in respect of District Health Boards (DHBs), Crown Research Institutes (CRIs), and State-owned Enterprises (SOEs).

16 The five management aspects, which are assessed as being either Excellent, Good, Satisfactory or Just Adequate, are:

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

17 For the latest such analysis, see *Central Government: Results of the 2001-02 Audits*, parliamentary paper B.29[03a], 2003, pages 27-32.



OUR STEWARDSHIP OF THE ORGANISATION AND ITS RESOURCES

The table below summarises the results of this analysis by comparing the changes in management aspect assessments between 1999-2000 and 2000-01 and between 2000-01 and 2001-02.

Changes in Management Aspect Assessments for Major Public Entities

2001-02 Compared to 2000-01				
	Higher	Same	Lower	Total
By Number				
Central Government	14	187	9	210
District Health Boards	5	86	14	105
Crown Research Institutes	2	41	2	45
State-owned Enterprises	6	51	6	63
	27	365	31	423
	<hr/>			
	6.4	86.3	7.3	100.0
By %				
Central Government	6.7	89.0	4.3	100.0
District Health Boards	4.8	81.9	13.3	100.0
Crown Research Institutes	4.4	91.1	4.4	100.0
State-owned Enterprises	9.5	81.0	9.5	100.0
	<hr/>			
	11.4	80.1	8.4	100.0
2000-01 Compared to 1999-2000				
	Higher	Same	Lower	Total
By Number				
Central Government	23	183	9	215
District Health Boards	9	72	24	105
Crown Research Institutes	2	43	0	45
State-owned Enterprises	15	45	3	63
	49	343	36	428
	<hr/>			
	11.4	80.1	8.4	100.0
By %				
Central Government	10.7	85.1	4.2	100.0
District Health Boards	8.6	68.6	22.9	100.0
Crown Research Institutes	4.4	95.6	0.0	100.0
State-owned Enterprises	23.8	71.4	4.8	100.0



Each class of entity shows a different trend:

- Government departments – There is continuing net improvement (more higher assessments than lower assessments) in both of the last two years, although the rate of improvement is slowing as the scope for it reduces.
- DHBs – There has been a net worsening of the assessments in each of the last two years, mainly in respect of the two service performance aspects, which we consider to be a reflection of the difficult funding environment for these entities.
- CRIs – There was a small improvement from 1999-2000 to 2000-01. The net situation of no change in the following year (the same number of higher assessments as lower assessments) shows that that improvement was sustained.
- SOEs – There was a quite significant improvement between 1999-2000 and 2000-01. The net situation of no change in the following year shows that that improvement was sustained.

With the exception of DHBs, which have been strongly influenced by funding considerations, the overall situation shown by this analysis is that the quality of management in public sector entities is continuing to improve. On the basis of our regular recommendations to eliminate weaknesses in management, we feel entitled to claim some credit for effecting those improvements.

Measuring and Reporting Our Capability

In last year's Annual Report, we reported an experimental 'capability snapshot' for the OAG. We are continuing to develop and expand our 'capability snapshot' and are looking at ways to present an accurate portrayal of the Audit Office's capability profile.

Where possible this year, we have sought to provide an Office-wide view. However, as some of our data collection methods have yet to be aligned across the Office, this has not always been possible, so similar data has been included instead. Also, comparative data has been included as much as possible.



OUR STEWARDSHIP OF THE ORGANISATION AND ITS RESOURCES

Current Capability

This selection of information is to provide an understanding of:

- the size, scale and complexity of the Office; and
- the investment which has been made to maintain and enhance the delivery of the Office's outcomes.

As at 30 June	2003	2002	2001
Staff Numbers	Full-time Equivalents		
OAG	54.5	51.4	50.6
Audit New Zealand	194.2	197.0	220.4
Total Audit Office	248.7	248.4	271
Staff by Function	%	%	%
Audit/Assurance	65	62	66
Technical and Advisory	7	5	3
Corporate Support	23	28	19
Management*	5	5	12
All Staff by Gender	%	%	%
Female	49	53	52
Male	51	47	48
Management Staff by Gender	%	%	%
Female	8	17	N/A
Male	92	83	N/A
Staff by Ethnicity	%	%	%
NZ European	62	65	67
NZ Māori	3	6	6
Pacific Island	2	2	2
Asian	9	15	13
Other European	13	12	12
Other ethnic group	7	-	-
Undeclared	4	1	-

* For 2001 included Audit Directors.



Increasing Diversity

We recognise that understanding and knowledge of different perspectives enhance the performance of our employees and hence the organisation. We are endeavouring to achieve this through:

- complying with the Human Rights Act 1993 and the New Zealand Bill of Rights Act 1990;
- ensuring that all employees have equal access to employment opportunities;
- continuing to operate a Māori scholarship programme; and
- continuing to operate a Pacific Island scholarship programme.

The Audit Office had previously undertaken a major review of its Māori responsiveness strategy and EEO programmes and identified key initiatives. During the last twelve months, the following initiatives have been undertaken:

- expanding our recruitment “horizons” to increase the diversity of applicants applying for positions within the Office;
- arranging special seminars (e.g. on preparing for retirement);
- creating a strategy to develop women for movement to more senior roles;
- including Human Rights Act training within our corporate development framework;
- piloting cultural awareness initiatives;
- improving our EEO monitoring processes;
- exploring the availability of local child care facilities; and
- continuing to provide, where possible, family friendly and flexible work arrangements.

We report separately on our Effectiveness for Māori Plan on pages 76-77.



OUR STEWARDSHIP OF THE ORGANISATION AND ITS RESOURCES

Maintaining and Enhancing Capability

In this section we further illustrate and detail trends and initiatives within our two business units in order to maintain the Audit Office's capability to achieve short-to-medium-term outcomes. See table opposite.

Maintenance of human resource capability can be measured through:

- recruitment of suitably qualified staff;
- level of experience in current role (measured as "time in job");
- turnover; and
- job satisfaction.

Enhancement of human resource capability can be measured through our commitment to employee development.

Over the course of the year, we have continued to focus on the professional development of staff including:

- Helping staff meet the membership requirements of the Institute of Chartered Accountants of New Zealand (ICANZ) by continuing Audit New Zealand's professional development programme. This programme ensures that Audit New Zealand fulfils its obligations as an Approved Training Organisation.
- Running formal study programmes, providing training relevant to an individual's needs, on-the-job coaching and organising in-house courses to meet the business and professional requirements of the Office.
- Introducing 360-degree feedback into the management assessment process to help with the development of specific management competencies.
- Management development for targeted senior staff – including sending one senior staff member of the OAG to participate in the Leadership Development Centre's "Centre for Individual Management Development". Audit New Zealand has made a significant investment in introducing a "Future Leaders" programme. Sixteen managers and directors were selected from Audit New Zealand to attend this programme, which focused on developing skills associated with –
 - visionary leadership;
 - being able to create an environment conducive to the motivation of staff; and
 - communication.



OUR STEWARDSHIP OF THE ORGANISATION AND ITS RESOURCES

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TERTIARY QUALIFICATIONS –	2002-03	2001-02
OAG		
No. of positions requiring tertiary qualifications	75%	75%
Staff with tertiary qualifications holding these positions	95%	95%
Staff holding post-graduate qualifications	59%	60%
Audit New Zealand		
No. of positions requiring tertiary qualifications	88%	Not reported
Staff with tertiary qualifications holding these positions	97%	Not reported
EXPERIENCE –		
OAG		
Average “time in job”	4.85 years	3.9 years
Audit New Zealand		
Average “time in job”	5.67 years	Not reported
TRAINING AND DEVELOPMENT –		
OAG		
Formal training spending per employee	\$1,894	\$2,140
Audit New Zealand		
Formal training spending per employee	\$2,363	Not reported
Average hours per employee spent on upgrading skills	155	Not reported
Pass rate of staff undertaking ICANZ accreditation	100%	98%
ORGANISATIONAL HEALTH –		
OAG		
Turnover	9.3%	12%
Average sick leave taken per employee	5.9 days	4.4 days
Audit New Zealand		
Turnover	20%	29%
Average sick leave taken per employee	5.0 days	Not reported
Staff survey results (average rating on a scale from 1-6 with 6 being the highest rating):		
Job satisfaction	4.38	4.24
Organisational satisfaction	4.55	4.28
Satisfaction with management	4.58	4.22
Understanding and support of vision and role	4.62	4.21





OUR STEWARDSHIP OF THE ORGANISATION AND ITS RESOURCES

- Creating and supporting secondment opportunities for staff within the Office to enhance their knowledge and experience outside of their normal job requirements. Secondments have continued with public sector organisations (including the Treasury and the Law Commission) and the Audit Offices of Canada, Australia and the United Kingdom.

The Audit Office is required by the Health and Safety in Employment Act 1992 to safeguard the health and well-being of all staff and visitors to the Office. During the year we have:

- established programmes and provided training and equipment to help ensure the safety of employees should a civil defence emergency or bomb alert occur;
- identified any hazards within our premises;
- incorporated emergency procedures within the Business Continuance Plan;
- undertaken our annual review of staff satisfaction within Audit New Zealand;
- provided a confidential Employee Assistance Programme to all staff; and
- provided flu vaccinations to staff.

Current and Required Changes in the Office's Skill Base

A number of specific and specialised roles have been vacated and either filled or reassessed for their future fit. It is common practice to reassess roles as they become vacant to ensure that vacancies are filled only with the most appropriate skills for our future identified requirements. With the changing environment in which the Office operates – now and in the near future – an appropriate skill base is a serious issue and one that we are constantly addressing.

Capacity Issue

A more serious issue that has been identified is the Office's overall ability to complete the work that is at hand. During 2003 (and looking to 2004) we have identified a potential serious capacity issue. The number, size and complexity of enquiries that have been dealt with during 2002-03 means

that the Office has to prioritise between starting an enquiry or deferring a programmed performance audit. This is an issue that could potentially jeopardise the long-term effectiveness and relevance of the Office if not addressed. We will address the matter in our strategic plan later in the year.

In all projects for special audits and studies, we identify the skills needed and, where appropriate, make use of advisers to ensure that specialist skills are available to the team undertaking the project. This is especially important during both the planning and the report-drafting stages of a project. In 2002-03 we engaged specialists for their knowledge of the health sector and hospitals and of the tax system.

Strategic Planning

We have started the process of completing the Strategic Business Plan. The plan will span the period 2004-07 and will specifically address the issues identified under Capability, in particular skill base and capacity.

Audit New Zealand

Audit New Zealand has implemented a Talent Management System (TMS), which is used to form sustainable views about the future capability of senior audit staff. TMS considers such things as:

- perceived alignment with the organisation's strategic direction;
- current levels of demonstration of the strategic competencies required for senior roles;
- perceived potential for career advancement; and
- perceived risk and significance of leaving.

TMS incorporates the views of a large number of senior staff and is nationally moderated. From TMS, Audit New Zealand has formed some conclusions on the perceived extent, depth, and challenges to our future capability. For 2002-03, the key findings from the talent management assessment were:

- Audit New Zealand has an improving "bench strength" – 10% of senior staff are perceived to be ready in less than two years to take on leadership roles;



OUR STEWARDSHIP OF THE ORGANISATION AND ITS RESOURCES

- there is some “stalled capability” – i.e. 19% of senior staff were seen as “needing improvement” in their performance and 25% were rated as having a low level of alignment with the organisation’s strategic direction;
- there is limited depth in leadership capabilities – i.e. only 70% of senior staff are rated 3 and above (out of 5) in leadership competencies; and
- there are relatively low risks to future capability – i.e. only 9% of key specialist senior staff are rated with a high risk of leaving.

Information Technology Systems

In the OAG, the aim is to, and we do, stay just behind the leading edge technologies, and about one generation behind the latest software releases. Hardware is upgraded on an average 3-year cycle.

As the OAG is a small organisation, it has limited capacity to duplicate or back up roles. As part of Business Continuity Planning, it has identified the more risky areas and is doing what it can to alleviate those risks. It has suitable manuals and desk files for some jobs and roles, but these are not as comprehensive as they should be. For crucial IT systems (hardware and software), it has support systems and back-up arrangements in place to cover most possibilities, and does not believe its exposure is significant.

During the year Audit New Zealand continued to maintain a modern technology environment, with upgrades to Windows 2000, Lotus Notes 6.0 and TeamMate 6.0. These core tools are an essential part of Audit New Zealand delivering services to clients. There was a steady uptake in the use of video conferencing during the year and the decision was made to extend the system to all larger offices.

In the annual staff survey, Audit New Zealand asks staff to rate the usefulness of its systems and procedures and also whether they have access to the information required to do the job. The 2002-03 survey produced an improvement in the ratings given for both these areas. During the year, Audit New Zealand published on-line its audit manual and HR policies and procedures. These initiatives would have contributed to the improvement in the rating.



Future Capability

This section will detail the extent and depth of, and challenges to, the Audit Office's ongoing ability to deliver its outcomes. This is largely a new area of reporting.

We are continuing to implement the capability action plan that was developed 2 years ago. During the last year, the main focus has been on creating an environment that fosters learning and innovation. In particular, to help impart knowledge throughout the organisation and to 'publicly' recognise the achievements of staff, the Auditor-General's monthly communication forum has been highly successful.

We have also implemented in-house training courses to ensure that all staff are up to date with our knowledge management systems. In addition, opportunities for staff to share and learn from the experiences gained by others, has been encouraged. Examples are reported on pages 90 and 92.

Measuring and Reporting Our Risks

The audit role is fundamentally based on the concept of risk, and auditors automatically think in terms of risk. However, we are more used to applying these concepts to audited entities than to ourselves. During 2000-01, we formally considered how we use risk concepts in managing and measuring our own activities.

During 2001-02, we analysed our risk management activities and agreed that the key steps we need to take in 2002-03 are to:

- develop an overarching policy statement about our risk management activities; and
- finalise, test, and refresh our Business Continuity Plan.

The Office has addressed a number of strategic risk areas during the course of the year. In particular, we have:

- Established an Audit Committee that forms the core of the Office's governance framework. Our 2003-04 *Annual Plan* describes in some depth the overall governance arrangements for the Office.
- Established an Independence Review Committee to provide guidance that judgements made on independence matters are appropriate.



OUR STEWARDSHIP OF THE ORGANISATION AND ITS RESOURCES

- Completed a Risk Management Framework comprising a set of risk management principles, a policy document, and an implementation plan. The framework has been based on the Australia and New Zealand Standard 4360/1999, which currently represents best practice on the subject. We will proceed to implement the framework during the 2003-04 year.
- Completed and implemented a Business Continuity Plan. The Plan is to be tested in the first quarter of 2003-04.

Improving Our Measurement and Reporting of Outcomes, Capability, and Risk

Our objective in producing the 2003-04 Annual Plan was to further enhance our planning and reporting consistent with the “Statement of Intent Model” (SOI).

In terms of the Managing for Outcomes Initiative, the Office has continued to participate in the central working parties leading the changes in performance reporting.

The publication of our own SOI as part of our *Annual Plan* was our second and most serious attempt to comply with the spirit of the non-financial performance reporting issues.

Throughout this report, we comment (in the previous section, in particular) on outcome measures we currently have in place and on improvements we have made in 2002-03.

The SOI that we produced for 2003-04 (published in our *Annual Plan* for that year) incorporates outcomes, capability, and risks, and is an attempt to quantify and define our outcomes and measures in a more meaningful way.¹⁸ We illustrated linkages as we see them between our “Desired Situation” (outcomes), the impacts we aim to have, our outputs, and our work programme in a diagram which is reproduced on the next page.

We will continue to refine our SOI and measures over time to ensure that the SOI does truly reflect the purpose of the Audit Office. In particular, we intend continuing to refine the measures of our performance and getting a more direct link with the measures set out in the Statement of Service Performance appearing in Part Five on pages 106-125.

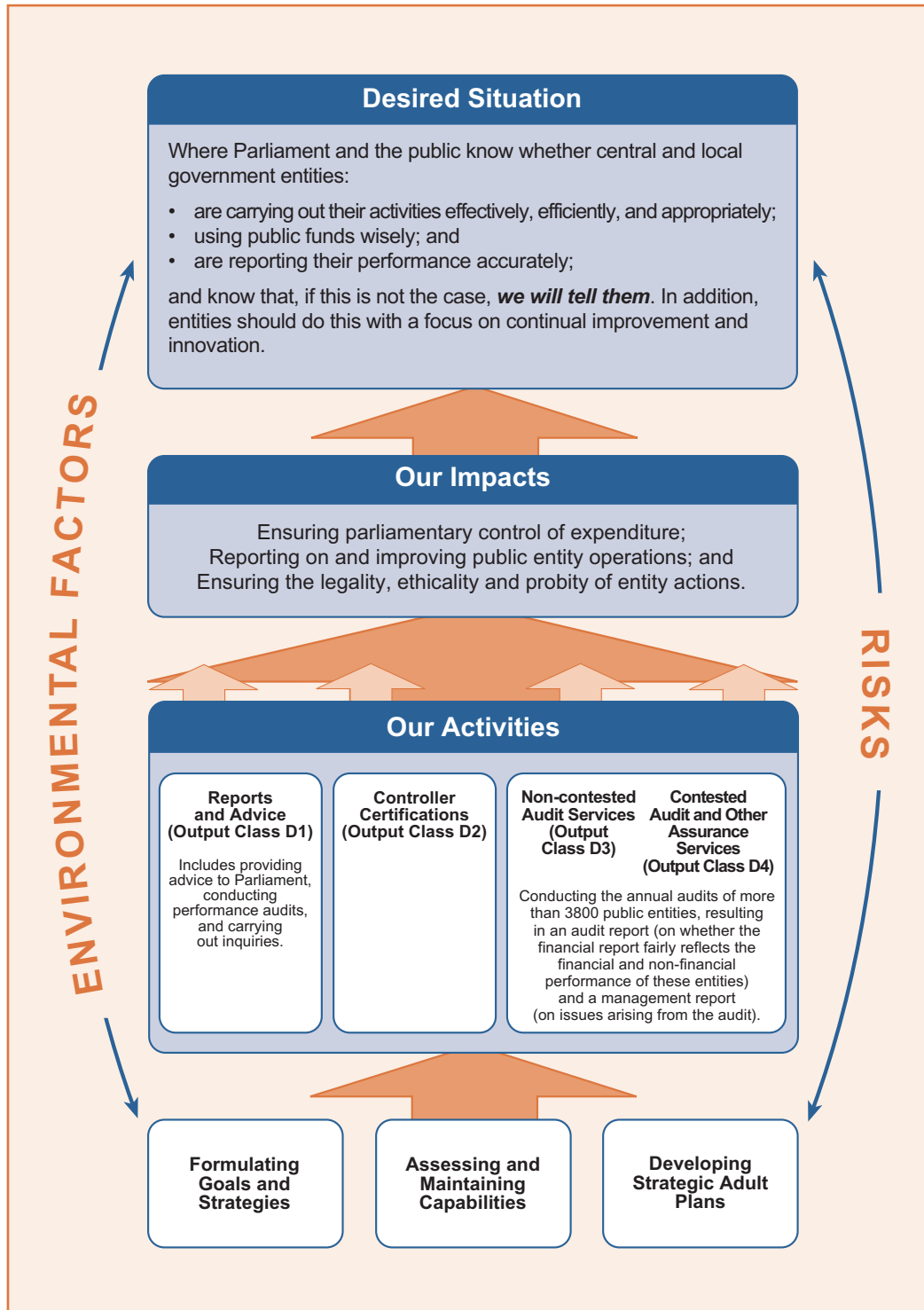
¹⁸ *The Controller and Auditor-General – Annual Plan 2003-04*, parliamentary paper B.28AP(03), 2003, pages 15-44.



OUR STEWARDSHIP OF THE ORGANISATION AND ITS RESOURCES

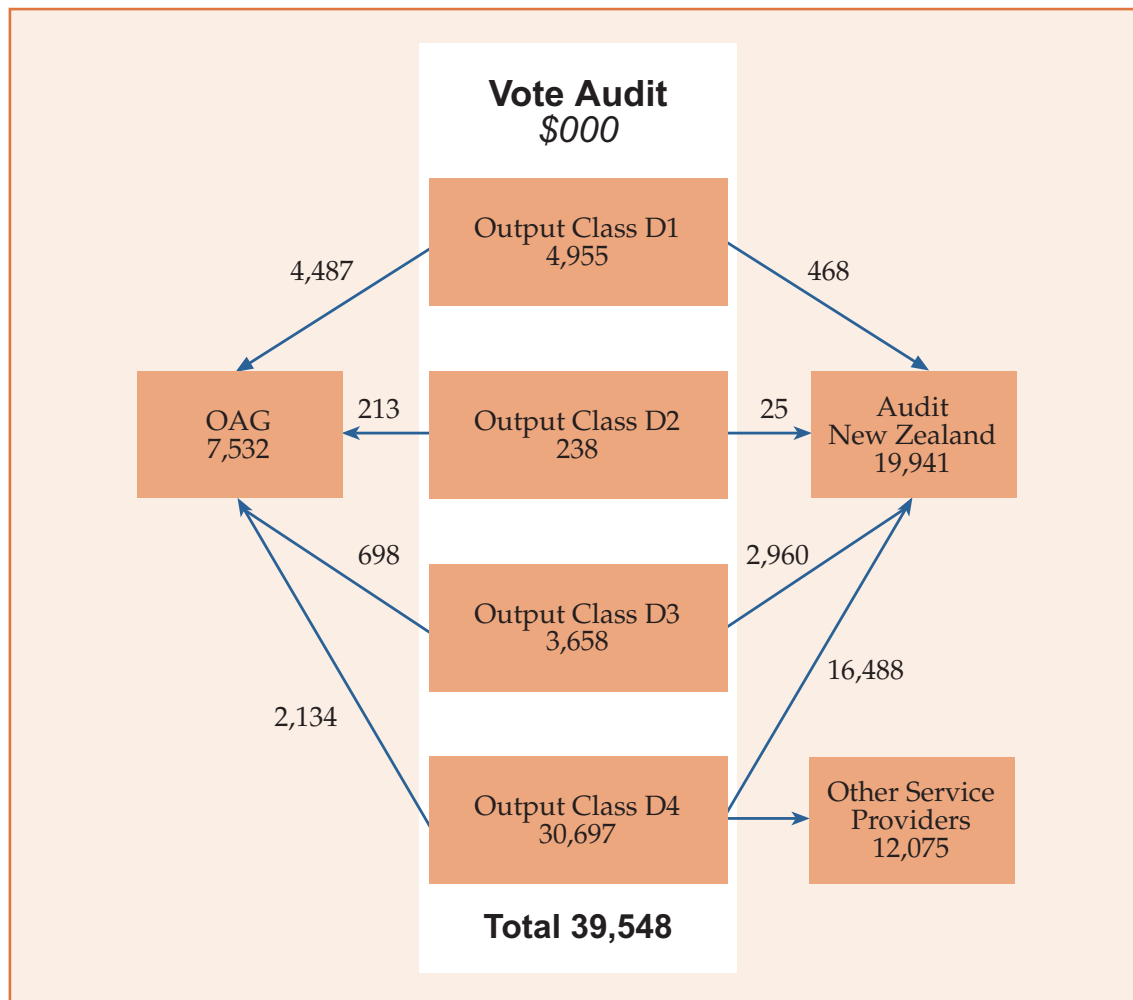
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This diagram depicts the linkages between our desired situation (outcomes), the impacts we aim to have, our outputs, and our work programme.



Overview of Appropriations

Costs of Production of the Audit Office's Output Classes



Funding of the Audit Office

In 2002-03 the Audit Office funded the costs of producing its outputs by receiving \$39.699 million, comprising:

- \$5.231 million in revenue from the Crown, and \$0.004 million from other sources, which was used to fund the costs incurred in the production and delivery of Output Classes D1 and D2.
- \$34.364 million in revenue from audited entities and \$0.100 million from the Crown, which was used to fund the costs incurred in the production and delivery of Output Classes D3 and D4.

In addition, the Audit Office used \$0.409 million of an overdraft facility of \$0.500 million to cope with the seasonal nature of its cashflows.



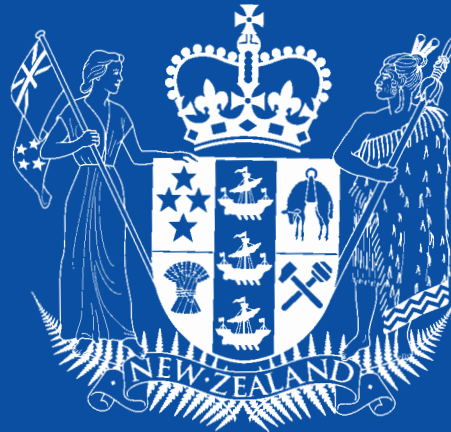


Part Five

Financial Statements
2002-03

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The Controller and Auditor-General

Tumuaki o te Mana Arotake

Financial Statements

for the Year Ended 30 June 2003

Statement of Responsibility

As Controller and Auditor-General, I am responsible for the accuracy of and judgements used in the preparation of the Financial Statements, and the establishment and maintenance of systems of internal control designed to provide ongoing assurance of the integrity and reliability of financial reporting.

Appropriate systems of internal control have been employed to ensure that:

- all transactions are executed in accordance with authority;
- all transactions are correctly processed and accounted for in the financial records; and
- the assets of the Office are properly safeguarded.

In my opinion, the information set out in the statements and attached notes to those statements fairly reflects the service performance, financial activities and cash flows of the Audit Office for the year ended 30 June 2003 and its financial position as at that date.



K B Brady
Controller and Auditor-General
30 September 2003



(Countersigned)
D E Atkin
Finance Manager
30 September 2003



Audit Report

**TO THE READERS OF THE FINANCIAL STATEMENTS OF
THE CONTROLLER AND AUDITOR-GENERAL
FOR THE YEAR ENDED 30 JUNE 2003**



CHARTERED
ACCOUNTANTS

We have audited the financial statements on pages 106 to 146. The financial statements provide information about the past financial performance of the Controller and Auditor-General and its financial position as at 30 June 2003. This information is stated in accordance with the accounting policies set out on pages 126 to 130.

Responsibilities of the Controller and Auditor-General

Sections 35 and 40 of the Public Finance Act 1989 require the Controller and Auditor-General to prepare annual financial statements in accordance with generally accepted accounting practice and which fairly reflect the financial position of the Controller and Auditor-General as at 30 June 2003 and the results of his operations, cash flows and service performance achievements for the year ended on that date.

Auditor's Responsibilities

Sections 38 and 40 of the Public Finance Act 1989 require the auditor appointed by the House of Representatives to audit the financial statements presented by the Controller and Auditor-General. It is the responsibility of the auditor to express an independent opinion on the financial statements and report that opinion to you.

Basis of Opinion

An audit includes examining, on a test basis, evidence relevant to the amounts and disclosures in the financial statements. It also includes assessing:

- the significant estimates and judgements made by the Controller and Auditor-General in the preparation of the financial statements, and
- whether the accounting policies are appropriate to the Controller and Auditor-General's circumstances, consistently applied and adequately disclosed.

We conducted our audit in accordance with the Auditing Standards issued by the Institute of Chartered Accountants of New Zealand. We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatements, whether caused by fraud or error. In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the financial statements.

Other than in our capacity as auditor, we have no relationship with or interests in the Controller and Auditor-General.

Unqualified Opinion

We have obtained all the information and explanations we have required.

In our opinion the financial statements of the Controller and Auditor-General on pages 106 to 146:

- comply with generally accepted accounting practice in New Zealand; and
- fairly reflect:
 - the financial position as at 30 June 2003;
 - the results of his operations and cash flows for the year ended 30 June 2003; and
 - the service performance achievements as measured in relation to the performance targets and other measures set out in the forecast report for the year ended on that date.

Our audit was completed on 30 September 2003 and our unqualified opinion is expressed as at that date.

Curran Sole & Tuck

Curran Sole & Tuck
Chartered Accountants
Manukau City

Curran Sole Tuck

CST Audit & Assurance Services

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Statement of Objectives and Service Performance For the Year Ended 30 June 2003

Departmental Output Classes

The Audit Office produces outputs in four classes. The extent to which we have met our objectives for each output class (as set out in our *Annual Plan 2002-03*¹) is reported below.

Output Class D1

*Reports and Advice arising from the
Exercise of the Function of
Legislative Auditor*

This class of outputs has six elements, each relating to the Audit Office's constitutional function of assisting Parliament to ensure accountability for public resources.

The products and services contained in this class of outputs are either demand-driven (e.g. ratepayer enquiries or advice to select committees), or are subject to the discretion of the Auditor-General as to the particular audit undertaken and reported (e.g. special audits and studies).

Desired Outcomes

- 1 Maintenance of the integrity of:
 - public sector accounting and reporting systems; and
 - reports on financial and non-financial performance by public bodies.
- 2 Better use of public resources.

¹ Parliamentary paper B.28AP(02), 2002, pages 73-87.



I Reports to Parliament and other constituencies on matters arising from annual audits, programmed special audits and studies, and unprogrammed special investigations

Performance Results

<i>Actual 2001-02</i>		<i>Actual 2002-03</i>	<i>Estimate or Target 2002-03</i>
	<i>Quantity</i>		
3	• Results of annual audits	2	At least 2 reports
10	• Results of programmed special audits and studies	7	At least 10 reports
5	• Results of unprogrammed special investigations	6	-
	<i>Quality</i>		
All	• All reports will be prepared with due professional care and be subject to: <ul style="list-style-type: none"> • internal peer review; • substantiation; and • entity confirmation of factual accuracy. 	All	All
	<i>Timeliness</i>		
Substantially achieved	• Reports will be completed in a manner which ensures that the subjects being reported are timely and relevant.	Substantially achieved	
\$000		\$000	\$000
2,952	<i>Value of resources applied</i>	3,052	3,106

Commentary on Performance

This year we published 15 reports against an overall target of 12. The lower number of reports which cover the results of programmed special audits and studies, compared with the target for that category, resulted from the increasingly complex nature of the projects and the corresponding time taken to complete them. Projects falling into this category include the studies on the Management of Hospital-acquired Infection (published in two volumes) and the Management of Biosecurity Risk (also published in two volumes, one covering seven stand-alone case studies).

THE AUDIT OFFICE - FINANCIAL STATEMENTS 2002-03
Statement of Objectives and Service Performance

The number of unprogrammed special investigations we undertake is demand-driven and largely determined by external factors. These investigations, as well as being complex, also require significant resources which reduces the time and effort available for programmed special audits and studies.

See pages 48-52 for more detail and commentary on reports issued.

II Reports and advice to select committees and Ministers

Performance Results

<i>Actual 2001-02</i>		<i>Actual 2002-03</i>	<i>Estimate or Target 2002-03</i>
	<i>Quantity</i>		
	<ul style="list-style-type: none"> • Reports to select committees: <ul style="list-style-type: none"> • financial reviews • estimates examinations • other. 		
89		83	100
27		79	40
41		43	20
	<ul style="list-style-type: none"> • Reports to portfolio Ministers on the results of annual audits. 		
134		137	120
	<i>Quality</i>		
	<ul style="list-style-type: none"> • All select committees will be surveyed as to their satisfaction with the quality of our reports and advice. 		
None		All	All
	<ul style="list-style-type: none"> • All reports and advice will be prepared with due professional care and, where the circumstances require it, be subject to: <ul style="list-style-type: none"> • internal peer review; • substantiation; and • entity confirmation of factual accuracy. 		
All		All	All
	<i>Timeliness</i>		
	<ul style="list-style-type: none"> • Reports presented to select committees at least two days before their examination, unless otherwise agreed with the committee. 		
All		All	All
	<ul style="list-style-type: none"> • Reports presented to portfolio Ministers before select committee scrutiny of departmental and Crown entity performance. 		
All		All	All
\$000		\$000	\$000
549	<i>Value of resources applied</i>	722	607



Commentary on Performance

The only significant change in the overall number of reports produced, compared to the previous year, is the increase in the number of Estimates examinations. Last year's Estimates examinations were not completed until the current year because Parliament was dissolved ahead of the general election held on 27 July 2002.

The Chairpersons of all select committees were surveyed during May and June 2003 on the quality of the advice and support they received from the Audit Office. Overall, the Chairpersons were extremely satisfied and thought the level of service provided was excellent.

III Responding to enquiries from taxpayers, ratepayers, and Members of Parliament

Performance Results

<i>Actual 2001-02</i>		<i>Actual 2002-03</i>	<i>Estimate or Target 2002-03</i>
	<i>Quantity</i>		
	• Enquiries received from:		
54	• taxpayers	41	60
167	• ratepayers	105	180
53	• Members of Parliament.	16	60
	<i>Quality</i>		
	• All reports and advice will be prepared with due professional care and, where the circumstances require it, be subject to:		
All	• internal peer review;	All	All
	• substantiation; and		
	• entity confirmation of factual accuracy.		
	<i>Timeliness</i>		
96%	• Initial response within five working days.	89%	100%
72%	• Cleared within 30 working days.	56%	80%
-	• Advised within 30 working days.	77%	100%
\$000		\$000	\$000
446	<i>Value of resources applied</i>	444	422



Commentary on Performance

This is a demand-driven activity, the quantity of enquiries received being beyond our control. And, although many of these enquiries can be responded to relatively promptly, others identify more significant issues and can lead to major or ongoing investigations. Enquiries that lead to major studies have an impact upon both response times and costs per enquiry.

During the past year, we have found enquiries to be of increasing complexity and demanding increasingly specialised knowledge. With very limited resources, and the need to ensure that the principles of “natural justice” are adhered to with respect to our conclusions and reporting of results, our performance in respect of timeliness has not met the standards we set ourselves.

With the aim of improving both the quality and timeliness of responding to enquiries, we have reviewed our policies and procedures and are working on improving our workflow management and monitoring of the enquiries process. We will implement improvements during the 2003-04 year.

IV Advice to government bodies and other agencies on auditing, accountability, and financial management in the public sector

Performance Results

Actual 2001-02		Actual 2002-03	Estimate or Target 2002-03
	<i>Quantity</i>		
*	<ul style="list-style-type: none"> • Responding to specific requests from, and participating in working parties on matters related to financial management and accountability with, organisations including: <ul style="list-style-type: none"> • central agencies; • government departments, local authorities and other public sector entities; • professional bodies such as the Institute of Chartered Accountants of New Zealand (ICANZ); • sector organisations such as Local Government New Zealand and the Society of Local Government Managers; • foreign delegations; and • other audit institutions and related organisations, such as the International Organisation of Supreme Audit Institutions (INTOSAI). 	*	*

THE AUDIT OFFICE - FINANCIAL STATEMENTS 2002-03

Statement of Objectives and Service Performance

B.28

... continued from previous page

<i>Actual 2001-02</i>		<i>Actual 2002-03</i>	<i>Estimate or Target 2002-03</i>
	<i>Quality</i>		
	<ul style="list-style-type: none"> All advice will be prepared with due professional care and, where the circumstances require it, be subject to internal peer review. 	All	All
	<i>Timeliness</i>		
	<ul style="list-style-type: none"> As requested 		
<i>\$000</i>		<i>\$000</i>	<i>\$000</i>
577	<i>Value of resources applied</i>	598	712

- * This is a demand-driven activity for which there are no wholly satisfactory quantity measures. All reasonable requests for information and participation were met, including from (among others):
- the State Services Commission committees associated with Managing for Outcomes, Review of the Centre, and Go Procure;
 - in association with ICANZ, the Financial Reporting Standards Board, and various other Committees;
 - International Federation of Accountants – Public Sector Committee;
 - Delegations from many overseas countries, such as Canada and the Peoples Republic of China during 2002-03; and
 - INTOSAI – Working Group on Environmental Auditing.

Commentary on Performance

We continue to provide a wide range of high-quality advice on financial management and accountability issues. Most is directed to governmental or sector organisations, but our involvement with professional bodies in New Zealand, and receiving international audit agencies and other international delegations, also consumes considerable time.

Within New Zealand we have contributed towards reasonable requests for information and participation in the State Services Commission committees associated with Managing for Outcomes, Review of the Centre and Go Procure. We also provided comments and analysis of draft legislation such as the Local Government Act 2002.



Our involvement with professional bodies relates mainly to:

- our participation in the activities of the Institute of Chartered Accountants of New Zealand, and submissions made to the Institute on Auditing Standards, Guidance Statements and Financial Reporting Standards; and
- our participation in the activities of the Public Sector Committee of the International Federation of Accountants.

Our ongoing involvement with international audit agencies relates to:

- Continuing participation in two international working groups of the International Organisation of Supreme Audit Institutions (INTOSAI) – on auditing activities with an environmental perspective, and accounting standards.
- Participation in the Auditors-General Global Working Group, which was initiated by the Comptroller General of the United States to promote informal dialogue among the Auditors-General of a small number of countries facing similar issues and challenges.
- Regular contact with our Australian colleagues through a forum known as the Australasian Council of Auditors-General (ACAG).
- Our role as Secretary-General to the South Pacific Association of Supreme Audit Institutions (SPASAI).

The Office continues to receive many delegations from other countries, not all of which are confined to audit-related matters. The international reputation of New Zealand's public sector reforms undoubtedly contributes significantly to this sustained high level of international interest.



V *Administering the provisions of the Local Authorities (Members' Interests) Act 1968*

Performance Results

<i>Actual 2001-02</i>		<i>Actual 2002-03</i>	<i>Estimate or Target 2002-03</i>
	<i>Quantity</i>		
123	<ul style="list-style-type: none"> Responding to specific requests in relation to the Audit Office's powers to: <ul style="list-style-type: none"> approve increased limits for contract payments; grant dispensations in certain circumstances from the prohibition against discussing and voting where members have a pecuniary interest; and consider alleged breaches of the Act. 	115	80
	<i>Quality</i>		
All	<ul style="list-style-type: none"> All reports and advice will be prepared with due professional care and, where the circumstances require it, be subject to internal peer review. 	All	All
	<i>Timeliness</i>		
99%	<ul style="list-style-type: none"> Initial response within five working days. 	97%	100%
88%	<ul style="list-style-type: none"> Cleared within 30 working days. 	85%	80%
-	<ul style="list-style-type: none"> Advised within 30 working days. 	100%	100%
\$000		\$000	\$000
81	<i>Value of resources applied</i>	139	111

Commentary on Performance

Much of our work under the Local Authorities (Members' Interests) Act involves giving advice and guidance to members of local authorities about possible pecuniary interests, and whether they ought to declare them at meetings of their authority. Some of these cases result in formal requests for dispensations from the rule against discussing and voting on matters in which the member has a pecuniary interest. We also deal with applications to approve contracts between local authorities and their members that exceed the permissible allowance of \$25,000 each financial year. We encourage local authorities members to continue to use these procedures. We are usually able to process requests quickly, without substantial cost.

THE AUDIT OFFICE - FINANCIAL STATEMENTS 2002-03
Statement of Objectives and Service Performance

We also receive a number of complaints, alleging breaches of the pecuniary interest rule. Many of these complaints are time-consuming and difficult to investigate. Three major investigations were completed or progressed during the year. Also, we completed (unsuccessfully) the first prosecution under the Act for many years. For more details of that case, see our report on *Local Government: Results of the 2001-02 Audits*.²

VI Implementation of the Transition to the Public Audit Act 2001

Performance Results

<i>Actual</i> 2001-02 \$000		<i>Actual</i> 2002-03 \$000	<i>Estimate</i> 2002-03 \$000
45	Value of resources applied	-	-

Commentary on Performance

Our implementation of the transition to the Public Audit Act 2001 was substantially completed in the 2001-02 year, and activities in the 2002-03 year were dealt with as part of normal activities.

Financial Performance of Output Class D1

<i>Actual</i> 2001-02 \$000		<i>Actual</i> 2002-03 \$000	<i>Estimate</i> 2002-03 \$000
4,815	Revenue – Crown	4,993	4,953
4	– Other	4	15
(4,650)	Expenditure	(4,955)	(4,958)
169	Surplus	42	10

² Parliamentary paper B.29[03b], 2003, pages 51-52.



Output Class D2

Certification of Authority to Release Funds from the Crown Bank Account

This class of outputs relates to the controller function under section 22 of the Public Finance Act 1989. The function is to act as a monitor, on behalf of Parliament, to control the issue of funds from the Crown Bank Account. Operationally this includes monitoring departmental and Crown financial reporting systems to ensure that releases of funds are supported by appropriations and are for lawful purposes.

Desired Outcome

Legal disbursement of public funds.

Performance Results

<i>Actual 2001-02</i>		<i>Actual 2002-03</i>	<i>Estimate or Target 2002-03</i>
	<i>Quantity</i>		
6	• Warrants issued	6	6
245	• Controller statements issued	245	245
	<i>Quality</i>		
All	• Authorities will be issued once correct documentation is received.	All	All
All	• Issues from the Crown Bank Account will be within the appropriations and other lawful authorities granted by Parliament.	All	All
No payments made without authority	• All payments not within a warrant from the Governor-General will be refused.	No payments made without authority	No payments made without authority
	<i>Timeliness</i>		
100%	• Valid certifications given on the day that documentation is provided to support certification.	100%	100%
\$000		\$000	\$000
244	<i>Value of resources applied</i>	238	278



Commentary on Performance

The volume of controller statements issued continues at a similar level to that of previous years. The quality of statements presented continued to remain sound during 2002-03, and is evidence that the improved Treasury performance level has been maintained.

Financial Performance of Output Class D2

<i>Actual</i> 2001-02 \$000		<i>Actual</i> 2002-03 \$000	<i>Estimate</i> 2002-03 \$000
244	Revenue – Crown	238	278
(244)	Expenditure	(238)	(278)
<u>Nil</u>	Surplus	<u>Nil</u>	<u>Nil</u>



Output Class D3

Provision of Non-contested Audit Services

The Audit Office has a statutory duty to conduct an audit of the financial reports of more than 3,800 public entities. The Office of the Auditor-General establishes the standards by which audits will be carried out.

This class of outputs relates to the provision of those audits which have not been allocated to audit service providers by a contestable process. These are:

- audits of national sensitivity; or
- audits where the Auditor-General considers that subjecting particular audits to contestability at this time is potentially too disruptive to the entity; or
- those audits which have yet to be subject to competitive tender.

The work is carried out by Audit New Zealand.

The two significant outputs of this class are:

- **Audit Reports** – on whether the public entity's financial report fairly reflects the financial and non-financial performance of the entity; and
- **Management Reports** – to the management and governing bodies of public entities, on issues arising from the audit.

Desired Outcomes

- 1 Maintenance of the integrity of:
 - public sector accounting and reporting systems; and
 - reports on financial and non-financial performance by public entities.
- 2 Better use of public resources.



THE AUDIT OFFICE - FINANCIAL STATEMENTS 2002-03

Statement of Objectives and Service Performance

Statement of Performance for Output Class D3 – Non-contested Audit Services Performance Quantity and Timeliness¹

Group	Quantity			Timeliness			
	Audit Status			Timely Issue of Audit Reports		Timely Issue of Management Reports	
	Total Entities in Group	Audits Completed	Arrears at Year End	Target ²	Actual	Target ³	Actual
Government Departments and Offices of Parliament	11	11	-	100%	100%	100%	100%
2001-02	15	15	-	100%	100%	100%	100%
Major Statutory Bodies ⁴	29	28	4	100%	86%	100%	83%
2001-02	38	37	4	100%	84%	100%	82%
Other Local Authorities ⁵	21	24	-	100%	76%	100%	83%
2001-02	25	26	3	100%	76%	100%	82%
Miscellaneous Public Bodies ⁶	118	136	42	75%	38%	100%	97%
2001-02	130	152	53	75%	52%	100%	98%
Audits for which fees will not be charged ⁷	156	202	71	75%	35%	100%	100%
2001-02	160	170	109	75%	25%	100%	99%
TOTALS	335	401	117		45%		97%
2001-02	368	400	169		47%		96%

¹ Figures may not balance exactly, or may vary from those presented in the *Annual Plan* and last year's *Annual Report*, because of in-year changes and corrections to the audit portfolio.

² Audits will be completed and audited financial statements will be available within statutory deadline or within 5 months of balance date.

³ Management reports and letters will be issued within 6 weeks of the date of the audit report.

⁴ Comprising State-owned Enterprises, Tertiary Education Institutions, Producer Boards, District Health Boards, Crown Research Institutes, and other major Crown Entities.

⁵ Comprising Licensing Trusts, Airports, LATEs, Energy Companies, Port Companies, and Sinking Fund Commissioners.

⁶ Comprising Maori Trust Boards, smaller Crown Entities, and subsidiaries of major statutory bodies.

⁷ Entities where there is no statutory right to charge an audit fee or no realistic possibility of obtaining a fee – comprising Cemetery Trustees, Hall and Reserve Boards, Racecourse Trustees and Patriotic Councils. From 2001-02, the Crown is funding up to \$100,000 of the cost of these audits.



Performance Quality

Standard

- 1 Work will be conducted with due professional care; ensuring adherence to standards of appropriateness, quality, efficiency and independence as set out in the Institute of Chartered Accountants of New Zealand's standards and other standards which the Auditor-General deems appropriate for the public sector.
- 2 A quality assurance programme will be carried out on audit arrangements and work undertaken.

Achievement

Done.

Programme undertaken, the results of which are reported on page 24.

Commentary on Performance

Our efforts over the past two years to reduce audit arrears has resulted in an excellent result this year, reducing arrears from 169 to 117. This is mainly the result of a reduction in Cemetery Trustees, and Hall and Reserve Boards sector in particular.

The result for timeliness for the issue of audit reports was comparable, if not slightly better, in most sectors compared to last year, with the exception of Miscellaneous Public Bodies where it was well short of target. This was bought about by an increase in the number of previously unaudited subsidiaries and trusts, identified during the year as public entities under the Public Audit Act 2001.



Financial Performance of Output Class D3

<i>Actual</i> 2001-02 \$000		<i>Actual</i> 2002-03 \$000	<i>Estimate</i> 2002-03 \$000
94	Revenue – Crown	100	100
4,557	– Other	3,661	5,881
(4,513)	Expenditure	(3,658)	(5,963)
138	Surplus/(Deficit)	103	18

Commentary on Financial Out-turn of Output Class D3

The financial out-turn for this output class for the year is well within estimate.

The revenue and expenditure is significantly less than the estimate as a result of the transfer of some entities into the contestable audit pool (Output Class D4) and a poor forecast of the split of total revenue and expenses between the two audit services outputs. The forecast did not take into account changes in the availability of our auditing resources and the ability of clients to prepare work ready for audit. We will look to improve our forecasting ability in the 2003-04 financial year.

The actual revenue and expenditure for the year better reflects the level of activity associated with non-contested audit services.



Output Class D4

Provision of Contested Audit and Assurance Services

The Audit Office has a statutory duty to conduct an audit of the financial statements of more than 3,800 public entities. The Auditor-General establishes the standards by which audits will be carried out.

This class of outputs relates to the provision of audits or audit-related services awarded through a competitive tender process or under the threat of competition. This class of output is appropriated on a Mode B net basis, and the work is carried out by Audit New Zealand and private sector auditing firms on contract to the Auditor-General.

The two significant outputs in this class are:

- **Audit Reports** – on whether the public entity’s financial report fairly reflects the financial and non-financial performance of the entity; and
- **Management Reports** – to the management and governing bodies of public entities, on issues arising from the audit.

Desired Outcomes

- 1 Maintenance of the integrity of:
 - public sector accounting and reporting systems; and
 - reports on financial and non-financial performance by public entities.
- 2 Better use of public resources.



Statement of Performance for Output Class D4 – Contested Audit and Assurance Services. Performance Quantity and Timeliness¹

Group	Quantity			Timeliness			
	Audit Status			Timely Issue of Audit Reports		Timely Issue of Management Reports	
	Total Entities in Group	Audits Completed	Arrears at Year End	Target ²	Actual	Target ³	Actual
Government Departments and Offices of Parliament	36	36	-	100%	97%	100%	100%
2001-02	34	34	-	100%	100%	100%	100%
Major Statutory Bodies ⁴	90	91	1	100%	94%	100%	91%
2001-02	83	82	1	100%	95%	100%	93%
Regional, City and District Councils	86	86	-	100%	99%	100%	95%
2001-02	86	86	-	100%	97%	100%	90%
Other Local Authorities ⁵	373	373	43	100%	85%	100%	94%
2001-02	344	356	18	100%	80%	100%	91%
School Boards of Trustees	2,585	2,900	180	50%	22%	100%	96%
2001-02	2,623	2,449	326	50%	22%	100%	98%
Miscellaneous Public Bodies ⁶	296	305	31	75%	72%	100%	100%
2001-02	245	243	29	75%	68%	100%	97%
TOTALS	3,466	3,791	255		37%		96%
2001-02	3,415	3,250	374		35%		96%

¹ Figures may not balance exactly, or may vary from those presented in the *Annual Plan* and last year's *Annual Report*, because of in-year changes and corrections to the audit portfolio.

² Audits will be completed and audited financial statements will be available within statutory deadline or within 5 months of balance date.

³ Management reports and letters will be issued within 6 weeks of the date of the audit report.

⁴ Comprising State-owned Enterprises, Tertiary Education Institutions, Producer Boards, District Health Boards, Crown Research Institutes, and other major Crown Entities.

⁵ Comprising Licensing Trusts, Airports, LATEs, Energy Companies, Port Companies, and Sinking Fund Commissioners.

⁶ Comprising mainly Maori Trust Boards, smaller Crown Entities, and subsidiaries of major statutory bodies.



Performance Quality

<i>Standard</i>	<i>Achievement</i>
1 Work will be conducted with due professional care; ensuring adherence to standards of appropriateness, quality, efficiency and independence as set out in the Institute of Chartered Accountants of New Zealand's standards and other standards which the Auditor-General deems appropriate for the public sector.	Done.
2 A quality assurance programme will be carried out on audit arrangements and work undertaken.	Programme undertaken, the results of which are reported on page 24.

Commentary on Performance

Our efforts over the past two years to reduce audit arrears has resulted in an excellent result this year reducing from 374 to 255. This is mainly the result of a reduction in the number of schools arrears in particular.

The result for timeliness was slightly improved on last year in all sectors except schools, where it was well short of target.

We have reported to Parliament on the timeliness of audit reporting of school audits on a number of occasions. Our most recent report on this issue, in March 2000³, mentioned the practical difficulties that auditors have in complying with the statutory deadline of completing the audit within 30 days of receiving draft financial statements.

This result for schools is now a consistent pattern, and we have resolved to review the performance measure in line with our recommendation to Parliament in 2000.

Commentary on the outcomes of audits (including non-standard audit reports issued) is set out on pages 65-67.

3 *First Report for 2000, parliamentary paper B.29[00a], pages 79-98.*



Financial Performance of Output Class D4

<i>Actual</i> 2001-02 \$000		<i>Actual</i> 2002-03 \$000	<i>Estimate</i> 2002-03 \$000
27,773	Revenue – Other	30,703	28,262
(27,401)	Expenditure	(30,697)	(28,229)
<u>372</u>	Surplus	<u>6</u>	<u>33</u>

Commentary on Financial Out-turn of Output Class D4

The revenue and expenditure is significantly more than the estimate as a result of the transfer of some entities into the contestable audit pool from the non-contested audit pool (Output Class D3) and a poor forecast of the split of total revenue and expenses between the two audit services outputs. The forecast did not take into account changes in the availability of our auditing resources and the ability of clients to prepare work ready for audit. We will look to improve our forecasting ability in the 2003-04 financial year.

The actual revenue and expenditure for the year better reflects the level of activity associated with contested audit services.



Financial Performance Indicators For the Year Ended 30 June 2003

Details of the actual performance of the Audit Office against performance measures established in the *Annual Plan* are summarised below.

<i>Actual</i> 2001-02 \$000		<i>Actual</i> 2002-03 \$000	<i>Final</i> <i>Estimates</i> 2002-03 \$000	<i>Annual</i> <i>Plan</i> 2002-03 \$000
	Operating Results			
25,048	Revenue: other than Crown and departmental audit fees	28,037	27,211	27,187
36,808	Output expenses	39,548	39,428	39,187
957	Surplus before capital charge	435	366	572
679	Surplus	151	61	267
	Working Capital Management			
2,071	Current assets less current liabilities	2,535	2,173	2,032
145%	<i>Current ratio</i>	153%	185%	176%
68 days	<i>Average receivables and work in progress</i>	58 days	41 days	41 days
44 days	<i>Average payables outstanding</i>	44 days	28 days	28 days
	Resource Utilisation			
	<i>Physical assets:</i>			
2,626	Total physical assets at year-end	2,037	2,530	2,771
30%	<i>Additions as % of physical assets</i>	38%	49%	45%
	Taxpayers' funds			
3,586	Level at year-end	3,586	3,586	3,586
	Net Cash Flows			
(25)	Surplus/(deficit) on operating activities	2,160	1,896	1,496
(643)	(Deficit) on investing activities	(532)	(1,085)	(1,085)
(351)	(Deficit) on financing activities	(679)	(679)	(270)
(1,019)	Net increase/(decrease) in cash held	949	132	141



Statement of Accounting Policies For the Year Ended 30 June 2003

Reporting Entity

These are the financial statements of the Controller and Auditor-General prepared in accordance with sections 35 and 40 of the Public Finance Act 1989.

The Auditor-General is a corporation sole established by section 10(1) of the Public Audit Act 2001, and is an Office of Parliament for the purposes of the Public Finance Act 1989.

The Auditor-General's activities include the work undertaken by private sector auditors appointed by the Auditor-General.

In this report, the activities of the Auditor-General are referred to as those of "the Audit Office", consistent with the meaning of that term in section 52 of the Public Audit Act 2001.

Measurement Base

Generally accepted accounting practice (GAAP) is used to measure and report the activities and financial position of the Audit Office on a historical cost basis.

Non-financial information, in the form of objectives and performance measures, is prepared from internal management information.

Accounting Policies

Revenue

The Audit Office derives revenue from the Crown for outputs provided to Parliament, from audit fees for services to third parties, and from other assurance work undertaken by Audit New Zealand at the request of audited entities.



Expenses

The remuneration of the Auditor-General and the Deputy Auditor-General, which are a charge against a permanent appropriation in terms of clause 5 of Schedule 3 to the Public Audit Act 2001, are recognised as expenses of the Audit Office.

Output Cost Allocation

Definitions

- *Direct costs* are those costs which are directly attributable to a single output.
- *Indirect costs* are all other costs. These costs include: payroll costs; variable costs such as travel; and operating overheads such as property costs, depreciation, and capital charges.

Method of Assigning Costs to Output Classes

- *Direct costs* that can readily be identified with a single output are assigned directly to the relevant output class. For example, the cost of audits carried out by contract audit service providers is charged directly to Output Class D4.
- *Indirect costs* are allocated according to the time charged to a particular activity.

Receivables and Work in Progress

Receivables and work in progress are stated at estimated realisable value, after providing for non-recoverable amounts.

Leases

The Audit Office leases office premises and office equipment. As substantially all of the risks and rewards of ownership are retained by the lessor, these leases are classified as operating leases. Operating lease costs are expensed on a systematic basis over the period of the lease.



Physical Assets

The initial cost of a physical asset is the value of the consideration given to acquire or create the asset and any directly attributable costs of bringing the asset to working condition for its intended use.

All physical assets costing more than \$500 are capitalised.

Depreciation

Depreciation of physical assets is provided on a straight-line basis so as to allocate the cost of the assets, less their residual value, over their expected useful lives. The estimated useful lives are:

Furniture and fittings	4 years
Office equipment –	
Computer hardware and software	2.5-5 years
Other office equipment	4 years
Motor vehicles	5-7.5 years

Provision for Employee Entitlements

Annual leave and time off in lieu of overtime worked are recognised as they accrue to employees based on current rates of pay. Long service leave and retiring/resigning leave are recognised on an actuarial basis. In calculating the present value of the estimated future cash outflows, the assumptions used in valuing the Government Superannuation Fund liability have been adopted.

Foreign Currency

Foreign currency transactions, relating primarily to subscriptions and travel, are paid for at the New Zealand dollar exchange rate at the date of the transaction.



Financial Instruments

Financial instruments primarily comprise bank balances, receivables and payables, which are recognised in the Statement of Financial Position. Revenue and expenses in relation to all financial instruments are recognised in the Statement of Financial Performance.

Goods and Services Tax (GST)

Amounts in the financial statements are reported exclusive of GST, except for:

- Payables and Receivables in the Statement of Financial Position, which are GST-inclusive.
- Figures in the Statement of Appropriations, which are GST-inclusive unless noted.

The amount of GST owing to or from the Inland Revenue Department at balance date, being the difference between Output GST and Input GST, is included in Payables or Receivables (as appropriate).

Income Tax

The Audit Office is exempt from the payment of income tax in terms of section 43 of the Public Audit Act 2001. Accordingly, no charge for income tax has been provided for.

Commitments

Future payments are disclosed as commitments at the point at which a contractual obligation arises. Commitments relating to employment contracts are not disclosed unless they had vested at balance date, in which case they are reflected in the item "Provision for employee entitlements" in the Statement of Financial Position.



Contingent Liabilities

Contingent liabilities are disclosed at the point at which the contingency is evident.

Changes in Accounting Policies

There have been no changes in accounting policies, including cost allocation accounting policies, from those contained in the last audited financial statements.



Statement of Financial Performance For the Year Ended 30 June 2003

Description of Statement

The Statement of Financial Performance details the revenue and expenses relating to all outputs (goods and services) produced by the Audit Office. Supporting statements showing the revenue and expenditure of each output class are on pages 114, 116, 120 and 124.

2001-02 Actual		Notes	2002-03 Actual	2002-03 Final Estimates*
\$000			\$000	\$000
Continuing Activities				
Revenue				
5,153	Crown	2	5,331	5,331
32,334	Other	3	34,368	34,158
<u>37,487</u>	Total Revenue		<u>39,699</u>	<u>39,489</u>
Expenses				
19,049	Personnel costs		19,260	19,027
16,434	Operating costs	4	18,904	18,915
1,047	Depreciation	5	1,100	1,181
278	Capital charge	6	284	305
<u>36,808</u>	Total Expenses		<u>39,548</u>	<u>39,428</u>
<u><u>679</u></u>	Surplus		<u><u>151</u></u>	<u><u>61</u></u>

* See Note 1 on page 139.

The accounting policies on pages 126-130 and notes on pages 139-146 form part of these statements.



Statement of Movements in Taxpayers' Funds (Equity) For the Year Ended 30 June 2003

Description of Statement

The Statement of Movements in Taxpayers' Funds combines information about the surplus with other aspects of the financial performance of the Audit Office to give a degree of measure of comprehensive income.

2001-02 Actual \$000		Notes	2002-03 Actual \$000	2002-03 Forecast \$000
3,586	Taxpayers' Funds brought forward at 1 July		3,586	3,586
679	Movements during the year Surplus		151	61
679	Total Recognised Revenues and Expenses for the Year		151	61
3,586	Flows to and from the Crown Capital Contribution	7	-	-
(3,586)	Repayment of Capital		-	-
(679)	Surplus payment due to the Crown	8	(151)	(61)
(679)			(151)	(61)
3,586	Taxpayers' Funds at 30 June		3,586	3,586

The accounting policies on pages 126-130 and notes on pages 139-146 form part of these statements.



Statement of Financial Position

As at 30 June 2003

Description of Statement

The Statement of Financial Position reports the total assets and liabilities of the Audit Office. The difference between the assets and liabilities is called Taxpayers' Funds.

30/6/02 Actual \$000	Notes	30/6/03 Actual \$000	30/6/03 Forecast \$000
Taxpayers' Funds			
3,586		3,586	3,586
3,586	Total Taxpayers' Funds	3,586	3,586
Represented by:			
Current Assets			
466	Cash and bank balances	1,415	598
218	Prepayments	344	290
2,055	Work in progress	1,802	1,118
3,935	Receivables	3,678	2,721
6,674	<i>Total Current Assets</i>	7,239	4,727
Non-current Assets			
2,626	Physical assets	2,037	2,530
2,626	<i>Total Non-current Assets</i>	2,037	2,530
9,300	Total Assets	9,276	7,257
Current Liabilities			
1,799	Payables and accruals	2,353	1,543
679	Surplus payment due to the Crown	151	61
2,125	Provision for employee entitlements	2,200	950
4,603	<i>Total Current Liabilities</i>	4,704	2,554
Non-current Liabilities			
860	Provision for employee entitlements	819	860
251	Property lease liabilities	167	257
1,111	<i>Total Non-current Liabilities</i>	986	1,117
5,714	Total Liabilities	5,690	3,671
3,586	Net Assets	3,586	3,586

The accounting policies on pages 126-130 and notes on pages 139-146 form part of these statements.



Statement of Cash Flows For the Year Ended 30 June 2003

Description of Statement

The Statement of Cash Flows summarises the cash movements in and out of the Audit Office during the year.

2001-02 Actual \$000		Notes	2002-03 Actual \$000	2002-03 Forecast \$000
	Operating Activities			
	Cash received from:			
5,098	The Crown		5,331	5,331
21,277	Others		22,803	24,866
	Cash disbursed on:			
(23,748)	Production of outputs		(23,252)	(26,188)
(2,374)	Net GST paid		(2,431)	(1,802)
(278)	Capital charge		(285)	(305)
-	Overdraft interest charges		(6)	(6)
<u>(25)</u>	Net Cash Flow from Operating Activities	15	<u>2,160</u>	<u>1,896</u>
	Investing Activities			
	Cash received from:			
146	Sale of physical assets		233	160
	Cash disbursed on:			
(789)	Purchase of physical assets		(765)	(1,245)
<u>(643)</u>	Net Cash Flow from Investing Activities		<u>(532)</u>	<u>(1,085)</u>
	Financing Activities			
	Cash received from:			
3,586	Capital contribution		-	-
	Cash disbursed on:			
(3,586)	Capital repayment		-	-
(351)	Surplus payment to the Crown		(679)	(679)
<u>(351)</u>	Net Cash Flow from Financing Activities		<u>(679)</u>	<u>(679)</u>
<u>(1,019)</u>	Total net increase/(decrease) in cash held		<u>949</u>	<u>132</u>
1,485	Add Opening cash balance at 1 July		466	466
<u>466</u>	Closing cash balance at 30 June		<u>1,415</u>	<u>598</u>

The accounting policies on pages 126-130 and notes on pages 139-146 form part of these statements.



Supplementary Information For the Year Ended 30 June 2003

Statement of Commitments

The Statement of Commitments records those expenditures to which the Audit Office is contractually committed at 30 June 2003 and which will become liabilities if and when the terms of the contracts are met.

The Audit Office had no capital commitments as at 30 June 2003 (2002 – nil).

The Audit Office has long-term leases on its premises. The annual property lease payments are subject to regular reviews, ranging from 3-yearly to 6-yearly.

Equipment lease commitments include leases of computer equipment, telephone exchange systems, facsimile machines and photocopiers.

30/6/02 Actual \$000		30/6/03 Actual \$000
	Operating Lease Commitments	
	Property Lease Commitments	
1,417	Less than one year	1,476
1,359	One to two years	1,217
2,796	Two to five years	1,710
<hr/> 5,572	<i>Total Property Lease Commitments</i>	<hr/> 4,403
	Equipment Lease Commitments	
497	Less than one year	681
304	One to two years	646
273	Two to five years	184
<hr/> 1,074	<i>Total Equipment Lease Commitments</i>	<hr/> 1,511
<hr/> 6,646	Total Operating Lease Commitments	<hr/> 5,914

The accounting policies on pages 126-130 and notes on pages 139-146 form part of these statements.



Statement of Contingent Liabilities

The Statement of Contingent Liabilities discloses situations which exist at 30 June 2003, the ultimate outcome of which is uncertain and will be confirmed only on the occurrence of one or more future events after the date of approval of the Financial Statements.

The Audit Office did not have any contingent liabilities as at 30 June 2003 (2002 – nil). There is potential for claims to arise against the Audit Office as a result of defalcations and other losses within entities of which the Auditor-General is the auditor, or from reliance by third parties on inaccurate financial information reported by entities of which the Auditor-General is the auditor. No demands for compensation have been made by any party as at the date of these financial statements. It is therefore impracticable to estimate any potential financial effect. The Audit Office has professional indemnity insurance.

There were no contingent assets as at 30 June 2003 (2002 – nil).

The accounting policies on pages 126-130 and notes on pages 139-146 form part of these statements.



Statement of Appropriations

The Statement of Appropriations reports actual expenses incurred against each appropriation administered by the Audit Office for the year ended 30 June 2003.

	2002-03		Appropriations GST Inclusive
	Output Expenses GST Exclusive \$000	GST Inclusive ¹ \$000	
Operating Flows			
Annual Appropriations			
<i>Mode B Gross</i>			
D1 Reports and advice to Parliament	4,449	5,010	5,010
D2 Controller function	238	268	313
D3 Non-contested audit services	3,658	4,128	6,711
Total Annual Appropriations	8,345	9,406	12,034
Other Appropriations			
<i>Mode B Gross</i>			
D1 Reports and advice to Parliament ²	506	506	506
<i>Mode B Net</i>			
D4 Contested audit and assurance services ³	30,697	34,535	31,762
Total Other Appropriations	31,203	35,041	32,268
Total Output Expenses as reported in the Statement of Financial Performance	39,548		
Capital Flows			
Non-Departmental Annual Appropriation			
<i>Repayment of Debt</i>			
Overdraft repayment ⁴		409	500
Total Appropriations		44,856	44,802

1 GST is based on the amount of revenue received within each output. All Appropriations are GST-inclusive, except for Other Appropriations (Mode B Gross) which are exempt from GST.

2 Costs incurred pursuant to clause 5 of Schedule 3 to the Public Audit Act 2001.

3 Costs incurred pursuant to section 10 of the Public Finance Act 1989.

4 Repayment of principal on an overdraft facility.

The accounting policies on pages 126-130 and notes on pages 139-146 form part of these statements.



Statement of Unappropriated Expenditure

The Audit Office incurred no unappropriated expenditure during the year ended 30 June 2003 (2002 - nil).

Statement of Trust Money

On 1 November 1996 the Audit Office was appointed Secretary-General of the South Pacific Association of Supreme Audit Institutions (SPASAI). SPASAI exists to encourage, promote and advance co-operation among its members in the field of public audit.

A trust account records the financial transactions undertaken by the Audit Office on behalf of SPASAI. All trust money transactions are recorded on a cash basis.

<i>2001-02</i>		<i>2002-03</i>
<i>Actual</i>		<i>Actual</i>
<i>\$000</i>		<i>\$000</i>
44	Opening balance at 1 July	19
236	Receipts	1,044
<hr/> 280		<hr/> 1,063
(261)	Payments	(759)
<hr/> 19 <hr/> <hr/>	Closing balance at 30 June	<hr/> 304 <hr/> <hr/>

The accounting policies on pages 126-130 and notes on pages 139-146 form part of these statements.



Notes to the Financial Statements For the Year Ended 30 June 2003

Note 1: Budget Estimates

The table below shows the main budget for the year as reflected in the *Estimates of Appropriations* approved by Parliament, the changes made in conjunction with the *Supplementary Estimates* approved by Parliament, and the aggregate budget estimates.

	2002-03 Main Budget Estimates \$000	2002-03 Supplementary Estimates Changes \$000	2002-03 Final Estimates (Forecast) \$000
Revenue			
Crown	5,320	11	5,331
Other	34,134	24	34,158
Total Revenue	39,454	35	39,489
Expenses			
Personnel costs	18,349	678	19,027
Operating costs	19,269	(354)	18,915
Depreciation	1,264	(83)	1,181
Capital charge	305	-	305
Total Expenses	39,187	241	39,428
Surplus	267	(206)	61

Note 2: Crown Revenue

Revenue is provided by the Crown to meet the costs of the Audit Office in assisting Parliament in its role of ensuring accountability for public resources. The services provided to Parliament include reports to Parliament and other constituencies, reports and advice to select committees, responding to taxpayer and ratepayer enquiries, advice to government bodies and other agencies, and administering the provisions of the Local Authorities (Members' Interests) Act 1968.



THE AUDIT OFFICE - FINANCIAL STATEMENTS 2002-03

Notes to the Financial Statements

Note 3: Other Revenue

2001-02 Actual \$000		2002-03 Actual \$000	2002-03 Estimate \$000
7,286	Audit fees – departments	6,331	6,947
24,991	Audit fees – other	27,933	27,196
57	Miscellaneous	104	15
<u>32,334</u>	Total Other Revenue	<u>34,368</u>	<u>34,158</u>

Note 4: Operating Costs

Operating costs include:

2001-02 Actual \$000		2002-03 Actual \$000	2002-03 Estimate \$000
(1)	Loss/(profit) on sale of physical assets	21	-
	Increase/(decrease) in provision for doubtful		
8	Receivables	(50)	-
	Fees to auditors for audits of the Financial		
58	Statements	58	58
4	Fees to auditors for other services provided	6	4
6	Overdraft interest cost	9	6
395	Equipment lease costs	396	395
1,517	Property lease costs	1,471	1,568
9,331	Fees paid to contracted auditors	12,075	11,443

Note 5: Depreciation Charge

2001-02 Actual \$000		2002-03 Actual \$000	2002-03 Estimate \$000
242	Furniture and Fittings	234	271
687	Office Equipment	744	780
118	Motor Vehicles	122	130
<u>1,047</u>	Total Depreciation Charge	<u>1,100</u>	<u>1,181</u>



Note 6: Capital Charge

The Audit Office pays a capital charge to the Crown on its average taxpayers' funds as at 30 June and 31 December each year. The capital charge rate for the year ended 30 June 2003 was 8.5 percent (2002 – 9 percent).

During the financial year the Audit Office participated in a pilot differential capital charge scheme. Under the scheme cash bank balances and term deposits attracted lower capital charge rates. For the year ended 30 June 2003, the capital charge reduced by \$32,000 (2002 – \$49,000) as a result of the scheme.

Note 7: Capital Contribution

The capital contribution in 2001-02 of \$3.586 million and its repayment reflect the value of the assets and liabilities transferred from the Audit Department to the Controller and Auditor-General as a new Officer of Parliament established under the Public Audit Act 2001.

Note 8: Surplus Payment Due to the Crown

Departments are not permitted to retain operating surpluses. Thus, the surplus for this year of \$151,393 is fully repayable to the Crown.

If there is an operating deficit, any interest received and any profit made on the sale of a physical asset are both returned to the Crown.

<i>30/6/02</i>		<i>30/6/03</i>
<i>Actual</i>		<i>Actual</i>
<i>\$000</i>		<i>\$000</i>
679	Surplus	151
<u>679</u>	Total Provision for Payment to the Crown	<u>151</u>



Note 9: Overdraft Facility

The Audit Office has the use of an overdraft facility to manage its seasonal cashflows during the second half of the financial year. The overdraft limit is \$500,000, and interest is charged on the daily balance at Westpac Banking Corporation's Prime Lending Rate.

As at 30 June 2003, \$409,000 (2002 – \$406,000) of the facility had been drawn down, and this was subsequently repaid on 31 July 2003.

Note 10: Receivables

<i>30/6/02 Actual \$000</i>		<i>30/6/03 Actual \$000</i>
4,014	Trade receivables	3,757
(222)	Provision for doubtful receivables	(172)
<u>3,792</u>	<i>Net Trade Receivables</i>	<u>3,585</u>
143	Other receivables	93
<u><u>3,935</u></u>	Total Receivables	<u><u>3,678</u></u>

Note 11: Physical Assets

<i>30/6/02 Actual \$000</i>		<i>30/6/03 Actual \$000</i>
Furniture and Fittings		
1,967	At cost	1,947
(1,598)	Accumulated depreciation	(1,732)
<u>369</u>	<i>Furniture and Fittings at Net Carrying Value</i>	<u>215</u>
Office Equipment		
4,679	At cost	4,381
(2,971)	Accumulated depreciation	(3,079)
<u>1,708</u>	<i>Office Equipment at Net Carrying Value</i>	<u>1,302</u>
Motor Vehicles		
747	At cost	674
(198)	Accumulated depreciation	(154)
<u>549</u>	<i>Motor Vehicles at Net Carrying Value</i>	<u>520</u>
<u><u>2,626</u></u>	Total Physical Assets at Net Carrying Value	<u><u>2,037</u></u>



Note 12: Payables and Accruals

30/6/02 Actual \$000		30/6/03 Actual \$000
1,591	Trade payables	2,274
208	Accruals	79
<u>1,799</u>	Total Payables and Accruals	<u>2,353</u>

Note 13: Provision for Employee Entitlements

30/6/02 Actual \$000		30/6/03 Actual \$000
	Current Liabilities	
1,045	Annual leave	1,168
22	Long service leave	49
57	Time off in lieu of overtime worked	45
1,001	Salary and other accruals	919
-	Retiring leave	19
<u>2,125</u>	Total Current Liabilities	<u>2,200</u>
	Non-current Liabilities	
129	Long service leave	92
731	Retiring/resigning leave	727
<u>860</u>	Total Non-current Liabilities	<u>819</u>
<u>2,985</u>	Total Provision for Employee Entitlements	<u>3,019</u>

Note 14: Property Lease Liabilities

Property lease liabilities consist of the unamortised value of lease inducements received.

30/6/02 Actual \$000		30/6/03 Actual \$000
57	Current Liabilities (Payables and accruals)	84
251	Non-current Liabilities	167
<u>308</u>	Total Property Lease Liabilities	<u>251</u>



Note 15: Reconciliation of Surplus to Net Cash Flow from Operating Activities

This reconciliation discloses the non-cash adjustments applied to the Surplus reported in the Statement of Financial Performance on page 131 to arrive at the Net Cash Flow from Operating Activities disclosed in the Statement of Cash Flows on page 134.

2001-02 Actual \$000		2002-03 Actual \$000	2002-03 Estimate \$000
679	Surplus	151	61
	Non-cash Items		
1,047	Depreciation	1,100	1,181
1,047	Total Non-cash Items	1,100	1,181
	Working Capital Movements		
9	(Increase)/decrease in prepayments	(126)	(72)
(1,194)	(Increase)/decrease in receivables	257	1,214
(587)	(Increase)/decrease in work in progress	253	937
(192)	(Decrease)/increase in payables	554	(256)
240	(Decrease)/increase in employee entitlements	75	(1,175)
(1,724)	Total Net Working Capital Movements	1,013	648
	Investing Activity Items		
(1)	Loss/(profit) on sale of physical assets	21	-
(1)	Total Investing Activity Items	21	-
	Other Items		
(100)	Increase/(decrease) in non-current employee entitlements	(41)	-
72	Increase/(decrease) in non-current property lease liabilities	(84)	6
2	Other items	-	-
(26)	Total Other Items	(125)	6
(25)	Net Cash Flow from Operating Activities	2,160	1,896



Note 16: Financial Instruments

The Audit Office is a party to financial instrument arrangements as part of its everyday operations. These include instruments such as bank balances, receivables and payables.

Credit Risk

In the normal course of its business, the Audit Office incurs credit risk from receivables and from transactions with financial institutions and the New Zealand Debt Management Office of the Treasury.

The Audit Office has no significant concentrations of credit risk. No collateral or security is held or given to support financial instruments.

Interest Rate Risk

The Audit Office has no interest rate risk, as all cash funds that earn interest are managed as part of the Crown's banking arrangements.

Currency Risk

The Audit Office has no exposure to currency risk, as all financial instruments are in New Zealand dollars.

Fair Values

The estimated fair values of all financial assets and liabilities are equivalent to the carrying amounts disclosed in the Statement of Financial Position.

Note 17: Related Party Information

Some 13% of the Office's revenue is provided by the Crown directly (see Note 2 on page 139) and a further 16% indirectly through fees for the audit of Government departments (see Note 3 on page 140). These transactions are conducted on an arm's-length basis.

In addition to these audit transactions, the Audit Office enters into numerous other transactions with entities controlled by the Crown. These transactions are also on an arm's-length basis. Related party disclosures have not been made for transactions conducted at arm's-length.

Note 18: Office Accommodation Statistics

The following statistics for the year ended 30 June 2003 are provided in accordance with directives issued by the Government to chief executives in 1991 on the management of departmental accommodation.

<i>30/6/02</i> <i>Actual</i>		<i>30/6/03</i> <i>Actual</i>
6,305m ²	Area	6,305m ²
248	Number of staff	248
25m ²	Space allocation per person	25m ²
\$1,517,455	Total costs of leased office accommodation	\$1,549,091
\$5,002	Rent costs per person	\$5,163
\$262	Utility costs per person	\$267
-	Vacant accommodation	-



Appendices

Appendix 1

Directory of Offices

Office of the Auditor-General

Level 7, Hitachi Data Systems House
48 Mulgrave Street
Private Box 3928
Wellington
Phone (04) 917-1500
Fax (04) 917-1549
Web site www.oag.govt.nz

Audit New Zealand

National Office

Level 8, St Paul's Square, 45 Pipitea Street
Private Box 99, Wellington
Phone (04) 496-3099 Fax (04) 496-3095
Web site www.auditnz.govt.nz

Whangarei

Level 2, State Insurance Building, 96 Bank Street
Private Box 395, Whangarei
Phone (09) 430-3083 Fax (09) 430-3084

Auckland

Level 10, Dynasty Pacific Building, 155 Queen Street
Private Box 1165, Auckland
Phone (09) 373-5457 Fax (09) 366-0215



Hamilton

Level 5, KPMG Centre, 85 Alexandra Street
Private Box 256, Hamilton
Phone (07) 839-3349 Fax (07) 838-0508

Tauranga

Ford Electrical Building, 34 Chapel Street
Private Box 621, Tauranga
Phone (07) 578-8400 Fax (07) 577-9321

Palmerston North

292 Featherston Street
Private Box 149, Palmerston North
Phone (06) 358-0449 Fax (06) 356-7794

Wellington

Level 9, St Paul's Square, 45 Pipitea Street
Private Box 99, Wellington
Phone (04) 496-3099 Fax (04) 496-3195

Christchurch

2nd Floor, Charles Luney House, 250 Oxford Terrace
Private Box 2, Christchurch
Phone (03) 379-8774 Fax (03) 377-0167

Dunedin

Level 5, Forsyth Barr House, 165 Stuart Street
Private Box 232, Dunedin
Phone (03) 477-0657 Fax (03) 479-0447



Appendix 2

Reports Issued During The Year Ended 30 June 2003

Reports to Parliament

General Reports of the Controller and Auditor-General

Local Government: Results of the 2000-01 Audits – B.29[02c]	17/9/02
Central Government: Results of the 2001-02 Audits – B.29[03a]	12/6/03

Programmed Special Reports

Managing the Relationship Between a Local Authority's Elected Members and its Chief Executive	31/7/02
Local Authority Involvement in Economic Development Initiatives – Choices for Successful Management	30/8/02
Ministry of Agriculture and Forestry: Management of Biosecurity Risks	27/11/02
Management of Biosecurity Risks: Case Studies	23/12/02
Department of Conservation: Administration of the Conservation Services Programme	23/12/02
New Zealand Defence Force: Deployment to East Timor – <i>Performance of the Helicopter Detachment</i>	23/12/02
New Zealand Defence Force: Deployment to East Timor – <i>Performance of the Health Support Services</i>	14/2/03
Management of Hospital-acquired Infection	25/6/03



Unprogrammed Investigation Reports

Certain Matters Arising from Allegations of Impropriety at Transend Worldwide Limited	16/12/02
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Accountability Reports of the Audit Office

Annual Report 2001-02 – B.28	3/10/02
Draft Annual Plan 2003-04	28/3/03
Annual Plan 2003-04 – B.28AP(03)	15/5/03

Other Reports And Publications

Unprogrammed Investigation Reports

Various Matters Relating to Financial Management and Governance at Cambridge High School	28/11/02
Various Matters Relating to Financial Management and Governance at Southland Girls' High School	1/4/03
ACT Parliamentary Party Wellington Out-of-Parliament Offices	30/5/03
Disposal of 17 Kelly Street by Institute of Environmental Science and Research Limited	10/6/03

Other

<i>All about ...</i> The Controller and Auditor-General	13/12/02
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Most of these reports and publications can be viewed on our web site (www.oag.govt.nz).

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Appendix 3

Entities Audited Under Section 19 of the Public Audit Act 2001

Section 37(2)(c) of the Public Audit Act requires us to include in the Annual Report a list of entities audited by the Auditor-General under an arrangement in accordance with section 19 of the Act.

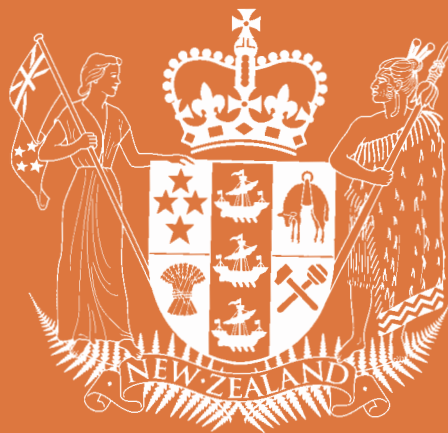
As this report was published, arrangements had been entered into for the following audits:

- Campus Services Limited
- Chatham Islands Enterprise Trust
- Colonial Arms Tavern JV and Te Punawai Hotel
- Corporate Property Investments Limited
- Enterprise Hamilton Trust Board
- France Trust
- Hutt Minoh House Friendship Trust
- Industrial Relations Foundation
- Kahungunu Executive Charitable Trust
- Lakes Ophthalmic Services Limited
- Literacy Aotearoa
- Māori Education Trust
- Matawiwi Tauatoru Limited
- Ngati Whatua O Orakei Corporate Limited
- Ngati Whatua O Orakei Health and Social Needs Limited
- Ngati Whatua O Orakei Health Clinic Limited
- Orakei Management Services Limited



- Orakei Retirement Care Limited
- Student Services Trust Massey @ Wellington
- Tararua Foundation
- Te Runanga O Kirikiriroa Trust Board
- The Quit Group
- T P M Education & Training Centre Limited
- Unipol Recreation Limited
- University Union Limited
- Waikato Polytechnic Student Residence Trust Board
- Wellington Polytechnic Students Association (WePSA)





Controller and Auditor-General
Tumuaki o te Mana Arotake

Annual Report 2002-03