

- 1.1 The Audit Office issued its audit report on the *Financial Statements of the Government of New Zealand for the Year Ended 30 June 2002* (the *Financial Statements*) on 13 September 2002. This is the same date on which the Treasurer and Minister of Finance, and the Secretary to the Treasury, signed their Statement of Responsibility for the *Financial Statements*.

Unqualified Opinion Issued

- 1.2 The audit report appears on pages 18-19 of the *Financial Statements*. The report includes our unqualified opinion that those statements:
- *comply with generally accepted accounting practice; and*
 - *fairly reflect –*
 - *the results of operations and cash flows for the year ended 30 June 2002; and*
 - *the financial position as at 30 June 2002.*
- 1.3 As in previous years, the Treasury has provided a comprehensive commentary on the financial performance and position, which is presented on pages 6-15 of the *Financial Statements*.
- 1.4 In addition to that commentary, we draw attention to the following significant items reflected in the reported results.

Valuation Issues

Department of Conservation Assets

- 1.5 In our 2001 report, we drew attention to the Department of Conservation (DOC) not having included visitor assets (such as huts and tracks) in the valuation of the Conservation Estate.¹ During 2001-02, DOC completed a

¹ *Central Government: Results of the 2000-01 Audits*, parliamentary paper B.29[01b], pages 13-14.

valuation of these assets and obtained a capital contribution from the Crown to bring the assets into its statement of financial position.

- 1.6 Using the transitional provisions of FRS-3 *Accounting for Property, Plant and Equipment*, the visitor assets were recognised at a value of \$197 million in the *Financial Statements* as an adjustment to equity and in DOC's own financial report. In our opinion, that value was less than it should have been. The difference was not material to the *Financial Statements*, but was material to DOC's financial report.²
- 1.7 During the 2001-02 audit, a further omission was identified – the value of boundary fences on the Crown Conservation Estate. This omission entailed a mixture of ownership and valuation implications that were not resolved in time for the value of the fences to be recognised in the *Financial Statements* as at 30 June 2002. The omission is reported in Note 11 to the *Financial Statements* (page 79).
- 1.8 For the same reason, no value for the fences was recognised in DOC's financial report.³
- 1.9 We understand that DOC will be undertaking an exercise to collect information on fences that will allow accurate recording and valuation of these assets. Ownership issues will also need to be resolved. This exercise must be completed in time to recognise these assets in the 2002-03 *Financial Statements*. If this is not achieved, the omission has the potential to affect our audit opinion on those *Financial Statements*.
- 1.10 Another significant issue that arose in the 2002 audit was the valuation of national parks, which were valued using the 30 June 2002 rateable valuations. Under FRS-3, rateable valuations are acceptable only if an independent valuer has confirmed the basis of valuation as appropriate. The valuer's confirmation was received in the final days before finalising the 2001-02 *Financial Statements*. However, the valuer identified duplicate assets in the rateable valuation records, which resulted in a late adjustment to reduce the carrying value of the national parks by \$200 million.

2 Consequently, our audit opinion on DOC's financial report was qualified accordingly. See more detailed comment in paragraph 2.6 on page 26.

3 Our audit opinion on DOC's financial report was qualified on this account as well.

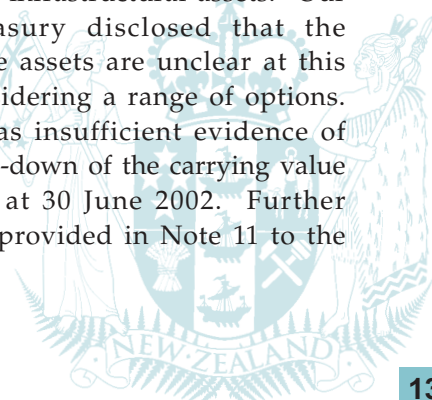
- 1.11 We have recommended that the Treasury work with DOC to ensure that asset ownership and valuation issues are resolved for the 2002-03 *Financial Statements*. We also recommended that the Treasury review DOC's capability to address these issues.

Crown Research Institute Databases and Reference Collections

- 1.12 Crown Research Institute (CRI) databases and reference collections are held and managed by CRIs but are included in neither their nor the Crown's statement of financial position (they were transferred from the Crown to the CRIs at nil value in 1992). There are issues relating to the ownership and valuation of these assets. Insufficient information was available in order to provide a reliable value of these assets for recognition in the 2001-02 *Financial Statements*. Additional disclosure is made in Note 11 to the *Financial Statements* drawing attention to the non-recognition of these assets (page 79).
- 1.13 It is important that the valuation and ownership issues affecting these assets are resolved to enable them to be accurately recorded in the 2002-03 financial statements of CRIs and the Crown. We will continue to monitor progress in recognising the assets during 2002-03.

Auckland Rail Corridor

- 1.14 We reviewed the accounting treatment to record the acquisition by the Crown of the Auckland rail corridor lease and associated infrastructural assets. Our discussions with the Treasury disclosed that the Crown's intentions for these assets are unclear at this stage and the Crown is considering a range of options. We concluded that there was insufficient evidence of impairment to require a write-down of the carrying value of the asset of \$81 million at 30 June 2002. Further disclosure on this has been provided in Note 11 to the *Financial Statements* (page 79).



- 1.15 The accounting treatment will need to reflect the final intentions of the Crown and we have asked the Treasury to keep us informed. When sufficient certainty is reached on those intentions, the accounting treatment of the existing \$81 million asset can be determined.

Tertiary Education Institutions – Crown-owned Land and Buildings

- 1.16 We identified a question of asset valuation affecting tertiary education institutions' Crown-owned land and buildings that needed to be addressed early in the 2002-03 year. These assets had been revalued to rateable value in prior years and were due for revaluation at 31 December 2002. The appropriate valuation methodology to be used as at that date needed careful consideration.
- 1.17 We recommended that the Treasury work with the Ministry of Education to ensure that these assets were valued in accordance with FRS-3.

Consolidation Issues

Preparation for Full Consolidation – General Observations

- 1.18 For 2001-02, significant additional reporting requirements were put in place for Crown entities and State-owned Enterprises (SOEs) to enable the Treasury to produce financial statements on both the modified equity basis and the full consolidation basis (for 1 July 2002 opening balances and full consolidation comparatives for the 2002-03 *Financial Statements*). Meeting these additional reporting requirements within the tight timetable required for production of the *Financial Statements* posed significant challenges for entities and their auditors. In general, the additional reporting went well – the exception was district health boards (see paragraphs 1.24-1.28).

- 1.19 The implementation of line-by-line consolidation for Crown entities and SOEs in 2002-03 means that these entities will need to provide information for the *Financial Statements* on a basis consistent with Crown accounting policies. We have discussed the implications of this requirement with the Treasury, with particular reference to entities such as district health boards that do not currently revalue land and buildings and will need to do so at 30 June 2003.
- 1.20 We will continue to work with the Treasury to ensure that the transition to fully consolidated *Financial Statements* goes as smoothly as possible for all involved.

Consolidation of Tertiary Education Institutions

- 1.21 We are concerned that the status of tertiary education institutions (TEIs) in terms of Crown control (and, therefore, consolidation into the *Financial Statements* under FRS-37 *Consolidating Investments in Subsidiaries*) has not been resolved. We were involved in discussions with the Treasury on this matter in November 2001.
- 1.22 The matter is complex and the inability of the Crown and the TEIs to reach consensus on it reflects the lack of clarity about the nature of the legislative relationship between the Crown and TEIs (especially universities) and how the relationship is to be interpreted under FRS-37. While we appreciate the difficulty in resolving the matter, we are concerned about the impact on the 2002-03 *Financial Statements* if it is not resolved.
- 1.23 The Treasury has initiated discussions with parties concerned in order to make progress and take the necessary action to resolve this matter.

Ministry of Health – Consolidation of District Health Boards

- 1.24 We encountered problems in obtaining assurance over the accuracy of the consolidated results of the district health boards (DHBs). This information is consolidated

and reported to the Treasury by the Ministry of Health (the Ministry), based on information reported to the Ministry by the individual DHBs. The main problems that arose were:

- Treasury reporting templates not being completed properly by DHBs to include all information required for the *Financial Statements* (e.g. commitments and inter-entity transactions); and
- a lack of appropriate quality control by the Ministry (and the DHBs themselves) over the information reported by individual DHBs.

1.25 Although we were able to gain assurance that the DHB information needed for the *Financial Statements* on a modified equity basis was materially correct, we have not been able to gain assurance as to the accuracy of the other information needed for full consolidation purposes. We will work with the Treasury to gain the assurance we need to be satisfied as to the accuracy of the opening full consolidation position and the comparative figures to be used in the 2002-03 *Financial Statements*.

1.26 A further issue that arose was how reporting for the Treasury was handled from a DHB governance perspective. Some DHB boards signed off the Treasury reporting; others did not. This contributed to delays in reporting.

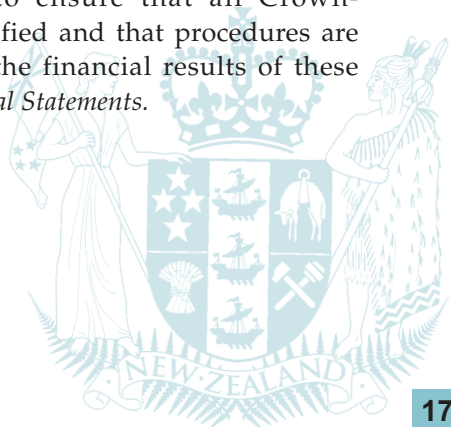
1.27 There appears to be a problem with the timing and accuracy of reporting by DHBs. We noted some variances between the initial reporting of results by DHBs and consolidation clearance, that indicate a need for greater attention and leadership in DHB reporting.

1.28 We have recommended that the processes used to collect the consolidation information be reviewed to ensure that DHB reporting is timely and accurate for *Financial Statements* reporting purposes.



*Financial Reporting Standard No. 37:
Consolidating Investments in Subsidiaries*

- 1.29 FRS-37 will come into effect for the 30 June 2003 *Financial Statements*, and is a main impetus behind the switch to fully consolidated financial statements. One major impact of FRS-37 will be in clarifying which entities are under the “control” of the Crown and, therefore, need to be consolidated in the *Financial Statements*.
- 1.30 From the work done to date on full consolidation, the outstanding issues that remain relate to whether the Crown controls TEIs (see paragraphs 1.21-1.23) and the National Provident Fund.
- 1.31 There are likely to be other entities that meet the definition of “control” and may need to be brought into the *Financial Statements* as Crown-controlled entities – as opposed to entities controlled directly by Crown entities and State-owned Enterprises that will be incorporated in the *Financial Statements* through the audited consolidated returns from the individual entities.
- 1.32 Crown-controlled entities will be entities controlled by Government departments or Ministers; for example:
- New Zealand Historic Places Trust
 - New Zealand Council for Educational Research
 - Armed Forces Canteen Council
 - Various trusts with trustees appointed by Ministers (such as the National Pacific Radio Trust).
- 1.33 The Treasury will need to ensure that all Crown-controlled entities are identified and that procedures are established to incorporate the financial results of these entities in the 2002-03 *Financial Statements*.



- 1.34 We have been identifying entities that meet the definition of a “public entity” under the Public Audit Act 2001 (the Public Audit Act definition includes consideration of control under FRS-37). We will work with the Treasury to identify Crown-controlled entities and (wherever possible) share information as to entities likely to be controlled.
- 1.35 We have recommended to the Treasury that it conduct a complete review of Crown-controlled entities for consolidation into the 2002-03 *Financial Statements*.

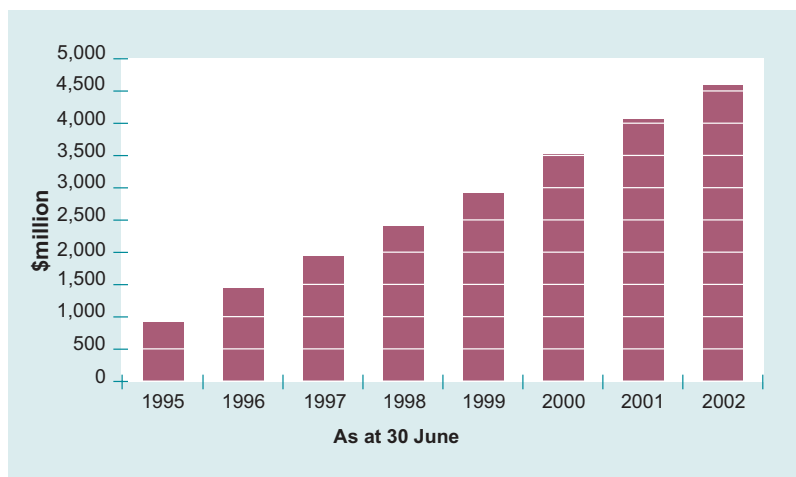
Other Issues

Student Loan Debt Valuation

- 1.36 In our 2001 report we again raised concerns as to the valuation of the outstanding balance of student loan debt and, in particular, the methodology used to determine how much represents doubtful debts.⁴ We recommended that the Treasury change to an actuarial basis of valuation as soon as possible.
- 1.37 Although an actuarial valuation of student loan debt is not yet available, substantial progress was made during 2001-02. A review of the current methodology to determine doubtful debts was completed – which concluded that, as at 30 June 2002, the provision for doubtful debts should be increased from 10% to 11.4%. We were satisfied with the review process and an adjustment was made in the *Financial Statements*, increasing the provision by \$75 million.
- 1.38 The inter-departmental steering committee continued to operate, and we understand that the Department of Statistics is currently working on a database that will integrate the information to allow an actuarial valuation to be undertaken. We understand the target is to have this information ready for the 2002-03 *Financial Statements*, and the intention is to disclose the actuarial valuation in those statements.

⁴ *Central Government: Results of the 2000-01 Audits*, parliamentary paper B.29[01b], pages 12-13.

Figure 1.1
Student Loan Debt 1995-2002



- 1.39 Figure 1.1 above represents student loan debt in net terms, after writing off bad debts and making a provision for doubtful debts. Total loans outstanding at 30 June 2002 were \$5,386 million, and provisions for doubtful debts and interest write-offs were \$637 million – giving a net loan asset value of \$4,749 million.
- 1.40 The movement in the debt and further information on the provisions is outlined on page 67 of the *Financial Statements*.
- 1.41 We discuss the subject of accountability information about student loans in Part 7 on pages 75-94.

Financial Reporting Standard No. 15: Provisions, Contingent Liabilities and Contingent Assets

- 1.42 In our 2001 report, we highlighted the need for the *Financial Statements* to comply with the new Financial Reporting Standard No. 15: *Provisions, Contingent Liabilities and Contingent Assets* (FRS-15), and in particular the need to identify and account for environmental obligations with respect to landholdings.⁵

⁵ Ibid., pages 14-15.

- 1.43 In general, we were satisfied with the work done to identify and account for environmental obligations. We note, however, that some departments (such as Land Information New Zealand) used a pilot study to extrapolate information for recognition in the 2001-02 *Financial Statements*. The identification of liabilities will be an ongoing process as departments continue to refine their data sets.
- 1.44 An aspect about which we have remaining concern is the accounting for liabilities for cleaning up abandoned contaminated land (“orphan sites”). We understand that the current approach adopted by the Ministry for the Environment to account for orphan sites is to recognise a liability for the annual amount of funding provided to the local authority when the funding agreement for cleaning up the site is signed with the relevant local authority. In our view, under FRS-15 the liability for the full (not just annual) agreed contribution should be recognised when the obligation (actual or constructive) arises. We are having discussions with the Ministry for the Environment to resolve this matter.
- 1.45 We have recommended to the Treasury that it maintain an active interest in the resolution of how orphan sites should be accounted for. We will continue to monitor progress in 2002-03.

Accounting for Financial Instruments

- 1.46 There are a number of respects in which the Crown’s financial reporting policies and disclosures for financial instruments need to be reviewed to ensure that they take account of international accounting developments while also continuing to comply with generally accepted accounting practice. In particular, the following matters have been raised as requiring consideration:

- netting off receivables and payables in asset and liability swap balances;
- netting off off-balance sheet instruments’ revaluations against the principal values of balance sheet items;

- inconsistencies between the accounting treatment of foreign currency debt (at modified historical cost) and foreign currency assets (at market value);
- whether all tactical trading activities should be reported on a mark-to-market basis; and
- whether swap establishment fees should be amortised rather than expensed.

1.47 We understand that the Treasury and its New Zealand Debt Management Office are planning to review the Crown's accounting policies for financial instruments during 2002-03. This review will need to take into account developments in standards on accounting for financial instruments.

1.48 We have recommended that the review of the accounting treatment for financial instruments be undertaken as soon as possible and completed in time for amended treatments to be used in the 2002-03 *Financial Statements*.

Net Present Values and Discounting Methodologies

1.49 A number of government departments are responsible for sizeable debt (asset) portfolios where the debts are of such a nature that collection takes place over a significant period of time. Student loan debt is one example of this and, as discussed above, progress is being made in determining the valuation of the student loan debt on an actuarial basis.

1.50 There are, however, other sizeable debts valued on a historical cost basis with no adjustment for the financial impacts of a potentially lengthy collection period (i.e. they are not accounted for at net present value). Examples of large debt balances where it may be appropriate to discount for the time value of money include:

- Ministry of Social Development – \$800 million Crown debt (e.g. benefit recoveries); and
- Department for Courts – \$315 million of unpaid fines.

- 1.51 We have recommended that the Treasury provide guidance on the discounting of assets and liabilities to ensure consistent treatment in the 2002-03 *Financial Statements* and beyond.

Trust Money

- 1.52 The *Financial Statements* include a Statement of Trust Money (pages 51-52) as required by section 27 of the Public Finance Act 1989. We believe that, to comply with generally accepted accounting practice, some of the trust money receipts and payments should be accounted for in the Crown Statement of Financial Performance, and that the balances of some of the funds should be included in the Crown Statement of Financial Position.
- 1.53 We have recommended to the Treasury that it review the Statement of Trust Money and provide guidance to departments as to the type of funds that are appropriately disclosed as trust money.

Air New Zealand Limited

- 1.54 We reviewed the accounting treatment to record the acquisition of the majority stake in Air New Zealand Limited by the Crown (see Part Four on pages 45-48), including goodwill. We also reviewed the adjustments made to Air New Zealand's financial statements to comply with Crown accounting policies. There were no major issues raised as a result of our review.

