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15 August 2006

Mr Kevin Brady
The Controller and Auditor-General
P O Box 3928
WELLINGTON

Dear Mr Brady

ANNUAL REPORT OF THE INDEPENDENT REVIEW OF AUDIT ALLOCATION AND TENDERING PROCESSES

1. You have retained me as an independent evaluator of the basis upon which auditors are appointed to act on your behalf. This is the fourth year in which I have been retained for that purpose.
2. This is my report on those processes for the financial year ended 30 June 2006. I confirm that I am independent of the Office of the Auditor-General (OAG), Audit New Zealand and all private sector audit firms.
3. My instructions require me to evaluate the processes involved and to report upon the probity and objectivity with which they are implemented. No limitation has been placed upon the manner in which I carry out my assignment.
4. There are three distinct types of process:
 - (a) an allocation made by the Auditor-General of an auditor for a given entity, in accordance with "the audit allocation model";
 - (b) an appointment of an auditor following a contestable tender; and
 - (c) a re-appointment for a further term of an approved auditor's contract to audit a particular entity.
5. In the past financial year, extensive use has been made of the re-appointment of existing auditors. The preceding section of this annual report describes the position in part:
 - (a) For the reasons specified, the auditors of 2,272 state and integrated state schools were re-appointed for one year, with audit fees being agreed with each board of trustees. In the case of 192 state and integrated state schools, a new auditor was appointed. This was effectively an allocation, though the OAG worked with each board of trustees to establish agreement as to the new auditor and as to the level of the audit fee.

- (b) At the end of May this year, the Auditor-General initiated a process for settling the arrangements as to state and integrated state school audits for the next three years. That process is an extensive one, and will not be concluded before December of this year.
 - (c) Apart from the audits for schools, the Auditor-General re-appointed existing auditors in respect of 162 public entities and their subsidiaries.
6. In the case of 17 of those 162 public entities, questions were raised by them about the appropriateness of the fee proposed by the appointed auditor:
- (a) In every such case, the OAG provided the entity with an analysis of the fee proposed. Those analyses dealt with factors which were likely to have influenced the level of the fee proposed, and set out current market parameters for fees in comparable cases.
 - (b) The provision of information of this kind facilitated agreement on fees in all cases.
 - (c) The information that is now provided by the OAG to enable an informed appreciation of relevant fee levels and their appropriateness has become much more extensive and sophisticated. It has clearly been of considerable assistance both to the entities and to the auditors involved.
 - (d) The OAG is seeking to ensure that the scope, validity and usefulness of the information as to fee levels continue to improve. This process should help to provide an assurance to the auditors that there is a fair return for their services, and an assurance to the entities, and to the public generally, that a sufficient but not excessive level of resources is being committed to obtaining an effective audit.
7. The allocation of an auditor by way of competitive tender is now largely reserved for those public entities which have a strong commercial focus and where a change of auditor is required. In the past financial year, that process was used on only one occasion:
- (a) The company was one which is involved in the energy sector. As is usual, a panel was established to advise the Auditor-General, with a representative of the entity, a representative of the Auditor-General and an experienced independent chair. The panel's recommendation as to the most suitable tender was unanimous, and was accepted by the Auditor-General.
 - (b) I did not monitor the meeting of the panel, but I did review the papers. I consider that the panel acted on a way that was robust, rational and appropriate.
8. During the course of the financial year, I have been supplied by the OAG with a range of information about the relevant processes. I have also sought additional information and have made particular enquiries. In all cases, my enquiries have been responded to fully and professionally.
9. I now state my overall conclusions. On the basis of the written material I have seen and the explanations I have been given, I consider that the processes adopted by you and by the OAG on your behalf in relation to the renewal, allocation and tendering of audits falling within your mandate during the financial year to 30 June 2006 have been appropriate for their purpose, and have been applied in a way which is consistently fair and appropriate, having regard to the rights, interests and obligations of the parties concerned.

3

10. That observation applies both to the way in which auditors have been appointed or re-appointed, and to the way in which enquiries as to that process, or as to the appropriateness of a proposed audit fee, have been dealt with.
11. Taking everything into account, my conclusion is that the processes by which audits in the public sector have been allocated and fees have been set in the financial year to 30 June 2006 have been carried out with due probity and objectivity.

Yours faithfully



David Gascoigne DCNZM CBE LLM