



B.29[08a]

Parliamentary paper

Central
government:
Results of the
2006/07 audits





Office of the Auditor-General
Private Box 3928, Wellington

Telephone: (04) 917 1500
Facsimile: (04) 917 1549

Email: reports@oag.govt.nz
www.oag.govt.nz

Central government: Results of the 2006/07 audits

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

May 2008

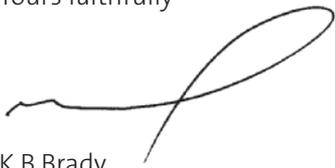
ISBN 978-0-478-32602-4

Hon Margaret Wilson MP
Speaker
House of Representatives
WELLINGTON

Madam Speaker

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

Yours faithfully

A handwritten signature in black ink, consisting of a horizontal line that curves upwards and loops back to the right.

K B Brady
Controller and Auditor-General

Wellington

13 May 2008

Contents

Introduction	5
Section 1: Government Financial Statements and the transition to NZ IFRS	
Part 1 – Matters arising from the audit of the 2006/07 Financial Statements of the Government	7
Part 2 – Transition to New Zealand equivalents to International Financial Reporting Standards	19
Section 2: Results of, and matters arising from, our 2006/07 audits	
Part 3 – Assessing entities’ environment, systems, and controls	27
Part 4 – Procurement, grants, and other funding arrangements	33
Part 5 – Statements of intent and our intentions with service performance information	41
Part 6 – The Controller function and the appropriation audit	47
Part 7 – Non-standard audit reports issued in 2007	53
Part 8 – Status of Māori Trust Board audits	61
Section 3: Good practice guides	
Part 9 – Auditor-General’s good practice guides	65
Part 10 – Audit committees	69
Section 4: Other work	
Part 11 – Department of Corrections’ consultation processes for new regional prisons	71
Appendices	
Appendix 1 – Our work on service performance information in 2007/08	85
Appendix 2 – Details of the non-standard audit reports issued in 2007	87
Figures	
1 Grading scale for assessment of environment, systems, and controls	29
2 Summary of grades for 2006/07	31
3 Our findings on the 2007/08 Statements of Intent we reviewed	44
4 Categories of unappropriated expenditure during 2006/07, by number of instances and number of departments	49
5 Deciding on the appropriate form of audit report	55
6 Status of Māori Trust Board audits 2004-2007	63
7 New prisons completed 2005-2007	71

Introduction

This is our report on the 2006/07 audits of the central government sector.

The purposes of this report are to:

- report on the 2006/07 audit of the Government reporting entity and its sub-entities – as reflected in the *Financial Statements of the Government of New Zealand for the Year Ended 30 June 2007*;¹
- report on the results of, and matters arising from, our 2006/07 audits of the central government sector; and
- raise other matters that we believe warrant consideration by Parliament.

Summary

Section 1 has two Parts:

- In **Part 1** we discuss the significant matters arising from the 2006/07 audit of the Government's financial statements, including our concerns with the performance of some entities in providing timely audited information to the Treasury for consolidation, and issues arising in the valuation of student loans.
- In **Part 2** we comment on our increasing unease with the appropriateness of New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) for the public sector, and report on progress made by the central government sector towards preparing the first set of financial statements in accordance with NZ IFRS.

Section 2 has six Parts dealing with the results of, and matters arising from, our 2006/07 audits of the central government sector.

- In **Part 3** we report on our 2006/07 assessments of central government entities' environment, systems, and controls. We note that many government departments and district health boards received a "needs improvement" grade for either the management control environment or the financial information systems and controls.
- In **Part 4** we discuss the range of funding arrangements in the public sector and the overarching principles that we see as relevant to managing such arrangements. We also discuss the findings from our work in 2006/07 on funding and procurement matters, and our expanding programme of work involving procurement, grants administration, and other funding arrangements.
- In **Part 5** we report on our review of 2007/08 statements of intent for government departments and many Crown entities. We comment on the disappointing quality of non-financial performance reporting and the need for it to significantly improve.

¹ Parliamentary paper B.11, published in 2007.

- In **Part 6** we briefly outline the public finance principles underpinning our Controller function and appropriation audit work, discuss the unappropriated expenditure for 2006/07, and report on some of the issues we have considered during the year.
- In **Part 7** we report on the non-standard audit reports issued during 2007 on the financial statements of public entities within our central government portfolio of audits. We report on school boards of trustees separately from the other public entities.
- In **Part 8** we discuss our concern about the continuing pattern of audit arrears in the Māori Trust Boards (MTBs) sector. We note our intention to continue to work directly with MTBs to bring these audits up to date as soon as possible.

Section 3 has two Parts:

- In **Part 9** we discuss our approach to producing good practice guidance and how we use it. We also list the good practice guides we have issued recently.
- In **Part 10** we discuss our most recent guide on audit committees in the public sector.

Section 4 has one Part dealing with other work we have carried out.

- In **Part 11** we describe how the Department of Corrections set up and managed consultation processes during a project to build four new regional prisons. We discuss the systems, policies, and processes used to support consultation about the Spring Hill prison site in North Waikato, and some of the Department's earlier experiences with consultation about the Ngawha prison site in Northland.

Part 1

Matters arising from the audit of the 2006/07 Financial Statements of the Government

Introduction

- 1.01 The Auditor-General issued the audit report on the *Financial Statements of the Government of New Zealand for the Year Ended 30 June 2007* (the FSG or the financial statements) on 28 September 2007. This is the same date on which the Minister of Finance and the Secretary to the Treasury signed their Statement of Responsibility.
- 1.02 The audit report appears on pages 26-27 of the financial statements. The report includes our unqualified opinion that those statements:
- comply with generally accepted accounting practice in New Zealand; and
 - fairly reflect:
 - the Government of New Zealand's financial position as at 30 June 2007; and
 - the results of its operations and cash flows for the year ended on that date.
- 1.03 As in previous years, the Treasury has provided a comprehensive commentary on the financial statements, which is presented on pages 6-23 of the financial statements.

Significant matters arising from the 2006/07 audit

- 1.04 The significant matters that arose during the 2006/07 audit of the financial statements are listed below and discussed in this Part:
- the Treasury and sector performance (paragraphs 1.05-1.16);
 - valuation of student loans (paragraphs 1.17-1.28);
 - the Kyoto Protocol provision (paragraphs 1.29-1.37);
 - recognition of income tax revenue (paragraphs 1.38-1.44);
 - Accident Compensation Corporation – future claims liability valuation assumptions (paragraphs 1.45-1.50);
 - Statement of Borrowings – derivative movements (paragraphs 1.51-1.57);
 - valuation of rail network assets (paragraphs 1.58-1.60);
 - an audit committee for the FSG (paragraphs 1.61-1.67); and
 - Financial Reporting Standard No. 37: *Consolidating Investments in Subsidiaries* (paragraphs 1.68-1.70).

The Treasury and sector performance

- 1.05 Under section 30(1) of the Public Finance Act 1989, the Treasury is required to provide the annual FSG to the Auditor-General by the end of August. This year, the Treasury provided us the draft of the FSG, which was substantially complete, on 31 August.

- 1.06 However, there were a number of material audit issues that were not resolved until late September. These issues put at risk our ability to achieve the statutory requirement under section 30(2) of the Public Finance Act 1989 to issue our audit opinion within 30 days of receiving the FSG from the Treasury.
- 1.07 We are concerned about the performance of some entities in providing financial information to the Treasury for consolidation into the FSG. Some of these entities reported crucial financial information to the Treasury well outside the agreed time frames and did not address important issues in a timely manner.
- 1.08 The departments and Crown entities that provided information significantly late to the Treasury or that had significant delays in achieving audit clearance on their consolidation information for the FSG included:
- Inland Revenue Department (IRD) – Audit clearance on all aspects of IRD’s reporting to the Treasury was achieved only in late September. A number of significant issues arose in the audit of the student loans valuation. Material correcting adjustments were necessary, and audit clearance for consolidation was achieved on 27 September (see our discussion on student loans in paragraphs 1.17-1.28).
 - Ministry for the Environment (MfE) – MfE is responsible for reporting the Government’s liability under the Kyoto Protocol. Final audit clearance on the Kyoto Protocol provision was achieved only in late September due to delays in providing the net position to the auditors and the complexity of the issues to consider (see our discussion on the Kyoto Protocol provision in paragraphs 1.29-1.37).
 - Ministry of Education (MOE) – The MOE audit clearance was delayed significantly due to late completion of the revaluation of school land and buildings and the time taken to resolve issues identified by our auditor.
 - ONTRACK – The audit clearance on the valuation of the rail network assets was delayed due to a number of late adjustments (see our discussion on valuation of rail network assets in paragraphs 1.58-1.60).
 - Ministry of Social Development (MSD) – MSD administers benefit recovery debt. Audit clearance on the fair value of benefit debt was obtained on 18 September because of the late delivery of workpapers to the auditors.
- 1.09 The performance of these entities put at risk the timely completion and publication of the audited FSG.
- 1.10 We recognise that these entities are dealing with very complex public sector accounting issues or complex physical asset valuations. Applying commercially based accounting standards to these issues can be very challenging, and for a

number of the issues external experts were engaged to perform valuations or provide advice.

- 1.11 Determining the fair value of non-commercial financial assets has caused particular challenges. With the Government reporting entity's transition to reporting in accordance with the New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) for the year to 30 June 2008 (see Part 2 of this report), fair value determinations will become increasingly important.
- 1.12 Given the complexity of the issues involved and the apparent difficulties in meeting established time frames, we are of the view that the timetable for these key financial or physical asset (or liability) valuation exercises needs to be reviewed. Earlier completion of these valuations would provide more time to properly resolve any issues arising without risking the timetable for completing the FSG.
- 1.13 In most if not all cases, we believe that the valuation can be substantially performed at a date earlier than 30 June (for example, 31 March or 31 May), with a subsequent roll forward to 30 June.
- 1.14 These issues also raise some concerns about the capacity of, and capability in, the finance functions of central government agencies. As we have noted, the issues have been very complex. In a number of cases, the agencies have realised that they need external expert assistance to enable them to complete their reporting obligations. However, the sector needs to have the capability to understand and adequately review and challenge the experts' work.
- 1.15 With the transition to NZ IFRS, the complexity of accounting will increase, and the capacity and capability of central government finance functions will continue to be tested.
- 1.16 We have recommended that the Treasury engage further with chief executives and boards (where relevant) about:
- the need to meet the set timetables for reporting financial information to the Treasury for consolidation and for providing this information and supporting information to auditors;
 - the capacity of, and capability in, departmental finance teams to deal with complex financial reporting issues; and
 - the need to bring forward the timetables for the valuation of key financial and physical assets (and liabilities).

Valuation of student loans

- 1.17 Student loans are recognised in the 2007 FSG at a carrying value of \$6.01 billion (2006: \$5.56 billion). Note 9 to the FSG provides detailed disclosures about student loans.
- 1.18 A number of significant issues arose in the audit of the student loans balance, and our auditor was not able to sign off on the accuracy of the student loan book value and disclosures until 27 September, the day before the audit report on the FSG was signed.
- 1.19 The accounting policy for student loans is to account for them as “loans and receivables” under NZ IAS¹ 39: *Financial Instruments: Recognition and Measurement*. This policy was adopted in the year ended 30 June 2006 because of the introduction of the interest-free policy for student loans and concerns that the fair value of student loans would drop significantly below their carrying value. This accounting policy requires initial recognition at fair value followed by subsequent measurement at amortised cost using the effective interest rate method.
- 1.20 The student loans book value and fair value (for disclosure) are generated using complex actuarial models. The actuary for the three departments jointly responsible for student loans administration developed these models. The departments are:
- the Ministry of Education (MOE), which provides policy advice and tertiary education data for the valuation models, and manages the contract with the actuary;
 - the Ministry of Social Development (MSD), which assesses applications, makes student loan payments, and provides data on borrowing for the actuarial models; and
 - the Inland Revenue Department (IRD), which manages the collection of loan repayments and provides data on loan repayments and balances for the actuarial models.
- 1.21 The accounting for student loans is split between MSD and IRD. MSD records all new borrowings and then transfers the accounts to IRD annually in February. This means that, as at 30 June, both MSD and IRD have student loan balances to account for. The complexity of the institutional arrangements for administering student loans provides an additional complication to our audit.
- 1.22 The most significant audit issue arose when we considered the Treasury’s and IRD’s explanations for the difference between the proposed student loan book value and proposed fair value. The fair value was \$1.468 billion lower than the book value in the initial valuation reports from the actuary. Most of this difference

1 New Zealand equivalent to International Accounting Standard.

was because revised risk margins were applied to the discount rate used to calculate the fair value to reflect the payment volatility of borrowers repaying less than their payment obligations (based on their income).

- 1.23 The way the actuary's methodology for the fair value model determines the premiums for expected default loss and the risk premium that are applied to the risk free discount rate has changed this year. The actuary's report highlighted that the changed methodologies were necessary because the data analysis during the year demonstrated that actual "repayments made by many borrowers are significantly less than their repayment obligations". The issue of borrowers repaying less than their repayment obligations (for example, because of supplying incorrect tax codes) was an issue that our management report identified and reported after the 2006 audit.
- 1.24 Our view was that the identified underpayments by borrowers that affected the fair value so significantly should also raise concern about the appropriateness of the book value.
- 1.25 At our request, the Treasury, with IRD and the actuary, investigated these issues further. This resulted in the Treasury proposing adjustments to decrease the book value of student loans by \$300 million and to increase the disclosed fair value of student loans by \$600 million.
- 1.26 These adjustments reduced the difference between book value and fair value to \$568 million (with book value being higher). This remaining difference is due to the increase in market risk-free interest rates (which have reduced the fair value but do not affect the book value) and revised assessments of expected future credit losses (which are allowed for in the fair value model, but are not accounted for in the book value model).
- 1.27 The late adjustments were determined outside the complex actuarial models and are estimations of the correcting entries required to ensure that the amounts recognised are in accordance with accounting standards. The written representations that we received from the actuary and the Treasury and our detailed audit work provided us with enough audit evidence to conclude that the book value and fair value are materially correctly stated and that the difference between the two values does not represent an impairment of the student loan asset. However, significant further work will be required on the models to ensure that they are robust and can be relied on for future financial reporting.
- 1.28 Given the significance and complexity of the student loan receivable valuation and to ensure that we avoid similar issues in 2008, we have recommended that:
- the Treasury and the three departments jointly responsible for student loans administration review the timing of the actuarial valuation processes

that determine the book value and fair value of student loans – completing the valuations before 30 June and then rolling them forward to year-end may provide more time to resolve the complex issues that may arise in the valuations; and

- another actuary carry out quality assurance review of the actuarial models and valuations on an annual basis, because of the complexity of the models and the significant effect on the values from changes in actuarial assumptions.

The Kyoto Protocol provision

- 1.29 New Zealand is a signatory to the Kyoto Protocol, which imposes binding emission reduction targets on New Zealand during the First Commitment Period (CP1) from 2008 to 2012.
- 1.30 A provision for New Zealand's net deficit position under the Kyoto Protocol for CP1 was first recognised in the 2005 FSG with a provision of \$310 million. The provision was revised to \$656 million in 2006, and increased to \$704 million in the 2007 FSG. Note 15 of the 2007 FSG provides detailed disclosure about the Kyoto Protocol provision. The Treasury has not recognised any provision or contingent liability for periods beyond 2012, because New Zealand currently has no specific obligations beyond CP1.
- 1.31 The provision is the Treasury's best estimate at this time. However, provisions by their nature are more uncertain than most other items in the Statement of Financial Position. It is likely that successive estimates will change as more updated information becomes available, better systems are implemented, or some uncertainties are reduced. Some of the aspects of the Kyoto Protocol provision that are subject to fluctuation over time include:
- the price for each tonne of carbon;
 - the exchange rate with the US dollar; and
 - the various assumptions underlying the calculation of the emissions and sinks (for example, forecasts of GDP, oil prices, availability of updated statistics).
- 1.32 Net removals of carbon through forest sinks are deducted from the projected emissions. The net removals through forests is reported after deducting 21 million tonnes for estimated deforestation. This estimate assumes policy interventions to give effect to the Government's policy to cap its liability at this amount. The FSG disclose that, without policy interventions and assuming current market conditions prevail, a deforestation intentions survey conducted in 2006 indicated likely deforestation of 41 million tonnes, which would result in an increase in the provision of \$310 million.

- 1.33 The Ministry for the Environment had an independent expert assess the reasonableness of the assumptions and methodologies underpinning the 2007 projections. The expert concluded that they were sound and reasonable, while making a number of recommendations and highlighting areas of risk.
- 1.34 The Government has agreed in principle that an Emissions Trading Scheme (ETS) will be implemented after 30 June 2007 as part of the Government's climate change response. The Treasury had stated that, at that stage, it was unable to quantify the likely effect of the ETS on the Government's Kyoto Protocol liability as the final decisions had not been made.
- 1.35 As discussed in paragraph 1.08, the audit of the Kyoto Protocol liability was completed later than expected due in part to the complexities of the issues under consideration, but also due to delays in providing the net Kyoto stocktake position to our auditor. The release of the stocktake position was delayed this year to enable officials to consider the effect on forecast agricultural emissions of the announcement in May 2007 by Fonterra Co-operative Group Limited of a significant increase in its forecast milk solids payout.
- 1.36 We have recommended that the Treasury and other relevant government agencies review the timetable for the annual Kyoto stocktake, with a view to providing the net position for audit by the end of June each year at the latest. This will ensure that enough time is available for audit assurance.
- 1.37 We have also recommended that the Ministry for the Environment and the Treasury take action on the recommendations from the independent expert's review, and carry out the work to quantify the effect of the ETS on the Kyoto Protocol liability.

Recognition of income tax revenue

- 1.38 Direct income tax revenue for the year to 30 June 2007 totalled \$36.89 billion. In recent years, we have raised a number of issues about revenue recognition policies for income tax, particularly the revenue recognition point for provisional tax and the treatment of payments into provisional tax pooling accounts.
- 1.39 Generally we have been pleased with the responses to the issues that we have raised, but there remain areas where revenue recognition policies need to be considered further. Given the large amounts involved, any change in revenue recognition policies can have significant effects on the FSG.
- 1.40 We have recommended that the Treasury and IRD consider two important issues further.

- 1.41 We recommended that the Treasury and IRD consider the potential for payments into provisional tax pooling accounts (which at 30 June 2007 total \$2.8 billion) to delay the recognition of provisional tax revenue in the monthly and annual FSG. Payments into pooling accounts are not recognised as revenue, whereas the same payments would be recognised as revenue if made into the individual taxpayers' accounts. Conceptually, provisional tax revenue should be recognised in the same period, regardless of whether the taxpayer uses tax pooling or not.
- 1.42 We also recommended that the Treasury and IRD consider whether provisional tax payments by taxpayers are a better indication of tax revenue for recognition purposes than provisional tax assessments, given that there are strong incentives (in terms of interest costs) for taxpayers to make accurate payments, but fewer incentives for taxpayers to make accurate self-assessments of provisional tax or to update assessments for income changes. Currently provisional tax payments are recognised as revenue only up to the time that a provisional tax assessment is issued. After the provisional tax assessment is issued, the tax assessed (less provisional tax payments made previously) is accrued as revenue, and payments made subsequently do not affect revenue recognition.
- 1.43 In addition, we note that, due to the planned alignment of provisional tax and GST, provisional tax will generally be paid later, may be paid more frequently, and could be paid in unequal instalments based on turnover. As a result, the calculation of the accrual for provisional tax revenue will need to be modified for next year.
- 1.44 We have recommended that the Treasury work with IRD to review provisional tax revenue recognition policies to ensure that they remain in line with generally accepted accounting practice and international best practice.

Accident Compensation Corporation – Future claims liability valuation assumptions

- 1.45 The claims liability of the Accident Compensation Corporation (ACC) represents the present value of future costs for accidents that have occurred before balance date and that are covered by ACC. The liability is valued each year by actuaries. As at 30 June 2007, the ACC claims liability was \$13.7 billion (2006: \$12.7 billion). Note 17 of the FSG provides detailed disclosure about the ACC claims liability.
- 1.46 In valuing the claims liability, the actuaries need to make a number of assumptions about future costs. One of these assumptions is referred to as the superimposed inflation rate, which is the increase in the cost of claims above the general inflation rate.

- 1.47 In determining the ACC claims liability at 30 June 2007, ACC adopted a long-term superimposed inflation assumption of 1% each year after five years for social rehabilitation for serious injury claims. The adequacy of the superimposed inflation assumption was subject to discussion between relevant parties, including the valuing actuary, the peer review actuary, and the actuary advising our auditor.
- 1.48 There is limited evidence to authoritatively support any particular level of superimposed inflation. Given the limited evidence, there was discussion among the various actuaries involved about the adequacy of this level. We have nevertheless accepted the 1% level because of the written representations that we have received from the valuing actuary and from the ACC Board who, between them, have the most detailed knowledge of ACC's rehabilitation costs.
- 1.49 However, we requested that the Treasury include some sensitivity analysis on superimposed inflation in Note 17 to the FSG. This discloses that a 1% movement in the superimposed inflation figure will affect the liability and the surplus by about \$450 million.
- 1.50 We have recommended that the Treasury work with ACC to improve the quality of information to support key actuarial assumptions in the ACC claims liability model.

Statement of Borrowings – derivative movements

- 1.51 Section 27 of the Public Finance Act 1989 requires the Treasury to include a Statement of Borrowings in the FSG. This statement is on page 37 of the FSG.
- 1.52 There are some large movements in the Statement of Borrowings between the 2006 and 2007 figures. These include US dollar debt moving from \$14.4 billion to negative \$3.9 billion, and US dollar securities moving from \$11.1 billion to negative \$10.9 billion.
- 1.53 These significant movements arise because derivative financial instruments (such as cross-currency interest rate swaps and forward foreign exchange contracts) are included within the statement balances. The New Zealand Debt Management Office manages derivative financial instruments. To give an accurate representation of debt by currency, the currency flows under these derivatives have been separated out and allocated to the relevant part of the statement.
- 1.54 There is no financial reporting standard that sets out how a Statement of Borrowings should be presented. The construction and presentation of the statement is consistent with previous years. The movements and negative balances arise from the effect of foreign exchange derivatives and the significant

changes in foreign exchange rates between the two years and the appreciation of the NZ dollar at the end of the financial year.

- 1.55 We have confirmed the accuracy of the figures presented in the statement. However, we do not believe that the statement as it is currently constructed is clear or informative to users.
- 1.56 We recommended that the Treasury reconsider the presentation of the Statement of Borrowings and particularly how to treat foreign exchange derivatives associated with borrowings in the statement, with a view to ensuring that the statement provides a clear and informative presentation of government borrowings, while meeting the requirements of the Public Finance Act.
- 1.57 We note that the Treasury has revised the presentation of the Statement of Borrowings in the FSG for the quarter ended 30 September 2007 (the first interim FSG reported under NZ IFRS). The revised format presents derivative balances separately from borrowings and financial assets, and no longer presents an analysis by currency.

Valuation of rail network assets

- 1.58 The accounting policy for rail network assets was changed to measurement at fair value rather than cost from 1 July 2006. This was done to provide a more current value of the rail network and to be more consistent with the approach taken for other significant items of property, plant, and equipment. The rail network assets were valued by an independent valuer on a depreciated replacement cost basis for the rail infrastructure and on a fair value of adjoining land basis for the land under the network. The revaluation was a complex exercise and resulted in an increase in the carrying value of rail network assets of \$10.3 billion.
- 1.59 Our auditor of ONTRACK audited the new valuation of rail network assets and confirmed that it is materially correct. The audit clearance for the FSG audit was delayed due to a number of late adjustments to the carrying value of the assets resulting from uncertainties about the ownership of some assets, impairment considerations, and additional assets being identified. The audit identified a number of weaknesses in ONTRACK's fixed asset records, and we have recommended that ONTRACK implement comprehensive fixed asset information and accounting systems.
- 1.60 As ONTRACK develops its knowledge of the assets it has taken over, and as its fixed asset information systems improve, the asset carrying values will probably be adjusted further.

An audit committee for the FSG

- 1.61 The FSG is an important document that provides a record of the Government's financial performance and position, and performance against the fiscal forecasts. As auditor of the FSG, we need to work with Treasury officials on many issues that arise. Mostly we work with officials within the Treasury's Fiscal Management and Reporting Cluster, although we raise significant issues about the FSG with the Secretary to the Treasury.
- 1.62 Most large public entities have set up an audit committee that has the function, among other things, of dealing with the auditor about the audit and any issues that arise. There is currently no audit committee providing oversight of the preparation and audit of the FSG.
- 1.63 In our view, some of the discussions that we have with Treasury staff about, for example, appropriate accounting policy choices for the Government or significant issues arising during the course of the audit would benefit from wider consideration through an audit committee.
- 1.64 As is best practice in public sector governance, we expect such an audit committee to include suitably experienced members independent of the Treasury.
- 1.65 An audit committee could also support the Secretary to the Treasury and the Minister of Finance in their statutory obligations under the Public Finance Act to sign the Statement of Responsibility for the FSG.
- 1.66 We note that some other jurisdictions have set up audit committees for their equivalents to the FSG, such as the Australian Government Financial Statements Audit Committee.
- 1.67 We have recommended that the Treasury investigate setting up an audit committee for the FSG.

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

- 1.68 Since 2003, the Treasury has equity accounted for tertiary education institutions (TEIs) in the FSG based on a 100% interest, rather than line-by-line, consolidation. This approach is based on a view that the control test in Financial Reporting Standard No. 37: *Consolidating Investments in Subsidiaries* (FRS-37) is not satisfied because the Crown does not have the ability to determine the financing and operating policies of TEIs, and that the Crown's relationship does not meet the "significant influence" test necessary for equity accounting. Note 13 to the FSG sets out the approach and the reasons for it.

- 1.69 Since 2003, we have expressed our view that line-by-line consolidation remains the treatment that best reflects the substance of the relationship between the Crown and TEIs, and the intent of FRS-37. However, we have accepted equity accounting for TEIs because the Crown arguably does not control TEIs according to a strict interpretation of the definition of control within FRS-37, and because of the additional disclosures provided in Note 13. With those additional disclosures, we have accepted that the financial statements remain fairly stated.
- 1.70 In July 2006, the Financial Reporting Standards Board (FRSB) issued Exposure Draft 109, which proposed that TEIs should be consolidated into the FSG as if they were wholly owned subsidiaries of the Government for the purposes of FRS-37. After considering submissions on the Exposure Draft, the FRSB decided not to proceed with the proposed amendments, but noted that it will consider the issue further during its consideration of the International Accounting Standards Board's proposals on consolidation. At this point in time, the status quo continues and is likely to do so for the 2008 financial year.

Part 2

Transition to New Zealand equivalents to International Financial Reporting Standards

2.1 In this Part, we:

- comment on our increasing unease with the appropriateness of New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) for the public sector; and
- report on progress made by the central government sector towards preparing the first set of financial statements in accordance with NZ IFRS.

Summary

2.2 We are becoming increasingly concerned about the credibility of NZ IFRS for the public sector. If appropriate and sensible changes are not made to NZ IFRS in the future, there is an increasing risk that the resulting set of standards will not be of high quality nor ultimately “fit for purpose” for the public sector.

2.3 We have raised our concerns with the chairman of the Accounting Standards Review Board (ASRB) because we consider that continuing with the current approach is not in the best interests of the public sector. We believe that the ASRB understands the nature of our concerns, and that the ASRB is trying to address the causes of the underlying problems within the current standard setting environment.

2.4 A considerable amount of work has been done to prepare for the 2008 Financial Statements of the Government (FSG). In general, good progress has been made with preparing the Government’s provisional NZ IFRS opening balance sheet and the provisional NZ IFRS comparative figures.

2.5 We have substantially completed our audits of these figures, but there are a few outstanding issues. There have been delays in the timetable for these audits because of the challenges of applying NZ IFRS to complex public sector issues, and some entities have not addressed NZ IFRS early enough to meet the Treasury’s timetable.

2.6 Unless the performance of central government entities in providing quality financial information to the Treasury within the agreed timetable improves significantly, we are concerned that the Treasury may not meet the statutory timetable for preparing the 2008 FSG.

2.7 Although many of the complex NZ IFRS issues have been dealt with during the transition process for the FSG, central government entities will also need to ensure that their own annual financial statements comply with the requirements of NZ IFRS.

Background

- 2.8 In December 2002, the ASRB announced its decision that New Zealand entities producing general purpose financial statements would be required to apply new standards based on International Financial Reporting Standards (IFRS) for reporting periods beginning on or after 1 January 2007. Entities were given the option to apply the new standards from reporting periods beginning on or after 1 January 2005.
- 2.9 In August 2003, the Government announced that NZ IFRS would be implemented in the FSG as part of Budget 2007¹ and that the first audited FSG reported under NZ IFRS would be for the year ending 30 June 2008.
- 2.10 The first set of NZ IFRS financial statements must include comparative figures presented on the same accounting basis. That is, the figures for the year ended 30 June 2007, and an opening balance sheet as at 1 July 2006, which also needs to be stated in accordance with NZ IFRS.
- 2.11 Government departments, State-owned enterprises (SOEs), and most Crown entities will also first report under NZ IFRS for the year ending 30 June 2008.
- 2.12 Tertiary education institutions (TEIs) and schools, however, have 31 December balance dates, so their transition to NZ IFRS is six months earlier. This means that their first set of audited financial statements under NZ IFRS will be for the year ended 31 December 2007, with their opening balance sheets restated under NZ IFRS as at 1 January 2006.

Increasing unease with NZ IFRS for the public sector

- 2.13 In our view, irrespective of the approach to setting financial reporting standards, an overriding objective of standard setting should be to set high quality standards that meet the needs of people using the financial statements of those entities that apply the standards.
- 2.14 The decision toward the end of 2002 to base New Zealand financial reporting standards on IFRS (which are written to be applied by large, profit-oriented entities) was made with the acknowledgement that the needs of the public sector are different to the private sector. They would therefore, in some circumstances, require different treatment. In our view, NZ IFRS will result in high quality standards for the public sector only if they are seen to:
- specifically consider public sector issues and the needs of people using public sector financial statements;
 - incorporate appropriate changes to IFRS so that the public sector is able to sensibly apply them; and
 - incorporate appropriate guidance to assist the public sector to apply the standards.

¹ Budget 2007 set out the Estimates of Appropriations for the Government for the year ending 30 June 2008.

2.15 We are becoming increasingly concerned about the credibility of NZ IFRS for the public sector. We believe the above three factors are not happening in all cases. If appropriate and sensible changes are not made in the future, there is an increasing risk that the resulting set of standards will not be of high quality, nor ultimately “fit for purpose” for the public sector.

Concern that public sector issues are inadequately addressed

2.16 We acknowledge that NZ IFRS provides a more complete set of standards than the standards previously applied. For example, under the previous standards there was no recognition and measurement standard dealing with financial instruments. NZ IFRS includes such a standard.

2.17 However, issues raised by public sector constituents about proposed standards do not always appear to be appropriately addressed within the standards. At the extreme, not appropriately addressing concerns can have serious implications for the usefulness of financial statements. For example, widespread concerns were raised throughout the public sector about a requirement to capitalise borrowing costs to certain assets and its implication for depreciated replacement cost valuations of assets, which are common in the public sector. No changes were made to standards or guidance issued as a result of the concerns raised. We fear that the reliability of valuations will be seriously impaired as a result of the requirement to capitalise borrowing costs to certain assets. The scope of some audits, including the audit of the FSG, may be limited, thereby affecting the nature of the audit reports issued. We also have reservations that the costs versus benefits of compulsory capitalisation have not been adequately assessed.

2.18 Also, some types of non-commercial transactions, which are common in the public sector, do not appear to have been addressed in the development of some standards. Examples include:

- imposing fines in an environment where collection is variable;
- making “loans” to non-related entities, with no interest and/or no fixed repayment terms or flexible interest options and/or flexible repayment terms; and
- providing funds documented as a loan, but otherwise exhibiting the characteristics of equity.

2.19 There have been very few disclosure changes made to NZ IFRS, meaning public sector entities are required to provide the same disclosures as large profit-oriented entities. People throughout the public sector have commented that NZ IFRS requires voluminous disclosures, many with questionable relevance to people using the financial statements of public sector entities. In some cases, NZ IFRS do not require disclosures that may be considered more relevant to those users. Once again, we have concerns that the costs versus benefits of NZ IFRS disclosures may not have been adequately assessed for the public sector.

- 2.20 One of the important implications of standards that do not fully respond to the needs of the public sector is the increasing scope for different interpretations of the requirements in the standards. We are already seeing many cases where the requirements within NZ IFRS are interpreted differently. We are likely to need to produce significantly more interpretations of the requirements than we needed to under the previous standards. Our strong preference is for the standards to be clear so that public sector entities and their auditors consistently interpret the requirements — without us needing to issue numerous interpretations.
- 2.21 We have concerns with the manner in which standards are currently being developed, and in particular the criteria being applied when changes are made to IFRS for public benefit entities. However, we are also becoming increasingly uneasy about the appropriateness of NZ IFRS for the public sector in the future.
- 2.22 We are aware of developments in international standard-setting that have us questioning the appropriateness of IFRS as the basis for public sector financial reporting standards in the longer term. The conceptual framework within which IFRS are set is undergoing revision (which could take five years), and early indications are that the revised framework will be heavily focused on cash flows and the information needs of investors, financiers, and creditors typically found in the private sector. Such a framework would be quite inappropriate for most of the public sector. In our view, it is going to become increasingly difficult to try and accommodate the public sector within such a regime.
- 2.23 Also, other big international projects such as business combinations and liabilities have the potential to significantly change financial reporting in the public sector. Without adequately considering the needs of people using the financial statements prepared for public sector entities (and, as a consequence, appropriate changes to NZ IFRS for public benefit entities), the resulting standards will, in our view, undermine the quality of reporting by the public sector.

Concern that institutional arrangements may no longer be appropriate

- 2.24 We have now begun to question whether the right institutional arrangements are in place in New Zealand for setting financial reporting standards. In New Zealand, the decision was made to adopt IFRS for profit-oriented entities. Few if any changes have been made to IFRS so that profit-oriented entities in New Zealand can assert compliance with IFRS. In this respect, New Zealand has become a “standard taker”.
- 2.25 The International Accounting Standards Board is responsible for writing IFRS. New Zealand can therefore be only an influencer at best of standards for profit-oriented entities. However, the ASRB acknowledged in 2004 that, for most public

sector entities, which are not profit-oriented, it would be necessary in the case of some IFRS to make changes to measurement and recognition requirements and to add disclosure requirements and/or give disclosure concessions so that those entities could apply the standards.²

- 2.26 Given that acknowledgement, it seems that New Zealand is now only really “setting standards” for entities other than profit-oriented entities (that is, most of the public sector and other not-for-profit entities such as charities). There needs to be appropriate standards for these entities, even though IFRS provides a base for those standards. Given this reality, the institutional arrangements that have been in place for many years in New Zealand, including the composition of the standard-setting board, need to be reviewed.

Where to from here?

- 2.27 We have begun to voice our concerns publicly, and we have raised our concerns with the chairman of the ASRB because we consider that continuing with the current approach is not in the best interests of the public sector. We believe that the ASRB understands the nature of our concerns, and that the ASRB is trying to address the causes of the underlying problems within the current standard-setting environment.
- 2.28 If real changes are not made to the current process soon, New Zealand will need to seriously consider moving to separate financial reporting standards for public benefit entities that better meet the needs of people using those entities’ financial statements.

Central government progress towards NZ IFRS financial statements

- 2.29 Publication of the Government’s first annual financial statements based on NZ IFRS is only months away. A considerable amount of work has been done to prepare for the 2008 FSG. In general, good progress has been made with preparing the Government’s opening balance sheet and provisional NZ IFRS comparative figures.
- 2.30 Achieving consolidation of all the entities comprising the FSG has required the Treasury to:
- establish NZ IFRS-compliant accounting policies;
 - develop an NZ IFRS reporting package to be completed by entities consolidated into the FSG; and
 - remap the Crown Financial Information System and prepare and document new consolidation journals.

² ASRB Release 8: *The Role of the Accounting Standards Review Board and the Nature of Approved Financial Reporting Standards*, May 2004.

- 2.31 A lot of work has gone into achieving these changes. In our view, the system operates effectively.
- 2.32 As we reported last year,³ government departments, SOEs, and Crown entities provided the Treasury with provisional NZ IFRS opening balance sheet information as at 1 July 2006. During the last year, those same entities provided the Treasury with provisional NZ IFRS-based numbers that will be reported as 2007 comparative figures in the 2008 FSG.
- 2.33 The Treasury had expected to complete and have audited both the provisional NZ IFRS opening balance sheet and provisional NZ IFRS comparative figures for inclusion in the 2008 FSG well before now. The audits are now substantially complete. However, because final NZ IFRS-based information on three outstanding issues (accounting for tax debt, the Earthquake Commission's insurance liabilities, and the financial instruments disclosures) has not been provided, the provisional NZ IFRS opening balance sheet and provisional NZ IFRS comparative figures are not yet finalised.

Outstanding issues

- 2.34 The outstanding issues with the provisional NZ IFRS opening balance sheet and/or provisional NZ IFRS comparative figures are outlined below. While there are only three outstanding issues now, there have been various issues that have delayed completion of this work. In our view, there have been two main reasons for delays:
- the challenge of applying NZ IFRS to complex public sector issues; and
 - entities not addressing the NZ IFRS transition early enough to meet the Treasury timetable.

Meeting deadlines for providing information

- 2.35 We are concerned that, if the performance of central government entities in providing quality financial information to the Treasury within the agreed timeframes does not improve significantly, the Treasury may not meet the statutory timetable for preparing the 2008 FSG.

Accounting for tax debt

- 2.36 Accounting for tax debt under NZ IFRS is an issue that has still not been resolved. Under current generally accepted accounting practice (GAAP), tax debt has been accounted for at the principal amount of the debt less any provision for amounts considered uncollectible. Under NZ IFRS, receivables (which include tax debt) are initially recognised at fair value and subsequently measured at amortised cost using an effective interest rate.

³ *Central government: Results of the 2005/06 audits*, parliamentary paper B.29[07a], pages 81-82.

- 2.37 NZ IFRS standards provide no guidance on how to calculate initial fair value for non-commercial debt, like tax debt, which is common in the public sector. The Treasury and the Inland Revenue Department are currently reviewing the approach to accounting for tax debt under NZ IFRS.

Earthquake Commission insurance liabilities

- 2.38 Accounting for the Earthquake Commission's insurance liabilities is another issue that has not been fully resolved. The issue is the adequacy of the liabilities and, in particular, consideration of the probability and impact of a major natural disaster within the scope of Earthquake Commission coverage. The Earthquake Commission is working with its advising actuary on this matter.

Financial instruments disclosures

- 2.39 The Treasury has yet to finalise and present for audit the intended disclosures for financial instruments under NZ IFRS for the 2008 FSG. The Government holds many and diverse financial instruments for which disclosures are required to enable users of the financial statements to:
- determine the nature and extent of risks arising from the financial instruments and how the risks are managed; and
 - evaluate the significance of financial instruments on financial performance and financial position.
- 2.40 Producing an appropriate consolidated disclosure that meets the requirements of the standard and the information needs of users is a challenge, given the devolved management of many of the financial instruments included within the FSG.

Significant NZ IFRS transition adjustments

- 2.41 Last year, we outlined the significant adjustments that arose in producing the provisional NZ IFRS opening balance sheet for the FSG. These same issues also required significant adjustments to be made to the provisional comparative Statement of Financial Position as at 30 June 2007 under NZ IFRS. The more significant adjustments, in terms of size of the adjustment and/or the effort involved in determining the NZ IFRS figures, included:
- reducing the liability for pension obligations in the Government Superannuation Fund and National Provident Fund;
 - increasing the ACC claims liability;
 - recognising derivative financial instruments, such as forward exchange contracts, interest rate swaps, and electricity and commodity derivatives;
 - writing down non-commercial debts to reflect the time value of money;

- categorising and valuing other financial instruments;
- establishing provisions for accumulating sick leave;
- reclassifying software to intangible assets; and
- reclassifying certain properties and revaluing them to fair value.

2.42 A number of the adjustments listed above also resulted in adjustments to the Government's provisional comparative Statement of Financial Performance under NZ IFRS. The more significant adjustments included:

- the movement in the ACC claims liability;
- the change in fair value of derivative financial instruments;
- the effect of the revised accounting for non-commercial debtors; and
- the reversal of goodwill amortisation.

2.43 A detailed analysis of the effect of the NZ IFRS transition on the FSG, including a reconciliation between the NZ IFRS figures and the previously reported figures, is available in the monthly Financial Statements of the Government available on the Treasury's website.

The challenges ahead

2.44 Although many of the complex NZ IFRS issues have been dealt with during the transition process, central government entities will also need to ensure that their own annual financial statements comply with the requirements of NZ IFRS.

2.45 The disclosure requirements of NZ IFRS are greater than under the previous Financial Reporting Standards. Entities will need to ensure that they address disclosure requirements at an early stage to ensure that they meet reporting deadlines.

2.46 The transition to NZ IFRS will continue to be a challenge for some central government entities, in terms of:

- workloads of finance teams;
- transition-related costs (such as professional advice and audit fees); and
- complexity of the issues to be addressed.

Part 3

Assessing entities' environment, systems, and controls

3.01 In this Part, we report on our 2006/07 assessments of the environment, systems, and controls of government departments, Crown entities (excluding school boards of trustees and tertiary education institutions), and State-owned enterprises.

Background

3.02 As part of the annual financial statements audit, our auditors examine, assess, and grade central government entities' environment, systems, and controls for managing and reporting financial and service performance information. We report these assessments to the entity, the responsible Ministers, and the relevant select committees.

3.03 Our examination of an entity's environment, systems, and controls is in the context of the auditor's work in forming an opinion on the financial and service performance statements. The purpose of commenting on these aspects is to highlight areas for improvement the audit identified, and the grades assigned directly represent the recommendations for improvement as at the end of the financial year.

3.04 We introduced a new assessment framework in the 2006/07 financial year to improve the transparency, usefulness, and understandability of our reporting.¹ It replaced the framework we had used for the previous 13 years.

3.05 We applied our new approach in the following sectors for 2006/07:

- government departments;
- Crown entities, excluding school boards of trustees and tertiary education institutions; and
- State-owned enterprises.

The areas we examine

3.06 We assess and report on three areas:

- management control environment;
- financial information systems and controls; and
- service performance information and associated systems and controls.

3.07 The management control environment is the foundation of the control environment, and the areas that our audit may consider are:

- clarity of strategic planning;
- communication and enforcement of integrity and ethical values;

¹ For more information on the differences between the new and old frameworks, see our report *Central government: Results of the 2005/06 audits*, parliamentary paper B.29[07a], pages 25-29.

- participation by those charged with governance (for example, the involvement and influence of the audit committee and the board, or equivalent);
- risk assessment and management;
- legislative compliance arrangements;
- key entity-level control policies and procedures;
- assignment of authority and responsibility; and
- information systems and communication (including information technology planning and decision-making).

3.08 Financial information systems and controls are the systems and controls (including application-level computer controls) over financial performance and financial reporting. Examples of areas that our audit may consider are:

- appropriateness of information provided and reported;
- presentation of financial information;
- reliability of systems for collecting and reporting information;
- control activity (including process-level policies and procedures); and
- monitoring of information.

3.09 Service performance information and associated systems and controls refers to the quality of the service performance measures selected for reporting against, and the systems and controls (including application-level computer controls) over service performance reporting. Examples of areas that our audit may consider are:

- appropriateness of information provided and reported;
- presentation of information in the Statement of Service Performance;
- reliability of systems for collecting and reporting information;
- control activity (including process-level policies and procedures); and
- monitoring of information.

Our grading system

3.10 Auditors base the grades that they assign in their assessments on deficiencies observed through the audit, and on the associated recommendations for improvement. Auditors' conclusions on deficiencies (that is, the gap between "actual practice" and "how practice should be"), and the associated recommendations for improvement, are based on their assessment of how far what the entity does is short of "good practice". "Good practice" is based on auditors' professional expertise and judgement, taking into account what is deemed appropriate for each entity, given its size, nature, and complexity. Our grading scale is shown in Figure 1.

Figure 1**Grading scale for assessment of environment, systems, and controls**

Grade	Explanation of grade
Very good	No improvements are necessary.
Good	Improvements would be beneficial and the entity should address these.
Needs improvement	Improvements are necessary and should be addressed at the earliest reasonable opportunity .
Poor	Major improvements are required , to which the entity should give urgent attention .

Interpretation of results

- 3.11 Our auditors' approach and the standards they apply reflect the unique circumstances of each entity in each financial year. Entities vary greatly in size and organisational structure, and sometimes undergo restructuring. Grades for a particular entity may fluctuate from year to year. Some of the factors that may contribute to such fluctuations include changes in the operating environment, standards, best practice expectations, and auditor emphasis. For these reasons, we advise caution when comparing grades between years and between different entities.
- 3.12 How an entity responds to the auditor's recommendations for improvement, as they arise, is more important than the grade change from year to year. Because of the factors that may cause fluctuations, a downward shift in grade, for example, may not indicate deterioration – it may just be that the entity has not kept pace with good practice expectations for similar entities between one year and the next. Consequently, the long-term trend in grade movement is a more useful indication of progress than year-to-year grade changes.
- 3.13 In future years, we intend to further analyse our assessments, to provide more information on the main areas the entities involved need to improve. We will also provide comparative information and trend analysis. We also expect to make ongoing refinements to our assessment approach.

The results for 2006/07

- 3.14 We assessed the environment, systems, and controls in each of the entities we audited. We graded both the management control environment and the financial information systems and controls. For those entities required to prepare a Statement of Service Performance, we did not grade but provided comments on improvements they could make to their service performance information and controls.

- 3.15 We reported the results to the entity (the chief executive and the Board where relevant), the responsible Minister, and the select committee that conducts the entity's financial review.
- 3.16 Figure 2 shows a summary of the grades for the management control environment and financial information systems and controls.
- 3.17 We have not provided comparisons with the previous year because the assessment approaches are too dissimilar to be compared.
- 3.18 We allowed for a transitional period before we started providing gradings of service performance information and associated systems and controls. In 2006/07, we introduced a greater emphasis on the appropriateness of service performance information. In doing so, we expected the shortcomings identified in our reviews of service performance reporting to affect entities' grades more significantly than they have to date. Our transitional approach allows entities time to adjust to this change of emphasis, and make the necessary improvements.
- 3.19 We will take the same approach in 2007/08, namely not grading service performance information and associated systems and controls but providing comments on where improvements can be made. Part 5 explains the reasons for this.
- 3.20 There are two main points to note from the summary of 2006/07 results.
- Many government departments and district health boards (DHBs) received a "needs improvement" grade for either the management control environment or financial information systems and controls. Of particular note is that 21% of departments and 24% of DHBs need to improve their management control environment, 33% of DHBs need to improve their financial information systems and controls, and 14% of DHBs needed to improve both. This is concerning, and we would expect the entities involved to take action to address the recommendations for improvement that the respective auditors have made.
 - The results were better for Crown Research Institutes, other Crown entities, and State-owned enterprises, with only a small percentage needing to improve in either of these areas.

Figure 2
Summary of grades for 2006/07

	Number of entities	Grades received (%) for MCE				Grades received (%) for FISC			
		VG	G	NI	P	VG	G	NI	P
Government departments	38	13	66	21	-	18	66	16	-
District Health Boards	21	-	76	24	-	-	67	33	-
Crown Research Institutes	9	56	44	-	-	11	89	-	-
Other Crown entities	65	53	42	5	-	32	63	5	-
State-owned enterprises	18	66	28	6	-	17	78	5	-

Notes:

- Areas covered in our assessment framework are:
 - MCE – Management control environment; and
 - FISC – Financial information systems and controls.
- Ratings used are:
 - VG – Very good;
 - G – Good;
 - NI – Needs improvement; and
 - P – Poor.
- The entities included in the summary are those referred to under the relevant categories in the Financial Statements of the Government of New Zealand for the year ended 30 June 2007 at pages 102 and 103. Government departments exclude Offices of Parliament, the Government Communications Security Bureau, and the Security Intelligence Service. School boards of trustees and tertiary education institutions are not included in Other Crown entities. Air New Zealand Limited has been included as if it were a State-owned enterprise. Terralink New Zealand Limited (in liquidation) and Electricity Corporation of New Zealand Limited have been excluded from State-owned enterprises.
- The summary includes only one grade per entity, and uses the grades for the primary parts of the entities involved. For a small number of entities, and where we deem appropriate on a case-by-case basis, we report separate grades to cover different parts of the entities' operations (for example, where there is a semi-autonomous body operating within the entity). In 2006/07, the grades for the different parts differed in the case of only one of these entities.

Part 4

Procurement, grants, and other funding arrangements

The range of funding relationships in the public sector

- 4.01 Public entities spend public funds in a range of ways. As well as using funds to carry out activities themselves, entities may buy goods or services from someone else, provide a grant or some other capacity-building support to another organisation or group, or some combination of these two. The differences between the various types of funding arrangements are not hard and fast; there is a spectrum of arrangements, rather than clearly separate categories. There is also a range of policies, procedures, and guidance available.
- 4.02 Our June 2006 good practice guide, *Principles to underpin management by public entities of funding to non-government organisations*, set out six overarching principles (see paragraph 4.05) that we considered public entities should use to manage going to non-government organisations (NGOs), regardless of whether the funding was as a grant or under a contract for goods or services. We also advocated a risk-based approach that would vary the attention given to the different principles according to the situation.

Principles relevant to all funding arrangements

- 4.03 Although that report was particularly focused on relationships with NGOs, in our view the six principles are relevant to all funding arrangements, whether grants or contracts and whether with NGOs or commercial organisations. In some sectors, there may be different sets of rules, procedures, or policies that govern how particular arrangements are to operate. For example, government departments are obliged and other public sector entities are encouraged to follow the Government's Procurement Policy Framework, including the *Mandatory Rules for Procurement by Departments* (the Mandatory Rules), when they are purchasing goods and services over a certain value. Many public entities have their own policies or guidelines for administering grant programmes. Any such rules, procedures, or policies are likely to be consistent with these high-level principles and to prescribe practical steps or procedures to give effect to the principles. But some entities, although encouraged, are not required to follow the Government's Procurement Policy Framework and the Mandatory Rules in their procurement or do not have procurement policies of their own, and not all entities have a clear framework for administering grants.
- 4.04 The fact that some funding arrangements are not covered by any explicit procedural requirements does not mean that there are no expectations around how entities manage such funds. In our view, all funding arrangements, and all rules, procedures, and policies governing them, should be consistent with the basic principles we have expressed. The arrangements should also reflect the practical need to take a risk-based approach to managing funding relationships.

Principles governing all funding arrangements

4.05 The overarching principles that we consider relevant to all funding arrangements are:

- **Lawfulness.** Public entities must act within the law, and meet their legal obligations.
- **Accountability.** Public entities should be accountable for their performance and be able to give full and accurate accounts of the use to which they have put public funds, including funds passed on to others for particular purposes. They should also have suitable governance and management arrangements in place.
- **Openness.** Public entities should be transparent in their administration of funds, both to support accountability and to promote clarity and shared understanding of respective roles and obligations between entities and any third parties entering into funding arrangements.
- **Value for money.** Public entities should use resources effectively, economically, and without waste, with due regard for the total costs and benefits of an arrangement and its contribution to the outcomes the entity is trying to achieve.
- **Fairness.** Public entities have a fundamental public law obligation to always act fairly and reasonably. Public entities must be, and must be seen to be, impartial in their decision-making. Public entities may also at times need to consider the imbalance of power in some funding arrangements, and whether it is significant enough to require a different approach to the way in which the relationship is conducted.
- **Integrity.** Anyone who is managing public resources should do so with the utmost integrity. The standards applying to public servants and other public employees are clear, and public entities need to make clear when funding other organisations that they expect similar standards from them.

Taking a risk-based approach

4.06 These principles are likely to require different responses in different circumstances. Sometimes one will be more relevant than another. Having the flexibility to adapt and tailor the management of the funding arrangement to the circumstances is the essence of what we have termed a risk-based approach. A “checklist” or “template” approach may often not be helpful if it is too prescriptive.

4.07 There will often be a range of ways to give effect to a particular principle. For example, being able to demonstrate that a particular purchase was value for money does not always mean that an entity has to go through a full competitive tender process for every purchase, unless required by the Mandatory Rules. Getting a number of quotations from different suppliers may be enough if the

purchase is for relatively standard goods. In some circumstances, particularly if there is no effective market operating for the relevant services, it may be more appropriate to periodically review an arrangement and benchmark prices or costings in some other way. Approaching this issue at a level of principle means that we expect entities to be able to demonstrate how they have satisfied themselves that they are receiving value for money with a particular arrangement. We do not have a set expectation as to exactly how that should be done.

Work during 2006/07 on funding and procurement issues

- 4.08 The way in which public funds are administered through both grant programmes and procurement contracts is a regular cause of concern, and is frequently the subject of complaints to this Office. Substantial amounts of public money are involved. The Auditor-General is therefore overseeing an expanding programme of work to examine policies and practice in this area and to support wider government initiatives to improve performance.
- 4.09 In June 2006, we published the good practice guide on funding arrangements with NGOs (see paragraph 4.02), and earlier that year we completed a performance audit on the administration of grant programmes by the Foundation for Research, Science and Technology. In 2006/07, we followed that up with a performance audit of Te Puni Kokiri's administration of grant programmes, and began a performance audit to examine the Ministry of Health's funding arrangements with NGOs. At the request of the Minister of Health, we also carried out a performance audit of the conflict of interest procedures of the three district health boards in the Auckland region, after the successful judicial review challenge to a major procurement decision by those entities.
- 4.10 Procurement is a specific and significant subset of the general area of funding arrangements. It covers all business processes associated with buying, spanning the whole cycle from identifying needs to disposing of the product or completing all the service requirements. Given that broad definition – and the wide range of public activities that are achieved through, or supported by, procurement in some form – it is an activity that is critical to the effectiveness and efficiency of public entities. In the last year, procurement has featured more strongly in our annual audit work, a number of inquiries, and in some special studies and reviews.

Annual audit work on procurement

- 4.11 We asked our auditors of government departments, State-owned enterprises, Crown entities, and some other entities to examine aspects of procurement as part of the 2006/07 annual audits. Specifically, we asked these auditors to review the entity's procurement policies and some aspects of practice, and to report any concerns.

- 4.12 We also continue to provide ongoing assurance services, outside the annual audit process, about specific procurement processes and the development or review of organisational policies and procedures on procurement to a wide range of public entities.

Our findings on procurement policy and practice

Annual audit work

- 4.13 Based on the work during the annual audits in the last year, we consider that there is considerable room for improvement in entities' procurement policies and practices. On the positive side, most entities have policies and procedures in place, and these policies were clearly based on the core principles of value for money, fairness, and openness. But more than half of the policies we looked at in our annual audits needed some improvement.
- 4.14 Our main findings on procurement policies were:
- Responsibility for maintaining the policy was often not clearly assigned, with a number of policies not being updated for recent developments (such as the introduction of the Mandatory Rules).
 - A number of policies contain requirements that vary from established good practice.
 - Many policies did not adequately address legal aspects, such as applicable legislation, the risk of judicial review, the nature of process contracts, and intellectual property.
 - While most policies referred to conflicts of interest, many policies did not recognise the different aspects of conflicts of interest and how they should be managed.
 - A number of policies referred to the importance of concepts such as "whole of life cost" and "value for money" without defining these terms or being clear what they mean in practice.
 - Many policies had limited or weak coverage of important matters (including the hierarchy of methods for procurement, the purposes and limitations of each stage of a multi-stage tendering process, the evaluation of tenders and evaluation methods, managing late tenders, risk management, good record-keeping, and the elements of a procurement plan).
 - Many policies were silent on a number of important aspects (such as how exceptions to policy should be managed, the need for business cases for high value or complex procurement, the risks of fraud and corruption, the engagement of ex-employees as contractors, confidentiality obligations, controls needed for communications with tenderers, the rolling over of existing contracts, and handling complaints).

- 4.15 Our main findings on procurement practice – the way decisions are actually made – were:
- Despite having developed a procurement policy, a number of entities did not have enough support in place to ensure good procurement practice (for example, not enough staff or staff without required expertise, and lack of information systems or management processes to carry out and monitor practices).
 - Procurement was sometimes done on a case-by-case basis, without taking a strategic or organisation-wide approach.
 - In some entities, compliance with their procurement policy was weak – procurement practice did not follow the requirements of the policy. For example, in one case the policy generally required competitive procurement, but in practice competition was avoided.
 - In some cases, there was a lack of documentation of tender or procurement processes, creating difficulties for any subsequent reviews or defending any challenges.
 - Problems have arisen in a number of individual procurement exercises (such as not enough attention to the timely management of conflicts of interest, or the handling of specific circumstances such as late tenders).
- 4.16 As noted, procurement is a major activity in the public sector. Many public services are achieved through, or with the support of, contracted suppliers of goods and services. Although the value of individual contracts varies widely, many involve substantial amounts of money. We are therefore concerned with these findings, which show substantial room for improvement.
- 4.17 We have provided individual feedback to entities about the areas where procurement policies and/or practices need to improve. We expect that those entities will work to address their deficiencies in the coming year.
- 4.18 We will also be continuing with our own programme of work on procurement and other funding arrangements with external parties, to support entities as they work to improve their own systems and practices and to deepen our scrutiny of funding systems.

Inquiries

- 4.19 We regularly receive requests for inquiries into the procurement processes and decisions of public entities. Often the request comes from a tenderer disappointed with the outcome of the process. We do not formally inquire into all such matters. Rather, our usual approach is to briefly review the process that the entity followed,

to decide whether there are any issues that warrant more formal examination. We are more likely to initiate an inquiry in cases where our initial review suggests that there may be systemic issues with the entity's practices that require further examination than in cases where we identify a one-off concern.

- 4.20 If we decide to inquire more fully into a procurement issue, we will look at the process followed by the entity, but not the merits of the decision itself. It is not our role to second-guess whether an entity made the "right" decision. Our work usually ends when we advise the complainant and the entity of our views on the issues that we have examined. However, we may also follow up on the matter during the next annual audit if we have recommended that the entity consider changes to its systems and policies.
- 4.21 In one case, we were asked to consider a completed tender process by an unsuccessful tenderer. The tenderer raised concerns about predetermination and procedural defects, and asked that we set aside the process and the outcome. The Auditor-General has no capacity to overturn a decision, or to provide redress to an unsuccessful tenderer, and we explained this to the correspondent. We met with the entity to understand fully the process they had followed. They had previously instructed an independent consultant to review the tender process and we reviewed the consultant's report. It identified some areas where ongoing improvement was needed by the entity. As a result of those preliminary enquiries, we decided that there was no need for us to investigate further. We did, however, ask the entity's auditor to keep us informed on the entity's progress with the issues raised in the consultant's report.
- 4.22 In another case, we received a request to inquire into a tender process where it was alleged that the entity selected a company that was not the cheapest, and did not follow relevant policies. We reviewed the tender process and were satisfied that these concerns were unfounded. As part of our review, however, we identified a number of issues that we considered needed to be addressed to improve future tender processes. These included concerns with staff of the entity accepting gifts from the incumbent supplier that were not declared, acceptance of a late tender without supporting explanation, and a lack of documentation including evaluation working papers. We advised the entity of these matters.
- 4.23 Other concerns that are often raised with us include:
- lack of a business case for the services required;
 - limited knowledge about the business needs or applications;
 - the tender specifications being written to suit one vendor; and
 - the outcome being predetermined.

- 4.24 Conflict of interest questions also arise regularly, particularly in sectors where the pool of people with relevant specialist knowledge is small. In many cases, a review of the relevant files is able to demonstrate quickly that concerns are unfounded. This highlights the importance of entities maintaining systematic processes and records in procurement matters.

Other developments in procurement

- 4.25 Central government is placing increasing emphasis on procurement, recognising its contribution to economic development and its role in achieving sustainable business development. Public entities should be aware of the Government Procurement Policy Framework, including the Mandatory Rules and minimum standards for sustainable procurement. These are binding on government departments. Other public entities will be bound to the extent that the Crown Entities Act 2004, other legislation, or their own specific enabling legislation requires them to comply with or take account of such policies. Those entities not formally bound by government policies are nevertheless expected to have regard to them as a source of sound guidance. Individual entities remain responsible for their own procurement decisions. Up-to-date details of current government policies, as well as guidance and other information on procurement, can be accessed at www.procurement.govt.nz.
- 4.26 The Ministry of Economic Development (Government Procurement Development Group) is responsible for co-ordinating whole-of-government procurement, developing best practice capability, and administering the Government Electronic Tenders Service. It is leading a strategic whole-of-government approach to procurement and the improvement of current practice across the public sector. Specific activities are directed to increasing procurement capability and capacity, including training in best procurement practice in government and industry.
- 4.27 Recent developments include the completion of the Australian and New Zealand Government Framework for Sustainable Procurement, the adoption of minimum standards and targets for certain categories of goods and services, and other activities within the Sustainable Government Procurement Project. Requirements to provide full and fair opportunity to domestic suppliers have also been strengthened.
- 4.28 In May 2007, Cabinet agreed in principle that a single procurement policy be extended to agencies beyond core departments, subject to appropriate mechanisms for implementation. The Ministry of Economic Development will work with key stakeholders in raising awareness and will advise entities on the application of the single procurement policy including sustainability requirements as and when implemented.

Our continuing interest

- 4.29 The Auditor-General is continuing to build a programme of work involving procurement, grants administration, and other funding arrangements. We have extensively revised our 2001 publication *Procurement: A Statement of Good Practice* over the last year, and intend to replace it later this year with a new good practice guide. The new publication will complement our 2006 good practice guide, *Principles to underpin management by public entities of funding to non-government organisations*.
- 4.30 When conducting the 2007/08 audits of most public entities in the central government sector, our auditors will review at a high level each entity's procurement policy to ensure that it takes account of the Government's policy framework, applicable rules, and good practice guidance, and will report any deficiencies.
- 4.31 These reviews will be conducted at a more detailed level for those government departments and district health boards where procurement is significant to the entity's activities. In addition, the auditors will review the information systems and processes for procurement decisions and will review a sample of these decisions to determine whether the entity is applying its procurement policy in practice.
- 4.32 We will also continue with a programme of performance audits on procurement, grants, and other funding arrangements in their various forms.

Part 5

Statements of intent and our intentions with service performance information

Background

- 5.01 Our 2006 report on the results of central government audits noted that the quality of departmental 2005/06 Statements of Intent (SOIs) varied. We had observed only incremental change in the overall quality of SOIs since 2004/05.¹ Similarly, in 2007, we observed that there has been little development in departments' 2006/07 SOIs compared with 2004/05 and 2005/06.²
- 5.02 We therefore indicated last year that our 2006/07 annual audits would emphasise service performance reporting – in particular, the appropriateness of service performance measures used in the statement of service performance (SSP). To do this, we reviewed 104 2007/08 SOIs for government departments and Crown entities. We provided feedback to entities and commentary on issues identified and on ways the auditors believed service performance information reported to Ministers and select committees should improve. We also provided feedback to central agencies and monitoring departments where relevant.

Conclusions on 2007/08 Statements of Intent

- 5.03 Overall, we were disappointed that many entities' service performance information did not, in our view, set out coherent performance frameworks showing logical links from the information about the medium-term outcomes sought by the entity to the annual outputs (goods and services) delivered by the entity. Many SOIs did not have well-specified, relevant performance measures and standards for both the medium-term and SSP information.
- 5.04 We were concerned about the weak links of the medium-term contextual and strategic information to the forecast SSP. These links should clearly set out the rationale for the outputs and identify key dimensions of service performance for each output. The relevance of performance measures and standards, and subsequent achievements against standards, can be assessed only in the context of the entity's operating environment and strategic direction. Therefore, a logical link between strategy and service delivery is vital not simply for external accountability but, more importantly, for management evaluation and future service planning.
- 5.05 We were concerned about the issues of identification and specification noted for both output information and medium-term achievement. In our view, as for financial reporting standards, if the underlying elements of the SSP are not properly identified and treated, the basis of the reporting is undermined for external accountability and for the usefulness and relevance of information for management and business improvement purposes.

1 *Central government: Results of the 2004-05 audits*, parliamentary paper B.29[06a], page 74.

2 *Central government: Results of the 2005/06 audits*, parliamentary paper B.29[07a], page 79.

- 5.06 We were also concerned about the lack in many instances of robust, best estimate-based standards combined with historical or benchmark information that gives context to the anticipated achievement.
- 5.07 In our view, service performance information should reflect good management practice. It should clearly articulate strategy, link strategy to operational and other business plans, monitor the delivery of operational and business planning, and evaluate strategy impacts and results.
- 5.08 We regard improving the state of information about public sector entities' performance as crucial not just to demonstrating accountability but to achieving continuous improvement in public sector effectiveness.
- 5.09 Many Crown entities were required to prepare SOIs under the Crown Entities Act 2004 for the first time in 2006/07, and it is therefore likely that these entities are still going through a learning process. Government departments, on the other hand, have been required to prepare the information currently required by the Public Finance Act 1989 since 2004/05. Before the 2004 Public Finance Act amendments, government departments had to prepare SOIs under Cabinet direction with similar requirements.
- 5.10 Despite the greater experience of government departments, their 2007/08 SOIs continue to be of variable quality. Improvements in quality since the 2004/05 SOIs have still been only small and incremental. We have also previously reported that, under our annual assessments of information systems and controls in government departments, the Service Performance Information Systems aspect³ consistently had the lowest proportion of "Excellent" or "Good" ratings between 1993/94 and 2005/06 (compared to the other aspects rated).⁴
- 5.11 Non-financial performance reports are essential documents for ensuring that government departments and Crown entities are held accountable to Parliament and the public. If Parliament is unable to adequately assess entity performance because of the poor quality of performance reporting, then we would expect those entities and the agencies that monitor them to be held accountable for their inadequate reporting. In our view, for the public sector to demonstrate accountability to Parliament, the quality of non-financial performance reporting needs to be significantly improved. It is a significant weakness in improving the effectiveness of the public sector.

³ "Service performance information systems" are the systems to record service performance (non-financial) data, and the internal controls (manual and computer-based) to ensure that data is complete and accurate.

⁴ *Central Government: Results of the 2005/06 audits*, parliamentary paper B.29[07a], "Part 2 – Government departments – results of the 2005/06 audits".

- 5.12 In 2007, the Treasury carried out a review of accountability documents at the Government's request and in consultation with Parliament, with the objectives of increasing the documents' usability and reducing duplication. The review:
- has resulted in structural changes (involving changes to the format of documents and the relocation of information from departmental SOIs to the annual Estimates of Appropriation); and
 - over time, proposes to improve the quality of service performance information, including through inter-departmental peer review, although to date this work has primarily focused on improving appropriation scope statements.
- 5.13 We are concerned that an undue focus on structural change in 2007/08 could displace effort that might have been directed to improving the quality of information. We urge both entities and central agencies to pay attention to the quality and the substance of information that appears in both forecast and annual reports as well as to its presentation or form.
- 5.14 In our view, enduring improvement in performance information will require clear and consistent policy objectives, strong central co-ordination and direction, well-established good management practices, and unwavering willingness to be accountable for results.
- 5.15 As long as the weaknesses in information persist, parliamentarians can have only limited assurance that the performance information of public entities reflects the purpose and effectiveness of their endeavours. While there are some good examples, these are few and far between.

Our detailed findings on 2007/08 Statements of Intent

- 5.16 We reviewed in depth 104 2007/08 SOIs, or 81% of the 128 SOIs required to be prepared. We requested and reviewed many of these in draft form. If we did not receive SOIs in enough time to provide feedback on a draft, we reviewed the final SOI. Twenty-eight percent of the SOIs we reviewed were for government departments.
- 5.17 Figure 3 sets out our findings on the 2007/08 SOIs we reviewed.
- 5.18 Appendix 1 sets out further information about our expectations leading into our examination of the 2007/08 SOIs and the basis for those expectations.

Figure 3
Our findings on the 2007/08 Statements of Intent we reviewed

Our expectations	Our findings
Medium-term component of the SOI	
Clearly identified outcomes, which provide the context for the entity's role and functions.	Over 15% of SOIs had shortcomings in the specification of outcomes.
Supporting discussion on the entity's role, functions, strategic priorities, challenges, risks.	About half of SOIs were well presented and "readable". Over 40% included useful discussion and contextual information in the medium-term component of the SOI.
Main measures and standards for outcomes, objectives, or impacts are clearly specified, cover a period of three years, and provide baseline data that places measures and standards in a more meaningful context and allows progress to be tracked.	Nearly a third of the SOIs had missing or unclear main measures, and another third needed to improve their main measures. Many SOIs would benefit by adding baseline data about the current state of outcomes, objectives, or impacts, and their associated measures.
 Link A coherent structure and integrated contextual information that makes evident, through linking within and between the information in the two components: <ul style="list-style-type: none"> – the reasons for the entity's outputs; and – the focus of its reporting, including the rationale for, and the relationships among, the elements, performance measures, and standards. 	Over 50% of SOIs could improve the structure of the forecast SSP and its links to the medium-term component of the SOI. Weaknesses in the links ranged from minor to more significant – for example, from suggestions about clarifying layout or the use of diagrams to more significant issues that made links difficult to assess, such as a lack of discussion about how outputs contributed to outcomes.
Forecast SSP	
Logically aggregated output classes/ outputs with clearly specified outputs that focus on external impacts.	We had queries about the basis for the identification and aggregation of output classes, and noted that outputs were missing, incomplete, or not well specified, to a varying degree, for nearly 40% of SOIs.
Clearly specified performance measures and standards that are relevant and balanced, and provide baseline data that places measures and standards in a meaningful context and allows progress to be tracked.	About 60% of the forecast SSPs had shortcomings in the range and coverage of performance measures and the specification of standards. Measures of output quality, in particular, need enhancing. Many SOIs would benefit from the addition of baseline data about current and recent achievement for output delivery.

Our intended work on service performance information in 2008/09

- 5.19 In the coming year, we intend to maintain our focus on service performance information. In our report last year, *Central government: Results of the 2005/06 audits*, we advised that, from the 2007/08 annual audits, our reporting to Ministers and select committees would include a grading for entities on their service performance aspect. We have reconsidered our intention to assign grades from 2007/08 audits in the light of the following factors:
- The results from our 2007/08 reviews of SOIs indicate that there is still considerable development work to be carried out by entities.
 - The structural and non-structural changes arising from the Treasury's Review of Accountability Documents will require additional effort to adjust the presentation of information, particularly for government departments. Non-structural changes will not receive the level of effort we know is needed to achieve the improvements needed.
 - We have been reviewing and updating our own audit methodology and standards for statement of service performance information to ensure that these also take account of the changes in the statutory requirements.
- 5.20 Therefore, we have concluded that we will defer grading the service performance aspect in our reporting to Ministers and select committees until the 2008/09 audits. Our 2007/08 audit reports to Ministers and select committees will continue to provide only commentary.
- 5.21 We will once again carry out a concentrated review of finalised 2008/09 forecast non-financial performance information during 2007/08 audits to provide suggestions to entities on how they can improve their preparation of 2009/10 forecast non-financial performance information. Because of the work programme associated with the structural changes from the Review of Accountability Documents, we intend to review final forecast non-financial performance information presented to Parliament (rather than the draft information as we did for many 2007/08 SOIs). Entities seeking feedback on draft performance information from their auditor will be provided with comments on the extent of their improvement in addressing issues noted on their 2007/08 SOIs. Our review of final information will provide more extensive feedback.
- 5.22 We will consider over the 2008/09 year, and in tandem with the efforts of central agencies as they implement the Review of Accountability Documents, how we can support greater improvement in the preparation and disclosure of performance information. This consideration will relate to both the audit work we do and the way in which we report this work to entities, Parliament, and others.

Part 6

The Controller function and the appropriation audit

- 6.01 The Controller function and the appropriation audit carried out by the Auditor-General are important aspects of the Auditor-General's work that supports Parliamentary authority over government expenditure.
- 6.02 In this Part, we briefly outline the public finance principles underpinning this work and the work's main features. We then discuss unappropriated expenditure in 2006/07, and also report on some other matters we have had to consider in this area during the past year.

Summary

- 6.03 Departments¹ should pay particular attention to ensuring that all public expenditure is within appropriate bounds, and should be satisfied that they have effective processes to support this aim.
- 6.04 We continue to see instances of unappropriated expenditure requiring approval or validation, including some clear breaches of appropriation. We emphasise again the need for departments to ensure that there is appropriate authority at the time of incurring expenses and capital expenditure, and for all departmental net assets that they hold, and the need for departments to improve their financial forecasting.
- 6.05 We recommend that departments carefully consider the scope of appropriations, in conjunction with the guidance available from the Treasury, before they are included in the Estimates of Appropriation for approval by Parliament.
- 6.06 We encourage early communication between departments and appointed auditors on any potential issues, such as remeasurements.

Public finance principles

- 6.07 Public expenditure is governed by two important principles, those of:
- appropriation; and
 - lawfulness of purpose.
- 6.08 The system of appropriations, as defined in the Public Finance Act 1989 (the Act) is the primary means by which Parliament authorises the Executive to use public resources. Under this system, expenses and capital expenditure by departments should be incurred only in accordance with an appropriation or other statutory authority, and net assets held by departments should not exceed the limits for which they have authority from Parliament.

¹ Reference to "departments" in this article means government departments and Offices of Parliament.

- 6.09 Lawfulness of purpose includes, but is wider than, the principle of appropriation. To be lawful, expenses or capital expenditure must be incurred not only in accordance with an appropriation, but also within the bounds of the legal authority or capacity that enables the department to engage in the activity concerned.
- 6.10 Departments must pay particular attention to ensuring that all expenses and capital expenditure are lawful on both counts, and that effective systems and processes are in place to support this aim.
- 6.11 The Treasury provides useful guidance on the system of appropriations. This includes:
- *A Guide to the Public Finance Act*;²
 - *Putting It Together: An Explanatory Guide to the New Zealand Public Sector Financial Management System*;³
 - *A Guide to Appropriations*;⁴ and
 - *Treasury Circular 2006/04: Unappropriated Expenditure – Avoiding Unintended Breaches*.⁵
- 6.12 During the year, the Treasury issued two further circulars of significance to appropriations. Treasury Circular 2006/7: *Unappropriated Expenditure 2006/07*⁶ provided information and templates for the process to be followed in dealing with 2006/07 unappropriated expenditure, and *Treasury Circular 2007/05: Multi-Year, Revenue Dependent and Department to Department Appropriations*⁷ provides an overview of three appropriation options that provide greater financial flexibility.

Operating the Controller function

- 6.13 The legislative provisions for the Controller function are set out in sections 65Y to 65ZB of the Act.
- 6.14 Key features of the Controller function are:
- Departments provide information to the Treasury about the expenses and capital expenditure incurred against the authority available. The Treasury collates and monitors this information throughout the year.
 - The Treasury supplies monthly reports,⁸ to enable the Controller to fulfil the role (section 65Y).
 - Each month the Office of the Auditor-General (OAG) and departments' appointed auditors operate the Controller function using standard procedures. These procedures are carried out in accordance with the Auditor-General's

2 See <http://www.treasury.govt.nz/publications/guidance/publicfinance/pfaguide/>.

3 See <http://www.treasury.govt.nz/publications/guidance/publicfinance/pit/>.

4 See <http://www.treasury.govt.nz/publications/guidance/appropriations/guide>.

5 See <http://www.treasury.govt.nz/publications/guidance/circulars/pdfs/tc-2006-04.pdf>.

6 See <http://www.treasury.govt.nz/publications/guidance/circulars/pdfs/tc-2007-06v2.pdf>.

7 See <http://www.treasury.govt.nz/publications/guidance/circulars/pdfs/tc-2007-05.pdf>.

8 Monthly reporting is not required for July and August.

Auditing Standard 2: *The Appropriation Audit and the Controller Function* (AG-2) and a Memorandum of Understanding between the Treasury and the OAG.⁹

- The Controller can direct a Minister to report to the House of Representatives if the Controller has reason to believe that expenditure has been incurred that is unlawful or not within the scope, amount, or period of any appropriation or other authority (section 65Z).
- The Controller can stop payments from a Crown or departmental bank account, to prevent money being paid out if the Controller believes the payments may be applied for a purpose that is not lawful or outside the scope, amount, or period of appropriation or other authority (section 65ZA).

6.15 The formal operation of the Controller process is underpinned by the audit work carried out on appropriations. This work is now explicitly recognised as part of the basic functions of the Auditor-General in section 15(2) of the Public Audit Act 2001. The Auditor-General's appointed auditors must carry out an appropriation audit as part of the annual audit of each department, to:

- determine whether expenses and capital expenditure have been incurred within the amount, scope, and period of an appropriation or other statutory authority;
- confirm that expenses incurred have been for lawful purposes; and
- confirm that any unappropriated expenditure is reported in the financial statements.

Unappropriated expenditure in 2006/07

6.16 There were 46 instances of expenditure outside the terms of an appropriation during the 2006/07 financial year, involving 19 departments. This is a significant reduction from the previous year (84 instances involving 21 departments), the first full year of operation of the Act following its amendment.¹⁰

6.17 All instances of unappropriated expenditure are reported in the *Financial Statements of the Government of New Zealand*,¹¹ and the individual financial statements of the relevant departments. Figure 4 shows a summary for 2006/07.

9 The joint understanding and expectations about the role and procedures associated with the Controller function are set out in the *Memorandum of Understanding between the Treasury and the Office of the Auditor-General: Controller Function* (MOU), which is available on the Treasury website (www.treasury.govt.nz). (The MOU is being updated to take into account current practice and matters requiring emphasis or further clarification.)

10 By the Public Finance Amendment Act 2004.

11 Those for 2006/07 are disclosed in the *Financial Statements of the Government of New Zealand for the year ended 30 June 2007*, pages 93-97.

Figure 4
Categories of unappropriated expenditure during 2006/07, by number of instances and number of departments

	Number of instances	Number of departments
Expenditure in excess of appropriation:		
Approved under section 26B	14	9
Validated by legislation under section 26C	23	11
Expenditure without appropriation or other authority	7	5
Net assets in excess of authority	2	2

6.18 These figures show that the majority of instances of expenditure in excess of appropriation were approved by legislation under section 26C of the Act. A number were able to be approved under section 26B, which provides for a Minister to approve expenses or capital expenditure incurred in excess of an appropriation, up to the greater of:

- an amount not exceeding \$10,000; or
- 2% of the total amount of that appropriation.

6.19 In keeping with the general drive in recent years to encourage better forecasting and attention to financial authorities, the Treasury guidance now encourages departments to identify at an early state the possible need for additional authority. Seeking approval in advance of incurring such expenses enables a department to avoid a situation of unauthorised (and therefore unlawful) expenditure occurring. In situations where expenditure has already been incurred, validation under section 26C will be needed.

6.20 In our experience, there are instances where departments could have avoided breaches of appropriation through better forecasting and through more timely requests for imprest supply.

Net asset holdings

6.21 The Act sets a limit on the net assets that departments may hold. Section 22(3) states:

The amount of net asset holding in a department must not exceed the most recent projected balance of net assets for that department at the end of the financial year, as set out in an Appropriation Act in accordance with section 23(1)(c).

- 6.22 Two departments breached their net asset limits during 2006/07. While this is fewer than the four in the previous year, we continue to see potential issues arising in this area in the current financial year. It is a complex area, from both a legal and an accounting perspective.
- 6.23 Departments should therefore take care in projecting net assets, and in monitoring the actual net asset levels throughout the year. We encourage them to seek advice early if they identify a possible risk.

Remeasurements

- 6.24 The Act makes provision for remeasurements. These are financial transactions that are defined so as to be excluded from the meaning of expenses used in the Act, and therefore, unlike other expenses, do not require an appropriation. The Act also provides authority for the reported net asset holdings of a department to increase as a result of a remeasurement of an asset or liability. Consequently, such an increase will not result in a breach of appropriation, even where the projected net asset limit is exceeded. An example of a remeasurement is the revaluation of land and buildings.
- 6.25 Remeasurements are defined in section 2 of the Act as “revisions of prices or estimates that result from revised expectations of future economic benefits or obligations that change the carrying amount of assets or liabilities”. Section 2 also sets out what remeasurements do not include. They do not include, for example, revisions that result from transactions or events directly attributable to actions or decisions taken by the Crown. For example, the revaluation of student loan receivables following a policy decision to change the applicable interest rate is not a remeasurement, and would therefore be subject to appropriation limits in the usual way.
- 6.26 In July 2006, the Treasury issued a paper entitled *Measuring Remeasurements*¹² to provide useful guidance in this area.
- 6.27 From our Controller function and appropriation audit work, we are frequently required to consider whether transactions or events result in a remeasurement. We regularly find that determining whether transactions give rise to remeasurements is a matter requiring careful judgement. The legal and accounting issues are not straightforward.
- 6.28 Departments therefore need to take care when assessing transactions as remeasurements, and refer to the guidance available from the Treasury in doing so. We also encourage early discussion between departments and appointed auditors where appropriate.

12 See <http://www.treasury.govt.nz/publications/guidance/appropriations/remmeasurements/remmeasurements.pdf>.

The significance of appropriation scope

- 6.29 The authority provided by an appropriation is limited to the scope of the appropriation, and is not allowed to be used for any other purpose.
- 6.30 Departments should take care that the scope of appropriations they administer are well specified so as to provide an effective basis for this authority. Scope specification will meet this objective where it:
- acts as an effective constraint against non-authorized activity;
 - does not inappropriately constrain activity intended to be authorised.¹³
- 6.31 Conversely, a poorly defined appropriation scope undermines the effectiveness of Parliamentary approval and scrutiny of expenditure.
- 6.32 The Treasury has an ongoing programme of providing guidance and improving the quality of appropriation scope statements. In September 2005, the Treasury issued a paper entitled *Scoping the Scope of Appropriations*¹⁴ to provide guidance for departments in developing appropriate descriptions, before they are included in the Estimates of Appropriation.
- 6.33 The Treasury is currently promoting clearer and more robust appropriation scope specifications as part of its Review of Accountability Documents work programme, and plans to issue further information in the context of this programme.

13 *Scoping the Scope of Appropriations*, page 2. See paragraph 6.25.

14 See <http://www.treasury.govt.nz/publications/guidance/appropriations/scope/ssappropriations.pdf>.

Part 7

Non-standard audit reports issued in 2007

7.01 In this Part, we report on the non-standard audit reports issued during the 2007 calendar year on the annual financial statements of public entities within our central government portfolio of audits.¹ We report on school boards of trustees separately from the other public entities.²

Why are we reporting this information?

7.02 An audit report is addressed to the readers of an entity's financial statements. However, all public entities are ultimately accountable to Parliament for their use of public money and their use of any statutory powers or other authority given to them by Parliament. Therefore, we consider it important to draw Parliament's attention to the matters that give rise to non-standard audit reports.

7.03 In each case, the issues underlying a non-standard audit report are drawn to the attention of the entity and discussed with its governing body, or chief executive in the case of a government department.

What is a non-standard audit report?

7.04 A non-standard audit report³ is one that contains:

- a qualified opinion; and/or
- an explanatory paragraph.

7.05 An auditor expresses a **qualified opinion** because of:

- a disagreement between the auditor and the entity about the treatment or disclosure of a matter in the financial statements; or
- a limitation in scope because the auditor has been unable to obtain enough evidence to support, and accordingly is unable to express, an opinion on the financial statements or a part of the financial statements.

7.06 There are three types of qualified opinion:

- an "adverse" opinion (see paragraph 7.10);
- a "disclaimer of opinion" (see paragraph 7.15); and
- an "except-for" opinion (see paragraph 7.18).

1 We report separately on entities within the local government portfolio, in our yearly report on the results of audits for that sector.

2 There are about 2450 state schools governed by boards of trustees, which are made up of members of the local community (usually parents of children attending the school). The board of each school is a Crown entity in its own right and, as such, is obliged to prepare annual financial statements in accordance with "generally accepted accounting practice".

3 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*.

- 7.07 The auditor will include an **explanatory paragraph** (see paragraph 7.23) in the audit report to emphasise a matter such as:
- a breach of law; or
 - a fundamental uncertainty.
- 7.08 Auditors are required to ensure that an explanatory paragraph is included in the audit report in such a way that it cannot be mistaken for a qualified opinion.
- 7.09 Figure 5 outlines the decisions to be made when considering the appropriate form of audit report.

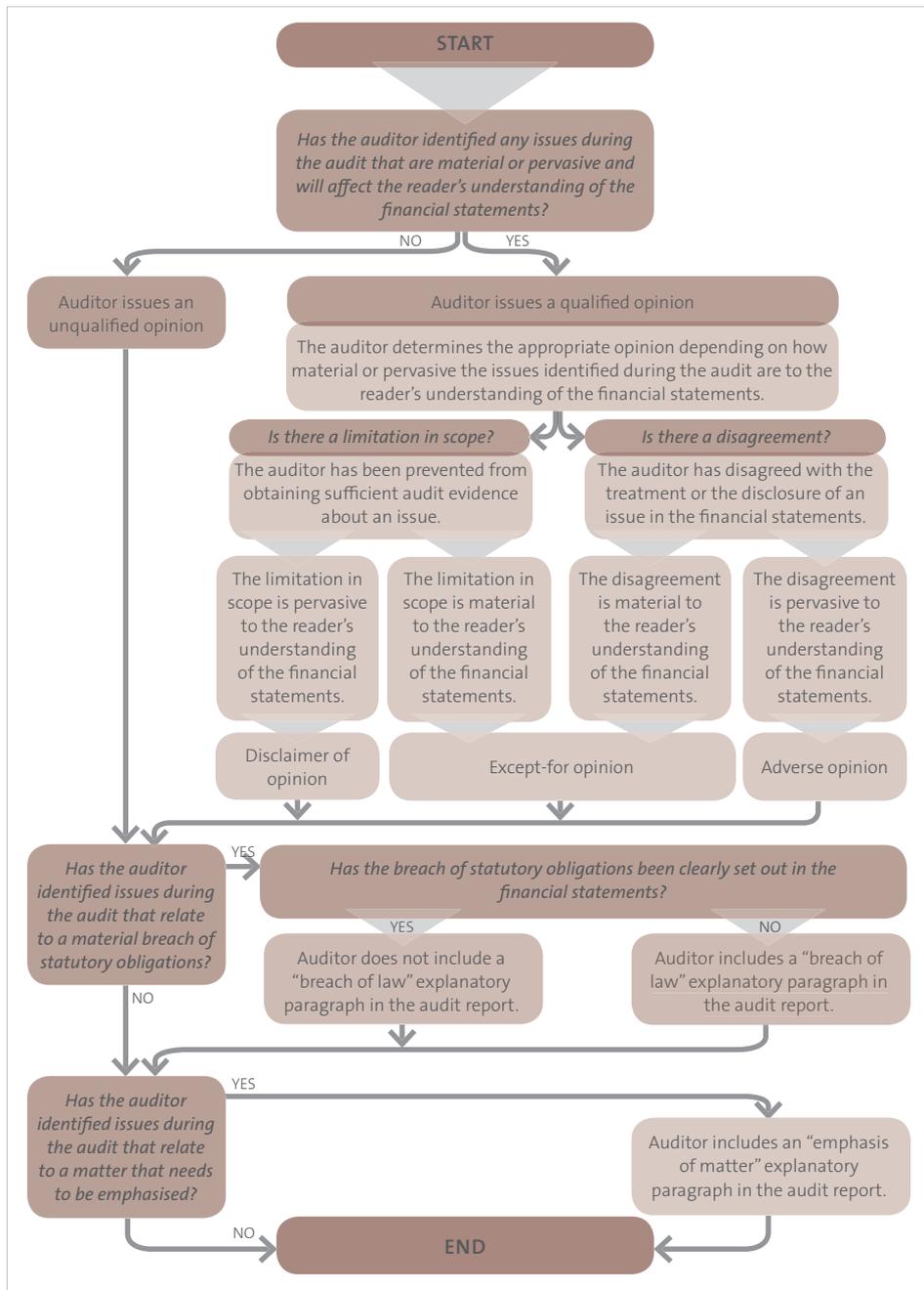
Adverse opinions

- 7.10 An adverse opinion is expressed when the auditor and the entity disagree about the treatment or disclosure of a matter in the financial statements and, in the auditor's judgement, the treatment or disclosure is so material or pervasive that the report is seriously misleading.
- 7.11 An adverse opinion is the most serious type of non-standard audit report.
- 7.12 During 2007, adverse opinions were expressed for three public entities:
- Queen Elizabeth II Army Memorial Museum;
 - RNZAF Museum Trust Board; and
 - Royal New Zealand Navy Museum Trust Incorporated.
- 7.13 Appendix 2 sets out the details of the adverse opinions.
- 7.14 We are pleased to report that it was not necessary for adverse opinions to be issued on any school boards' financial statements in the 2007 calendar year.

Disclaimers of opinion

- 7.15 A disclaimer of opinion is expressed when the scope of an auditor's examination is limited, and the possible effect of that limitation is so material or pervasive that the auditor has not been able to obtain enough evidence to support an opinion on the financial statements. The auditor is accordingly unable to express an opinion on the financial statements or on part of it.
- 7.16 During 2007, a disclaimer of opinion was expressed for one public entity – the Pacific Islands Polynesian Education Foundation. Appendix 2 sets out the details of the disclaimer of opinion.
- 7.17 We are pleased to report that it was not necessary for disclaimers of opinion to be issued on any school boards' financial statements in the 2007 calendar year.

Figure 5
Deciding on the appropriate form of audit report



Except-for opinions

- 7.18 An except-for opinion is expressed when the auditor reaches one or both of the following conclusions:
- The possible effect of a limitation in the scope of the auditor's examination is (or may be) material but is not significant enough to require a disclaimer of opinion. The opinion is qualified by using the words "except for the effects of any adjustments that might have been found necessary" had the limitation not affected the evidence available to the auditor.
 - The effect of the treatment or disclosure of a matter with which the auditor disagrees is (or may be) material, but is not, in the auditor's judgement, significant enough to require an adverse opinion. The opinion is qualified by using the words "except for the effects of" the matter giving rise to the disagreement.
- 7.19 An except-for opinion can be expressed when the auditor concludes that a breach of statutory obligations has occurred and that the breach is material to the reader's understanding of the financial statements. An example of this is where a Crown entity has breached the requirements of the Crown Entities Act 2004 because it has not included budgeted figures in its financial statements.
- 7.20 During 2007, except-for opinions were expressed for 13 public entities:
- Te Wānanga O Aotearoa Te Kuratini O Nga Waka;
 - MO1 Limited (a subsidiary of Te Wānanga O Aotearoa Te Kuratini O Nga Waka);
 - Victoria University of Wellington and Group;
 - Christchurch Polytechnic Institute of Technology and Group;
 - Christchurch College of Education;
 - New Zealand Centre for Reproductive Medicine Limited (a company jointly controlled by the University of Otago and Canterbury District Health Board);
 - Delta S Technologies Limited (an indirect subsidiary of the University of Otago);
 - Ngati Whakaue Education Endowment Trust Board;
 - Ivey Hall and Memorial Hall 125th Anniversary Appeal Gifting Trust (a trust controlled by Lincoln University);
 - Ivey Hall and Memorial Hall 125th Anniversary Appeal Taxable Activity Trust (a trust controlled by Lincoln University);
 - Creative Campus Enterprises Limited (a subsidiary of Massey University);
 - Three Harbours Health Foundation (a trust controlled by Waitemata District Health Board); and
 - Wilson Home Trust (a trust controlled by Waitemata District Health Board).

7.21 Except-for opinions were expressed for the financial statements of 31 schools:

- Coastal Taranaki School;
- Glenfield Primary School;
- Hamilton Boys' High School;
- Henderson Intermediate School;
- Henderson North School;
- Kohia Terrace School;
- Kopane School;
- Mangorei School;
- Mansell Senior School;
- Marist School (Herne Bay);
- Mornington School;
- Orauta School;
- Orewa Primary School;
- Sacred Heart Colledge (Auckland);
- St Dominic's College (Henderson);
- St John's College (Hillcrest);
- St Matthew's School (Marton);
- St Michael's School (Remuera);
- Stanhope Road School;
- Stanmore Bay School;
- Taumarunui High School and Community Trust;
- Te Kura Kaupapa Māori O Te Rito;
- Te Kura Kaupapa Māori O Wairarapa;
- Te Kura O Te Whakarewarewa;
- Te Tino O Pourangi;
- Wakaaranga School;
- Wanganui City College;
- Wellington East Girls' College;
- Wellington Girls' College;
- Whanganui Awa School; and
- Woodford House.

7.22 Appendix 2 sets out the details of the except-for opinions. In some cases, an audit opinion was qualified for more than one reason.

Explanatory paragraphs

- 7.23 In certain circumstances, it may be appropriate for the auditor to include additional comments in the audit report. Through an explanatory paragraph, the auditor emphasises a matter that they consider relevant to a reader's proper understanding of an entity's financial statements.
- 7.24 For example, an explanatory paragraph could draw attention to an entity having breached its statutory obligations for matters that may affect or influence a reader's understanding of the entity's financial statements. In this situation, the audit report would normally draw attention to the breach only if the entity had not clearly disclosed the breach in its financial statements.
- 7.25 During 2007, explanatory paragraphs were included in the audit reports for 21 public entities:
- Northland Polytechnic and Group;
 - Counties Manukau District Health Board and Group;
 - New Zealand Institute for Crop and Food Research Limited;
 - Gracelinc Limited (a subsidiary of New Zealand Institute for Crop and Food Research Limited);
 - NIWA Natural Solutions Limited (a subsidiary of National Institute of Water and Atmospheric Research Limited);
 - Air New Zealand Associated Companies (Australia) Limited (a subsidiary of Air New Zealand Limited);
 - Ansett Australia and Air New Zealand Engineering Services Limited (a subsidiary of Air New Zealand Limited);
 - Air New Zealand Travel Business Limited (a subsidiary of Air New Zealand Limited);
 - Eagle Air Maintenance Limited (a subsidiary of Air New Zealand Limited);
 - Enzedair Tours Limited (a subsidiary of Air New Zealand Limited);
 - Jetaffair Holidays Limited (a subsidiary of Air New Zealand Limited);
 - Tasman Empire Airways (1965) Limited (a subsidiary of Air New Zealand Limited);
 - Travelseekers International Limited (a subsidiary of Air New Zealand Limited);
 - Zeal 320 Limited (a subsidiary of Air New Zealand Limited);
 - Carter Observatory Board;
 - Association of Colleges of Education in New Zealand;
 - Te Arawa Maori Trust Board;
 - Southland Provincial Patriotic Council;

- Open Mind Journals Limited (a subsidiary of The Open Polytechnic of New Zealand);
- East City Community Education; and
- Manukau Health Trust Limited (a subsidiary of Counties Manukau District Health Board).

Explanatory paragraphs for schools – breaches of the law

- 7.26 Some explanatory paragraphs concern a breach of law. In most cases, boards have a choice of disclosing a breach of law in their financial statements. Where a board decides to make a voluntary disclosure, we would not normally include an explanatory paragraph in the audit report unless we felt the matter was important enough to warrant it.
- 7.27 We are not listing each school for which an explanatory paragraph was included in its audit report. Because of the number of non-standard audit reports in each category, we are instead reporting the types of explanatory paragraphs that were issued and the number of schools that received each type.
- 7.28 There were seven major types of explanatory paragraphs included by auditors for breaches of law:
- not reporting by 31 May 2007 (79 schools);
 - not including the required variation statement (3 schools);
 - unapproved expenditure by integrated schools on capital works (22 schools);
 - borrowing without approval (14 schools);
 - investing in non-approved institutions (8 schools);
 - payments in advance to staff (16 schools); and
 - enrolling international students without signing the Code of Practice for Pastoral Care for International Students (2 schools).
- 7.29 Appendix 2 includes more information on these types of breaches.

Explanatory paragraphs for schools – emphasis of matters

- 7.30 There were three main types of matters emphasised by auditors in explanatory paragraphs:
- school closures (6 schools);
 - serious financial difficulties (17 schools); and
 - a change of proprietor and no Integration Agreement (6 schools).
- 7.31 Auditors emphasised matters for other reasons for twelve schools. Appendix 2 contains more information on the other reasons and on the types of emphasised matters.

Part 8

Status of Māori Trust Board audits

Summary

- 8.01 We remain concerned about the continuing pattern of audit arrears in the Māori Trust Boards (MTBs) sector. We will continue to work directly with MTBs to bring these audits up to date as soon as possible.
- 8.02 We are pleased that policy proposals are being considered that will address many of the matters we have raised in previous reports to Parliament about the audit and accountability framework for MTBs.

Introduction

- 8.03 We have previously reported to Parliament in 1993, 1995, 1998, and 2006 about the audit and accountability arrangements for those MTBs governed by the provisions of the Māori Trust Boards Act 1955 (the Act).¹
- 8.04 While the legislative framework governing the MTBs sector remains unchanged since our 2006 report to Parliament, a review of the accountability provisions within the Act is in progress. We understand that this review may result in, among other changes, MTBs being no longer classified as public entities under the Public Audit Act 2001, but still being required to have their annual financial statements audited by an independent auditor.
- 8.05 We support these proposed changes. They are consistent with the conclusions that we made in our 2006 report to Parliament.
- 8.06 The proposed changes will require amendments to the Act. Until such changes are made by Parliament and take effect, MTBs remain public entities and the Auditor-General remains their auditor.² Given the history of audit arrears in the MTBs sector, we considered it timely to report again publicly on the status of audits in the MTBs sector.

What is the Māori Trust Boards sector?

- 8.07 Broadly speaking, MTBs are organisations that exist to manage tribal assets for the general benefit of their beneficiaries. MTB beneficiaries can be loosely described as those persons who have genealogical links to the tribe(s) that the MTB represents.³ The Act empowers MTBs to provide money for the benefit or

1 *First Report for 1993* (parliamentary paper B.29[93a]), *First Report for 1995* (parliamentary paper B.29[95a]), *Second Report for 1998* (parliamentary paper B.29[98b]), *Central government: Results of the 2005/06 audits* (parliamentary paper B.29[06a]).

2 The proposal is for there to be a two-year transition period before MTBs are removed from the public audit portfolio. The Auditor-General will remain responsible for completing the audits up until the date that the new provisions take effect.

3 Part 1 of the Act defines who constitutes a beneficiary for each of the MTBs governed by the Act.

advancement of their beneficiaries and to apply money towards the promotion of health, social, and economic welfare, and education and vocational training.⁴

8.08 As we noted in our 2006 report to Parliament, many MTBs are reconsidering their legal form for the future. This has led to the gradual reduction in the number of MTBs – from 19 in 1993 to 15 in 2006.

8.09 Sixteen MTBs were governed by the provisions of the Act for all or part of the 2006/07 audit period.⁵ They were:

- Aorangi;
- Hauraki;
- Maniapoto;
- Ngāti Whātua o Orakei;
- Taranaki;
- Tauranga-Moana;
- Te Arawa;
- Te Aupōuri;
- Te Rūnanga o Ngāti Porou;
- Te Rūnanga o Ngāti Whātua;
- Te Tai Tokerau;
- Tūhoe-Waikaremoana;
- Tūwharetoa;
- Wairoa-Waikaremoana;
- Whakatōhea; and
- Whanganui River.

What is the current status of audits in the Māori Trust Boards sector?

8.10 MTBs are required to keep full and accurate accounts of all their receipts and payments, and to prepare annual statements setting out their financial position and financial operations every year.⁶ Most MTBs have 30 June balance dates, but the balance date for four MTBs is 31 March.

8.11 The financial statements of MTBs are audited by the Auditor-General and sent to the Minister of Māori Affairs who will forward them with their comments

4 Section 24.

5 By 30 June 2007, there were 15 MTBs, after the disestablishment of Te Arawa as an MTB governed by the Act on 25 September 2006, as part of its Treaty settlement process with the Crown.

6 Sections 30 and 31.

to the MTB.⁷ Audited financial statements are a critical input into future planning and for communicating performance to those to whom MTBs are accountable.

- 8.12 There is, however, no statutory deadline for the completion of audits. Instead, the Auditor-General has set a self-imposed time frame of five months after balance date before considering any MTB audits as being in arrears.
- 8.13 The MTBs sector continues to have a trend of audit arrears. There are a range of reasons for these arrears, some of which relate to auditor performance. Other reasons include delays by MTBs in producing quality financial statements for audit (for MTBs themselves and/or their subsidiary entities), and difficulty in resolving technical accounting and auditing issues.
- 8.14 We continue to be concerned about the status of audits in the MTBs sector. Figure 6 sets out the situation as at 31 March 2008.

Figure 6
Status of Maori Trust Board audits 2004-2007

Audit status	2004	2005	2006	2007
Number of MTBs in audit portfolio*	17	16	16	15
Number of audits completed	14	13	8	4
Number of audits in arrears (i.e. not completed within 5 months of balance date**)	3	3	8	11

* As at 30 June 2005, there were 16 MTBs governed by the Act, after the disestablishment of Te Rūnanga o Ngāti Awa in March 2005 as an MTB governed by the Act. As at September 2006, there were 15 MTBs, after the disestablishment of the Te Arawa Māori Trust Board.

** Four MTBs (Ngāti Whātua o Orakei, Tūhoe-Waikaremoana, Wairoa-Waikaremoana, and Whanganui River) have a balance date of 31 March. The rest have balance dates of 30 June.

- 8.15 We continue to work with MTBs directly, and with Te Puni Kōkiri where appropriate, to bring audits up to date. We recognise the undesirability of having so many MTBs with audit arrears, and some having multiple years in arrears. Finalising these audits will be critical to the effective transition of MTBs out of the public audit portfolio, in the event that this does occur.

Part 9

Auditor-General's good practice guides

- 9.01 The Auditor-General has a statutory responsibility to audit the financial and other accountability information of every public entity, and has the ability at any time to examine performance on a range of dimensions or to inquire into an entity's use of public resources. Putting these various functions together has resulted in us focusing our efforts on five main areas:
- performance;
 - acting within authority;
 - waste;
 - probity; and
 - accountability.

- 9.02 Although the Auditor-General's primary role is to provide independent assurance to Parliament on these matters, our work should also contribute to improvements in public sector management and performance. To help entities understand our approach and to address their own responsibilities effectively, in recent years we have renewed our emphasis on the development of good practice guides on topics of general interest.

Producing a good practice guide

- 9.03 As a result of our general work with public entities on annual audits, other assurance services, performance audits, and inquiries, we may recognise that certain aspects of public sector management are problematic or that a number of entities are grappling with similar issues. Where a pattern emerges, we may conclude that some general guidance would be helpful for the public sector.
- 9.04 We are aware that good practice expectations come from a range of other entities, such as State Services Commission and the Treasury, which have a leading role in providing such guidance to the state sector. Therefore, we carefully consider the circumstances in which we issue good practice guidance. We note, however, that no other agency covers the whole public sector. The communication of the Auditor-General's expectations, both to entities and to auditors, helps develop a common understanding of important issues facing the public sector.
- 9.05 Once the need has been identified, we follow a careful development process to produce a guide. This includes research on the New Zealand and international legal, administrative, and practical context, as well as consultation with other agencies with an interest in public management and/or the topic in question. It is important that the guidance, once produced, is in harmony with other support and advice available to public entities.

- 9.06 A good practice guide is generally written on the basis of providing principles rather than detailed rules, although it will usually also address some of the more detailed practical issues that many entities face. This approach means the guidance is flexible enough to apply to the wide range of central and local government entities within the Auditor-General's mandate. The aim is that the guidance will state the Auditor-General's view of good practice, and will help entities to develop policies appropriate to their own situation.

How we use good practice guides

- 9.07 Good practice guides have a life cycle, which reflects that it takes time for entities to digest and apply the relevant principles to their own systems, and that management systems and approaches will evolve over time.
- 9.08 Once a good practice guide has been issued, therefore, our initial focus is on education and information – ensuring that the guide is widely available and that its contents are being considered. We may later seek assurance that, where applicable, the guidelines have informed the development or revision of each entity's own policies.
- 9.09 We also use the principles, expectations, and guidance contained in good practice guides as a basis for setting our expectations when carrying out performance audits and inquiries under the Public Audit Act 2001.
- 9.10 Over time, it may become apparent that new developments, later audit findings, new legislation and policy, and changing expectations are affecting the relevance of the good practice guide on a particular topic. At that point, we would review and update the guide.

Recent and current work on good practice guides

- 9.11 In the past two years, we have issued the following good practice guides:
- *Principles to underpin management by public entities of funding to non-government organisations* (June 2006);
 - *Local government codes of conduct* (June 2006);
 - *Controlling sensitive expenditure: Guidelines for public entities* (February 2007);
 - *Managing conflicts of interest: Guidance for public entities* (June 2007);
 - *Guidance for members of local authorities about the law on conflicts of interest* (June 2007);
 - *Turning principles into action: A guide for local authorities on decision-making and consultation* (September 2007); and
 - *Audit committees in the public sector* (April 2008).

- 9.12 Part 10 of this report discusses audit committees, the topic of our most recent good practice guide.
- 9.13 During 2008, we expect to issue updated guidelines on procurement. We are also preparing a good practice guide on public entities setting fees to recover costs.
- 9.14 The good practice guides we have published are listed on our website at www.oag.govt.nz.

Part 10

Audit committees

- 10.01 Audit committees have a valuable contribution to make in improving the governance, and so the performance and accountability, of public entities. They can play an important role in examining an organisation's policies, processes, systems, and controls, through providing objective advice and insight. In doing so, they can identify potential improvements to governance, risk management, and control practices.
- 10.02 After some well-publicised international accounting and auditing failures in 2001 and 2002, there has been an increasing focus on the role of audit committees in the public and private sectors. Overseas regulatory bodies are intervening more to set clear governance and assurance standards and expectations. Although New Zealand might not legislate for mandatory audit committees, Parliament and the public expect the public sector to adopt governance principles that are consistent with good practice.
- 10.03 An effective audit committee shows that an organisation is committed to a culture of openness and continuous improvement.
- 10.04 Our *Audit committees in the public sector* good practice guide sets out the principles and practices needed to set up and effectively operate an audit committee in the public sector, and provides other useful resources such as example charters and checklists. The guide is not sector-specific. In our view, the principles and practices it outlines apply to the public sector as a whole.
- 10.05 The Auditor-General expects all public entities to consider setting up an audit committee in line with the good practices identified in that publication.

Part 11

Department of Corrections' consultation processes for new regional prisons

- 11.01 In this Part, we describe how the Department of Corrections (the Department) set up and managed consultation processes during a project to build four new regional prisons. We discuss the systems, policies, and processes used to support consultation about the Spring Hill prison site in North Waikato and some of the Department's earlier experiences with consultation about the Ngawha prison site in Northland.
- 11.02 In 1997, the Department started a project to build several new regional prisons to meet an expected growth in prisoner numbers.
- 11.03 One of the aims of the project to build new prisons was to implement the Department's Regional Prisons Policy. This policy was developed in 1997 and was based on research which suggests that locating prisoners as near to their home area as possible improves the chances of successful reintegration into society and reduces re-offending rates.
- 11.04 The new prison construction project was large by New Zealand standards, requiring extensive consultation and project management, and specialist expertise. It represented a challenge for the Department, which entered into the project in a position of relative inexperience in delivering large public works under the Resource Management Act 1991 (RMA).
- 11.05 The final four sites for the prisons, chosen after consideration of various alternatives, were in Northland (Ngawha, near Kaikohe), North Waikato (Spring Hill, near Meremere), Auckland (in Mangere), and Otago (Milburn).¹ Figure 7 lists the four new prisons in order of completion date. Although the work on each new prison has, to a certain extent, been sequential, there has also been significant overlap.

Figure 7
New prisons completed 2005-2007

Location	Full name	Capacity	Construction completed
Northland	Northland Region Corrections Facility	350 beds	February 2005
Auckland	Auckland Region Women's Corrections Facility	286 beds	May 2006
Otago	Otago Corrections Facility	335 beds	March 2007
North Waikato	Spring Hill Corrections Facility	650 beds	July 2007

¹ The Department originally considered potential sites for new prisons in Northland, Auckland, Dunedin, Bay of Plenty, and Nelson.

- 11.06 In April 2004, two members of Parliament approached the Auditor-General with concerns about the Department's spending on consultation with Māori about the Spring Hill site. We did not inquire into this matter because the Department had already made changes to improve the way it managed contracts for consultation. However, to provide information for other public entities entering into large development projects, we decided to review the Department's systems, policies, and processes that supported consultation about the Spring Hill prison. We looked at:
- the establishment of the project structure and governance mechanisms to deliver the new prisons;
 - the development of consultation strategies and plans;
 - resourcing for the project and the use of advisers;
 - systems for carrying out and recording consultation;
 - systems to support consultation with Māori; and
 - arrangements for contract management.
- 11.07 Our assessment took account of the requirements of the RMA and associated consultation, including consultation with Māori.

Background

Resource Management Act processes for Crown developments

- 11.08 Large building projects must comply with the requirements of the RMA. This includes when the developer is the Crown or another public body.
- 11.09 Territorial authorities (that is, city and district councils) control the granting of consents for land use and subdivision. Regional councils control the granting of consents for most activities involving water, and the discharge of contaminants. Where an activity is not permitted as of right under the rules in a district or regional plan, or does not comply with those rules, the person wanting to carry out the activity will usually need to seek resource consent.
- 11.10 The developer of a large building project will often need to seek one or more consents. Applications for consent will usually be publicly notified, unless the effects of the project are minor and the written approval of directly affected parties has been obtained. The notification process allows members of the public to make submissions on the project. Decisions on resource consents can be appealed to the Environment Court.
- 11.11 However, Ministers of the Crown (among others) are "requiring authorities" under the RMA. A requiring authority can issue a "notice of requirement" for a designation for a public work or other project or work in respect of any land. A

designation, once confirmed, is included in the relevant district plan. Having a designation over a piece of land means that a land use resource consent is not needed to carry out the designated project or work, and no other person may (without the requiring authority's approval) do anything to the land that would prevent or hinder the project or work.

- 11.12 The process for confirming a designation is similar to obtaining a resource consent, but the requiring authority, rather than a territorial authority, is the decision-maker (although the territorial authority can make recommendations and can appeal the decision of the requiring authority).
- 11.13 The then Minister of Corrections (the Minister) used designations for each of the four new prison sites, issuing a notice of requirement (for land use) to the relevant territorial authorities and seeking resource consents for a wide range of activities (for example, air and water discharges) from the relevant regional councils.

Consultation requirements

- 11.14 The RMA does not expressly require anyone to consult about projects they propose. However, there is a requirement to assess the environmental effect of project proposals. The Environment Court has recognised that consultation provides an effective mechanism to identify, clarify, and potentially resolve issues about the proposal. Also, an application for consent or notice of requirement must include a statement about the consultation, if any, that has been carried out with people interested in, or affected by, the proposal.
- 11.15 Where a project is being carried out by the Crown and raises issues affecting Māori, the Crown may have a duty to consult with Māori to fulfil its obligations under the Treaty of Waitangi. The RMA requires decision-makers to take into account the principles of the Treaty of Waitangi. One way of doing this is to consult with those Māori who hold kaitiakitanga (guardianship) for the area affected by a proposal.

Early consultation on prison site selection

- 11.16 In August 1997, Cabinet agreed to the investigation of potential prison sites in five regions.² The Department established new systems and structures to do this work. It established the National Services and Facilities Committee to oversee the management of current prisons, and the acquisition of sites and development of new prisons. The Department's Assets and Property Group was given the task of acquiring sites for the new prisons and obtain the necessary planning approvals.³
- 11.17 The Assets and Property Group wrote a project plan for site acquisition, and communications strategies (including a strategy for consulting with Māori) for identifying new prison sites. It also obtained legal advice on resource

² These were Northland, Auckland, Bay of Plenty, Nelson, and Otago.

³ The Assets and Property Group is responsible for the maintenance and improvement of the existing national prison portfolio, as well as the acquisition of new prison sites.

management considerations. It reported back to the National Services and Facilities Committee on progress and to get budgets and sub-projects approved.

- 11.18 In late 1997, the Assets and Property Group investigated the regions approved by Cabinet to identify potential sites for the new prisons. This involved meeting with regional stakeholders such as councils, iwi and other Māori organisations, and Pacific Island communities. In May 1998, the Minister announced that Northland and South Auckland were the priority areas for new men's prisons because many offenders from these areas were being held in institutions outside of their home regions.⁴
- 11.19 The Assets and Property Group produced criteria to assess possible prison sites, and consulted on those criteria with the general public as well as with local stakeholders. It asked for registrations of interest from individuals and groups who would consider selling land to the Department, and began assessing land put forward through this process to form a shortlist of possible sites.
- 11.20 The Department identified a site at Ngawha as its preferred site in Northland. It started consultation with site neighbours, tangata whenua, local communities, and other stakeholders to obtain feedback on the environmental and social effects of the Ngawha prison.

Site selection and development for Spring Hill

- 11.21 Before a shortlist was confirmed for a new men's prison in South Auckland, the Minister decided in 1999 to defer the South Auckland prison project for 12 months. This deferral was to gain time to reassess the demand for new prisons and assess whether the introduction of home detention would reduce the growth of the prison population. On 16 August 2000, the Minister announced that the site search would resume.
- 11.22 The Assets and Property Group then consulted with communities in South Auckland and North Waikato to help find a suitable site. After registrations of interest by potential land sellers, the Assets and Property Group assessed possible sites against the criteria it had developed earlier. In December 2000, the Department announced a shortlist of two possible sites in North Waikato for more detailed technical assessment, one of which was the Spring Hill site.
- 11.23 The Department consulted with site neighbours, stakeholders, and local communities on the two possible sites (including specific consultation with Māori). The feedback from consultation was taken into account in making the final selection of the Spring Hill site and was considered alongside a range of technical investigations. On 7 June 2001, the Minister announced that he would seek a designation to construct and operate a prison on the Spring Hill site.

⁴ Auckland Women's prison and Otago prison were the next new prisons to be announced. Consultation for these sites started in 2000 and 2001 respectively.

- 11.24 After selecting the Spring Hill site, the Department consulted further with neighbours of the site, tangata whenua, and stakeholders, focusing on the environmental effects that the new prison would have on the area. The results of the consultation were incorporated into the various reports and submissions (such as the notice of requirement) needed to progress the RMA designations and resource consent process. The Department also used its consultation processes to help establish long-term relationships with the community, and tangata whenua in particular, to support the ongoing operation of the Spring Hill prison under the Regional Prisons Policy (see paragraph 11.03).
- 11.25 Opposition to the Spring Hill prison focused on the location of the prison and the issue of security for local residents. The possible effect of the prison on land and property values was another concern to residents. Tangata whenua also raised concerns, including questions about the consultation process and about the effect of the prison on the natural environment and any sites of cultural significance. The Waikato District Council deliberated on the arguments for and against the prison, and, in May 2003, recommended that the designation be confirmed. The associated resource consents were granted by Environment Waikato. However, the designation and the resource consents were appealed to the Environment Court.
- 11.26 In June 2004, the Environment Court found for the Department on appeals against the Spring Hill site designation and resource consent. Construction of the prison began in November 2004 and was completed in July 2007. The first prisoners arrived on 1 November 2007.

Changes to the regional prisons project structure

- 11.27 Any large project requires governance arrangements to help ensure that the project runs smoothly and to time by overseeing the activities of management, and monitoring project risks.
- 11.28 In August 2000, the Department established a new project team to construct the prison at Ngawha. The project team was established because the Assets and Property Group already faced a high workload in managing growth at existing prison sites, as well as identifying and consulting on potential sites for new men's and women's prisons in South Auckland and Otago.
- 11.29 The new project team had a mix of contracted staff with construction expertise and staff seconded from elsewhere in the Department. It was later named the Regional Prisons Development Project (RPDP) and given responsibility for managing the construction and commissioning of all four new prisons. A steering group (the RPDP Steering Group) was set up as the internal decision-making group and was charged by the Department's chief executive to monitor the progress of the RPDP.

- 11.30 There was a clear division of responsibility between the Assets and Property Group and the RPDP team. The Assets and Property Group was responsible for identifying suitable sites and obtaining the necessary designations and resource consents to build and operate a prison (which required consultation with the community). The RPDP team was responsible for managing the detailed design (including consultation on design-related matters), construction, and commissioning of the new prisons. Each group reported to its own governing body (the National Services and Facilities Committee and the RPDP Steering Group respectively) on project risks and progress to achieve milestones.
- 11.31 The National Services and Facilities Committee provided formal oversight of the early consultation, while the RPDP Steering Group oversaw the later consultation. However, delays with the Ngawha and Spring Hill projects meant that the Assets and Property Group handed responsibility for consultation at both locations to the RPDP team part-way through the RMA and associated consultation processes.⁵ At Ngawha, this occurred in February 2001 after the Northland Regional Council declined the required resource consent for the prison. At Spring Hill, the handover occurred in March and April 2002, when the RPDP team assumed responsibility for completing the consultation with the public and iwi, and for seeking the necessary approvals from the respective councils. The Assets and Property Group and the RPDP team worked closely together, and the two governance bodies received parallel reports on progress.
- 11.32 In late 2004, the Department's internal auditor commissioned Audit New Zealand to review project risks specific to the Northland prison. Audit New Zealand's report identified a number of issues relating to the governance and monitoring arrangements for the RPDP Steering Group (for example, that there had not been enough reporting from the RPDP team to the Steering Group). The Department consequently decided to restructure the RPDP team.
- 11.33 In this restructuring, the Department split the RPDP team into three distinct groups. One group was responsible for all construction matters, while another was given responsibility for commissioning the new prisons. The third group, the Programme Management Office, was set up as a dedicated resource for reporting on project and risk management. Before the restructuring, reporting tasks had been carried out by staff who also had busy day-to-day project delivery roles. The 2006 *Report of the State Services Commissioner into the Cost Escalation in the Regional Prisons Development Project*⁶ noted that the changes to the governance structure had "greatly increased the quality of review, reporting and decision making on the projects".⁷

5 The Department opted not to take this approach for the Auckland Women's and Otago prisons. Instead, it followed the division of responsibility set out in paragraph 11.30.

6 State Services Commission, 2006, page 54.

7 After cost increases in the construction of the Spring Hill and Otago prisons in late 2005, Cabinet invited the State Services Commission, in consultation with the Treasury, to review the processes, systems, and contracting practices in the RPDP to learn lessons for future capital projects and to determine the cause of the cost increases. The report was released in August 2006 and is available on the SSC website: <http://www.ssc.govt.nz/report-prisons-cost-escalation>.

Consultation strategies

- 11.34 Consultation strategies provide overall direction and purpose to a consultation process. Careful planning is necessary to ensure that public entities can demonstrate to decision-makers that they followed an effective consultation process.
- 11.35 In 1997 and 1998, the Department developed project plans and communications strategies for the consultation needed to identify and assess suitable sites for new prisons. After the delay in the site selection process for the men's prison at South Auckland (see paragraph 11.21), the Department drew up more detailed consultation strategies. There was an overarching strategy for all four prisons, a strategy for the Department's communications with Māori, and a consultation plan specific to Spring Hill prison.
- 11.36 After the delays at Ngawha (see paragraph 11.31), the Department commissioned an expert review of the Ngawha consultation process to identify lessons learned and to improve consultation at the other new prisons (including Spring Hill prison). The reviewer reported back in October 2001, and commented that the original consultation strategy for Ngawha prison had been incomplete.
- 11.37 The Department incorporated the lessons from the October 2001 review into a new consultation strategy for all prisons, with specific plans for Auckland Women's prison and Spring Hill prison (even though consultation on the Spring Hill site had already started), and the Otago prison.
- 11.38 The consultation plan for the Spring Hill site set out who the Department expected it would need to engage with and provided a timetable for consultation. The plan acknowledged that the purpose of the consultation was not only to meet RMA requirements but also to build relationships (with Māori especially) for the long term.
- 11.39 The October 2001 review noted that the Department had experienced difficulties at Ngawha because the designation and resource consent applications were dealt with at separate hearings (one for the notice of requirement at the district council, and one for resource consents at the regional council). This gave opponents of the prison two opportunities to formally object to the project. The Spring Hill consultation reflected this lesson, by noting that there would be a joint council hearing of the notice of requirement and the application for resource consents.

Contracting specialist support

- 11.40 At the time of setting out to build new prisons, the Department recognised that it had limited technical experience and expertise in running such large-scale consultation and RMA processes. Most of the staff responsible for consultation

were based in Wellington, and the Department therefore employed community liaison advisers to support site managers and help the Department to engage with local communities.

- 11.41 The core team of Department staff was supported by a team of external consultants and advisers, including community liaison advisers, resource management consultants, social impact assessment specialists, and technical specialists. The Department's legal advisers provided strategic advice for the project and reviewed processes from a legal perspective.
- 11.42 At Ngawha, the Department initially contracted planning experts to support the consultation process. This included assistance and technical expertise for preparing the notice of requirement and applications for resource consents. However, difficulties arose during the council hearing that were primarily legal in nature. As a result, the Department's legal advisers assumed a greater role in preparing and co-ordinating notice-of-requirement documentation for each of the other three new prisons.
- 11.43 Once the Spring Hill site had been identified, the Department contracted local assistance for site-specific consultation. This included contracts with kaitiaki representatives to assist the Department in its consultation with Māori. It also contracted a planning expert to co-ordinate advice on prison design and social effects, and reports on other technical matters needed for the notice of requirement and Environment Court processes.
- 11.44 The Department considered that the strategic advice of its legal advisers had been very useful to the Spring Hill project, and to the overall prison building programme. Similarly, the Department considered the use of community liaison advisers to be a strength of the Ngawha, Auckland Women's, and Spring Hill consultation processes.
- 11.45 The close operating relationship between the Department and its legal advisers continued beyond the Spring Hill consultation and designation process. The legal advisers also provided strategic input into the consultation process at Otago, and helped to co-ordinate the compilation of technical documentation for the Otago notice of requirement and associated council hearing processes.
- 11.46 One result of the Department's contracting approach was that there was only a small core of Department staff assigned to the overall project. This meant that the project relied heavily on the expertise of a few individuals, and on the relationships those individuals had formed over time with the local communities. The Department told us that it had initially underestimated what the overall process required and could have allocated more resources at an earlier stage

(especially in the area of administrative support). It also acknowledged that it had faced risks of crucial personnel leaving the project.

- 11.47 The Department continued to refine its consultation processes during the remainder of the overall project. Additional staff joined the project, and additional resources were applied to reporting and risk management. Staff consulting on the Otago prison site considered that they had been well resourced, and were able to engage specific expertise as it was needed.

Systems for communicating with the public

- 11.48 The implementation of consultation plans needs to be supported by effective systems and processes, especially for supporting direct interaction between a public entity and the public.
- 11.49 The Department's approach to consulting on its prison building programme emphasised the need to develop and maintain effective relationships and communications with the public.
- 11.50 The Department considered that a range of systems and approaches had worked well at Ngawha, and used them again at Spring Hill. These included:
- establishing an 0800 number as a point of contact for the public;
 - compiling and maintaining a mailing list of interested parties;
 - keeping a record of (and distributing answers to) frequently asked questions;
 - preparing a range of information sheets about the proposed prison, as well as aspects of prison construction and management (in some cases tailored specifically to Spring Hill and sometimes translated so that they could be distributed to the various local communities); and
 - maintaining a public profile through local media and advertising, and issuing Department publications such as newsletters (to provide project updates on a regular basis).
- 11.51 The Department operated a policy of face-to-face meetings if requested, and of responding promptly to communication (such as questions, and requests and actions arising from meetings) from the public. Contract writers were employed at busy periods to ensure that members of the public received timely responses to correspondence and other requests. Local communities appreciated visits from the Minister and Department executives.
- 11.52 The Department held public information days in the communities close to the Spring Hill site, and also held public meetings. The Department assessed the likely nature of these meetings and identified the Department staff and contractors who would be best suited to address questions from the public.

- 11.53 At Ngawha, the Department initially focused on building relationships with the community rather than on obtaining all of the information needed to satisfy RMA requirements. At Spring Hill, the Department commissioned reports on each of the shortlisted sites and released these to the community so that members of the public would have more detailed information, at an earlier stage, on which to base their feedback.

Administration systems

- 11.54 Under the RMA, a requiring authority lodging a notice of requirement or resource consent must submit a record of any consultation that it has carried out. Therefore, it is particularly important that there are systems in place to detail what consultation has taken place, and to record the results.
- 11.55 The expert review of the Ngawha consultation process commissioned by the Department found that the record keeping systems had not worked well. Although the Department had been able to produce a final record of the Ngawha consultation, this had taken additional administrative work to identify all instances of consultation. An incomplete record would have caused the Department's systems to appear weak during council or Environment Court hearings.
- 11.56 These issues were addressed for the Spring Hill project. For example, attention was given to establishing and maintaining a consultation database. The Department recorded the date of consultation, who had been consulted, the means of consultation, what feedback was provided, and what actions were agreed. This was useful as it provided a single information source for specialists assessing the potential effect of the prison, and allowed the Department to produce a detailed record of all consultation to a standard suitable for presentation to the Environment Court.
- 11.57 The administration systems used for the Spring Hill project were an improvement on those used at Ngawha. Accordingly, the Department used a similar database to record consultation about Otago prison, and continued to ensure that its documentation met Environment Court standards.
- 11.58 However, these improvements did not protect the Spring Hill project from disruption by third parties. For example, the Department had written to neighbours of the Spring Hill site advising them of the Minister's decision to seek a designation over the site, but an irregularity in the delivery process meant that some neighbours of the site received information ahead of others. This led to uncertainty in the community, which meant that the Department had to spend time explaining the situation to the neighbours of the site. Although this was a minor administrative matter, it had consequences that required close management by the Department to resolve.

- 11.59 The Department used the same approach to communications for the Otago prison that it had used for Spring Hill prison, but with some changes to take account of what it had learned. For example, at the time of the Minister's announcement that the Milburn site in Otago had been identified for detailed technical assessment and public consultation, the Department arranged for hand-delivery of key correspondence to the neighbours of the Otago prison site.

Consultation with Māori

- 11.60 The RMA requires decision-makers to take into account the principles of the Treaty of Waitangi. One of these principles is a duty to make informed decisions. While this duty is not absolute, it does require the Crown to consult with Māori on major issues. In its overall consultation strategy for the new prisons, the Department recognised that it had a duty to consult with Māori, especially those who held kaitiaki status over potential prison sites.
- 11.61 The Ngawha prison consultation eventually led to a formal partnership being set up between the Department and local Māori. The Department wanted to establish a similar partnership at all other sites, including the Spring Hill site.
- 11.62 The Department consulted with Māori about the Spring Hill site to understand the cultural effects of the planned prison, and to identify and establish relationships with the kaitiaki of the site. The Assets and Property Group and the RPDP team contracted local expert Māori to help identify key Māori with whom to consult and to make the appropriate introductions on behalf of the Department. The Department also made use of the experience of its own Māori policy teams in this regard.
- 11.63 Identifying Māori with kaitiaki status over the Spring Hill site took longer than expected. The Department was under time pressure to start the consultation process, and so as an interim measure it contracted a number of local individuals to assist the Department in its consultation with Māori. We discuss some issues that arose as a result of these contracts in paragraphs 11.68-11.76. By May 2002, the Department's relationship with the main Waikato iwi was advanced enough for a formal kaitiaki group to be mandated to deal with the Department about the Spring Hill site.
- 11.64 After the identification of a mandated kaitiaki group, the existing contracts with the individual Māori consultation advisers were replaced by two main contracts between the Department and the representative organisations of the kaitiaki group. Under these contracts, the kaitiaki provided assistance to the Department by:
- organising consultation meetings attended by the Department;

- producing technical reports on historical and cultural aspects of the site for the purposes of seeking a designation under the RMA; and
- providing professional architectural advice on design aspects of the new prison.

- 11.65 One of the objectives of the two main contracts was to build organisational capacity so that the kaitiaki could operate as an equal partner. Accordingly, the Department provided funding to the kaitiaki for project management and administration tasks (for example, it provided funding for full- and part-time staff to carry out these roles).
- 11.66 The kaitiaki were involved in setting operational policies and designing courses to be provided to inmates. In addition, the kaitiaki nominated several local people to receive training in interview techniques and who were part of the selection panel for staff recruitment for Spring Hill prison.
- 11.67 The Department set up and funded a Kaitiaki Support Team to co-ordinate feedback from the kaitiaki groups for each prison site and to provide input into decision-making forums. The role of the Kaitiaki Support Team included conducting joint review of important papers as a source of formal input into the design and commissioning processes. The Department found the Kaitiaki Support Team to be a useful feedback system and is investigating ways in which the team can contribute to the ongoing operation of the new prisons. In addition, by drawing on its previous experience, the Department has incorporated the wider learning from its consultation with Māori into a Department-wide kaitiaki consultation strategy. It hopes to be able to set up kaitiaki relationships at other prisons, where suitable.

Managing consultation contracts

- 11.68 Government agencies that contract for services from non-government organisations are accountable for public resources used by those organisations. Both parties need to understand their respective obligations and ensure that the terms of the contract are adhered to. Effective contract management is important to ensure transparency over the use of public resources.
- 11.69 A number of allegations were made about the way in which the Department managed contracts for consultation activities with Māori at Spring Hill (see paragraph 11.05). The Department investigated the allegations regarding the contracts and reported back to the Minister of Corrections in April 2004. In the report, the Department accepted that the process for managing consultation with Māori could have been better managed.

- 11.70 The Department considered that there had been too many individuals contracted to provide consultation services at Spring Hill in 2001/02 and 2002/03, in the period before it had reached agreement on the formal kaitiaki mandate and set up the two main contracts for consultation. The Department also noted that more detailed background checks should have been carried out, as one of the individuals contracted was found to be facing fraud charges (unrelated to the work with the Department). In addition, the Department did not stand down the contractor once the charges were brought to its attention.
- 11.71 The Department also identified other concerns, including that there had not been enough monitoring and review of the contracts. It identified contracts with prices that were potentially higher than market value and thus did not ensure value for money.
- 11.72 The Department reported that, for the whole of the new prisons project, existing consultation contracts would be reviewed and a report made to the Minister. The Department also said it would tighten its contract management processes, and bring future contracts for consultation to the Minister's attention.
- 11.73 At the time of our review, the Department was able to provide evidence that contract management practices had been reviewed and improved since the Spring Hill prison consultation experience. We also saw evidence of some reporting to the Minister on existing consultation contracts, with an internal audit review of one of the main consultation contracts completed and reported to the Minister.
- 11.74 The Department's contracting procedures for new prisons evolved during the course of the overall project. At the start, the Department's main set of policies and procedures for contract management were set out in its Finance Manual. As the project progressed and the RPDP team was established, a range of more specific manuals were developed, including:
- a procurement manual;
 - a contract management manual; and
 - guidelines for appropriate costs for contracting with Māori.
- 11.75 The Department had not awarded any new contracts for kaitiaki consultation since it reported to the Minister in April 2004. However, there had been contracts with kaitiaki for services for the commissioning and ongoing operation of the Auckland Women's, Spring Hill, and Otago prisons. The Minister received briefing reports on the proposed agreements for kaitiaki services at these prisons and approved the draft contracts.

- 11.76 The Department's management of contracts for kaitiaki services has been tightened since the Spring Hill project was completed. The Department's contracts now include detailed performance expectations and enforceable accountabilities. This decision was driven by the controversy about contracts with Māori advisers for Spring Hill prison. Department staff we interviewed were all very aware that contracts were to be tightly managed.
- 11.77 The Department also noted that this strict approach to contracting sometimes caused tensions in the relationships between the Department and the kaitiaki groups contracted at each prison. This issue led the Department to conduct research into the way it contracts with all non-government organisations (that is, those that provide health, spiritual, and rehabilitation support to prisoners), and the appropriateness of using highly commercial contracting approaches to achieve outcomes in a non-commercial sector.

Conclusion

- 11.78 The Department's project to deliver four new prisons presented challenges for a public entity with little experience in consultation under the RMA for the purposes of constructing large public works. These challenges were compounded by the fact that the new prison projects overlapped each other, at times creating pressure on project resources. There was also a pressing need to deliver new prisons within defined time frames to meet high growth in the number of prisoners.
- 11.79 Accordingly, the Department had to establish new systems, policies, and processes to support consultation under the RMA, and these evolved throughout the process. Although lessons were learned and several improvements were made, these were put in place later than they ideally should have been. One way to have avoided this would have been to implement a system of regular reviews at key consultation milestones throughout the entire project, with the intention of amending systems, policies, and processes as required.
- 11.80 We are pleased that the Department is conducting a formal "lessons-learned" review for the process as a whole, as part of finalising the RPDP. This was due to be reported to the Department in mid-March 2008.

Appendix 1

Our work on service performance information in 2007/08

Our audit emphasis involved reviewing 2007/08 SOIs for most government departments and Crown entities to understand the strategic and outcome context for annual SSP performance measures, as well as entities' processes and rationale for including these in the SOI. Our reviews covered the following information required under the Public Finance Act 1989 for government departments and the Crown Entities Act 2004 for Crown entities as related to the two components of service performance reports:

<p>The SOI medium-term, outcomes-oriented component:</p> <ul style="list-style-type: none"> • As the contextual base for the forecast SSP. • As a major reference for drawing conclusions on the “appropriateness” of the forecast SSP elements (outputs and output classes, measures, and standards). 	<p>Public Finance Act, section 40. Crown Entities Act, section 141.</p>
<p>The SOI annual, outputs-oriented component (forecast SSP):</p> <ul style="list-style-type: none"> • As the framework against which the actual performance is to be reported in the annual report. 	<p>Public Finance Act, section 41. Crown Entities Act, section 142.</p>

Overall, we expected that entities would have a performance reporting framework comprising:

- the medium-term component, including information on the reporting entity's objectives, outcomes, impacts, and operating intentions, together with related performance measures and standards and other information required by legislation and generally accepted accounting practice (GAAP):
 - clearly identified outcomes and supporting discussion on the entity's role, functions, strategic priorities, challenges, and risks to provide the context for the entity's role and functions; and
 - main measures and standards for outcomes, objectives, or impacts that are clearly specified and that cover a period of three years and provide baseline data that places measures and standards in a more meaningful context and allows progress to be tracked;
- the annual forecast SSP component, including information on the reporting entity's intended outputs, together with related performance measures and standards and other information required by legislation and GAAP:
 - logically aggregated output classes/outputs with clearly specified outputs that focus on external impacts; and
 - clearly specified performance measures and standards that are relevant and balanced, and provide baseline data for measures and standards; and

- a coherent structure and integrated contextual information that makes evident, through linking within and between the information in the two components:
 - the reasons for the entity's outputs; and
 - the focus of its reporting including the rationale for, and the relationships among, the elements, performance measures, and standards.

We based the content and qualities expectations against which we reviewed SOIs mainly on the following sources:

- applicable public accountability information requirements – for example:
 - Public Finance Act 1989 (and related Treasury/SSC guidance);¹
 - Crown Entities Act 2004 (and related Treasury/SSC/DPMC guidance);² and
 - Local Government Act 2002; and
- *Statement of Concepts for General Purpose Financial Reporting* (ICANZ), interpreted and modified by us for application to service performance reporting:
 - TPA-9, *Service Performance Reporting* (ICANZ); and
 - AG-4, *Audit of Service Performance Reports* (OAG).

1 The Treasury and the State Services Commission (March 2007), *Guidance and Requirements for Departments: Preparing the Statement of Intent*.

2 The Treasury and the State Services Commission in consultation with the Department of the Prime Minister and Cabinet (September 2005), *Preparing the 2006/07 Statement of Intent – Guidance and Requirements for Crown entities*.

Appendix 2

Details of the non-standard audit reports issued in 2007

Except-for opinions for schools

Coastal Taranaki School

Financial statements years ended: 31 December 2005 and 31 December 2006

Our audit was limited because we were unable to verify some expenses due to limited control over those expenses.

Glenfield Primary School

Financial statements year ended: 31 December 2005

Our audit was limited because we were unable to verify some expenses due to limited control over those expenses.

Hamilton Boys' High School

Financial statements year ended: 31 December 2006

We disagreed with the Board of Trustees recognising the land the school occupies as an asset in the Statement of Financial Position, despite the fact that the Board has been advised that it does not own the land.

Henderson Intermediate School

Financial statements year ended: 31 December 2006

Our audit was limited because we were unable to verify some revenue due to limited control over that revenue.

Henderson North School

Financial statements year ended: 31 December 2006

Our audit was limited because we were unable to verify some revenue and expenses due to limited control over those amounts.

Kohia Terrace School

Financial statements year ended: 31 December 2006

Our audit was limited because we were unable to verify some revenue due to limited controls over that revenue.

Kopane School

Financial statements year ended: 31 December 2006

Our audit was limited because we were unable to verify the provision for cyclical maintenance that the Board of Trustees recognised in its financial statements (there was insufficient evidence available to accurately measure the obligation).

Mangorei School

Financial statements year ended: 31 December 2006

We disagreed with the Board of Trustees not reporting budget figures in the Statement of Financial Position. This is a departure from statutory reporting requirements.

Mansell Senior School

Financial statements year ended: 31 December 2006

Our audit was limited because we were unable to verify some revenue and expenses due to some source documentation being manipulated or destroyed by a former employee of the school.

Marist School (Herne Bay)

Financial statements year ended: 31 December 2006

We disagreed with the Board of Trustees transferring public funds to a third party without appropriate authority.

Mornington School

Financial statements year ended: 31 December 2006

We disagreed with the Board of Trustees not preparing group financial statements. This is a departure from Financial Reporting Standard No. 37: *Consolidating Investments in Subsidiaries*, which requires the Board to present consolidated financial statements including its subsidiary, the Mornington School Community Trust.

Orauta School

Financial statements period ended: 28 January 2005

We disagreed with the Board of Trustees not reporting budget figures in the Statement of Financial Position. This is a departure from statutory reporting requirements. In addition, our audit was limited because we were unable to verify some expenses due to a lack of appropriate documentation to support the expenses. Our audit was limited because we were unable to review the board minutes, which were not available.

Orewa Primary School

Financial statements year ended: 31 December 2006

Our audit was limited because we were unable to verify some revenue and expenses due to a lack of appropriate documentation to support the revenue and expenses.

Sacred Heart College (Auckland)

Financial statements year ended: 31 December 2006

Our audit was limited because we were unable to verify some revenue due to limited controls over that revenue. In addition, our audit was limited because we were unable to obtain sufficient evidence to support the validity of funds transferred by the Board of Trustees to other entities.

St Dominic's College (Henderson)

Financial statements year ended: 31 December 2006

We disagreed with the Board of Trustees transferring public funds to a third party without appropriate authority.

St John's College (Hillcrest)

Financial statements year ended: 31 December 2006

We disagreed with the Board of Trustees not recognising some of its buildings and land improvements in the financial statements, which has the effect of understating the total assets and the depreciation expenses of the school.

St Matthew's School (Marton)*Financial statements year ended: 31 December 2006*

Our audit was limited because we were unable to verify the provision for cyclical maintenance that the Board of Trustees recognised in its financial statements (there was insufficient evidence available to accurately measure the obligation).

St Michael's School (Remuera)*Financial statements year ended: 31 December 2006*

We disagreed with the Board of Trustees transferring public funds to a third party without appropriate authority.

Stanhope Road School*Financial statements year ended: 31 December 2006*

Our audit was limited because we were unable to verify some revenue and expenses due to limited control over those amounts.

Stanmore Bay School*Financial statements year ended: 31 December 2005*

Our audit was limited because we were unable to verify some revenue and expenses due to limited control over those amounts.

Taumarunui High School and Community Trust*Financial statements year ended: 31 December 2006*

Our audit was limited because we were unable to verify some revenue due to limited controls over that revenue.

Te Kura Kaupapa Māori O Te Rito*Financial statements year ended: 31 December 2006*

Our audit was limited because we were unable to verify some expenses due to a lack of appropriate documentation to support the expenses.

Te Kura Kaupapa Māori O Wairarapa*Financial statements year ended: 31 December 2005*

Our audit was limited because we were unable to verify some revenue due to limited controls over that revenue. In addition, our audit was limited because we were unable to obtain adequate assurance to verify the quantities and condition of inventory. Our audit was also limited because we were unable to obtain sufficient evidence to support the amounts owing to and from third parties.

Te Kura Kaupapa Māori O Wairarapa*Financial statements year ended: 31 December 2006*

Our audit was limited because we were unable to verify some expenses because the Board of Trustees did not keep sufficient records. In addition, our audit was limited because we were unable to verify the closing balances of inventory and the income and expenses associated with the sale of inventory because there were insufficient records. We also disagreed with the Board setting off some revenue against expenses, thereby understating both.

Te Kura O Te Whakarewarewa*Financial statements year ended: 31 December 2006*

Our audit was limited because we were unable to verify the provision for cyclical maintenance that the Board of Trustees recognised in its financial statements (there was insufficient evidence available to accurately measure the obligation).

Te Tino O Pourangi**Financial statements year ended: 31 December 2004*

Our audit was limited because we were unable to verify some expenses due to limited control over those expenses. In addition, our audit was limited because no inventory count information was available to verify the value of inventory on hand. We noted that the going concern assumption had not been used in preparing the financial statements because the Board of Trustees was wound up at 31 March 2007.

Wakaaranga School*Financial statements years ended: 31 December 2004 and 31 December 2005*

Our audits were limited because we were unable to verify some revenue and expenses due to some source documentation being manipulated or destroyed by a former employee of the school.

Wanganui City College*Financial statements year ended: 31 December 2006*

We disagreed with the Board of Trustees for not preparing group financial statements. This is a departure from Financial Reporting Standard No. 37: *Consolidating Investments in Subsidiaries*, which requires the Board to present consolidated financial statements including its subsidiary, the College House Hostel Trust.

Wellington East Girls' College*Financial statements year ended: 31 December 2006*

We disagreed with the Board of Trustees' decision to increase the amount owing to trusts for bequests received to help restore the capital value of the bequests. This is a departure from Financial Reporting Standard No. 15: *Provisions, Contingent Liabilities and Contingent Assets*, which requires provisions to be valued at their present obligation.

Wellington Girls' College*Financial statements year ended: 31 December 2006*

We disagreed with the Board of Trustees not preparing group financial statements. This is a departure from Financial Reporting Standard No. 37: *Consolidating Investments in Subsidiaries*, which requires the Board to present consolidated financial statements including its subsidiary, the Wellington Girls' College Charitable Foundation.

Whanganui Awa School*Financial statements year ended: 31 December 2006*

Our audit was limited because we were unable to verify the provision for cyclical maintenance that the Board of Trustees recognised in its financial statements (there was insufficient evidence available to accurately measure the obligation).

* The Board of Trustees comprising activities at Te Kura Kaupapa Māori O Wairipo, Te Kura Kaupapa Māori O Te Waiu O Ngati Porou, and Te Kura Kaupapa Māori O Mangatuana.

Woodford House

Financial statements year ended: 31 December 2006

Our audit was limited because we were unable to verify the provision for cyclical maintenance that the Board of Trustees recognised in its financial statements (there was insufficient evidence available to accurately measure the obligation).

Explanatory paragraphs for schools

Breaches of law by type and number

Not reporting by 31 May 2007 (79 schools)

Boards have a statutory obligation to issue their audited financial statements by 31 May. We noted that 79 schools had breached the law by failing to meet this statutory reporting deadline, and had not chosen to disclose the breach in their financial statements.

Variation statements (3 schools)

Schools are obliged by the Education Act 1989 to include, in their annual reports, statements comparing their performance against their objectives. We noted that 3 schools had breached the law by not including such statements in their annual reports.

Expenditure by integrated schools on capital works (22 schools)

Integrated schools are not permitted to incur expenditure on capital works owned by proprietors without the approval of the Ministry of Education and the proprietor's written recognition of the board's financial interest. We noted that 22 schools had breached the law by using their funds to pay for improvements to buildings on land owned by the schools' proprietors. A large number of schools made voluntary disclosure of this inadvertent breach of the law in their financial statements. Our 2007 report *Central government: Results of the 2005/06 audits* provided detailed comments on the issues involved (see Part 7 – Unlawful expenditure by schools).

Borrowing without approval (14 schools)

Boards are not permitted to borrow above a prescribed limit without the approval of the Ministers of Education and Finance. We noted that 14 schools had breached the law by not seeking authority from the joint Ministers for borrowing above the limit. One school also did not fulfil the conditions of its borrowing.

Investing in non-approved institutions (8 schools)

In order to safeguard public money, schools may invest their surplus funds only in approved banking and other institutions. We noted that 8 schools had breached the law by investing in non-approved banking institutions without the authority of the Ministers of Education and Finance.

Payment in advance to staff (16 schools)

Schools are not permitted to pay their staff in advance without the approval of the Ministry of Education. We noted that 16 schools had paid some of their staff in advance, to make use of government grants that would otherwise have been lost. This was in anticipation of the staff working without pay in the future.

Code of Practice for Pastoral Care for International Students (2 schools)

We noted that 2 schools had enrolled overseas students without being a signatory to the relevant Code of Practice. One school also did not calculate fees for international students in accordance with the provisions of section 4B of the Education Act 1989.

Emphasis of matter by type and number**Closures (6 schools)**

Accounting standards require schools that have been or are being closed to prepare their financial statements on the basis that they are not a “going concern”.

We noted that 6 closed schools had prepared their financial statements correctly.

Serious financial difficulties (17 schools)

Some schools are in serious financial difficulty, mainly because of large working capital deficits.

We noted that 17 schools had included disclosures in their financial statements that outlined their financial difficulties and the actions they are taking to address the factors that had resulted in those difficulties.

Integration Agreement (6 schools)

Integrated schools are required to have an Integration Agreement between the Minister of Education and the proprietors. We noted 6 instances where there had been a change in the proprietor and there was no Integration Agreement in place between the Minister of Education and the new proprietor.

Other reasons (12 schools)

Our audit reports included explanatory paragraphs for other reasons:

- One school was using a bank account that was not under its direct control and authority.
- One school acquired an interest in land without the approval of the Minister of Education.
- One school had made payments of additional remuneration to teachers without the approval of the Secretary for Education.
- Two schools had made payments to staff outside the Ministry of Education payroll service.
- One school did not exclude a board member having a pecuniary or other interest in a matter from attending that part of the board meeting when the matter was considered.
- One school did not exclude proprietor representatives from meetings in which financial arrangements were made between the school and the proprietor.
- One school did not meet the minimum of three parent representatives on the Board.
- One school did not have a policy for managing conflicts of interests relating to the school's international student programme and did not review the procedures for the programme.
- One school made an inappropriate transfer of public funds to a trust, which was subsequently returned.
- One school that had previously received money by way of loan from the proprietor wrote off the balance of the amount owing and recognised it as donation revenue because the loan from the proprietor was unlawful.
- One school with irregularities over expenses had referred the matter to the Police.

Adverse opinions for other public entities

Queen Elizabeth II Army Memorial Museum

Financial statements year ended: 30 June 2007

We disagreed with the Trustees not recognising the museum collection assets of the Museum nor the associated depreciation expense, in the Museum's financial statements. These are departures from Financial Reporting Standard No. 3: *Accounting for Property, Plant and Equipment*, which requires museum collection assets not previously recognised to be recognised at fair value and depreciated where appropriate.

RNZAF Museum Trust Board

Financial statements year ended: 30 June 2007

We disagreed with the Trustees not recognising the museum collection assets of the Museum nor the associated depreciation expense, in the Board's financial statements. These are departures from Financial Reporting Standard No. 3: *Accounting for Property, Plant and Equipment*, which requires museum collection assets not previously recognised to be recognised at fair value and depreciated where appropriate.

Royal New Zealand Navy Museum Trust Incorporated

Financial statements year ended: 30 June 2006

We disagreed with the Trustees not recognising the museum collection assets of the Museum Trust nor the associated depreciation expense, in the Trust's financial statements. These are departures from Financial Reporting Standard No. 3: *Accounting for Property, Plant and Equipment*, which requires museum collection assets not previously recognised to be recognised at fair value and depreciated where appropriate. In addition, we were unable to verify some cash sales and donations due to limited control over those revenues.

Disclaimers of opinion for other public entities

Pacific Islands Polynesian Education Foundation

Financial statements year ended: 31 December 2001

We were unable to form an opinion on the statement of financial performance and statement of cash flows because the Board did not keep sufficient accounting records, including source documents. However, the financial statements fairly reflected the Foundation's financial position.

Except-for opinions for other public entities

Christchurch Polytechnic Institute of Technology and Group

Financial statements year ended: 31 December 2006

We disagreed with the CPIT Council not preparing consolidated financial statements for the Group. This is a departure from Financial Reporting Standard No.37: *Consolidating Investments in Subsidiaries* (FRS-37). As the Council did not prepare group financial statements in accordance with FRS-37 for the year ended 31 December 2005, there is no comparative information for the Group in the 2006 financial statements.

Christchurch College of Education*Financial statements year ended: 31 December 2006*

We disagreed with the accounting treatment to recognise a convertible suspensory loan (to assist with the costs of the merger between the College of Education and the University of Canterbury) as income. In our opinion, the amount of the loan should have been recognised as a capital contribution from the Crown in the College's Statement of Movements in Equity. We noted the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements because the College was merged with the University of Canterbury on 1 January 2007.

New Zealand Centre for Reproductive Medicine Limited (a company jointly controlled by the University of Otago and Canterbury District Health Board)

Financial statements year ended: 30 June 2007

We disagreed with the Board of Directors not preparing a Statement of Intent for the year beginning 1 July 2006 as required by the Crown Entities Act 2004, and therefore not preparing a statement of service performance that fairly reflects its service achievements. However, the financial statements of the company gave a true and fair view of the financial position, results of its operations, and cash flows. We noted that the company adequately disclosed in the financial statements the shareholders' intentions to dispose of their interests in the company by the end of 2007, and for prospective purchasers of the company to have the option of either bidding for the shares or for the business. We also noted that the company did not prepare a statement of intent for the period beginning 1 July 2007.

Delta S Technologies Limited (an indirect subsidiary of the University of Otago)

Financial statements year ended: 31 March 2005

Our audit was limited because the financial statements of the company had not previously been audited. Therefore, we did not form an opinion about the comparative information and noted that any misstatement of the comparative figures would affect the results for the year ended 31 March 2005.

Delta S Technologies Limited (an indirect subsidiary of the University of Otago)

Financial statements year ended: 31 March 2006

Our audit was limited (in respect of comparative information only) because the financial statements of the company were first independently audited for the year ended 31 March 2005. Therefore, we did not form an opinion about the comparative information on the opening balances in the financial position of the company as at 1 April 2004. Any misstatement of these opening balances would affect the results for the year ended 31 March 2005. In our opinion, the financial statements gave a true and fair view of the company's financial position, the results of its operations, and cash flows for the year ended 31 March 2006.

Ngati Whakaue Education Endowment Trust Board

Financial statements year ended: 31 December 2006

Our audit was limited because we were unable to confirm the value of the Trust Board's land that was classified as investment property. The land had not been revalued but instead was recognised at its rating value. This is a departure from Statement of Standard Accounting Practice No. 17: *Accounting for Investment Properties and Properties Intended for Sale*, which requires the investment property to be revalued annually to net current value.

Te Wānanga O Aotearoa Te Kuratini O Nga Waka*Financial statements year ended: 31 December 2004*

Our audit was limited because we were unable to verify that related party transactions were properly recorded and disclosed in the financial statements in accordance with Financial Reporting Standard No. 9: *Information to be Disclosed in Financial Statements* and Statement of Standard Accounting Practice No. 22: *Related Party Disclosures* due to limited controls over related party transactions. We also noted the uncertainties surrounding the going concern assumption. The validity of the going concern assumption depended on the number of equivalent full-time students for the years ending 31 December 2007 and 31 December 2008, and the Council's negotiations for a \$20 million Crown suspensory loan to settle an outstanding Treaty of Waitangi claim.

Te Wānanga O Aotearoa Te Kuratini O Nga Waka*Financial statements year ended: 31 December 2005*

Our audit was limited because we were unable to verify that related party transactions were properly recorded and disclosed in the financial statements in accordance with Financial Reporting Standard No. 9: *Information to be Disclosed in Financial Statements* and Statement of Standard Accounting Practice No. 22: *Related Party Disclosures*, due to limited controls over related party transactions for a limited period of time before the appointment of a Crown Manager. The scope of the audit on the comparative information was limited because the Wānanga and group did not maintain adequate systems and controls during the year ended 30 June 2004 to identify all related party transactions. We also noted the uncertainties surrounding the going concern assumption. The validity of the going concern assumption depended on the number of equivalent full-time students for the years ending 31 December 2007 and 31 December 2008, and the Council's negotiations for a \$20 million Crown suspensory loan to settle an outstanding Treaty of Waitangi claim.

MO1 Limited (a subsidiary of Te Wānanga O Aotearoa Te Kuratini O Nga Waka)*Financial statements years ended: 31 December 2003, 31 December 2004, and 31 December 2005*

Our audit was limited because we were unable to verify that related party transactions were properly recorded and disclosed in the financial statements in accordance with Financial Reporting Standard No. 9: *Information to be Disclosed in Financial Statements* and Statement of Standard Accounting Practice No. 22: *Related Party Disclosures*, due to limited controls over related party transactions. The scope of the audit on the comparative information for the years ended 31 December 2004 and 31 December 2005 was limited because the company did not maintain adequate systems and controls during the years ended 31 December 2003 and 31 December 2004 to identify all related party transactions.

Victoria University of Wellington and Group*Financial statements year ended: 31 December 2006*

We disagreed in the previous accounting period with the accounting treatment to incorporate the net assets of the Wellington College of Education into the University as an unusual item in the University's Statement of Financial Performance. In our opinion, the net assets should have been treated as a contribution from the Crown in the University's Statement of Movements in Equity. Because we had previously disagreed with the accounting treatment, we disagreed with the comparative information disclosed in the 31 December 2006 financial statements that related to transactions in the previous accounting period.

Ivey Hall and Memorial Hall 125th Anniversary Appeal Gifting Trust (a trust controlled by Lincoln University)

Financial statements years ended: 31 December 2004, 31 December 2005, and 31 December 2006

Our audit was limited because we were unable to verify some revenue due to limited controls over that revenue.

Ivey Hall and Memorial Hall 125th Anniversary Appeal Taxable Activity Trust (a trust controlled by Lincoln University)

Financial statements years ended: 31 December 2004, 31 December 2005, and 31 December 2006

Our audit was limited because we were unable to verify some revenue due to limited controls over that revenue.

Creative Campus Enterprises Limited (a subsidiary of Massey University)

Financial statements year ended: 31 December 2006

Our audit was limited because we were unable to verify some revenue due to limited controls over that revenue.

Three Harbours Health Foundation (a trust controlled by Waitemata District Health Board)

Financial statements year ended: 30 June 2006

Our audit was limited because we were unable to verify some revenue due to limited controls over that revenue.

Wilson Home Trust (a trust controlled by Waitemata District Health Board)

Financial statements year ended: 30 June 2006

Our audit was limited because we were unable to verify some revenue due to limited controls over that revenue.

Explanatory paragraphs (emphasis of matter) for other public entities

Northland Polytechnic and Group

Financial statements year ended: 31 December 2006

We noted that the Council did not prepare consolidated financial statements as required by section 154(2) of the Crown Entities Acts 2004.*

Counties Manukau District Health Board and Group

Financial statements year ended: 30 June 2007

We noted that the Board did not prepare consolidated financial statements as required by section 154(2) of the Crown Entities Act 2004.*

* There is a subsidiary that is not material to the group for financial reporting purposes. However, the Crown Entities Act 2004 requirement does not have regard to materiality.

New Zealand Institute for Crop and Food Research Limited*Financial statements year ended: 30 June 2007*

We noted the disclosures in the financial statements that referred to the uncertainty over the plan of raising capital to finance the development of products by the wholly-owned subsidiary, GraceLinc Limited.

GraceLinc Limited (a subsidiary of New Zealand Institute for Crop and Food Research Limited)*Financial statements year ended: 30 June 2006 and 30 June 2007*

We noted the disclosures in the financial statements that referred to the uncertainty over the outcome of the company's plans to raise new capital to finance the development of its products in the future. The viability of the company depended on the success of the company's plans in generating the necessary capital, and thereafter on the commercial success of the company's products. The validity of the going concern assumption depended on the continued financial support of the parent company and the provision of working capital from an improvement in trading performance.

NIWA Natural Solutions Limited (a subsidiary of National Institute of Water and Atmospheric Research Limited)*Financial statements year ended: 30 June 2006*

We noted the disclosures in the financial statements that referred to the uncertainty over the continuing financial support of the parent company.

Air New Zealand Associated Companies (Australia) Limited (a subsidiary of Air New Zealand Limited)*Financial statements year ended: 30 June 2006*

We noted that the financial statements were appropriately prepared on the going concern basis because the parent company had confirmed that it would provide adequate support to ensure that the company would meet its debts as they fall due.

Ansett Australia and Air New Zealand Engineering Services Limited (a subsidiary of Air New Zealand Limited)*Financial statements year ended: 30 June 2006*

We noted that the financial statements were appropriately prepared on the going concern basis because the parent company had confirmed that it would provide adequate support to ensure that the company would meet its debts as they fall due.

Air New Zealand Travel Business Limited (a subsidiary of Air New Zealand Limited)*Financial statements year ended: 30 June 2006*

We noted that the financial statements were appropriately prepared on the going concern basis because the parent company had confirmed that it would provide adequate support to ensure that the company would meet its debts as they fall due.

Eagle Air Maintenance Limited (a subsidiary of Air New Zealand Limited)*Financial statements year ended: 30 June 2006*

We noted that the financial statements were appropriately prepared on the going concern basis because the parent company had confirmed that it would provide adequate support to ensure that the company would meet its debts as they fall due.

Enzedair Tours Limited (a subsidiary of Air New Zealand Limited)*Financial statements year ended: 30 June 2006*

We noted that the financial statements were appropriately prepared on the going concern basis because the parent company had confirmed that it would provide adequate support to ensure that the company would meet its debts as they fall due.

Jetaffair Holidays Limited (a subsidiary of Air New Zealand Limited)*Financial statements year ended: 30 June 2006*

We noted that the financial statements were appropriately prepared on the going concern basis because the parent company had confirmed that it would provide adequate support to ensure that the company would meet its debts as they fall due.

Tasman Empire Airways (1965) Limited (a subsidiary of Air New Zealand Limited)*Financial statements year ended: 30 June 2006*

We noted that the financial statements were appropriately prepared on the going concern basis because the parent company had confirmed that it would provide adequate support to ensure that the company would meet its debts as they fall due.

Travelseekers International Limited (a subsidiary of Air New Zealand Limited)*Financial statements year ended: 30 June 2006*

We noted that the financial statements were appropriately prepared on the going concern basis because the parent company had confirmed that it would provide adequate support to ensure the company would meet its debts as they fall due.

Zeal 320 Limited (a subsidiary of Air New Zealand Limited)*Financial statements year ended: 30 June 2006*

We noted that the financial statements were appropriately prepared on the going concern basis because the parent company had confirmed that it would provide adequate support to ensure that the company would meet its debts as they fall due.

Carter Observatory Board*Financial statements year ended: 30 June 2006*

We noted that the financial statements were appropriately prepared on the going concern basis because the Board negotiated for continued financial support from external government agencies.

Association of Colleges of Education in New Zealand*Financial statements year ended: 31 December 2005*

We noted the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements because the Association ceased trading on 31 December 2005.

Te Arawa Maori Trust Board*Financial statements year ended 30 June 2006 and period ended 25 September 2006*

We noted the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements because the Board was disestablished on 25 September 2006.

Southland Provincial Patriotic Council

Financial statements year ended: 30 September 2006

We noted the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements because the Council resolved to disestablish once a decision was made on where the assets and liabilities would vest.

Open Mind Journals Limited (a subsidiary of The Open Polytechnic of New Zealand)

Financial statements year ended: 31 December 2005

We noted the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements because the company had ceased trading.

East City Community Education

Financial statements year ended: 30 June 2005

We noted the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements because the entity was closed on 9 December 2005.

Manukau Health Trust Limited (a subsidiary of Counties Manukau District Health Board)

Financial statements year ended: 30 June 2003

We noted the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements because the company was wound up on 14 May 2004.

Publications by the Auditor-General

Other publications issued by the Auditor-General recently have been:

- The Auditor-General's Auditing Standards – B.28(AS)
- Responses to the Coroner's recommendations on the June 2003 Air Adventures crash
- Inland Revenue Department: Effectiveness of the Industry Partnership programme
- Audit committees in the public sector
- New Zealand Trade and Enterprise: Administration of grant programmes – follow-up audit
- Mental health services for prisoners
- New Zealand Agency for International Development: Management of overseas aid programmes
- Liquor licensing by territorial authorities
- Implementing the Māori Language Strategy
- Management of conflicts of interest in the three Auckland District Health Boards
- Annual Report 2006/07 – B.28
- Turning principles into action: A guide for local authorities on decision-making and consultation
- Matters arising from the 2006-16 Long-Term Council Community Plans – B.29[07c]
- Local government: Results of the 2005/06 audits – B.29[07b]
- Effectiveness of the New Zealand Debt Management Office
- Statements of corporate intent: Legislative compliance and performance reporting
- Department of Labour: Management of immigration identity fraud

Website

All these reports are available in HTML and PDF format on our website – www.oag.govt.nz. They can also be obtained in hard copy on request – reports@oag.govt.nz.

Mailing list for notification of new reports

We offer a facility for people to be notified by e-mail when new reports and public statements are added to our website. The link to this service is in the Publications section of the website.

Sustainable publishing

The Office of the Auditor-General has a policy of sustainable publishing practices. This report is printed on environmentally responsible paper stocks manufactured under the environmental management system ISO 14001 using Elemental Chlorine Free (ECF) pulp sourced from sustainable well-managed forests. Processes for manufacture include use of vegetable-based inks and water-based sealants, with disposal and/or recycling of waste materials according to best business practices.



Office of the Auditor-General
Private Box 3928, Wellington

Telephone: (04) 917 1500
Facsimile: (04) 917 1549

Email: reports@oag.govt.nz
www.oag.govt.nz