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Parliamentary paper

Annual Report 2008/09

Office of the Auditor-General
PO Box 3928, Wellington 6140

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

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

Annual Report for the year ended 30 June 2009

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

September 2009

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Hon Dr Lockwood Smith MP
Speaker
House of Representatives
Wellington

Mr Speaker

In accordance with section 37 of the Public Audit Act 2001, I am pleased to submit the Annual Report of the Controller and Auditor-General for the year ended 30 June 2009.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Phillippa Smith', written in a cursive style.

Phillippa Smith
Deputy Controller and Auditor-General

30 September 2009

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Overview



I acknowledge and thank the outgoing Auditor-General, Kevin Brady, for his contribution as Auditor-General during the last seven years and throughout his 38-year career with the Office. Kevin's legacy is to leave the Office in good heart and widely respected for its work with the public sector.

This standing was confirmed by an International Peer Review of the Office carried out in 2007/08, which reported that "the Office would rate highly both absolutely and relatively in any international comparison." We also got feedback from Parliamentary select committees and other stakeholders that

they all continue to assess the Office as performing at a high level and that they value the professional and impartial advice and guidance they receive from us. We again received improved satisfaction ratings from our annual audit clients.

We were also pleased with the results of a practice review of Audit New Zealand by the New Zealand Institute of Chartered Accountants (NZICA) in 2008. The result of this review was "Satisfactory" – the highest possible grading. Participation in the review was voluntary for Audit New Zealand because it does not offer accounting services to the public. Nevertheless, as an Office, we are committed to testing ourselves against external benchmarks and appraisals, as well as against our own expectation that we practise what we preach.

During 2008/09, we developed a strategic plan for the period 2009–12 to ensure that our strategies, intentions, and risks were clearly laid out as a basis for the incoming Auditor-General to determine the direction of the Office during her term. This strategy is aimed at better using the wealth of information and knowledge that we have about the public sector to add value through reporting the performance of public entities, both individually and collectively. This will give Parliament, public entities, and the public the maximum assurance and potential for improvement arising from our work. A number of the key areas of this strategic plan are already being implemented and are showing encouraging early results.

The year in review

Overview of our service performance results

The 2008/09 year was demanding, but we achieved most of our output and impact measures, and our staff and contracted auditors can be proud of their efforts throughout the year.

There were a number of significant events and achievements in 2008/09.

We performed our three-yearly audits of long-term council community plans (LTCCPs). In our view, the effort we put into revising the methodology, planning the workload, and training our auditors has paid off, as the LTCCP audits went more smoothly than in 2005/06. However, the effort required once every three years puts a heavy demand on the Office's resources.

We note increasing complexity in many of the inquiries we carry out. In particular, our work on the Immigration service was more demanding than our usual inquiries. Given the demands of the LTCCP audits and more inquiries than usual, we were not surprised that our timeliness for other work (such as completing local government annual audit opinions and management reports) fell compared with past years.

However, we completed 19 performance audits, other studies, and inquiry reports. We also increased our effort to support newly formed select committees taking up their review and scrutiny work after the 2008 General Election. While 19 reports is fewer than the number we achieved for 2007/08, it falls within our target range. We also completed the bulk of work on several other performance audits and inquiries during 2008/09 that we will report on in the first part of 2009/10. Our target range for performance audits, other studies, and inquiry reports reflects the fact that the number of reports we prepare can fluctuate according to their nature and complexity, and the wider demands on the Office.

We prepared for two significant internal changes that occurred in early July 2009 – the relocation of the Office of the Auditor-General and the shared Corporate Services team into new premises, and the launch of our new financial management information system. Throughout our preparation for these changes, and through the leadership transition to a new Executive Director for Audit New Zealand and the impending departure of the Auditor-General, we continued to deliver our audit and other services, generally maintaining our quality and levels of output.

In the previous year, an issue of concern was the increasing number of audits in arrears of their statutory reporting time frame (a peak of 453 at 30 June 2008)

and, within that, the proportion of arrears that were due to inaction on our part. We are pleased to have reduced the number of audits in arrears to 429 at 30 June 2009. This probably reflects the stabilising of financial reporting requirements, with the New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) now implemented, although we continue to be concerned about the cost and appropriateness of NZ IFRS for the public sector.

More than half of the 429 audits in arrears are for small entities – schools, reserve boards, and cemetery trusts. That weighting is likely to reflect both the difficulties small entities have in meeting their accountability obligations, and our need to prioritise our work on larger and more significant audits.

We were also pleased to see some reduction in the percentage of arrears that were caused by inaction on our part, from 55% at the end of the previous year to 49% of the arrears at 30 June 2009. We intend to continue to focus on further reducing this proportion in future years. However, achieving our target (less than 10% of outstanding audit reports at 30 June being caused by inaction on our part) is particularly challenging, and is unlikely to be achieved until we bring total arrears down from the current level.

Ensuring that Parliament and the public receive timely and relevant reports is something we are committed to, because accountability is not served until audited information is available to users. We will continue to work with our audit service providers to remove the main obstacles to prompt completion of audits, and to reduce both the total number of arrears and the percentage that are our responsibility.

Main risks and issues

During 2008/09, we continued to manage our key strategic risks of loss of our independence, audit failure, loss of capability, and loss of reputation.

We set high standards for the independence of our employees and the auditors appointed from chartered accounting firms. The Auditor-General's independence standard is based on the NZICA Code of Ethics. Compliance with the standard, by statutory officers, employees, and all appointed auditors, is monitored through a range of measures. These measures are designed to identify any threat to auditor independence and to ensure that appropriate mitigation actions are taken to either eliminate or reduce the threat to an acceptable level.

The Auditor-General's independent Audit and Risk Committee, comprising three external members and the Deputy Auditor-General, continued to meet every three months. The report from the Chairman of the Audit and Risk Committee is included at pages 81–82.

Follow up of International peer review

We sought independent assurance from our own auditor, CST Nexia,¹ on the extent to which we were implementing the recommendations of the International Peer Review carried out in 2007/08. CST Nexia reported that:

... the majority of the suggestions have been effectively implemented in line with the rationale or spirit behind those suggestions. Most were rapidly accepted in that they either were already in the process of being implemented by management, or made immediate sense and were readily adopted.

We also identified that a small number [of the recommendations] were either impractical or inappropriate within the OAG operational environment, but do have potential impacts for the independence and the objectivity of the Office. Accordingly, we suggested that these warrant some form of ongoing risk review (if they are not already subject to review).

The year ahead

In the current economic environment, the country as a whole, and therefore the public sector and the Office, face perhaps the most significant and fundamental challenges we have experienced in many years. As the public sector seeks to deliver services in increasingly cost-effective ways, a growing range of funding and delivery arrangements between public entities, the private sector, and the non-government sector are likely to emerge. Issues concerning procurement, governance, conflicts of interest, and misuse of resources need to be worked through and understood in the context of the wider purposes of these arrangements. Deciding whether funds have been spent wisely and with due probity is more challenging in this environment.

A significant concern is to get better value from our audit work while managing the cost of audits for public entities. At a time when the public sector as a whole must be working toward greater cost-effectiveness, we need to continue to ensure that our audit fees are reasonable and that our audit effort is appropriately directed.

Managing audit costs in the current environment

We know that accountability requirements – including those for an audit – are often a burden for smaller public entities and subsidiaries of larger public entities. However, much of our annual audit work is carried out under statute and professional standards, and is largely beyond our control. To the extent that annual audit work is within our control, we aim to perform effective and efficient audits, so that we can gather the maximum amount of information from each audit while keeping the level of audit work in proportion to the level of public risk for each public entity.

¹ The Office's auditor is appointed by the Officers of Parliament Committee.

During the last few years, auditors have been required by changing professional standards to do more work. The cost of employing auditors has also been steadily increasing, largely as a result of the adoption of international accounting and auditing standards. The changing economic conditions, combined with changing immigration rules by countries such as the United Kingdom, are influencing many newly qualified accountants to remain longer in New Zealand. As a result, our staff turnover is starting to reduce. However, we are not yet certain how the current economic conditions will affect audit fees.

Public entities experiencing revenue and expenditure changes sometimes expect that our audit fees can be adjusted to reflect such changes. While the level of revenue and expenditure has some effect on the cost of an audit, there is certain work that must always be carried out to perform a professional audit in accordance with the Auditor-General's standards. There is, therefore, a point at which factors such as revenue and expenditure have only a small effect on audit costs. The best way for public entities to manage their audit costs is to ensure that their management systems and processes are working effectively, so that audits can be carried out seamlessly and limit the need for specific audit inquiry work.

Parliament provides some money to compensate us for auditing entities (such as reserve boards and cemeteries) that are required to have an annual audit but have little or no revenue to pay audit fees. The cost of these audits exceeds the level of Crown funding, which has not been adjusted since it was first made in 2004. The size of audits has generally increased because of changes in auditing and financial reporting standards, and labour market supply shortages have driven up the cost of auditing staff. We have raised our concern with the Treasury and the Officers of Parliament Committee, because these costs are increasingly met from audit fees charged to other entities, which themselves are under pressure. We consider this situation unsatisfactory, and will be looking to discuss this cross-subsidisation further with the Committee in 2009/10.

We again sought independent assurance that our audit appointments and fee monitoring processes are working effectively. The report from the independent reviewer, Sir David Gascoigne, is on pages 40–42.

Adding value through audit in the current environment

In the last two years of his term as Auditor-General, Kevin Brady published his observations on the quality of performance reporting (in June 2008) and on setting financial reporting standards for the public sector (in June 2009). These areas are of core interest to us, because they directly affect the accountability information on which we report when carrying out annual audits.

Our annual audits encompass this reported accountability information, attesting whether it is a fair reflection of the actual financial achievements. We are keen to play our part in ensuring that improvements are made, so that external reports are more meaningful and useful to their readers. We report whether that information fairly reflects the achievements of public entities, thus providing a basis for assessing the cost-effectiveness of public services.

We have increasingly questioned whether statutory compliance and audit requirements for smaller public entities are too onerous. These requirements include the adoption of NZ IFRS, standards that were originally designed for large companies in the private sector. There have been several developments since the two “observations” reports were presented to Parliament, such as the discussion papers issued recently by the Ministry of Economic Development and the Accounting Standards Review Board. We hope these will lead to improvements in public sector reporting.

We have been concerned that the demands created by changes to accounting and auditing standards have meant that our audit work has to focus more heavily on public entities’ financial statements. This has been at the expense of public-interest audit work based on fuller consideration of the risks and challenges that public entities face in their strategic, governance, and operational contexts.

We are therefore working to shape our audit work to generate greater insight through taking a stronger focus on issues and risks as they relate to the business of public entities. In July 2009, the Auditor-General issued his revised auditing standard for the audit of service performance reports. This revised standard will take effect for local authorities for the year ending 30 June 2010, and for government departments and Crown entities for the year ending 30 June 2011. There will be some cost implications from applying the standard, which we are working to manage and plan to provide advice about later this year. Nevertheless, we have a professional duty to carry out robust audits that meet their statutory purposes in relation to both financial and non-financial information.

This standard is a key element in our wider effort to ensure that our audit work is focused on issues with, and risks to, the business of public entities, and on assessing the outcomes, impacts, and cost-effectiveness of public services. We are carrying out extensive internal preparation work to audit under our revised standard and to improve our own reporting to entities and Parliament as the revised standard is implemented. We are also working with the Treasury and State Services Commission to support improved performance reporting by public entities that, as intended by legislation, will allow readers to understand and assess the outcomes, impacts, and cost-effectiveness of public services.

Parliamentary feedback on our work programme for 2009/10

We appreciate the opportunity to operate transparently in setting out the Office's annual work programme, including seeking feedback from members of Parliament as part of our annual plan preparation.

Members of Parliament mainly supported the approach we have taken to determining the Office's work programme, and neither the Speaker nor any select committee requested any change to our work programme priorities. The feedback included:

- guidance on the scope and relative emphasis we should place on some areas of concern; and
- suggestions of potential areas of exploration for studies in future years.

I thank Parliament for this feedback, and will ensure that it is incorporated as we carry out our 2009/10 annual plan and as we scope and prepare our 2010/11 work programme. As a result of this feedback, we are confident that the performance audits we intend to carry out in 2009/10 will be relevant and useful to Parliament, public entities, and the public.

Concluding remarks

Again, I extend my thanks to the outgoing Auditor-General, Kevin Brady, and welcome our incoming Auditor-General, Lyn Provost, who starts her term in October 2009. I thank our Audit and Risk Committee and our staff and appointed auditors for their efforts and achievements and for their commitment to integrity, honesty, and independence.

The Office, as part of the public sector, faces a challenging year in which the wider economic environment means that we must focus on being more effective and more transparent about that effectiveness. I am proud of the contribution the Office has made in 2008/09, and am confident that we have a strong basis for continuing to make that contribution.



Phillippa Smith
Deputy Controller and Auditor-General

30 September 2009

Part 1
Background

Nature and scope of the Auditor-General's functions and operations

The Controller and Auditor-General (the Auditor-General) is an Officer of Parliament. This means that the Auditor-General is answerable to Parliament, and is independent of Government. The Auditor-General is responsible for auditing all public entities in New Zealand – a total of about 4000 public entities – and for reporting to Parliament about the performance of the public sector.

The work of the Auditor-General is carried out by staff in two business units – the Office of the Auditor-General (OAG) and Audit New Zealand, supported by a shared team of corporate services staff – and by contracted auditors from the private sector. We refer to these collective resources as “the Office”.

The Office's purpose is to give independent assurance to Parliament, public entities, and the public about whether public entities are:

- carrying out their activities effectively, efficiently, and appropriately;
- using public funds wisely; and
- reporting their performance appropriately.

Our outcomes, impacts, and cost effectiveness

Our vision is that our audit and assurance work improves the performance of, and the public's trust in, the public sector. The outcome that we work toward is building trust in the public sector.

We base our intermediate outcomes on the Auditor-General's legislative audit mandate, set out in the Public Audit Act 2001. Our intermediate outcomes can be described as:

- **Authority** – Have activities been carried out and accountability requirements observed within the authority granted by Parliament?
- **Waste** – Are taxpayers' dollars and public resources wasted? Do governance and management arrangements ensure that public resources are obtained and applied efficiently and economically?
- **Probity** – Are public entities meeting Parliament's and the public's expectations of an appropriate standard of behaviour?
- **Performance** – Are services and activities effectively achieving their intended purpose and having the intended effect on outcomes or objectives?
- **Accountability** – Have public entities given full and accurate accounts?

Our measure for the degree of trust in the public sector is that New Zealand's score in the annual Transparency International Corruption Perception Index is maintained or improved during the next three years. In 2008, New Zealand's score was 9.3, and we were ranked first equal on the index with Denmark and Sweden.

Relationship between our intermediate outcomes and our outputs

To achieve our intermediate outcomes, we primarily gather and analyse information to provide independent advice and assurance through our output classes, which reflect the reporting functions of the Auditor-General under the Public Audit Act 2001. Our output classes are:

- **Audit and assurance services** – We provide audit and related assurance services as required or authorised by statute. In addition, the Auditor-General is required to audit the long-term council community plans (LTCCPs) for all local authorities. The Auditor-General can provide other services that are reasonable and appropriate for an auditor to perform and can also audit other quasi-public entities.
- **Supporting accountability to Parliament** – We provide advice and assistance to select committees, Ministers, and individual members of Parliament, as well as to central agencies and other public sector representative groups, to help them in their work to improve the performance and accountability of public entities. This includes assisting select committees with their financial reviews of public entities and Estimates examinations, and reporting to Ministers on the results of annual financial audits. We also perform the Controller function, through which the OAG and appointed auditors provide independent assurance to Parliament that expenses and capital expenditure of departments and Officers of Parliament have been incurred for purposes that are lawful, and within the scope, amount, and period of the appropriation or other authority.
- **Performance audits and inquiries** – We carry out, and report on, performance audits and inquiries of public entities under the Public Audit Act 2001, and respond to requests for approvals of pecuniary interest questions regulated by the Local Authorities (Members' Interests) Act 1968.

The outputs of the Auditor-General are highly interrelated and complementary.

Annual audits are our major output and account for about 87% of our expenditure. The main purpose of an annual audit is to provide independent assurance about the fair disclosure of the financial information – and, in many instances, service performance information – within annual reports. An annual audit involves a range of procedures, tests, and management and governance enquiries to support our audit opinion. Our annual audit work contributes to the accountability and authority aspects of our legislative audit mandate.

In carrying out annual audits, we look to varying degrees at the other aspects of our legislative audit mandate, and recommendations on these matters may appear in our management reports to the governors and managers of public entities. However, we also use our annual audits to gather information and

knowledge about public entities. This knowledge helps determine the work we do in our performance audits, inquiries, and good practice guides. Through this discretionary work, the Office considers issues of performance, waste, probity, and authority in greater depth than is appropriate within the scope of an annual audit.

The major focus of our output class for *Supporting accountability to Parliament* is reporting to and providing advice to Parliament and others. This involves using what we have found in all aspects of our audit work. The support we provide promotes accountability to Parliament and the public, and promotes improvement within the public sector.

Figure 1 summarises our outcomes, our outputs, and our strategy.

In our *Statement of service performance*, for each output class, we report against our impact and output measures and their associated standards. Two sets of tables are presented, reporting on the impact measures and the output measures associated with each output. Our *Statement of service performance* comprises pages 25–39 and 43–65.

The impact measures help us understand whether our outputs are having the effect we want (as required by section 40(d)(i) of the Public Finance Act 1989). As these measures focus on impacts, we can seek only to influence, rather than to control, performance against the measures. The output performance measures and standards help us understand whether we are producing quality outputs within time and resource constraints (as required by section 41(1)(e)(ii) of the Public Finance Act).

Our annual audit and other assurance work suggest that the quality of financial reporting and management in the public sector was broadly maintained:

- The number of audit reports being issued on time improved to 81%, compared to 78% in 2007/08 and closer to the 83% result in 2006/07, which we think largely reflects the passing of the effect of the transition to NZ IFRS.
- The number of audit reports being qualified remained similar to previous years. In 2008/09, 2.4% of audit reports we issued were qualified, compared to 2.3% in 2007/08 and 2.4% of reports in the two previous years.
- There was increased acceptance of Audit New Zealand's recommendations in annual audit management reports to public entities in 2008/09 (79%) compared to the previous two years (72% and 64% respectively). The trend of increasing acceptance has resulted from lower levels of recommendations not being responded to, although the number of recommendations that were rejected has also been increasing, with 11% of our recommendations being rejected this year compared to the previous two years (4% and 1% respectively).

- Our assessments of central government entities' management control environment and financial information systems and control improved against the previous year, with most of this improvement resulting from entities we assessed as "Good" in 2007/08 being assessed as "Very Good" in 2008/09. The number of "Needs Improvement" gradings remained essentially the same.

Our output service performance for our *Audit and assurance services* output class was maintained or exceeded, except for:

- completing annual audits on time, which improved on last year's result but remains below our target; and
- our three-yearly LTCCP audits, where all audit opinions were issued on time (with none assessed as being due to inaction on our part) and management reports were issued on time. However, these results were on a par with our general annual audit reporting trends.

These results were achieved within our appropriation for audit and assurance services. This appropriation has been increasing in recent years because of factors such as the introduction of international financial reporting and auditing standards, labour market supply shortages for accounting and auditing expertise, and because in 2008/09 we carried out the three-yearly LTCCP audits.

For our *Supporting accountability to Parliament* and *Performance audits and inquiries* output classes, our impact measures suggest that our work is achieving its desired effect, with:

- select committees advising (through our stakeholder feedback interviews) that our advice assists them in their Estimates examinations and financial reviews;
- reviews of a sample of performance audits and inquiries showing that public entities have responded to our recommendations for improvement;
- the Controller process and appropriation audit being carried out, and an internal review confirming there had been improvement in the appropriation audit approach and documentation to demonstrate compliance with the auditing standard; and
- our follow up of the response by public entities to recommendations made from sensitive and major inquiries showing that satisfactory action had been taken.

Our output service performance for *Supporting accountability to Parliament* and *Performance audits and inquiries* output classes was maintained or exceeded, except for the following.

- Our stakeholder feedback interviews assessed the usefulness of our performance audits at a similar level to that of the previous year and lower

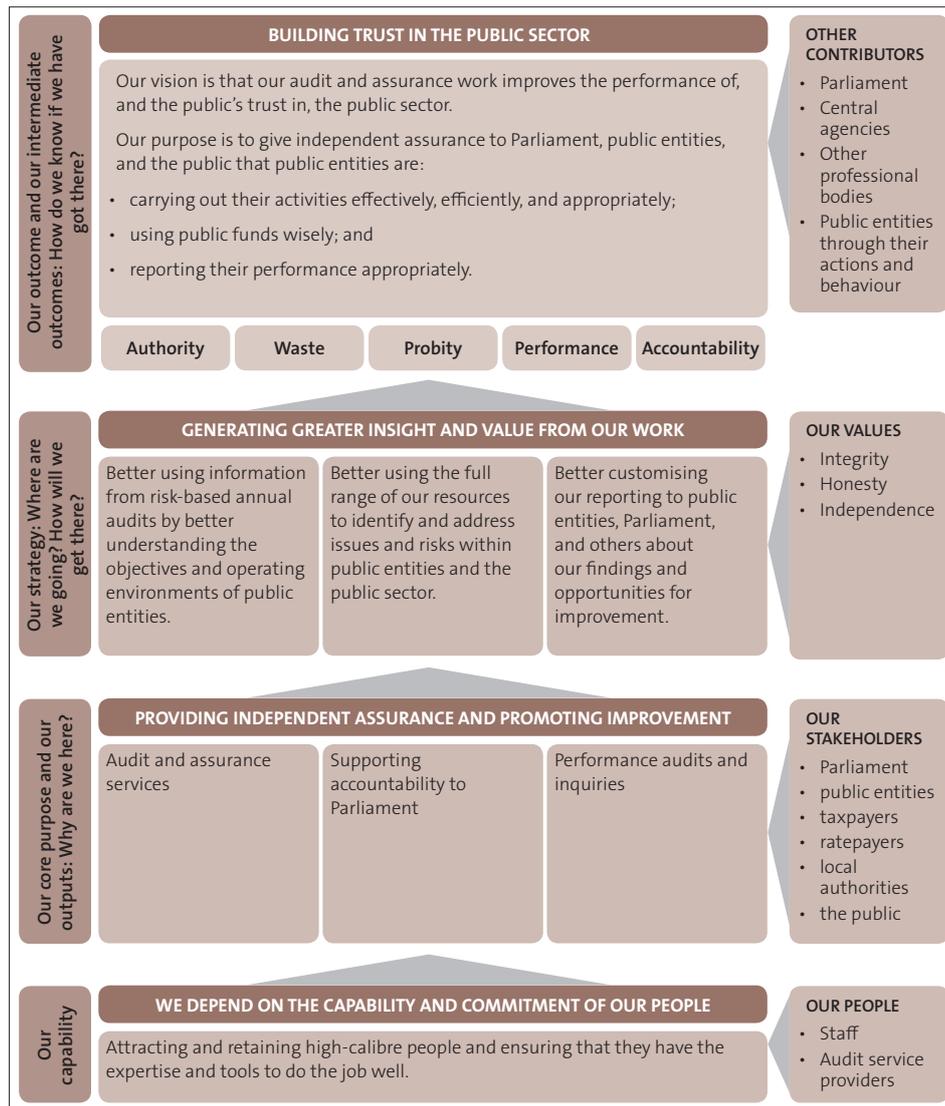
than our target. We do make extensive effort to ensure that our performance audits and other studies will be useful by consulting on our draft work programme and draft annual plan. Our stakeholder feedback interviews provide us with important feedback, and we are taking steps to respond. A range of other indicators of our performance audits showed that we maintained both the quality of our reports and the underlying methodology for their preparation.

- Our timeliness in dealing with routine and sensitive inquiries, as discussed within the Inquiries output section, was affected by the larger number of unusually sensitive and major inquiries during the year.

These results were achieved within our appropriation for Audit and assurance services, which has been adjusted in recent years only for remuneration costs.

We therefore conclude that the Office has generally achieved its service performance intentions and that its services do appear to have had a positive influence on the impacts and outcomes sought.

Figure 1
Summary of our outcomes, our outputs, and our strategy



Part 2

**Our output classes, performance
measures, and targets (including
Statement of service performance)**

Our output classes and the outputs within those classes are:

- Audit and assurance services
- Supporting accountability to Parliament
 - Parliamentary services
 - Controller function
- Performance audits and inquiries
 - Performance audits
 - Inquiries.

Audit and assurance services

This output class relates primarily to the Auditor-General's statutory duty to carry out annual audits of the financial reports, and in some cases performance information, of just over 3900 public entities, including the Financial Statements of the Government. This output class also includes other audits that the Auditor-General is required to do by statute, such as the three-yearly audits of local authorities' LTCCPs, and other assurance services provided to public entities on behalf of the Auditor-General. The cost of this work is funded mainly by fees paid by the public entities being audited. In 2008/09, annual audits and other assurance services accounted for 87% of our total expenditure.

The major portion of the output class relates to annual audits. There are several key processes that support the annual audit work, including:

- appointing auditors and monitoring audit fees;
- setting the Auditor-General's auditing standards;
- maintaining auditor independence; and
- quality assurance.

There are two main products from an annual audit:

- the audit report; and
- the management report.

For some public entities, there is also a financial review report.

The audit report is addressed to the readers of the financial statements and, where applicable, of the performance information. It provides the auditor's independent opinion (the audit opinion) on whether the financial statements (and, where applicable, the performance information) fairly reflect the public entity's performance and financial position. If the financial statements fairly reflect the public entity's financial performance and position (and, where applicable, the service performance information), the auditor issues an audit

report with an unqualified opinion. However, if the auditor identifies a material¹ error or omission in the financial statements or performance information, the auditor issues an audit report with a qualified opinion.

The management report is addressed to the governing body or the senior management of public entities. It sets out any significant issues identified by the auditor during the audit and provides recommendations for improving the public entity's controls, systems, and processes.

Where public entities are subject to financial review by a select committee, we also report the results of annual audits to responsible Ministers and select committees. The report includes a grading for each public entity, based on our assessment of their management control environment, and financial and service performance (where required) systems and controls.

Appointing auditors and monitoring audit fees

The Auditor-General appoints auditors to carry out the annual audits of public entities. These auditors are appointed from a group of about 60 audit service providers. The group includes Audit New Zealand and private sector accounting firms, which range from the four major chartered accounting firms to sole practitioners. Most audits are allocated directly to an auditor, but from time to time an auditor is appointed to an audit after a competitive tender.

Because we mainly use an allocation approach, we monitor audit fees at the point of negotiation between the appointed auditor and the public entity. We also provide a comparative analysis to help resolve any concerns about proposed audit fees. Our objective in monitoring fees is to ensure that fees are based on realistic hours (that is, hours that reflect the nature and extent of work required) and charge-out rates that are in line with market rates. We aim for fees that are fair to the public entities and also provide a fair return to the auditors for the work required by them to meet the Auditor-General's auditing standards.

During 2008/09, the Auditor-General appointed or reappointed the existing auditors to conduct the audits of 159 public entities and their subsidiaries (excluding 134 non-fee audits).

The Auditor-General's auditing standards

Section 23 of the Public Audit Act 2001 requires the auditing standards of the Auditor-General to be published, by way of a report to the House of Representatives, "at least once every 3 years". The Auditor-General's Auditing

1 "Material is defined in the New Zealand Institute of Chartered Accountants Auditing Standard AS-702: *The Audit Report on an Attest Audit* as: "a statement, fact or item is material if it is of such a nature or amount that its disclosure, or the method of treating it, given full consideration of the circumstances applying at the time the written assertion or set of assertions is completed, has the potential to influence users of the audit subject matter in making decisions or assessments."

Standards were most recently published in May 2008. These standards are available on our website (www.oag.govt.nz).

Section 23 also requires that each annual report include a description of any significant changes made to the standards during the year. During 2008/09, we updated the following standards:

- We updated the Auditor-General's Auditing Standard 1: Reporting to the OAG (AG-1) to clarify the information that auditors who carry out audits on behalf of the Auditor-General must provide to the OAG.
- We also revised the Auditor-General's Auditing Standard 4: *The Audit of Service Performance Reports* (AG-4). The revised AG-4 will be progressively applied to the audits of public entities that are required to prepare a Statement of Service Performance (or equivalent document) in its annual report and where the Statement of Service Performance is required to be audited. The primary intention of the revised AG-4 is to increase audit focus on the meaningfulness of non-financial reporting.

Work is currently under way to incorporate into the Auditor-General's auditing standards any changes considered necessary in respect of a new set of auditing standards that are being progressively introduced by the New Zealand Institute of Chartered Accountants for application in New Zealand (New Zealand equivalents to International Standards on Auditing). These changes may require publication of the Auditor-General's auditing standards earlier than May 2011, the next scheduled publication date.

Maintaining auditor independence

High independence standards are set for both the Auditor-General's employees and appointed auditors from chartered accounting firms. Compliance with these standards is monitored regularly. Any threats to auditor independence that were identified during the year were subject to mitigation actions that the Auditor-General considered appropriate to either eliminate the threats or reduce them to an acceptable level.

Quality assurance

We carry out quality assurance reviews of appointed auditors to ensure that they have complied with the relevant professional standards, as well as the Auditor-General's own published auditing standards. We aim to review the performance of each of our appointed auditors at least once every three years.

Measuring our performance for output audit and assurance services

Figure 2
Actual performance against impact measures and standards for output class:
Audit and assurance services

2008/09 forecast main impact measures and standards	2008/09 Actual	2007/08 Actual	2006/07 Actual
The number of public entities' audited financial reports issued within the statutory timeframe is improved (or at least maintained), measured against the previous two years. ¹	Total audits due for completion in year: 3908 On time: 81%	Total audits due for completion in year: 3946 On time: 78%	Total audits due for completion in year: 3949 On time: 83%
The number of public entities' audited financial reports containing qualified opinions is reduced (or at least maintained), measured against the previous two years.	Total qualified opinions: 95 (2.4%)	Total qualified opinions: 91 (2.3%)	Total qualified opinions: 96 (2.4%)
Public entities' acceptance of Audit New Zealand's management report recommendations is improved (or at least maintained), measured against the previous two years.	Accepted: 79% Rejected: 11% Noted, under consideration, or not responded to: 10%	Accepted: 72% Rejected: 4% Noted, under consideration, or not responded to: 24%	Accepted: 64% Rejected: 1% Noted, under consideration, or not responded to: 35%

¹ Audits may not have been completed for several different reasons, including that the entity has not produced financial statements for audit, that the audit of the previous year's financial statements has not been completed (and must be audited first), that there are delays on the part of the entity in responding to audit queries, that the audit is under way but the financial statements have not been available to us for more than 30 days, and that the audit is complete and waiting for the entity's governing body to adopt the financial statements. The number of audits due in the year has reduced from 3946 last year to 3908 this year because the number of entities that have been disestablished or no longer require an audit exceed the number of new public entities. About 30 entities did not require an audit in the year as they are small non-active companies that are no longer required to prepare financial statements or have them audited because of changes in the Financial Reporting Act 1993.

2008/09 forecast main impact measures and standards	2008/09 Actual	2007/08 Actual	2006/07 Actual
Central government entities' management control environment, financial information and service performance ² information systems and controls are improved (or at least maintained), measured against the previous two years.	<p><i>Assessments from 2007/08 audits</i></p> <p><i>Management Control Environment:</i></p> <ul style="list-style-type: none"> • Very good: 46% • Good: 44% • Needs improvement: 10% • Poor: 0% <p><i>Financial Systems and Controls:</i></p> <ul style="list-style-type: none"> • Very good: 32% • Good: 58% • Needs improvement: 10% • Poor: 0% 	<p><i>Assessments from 2006/07 audits</i></p> <p><i>Management Control Environment:</i></p> <ul style="list-style-type: none"> • Very good: 38% • Good: 51% • Needs improvement: 11% • Poor: 0% <p><i>Financial Systems and Controls:</i></p> <ul style="list-style-type: none"> • Very good: 21% • Good: 68% • Needs improvement: 11% • Poor: 0% 	Not applicable – benchmark data was collected in 2007 for our first assessment of central government entities' management control environment and financial systems and controls aspects.

² Service Performance Information and Associated Systems and Controls will be graded for the first time under the new framework as part of the 2008/09 audits to be carried out in 2009/10.

Figure 3
Actual performance against output delivery measures and standards for output class: Audit and assurance services

2008/09 forecast measures and standards of output delivery	2008/09 Actual	2007/08 Actual	2006/07 Actual
Less than 10% of the outstanding audit reports at 30 June 2009 are because of inaction on our part.	Total arrears at 30 June: 429 Due to inaction on our part: 49%	Total arrears at 30 June: 453 Due to inaction on our part: 55%	Total arrears at 30 June: 362 Due to inaction on our part: 51%
All management reports are issued within six weeks of issuing the audit report.	Issued within six weeks: 93%	Issued within six weeks: 93%	Issued within six weeks: 95%
No outstanding LTCCP opinions at 30 June 2009 are because of inaction on our part and all LTCCP management reports are issued within six weeks of issuing the LTCCP opinion. (New measure in 2008/09. LTCCP audits are carried out every three years.)	8% of LTCCP opinions were outstanding at 30 June 2009, one of which remained outstanding at 31 August 2009. No outstanding opinions were due to inaction on our part. 85% of LTCCP management reports were issued within six weeks of issuing the LTCCP opinion.	N/A	N/A
Client satisfaction survey shows that, overall, 75% of respondents are satisfied with the quality of audit work (including the expertise of staff and the quality of the entities' relationships with their audit service provider).	On a scale of 1 to 10, 80% of respondents gave overall service ratings of 7 or greater.	On a scale of 1 to 10, 75% of respondents gave overall service ratings of 7 or greater.	On a scale of 1 to 10, 68% of respondents gave overall satisfaction ratings of 7 or greater. ³

3 In 2006/07, the client satisfaction survey was confined to public entities audited by Audit New Zealand.

Quality assurance reviews for all appointed auditors are completed during a three-year period. Of the auditors reviewed in any given year, 95% achieve a result of satisfactory or better.	All completed. Achieved satisfactory or better: 100%	All completed. Achieved satisfactory or better: 93%	All completed. Achieved satisfactory or better: 84%
An annual independent review of our processes confirms the probity and objectivity of the methods and systems we use to allocate and tender audits, and monitor the reasonableness of audit fees.	Review undertaken and confirmation provided (see pages 40–42 for the Reviewer’s report).	Review undertaken and confirmation provided.	Review undertaken and confirmation provided.
The Officers of Parliament Committee accepts any significant proposals for an appropriation increase in audit fees and expenses.	No significant proposal made for an appropriation increase in audit fees and expenses. However, a request for an increase in appropriation of \$50,000 for audits of smaller entities (Cemetery Trusts and Reserve Boards) was not accepted by the Officers of Parliament Committee.	No significant proposal made for an appropriation increase in audit fees and expenses.	Not applicable – new measure for 2007/08.

Audit completions, reporting, and arrears

An important aspect of the performance of public entities is the issuing of audited financial statements within statutory time frames. We want those interested in the accountability of public entities to receive our audit assurance as soon as possible after the end of the financial year.

As Figure 4 shows, not all public entities met their statutory time frames. Overall, the timeliness of audit completions improved slightly from the previous year, with 81% of the audits due for completion in the year being finished within the statutory time frame, compared with 78% and 83% in the previous two years.

Therefore, we achieved our performance measure in that the number of public entities’ audited financial reports issued within the statutory time frame was at least maintained, measured against the previous two years.

In the schools sector, the number of audits completed on time was better than in the last two years, at 93% compared with 86% and 91%.

In the central government sector, the number of audits completed on time reduced from 66% and 64% to 58%. The reasons for this reduction are summarised in the comment on individual sectors below.

In the local government sector, the number of audits completed on time reduced from 74% in 2006/07 and 64% in 2007/08 to 60% in 2008/09. Again, the reasons for this reduction are summarised below. The main deteriorating indicator of audits completed on time relates to “Other local government entities”. This group comprises many small and often voluntary-type entities associated with local government or the provision of local services, such as cemetery trusts. Clearance of these audits can vary substantially and, at times, require us to follow up in obtaining the annual reports before we can carry out the audit. Our capacity to do so in 2008/09 was significantly affected by the resource commitment of our auditors to the triennial audit of LTCCPs. The effect of LTCCP audits on our annual audit obligations remains a concern.

Figure 4
Audits completed on time

Sector*	Total audits due in 2008/09**	Number on time in 2008/09	Percentage on time in 2008/09	Percentage on time in 2007/08	Percentage on time in 2006/07
Central government					
Government departments	41	41	100%	100%	100%
State-owned enterprises	113	46	41%	46%	52%
District health boards	48	32	67%	64%	69%
Tertiary education institutions	134	82	61%	72%	67%
Crown Research Institutes	58	21	36%	51%	58%
Other entities***	309	187	61%	67%	68%
Central government total	703	409	58%	64%	66%
Local government					
Local authorities	85	77	91%	88%	99%
Other council organisations	211	151	72%	77%	78%
Energy companies	57	49	86%	75%	97%
Ports and airports	57	47	82%	80%	94%
Licensing trusts	44	18	41%	64%	71%

Fish and game councils	14	14	100%	100%	100%
Other local government	210	54	26%	37%	52%
Local government total	678	410	60%	64%	74%
Schools	2527	2338	93%	86%	91%
Total for all sectors	3908	3157	81%	78%	83%

* In all of the sectors except government departments and local authorities, we have included any related subsidiaries within the total of the main entities.

** "Total audits due" is the number of audits in each sector with an expected completion date between 1 July 2008 and 30 June 2009.

*** The "Other entities" group in the central government sector includes Māori Trust Boards, Rural Education Activity Programmes, section 19 audits, subsidiaries of government departments, Crown entities not separately identified, Crown agents, and miscellaneous other central government entities.

Figure 5 shows the number of audits outstanding at 30 June 2009. As our Annual Plan 2008/09 anticipated, the number of audits outstanding increased in the previous year, from 362 at 30 June 2007 to 453 at 30 June 2008. We are pleased to record that the number has been reduced to 429 at 30 June 2009.

Figure 5
Audits outstanding at 30 June

Sector	Total audits due in 2008/09	Arrears at 30 June 2009	Percentage of Arrears at 30 June 2009	Arrears at 30 June 2008	Arrears at 30 June 2007
Central government					
Government departments	41	0	0%	0	0
State-owned enterprises	113	0	0%	0	3
District health boards	48	12	25%	12	13
Tertiary education institutions	134	42	31%	23	33
Crown Research Institutes	58	0	0%	4	3
Other entities*	309	69	22%	50	54
Central government total	703	123	17%	89	106
Local government					
Local authorities	85	0	0%	4	2
Other council organisations	211	24	11%	17	21
Energy companies	57	8	14%	12	3

Ports and airports	57	5	9%	2	0
Licensing trusts	44	9	20%	8	5
Fish and game councils	14	0	0%	0	0
Other local government	210	163	78%	141	92
Local government total	678	209	31%	184	123
Schools	2527	97	4%	180	133
Total for all sectors	3908	429	11%	453	362

* The "Other entities" group in the central government sector includes Māori Trust Boards, Rural Education Activity Programmes, section 19 audits, subsidiaries of government departments, Crown entities not separately identified, Crown agents, and miscellaneous other central government entities.

While audits in arrears have increased in the central and local government sectors, they have nearly halved in the schools sector. The increase in the central government sector is mainly because of increases in the tertiary education sector and the "Other entities" group.

We intend to continue monitoring and managing the number of arrears to ensure that arrears attributable to auditor performance are addressed. This will include continuing to seek explanations from auditors who do not meet our expectations, and taking action where necessary.

Our assessment is that 49% of the arrears at 30 June 2009 were caused by inaction on our part, compared with 55% at the end of the previous year. The target of less than 10% of the outstanding audit reports at 30 June being caused by inaction on our part is particularly challenging, and is unlikely to be achieved until we have managed to bring total arrears down from the current level to about 150. We will be working with our audit service providers to ensure that the main obstacles to prompt completion of audits are removed, with the objective of significantly reducing both the number of arrears in total and those that are our responsibility.

As mentioned in last year's annual report, priority has been given to audit work in larger public entities at the expense of smaller audits such as cemeteries and administering bodies (for example, hall boards).

In the medium term, we would like to see more public sector audits completed on time. We will also be monitoring more closely, and seeking to improve, our own timeliness in completing audits and reporting.

We comment on the individual sectors below.

Central government and local government sectors

Only 58% of audits in the central government sector were completed within the statutory time frame in 2008/09, compared with 66% and 64% in the previous two years. The main sub-sectors in which there was a reduction in audit timeliness were State-owned enterprises, Crown Research Institutes, education institutions, and other entities. The main reason for the reduction in the completion rate was because of not completing audits of subsidiary companies on time. This was because auditors continued to give priority to completing group accounts, with most subsidiaries not being material to the group accounts. We intend to ensure that auditors give sufficient priority to completing audits of subsidiaries, to improve our overall performance. In addition, in the tertiary education sector, a significant audit issue affecting a number of audits was identified late in the audit process. It affected the timely completion of these audits.

In the local government sector, 60% of audits were completed within the statutory time frame in 2008/09 compared with 74% and 64% in the previous two years. Consistent with the effect on clearance of other local government audits during 2008/09, the effect of diverting resources to the triennial audit of LTCCPs contributed to a lower clearance of audits of entities in the “Other local government” group.

Schools sector

Most of the public entities subject to audit by the Auditor-General are schools. Our target is to complete more than 90% of school audits within the statutory time frame and 99% within 12 months of balance date. The statutory date for school audits is 31 May, only a month before the end of our reporting year, so there will always be a reasonable number of school audits in arrears at 30 June.

Only 86% of school audits were completed on time in 2007/08, and 180 were in arrears at the end of the year (7% of the total). The main reason for the slower completion rate in 2007/08 was the transition to new accounting standards (NZ IFRS). We worked closely with the Ministry of Education to mitigate the effect of the transition, but it was inevitable that such a major change would cause difficulties in many schools.

We are pleased to report that in 2008/09 we managed to achieve the same level of performance as earlier years, with more than 90% of audits being completed by the statutory deadline and more than 99% being completed within 12 months of balance date. The number of school audits outstanding at 30 June 2009, excluding subsidiaries, was the lowest on record for the end of our reporting period.

Management reports issued within six weeks

This year we issued 93% of our draft or final management reports within six weeks of signing the audit report, which is about the same level of performance as in the previous two years (see Figure 6). We intend to increase the focus on timely completion of management reports during 2009/10.

Figure 6

Management reports issued within six weeks

Sector*	Total due in 2008/09	Total on time in 2008/09	Percentage on time in 2008/09	Percentage on time in 2007/08	Percentage on time in 2006/07
Central government					
Government departments	42	38	90%	100%	95%
State-owned enterprises	115	111	97%	87%	98%
District health boards	50	44	88%	84%	80%
Tertiary education institutions	122	92	75%	80%	95%
Crown Research Institutes	65	65	100%	100%	100%
Other entities**	307	272	89%	90%	92%
Central government total	701	622	89%	89%	94%
Local government					
Local authorities	91	64	70%	64%	75%
Other council organisations	207	154	74%	70%	77%
Energy companies	55	48	87%	97%	95%
Ports and airports	54	47	87%	81%	84%
Licensing trusts	39	20	51%	67%	93%
Fish and game councils	14	13	93%	100%	100%
Other local government	182	156	86%	85%	88%
Local government total	642	502	78%	78%	84%
Schools	2598	2545	98%	98%	98%
Total for all sectors	3941	3669	93%	93%	95%

* The total number of management reports due in 2008/09 is not the same as the "Total audits due in 2008/09" shown in Figure 6. This is because the due dates of management reports are dependent on, but different to, the dates that audits are completed. The dates used are audit reports issued between 20 May 2008 and 19 May 2009, which is six weeks before the year end.

** The "Other entities" group in the central government sector includes Māori Trust Boards, Rural Education Activity Programmes, section 19 audits, subsidiaries of government departments, Crown entities not separately identified, Crown agents, and miscellaneous other central government entities.

We did not achieve our target of issuing all management reports within six weeks of issuing the audit report. However, our achievement rate of 93% was similar to the previous two years. The completion rate in the schools sector remained high at 98%. In the central and local government sectors, our completion rate was less than 90%.

In the central government sector, our completion rate of 89% was the same as last year. Results in the tertiary education sector and the “Other entities” group are the main reasons why our performance has remained below target. We intend to investigate the reasons for this under-performance, and establish measures to ensure that auditors meet the target consistently.

We note with concern that the clearance rate for local government management reports has varied. Our performance appears to have reached a plateau in the 75–85% range. We consider this unsatisfactory and will investigate further why there are delays in reporting.

Results of our annual audit opinions and Ministerial reporting

Results of our annual audit opinions

A qualified audit report is issued in accordance with the NZICA Auditing Standard No. 702: *The Audit Report on an Attest Audit (AS-702)*. AS-702 provides for three types of qualified audit opinions (that is, a disclaimer of opinion, an adverse opinion, or an except-for opinion) that may be issued in different situations.

A fuller definition of a qualified audit report and the situations where the different types may be issued are set out in our report *Central Government: Results of the 2007/08 Audits* (parliamentary paper B.29[09b], 2008, pages 37–40). Figure 7 provides an analysis of all qualified audit reports issued in 2008/09. Information for the previous two years is provided for comparison.

Figure 7
Qualified audit reports issued

Type of qualified audit report	2008/09	2007/08	2006/07
Disclaimer of opinion	4	1	6
Adverse opinion	13	12	10
Except-for opinion	78	78	80
Total of qualified audit reports	95	91	96
Total of all audit reports due	3908	3946	3949
% qualified	2.4%	2.3%	2.4%

The proportion of qualified audit reports issued compared to the number of audits due for completion was relatively stable during the three-year period.

Details of the qualified audit opinions issued in the 2008 calendar year are included in our parliamentary papers B.29[09b] and B.29[09c]:

- *Central government: Results of the 2007/08 audits;* and
- *Local government: Results of the 2007/08 audits.*

Results of 2009–19 LTCCP audits

Under the Local Government Act 2002, we have the statutory responsibility to report on the “fit for purpose” quality of the LTCCPs prepared, consulted on, and adopted by each local authority. We issue audit opinions on both the proposed LTCCP and the version finally adopted. We reported fully on our first involvement in auditing LTCCPs after 2006.²

For their 2009–19 LTCCPs, each local authority was required to complete the process so that their adopted LTCCP was operating on 1 July 2009. Of the 85 local authorities, 92% completed their statutory responsibilities by 30 June 2009. Of the seven local authorities completing their responsibilities after 30 June 2009, one has yet to adopt its final LTCCP. The work was intensive, particularly from February to June 2009. It dominated the workload of our audit service providers and, as noted earlier, was a factor in some deteriorating performance in our annual audit commitments.

All of our audit opinions were provided within the time required by the local authority. Our reporting included a number of “non-standard” audit reports, as detailed in Figure 8.

² *Matters arising from the 2006-16 Long-Term Council Community Plans, June 2007.*

Figure 8
Non-standard audit reports issued on 2009–19 LTCCPs

	Type of opinion		
	Adverse	Except-for	Emphasis of matter
LTCCP for consultation	8	1	4
Adopted LTCCP (after consultation)	4	0	14

A number of local authorities were able to remedy defects with the draft LTCCPs before their final adoption.

Of the 84 local authorities that have completed the process, only four had matters so significant that, in our view, the adopted LTCCP was rendered inadequate for its purpose.³ In those four cases, we issued an adverse opinion on the adopted LTCCP.

An “emphasis of matter” is a reporting method we use to highlight significant matters that we consider should be drawn to the attention of the reader. Ten of the 14 emphases of matter relate to uncertainties about long-term plans arising from the ongoing reorganisation of local government in Auckland.

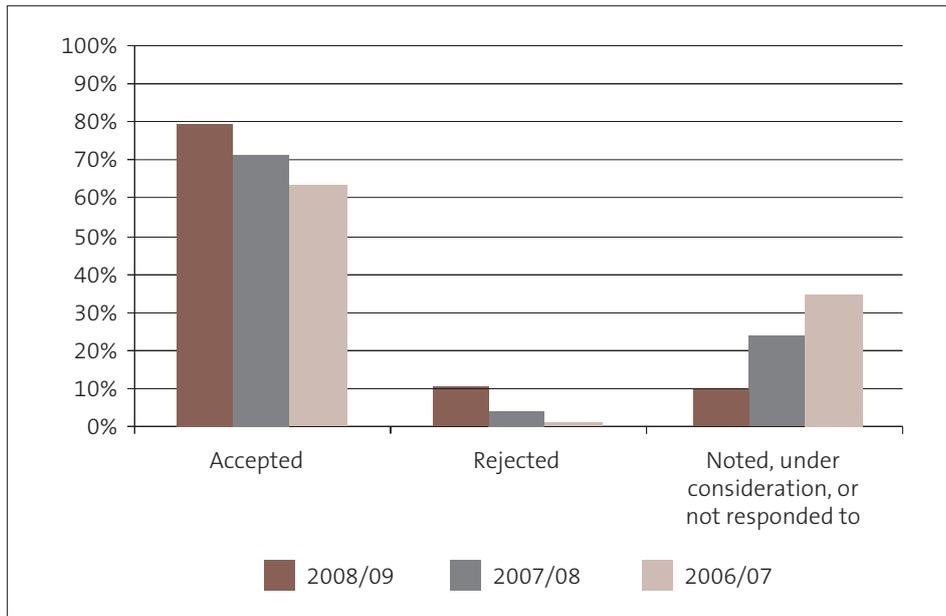
We are planning to report fully to Parliament in 2010 on our observations on auditing the 2009–19 LTCCPs.

Acceptance of Audit New Zealand’s management report recommendations

Figure 9 provides an analysis of public entity acceptance of Audit New Zealand’s management report recommendations. It is pleasing to see a trend of increasing acceptance of our recommendations. Although the percentage of recommendations rejected has increased, this was matched by a reduction in the recommendations noted, being considered, or not responded to.

³ There is no sanction on a local authority for having such an opinion.

Figure 9
Entity acceptance of Audit New Zealand’s management report recommendations



Client satisfaction survey

The results of our client satisfaction survey continue to exceed our target of 75% of respondents rating service as 7 or greater on a scale of 1 to 10. Overall, the client satisfaction survey resulted in an overall satisfaction rating of 80% (2008/09) compared with 78% (2007/08).

Quality assurance reviews

There are five levels of quality assurance rating, assessed using the reviewers’ overall judgement of the quality of the audit work carried out. The five levels are “excellent”, “very good”, “good”, “satisfactory”, and “re-review”.

We reviewed 45 appointed auditors during 2008/09. All auditors we reviewed received a grade of satisfactory or above.

Of the 44 appointed auditors reviewed during 2007/08, three received a rating of re-review. Follow-up reviews of appointed auditors are normally carried out within the next year.

Audit fees

Our independent reviewer again assessed our audit allocation and fee-setting and monitoring systems (the full report is included at pages 40–42). The reviewer concluded that the processes for allocating audits in the public sector and for

setting fees in the financial year to 30 June 2009 have been carried out with due probity and objectivity.

However, there continues to be pressure on audit fees. During 2008/09, fees for all types of audits continued to be affected by the residual and ongoing costs associated with changes in auditing and financial reporting standards (including NZ IFRS) and the continuing higher costs of employing accountants and related audit staff.

Figure 10 summarises the movements in audit fees from 2006/07 to 2008/09, based on those audit fees that had been agreed at the time when the analysis was prepared. It shows how the factors described in the previous paragraph have continued to affect both the hours and the average hourly cost of carrying out audits in the public sector.

Figure 10
Analysis of movements in audit fees

	2007/08 to 2008/09				2006/07 to 2007/08			
	Number of entities	Increase in total fee	Due to hours	Due to charge-out rate	Number of entities	Increase in total fee	Due to hours	Due to charge-out rate
Government departments	40	6.7%	1.9%	4.8%	35	10.1%	-2.9%	13.0%
State-owned enterprises	19	14.5%	7.6%	6.9%	16	7.5%	4.1%	3.4%
Crown entities	70	10.4%	4.7%	5.7%	37	7.5%	2.0%	5.5%
District health boards	21	7.2%	7.2%	0.0%	28	5.0%	0.1%	4.9%
Crown Research Institutes	9	16.3%	4.8%	11.5%	7	14.4%	-2.0%	16.4%
Tertiary education institutions	26	3.4%	12.6%	-9.2%	19	2.7%	-0.9%	3.6%
Energy companies	23	20.1%	6.6%	13.5%	24	4.7%	6.4%	-1.7%
Local authorities	91	5.9%	7.1%	-1.2%	46	6.6%	2.2%	4.4%
Local government subsidiaries	192	10.3%	11.0%	-0.7%	64	10.7%	2.8%	7.9%
Port companies	11	-0.8%	6.0%	-6.8%	7	-3.3%	3.5%	-6.8%

Licensing and community trusts	16	7.3%	-5.8%	13.1%	12	6.7%	5.3%	1.4%
Māori Trust Boards	6	11.3%	0.8%	10.5%	2	10.4%	0.0%	10.4%
Schools	2445	0.6%	-2.6%	3.2%	2456	12.3%	12.6%	-0.3%
Other	74	4.0%	1.2%	2.8%	30	25.8%	15.0	10.8%
Total	3043	6.7%	3.4%	3.3%	2783	9.1%	5.9%	3.2%

Notes:

1. Movements in total audit fees comprise movements in audit hours and movements in charge-out rates of staff engaged on the audits.
2. Fee movements are based on those of entities with balance dates falling within the financial year of the Office (for example, fees for the 31 December 2008 audits of schools are included in the 2008/09 year).

Figure 11

Financial performance of output class: Audit and assurance services

	2008/09 Actual \$000	2008/09 Supp. Estimates \$000	2007/08 Actual \$000	2006/07 Actual \$000
Income				
Crown	150	150	150	150
Other	60,483	62,607	58,505	58,474
Expenditure	(60,602)	(62,757)	(58,624)	(58,750)
Surplus/(Deficit)	31	0	31	(126)

From SIR DAVID GASCOIGNE

Apartment A
11 Cable Street
Wellington 6001
New Zealand

Tel: +64 4 385 2553
Mobile: +64 274 405 405
e-mail: david.gascoigne@xtra.co.nz

4 September 2009

Ms Phillippa Smith
Deputy Controller and Auditor-General
PO Box 3928
WELLINGTON

Dear Ms Smith,

ANNUAL REPORT OF THE INDEPENDENT REVIEWER OF AUDIT ALLOCATION PROCESSES

1. The previous Controller and Auditor-General, Mr Kevin Brady, has retained me as an independent reviewer of the basis upon which auditors are appointed to act on your behalf, and upon which appropriate levels of audit fees are determined.
2. This is my report on those processes for the financial year ended 30 June 2009. I confirm that I am independent of the Office of the Auditor-General (OAG), Audit New Zealand and all private sector audit firms.
3. My instructions require me to evaluate the processes involved and to report upon the probity and objectivity with which they are implemented. No limitation has been placed upon the manner in which I carry out my assignment.
4. There are three distinct types of allocation process:
 - (a) an allocation made by the Auditor-General of an auditor for a given entity, in accordance with "the audit allocation model";
 - (b) an appointment of an auditor for a given entity, following a contestable tender; and
 - (c) a re-appointment for a further term of an approved auditor's contract to audit a particular entity.
5. In the past financial year, the Auditor-General appointed auditors for 53 new entities. The "audit allocation model" under which those appointments were made has been the principal method of allocation since 2003. There is a well-established set of criteria for those appointments. There has been no evident dissatisfaction expressed by those entities either with the method or with the terms of any of the appointments effected during the year.
6. The appointment of auditors through a contestable tender process is now reserved for large entities, generally those with a commercial focus, and for some schools. No appointments were made by means of this process during the past year.

2

7. During the financial year, existing auditors were re-appointed to audit 72 public entities and their subsidiaries for a further term. In addition, in 160 instances a change was effected, with a different auditor being appointed in place of an existing one. The circumstances leading to these latter appointments were various: for example, retirement of an auditor, rotation of auditors within a firm. Again, in the case of all 232 appointments covered by this paragraph 7, a careful process has been followed. There has been no evident dissatisfaction expressed as to the method or the terms of appointment.
8. During the course of the past year, a number of entities raised questions about the level of increase in audit fees. The number of enquiries or complaints about fees has risen markedly in the past year. Some of these have been informal in nature (and have been dealt with readily by means as simple as a telephone discussion). Others have been more formal in nature (with well articulated letters expressing the grounds for an entity's concern).
9. The basis for these claims is, generally, that in difficult financial times, when an entity's revenue may be static or falling, it is neither appropriate nor fair that an audit fee should be allowed to move sharply upwards.
10. In recent times, the OAG has been developing a detailed and increasingly sophisticated data-base. It provides an analysis of audit fees for all public entities. The contributing components (hours and rates) of the fees for all entities, year by year, individually and sector by sector, may be compared and contrasted. In particular, the movement in hourly rates and in time expended on an audit, or a range of audits, can be accurately identified.
11. The OAG uses this material, constructively, to help respond to enquiries or complaints received. The response is usually given by the OAG direct to the entity, though sometimes the auditor responds, using the data supplied by the OAG. In either case, the data which is relevant to a particular entity is recorded in an explanatory letter, along with a description of the factors lying behind the cost increases. Some of those factors include: shortages of suitable audit staff (leading to salary increases aimed at retention), increasing costs of regulatory compliance, additional work required to respond to new accounting, auditing and quality control standards.
12. In a number of cases, it is apparent that the actions of the entity itself have contributed to the increase in fees. This has been particularly evident this past year in fees for the audit of some local authorities' Long Term Council Community Plans. Some plans put forward for audit have been incomplete, contradictory or have had several iterations. And those factors have resulted in significant increases in fees.
13. In the great majority of cases, the detailed explanation given to entities by the OAG (or, in some cases, by an auditor using data supplied by the OAG) has led to a resolution, or to a withdrawal of the complaint, or to no further action being taken by the entity. Some cases have not yet reached a conclusion, but the parties involved are proceeding in evident good faith. There has been only one instance where an entity remains dissatisfied with the process (and I do not question its good faith). There is, however, a clearly defined mechanism set out in the Public Audit Act 2001 for the resolution of such an issue. That mechanism has been followed to date. I will monitor the outcome.
14. It is hardly surprising that, in the context of the times, the major issue to have arisen during the year is about the level of fee increases. Viewed broadly, the role of the Auditor-General, acting through the OAG, is to ensure that audit fees are fair and

reasonable. The OAG provides detailed information, when needed, to help the entity and the auditor come to a common view about this. As the previous Auditor-General has said, it is important that an audit fee is struck in each case that gives the entity, the Auditor-General and Parliament "confidence that an audit may be conducted to the standards required of public sector entities and provides a fair return (but no more than that) to the auditor to do the job that all expect." Overall, I consider that that statement of purpose has been substantially achieved during the past year.

15. I now state my conclusions:
- (a) On the basis of the written material I have seen and the explanations I have been given by OAG personnel, I consider that the processes adopted by the Auditor-General and by the OAG in relation to the allocation and appointment of auditors for audits falling within the Auditor-General's mandate, during the financial year to 30 June 2009, have been appropriate for their purpose, and have been applied in a way which is fair and responsible, having regard to the respective interests of the parties concerned.
 - (b) That observation applies both to the way in which auditors have been appointed or re-appointed, and to the way in which questions as to the appropriateness of a proposed audit fee have been dealt with.
 - (c) In cases where issues have been raised by entities as to fee levels or as to performance standards those issues have been, or are being, dealt with fairly and professionally.
16. Taking everything into account, my conclusion is that the processes by which audits in the public sector have been allocated and fees have been set, in the financial year to 30 June 2009, have been carried out with due probity and objectivity.

Yours sincerely



Sir David Gascoigne, KNZM, CBE

Supporting accountability to Parliament

This output class includes two outputs:

- Parliamentary services – providing advice and assistance to select committees and other stakeholders; and
- Controller function – carrying out the Controller function.

Advice and assistance

Through our annual audits, performance audits, and inquiries, the Auditor-General has a broad overview of public entities – individually and throughout sectors. Through our services to Parliament, we provide advice and assistance to select committees, Ministers, and individual members of Parliament, as well as to central agencies and other public sector representative groups, to assist them in their work to improve the performance and accountability of public entities.

The main ways in which we provide this advice and assistance are:

- reports and advice to select committees to assist their financial reviews of government departments, Crown entities, and State-owned enterprises;
- reports and advice to select committees to assist their examination of the Estimates of Appropriations and financial reviews; and
- reports to responsible Ministers on the results of the annual audits.
- We also provide advice and assistance through:
 - reports to Parliament and other constituencies on matters arising from our annual audits (including tabling two reports in Parliament on the results of our audits in central and local government);
 - responding to requests and participating in working parties on matters related to financial management and accountability with other stakeholders, including government departments, central agencies, local authorities, professional bodies, sector organisations, and other public entities; and
 - working with Auditors-General in other countries to encourage, promote, and advance co-operation in the field of public audit. This includes our role as Secretariat of the Pacific Association of Supreme Audit Institutions (PASAI), being a member of various committees of the International Organisation of Supreme Audit Institutions (INTOSAI), and being executing agent for the Pacific Regional Audit Initiative (funded by the Asian Development Bank, with co-financing from the Japan Special Fund and the Government of Australia).

Measuring our performance for output: Parliamentary services

Figure 12
Actual performance against impact measure and standard for output:
Parliamentary services

2008/09 forecast main impact measure and standard	2008/09 Actual	2007/08 Actual	2006/07 Actual
Select committees confirm that our advice assists them in Estimates of Appropriations examinations and financial reviews.	100% of respondents rated us as 4 or better on a scale of 1 to 5 as assessed through our stakeholder feedback interviews.	100% of respondents rated us as 4 or better on a scale of 1 to 5 as assessed through our stakeholder feedback interviews.	86% of respondents rated us as 4 or better on a scale of 1 to 5 as assessed through our stakeholder feedback interviews.

Figure 13
Stakeholder feedback on Parliamentary services impact

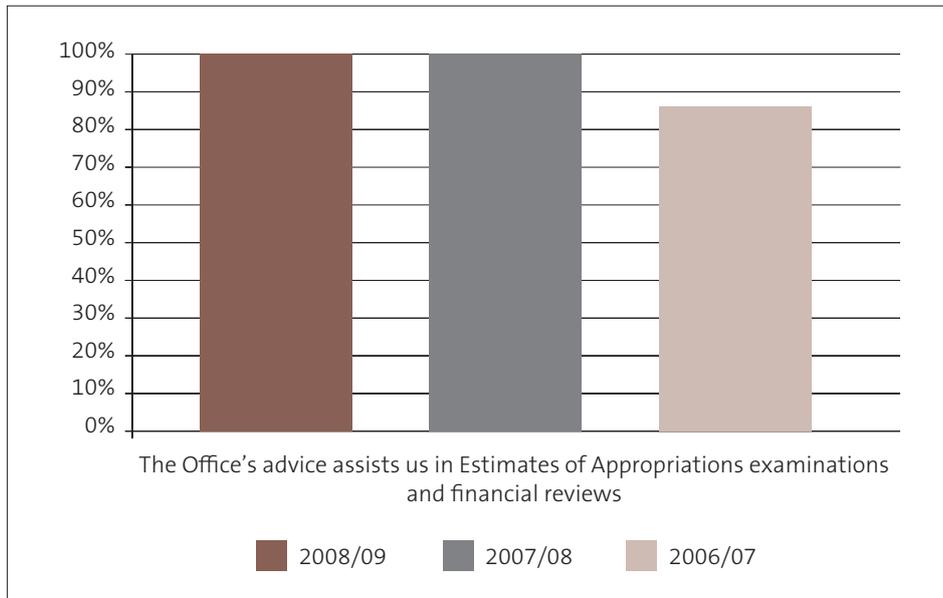
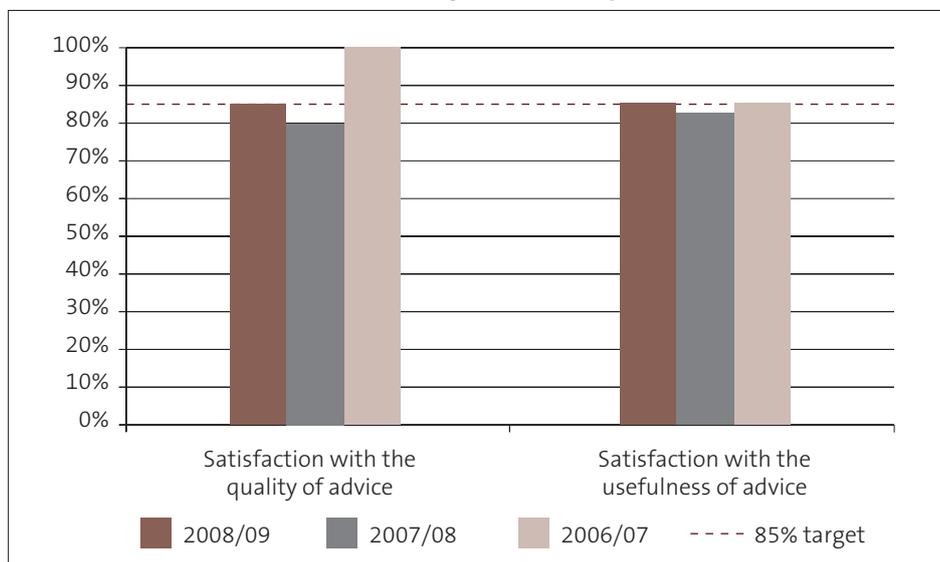


Figure 14
Actual performance against output delivery measures and standards for output:
Parliamentary services

2008/09 forecast measures and standards of output delivery	2008/09 Actual	2007/08 Actual	2006/07 Actual
Reports and advice are given to select committees and Ministers at least two days before an examination, unless otherwise agreed.	100%	100%	100%
An internal review of a sample of financial review, Estimates, and Ministerial reports confirms that they meet relevant standards and procedures, including that reports are consistent in their framework and approach and are peer reviewed in draft. (The nature, extent, and frequency of the quality assurance review are determined based on risk. The review is carried out during a three-year period.)	There was no internal review this year.	Confirmed by internal review of a sample of reports.	Confirmed by internal review of a sample of reports.
At least 85% of select committee members we seek feedback from rate the advice they receive from us as 4 or better on a scale of 1 to 5 for: <ul style="list-style-type: none"> • quality; and • usefulness. 	86% 86%	80% 83%	100% 86%
At least 85% of other stakeholders we seek feedback from rate the advice they receive from us as 4 or better on a scale of 1 to 5 for relevance and usefulness.	100%	100%	100%

Figure 15
Stakeholder feedback on Parliamentary services outputs



To assess the relevance, value, and timeliness of our advice and assistance to select committees, Ministers, and other stakeholders, we commission independent stakeholder feedback interviews (conducted for 2008/09 in June 2009). Stakeholder ratings for the quality and usefulness of advice to select committees increased slightly this year, to be above our target of 85% of select committee members rating our advice as 4 or better on a scale of 1 to 5 (see Figures 14 and 15).

Our measure of the extent to which our advice assists select committee members in their Estimates examinations and financial reviews has remained the same as last year – with all stakeholders who provided feedback rating us as 4 or better on a scale of 1 to 5 (see Figures 12 and 13). The stakeholder feedback report noted that the results show that the Office is continuing to perform at a high level, and that stakeholders value the professional, impartial advice and guidance they receive from the Office.

The report recommended that the Office assess the improvements suggested, but noted that:

... stakeholders commented that, while they were happy to suggest improvements, these were minor compared with their overall satisfaction and respect for the Office and the quality of its work.

It is pleasing that the new Parliament recognises and values the advice we provide. The results of the stakeholder feedback interviews are particularly pleasing in the context of the increase in the number of reports we provided this year compared to the previous year, and the more compressed time frame in which they were provided. In 2008/09, we provided 56 Estimate of Appropriation reports to the new select committees, compared to 51 last year. While we prepared a similar number of financial review reports this year compared to last year (85), we also prepared six reports to assist select committees with their first examinations of non-departmental appropriation reports. These reports were provided during the period of February–June rather than the typical period of October–June.

We also provided reports to incoming Ministers on the results of our recent work in their portfolios (in addition to our usual reporting of annual audit results), and briefed the incoming select committees on the role and functions of the Auditor-General and the assistance they could expect from the Office.

The improvements suggested by stakeholders included encouraging the Office to focus more directly on the issue of value for money for the taxpayer, showing how a report fits with any bigger picture information such as the Budget, and

considering the extent to which the Office can play a greater and broader advisory role with select committees.

We will consider how we can address the suggestions for improvement. We are also continuing to consider how we can get greater input from select committees on their particular interests and concerns to better shape our reporting to their needs, while still performing our role of advising on the results of our audits and the observations and issues that arise from these.

Our last internal review of financial review, Estimates, and Ministerial reports carried out in March 2008 concluded that we have appropriate systems in place to meet the Office's responsibilities to provide advice to select committees on Estimates examinations and financial reviews, and that the key controls identified had been operating effectively. The review made several minor recommendations for improvement, which we have addressed.

Controller function

The "Controller" function of the Controller and Auditor-General provides independent assurance to Parliament that expenses and capital expenditure of departments and Offices of Parliament have been incurred for purposes that are lawful, and within the scope, amount, and period of the appropriation or other authority.

The OAG and appointed auditors carry out standard operating procedures to give effect to the Controller function in keeping with the Auditor-General's auditing standards and the Memorandum of Understanding with the Treasury. This involves reviewing the monthly reports provided by the Treasury, and advising the Treasury of any issues arising and the action to be taken.

Each year, we report to Parliament on the significant issues arising from operation of the Controller function.

Measuring our performance for output: Controller function

Figure 16

Actual performance against impact measure and standard for output: Controller function

2008/09 forecast main impact measure and standard	2008/09 Actual	2007/08 Actual	2006/07 Actual
Expenses and capital expenditure of departments and Offices of Parliament are incurred for purposes that are lawful and within the scope, amount, and period of the appropriation or other authority. Where there is a breach, actions are taken in accordance with the Auditor-General's powers and auditing standards, and the Memorandum of Understanding with the Treasury.	The operation of the monthly Controller process and the appropriation audit were carried out to ensure that this measure was achieved.	The operation of the monthly Controller process and the appropriation audit were carried out to ensure that this measure was achieved.	Not applicable – new measure for 2007/08.

Most of the government expenditure during 2007/08 was authorised by appropriations in the usual way. However, there were 32 instances of expenditure (adding up to \$567 million) that were not authorised by Parliament. In 26 of the 32 instances (adding up to \$330 million), expenditure was within the scope of the appropriation but more than the amount authorised by Parliament. In the other six instances, the expenditure was outside the scope of the appropriation. This is a relatively small amount of unauthorised expenditure compared to total government expenditure, but unauthorised expenditure is always a concern.

Common factors contributing to unappropriated expenditure include:

- poor forecasting by departments;
- departments not making timely requests for authority to spend; and
- departments not specifying requests for authority clearly enough to accommodate the actual expenditure.

We continue to encourage departments to pay closer attention to ensuring that they have authority before incurring any expenditure. We also work with the Treasury to provide better guidance and support through the administrative systems that support the Crown's financial management.

A new Memorandum of Understanding with the Treasury has been finalised and has applied during the 2008/09 year.

Figure 17**Actual performance against output delivery measures and standards for output:
Controller function**

2008/09 forecast measures and standards of output delivery	2008/09	2007/08	2006/07 Actual
Monthly statements provided by the Treasury are reviewed for the period September to June inclusive. Advice of issues arising and action to be taken is provided to the Treasury and appointed auditors within five working days of receipt of the statement.	All monthly procedures have been followed, and agreed time frames achieved.	All monthly procedures have been followed, and agreed time frames achieved.	All monthly procedures have been followed, and agreed time frames achieved.
Internal quality assurance is undertaken to gain assurance that our policies, procedures, and standards in relation to the Controller function have been applied appropriately.	An internal review was carried out in May 2009, which confirmed the central work carried out was consistent with the Memorandum of Understanding and that the monthly processes operated effectively. There was considerable improvement in the appropriation audit approach and documentation to demonstrate compliance with the auditing standard.	Review to be carried out in the first quarter of 2008/09, at the end of Controller function work for 2007/08.	An internal review carried out in May 2007 confirmed that the design of the work to address the Controller function and appropriation audit is appropriate but that there was variable practice by auditors in applying the auditing standard. Several recommendations for improvement were made.

In May 2007, we carried out a quality assurance review of the processes underlying the Controller function and appropriation audit. Our review found that the design of work to address the Controller function and appropriation audit was appropriate, but there were some variable practices between auditors

in demonstrating compliance with the auditing standard. We made several recommendations for improvement, mainly on revising audit procedures, improving documentation to demonstrate compliance with the auditing standard, and providing training for auditors of government departments. Action was taken to address the recommendations.

A follow-up review was carried out in May 2009. This review again found that the work carried out by the central Controller team was consistent with the Memorandum of Understanding, and that the monthly processes operated effectively. Regarding the appropriation audit work, the review found that there was considerable improvement in the audit approach and documentation to demonstrate compliance with the auditing standard. There are still some aspects that require more attention, to do with the evidence to support conclusions. The recommendations that we made will be actioned.

Figure 18

Financial performance of output class: Supporting accountability to Parliament

	2008/09 Actual \$000	2008/09 Supp. Estimates \$000	2007/08 Actual \$000	2006/07 Actual \$000
Income				
Crown	3,176	3,176	3,064	2,890
Other	7	0	6	9
Expenditure	(3,173)	(3,176)	(3,014)	(2,785)
Surplus/(Deficit)	10	0	56	114

Performance audits and inquiries

This output class includes two outputs:

- Performance audits – reporting to Parliament and other constituencies on matters arising from performance audits and other studies, including good practice guides; and
- Inquiries – carrying out and reporting on inquiries relating to central and local government entities.

In 2008/09, we published 19 performance audits, other studies, and inquiries. Appendix 1 on pages 117–123 summarises these publications. A copy of each report is also published on our website: www.oag.govt.nz.

Performance audits and other studies

A performance audit is a significant and in-depth audit covering issues of effectiveness and efficiency. It provides Parliament with assurance about specific issues or programmes and their management by the relevant public entity or entities. We also carry out other studies that may result in published good practice guidance on topical issues of public sector accountability and performance.

To select performance audits and studies, each year we scan the environment, identify issues, assess risk, and identify assurance responses, to help determine how we can use our discretionary resources to best effect.

In deciding the discretionary work programme, the Auditor-General considers that, regardless of any other work completed by the Office, the Auditor-General has a responsibility to Parliament and the public to provide regular assurance about the activities of public entities that are large and complex, and/or where it is difficult to assess their performance.

Core areas of interest for the Auditor-General include:

- major public investment or liability management (focusing on the New Zealand Debt Management Office, Accident Compensation Corporation, New Zealand Superannuation Fund, Government Superannuation Fund, Earthquake Commission, and Student Loans Scheme);
- major public revenue management or generation (focusing on the Inland Revenue Department and New Zealand Customs Service);
- major asset management or infrastructure spending or management (focusing on health, correctional facilities, education, defence, conservation, transport, housing, and energy);
- major expenditure including service delivery expenditure (focusing on health, education, and social security and welfare).

Guided by these core areas of interest, we identify areas within or throughout entities or sectors that warrant further examination. To assign priorities to these assurance interventions, we consider the:

- severity and significance of the issue;
- benefit to the public;
- extent to which the performance or the public entity or sector could be improved; and
- fit with the Auditor-General's role and mandate.

We consult with Parliament and other stakeholders on our draft annual plan (and in particular our proposed discretionary work programme) to ensure that stakeholders agree that we are addressing the issues of greatest relevance.

We describe our progress on the performance audits and other studies we proposed in our *Annual Plan 2009/10* on pages 45–47.

Measuring our performance for output: Performance audits

Figure 19

**Actual performance against impact measure and standard for output:
Performance audits**

2008/09 forecast main impact measure and standard	2008/09 Actual	2007/08 Actual	2006/07 Actual
Entities accept or respond to the recommendations made in our performance audits, as assessed by internal review of three reports of performance audits published in the previous year and selected by our independent Audit and Risk Committee. The results of these reviews are presented to the Officers of Parliament Committee.	Three performance audit reports were selected by our Audit and Risk Committee for review and the results were presented to the Officers of Parliament Committee. The review concluded that our recommendations had been accepted by the relevant entities and either had been implemented or were being implemented.	Three performance audit reports were selected by our Audit and Risk Committee for review and the results were presented to the Officers of Parliament Committee. The review concluded that our recommendations had been accepted by the relevant entities and either had been implemented or were being implemented.	New measure for 2007/08. In 2006/07, however, three performance audits reviewed were selected by our Audit and Risk Committee and the results were presented to the Officers of Parliament Committee. Our review concluded that our recommendations had been accepted by the relevant entities in two cases, and some of our recommendations had been accepted in the third case. The accepted recommendations were being implemented at the time of our review.

For 2008/09, the summarised results of our reviews of entities' acceptance and response to recommendations made in three selected performance audits were as follows:

- The public entities covered by our first selected report had accepted our recommendations and made changes to their policies and processes as appropriate. These changes raised awareness and understanding in the entities, and made management of the issues identified by our report more rigorous. Our report was strongly influencing the content and direction of guidelines being prepared for other entities in the sector.
- The public entity accepted the key findings of our second selected report and committed to implementing our recommendations. In response to our findings on one issue, the entity set up a strengthening programme to address weaknesses. We followed up on progress with the strengthening programme as part of our annual financial audit and were satisfied that the entity's systems and practices in this area were improving.
- The public entity had made good progress in implementing the recommendations of our third selected report. It had still to complete implementing some of them. We noted in our report that we expected the entity would continuously review and change its approaches as the organisation grew, and in response to changes in the environment it worked in.

Figure 20

Actual performance against output delivery measures and standards for output: Performance audits

2008/09 forecast measures and standards of output delivery	2008/09 actual	2007/08 actual	2006/07 actual
We complete 19 to 21 reports on matters arising from performance audits and special studies, and inquiries.	19	22	20
Select committees and other stakeholders are satisfied with the proposed work programme of performance audits (as indicated by feedback on our draft annual work programme).	We sought feedback on our proposed 2009/10 work programme on two occasions under section 36(1) of the Public Audit Act 2001. The feedback mainly supported the approach we had taken to determining the proposed work programme.	We sought feedback on two occasions under section 36(1) of the Public Audit Act 2001. The feedback mainly supported the approach we had taken to the proposed work programme and gave us guidance on the scope and relative emphasis we should place on one or two key studies.	We sought feedback on two occasions under section 36(1) of the Public Audit Act 2001. The feedback mainly supported the approach we had taken to the proposed work programme, and gave us guidance on the scope and relative emphasis we should place on one or two key studies.

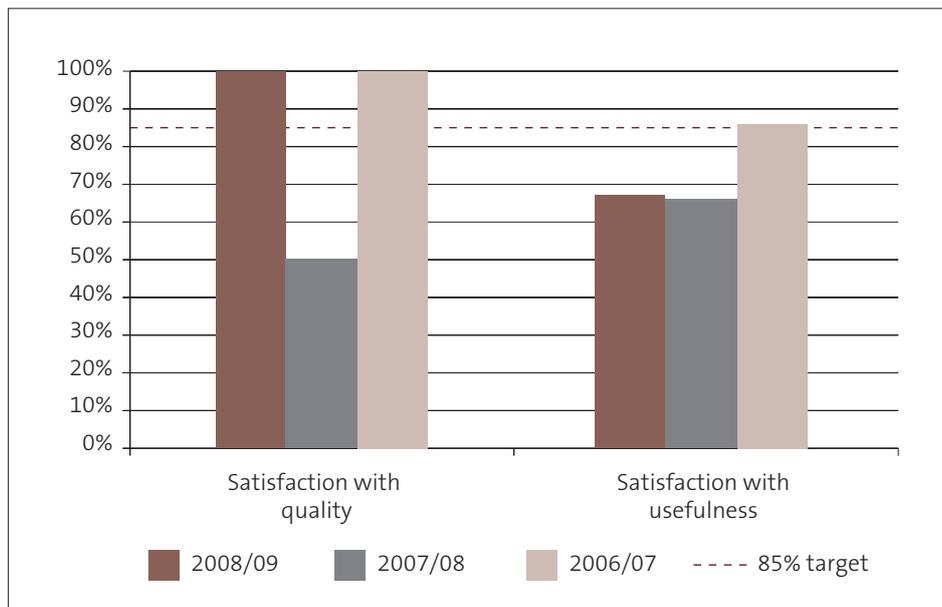
<p>At least 85% of the stakeholders that we seek feedback from rate our performance audit reports (relevant to their sector or interest), as 4 or better on a scale of 1 to 5 for:</p> <ul style="list-style-type: none"> • quality; and • usefulness. 	<p>100%</p> <p>67%</p>	<p>50%</p> <p>66%</p>	<p>100%</p> <p>86%</p>
<p>Our performance audit methodology reflects good practice for undertaking such audits, as assessed every second year by the Australian National Audit Office.</p>	<p>The Australian National Audit Office reviewed two performance audits and confirmed areas in which the quality of our reports is strong and areas for us to improve.</p>	<p>N/A.</p>	<p>The Australian National Audit Office reviewed two performance audits looking at all aspects of the audit process, and endorsed the quality of the two audits.</p>
<p>Each year independent reviews of two performance audits are undertaken. These reviews confirm the quality of these reports in terms of the presentation of administrative and management context, report structure, presentation, and format (including use of graphics and statistics), and the reasonableness of the methodology used and the resulting conclusions and recommendations.</p>	<p>Independent reviews of two performance audits confirmed areas in which the quality of our reports is strong and areas for us to improve.</p>	<p>Independent reviews of two performance audits confirmed the quality of reports.</p>	<p>Independent reviews of two performance audits confirmed the quality of reports.</p>
<p>Internal quality assurance reviews on selected performance audit reports confirm that reports are prepared in keeping with the performance audit methodology. (The nature, extent, and frequency of the quality assurance review are determined based on risk. The review is carried out during a three-year period.)</p>	<p>There was no internal review this year.</p>	<p>Internal review confirmed that appropriate systems and controls are in place, and that reports are prepared in keeping with the performance audit methodology.</p>	<p>Internal review confirmed that appropriate systems and controls are in place.</p>

Since we set the target of completing 19 to 21 reports each year on matters arising from performance audits, special studies, and inquiries, we are very pleased to have consistently achieved this. We completed 19 reports in 2008/09. While this is less than in the previous two years, our reports in 2008/09 included our *Inquiry into immigration matters* and our performance audit on the *Department of Corrections: Managing offenders on parole*, both major and sensitive pieces of work. During 2008/09, we also completed the bulk of work on several performance audits and special studies, and inquiries, which we intend to report in the first part of 2009/10. Each of the reports that we complete is unique and requires a different level of time and resource, so the number of reports that we produce can be expected to fluctuate from year to year.

We consult select committees and other stakeholders on our proposed annual work programme. The feedback we received this year on our proposed 2009/10 work programme mainly supported the approach we had taken to determining the programme. It included expressions of interest in particular areas of work or studies, guidance on the scope and relative emphasis we should place on one or two key studies, and suggestions for potential studies.

Each year, we also seek the views of a small sample of select committee chairpersons, deputy chairpersons, and other stakeholders on the quality and usefulness of the performance audit reports that we have published. A summary of our performance in the last three years against our target for stakeholder satisfaction with the quality and usefulness of our performance audit reports is shown in Figure 21.

Figure 21
Stakeholder feedback on performance audit outputs



For 2008/09, we are pleased that all of the stakeholders we surveyed rated the quality of our performance audits highly, exceeding our target. Independent reviews of some of our performance audits also confirmed areas of strength in our methodology and reports. These included:

- our performance audits are soundly planned, clearly defining the scope and issues to be examined; and
- our reports are logically structured, clearly written, and convey the key messages effectively.

For the second year in succession, two-thirds of the stakeholders we surveyed also rated the usefulness of our performance audits highly. This is below our target level of 85% of stakeholders rating the usefulness of our performance audits highly.

Feedback from stakeholders in 2008/09 included the suggestion that we present more information and analysis in our reports, to enable an assessment of value for money to be made (for example, more information and analysis on the costs and benefits of programmes). This feedback is consistent with that we received from independent reviews of some of our performance audits. During 2009/10 and 2010/11, we will be piloting an approach to carrying out audits with more focus on cost-effectiveness to determine how we can do this, the value it adds, and the

affect such an approach has on the methods we use, the size of our reports, how we resource them, and how many we produce.

We also participated in a peer review of our performance audit methodology. Strengths of our performance audits and the underlying processes include:

- sound planning process;
- significant review and editing process; and
- logical structure and clear writing style.

Areas suggested for improvement included:

- reducing process description and increasing independent analysis; and
- providing greater analysis of the impact of audit findings.

Relative to our international counterparts, the Office audits a very large number of public entities annually. We have very limited discretionary resources to carry out in-depth audit work, such as through performance audits, to provide Parliament with assurance about specific issues or programmes and their management by the relevant public entity or entities. This means that our performance audits are carried out with significantly lesser resource and costs than many of our peers. It also means that, at times, we are not able to do as much in-depth work as we would like. Our pilot study to examine cost-effectiveness will sit alongside other development work that we carry out in response to internal and external reviews of our methodology and reports to continuously strengthen the depth and relevance of our performance audits and other studies.

Progress against our *Annual Plan 2008/09*

On pages 61–62 of our *Annual Plan 2008/09*, we listed 25 performance audits and other studies that we proposed to start and/or complete in 2008/09.

Our actual work programme varies from that planned in response to changing priorities, such as urgent work on new inquiries, and changes in government policy or entity circumstances affecting the timing or relevance of audits.

To help accommodate these inevitable changes, the planned work programme includes more performance audits than our target of 19 to 21 reports on matters arising from performance audits, special studies, and inquiries.

Of the 25 performance audits and other studies listed in our *Annual Plan 2008/09*, we completed two earlier than planned (before the end of 2007/08), we completed eight in 2008/09, we started and partially completed work on another 10 that are ongoing, we started work on two more and then decided to postpone them, and we plan to start the remaining three in 2009/10.

Although not forming part of the 19 reports produced, Audit New Zealand also revises and updates model financial statements for various types of public entities, and in 2008/09 revised and reissued its model financial statements for council-controlled organisations. Figure 22 summarises our progress against our *Annual Plan 2008/09*.

Figure 22
Summary of progress against our *Annual Plan 2008/09*

Two performance audits completed earlier than planned (before the end of 2007/08):

- *The Accident Compensation Corporation's leadership in the implementation of the national falls prevention strategy*; and
- *Ministry of Education: Monitoring and supporting school boards of trustees*.

Eight performance audits and other studies completed as planned in 2008/09:

- *Ministry of Health: Monitoring the progress of the Primary Health Care Strategy*;
- *Housing New Zealand Corporation: Maintenance of state housing*;
- *Department of Corrections: Managing offenders on parole*;
- *Workforce planning in Crown Research Institutes*;
- *How government departments monitor Crown entities*;
- *Electricity Commission: Review of the first five years*;
- *Inland Revenue Department: Managing tax debt*; and
- *Response of the New Zealand Police to the Commission of Inquiry into Police Conduct: First monitoring report*.

Ten performance audits and other studies started and partially completed during 2008/09:

- Civil Aviation Authority – follow-up of the Auditor-General's 2005 audit;
- District health boards – effectiveness of managing patients in Active Review;
- District Health Boards – procurement;
- Local authorities – strategies to meet water demand;
- Ministry of Defence and New Zealand Defence Force – Major acquisition project monitoring and reporting systems;
- Ministry of Education (Group Special Education) – progress report on the Better Outcomes for Children action plan;
- Ministry of Justice – management of Court workloads;
- New Zealand Defence Force – Defence Sustainability Initiative;
- Transit New Zealand – State highway maintenance; and
- Work and Income – effectiveness of case management of sickness and invalid beneficiaries.

Two performance audits started and postponed during 2008/09:

- Department of Building and Housing – implementation of the Building Act 2004;* and
- Ministry of Education – effective management of the Crown’s financial interest in integrated schools.**

Three performance audits and other studies now planned to be started in 2009/10:

- District health boards – asset management planning;
- Tertiary Education Commission – monitoring of tertiary education institutions; and
- Transpower – managing the national grid.

* An audit assessing the effectiveness of the Department of Building and Housing’s implementation of the Building Consent Authority (BCA) accreditation scheme was not carried out because the Department was planning a similar review. The Department commissioned PricewaterhouseCoopers (PwC) to carry out a review of the implementation of phase 1 of the BCA accreditation scheme. PwC’s final report outlining the findings of the review was released on 29 May 2009.

** Preliminary work for the audit found that the Ministry of Education is aware of, and attempting to address, the ongoing risks associated with existing public funding arrangements of integrated school properties. Also, in the 2009 financial statements, all integrated schools should disclose their proprietors as related parties and disclose all transactions between the board of trustees and the proprietor. This should improve the transparency of financial transactions and how public funding is spent in integrated schools.

In addition to work on the performance audits and other studies listed in our *Annual Plan 2008/09*, during 2008/09 we completed two performance audits from our *Annual Plan 2007/08* and published three other outputs. Some of our performance audit staff worked on major inquiries such as our *Inquiry into immigration matters*. Figure 23 summarises the additional performance audits and other studies we completed in 2008/09.

Figure 23

Summary of additional performance audits and other studies completed in 2008/09

Two performance audits completed from our Annual Plan 2007/08:

- *Maintaining and renewing the rail network**; and
- *Ministry of Education: Supporting professional development for teachers.*

Three other outputs:

- *Performance audits from 2007: Follow-up report;*
- *The Auditor-General’s views on setting financial reporting standards for the public sector;* and
- *Statements of intent: Examples of reporting practice.*

* Almost all of the work on this audit was completed during 2007/08. The report was presented to the House of Representatives on 1 July 2008.

Inquiries

Overview of inquiries in 2008/09

The Auditor-General has the discretion to inquire into a public entity's use of resources. We can carry out inquiries on our own initiative and when correspondence from the public draws attention to particular issues. We are also sometimes asked by a Minister responsible for a public entity, or an entity itself, to inquire into a matter of public concern about that entity.

In 2008/09, our inquiries work was dominated by several large, complex, and high profile inquiries that arose in this way; in particular, the inquiry into the Immigration Service. In May 2008, the then Prime Minister asked the Auditor-General to carry out a comprehensive inquiry into the concerns emerging about the operation of the Service and related recruitment issues. This inquiry was completed with the tabling of two reports in Parliament in June 2009, after a process that occupied a small team of staff full-time for most of the year. It is one of the larger inquiries we have carried out in recent years.

The report into the operation of the Service looked at the integrity and probity of Immigration New Zealand's systems, processes, and practices for deciding who will be issued with a visa or permit. We did not find any widespread integrity or probity issues. However, we did identify organisational issues that were of concern and a need for the Department to improve its systems and processes. In particular, we raised concerns about excessive variation in quality, approach, and processes between branches, an undue focus on quantity rather than quality in performance targets, a culture in which staff did not feel safe about raising concerns, a "silo" culture and poor management practices, and specific problems in the Pacific Division. The Department of Labour has indicated that it will work to address these concerns and implement our various recommendations.

The second report examined the public sector recruitment and related processes involving Mary Anne Thompson, the former Deputy Secretary (Workforce) in the Department of Labour. We concluded that the processes used to recruit her to various roles since 1989 appear to have been reasonably standard, and reflected practice at the time. It seems unlikely that her qualifications were checked until she applied for a chief executive role in 2004. Ministers were not aware of any uncertainty about her qualifications until just before the issue became public in May 2008. That was consistent with the norms governing Ministerial involvement in public service employment matters.

We published a report on our inquiry into the West Coast Development Trust in August 2008, after a complex inquiry that had begun as a result of a “whistleblower” disclosure to us in November 2007. Our inquiry found no significant issues relating to the various detailed concerns that were initially raised with us. Rather, we concluded that the main problem was that the Trust was dysfunctional at a governance level. The trustees were not able to work together effectively and were creating an atmosphere of suspicion and distrust. Our sole recommendation was that the trustees urgently needed to find a way to work together so that they could take effective collective responsibility for the governance of the Trust.

Other significant inquiries that we began during the year as a result of requests from Ministers or entities include those into the Plumbers, Gasfitters and Drainlayers Board, the payment of accommodation allowances to New Zealand Defence Force staff seconded to the United Nations, the Ministry of Education’s administration of the national school bus tender round, Auckland City Council’s management of footpath contracts, and Auckland Regional Council’s management of the visit of the LA Galaxy football team.

We have noted in previous reports that most of our inquiry work is responsive and so the workflow can be uneven. The number of major inquiries that we have been asked to carry out in the course of 2008/09 has created substantial additional demands on the Office that could not have been anticipated. This workload was in addition to our usual flow of general requests in a wide range of areas.

Even among our general requests, we have noted that many of the issues we are being asked to consider are increasingly complex, significant, and long-running, particularly in relation to major activities or infrastructure projects being considered by local authorities. For example, during 2008/09 we spent a significant amount of time considering issues associated with the proposal to build a new sports stadium in Dunedin, after a large number of requests at several stages of the decision-making process. We also reviewed the way in which Christchurch City Council decided to purchase a number of inner-city properties at short notice from a single vendor. Our work on these topics illustrates an increasing trend for this Office to be asked to comment on whether local authorities are complying adequately with the decision-making requirements of the Local Government Act on wide-ranging issues. These requests can be factually and legally challenging, and are often made in the context of heated political debate about the particular issues.

Most of our inquiry requests continue to be in the local government sector. During 2008/09, we were also carrying out our three-yearly audits of LTCCPs, meaning

that for some months we were unable to give our routine inquiry work the same level of priority as in previous years.

As a result of these various factors, our general timeliness has reduced this year and we have not met some of our performance targets.

Although staff vacancies during 2008/09 also affected our timeliness, we are carefully monitoring what appears to be a steadily rising workload in this area. If this trend continues, we will need to begin refusing inquiries or to reprioritise resources within the *Performance audit and inquiries* output class (the only output class in which the work we carry out is discretionary). Alternatively, we will need to seek additional funding from Parliament.

General requests for inquiries

We receive a large number of requests for inquiries each year. In 2008/09, we received 271 requests, which is more than usual. We also brought forward 27 from the previous year. By the end of the year, we had responded to 254 of these requests, and have carried 44 forward into the following year.

Not all requests result in an inquiry, because some requests raise issues that are outside our mandate, have not been raised yet with the relevant public entity, or are better dealt with by another organisation. For those requests that are appropriately made to us, we consider each one to determine the most appropriate way to proceed. Factors we consider include whether the Auditor-General is the appropriate authority to consider the issues, whether we have the resources to do so, and the seriousness of the issues raised. It is also common for us to receive a number of requests about the same issue if it is a matter of public controversy.

We classify inquiries into three categories – “routine”, “sensitive”, and “major” – depending on how serious the issues raised are. A routine inquiry involves straightforward issues, and can often be carried out either by a review of documents or through correspondence and discussion with the public entity. It will not usually result in a published report. We always advise the correspondent of our conclusions and the reasons for them, and in some instances we advise the public entity of the matter.

Sensitive and major inquiries involve more complex issues and may attract a broader level of public interest and attention. In these inquiries, we will often review the entity’s files and may also formally interview people. We may report the results of these inquiries publicly, as well as advising the correspondent and the entity.

Measuring our performance for output: Inquiries

Figure 24

Actual performance against impact measure and standard for output: Inquiries

2008/09 forecast main impact measure and standard	2008/09 Actual	2007/08 Actual	2006/07 Actual
Entities take action in response to concerns identified in inquiry reports, as assessed by follow-up on a sample of sensitive and major inquiries undertaken in the previous year.	We followed up on four of the 11 inquiries within these categories from the previous year that contained recommendations or suggestions for action. In all cases, we were satisfied with the action taken.	We have followed up the one sensitive inquiry that was undertaken in 2006/07 (there were no major inquiries). The entity concerned has taken positive steps to address the comments we made.	Not applicable – new measure for 2007/08.

Figure 25

Actual performance against output delivery measures and standards for output: Inquiries

2008/09 forecast measures and standards of output delivery	2008/09 Actual	2007/08 Actual	2006/07 Actual
80% of our findings on inquiries are reported to the relevant parties within: <ul style="list-style-type: none"> • three months for routine inquiries • six months for sensitive inquiries • 12 months for major inquiries. 	84% (99 routine inquiries, 83 reported within three months). 73% (11 sensitive inquiries, 8 reported within six months). 0% (two major inquiries, both reported within 13 months).	91% (115 routine inquiries, 105 reported within three months). 82% (11 sensitive inquiries, 9 reported within six months). No major inquiries were carried out.	95% (80 routine inquiries, 76 reported within three months). 0% (one sensitive inquiry, not reported within six months). No major inquiries were carried out.
For enquiries under the Local Authorities (Members' Interests) Act 1968, we complete 80% within 30 working days.	87% (53 received, 46 reported within 30 working days).	95% (103 received, 98 reported within 30 working days).	87% (47 received, 41 reported within 30 working days).

Responses to requests for inquiries, and our administering of the Local Authorities (Members' Interests) Act 1968 requests, are in accordance with relevant policies, procedures, and standards, as confirmed by internal quality assurance review. (The nature, extent, and frequency of the quality assurance review are determined based on risk. The review is carried out during a three-year period.)	No internal quality assurance review was undertaken in 2008/09.	Review was completed and confirmed that requests are undertaken in accordance with relevant policies, procedures, and standards.	Review was completed and confirmed that requests are undertaken in accordance with relevant policies, procedures, and standards.
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Figure 26 provides a summary of the requests for inquiries dealt with during 2008/09.

Figure 26

Summary of requests for inquiries dealt with during 2008/09

	Requests brought forward from 2007/08	Requests received during 2008/09	Requests dealt with during 2008/09	Requests carried forward to 2009/10
No inquiry	27 (not categorised)	271	142	44 (not categorised)
Routine inquiries			99	
Sensitive inquiries			11	
Major inquiries			2	
Total	27	271	254	44

Enquiries under the Local Authorities (Members' Interests) Act 1968

We also administer the Local Authorities (Members' Interests) Act 1968 (the Act), which governs the financial interests of members of local authorities. In 2008/09, we received 57 enquiries under the Act (see Figure 27).

Figure 27
Summary of Local Authorities (Members' Interests) Act enquiries dealt with during 2008/09

	Brought forward from 2007/08	Received during 2008/09	Completed during 2008/09	Carried forward to 2009/10
Number of enquiries	0	57	53	4

We remain concerned that the Act is out of date, operates unevenly, and creates additional risks and compliance costs for elected members and local authority staff. We are pleased that the Department of Internal Affairs began a review of the Act during 2008/09, and we have co-operated with the Department to ensure that it has access to our practical experience. We recognise that this is not a high priority for reform, but hope that it will proceed during 2009/10.

We carried out one significant investigation under the Act during the year, when it was suggested that the Mayor of the Thames Coromandel District Council had participated in a decision in which she had a pecuniary interest. We concluded that she did not have a pecuniary interest in the decision and so had not breached the Act, but that she had failed to identify and adequately manage the clear risk that others would perceive a conflict of interest. We are aware that this issue has caused a considerable amount of public concern in the district.

It provides a useful reminder for all elected members about the need to actively monitor their own financial affairs and business coming before councils to ensure that any actual or perceived conflicts of interest, whether financial or not, are identified early and actively managed. Even if there is no actual conflict of interest or legal risk, poor management of possible perceptions of conflict of interest can create significant public and political concern. This is not only time consuming to resolve; it can also damage public trust in the institutions of government. Local authority staff are usually able to provide advice, and will often contact us to discuss the most appropriate way of managing complex situations.

Figure 28
Financial performance of output class: Performance audits and inquiries

	2008/09 Actual \$000	2008/09 Supp. Estimates \$000	2007/08 Actual \$000	2006/07 Actual \$000
Income				
Crown	6,587	6,587	6,407	6,295
Other	17	0	14	20
Expenditure	(6,159)	(6,587)	(6,223)	(6,018)
Surplus/(Deficit)	445	0	198	297

Part 3

Organisational health and capability

Capability report

Our operating model

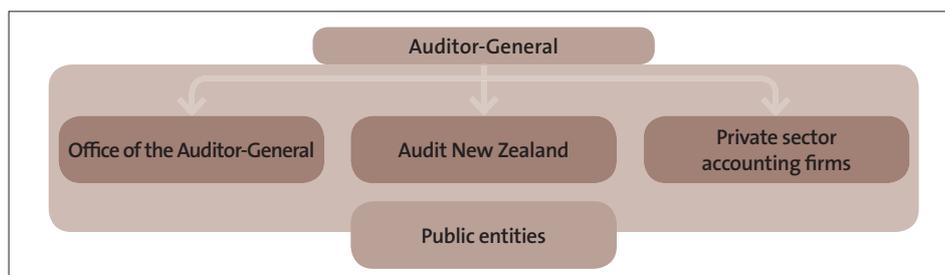
The Auditor-General's staff are organised into two business units – the Office of the Auditor-General (OAG) and Audit New Zealand.

The OAG carries out strategic planning, sets policy and standards, appoints auditors and oversees their performance, carries out performance audits, provides reports and advice to Parliament, and carries out inquiries and other special studies.

Audit New Zealand is the operating arm, and carries out annual audits allocated by the Auditor-General. It also provides other assurance services to public entities within the Auditor-General's mandate and in keeping with the Auditor-General's auditing standard on the independence of auditors.

The Auditor-General also engages private sector accounting firms to carry out audits of some public entities. Figure 29 shows the Auditor-General's operating model.

Figure 29
Our operating model



Size and scale of our operations

The Auditor-General has a statutory duty to conduct annual audits of the financial reports and other audits required by various statutes of about 4000 public entities, of which about 3000 are schools and other very small entities. The Auditor-General is also able to perform other services reasonable and appropriate for an auditor to perform, and to audit other quasi-public entities.

We employ about 350 staff in eight locations, and engage about 60 private sector accounting firms to carry out annual audits of public entities.

Summary results for 2008/09

Our *Annual Plan 2008/09* set out the measures we intended to use to assess our current capability, specifically:

- staff numbers and the distribution of staff by function, gender, and ethnicity;
- staff tenure and turnover, including numbers of internal promotions to senior roles; and
- investment in staff training and development.

Our specific intentions and results against these measures for 2008/09 were to maintain and improve:

- our audit staff numbers;
- the engagement and satisfaction of our staff; and
- all of the key capability statistics from the previous year.

Specific areas of focus were:

- continued strengthening of the management and leadership capability of our senior people;
- maintaining and extending the national professional development programme;
- improving Individual Development Plans for all staff;
- ongoing investment in targeted areas of generic training (for example, te reo, presentation skills, media liaison, and plain English writing);
- resourcing and aligning the mix of staff in Audit New Zealand to better align with our future resourcing model;
- improving and expanding our high potential and talent management programmes to recognise, reward, and develop our high performers;
- maximising the quality of our national internship programme; and
- further aligning our human resources policies and procedures to support the recruitment, retention, and development of the best people.

Based on this information, we drew our own conclusions about the adequacy, quality, and effectiveness of our current capability. Overall, we have made good progress during 2008/09 in:

- continuing to develop the leadership skills and capability of our staff;
- improving our systems and processes;
- improving recruitment and retention to attract and retain good people; and
- maintaining acceptable levels of organisational health.

Resources

Throughout 2008/09, our overall staff turnover has remained around 20%. However, there has been a noticeable drop in the turnover of Audit New Zealand staff, ending the year at around 17%. We attribute this drop to two factors: the worldwide recession and improved culture. The recession has undoubtedly led to lower worldwide demand for accounting staff, which has reduced the number of our newly qualified auditors leaving to travel overseas. We believe that our leadership development programme has also contributed to a reduction in attrition, because more senior staff have chosen to stay and staff engagement and satisfaction have improved.

We use a resource planning model to forecast audit staff requirements in future years. This model has shown us that, even though attrition is reducing, we need to maintain a certain level of recruitment for graduates but reduce the recruitment of qualified employees. It also shows that we need to continue to supplement our internal staff with secondees from other chartered accounting firms to help us through our peak workload periods.

Our recruitment initiatives and processes were again successful in 2008/09. Thirty-one graduates joined the Office during the year, including 19 who had worked with us as interns in the previous year. We continued to recruit a small number of qualified auditors from the United Kingdom and South Africa. We also attracted a number of highly experienced professionals from both the public and private sectors in New Zealand. We believe that, for the first time in a number of years, we have sufficient staff.

Figure 30 provides a summary of staff numbers, their functional distribution, and staff turnover for the year.

Figure 30
Staff numbers, functions, and turnover

As at 30 June	2009	2008	2007
Staff numbers (full-time equivalents)			
Office of the Auditor-General	61	57	71
Audit New Zealand	249	216	217
Corporate Services*	44	38	N/A
Total	354	311	288
Functional distribution			
Audit/assurance	65%	74%	72%
Technical and advisory	10%	9%	4%
Corporate support	22%	13%	20%
Senior management	3%	4%	4%
Turnover			
Office of the Auditor-General	19%	19%	19%
Audit New Zealand	17%	21%	18%
Corporate Services*	24%	21%	N/A

* Corporate Services function is shared between the OAG and Audit New Zealand. From 2008, the staff numbers for Corporate Services are shown separately. In previous years, these staff numbers were distributed between the two business units.

Equal employment opportunities

The principles of equal opportunity are embedded in the Office's policies and procedures. Our recruitment programme in particular aims to attract and appoint the best people, who have the appropriate skills, values, and attributes to meet the Office's needs, objectives, and strategic direction, in a manner that provides equal employment opportunity to Māori, women, ethnic or minority groups, and people with disabilities.

The Office benefits from a diverse workforce, and we are committed to recognising and valuing different skills, talents, experiences, and perspectives among our employees. A diverse workforce will help the Office relate to our clients and bring a variety of perspectives to bear on our work.

As shown in Figure 31, the diversity of our staff remains high.

Figure 31
Staff diversity

As at 30 June	2009	2008	2007
Gender distribution – all staff			
Women	52%	52%	54%
Men	48%	48%	46%
Gender distribution – executive management			
Women	42%	42%	45%
Men	58%	58%	55%
Ethnicity distribution			
NZ European	48%	42%	48%
NZ Māori	2%	4%	3%
Pacific Islander	3%	3%	2%
Asian	12%	12%	9%
Other European	7%	12%	8%
Other ethnic groups	4%	2%	3%
Undeclared	24%	25%	27%

Training and development

We aim to continue to improve the overall skill, leadership capability, and experience level of staff. This is of particular importance for audit staff, but applies to the whole organisation. Statistics on staff experience and training are shown in Figure 32.

Figure 32
Staff experience and training

	2008/09	2007/08	2006/07
Experience – average years in job (at 30 June)			
Office of the Auditor-General	7.6	7.2	5.8
Audit New Zealand	4.2	4.3	4.3
Corporate Services*	2.9	5.4	N/A
Training and development – average expenditure for each employee			
Office of the Auditor-General (incl. Corporate Services)	\$1,658	\$1,884	\$2,572
Audit New Zealand	\$2,371	\$4,509	\$3,165
Pass rate of staff undertaking NZICA accreditation			
	94%	100%	100%

* Corporate Services function is shared between the OAG and Audit New Zealand. From 2008, the staff numbers for Corporate Services are shown separately. In previous years, these staff numbers were distributed between the two business units.

We have continued to develop our high potential and talent management programmes, to improve staff retention and to broaden the skills of our current and future leaders. In 2008/09, two new programmes were launched: an aspiring managers' programme and an aspiring directors' programme. These programmes target audit staff who have shown the capability and desire to take on more senior roles, focusing on self-development and leadership skills.

Expenditure on training and development has decreased for Audit New Zealand, in particular. The peak figure in 2007/08 reflects the investment we made in establishing leadership development programmes in that year.

Many staff members throughout the organisation have also received generic training, which includes plain English writing, presentation, and media liaison skills.

Professional development continues to have a very high priority. In 2008/09, Audit New Zealand refreshed its national professional development programme for all audit staff. The programme delivered 30 modules/courses to 513 course participants. These were highly rated by audit staff, with an average rating of 7.9 out of 10. The programme aims to improve the base professional competencies of audit staff. This includes equipping them to work within Audit New Zealand's national professional practice framework, audit methodology, and quality control systems, and the Auditor-General's auditing standards.

Organisational health and staff satisfaction

Each year we survey our staff to understand trends in various aspects of our staff satisfaction. For a second year, we used the Gallup Q12[®] employee engagement survey to survey our staff.

We are particularly interested in the overall satisfaction and engagement of our staff, whether the organisation meets the basic needs of our people, the degree to which our people contribute as individuals and as teams, and the opportunity for growth in the organisation.

We are pleased to note that our results have improved in almost all areas since the previous year (see Figure 33). While it is difficult to quantify the effect of particular initiatives, we believe that the ongoing leadership development programme in Audit New Zealand has played a significant part.

We consider it desirable and beneficial to continue improving our employees' engagement and satisfaction across the board, and will be working on this throughout 2009/10.

Figure 33
Staff survey results

As surveyed in May	2009	2008
Staff survey results (1 = low, 5 = high)		
Overall engagement	3.8	3.7
Overall satisfaction	3.7	3.5
Basic needs met	4.0	4.0
Individual contribution	3.7	3.5
Teamwork	3.7	3.5
Growth	4.2	4.0

Another indicator of organisational health is the average number of sick days taken by an employee. As shown in Figure 34, the figures for 2008/09 are consistent with previous years.

Figure 34
Sick leave

Sick leave taken – average for each employee			
12 months to 30 June	2009	2008	2007
Office of the Auditor-General	4.8	5.2	5.3
Audit New Zealand	5.1	5.5	4.8
Shared Corporate Services	4.8	4.3	N/A

Information systems

The Office, especially Audit New Zealand, is highly dependent on information technology to complete its work. Audit staff working in the field need to have remote access and communications tools to ensure an effective, efficient, and customer-focused service. The OAG needs systems to manage the approximately 4000 audits we are responsible for.

During 2008/09, the Office invested in the replacement of its core financial system and an integrated time and cost management system. The new system replaces several separate systems that were no longer able to meet the information, management, and security needs of the Office. The replacement system contains increased functionality, including process workflow management and significantly improved operational and management reporting functions.

Also in 2008/09, a project was started to put in place a single document and records management system.

Financial performance indicators

Details of our performance against measures established in the Annual Plan 2008/09 are summarised in Figure 35.

Figure 35
Financial performance indicators for the year ended 30 June 2009

Measure	2008/09 Actual \$000	2008/09 Supp. Estimates \$000	2008/09 Annual Plan \$000	2007/08 Actual \$000	2006/07 Actual \$000
Operating results					
Income: other than Crown	60,506	62,607	61,332	58,525	58,503
Output expenditure	69,934	72,520	71,228	67,861	67,553
Surplus before capital charge	750	165	120	549	552
Surplus	486	-	-	285	285
Working capital management					
Current assets less current liabilities	1,687	1,736	2,272	2,324	1,844
Current ratio	118%	122%	129%	130%	123%
<i>Average receivables and work in progress</i>	<i>42 days</i>	<i>41 days</i>	<i>45 days</i>	<i>42 days</i>	<i>35 days</i>
Resource use					
Total plant, equipment, and intangible assets at year-end	2,351	2,440	2,019	1,847	2,389
<i>Additions as % of total</i>	<i>64%</i>	<i>67%</i>	<i>76%</i>	<i>42%</i>	<i>51%</i>
Taxpayers' funds					
Level at year-end	3,521	3,521	3,521	3,521	3,521
Net cash flows					
Surplus on operating activities	2,233	813	1,589	452	1,867
Surplus/(Deficit) on investing activities	(1,428)	(1,531)	(1,410)	(652)	(1,015)
Surplus/(Deficit) on financing activities	(285)	(285)	-	(469)	-
Net increase/(decrease) in cash held	520	(1,003)	179	(669)	852

Part 4
Risk management

Risk management framework

Our risk management framework is the set of elements of our management system that we use to identify and manage risk. The framework is aligned to our business outcomes and the strategies designed to achieve these outcomes.

Identifying and managing risk is a key part of our planning. Our strategic planning defines plans and allocates resources to achieve certain objectives. An integral part of the planning is to identify anything that might threaten the achievement of those objectives.

We categorise the risks that we are exposed to as strategic or operational risks. All risks are managed within the same framework, because experience shows that inadequately managed operational risks can escalate to become strategic risks.

Strategic risks

We have identified our main strategic risks as being the loss of our independence, audit failure, loss of capability, and loss of reputation:

- Loss of independence – The risk that we lose independence, in fact or appearance, whether by failure on the part of the Auditor-General or appointed auditors to act independently or otherwise, As independence underpins the value of the Auditor-General's work, loss of independence would undermine trust in our organisation.
- Audit failure – The risk that we issue an incorrect audit opinion with material impact, or a report that is significantly wrong in nature or process.
- Loss of capability – The risk that we are unable to retain, recruit, or access people with the technical and other skills our audit work requires.
- Loss of reputation – The risk that we may lose reputation or credibility, which would affect our relationships with stakeholders.

These risks will always be present, but the way we do our work can greatly reduce them.

Strategic risk mitigation actions

The key mitigation actions are:

- the Auditor-General's independence standards – the Auditor-General sets a high standard for independence for both employees and appointed auditors from chartered accounting firms;
- monitoring the independence of the two statutory officers, employees, and appointed auditors – the system includes regular declarations of interest and, where necessary, implementation of measures to avoid conflicts of interest;

- adhering to professional auditing standards;
- quality assurance procedures, including complying with NZICA's quality control standards;
- peer review and substantiation procedures – these include annual independent evaluation of our audit allocation and tendering processes, independent external review of two performance audits each year, stakeholder feedback interviews, and client surveys;
- an independent Audit and Risk Committee, comprising three external members and the Deputy Controller and Auditor-General; and
- ongoing training and development of our staff – including talent and capability management programmes, leadership development initiatives, and professional development programmes.

Operational risks

We identify specific risks during our annual planning by carrying out a review of the environment in which we operate. We consider economic, legal, social, environmental, and technological developments, and changes in the accounting and auditing professions, which might affect us. We look too at the effect such matters might have on our stakeholders and the public entities that we audit.

Demand created by changes within the public sector and the accounting and auditing profession, together with the historic difficulty in finding and retaining suitably qualified and experienced staff, has meant that our audit work has had to focus more heavily on the financial statements of public entities. This has been at the expense of public interest audit work based on fuller consideration of the risks and challenges that entities face in their strategic, governance, and operational contexts.

We have been working to rebalance our audit effort to consider this fuller perspective in the audit of each public entity, to the extent judged appropriate by the entity's appointed auditor. These changes have been reflected in the revised Auditor-General's Auditing Standard (AG-4) issued in July 2009. This should result in a stronger emphasis on non-financial reporting, waste, probity, and accountability. It may, over time, affect how our audits are costed, resourced, carried out, and reported.

In Part 3 of this report, we describe the efforts we are making to maintain and build our organisational health and capability to equip us to deal with the increased demands of our environment.

Refining our risk management framework

During 2008/09, we continued to refine our processes for managing risk, to ensure that all significant risks are identified, that mitigation measures are put in place where appropriate, and that responsibility for implementing those measures is clearly allocated. We have also reviewed and updated our risk management documentation to reflect those enhancements.

As a result, we have now established two key steps in our risk management framework:

- an annual refreshing of our risks and controls, encompassing strategic, environmental, and business plan changes; and
- a six-monthly review of the identified risks and controls, with subsequent reporting to our leadership teams and our Audit and Risk Committee.

Report of the Audit and Risk Committee

for the year ended 30 June 2009

Members

John Hagen MBA, MCom, FCA (Chairman), *Investigating accountant*

Stephen Revill BA, LLB

Ross Tanner MA (Hons), MPA (Harvard), *Director, Ross Tanner Consulting Limited* (to 20 March 2009)

Phillippa Smith BA, LLB, MPP, *Deputy Controller and Auditor-General*

Neil Walter MA, CNZM, *Director* (from 20 March 2009)

The Audit and Risk Committee is an independent committee established by and reporting directly to the Auditor-General. The Committee was established in 2003, as the Audit Committee. The reference to risk was included in the name of the Committee in December 2005, to better describe the Committee's role.

The purpose of the Committee is to oversee:

- risk management and internal control;
- audit functions (internal and external) for the Office;
- financial and other external reporting;
- the governance framework and processes;
- compliance with legislation, policies, and procedures.

The Committee has no management functions.

During the past year, the Committee:

- met on five occasions to fulfil its duties and responsibilities;
- received briefings from the Auditor-General and other senior managers on key business activities of the Office, as a basis for ensuring that risks facing the Office are being appropriately addressed;
- oversaw the Office's continuing review of its risk management framework and the procedures underpinning the framework;
- discussed with the external auditors their audit plan for the year and findings from their audit work;
- monitored the implementation of recommendations made by the external auditor;
- received and considered reports from the internal auditors (KPMG), and monitored implementation of any recommendations made by the internal auditors;

- reviewed the annual plan and annual financial statements of the Office prior to their approval by the Auditor-General, having particular regard to the accounting policies adopted, major judgmental areas, and compliance with legislation and relevant standards;

The Committee has reported to the Auditor-General on the above and other matters it has seen fit to do so. There are no outstanding or unresolved concerns that the Committee has brought to the attention of the Auditor-General.

John Hagen
Chairman

for the Audit and Risk Committee

6 August 2009

Part 5

Financial statements 2008/09

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Audit report



AUDIT REPORT

TO THE READERS OF THE CONTROLLER AND AUDITOR-GENERAL'S FINANCIAL STATEMENTS AND STATEMENT OF SERVICE PERFORMANCE FOR THE YEAR ENDED 30 JUNE 2009

We have been appointed by the House of Representatives to carry out the audit of the financial statements and the statement of service performance included in the annual report of the Controller and Auditor-General for the year ended 30 June 2009.

Unqualified Opinion

In our opinion:

- The financial statements of the Controller and Auditor-General on pages 89 to 116:
 - comply with generally accepted accounting practice in New Zealand; and
 - fairly reflect:
 - the Controller and Auditor-General's financial position as at 30 June 2009;
 - the results of its operations and cash flows for the year ended on that date.
- The statement of service performance of the Controller and Auditor-General on pages 25 to 39 and 43 to 65:
 - complies with generally accepted accounting practice in New Zealand; and
 - fairly reflects, for each class of outputs:
 - its standards of delivery performance achieved, as compared with the forecast standards outlined in the statement of forecast service performance adopted at the start of the financial year; and
 - its actual revenue earned and output expenses incurred, as compared with the forecast revenue and output expenses outlined in the statement of forecast service performance adopted at the start of the financial year.

The audit was completed on 30 September 2009, and is the date at which our opinion is expressed.

The basis of our opinion is explained below. In addition, we outline the responsibilities of the Controller and Auditor-General and our responsibilities, and explain our independence.

Basis of Opinion

We carried out the audit in accordance with New Zealand Auditing Standards.

We planned and performed the audit to obtain all the information and explanations we considered necessary in order to obtain reasonable assurance that the financial statements and the statement of service performance did not have material misstatements, whether caused by fraud or error.

Material misstatements are differences or omissions of amounts and disclosures that would affect a reader's overall understanding of the financial statements and statement of service performance. If we had found material misstatements that were not corrected, we would have referred to them in our opinion.

audit and assurance services CST NEXIA AUDIT visit us at www.cstnexus.co.nz

Level 3, CST Nexia Centre, 22 Amersham Way, PO Box 76 261 Manukau City New Zealand. Tel 0-9 262 2595 Fax 0-9 262 2606 Email: team@cstnexus.co.nz

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The audit involved performing procedures to test the information presented in the financial statements and statement of service performance. We assessed the results of those procedures in forming our opinion.

Audit procedures generally include:

- determining whether significant financial and management controls are working and can be relied on to produce complete and accurate data;
- verifying samples of transactions and account balances;
- performing analyses to identify anomalies in the reported data;
- reviewing significant estimates and judgements made by the Controller and Auditor-General;
- confirming year-end balances;
- determining whether accounting policies are appropriate and consistently applied; and
- determining whether all financial statement and statement of service performance disclosures are adequate.

We did not examine every transaction, nor do we guarantee complete accuracy of the financial statements and statement of service performance.

We evaluated the overall adequacy of the presentation of information in the financial statements and statement of service performance. We obtained all the information and explanations we required to support our opinion above.

Responsibilities of the Controller and Auditor-General and the Auditor

The Controller and Auditor-General is responsible for preparing the financial statements and statement of service performance in accordance with generally accepted accounting practice in New Zealand. The financial statements must fairly reflect the financial position of the Controller and Auditor-General as at 30 June 2009 and the results of its operations and cash flows for the year ended on that date. The statement of service performance must fairly reflect, for each class of outputs, the Controller and Auditor-General's standards of delivery performance achieved and revenue earned and expenses incurred, as compared with the forecast standards, revenue and expenses adopted at the start of the financial year. The Controller and Auditor-General's responsibility arises from sections 45A, 45B, and 45F of the Public Finance Act 1989.

We are responsible for expressing an independent opinion on the financial statements and statement of service performance and reporting that opinion to you. This responsibility arises from section 38 of the Public Audit Act 2001 and sections 45D and 45F of the Public Finance Act 1989.

Independence

When carrying out the audit, we followed the independence requirements of the Institute of Chartered Accountants of New Zealand.

We carry out audit assignments on behalf of the Controller and Auditor-General. The level of work from these assignments is no greater than the level of work prior to our appointment as auditor. Other than the audit and these assignments, we have no relationship with or interests in the Controller and Auditor-General.

CST Nexia Audit
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Chartered Accountants
Manukau City, New Zealand

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Statement of responsibility

In terms of the Public Finance Act 1989 and the Public Audit Act 2001, the Controller and Auditor-General is responsible for the accuracy and judgements used in the preparation of the financial statements, and for establishing and maintaining systems of internal control designed to provide ongoing assurance of the integrity and reliability of financial reporting.

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

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

In my opinion, the information set out in the Statement of service performance, the financial statements, and attached notes to those statements (on pages 25–39, 43–65, and 89–116) fairly reflects our service performance, financial activities, and cash flows for the year ended 30 June 2009, and our financial position as at that date.

Signed:



Phillippa Smith
Deputy Controller and Auditor-General

30 September 2009

Countersigned:



Maria Viviers
Financial Controller

30 September 2009

Statement of financial performance

for the year ended 30 June 2009

This statement reports the income and expenditure relating to all outputs (goods and services) produced by the Office. Supporting statements showing the income and expenditure of each output class are on pages 39, 50, and 65.

Explanations of significant variances against the main Estimates are detailed in Note 19.

Actual 2008		Notes	Actual 2009	Supp. Estimates 2009	Main Estimates 2009
\$000			\$000	\$000	\$000
Income					
9,621	Crown funding	2	9,914	9,913	9,896
58,525	Audit fee revenue and other income	3	60,489	62,607	61,332
0	Gain on sale of plant and equipment		17	0	0
68,146	Total income		70,420	72,520	71,228
Expenditure					
31,583	Personnel costs	4	35,817	35,816	33,760
34,841	Operating costs	5	32,911	35,601	35,917
1,173	Depreciation and amortisation expense	9, 10	942	938	1,431
264	Capital charge	6	264	165	120
67,861	Total expenditure		69,934	72,520	71,228
285	Net surplus		486	0	0

The accompanying notes form part of these financial statements.

Statement of movements in taxpayers' funds (equity)

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for the year ended 30 June 2009

Actual 2008		Notes	Actual 2009	Supp. Estimates 2009	Main Estimates 2009
\$000			\$000	\$000	\$000
	Taxpayers' funds brought forward				
3,521	at 1 July		3,521	3,521	3,521
285	Surplus for the year		486	-	-
(285)	Repayment of surplus to the Crown	12	(486)	-	-
3,521	Taxpayers' funds at 30 June		3,521	3,521	3,521

The accompanying notes form part of these financial statements.

Statement of financial position

as at 30 June 2009

This statement reports total assets and liabilities. The difference between the assets and liabilities is called taxpayers' funds.

Actual 2008		Notes	Actual 2009	Supp. Estimates 2009	Main Estimates 2009
\$000			\$000	\$000	\$000
Current assets					
3,175	Cash and cash equivalents		3,695	2,172	3,979
200	Prepayments		197	210	397
2,284	Work in progress		2,195	2,290	1,587
4,455	Debtors and other receivables	8	4,829	4,763	4,275
10,114	<i>Total current assets</i>		10,916	9,435	10,238
Non-current assets					
1,533	Plant and equipment	9	1,211	1,385	1,529
314	Intangible assets	10	1,140	1,055	490
1,847	<i>Total non-current assets</i>		2,351	2,440	2,019
11,961	Total assets		13,267	11,875	12,257
Current liabilities					
4,279	Creditors and other payables	11	4,633	4,538	5,296
285	Repayment of surplus	12	486	-	-
3,226	Employee entitlements	13	4,110	3,161	2,670
7,790	<i>Total current liabilities</i>		9,229	7,699	7,966
Non-current liabilities					
650	Employee entitlements	13	517	655	770
650	<i>Total non-current liabilities</i>		517	655	770
8,440	Total liabilities		9,746	8,354	8,736
3,521	Net assets		3,521	3,521	3,521
Taxpayers' funds					
3,521	General funds		3,521	3,521	3,521
3,521	Total taxpayers' funds		3,521	3,521	3,521

The accompanying notes form part of these financial statements.

Statement of cash flows

for the year ended 30 June 2009

This statement summarises the cash movements in and out of the Office during the year. It takes no account of money owed to the Office or owing by the Office, and therefore differs from the Statement of financial performance.

Actual 2008		Notes	Actual 2009	Supp. Estimates 2009	Main Estimates 2009
\$000			\$000	\$000	\$000
Cash flows from operating activities					
9,621	Receipts from the Crown		9,914	9,913	9,896
32,865	Receipts from public entities*		39,361	37,840	37,333
97	Interest earned		136	-	-
(7,405)	Payments to suppliers *		(9,312)	(7,407)	(11,832)
(30,959)	Payments to employees		(35,003)	(35,868)	(33,688)
(3,503)	Net GST paid**		(2,599)	(3,500)	0
(264)	Capital charge paid		(264)	(165)	(120)
452	<i>Net cash flow from operating activities</i>	14	2,233	813	1,589
Cash flows from investing activities					
127	Receipts from sale of plant and equipment		83	103	132
(628)	Purchase of plant and equipment		(585)	(791)	(794)
(151)	Purchase of intangible assets		(926)	(843)	(748)
(652)	<i>Net cash flow from (used in) investing activities</i>		(1,428)	(1,531)	(1,410)
Cash flows from financing activities					
(469)	Surplus repayment to the Crown		(285)	(285)	-
(469)	<i>Net cash flow from (used in) financing activities</i>		(285)	(285)	-
(669)	Total net increase (decrease) in cash held		520	(1,003)	179
3,844	Cash at the beginning of the year		3,175	3,175	3,800
3,175	Cash at the end of the year		3,695	2,172	3,979

* The Statement of cash flows does not include the contracted audit service provider audit fee revenue or expenditure, as these do not involve any cash transactions with the Office.

** The GST component of operating activities reflects the net GST paid to and received from the Inland Revenue Department. GST has been presented on a net basis, as the gross amounts do not provide meaningful information for financial statement purposes.

The accompanying notes form part of these financial statements.

Statement of commitments

as at 30 June 2009

This statement records expenditure to which the Office is contractually committed at 30 June 2009.

Non-cancellable operating lease commitments

The Office has long-term operating leases on its premises. The annual property lease payments are subject to regular reviews, ranging from 3-yearly to 9-yearly.

Equipment lease commitments include leases of telephone exchange systems, fax machines, and photocopiers. There are no restrictions placed on the Office by any of its leasing arrangements.

Actual 2008 \$000		Actual 2009 \$000
Non-cancellable operating lease commitments		
Property lease commitments		
1,882	Not later than one year	2,047
1,770	Later than one year and not later than five years	2,439
201	Later than five years	99
3,853	<i>Total property lease commitments</i>	4,585
Equipment lease commitments		
33	Not later than one year	169
19	Later than one year and not later than five years	175
-	Later than five years	-
52	<i>Total equipment lease commitments</i>	344
3,905	Total operating lease commitments	4,929

Statement of contingent liabilities and contingent assets

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as at 30 June 2009

This statement discloses situations that existed at 30 June 2009, the ultimate outcome of which is uncertain and will be confirmed only on the occurrence of one or more future events after the date of approval of the financial statements.

Contingent liabilities

The Office did not have any contingent liabilities as at 30 June 2009 (nil as at 30 June 2008).

Contingent assets

There were no contingent assets as at 30 June 2009 (nil as at 30 June 2008).

Statement of output expenses, other expenses, and capital expenditure against appropriations

for the year ended 30 June 2009

This statement reports actual expenses incurred against each appropriation administered by the Office.

Actual 2008 \$000	Vote Audit	Actual 2009 \$000	Supp. Estimates 2009 \$000
Appropriations for output expenses			
<i>Multi-class output appropriations</i>			
Legislative auditor			
2,315	Supporting accountability to Parliament	2,457	2,460
6,223	Performance audits and inquiries	6,159	6,587
8,538	<i>Total legislative auditor</i>	8,616	9,047
<i>Annual and other appropriations</i>			
150	Audit and assurance services	150	150
58,474	Provision of audit and assurance services (revenue-dependent appropriation) ¹	60,452	62,607
67,162	<i>Total appropriations for output expenses</i>	69,218	71,804
Other expenses to be incurred by the Office			
699	Remuneration of the Auditor-General and Deputy Auditor-General ²	716	716
781	Capital expenditure	1,512	1,634
68,642	Total	71,446	74,154

1 Revenue-dependent appropriation – Provision of audit and assurance services. In 2008/09, the Office earned \$60.489 million from audit and assurance services – refer Note 3. The Office is permitted to incur expenditure up to the amount of revenue earned for this appropriation.

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

Statement of unappropriated expenditure for the year ended 30 June 2009

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The Office incurred no unappropriated expenditure during the year ended 30 June 2009 (nil for the year ended 30 June 2008).

Statement of trust money for the year ended 30 June 2009

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

A trust account records the financial transactions the Office carries out on behalf of PASAI. All trust money transactions are recorded on a cash basis.

None of the transactions associated with the PASAI trust account are recorded within the Statement of financial performance or the Statement of financial position.

Actual 2008 \$000	Actual 2009 \$000
22 Opening balance at 1 July	22
2 Receipts	60
(2) Payments	(71)
22 Closing balance at 30 June	11

Notes to the financial statements

for the year ended 30 June 2009

Note 1: Statement of accounting policies

Reporting entity

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

The Controller and Auditor-General's activities include work carried out by the Office of the Auditor-General (OAG) and Audit New Zealand (referred to collectively as "the Office"), and contracted audit service providers. The Office has designated itself as a public benefit entity for the purposes of New Zealand equivalents to International Financial Reporting Standards (NZ IFRS).

In addition, the Office has reported on trust money that it administers.

The financial statements of the Office are for the year ended 30 June 2009. The financial statements were authorised for issue by the Deputy Auditor-General on 30 September 2009.

Basis of preparation

The financial statements of the Controller and Auditor-General have been prepared in accordance with sections 45A, 45B, and 45F of the Public Finance Act 1989.

These financial statements have been prepared in accordance with New Zealand generally accepted accounting practice (NZ GAAP). They comply with NZ IFRS and other applicable Financial Reporting Standards, as appropriate for a public benefit entity.

The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

The financial statements have been prepared on a historical cost basis. The financial statements are presented in New Zealand dollars, and all values are rounded to the nearest thousand dollars (\$000). The functional currency of the Office is New Zealand dollars.

Standards, amendments and interpretations issued that are not yet effective and have not been early adopted

Standards, amendments and interpretations issued but not yet effective that have not been early adopted, and which are relevant to the Office include:

NZ IAS 1: *Presentation of Financial Statements* (revised 2007) replaced NZ IAS 1: *Presentation of Financial Statements* (issued 2004) and is effective for reporting

periods beginning on or after 1 January 2009. The revised standard requires information in financial statements to be aggregated on the basis of shared characteristics and to introduce a statement of comprehensive income. This will enable readers to analyse changes in equity resulting from transactions with the Crown in its capacity as “owner” separately from “non-owner” changes. The revised standard gives the Office the option of presenting items of income and expenditure and components of other comprehensive income either in a single statement of comprehensive income with subtotals, or in two separate statements (a separate income statement followed by a statement of comprehensive income). The Office expects to apply the revised standard for the first time for the year ending 30 June 2010, and is yet to decide whether it will prepare a single statement of comprehensive income or a separate income statement followed by a statement of comprehensive income.

Accounting policies

Income

Income is measured at the fair value of the consideration received. Income is derived from the Crown for outputs provided to Parliament, from audit fees for the audit of public entities’ financial statements, and from other assurance work carried out by Audit New Zealand at the request of public entities.

Crown funding is recognised in the period to which it relates.

Fee revenue generated by the Office for audit and assurance services is recognised as the work progresses and time is allocated within work in progress to public entities.

Income of audit service providers

Fee revenue generated by contracted audit service providers for audits of public entities is also recognised as the work progresses based on advice from the contracted audit service providers. Contracted audit service providers invoice and collect audit fees directly from public entities.

Interest

Interest revenue is recognised using the effective interest method.

Expenditure

Expenses of audit service providers

Fees for audits of public entities carried out by contracted audit service providers are recognised as the work progresses, based on advice from the contracted audit service providers. Contracted audit service providers invoice and collect audit fees directly from public entities.

Leases

An operating lease is a lease that does not transfer substantially all the risks and rewards incidental to ownership of an asset. Lease payments under an operating lease are recognised as an expense on a straight-line *basis over the lease term*. All leases entered into by the Office are operating leases.

Foreign currency transactions

Foreign currency transactions are translated into New Zealand dollars using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions are recognised in the Statement of financial performance.

Financial instruments

Financial assets and financial liabilities are initially measured at fair value plus transaction costs, unless they are carried at fair value through profit or loss, in which case the transaction costs are recognised in the Statement of financial performance.

Cash and cash equivalents

Cash includes cash on hand and highly liquid short-term deposits with banks.

Work in progress

Work in progress is stated at estimated realisable value, after providing for non-recoverable amounts.

Debtors and other receivables

Debtors and other receivables are initially measured at fair value and, where appropriate, subsequently measured at amortised cost using the effective interest rate, less impairment changes.

Impairment of a receivable is established when there is objective evidence that the Office will not be able to collect amounts due according to the original terms of the receivable. Significant financial difficulties of the debtor, probability that the debtor will enter into bankruptcy, and default in payments are considered indicators that the debt is impaired. The amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted using the original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognised in the Statement of financial performance. Overdue receivables that are renegotiated are reclassified as current (that is, not past due).

Plant and equipment

Plant and equipment consists of furniture and fittings, office equipment, IT hardware, and motor vehicles. Plant and equipment is shown at cost, less accumulated depreciation and impairment losses.

Additions

Individual assets, or group of assets, are capitalised if their cost is greater than \$1,000.

The cost of an item of plant and equipment is recognised as an asset if, and only if, it is probable that future economic benefits or service potential associated with the item will flow to the Office and the cost of the item can be measured reliably.

In most instances, an item of plant and equipment is recognised at its cost. Where an asset is acquired at no cost, or for a nominal cost, it is recognised at fair value as at the date of acquisition.

Disposals

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount of the asset. Gains and losses on disposals are included in the Statement of financial performance.

Subsequent costs

Costs incurred subsequent to initial acquisition are capitalised only when it is probable that future economic benefits or service potential associated with the item will flow to the Office and the cost of the item can be measured reliably.

Depreciation

Depreciation is provided on a straight-line basis on all plant and equipment, at rates that will write off the cost less estimated residual values of the plant and equipment over their useful lives. The useful lives and associated depreciation rates of major classes of assets have been estimated as follows:

Furniture and fittings	4 years (25%)
Office equipment	2.5 - 5 years (20% - 40%)
IT hardware	2.5 - 5 years (20% - 40%)
Motor vehicles	3-4 years (25% - 33%).

The residual value and useful life of an asset is reviewed, and adjusted if applicable, at each balance date.

Intangible assets*Software acquisition and development*

Acquired computer software licenses are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. Costs associated with maintaining computer software are recognised as an expense when incurred.

Costs that are directly associated with the development of software for internal use by the Office are recognised as an intangible asset. Direct costs include the software development and employee costs.

Staff training costs are recognised as an expense when incurred.

Amortisation

The carrying value of an intangible asset with a finite life is amortised on a straight-line basis over its useful life. Amortisation begins when the asset is available for use and ceases at the date that the asset is derecognised. The amortisation charge for each period is recognised in the Statement of financial performance.

The useful life and associated amortisation rate of computer software is estimated at between 2.5 and 5 years (20% - 40%).

Impairment of non-financial assets

Plant and equipment and intangible assets that have a finite useful life are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable through either continued use or disposal. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use.

An intangible asset that is not yet available for use at balance date is tested for impairment annually.

Value in use is depreciated replacement cost for an asset where the future economic benefits or service potential of the asset are not primarily dependent on the asset's ability to generate net cash inflows and where the entity would, if deprived of the asset, replace its remaining future economic benefits or service potential.

If an asset's carrying amount exceeds its recoverable amount, the asset is impaired and the carrying amount is written down to the recoverable amount. The impairment loss is recognised in the Statement of financial performance. Any reversal of an impairment loss is also recognised in the Statement of financial performance.

Creditors and other payables

Creditors and other payables are initially measured at fair value and, where appropriate, subsequently measured at amortised cost using the effective interest method.

Income in advance

Income in advance is recognised where invoiced audit fees exceed the value of time allocated within work in progress to public entities.

Employee entitlements*Short-term employee entitlements*

Employee entitlements that the Office expects to be settled within 12 months of balance date are measured at nominal values based on accrued entitlements at current rates of pay.

These include salaries and wages accrued up to balance date, annual leave and time off in lieu earned but not yet taken at balance date, retiring and long service leave entitlements expected to be settled within 12 months, and sick leave.

The Office recognises a liability for sick leave to the extent that absences in the coming year are expected to be greater than the sick leave entitlements earned in the coming year. The amount is calculated based on the unused sick leave entitlement that can be carried forward at balance date, to the extent that the Office anticipates it will be used by staff to cover those future absences.

The Office recognises a liability and an expense for bonuses where it is contractually obliged to pay them, or where there is a past practice that has created a constructive obligation.

Long-term employee entitlements

Entitlements that are payable beyond 12 months, such as long service leave and retiring leave have been calculated on an actuarial basis. The calculations are based on:

- likely future entitlements based on years of service, years to entitlement, the likelihood that staff will reach the point of entitlement and contractual entitlements information; and
- the present value of the estimated future cash flows. A weighted average discount rate of 5.75% and a salary inflation factor of 2.75% are used in the calculation of present value.

Superannuation schemes

Obligations for contributions to the Auditor-General's Retirement Savings Plan, Kiwisaver, and the Government Superannuation Fund are accounted for as defined contribution plans, and are recognised as an expense in the Statement of financial performance as incurred.

Taxpayers' funds

Taxpayers' funds is the Crown's investment in the Office, and is measured as the difference between total assets and total liabilities.

Commitments

Expenses yet to be incurred on non-cancellable contracts that have been entered into on or before balance date are disclosed as commitments to the extent that there are equally unperformed obligations.

Cancellable commitments that have penalty or exit costs explicit in the agreement on exercising that option to cancel are included in the Statement of commitments at the value of that penalty or exit cost.

Goods and Services Tax

All items in the financial statements, including appropriation statements, are stated exclusive of Goods and Services Tax (GST), except for receivables and payables in the Statement of financial position, which are stated on a GST-inclusive basis.

Where GST is not recoverable as input tax, it is recognised as part of the related asset or expense. The net amount of GST recoverable from, or payable to, the Inland Revenue Department (IRD) is included as part of receivables or payables in the Statement of financial position. The net GST paid to or received from the IRD, including the GST relating to investing and financing activities, is classified as an operating cash flow in the Statement of cash flows.

Commitments and contingencies are disclosed exclusive of GST.

Income tax

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

Main Estimates and Supplementary Estimates

The Main Estimates figures are those included in the Office's Annual Plan for the year ended 30 June 2009. In addition, the financial statements also present updated figures from the Supplementary Estimates.

Output cost allocation

The Office has determined the cost of outputs using allocations as outlined below.

Direct costs are those costs directly attributable to a single output.

Direct costs that can readily be identified with a single output are assigned directly to the relevant output class. For example, the cost of audits carried out by contracted audit service providers is charged directly to output class: Provision of audit and assurance services.

Indirect costs are all other costs. These costs include: payroll costs; variable costs such as travel; and operating overheads such as property costs, depreciation, and capital charges.

Indirect costs are allocated according to the time charged to a particular activity.

There have been no changes in cost allocation policies since the date of the last audited financial statements.

Judgements and estimations

The preparation of these financial statements requires judgements, estimations, and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates. The assessment of work in progress value is the most significant area where such judgements, estimations, and assumptions are made.

Note 2: Crown funding

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

Note 3: Audit fee revenue and other income

Actual 2008 \$000		Actual 2009 \$000
34,600	Fee revenue generated by the Office for audit and assurance services	39,086
23,698	Fee revenue generated by contracted audit service providers for audits of public entities*	20,948
97	Interest	136
130	Miscellaneous	319
58,525	Total audit fee revenue and other income	60,489

* Revenue generated by contracted audit service providers does not involve any cash transactions with the Office.

Note 4: Personnel costs

Actual 2008 \$000		Actual 2009 \$000
28,731	Salaries and wages	32,996
1,395	Other employee-related costs	1,167
833	Employer contributions to defined contribution plans	903
624	Increase/(decrease) in employee entitlements	751
31,583	Total personnel costs	35,817

Employer contributions to defined contribution plans include contributions to the Auditor-General's retirement savings plan, Kiwisaver, and the Government Superannuation Fund.

Note 5: Operating costs

Actual 2008 \$000	Actual 2009 \$000
(55) (Decrease)/Increase in provision for impairment of receivables	62
83 Fees to CST Nexia for the audit of the Office's financial statements	92
5 Fees to CST Nexia for the audit of the Office's transition to NZ IFRS	0
22 Fees to CST Nexia for other assurance services provided to the Office	35
1,876 Operating lease payments	1,861
99 Fees for audits of public entities carried out by CST Nexia	96
23,599 Fees for audits of public entities carried out by other contracted audit service providers*	20,852
21 Net loss on disposal	0
9,191 Other expenses	9,913
34,841 Total operating costs	32,911

* Expenditure relating to audits carried out by contracted audit service providers does not involve any cash transactions with the Office.

Note 6: Capital charge

The Office pays a capital charge to the Crown on its taxpayers' funds as at 31 May and 30 November each year. The capital charge rate is determined by the Treasury and for the year ended 30 June 2009 was 7.5% (2008 – 7.5%).

Note 7: Overdraft facility

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

During this financial year, no funds were drawn down under the facility (and none were drawn down in 2007/08).

Note 8: Debtors and other receivables

Actual 2008 \$000	Actual 2009 \$000
4,613 Debtors	5,052
(161) Less provision for impairment of receivables	(223)
4,452 <i>Net debtors</i>	4,829
3 Other receivables	0
4,455 Total receivables	4,829

The carrying value of debtors and other receivables approximates their fair value.

As of 30 June 2009 and 2008, all overdue receivables have been assessed for impairment and appropriate provisions applied, as detailed below:

	2008			2009		
	Gross \$000	Impairment \$000	Net \$000	Gross \$000	Impairment \$000	Net \$000
Current	3,299	-	3,299	3,768	-	3,768
31 to 60 days	397	-	397	454	-	454
61 to 90 days	332	-	332	186	-	186
91 to 120 days	191	-	191	226	-	226
Over 120 days	397	(161)	236	418	(223)	195
Carrying amount	4,616	(161)	4,455	5,052	(223)	4,829

The impairment provision has been calculated based on expected losses for the Office's pool of debtors. Expected losses have been determined based on an analysis of the Office's losses in previous periods and review of specific debtors.

Movements in the provision for impairment of receivables are as follows:

Actual 2008 \$000	Actual 2009 \$000
216 Balance at 1 July	161
(41) Additional provisions made during the year	62
(14) Receivables written off during the period	0
161 Balance at 30 June	223

Note 9: Plant and equipment

	Furniture and fittings \$000	Office equipment \$000	IT hardware \$000	Motor vehicles \$000	Total \$000
Cost					
Balance at 1 July 2007	2,422	202	2,541	1,094	6,259
Additions	127	7	114	382	630
Disposals	(21)	0	(17)	(308)	(346)
Balance at 30 June 2008	2,528	209	2,638	1,168	6,543
Additions	63	20	318	184	585
Disposals	0	(1)	(595)	(181)	(777)
Balance at 30 June 2009	2,591	228	2,361	1,171	6,351
Accumulated depreciation and impairment losses					
Balance at 1 July 2007	1,713	159	1,965	388	4,225
Depreciation expense	350	23	353	286	1,012
Elimination on disposal	(21)	0	(16)	(190)	(227)
Balance at 30 June 2008	2,042	182	2,302	484	5,010
Depreciation expense	280	17	315	229	841
Elimination on disposal	0	-	(596)	(115)	(711)
Balance at 30 June 2009	2,322	199	2,021	598	5,140
Carrying amounts					
At 1 July 2007	709	43	576	706	2,034
At 30 June 2008	486	27	336	684	1,533
At 30 June 2009	269	29	340	573	1,211

Note 10: Intangible assets

	Acquired software \$000	Internally generated software \$000	Total \$000
Cost			
Balance at 1 July 2007	2,695	-	2,695
Additions	31	120	151
Disposals	(232)	-	(232)
Balance at 30 June 2008	2,494	120	2,614
Additions	927	0	927
Disposals	(290)	-	(290)
Balance at 30 June 2009	3,131	120	3,251
Accumulated amortisation and impairment losses			
Balance at 1 July 2007	2,340	-	2,340
Amortisation expense	161	-	161
Disposals	(201)	-	(201)
Balance at 30 June 2008	2,300	-	2,300
Amortisation expense	85	16	101
Disposals	(290)	-	(290)
Balance at 30 June 2009	2,095	16	2,111
Carrying amounts			
At 1 July 2007	355	-	355
At 30 June 2008	194	120	314
At 30 June 2009	1,036	104	1,140

Note 11: Creditors and other payables

	Actual 2008 \$000	Actual 2009 \$000
1,847 Creditors		1,782
1,873 Income in advance		2,134
123 Accrued expenses		198
436 GST payable		519
4,279 Total creditors and other payables		4,633

Creditors and other payables are non-interest-bearing, and are normally settled on 30-day terms. The carrying value of creditors and other payables therefore approximates their fair value.

Note 12: Surplus payment due to the Crown

The Office is not permitted to retain operating surpluses under the Public Finance Act 1989. Thus, the surplus for the year of \$486,000 is repayable to the Crown, and is due to be paid by 31 October 2009.

Actual 2008 \$000		Actual 2009 \$000
285	Surplus current year	486
469	Surplus brought forward	285
(469)	Payment to the Crown	(285)
285	Total provision for payment to the Crown	486

Note 13: Employee entitlements

Actual 2008 \$000		Actual 2009 \$000
Current employee entitlements comprise:		
1,153	Salary and other accruals	1,721
1,659	Annual leave	2,034
63	Long service leave	94
148	Time off in lieu of overtime worked	146
116	Retiring/resigning leave	35
87	Sick leave	80
3,226	<i>Total current portion</i>	4,110
Non-current employee entitlements comprise:		
31	Long service leave	30
619	Retiring/resigning leave	487
650	<i>Total non-current portion</i>	517
3,876	Total employee entitlements	4,627

The present value of the retirement and long service leave obligations depends on a number of factors that are determined on an actuarial basis using a number of assumptions. Two key assumptions used in calculating this liability include the discount rate and the salary inflation factor. Any changes in these assumptions will affect the carrying amount of the liability.

Note 14: Reconciliation of surplus to net cash flow from operating activities

This reconciliation discloses the non-cash adjustments applied to the surplus reported in the Statement of financial performance on page 89, to arrive at the net cash flow from operating activities disclosed in the Statement of cash flows on page 92.

Actual 2008 \$000		Actual 2009 \$000
285	Surplus	486
	Non-cash items	
1,173	Depreciation and amortisation	942
1,173	Total non-cash items	942
	Working capital movements	
189	(Increase)/decrease in prepayments	3
(352)	(Increase)/decrease in receivables	(374)
(759)	(Increase)/decrease in work in progress	89
(729)	(Decrease)/increase in payables	354
686	(Decrease)/increase in employee entitlements	883
(965)	Total net working capital movements	955
	Investing activity items	
(10)	Loss/(profit) on sale of plant and equipment	(17)
31	Loss/(profit) on sale of intangible assets	0
21	Total net investing activity items	(17)
	Other items	
(62)	Increase/(decrease) in non-current employee entitlements	(133)
(62)	Total other items	(133)
452	Net cash flow from operating activities	2,233

Note 15: Related party transactions

The Office is a wholly owned entity of the Crown. The Office transacts with government departments, Crown entities, and state-owned enterprises on an arm's-length basis. Examples of those transactions include the Office providing audit services, paying ACC levies, and purchasing airfares and postal services, all of which occur within a normal supplier or client relationship. The transactions are carried out on terms and conditions no more or less favourable than those which

it is reasonable to expect the Office would have adopted if dealing with that entity at arm's length in the same circumstances, and therefore have not been disclosed.

During the year, there were transactions between the Office and close family members of key management personnel, as follows:

- Some close family members of key management personnel were employed by the Office. The terms and conditions of their appointment were no more favourable than the Office would have adopted if there were no relationship to key management personnel.
- Close family members of a member of key management personnel were directors in a company that provided services to the Office under a contract that was entered into prior to the appointment of the member of key management personnel. The cost of the services purchased was \$6,800 (2008 – \$8,950) and there was a balance outstanding at balance date of \$6,800 (2008 – \$3,093).
- During the year, there were also transactions between the Office and entities in which close family members of key management personnel were involved, as follows:
 - A close family member of a member of key management personnel was employed as a member of key management personnel of public entities that are audited by the Auditor-General. The audit fees charged to those public entities were negotiated on normal commercial terms.
 - A close family member of a member of key management personnel was employed by one of the Office's contracted audit service providers and was involved in an audit carried out by that provider on behalf of the Auditor-General.
 - A close family member of a member of key management personnel was on the governing body of an entity that wholly owned an entity audited by the Auditor-General.

The members of key management personnel associated with the above transactions had no involvement with those transactions.

Key management personnel compensation

Actual 2008 \$000		Actual 2009 \$000
2,895	Salaries and other short-term employee benefits	2,946
	- Post-employment benefits	-
	- Other long-term benefits	-
	- Termination benefits	-
2,895		2,946

Key management personnel include the Auditor-General, the Deputy Auditor-General, and the ten members of the OAG and Audit New Zealand Leadership Teams.

Note 16: Financial instrument risks

The Office's financial instruments are limited to cash and cash equivalents, debtors and other receivables, and creditors and other payables. These activities expose the Office to low levels of financial instrument risks, including market risk, credit risk, and liquidity risk.

Market risk*Currency risk*

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

The Office incurs a small portion of operating expenditure in foreign currency, and risk is minimised through prompt settlement. Recognised liabilities, which are payable in a foreign currency were nil at balance date.

Interest rate risk

Interest rate risk is the risk that the fair value of a financial instrument will fluctuate, or the cash flows from a financial instrument will fluctuate, due to changes in market interest rates.

The Office has no interest-bearing financial instruments and, accordingly, has no exposure to interest rate risk.

Credit risk

Credit risk is the risk that a third party will default on its obligation to the Office, causing the Office to incur a loss.

In the normal course of the Office's business, credit risk arises from debtors and deposits with banks.

The Office is permitted to deposit funds only with Westpac, a registered bank with high credit ratings. For its other financial instruments, the Office does not have significant concentrations of credit risk.

The Office's maximum credit exposure for each class of financial instrument is represented by the total carrying amount of cash and cash equivalents, and net debtors and other receivables (see Note 8).

There is no collateral held as security against these financial instruments, including those instruments that are overdue or impaired.

Liquidity risk

Liquidity risk is the risk that the Office will encounter difficulty raising liquid funds to meet commitments as they fall due.

In meeting its liquidity requirements, the Office closely monitors its forecast cash requirements with expected debtor receipts and cash drawdowns from the New Zealand Debt Management Office. The Office maintains a target level of available cash to meet liquidity requirements.

The Office's financial liabilities are outlined in Note 11: Creditors and other payables. These are all due to be settled within two months.

Note 17: Categories of financial instruments

The carrying amounts of financial instruments in each of the NZ IAS 39 categories are as follows:

Actual 2008 \$000		Actual 2009 \$000
Loans and receivables		
3,175	Cash and cash equivalents	3,695
4,455	Debtors and other receivables (Note 8)	4,829
7,630	Total loans and receivables	8,524
Financial liabilities measured at amortised cost		
4,279	Creditors and other payables (Note 11)	4,633
4,279	Total creditors and other payables	4,633

Note 18: Management of taxpayers' funds (equity)

The Office's taxpayers' funds (equity) comprise general funds and is represented by net assets.

The Office manages its revenues, expenses, assets, liabilities, and general financial dealings prudently to achieve the goals and objectives for which it has been established. The Office's equity is largely managed as a by-product of managing income, expenses, assets, liabilities, and compliance with the Government Budget processes and with Treasury Instructions.

Note 19: Explanation of major variances against budget

Explanations for major variances from the Office's forecast figures in the *Annual Plan 2008/09* are as follows:

Statement of financial performance

Audit fee revenue and other income was lower than forecast, mainly because contracted audit service providers were less advanced with the completion of audits at 30 June 2009 than had been forecast.

Personnel costs were higher than forecast, mainly because of more contract staff being required to help complete LTCCP work than was forecast.

Operating costs were lower than forecast, mainly because contracted audit service providers were less advanced with the completion of audits at 30 June 2009 than had been forecast.

Depreciation and amortisation expense was lower than forecast because the forecast included replacement of information systems that did not actually occur during the year.

The capital charge expense was higher than forecast because the actual expense is stated gross, whereas the forecast capital charge expense was stated net of interest revenue.

Statement of financial position

The cash balance was lower, and receivables and work in progress higher than forecast because of a delay in invoicing and receiving payment for audit services.

The creditors and other payables balance was lower than forecast because of accounts being paid earlier than forecast.

The higher employee entitlements relates to increased annual leave entitlements because of an increase in staff numbers and staff taking less leave than forecast.

Statement of cash flows

The differences in operating items all relate to the Statement of financial position items noted above.

Note 20: Office accommodation statistics

The following statistics are provided in accordance with directives issued by the Government to chief executives in 1991 on the management of departmental accommodation.

Actual 2008		Actual 2009
6144m ²	Area	6144m ²
311	Number of staff (FTE)	354
19.8m ²	Space allocation per person	17.4m ²
\$1,731,754	Total costs of leased office accommodation	\$1,825,284
\$5,568	Rent costs per person	\$5,156
\$387	Utility costs per person	\$307
-	Vacant accommodation	-

Appendix 1

Summary of reports on performance audits, inquiries, and other studies published in 2008/09

Performance Audits

Defence Sustainability Initiative

We carried out a performance audit on the progress made by the Ministry of Defence and the New Zealand Defence Force in implementing the Defence Sustainability Initiative. This was a classified report to defence and central agencies outlining our views on the implementation of the Initiative against specific, technical measures. A further, non-classified report will be published later.

Department of Corrections: Managing offenders on parole

How well the Department of Corrections manages offenders on parole is an area of great public and political interest. In our performance audit we looked at how well the department managed offenders released on parole by assessing whether probation officers and other staff were managing offenders in keeping with the department's requirements. In most of the case files we examined the department had not followed one or more of its own sentence management requirements and in some cases we determined that the Department had not managed cases adequately. If offenders on parole are not adequately managed in keeping with parole requirements, public safety is put at risk. Given the nature and extent of what was identified during this audit, we will be closely watching the department's progress in implementing our recommendations.

Electricity Commission: Review of the first five years

In 2003, the Government established the Electricity Commission (the Commission) to provide better governance over the generation, supply, and use of electricity. We carried out a performance audit to provide a more in-depth review of the Commission's progress in reporting its performance against the Government Policy Statement's objectives, outcomes, and performance standards. Although the Commission has completed many tasks that are important to the ongoing functioning and development of the electricity market, it has had difficulty measuring its achievements against the Government Policy Statement's objectives and outcomes. It will take time before meaningful trends and information provided by the impact indicators will enable the Commission to assess the outcomes of its work and whether this work is enough. The Commission considers that there is strong evidence of positive outcomes from its work, and its challenge is to develop the arrangements, voluntary and regulatory, that allow commercial entities to deliver the desired outcomes. We will be watching the Commission's progress in assessing the effectiveness of its work in influencing outcomes.

Housing New Zealand Corporation: Maintenance of state housing

State housing is the largest publicly owned property portfolio in the country, with an estimated value in 2008 of \$15.2 billion. Housing New Zealand Corporation (the Corporation) is the agency responsible for maintaining state housing. We carried out a performance audit to assess the effectiveness of the systems and processes the Corporation uses to maintain state housing. Overall, the systems for maintaining state housing properties are comprehensive and effective. The Corporation has set clear standards for the quality of its responses to tenants and for the quality of its maintenance work. It also monitors how the standard of its properties compares with properties in the private sector rental market. However, the inability of the Corporation's existing systems to provide detailed information about the condition of state housing properties has limited the effectiveness of its planning for maintenance. This means that it has lacked a reliable basis for measuring and managing its overall maintenance workload.

How government departments monitor Crown entities

This report describes how well three government departments – the Department of Internal Affairs, the Ministry for Culture and Heritage, and the Ministry of Economic Development – support Ministers in meeting their responsibilities for selected autonomous Crown entities, Crown agents, and independent Crown entities. This was the second of three reports looking at how particular categories of Crown entity are monitored. The main focus of our audit was to examine how well the selected departments carried out their day-to-day monitoring tasks and whether they had effective systems in place to support their Minister. Overall, the three departments were reasonably positioned to support their Ministers through their monitoring work. However, there is clear room for improvement. All three departments did some aspects of their monitoring work well, but fell short of what was expected in other aspects.

Inland Revenue Department: Managing tax debt

Although most taxpayers pay their tax on time, the Inland Revenue Department (Inland Revenue) acknowledges that tax debt is growing at a rate that is outpacing Inland Revenue's capacity to deal with it. Inland Revenue has estimated that total tax debt could more than double within five years unless it takes a different approach to managing the debt. We looked at how Inland Revenue manages its tax debt collection role and examined whether it was taking a strategic approach to debt management, and adequately monitoring and reporting its performance in managing tax debt. Although Inland Revenue's management of tax debt was satisfactory once debt cases were assigned to its debt officers, its overall approach

to tax debt management is insufficient to control the growth in tax debt. Inland Revenue has limited information to monitor the effectiveness and efficiency of its tax debt collection work. Inland Revenue was aware of how many tax debt cases it needs to manage, but was not able to identify how many tax debt cases it was actively managing.

Ministry of Education: Supporting professional development for teachers

We carried out a performance audit that looked at the Ministry of Education's (the Ministry's) arrangements to support the professional development of primary and secondary school teachers after they have graduated from a teacher education programme. Professional development can be informal or formal and covers a wide range of activities. It includes training courses, conferences, tertiary study, observed practice, and study groups. We determined that there are aspects of the Ministry's work that could be improved. These improvements include greater coherence of its information and activities for the professional development of teachers. We found that while the Ministry is aware of the range of sources of funding it uses for professional development, it does not consider all of these sources as a whole when making decisions about the relative priority of initiatives, or the adequacy of the funding available for professional development for teachers. The Ministry's focus on evidence of what is effective professional development is one of the strengths of the professional development system. There is, however, potential within both the Ministry and the wider education sector for greater use of this evidence.

Ministry of Health: Monitoring the progress of the Primary Health Care Strategy

In 2001, the then Minister of Health launched the Primary Health Care Strategy (the Strategy), which the Government regarded as introducing the most significant changes to primary health care in more than 50 years. It was estimated that carrying out the Strategy could take five to 10 years. It is a large and difficult task, which involves participation by many primary health care stakeholders. We carried out a performance audit on how the Ministry of Health (the Ministry) has monitored progress toward the Strategy's goals. Overall, the Ministry needs to review its measures to ensure that it can assess progress toward all of the goals in the Strategy's vision statement. Once it has that progress information, it needs to report it publicly and regularly in a consolidated report.

Ontrack – Maintaining the rail network

We carried out a performance audit to provide assurance about the effectiveness of Ontrack's systems for maintaining and renewing the rail network. We focused on Ontrack's long-term planning, its systems, plans, policies, and procedures

for managing day-to-day maintenance and renewal work, and the checks it had carried out on the work done. We expected that its top priority would be to ensure that it had systems, plans, policies, and procedures for managing day-to-day work. We also expected Ontrack to have started preparing a long-term plan for managing the rail network. Overall, Ontrack had, or was putting in place, various systems, plans, policies, and procedures for maintaining and renewing the rail network. However, these varied in completeness and comprehensiveness, and in most instances there was room for improvement.

Performance audits from 2007: Follow-up report

Our report to Parliament sets out the actions taken in response to the findings of the 14 performance audits we completed in 2007. The work we do provides Parliament with independent assurance that public sector organisations are operating, and accounting for their performance, in keeping with Parliament's intentions. This includes assurance about the activities and operations of local government, local authorities and the entities they control.

Reporting the progress of defence acquisition projects

We were unable to complete our planned performance audit to identify and report changes in recent major defence acquisition projects managed by the Ministry of Defence and the New Zealand Defence Force (the defence agencies). We had difficulty getting all of the necessary information, particularly from the Ministry's information systems, and had to change our audit approach. Although we were unable to complete our audit, we were able to compile a high-level summary of how the costs and time frames have changed for each of the 10 acquisition projects we looked at. For most of the 10 projects, estimated costs and time frames had increased, in some cases significantly, between when Cabinet gave approval for acquisition to commence and when Cabinet gave approval for the contract to be signed. In our view, this information is not enough for the defence agencies to demonstrate how well they are managing the projects or for Parliament or other stakeholders to reach a view on this. There is scope to improve the quality, transparency, and usefulness of the reports that the defence agencies provide about the progress of defence acquisition projects. We will work with the defence agencies during the next two financial years to make the changes needed.

Workforce planning in Crown Research Institutes

Crown Research Institutes (CRIs) are the largest providers of scientific research in New Zealand. Their staff have a diverse range of research, science, and technology skills, and have an important role in enhancing economic growth

and environmental well-being. The ability of CRIs to deliver research, science, and technology products depends on attracting and retaining people with the necessary skills and knowledge. Competition for science skills, changing workforce demographics, and tight labour markets pose a risk to the ability of CRIs to attract and retain staff, and therefore to scientific research in New Zealand. We carried out a performance audit of the workforce planning within all nine CRIs with a focus on how CRIs identify their workforce needs, establish initiatives to address their needs, and monitor and evaluate those initiatives. Overall, we found that all the CRIs had established, or were establishing, appropriate systems to support effective workforce planning. However, the maturity of workforce planning differed between the CRIs.

Response of the New Zealand Police to the Commission of Inquiry into Police Conduct: First monitoring report

In 2007, the Commission of Inquiry into Police Conduct (the Commission) released its report. The report criticised the historical conduct of some police officers and their associates. The conduct included inappropriate sexual activity and a culture of scepticism in dealing with complaints about sexual assault. As recommended by the Commission, the Government invited us to monitor the Police's response to the Commission's recommendations. In our first monitoring report, we observed that, overall, the Police have responded in a committed manner to the Commission's findings. The Police need to review and amend how they report their progress with implementing the Commission's recommendations in their internal and external reporting documents. The reporting documents need to appropriately reflect the importance of the Commission's findings to changes within the Police. Making sustained changes within the Police to implement the Commission's recommendations is not easy. The Police organisation is large, complex, and hierarchical. Achieving effective change within this type of organisation takes time and tenacity. The Police's commitment to making these changes is clear, but there is still much work to do.

Inquiries

Inquiry into immigration matters (two reports)

In May 2008, the then Prime Minister and the then Minister of Immigration requested that we carry out an inquiry into a range of integrity concerns arising out of Immigration New Zealand, which is part of the Department of Labour. The request was in response to various concerns that had been discussed in the public domain. This inquiry did not find widespread integrity and probity issues within Immigration New Zealand. However, the inquiry has identified a need for

the Department to improve the systems and processes that Immigration New Zealand uses to support staff who make visa and permit decisions (Volume 1). This inquiry also examined the public sector recruitment processes involving Ms Thompson and the handling of recruitment-related concerns (Volume 2).

Inquiry into the West Coast Development Trust

Our inquiry began after a number of specific allegations were made about individual files and transactions at the West Coast Development Trust. After investigating the detail of those allegations, we concluded that many of the concerns were unfounded and that others were based on minor administrative or procedural errors, or occasional errors of judgement. In the course of this inquiry, it became apparent that the governance of the Trust was dysfunctional and did not work effectively. The inquiry revealed an atmosphere of suspicion and distrust, behaviour that was inappropriate for a public entity or for trustees. We concluded that assurance could not be provided to Parliament that the Trust was able to deliver fully on its purpose of generating sustainable employment opportunities and economic benefits for the people of the West Coast region until this dysfunction was rectified.

Inquiry into the Christchurch City Council's decision in July 2008 to purchase five central city properties

We inquired into this matter as a result of the high public interest shown in the Christchurch City Council's decision in July 2008 to purchase five central city properties. Overall, we concluded that the decision-making process followed by the Council was sound. We considered that the Council's process for deciding to purchase the five properties complied with the principles of decision-making set out in the Local Government Act 2002, and was consistent with the Council's wide discretionary powers under the Act. The Council's decision was made under time pressure and the Council considered relevant factors, including its policy on determining significance. The Council considered the consistency of the decision with existing Council strategies and plans; in particular its aspirations for city revitalisation and urban regeneration. The merits of the decision to purchase the properties are a matter for the Council's elected members. In this instance, a majority of elected members decided that the Council should buy the five properties.

Other studies

Statements of intent: Examples of reporting practice

Our discussion paper gives examples of reporting practice from the statements of intent (SOIs) of government departments and Crown entities, including statements of forecast service performance (forecast SSPs). The examples were selected during the Office's review of the 2008–11 SOIs. Each of the 26 examples includes features of "better practice". It is intended that highlighting these examples will stimulate discussion within public entities and contribute to better non-financial performance reporting. Performance reports (such as SOIs and SSPs) should reflect the entity's management intentions, and are an essential part of accountability documents. These documents help ensure that government departments and other state sector entities are held accountable to Parliament and the public. The quality of performance reports needs to improve significantly to achieve their purpose satisfactorily.

The Auditor-General's views on setting financial reporting standards for the public sector

Our discussion paper set out the Auditor General's views and concerns on the setting of financial reporting standards for the New Zealand public sector and outlined some changes that are needed to provide a better basis for public sector financial reporting standards in New Zealand. The financial statements required by generally accepted accounting practice need to be relevant and appropriate for financial accountability purposes. It is important that financial reporting standards result in financial information that can be readily integrated with non-financial performance information. Financial and non-financial performance information needs to be integrated, because true accountability requires transparency about financial and non-financial performance and an appropriate relationship between the two.

Model financial statements

In addition to the work outlined above, Audit New Zealand prepares model financial reports to assist different types of public entities with the preparation of financial statements. The model reports are based on fictitious entities but set out good practice reporting of typical operations, balances, and transactions for the type of public entity that the model is intended to assist. Audit New Zealand updates its model financial statements periodically to reflect changes in financial reporting standards and other requirements over time. In 2008/09, Audit New Zealand reviewed and reissued its model financial statements for council-controlled organisations in accordance with New Zealand equivalents to International Financial Reporting Standards.

Appendix 2

Entities audited under section 19 of the Public Audit Act 2001

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

At 30 June 2009, arrangements had been entered into for audits of the following entities:

- Antarctic Institute: Andrill Joint Venture
- Chatham Islands Enterprise Trust
- France Trust (Central Hawkes Bay)
- Gisborne Laundry Services
- Greytown District Trust Lands Trust
- Kahungunu Executive Ki Te Wairoa Charitable Trust
- Literacy Aotearoa
- Maori Education Trust
- Te Runanga O Kirikiriroa Trust
- Te Wheke Atawhai Limited
- TLab Limited
- Tokelau International Trust Fund
- Unipol Recreation Limited.

Appendix 3

Public entities not audited by the Auditor-General

Under section 5 of the Public Audit Act 2001, the Auditor-General is the auditor of every public entity, which includes any entity controlled by one or more public entities.

Section 5 uses both legal and financial reporting definitions of control. Section 5(2) says that an entity is controlled by one or more other entities if:

- (a) the entity is a subsidiary of any of those other entities; or*
- (b) the other entity or entities together control the entity within the meaning of any relevant approved financial reporting standard; or*
- (c) the other entity or entities can together control directly or indirectly the composition of the board of the entity within the meaning of sections 7 and 8 of the Companies Act (which, for the purposes of this paragraph, are to be read with all necessary modifications).*

Applying paragraph (b) requires us to consider the substance of the relationship between two entities to determine whether one controls another (within the meaning of any relevant approved financial reporting standard).

In a number of instances, entities have disagreed with our conclusion that they are public entities because they are controlled by one or more public entities. The following entities are not currently audited by the Auditor-General because they do not accept that they are public entities.

Te Wharekura O Rakaumangamanga Foundation Charitable Trust Board

Te Wharekura O Rakaumangamanga (a state school) set up Te Wharekura O Rakaumangamanga Foundation Charitable Trust Board (the Foundation). The purpose of the Foundation is mainly to promote education for the benefit of the school and its community.

South Auckland Health Foundation

Counties Manukau Health Limited (which became Counties Manukau District Health Board) was involved in setting up the South Auckland Health Foundation (the Foundation). The purpose of the Foundation is mainly to support the provision of healthcare in the Counties Manukau area.

Appendix 4

Approach and method used for our stakeholder feedback interviews and client surveys

Stakeholder feedback interviews

We use our stakeholder feedback interviews to assess how Parliament and other key stakeholders perceive the quality, relevance, and usefulness of our reports and advice.

Using an independent consultant, we seek feedback from a sample of stakeholders made up of 50% of select committees, a selection of central agencies, and other representative groups. For our 2009 feedback interviews, our consultant interviewed seven representatives of select committees and two representatives of our other stakeholders.

Our questions covered the stakeholders' satisfaction with the effect and effectiveness of our work, as well as their satisfaction with the quality, relevance, and usefulness of specific reports and types of advice.

Stakeholders were asked to respond to a series of qualitative open questions and to rate us in a number of areas on a scale from 1 to 5, with 1 being strongly disagree or very dissatisfied and 5 being strongly agree or very satisfied.

Client surveys

The Auditor-General uses an independent firm to conduct an annual client satisfaction survey of public entities audited by the Auditor-General. The firm surveys a random sample of public entities to measure the level of satisfaction and identify areas where we need to improve our audit services.

Before 2007/08, the survey sample was confined to public entities audited by Audit New Zealand. In 2007/08, we extended the sample to cover public entities audited by private sector accounting firms.

Representatives of a sample of these entities are invited to participate in a telephone interview to provide comment and to rate the following factors on a scale from 1 to 10, with 1 being very low and 10 being very high:

- audit service providers' core audit ability;
- audit service providers' staff knowledge;
- the way audit service providers' staff work with entities, including governing bodies and audit committees where relevant;
- the value that audit service providers add and the usefulness of the advice given;
- the performance and contribution that audit service providers made as entities prepared to adopt NZ IFRS; and
- the overall degree of satisfaction with the service received from audit service providers.

Appendix 5

Senior management

Controller and Auditor-General	Kevin Brady (until 22 July 2009)
Deputy Controller and Auditor-General	Phillippa Smith

OAG Leadership Team

Assistant Auditor-General, Accounting & Auditing Policy	Greg Schollum
Assistant Auditor-General, Corporate Services	Peter Grant
Assistant Auditor-General, Legal	Nicola White
Assistant Auditor-General, Local Government	Bruce Robertson
Assistant Auditor-General, Parliamentary Group	Wendy Venter
Assistant Auditor-General, Performance Audit Group	Mike Scott
Assistant Auditor-General, Research and Development	Ann Webster

Audit New Zealand Executive Leadership Team

Executive Director, Audit New Zealand	Stephen Walker (from 12 January 2009)
General Manager, Operations	Bethia Gibson
General Manager, Professional Practices	Chong Lim

Appendix 6

Directory of offices

Office of the Auditor-General

Level 2
State Services Building
100 Molesworth Street
PO Box 3928
Wellington 6140
Telephone: (04) 917 1500
Fax: (04) 917 1549
Website: www.oag.govt.nz

Audit New Zealand

National Office

Level 8
St Paul's Square
45 Pipitea Street
PO Box 99
Wellington 6140
Telephone: (04) 496 3099
or 0508 283 486 (0508 AUDIT NZ)
Fax: (04) 496 3095
Website: www.auditnz.govt.nz

Auckland

Level 10
Great Walls Finance Building
155 Queen Street
PO Box 1165
Auckland 1140
Telephone: 0508 283 486 (0508 AUDIT NZ)
Fax: (09) 366 0215

Hamilton

17 Clifton Road
PO Box 256
Hamilton 3240
Telephone: 0508 283 486 (0508 AUDIT NZ)
Fax: (07) 838 0508

Tauranga

745 Cameron Road
PO Box 621
Tauranga 3140
Telephone: 0508 283 486 (0508 AUDIT NZ)
Fax: (07) 577 9321

Palmerston North

49 Victoria Avenue
PO Box 149
Palmerston North 4440
Telephone: 0508 283 486 (0508 AUDIT NZ)
Fax: (06) 356 7794

Wellington

Level 8
St Paul's Square
45 Pipitea Street
PO Box 99
Wellington 6140
Telephone: (04) 496 3099
or 0508 283 486 (0508 AUDIT NZ)
Fax: (04) 496 3195

Christchurch

Level 2
Charles Luney House
250 Oxford Terrace
PO Box 2
Christchurch 8140
Telephone: 0508 283 486 (0508 AUDIT NZ)
Fax: (03) 377 0167

Dunedin

Level 1
399 Moray Place
PO Box 232
Dunedin 9054
Telephone: 0508 283 486 (0508 AUDIT NZ)
Fax: (03) 479 0447

Publications by the Auditor-General

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

- Ministry of Social Development: Changes to the case management of sickness and invalids' beneficiaries
- How the Ministry of Education managed the 2008 bus tender process
- New Zealand Defence Force: Progress with the Defence Sustainability Initiative
- Response of the New Zealand Police to the Commission of Inquiry into Police Conduct: First monitoring report
- Statements of intent: Examples of reporting practice
- The Auditor-General's views on setting financial reporting standards for the public sector
- Inland Revenue Department: Managing tax debt
- Electricity Commission: Review of the first five years
- Local government: Results of the 2007/08 audits
- How government departments monitor Crown entities
- Inquiry into immigration matters
- Central government: Results of the 2007/08 audits
- Annual Plan 2009/10
- Workforce planning in Crown Research Institutes
- Performance audits from 2007: Follow-up report
- Department of Corrections: Managing offenders on parole
- Housing New Zealand Corporation: Maintenance of state housing
- Ministry of Health: Monitoring the progress of the Primary Health Care Strategy
- Ministry of Education: Supporting professional development for teachers

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.

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Office of the Auditor-General
PO Box 3928, Wellington 6140

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

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