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Parliamentary paper

Central government: Results of the 2007/08 audits

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Central government: Results of the 2007/08 audits

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

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Hon Dr Lockwood Smith MP
Speaker
House of Representatives
WELLINGTON

Mr Speaker

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

Yours faithfully

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

K B Brady
Controller and Auditor-General

Wellington

25 May 2009

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Introduction

This is our report on the 2007/08 audits in the central government sector.

The purposes of this report are to:

- report on the 2007/08 audit of the Government Reporting Entity and its sub-entities – as reflected in the *Financial Statements of the Government of New Zealand for the Year Ended 30 June 2008*;
- report on the results of, and matters arising from, our 2007/08 audits of the central government sector; and
- raise other matters that we believe warrant consideration by Parliament.

Summary

Section 1 has four Parts that cover the overall audit results for 2007/08:

- In **Part 1**, we discuss the significant matters arising from the 2007/08 audit of the Government's financial statements, and set out the recommendations we have made.
- In **Part 2**, we report on our 2007/08 assessments of central government entities' environment, systems, and controls. Similarly to 2006/07, in 2007/08 we found that either the management control environment or financial information systems and controls of a significant number of district health boards (DHBs) and government departments needed to improve.
- In **Part 3**, we briefly outline the public finance principles underpinning our Controller function and appropriation audit work, discuss the unappropriated expenditure for 2007/08, and report on some of the issues we have considered during the year. While there were fewer instances of unappropriated expenditure in 2007/08 than in 2006/07, it is always of concern when government agencies incur expenditure without the necessary authority from Parliament.
- In **Part 4**, we report on the non-standard audit reports issued during the 2008 calendar year on the financial statements of public entities within our central government portfolio of audits. These audit reports contain qualified opinions and/or explanatory paragraphs.

Section 2 has three Parts that address audit matters arising in specific sectors:

- In **Part 5**, we discuss the results of DHB audits for 2007/08. In particular, we discuss our assessments of DHBs' environment, systems, and controls, our views on the quality of information about DHBs' future operating intentions, and how the sector manages procurement.

- In **Part 6**, we discuss results of tertiary education institution audits for 2007/08. We also discuss procurement policies and capital asset management, which were focus areas in the audits.
- In **Part 7**, we report on the status of Māori Trust Board (MTB) audits, including the ongoing trend of audit arrears in the sector. We reiterate our view that the Minister of Māori Affairs and Te Puni Kōkiri should give urgent attention to proposals for improving the governance and accountability of MTBs.

Section 3 has two Parts that consider cross-sector matters arising from audit work in 2007/08:

- In **Part 8**, we report on our review of 2008-11 statements of intent (SOIs) for government departments and many Crown entities. We conclude that the quality of SOIs has not improved between our reviews of the 2007-10 and 2008-11 SOIs. We also set out the work we intend to do in 2009/10 to help improve agencies' performance information.
- In **Part 9**, we discuss the findings of work we carried out during the 2007/08 annual audits examining procurement policies and practices in departments, Crown entities, Crown Research Institutes, and State-owned enterprises. Although increasing numbers of entities are improving their policies and practices, we will continue to monitor progress in 2008/09.

Section 4 has two Parts:

- In **Part 10**, we discuss the Auditor-General's inquiry function, and provide an overview of some of the larger inquiries we completed in the central government sector during the year.
- In **Part 11**, we report on what the Ministry of Education has done to address the issue of unlawful expenditure by schools – a matter we have drawn to the Ministry's attention on previous occasions.

Part 1

Matters arising from the audit of the 2007/08 financial statements of the Government

- 1.1 The Auditor-General issued the audit report on the *Financial Statements of the Government of New Zealand for the Year Ended 30 June 2008* (the financial statements) on 30 September 2008.
- 1.2 The audit report appears on pages 20-21 of the financial statements. The audit report includes our unqualified opinion that those statements:
- comply with generally accepted accounting practice in New Zealand; and
 - fairly reflect:
 - the Government's financial position as at 30 June 2008; and
 - the results of the Government's operations and cash flows for the year ended 30 June 2008.
- 1.3 As in previous years, the Treasury has commented comprehensively on the financial statements. These comments are presented on pages 4-18 of the financial statements.

Significant matters arising from the 2007/08 audit

- 1.4 In this Part, we discuss some significant matters that arose during the 2007/08 audit of the financial statements:
- the transition to New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) (paragraphs 1.5-1.20);
 - Treasury and sector performance (paragraphs 1.21-1.25);
 - valuation of the student loan scheme (paragraphs 1.26-1.36);
 - tax revenue recognition for structured finance transactions (paragraphs 1.37-1.43);
 - tax pooling (paragraphs 1.44-1.49);
 - state highway valuation (paragraphs 1.50-1.62);
 - the Kyoto Protocol provision (paragraphs 1.63-1.69);
 - discount rates applied to significant liabilities (paragraphs 1.70-1.76);
 - transactions with related parties (paragraphs 1.77-1.82); and
 - acquisition of Toll NZ Limited (paragraphs 1.83-1.86).

Transition to New Zealand equivalents to International Financial Reporting Standards

- 1.5 The 2008 financial statements are the first to have been prepared in compliance with NZ IFRS. Producing financial statements that comply with NZ IFRS has been an extremely complex and challenging task. It required a huge effort over a

number of years by the Treasury's Fiscal Reporting team, the finance teams in the many entities that have their data consolidated into the financial statements, and our auditors. We congratulate those involved for achieving this substantial task on time and with an unqualified audit report.

- 1.6 The transition to NZ IFRS – driven by the requirements of NZ IFRS 1: *First-time Adoption of New Zealand Equivalents to International Financial Reporting Standards* – has been lengthy and complex. The Government Reporting Entity (and the many entities within it) had to prepare an opening balance sheet at 1 July 2006 that complied with NZ IFRS. It also had to restate its comparative information for the year ended 30 June 2007 under NZ IFRS.
- 1.7 We completed the audits of the opening balance sheet and the restated comparative information. This information was correctly incorporated into the 2008 financial statements, as required by NZ IFRS 1.

Consolidation processes

- 1.8 The transition to NZ IFRS has required the Treasury to remap its Crown Financial Information Systems (CFIS). The Treasury also had to prepare consolidation journals to work with the new NZ IFRS reporting pack and accounting policies. This has been a substantial piece of work for the Treasury.
- 1.9 The Fiscal Reporting team has put much time and effort into improving the documentation of the consolidation process. This included creating an eliminations framework under NZ IFRS and defining the purpose of each consolidation journal in the system. The documentation is now comprehensive and thorough.
- 1.10 The Treasury's work has allowed us to gain a good understanding of the new CFIS system. Therefore, we were able to complete our consolidation audit efficiently.

NZ IFRS accounting policies – sovereign receivables

- 1.11 The Treasury initially set the accounting policies that comply with NZ IFRS for the financial statements in 2006. It then communicated the policies to all entities within the Government Reporting Entity. Those entities used the policies to prepare the NZ IFRS-compliant opening balance sheet and restated comparative information.
- 1.12 Significant issues arose in applying the policies to the valuation of the Crown's non-commercial debt portfolios, particularly for tax receivables, benefit recoveries, and fines debt.

- 1.13 The figures for tax receivables, benefit recoveries, and fines debt in the opening balance sheet were based on the Treasury's initial NZ IFRS accounting policy. This policy was to account for all such receivables as "loans and receivables" under the New Zealand equivalent to International Accounting Standard (NZ IAS) 39: *Financial Instruments: Recognition and Measurement*. This required the receivable to be initially recognised at fair value and then measured at amortised cost.
- 1.14 It became clear that there were practical difficulties in trying to apply the policy based on NZ IAS 39 to tax receivables for the purposes of the restated comparative year. In May 2008, the Treasury proposed a change to the NZ IFRS accounting policies for the financial statements that established a new category of asset called "sovereign receivables". These are receivables that arise out of the use of the Crown's sovereign power rather than out of contracts. Under the changed policy, the accounting policy for tax receivables is now:
- Tax receivables are recognised initially at the amount of tax owed, subsequently adjusted for penalties and interest as they are charged, and tested for impairment.*
- 1.15 In our view, this is an appropriate response given the limitations of NZ IFRS in the context of public benefit entities. It is also a simpler policy for the Inland Revenue Department (IRD) and other entities to apply to their complex debt portfolios. Therefore, we have accepted the changed policy because non-contractual receivables are specifically scoped out of NZ IAS 39. The revised policy provides more meaningful reporting in the financial statements.

Effect of transition to NZ IFRS

- 1.16 Note 33 to the financial statements provides information on the effect of the transition to NZ IFRS. Overall, the transition increased the Crown's reported net worth by \$1,961 million at 1 July 2006 and \$991 million at 30 June 2007. The Crown's operating balance for the year ended 30 June 2007 reduced by \$641 million when restated under NZ IFRS. We are satisfied that the 2008 financial statements appropriately reflect the effects of the transition to NZ IFRS.
- 1.17 The major effects on the statement of financial position from the change to NZ IFRS are:
- Under NZ IFRS, the assets and liabilities of the Government Superannuation Fund (GSF) are not consolidated line by line in the financial statements. Instead, the GSF has been accounted for as a net retirement plan liability. The net retirement plan liability for the GSF on transition to NZ IFRS decreased by \$3,133 million at 1 July 2006 and by \$3,234 million at 30 June 2007. This change arose from eliminating the liability for future tax that will be payable

(primarily to the Crown) on future investment tax income because of the use of a pre-tax rather than post-tax discount rate.

- The claims liability of the Accident Compensation Corporation (ACC) has increased. NZ IFRS requires an additional risk premium and a liability adequacy test on the unearned levy liability to meet estimated future claims. The actuarially calculated liability before adopting NZ IFRS represented the expected outflows for the claims (a mid-point estimate with an equal chance of actual payouts being greater or less than the central estimate). NZ IFRS 4: *Insurance Contracts* requires a risk margin to be added to the central estimate to reflect the inherent uncertainty in the central estimate. The risk margin has been calculated at a 75% probability of adequacy. After the transition to NZ IFRS, ACC's claims liability increased by \$1,603 million at 1 July 2006 and by \$1,976 million at 30 June 2007.
- NZ IFRS requires all derivative financial instruments (such as interest rate swaps and forward foreign exchange contracts) to be recognised in the statement of financial position at their fair value. Recognising derivatives at fair value has increased the Crown's net worth by \$304 million at 1 July 2006 but decreased the Crown's net worth by \$386 million at 30 June 2007.
- Under NZ IFRS, the Crown's receivables portfolios (such as tax debt, fines debt, and benefit recoveries) have been remeasured. NZ IFRS requires the time value of money and collection costs to be taken into account. This resulted in a decrease in receivables carrying values of \$369 million at 1 July 2006 and \$481 million at 30 June 2007.
- In addition, many items within the Crown's statement of financial position have been reclassified. This is a result of specific classifications that are required under NZ IFRS and the clearer classification criteria that the Treasury set out in its instructions to entities within the Government Reporting Entity.

1.18 The major effects on the statement of financial performance from the change to NZ IFRS are:

- The change in the risk premium for ACC's claims liability from one reporting date to the next has affected the statement of financial performance. This resulted in a decrease in the operating balance for the year ended 30 June 2007 of \$373 million.
- The change in fair value of derivative financial instruments (to the extent they are not hedge accounted) has affected the statement of financial performance. This resulted in a decrease in the operating balance for the year ended 30 June 2007 of \$226 million.
- The changes in accounting for receivables under NZ IFRS resulted in a decrease in the operating balance for the year ended 30 June 2007 of \$202 million.

- Under NZ IFRS, goodwill is not amortised but rather tested annually for impairment. This resulted in the previous amortisation charge of \$98 million (primarily for goodwill on Air New Zealand) for the year ended 30 June 2007 being written back.

- 1.19 One other major effect of the transition to NZ IFRS has been the substantial increase in the volume of disclosures required, particularly for financial instruments. This is demonstrated by the significant increase in the number of pages in the published financial statements. In a number of areas, the increased disclosure provides potentially useful information to the reader (for example, sensitivity analysis of key assumptions or market risks for financial instruments). In other areas, it is less clear whether the benefits to readers outweigh the costs of collecting and reporting the information.
- 1.20 The focus for the 2008 financial statements has, to a significant extent, been on meeting the requirements of NZ IFRS. We have recommended that, during 2008/09, the disclosures in the financial statements be further reviewed to identify any that are not material and that do not convey information potentially important to a reader.

Treasury and sector performance

- 1.21 Under section 30(1) of the Public Finance Act 1989, the Treasury is required to provide the financial statements to the Auditor-General by the end of August of each year. This year, the Treasury provided the financial statements by the end of August, which is a notable achievement in the first year of applying NZ IFRS.
- 1.22 We reported at the end of our 2006/07 audit that we were concerned about the performance of some entities in providing financial information to the Treasury for consolidation into the financial statements. We also highlighted our concerns about the capacity of, and capability in, the finance functions of some central government agencies to deal with some of the complex issues arising under NZ IFRS.
- 1.23 Our concerns about the performance and capability of some agencies remain. However, we were pleased with the Treasury's response to our concerns. It is working with relevant agencies on these issues. It is also proactively monitoring and managing the reporting of entities of significance to the financial statements where there have been concerns about the timeliness or accuracy of reporting.
- 1.24 Despite the Treasury's additional work, a number of entities provided information late or with material errors, or had long delays in achieving audit clearance on their consolidation information for the 2008 financial statements.

- 1.25 We have encouraged the Treasury to continue to closely monitor the reporting performance of entities and to work with chief executives where necessary.

Valuation of the student loan scheme

- 1.26 Student loans are recognised in the 2008 financial statements at a carrying value of \$6,741 million (\$6,011 million in 2007). Note 17 to the financial statements provides detailed disclosures about student loans.
- 1.27 The student loans carrying value and fair value (which is used for disclosure purposes only) are generated using complex actuarial models. The actuary created these models on behalf of the three departments that are jointly responsible for administering student loans. These departments are:
- the Ministry of Education, which provides policy advice and tertiary education data for the valuation models, and manages the contract with the actuary;
 - the Ministry of Social Development (MSD), which assesses applications, makes student loan payments, and provides information on borrowing for the models; and
 - IRD, which manages the collection of loan repayments and provides data on loan repayments and balances for the models.
- 1.28 The responsibility for accounting for student loans is split between the MSD and IRD. MSD accounts for all new borrowings and then transfers these to IRD in February each year. This means that, as at 30 June every year, both MSD and IRD have student loan balances to account for. The institutional arrangements for administering student loans add more complexity to our audit.
- 1.29 Significant issues arose in the audit of the student loans balance during our 2006/07 audit. The receivable valuation of student loans is complex. Therefore, in an attempt to avoid similar issues in future years, we recommended in our report about the 2006/07 audit that:
- another actuary carry out a quality assurance review of the actuarial models and valuations each year, because of the complexity of the models and the significant effect of changes in actuarial assumptions on the values; and
 - the Treasury and the three departments jointly responsible for administering student loans review the timing of the actuarial valuation processes that determine the student loans carrying values and fair values. We noted that completing the valuations before 30 June each year and then rolling forward to the end of the financial year may provide more time to resolve any complex issues that may arise in the valuation process.

- 1.30 This year, the timetable for the student loans valuation was brought forward by a few weeks. However, the timetable for the valuation and audit remains very tight, with little room for delays. We remain of the view that aspects of the valuation could be completed earlier.
- 1.31 The Treasury and IRD did not accept our 2007 recommendation that the model be reviewed independently. Therefore, our own expert actuary performed a quality assurance review of the key assumptions used by the actuary who carried out the valuation. This review identified some errors and areas of concern in the valuation. The most significant issue that our expert actuary identified was about the adequacy of the risk premium used in the valuation. This was adjusted in the final valuation.
- 1.32 We remain of the view that the actuarial model should be independently reviewed.
- 1.33 The actuarial model also determines a fair value to meet the fair value disclosure requirements of NZ IFRS 7: *Financial Instruments: Disclosures*. As at 30 June 2008, the fair value of student loans was determined to be \$5,521 million, which is \$1,220 million lower than the carrying value (\$568 million lower at 30 June 2007).
- 1.34 We discussed the difference between the carrying value and the fair value with the Treasury, IRD, and IRD's appointed actuary. They attributed most of the difference to the change in the discount rate that was used in the calculation of fair value, predominantly because of an increase in the risk premium.
- 1.35 Our consideration of the reasons for the increasing difference between carrying and fair values was hampered by an error in the discount rate information in the draft financial statements.
- 1.36 These matters have again raised our concerns about the robustness of the quality assurance processes for reporting on student loans. To address these concerns, we recommended that:
- the Treasury and IRD review their quality assurance processes for reporting on student loans in the financial statements;
 - the actuary annually complete a roll-forward of the fair value of student loans, showing the components causing the change (new borrowing, initial fair value write down, repayments, impairments, discount unwind, discount rate changes) and supporting the disclosed fair value; and
 - the actuary be asked to document each year the reasons for the cumulative difference between the carrying value and fair value.

Tax revenue recognition for structured finance transactions

- 1.37 Terminal taxation revenue is normally recognised in the financial statements at the time that assessments are raised. However, revenue has not been recognised for tax assessments of \$1,589 million for “structured finance” transactions (predominantly in the banking industry) because the amount of revenue that may arise cannot be reliably measured at this stage.
- 1.38 The range of factors that cause this fundamental uncertainty include:
- there being no legal precedent;
 - these being New Zealand’s largest tax cases; and
 - the technical nature of the disputes.
- 1.39 One of these cases is currently before the courts. However, given the complexity of the cases and the sums of money involved, it is likely to be some years before the final amount of tax owing is known with any certainty.
- 1.40 Since these transactions occurred, income tax legislation has been amended to limit the extent to which foreign-owned banks can debt fund their operations and deduct interest from their assessable income.
- 1.41 Note 31 to the financial statements includes the following unquantifiable contingent asset disclosure for these transactions:
- The Crown is currently in dispute with a number of financial institutions regarding the tax treatment of certain structured finance transactions. However, it was not possible to recognise revenue and a receivable for the transactions because of fundamental uncertainty with the application of tax law to the structured finance transactions, which will be tested in court in due course, and the fact that the likelihood of success of a court case cannot be reliably predicted.*
- 1.42 We accepted this accounting treatment in the 2008 financial statements because of the level of uncertainty about the amount of any revenue that will eventually arise.
- 1.43 We recommended that the Treasury and IRD continue to monitor progress in resolving these cases and ensure that the circumstances of these transactions are appropriately assessed each time budgets and financial statements are prepared.

Tax pooling

- 1.44 Tax pooling was introduced on 1 April 2003 to allow taxpayers to manage provisional tax payment risk by reducing interest on underpaid tax and increasing interest on overpaid tax.
- 1.45 More taxpayers are using the tax pooling account for provisional tax payments. Therefore, the tax pool has continued to increase to \$3.3 billion as at 30 June 2008 (\$2.8 billion in 2007). A number of financial institutions have paid amounts into the tax pooling account for tax in dispute in earlier periods.
- 1.46 Provisional tax revenue is initially recognised based on the provisional tax assessment that is adjusted according to the due dates for payments. If no provisional tax assessment has been made, revenue is recognised based on payments recognised against the taxpayer's account. However, the financial statements do not recognise payments into the tax pooling accounts as provisional tax revenue. Rather, these amounts are treated as tax paid in advance. Therefore, revenue recognition is delayed if provisional tax payments are made through a pooling account. It also causes problems for accurately forecasting tax revenue.
- 1.47 We have accepted this accounting treatment to date because:
- IRD has not yet determined a practical and reliable solution to accounting for revenue paid into tax pools (in part because of the limited information available to the IRD about the reasons for the payments); and
 - IRD has reviewed the largest balances in the tax pools at the end of the financial year to determine whether there is enough support for revenue recognition.
- 1.48 IRD and the Treasury have recognised the issues caused by tax pooling for taxation revenue recognition and forecasting. They are taking steps to improve information flows for tax pooling. These steps should help predict the amount and timing of tax assessments and revenue recognition from tax pooling taxpayers. However, some deferral of revenue recognition and risks to the accuracy of tax forecasts caused by tax pooling will continue.
- 1.49 We recommended that IRD continue to analyse, at the end of the financial year, overly large balances in tax pools, with appropriate monitoring from the Treasury. This will ensure that revenue recognition at the end of the financial year continues to be materially correct.

State highway valuation

- 1.50 In the 2008 financial statements, the state highway network is valued at \$20.9 billion. By value, it is the largest physical asset on the Crown's balance sheet. Note 20 of the financial statements contains detailed information about the state highway valuation.
- 1.51 During our audit of the state highway valuation, we encountered a number of significant issues that resulted in delays to achieving audit clearance.

Quality assurance processes

- 1.52 We are concerned that the draft state highway valuation provided to our auditors contained a number of significant errors. This resulted in material adjustments being proposed to the valuation. We expected the New Zealand Transport Agency (NZTA, formerly Transit New Zealand) or the quality assurance and checking processes of the independent valuer to have picked up and corrected these errors.
- 1.53 We recommended that, in future, the state highway valuation be subject to more appropriate levels of quality assurance by both the valuers and by NZTA's management before it is submitted to us for audit.

Valuation methodology – rolling valuations

- 1.54 The current methodology for state highway valuation provides for the annual valuation to be carried out on a rolling basis. A full valuation is carried out for three of the roading regions each year. An independent valuer updates the valuations of the remaining 11 roading regions by using index information. The resulting valuation is supported by an overall sign-off by the independent valuer, who confirms that the annual valuation complies with financial reporting and valuation standards.
- 1.55 In 2008, full valuations were completed for the Otago, Taranaki, and Wanganui regions, but did not cover the Auckland or other major (by value) state highway regions. We were concerned about the limited coverage of the regions that were fully valued. We were also concerned that the movements in the valuations of the three regions were very significant. These movements caused us to question how appropriate the assumptions in the valuation methodology were for the 11 regions that were not fully valued.
- 1.56 We discussed our concerns about the validity of the assumptions in the valuation methodology with NZTA's management and the independent valuer. We were satisfied with the outcome of those discussions for the purpose of the 2008 valuation. NZTA has also started a project to review the assumptions.

- 1.57 We recommended that NZTA consider whether to carry out a full valuation of the whole state highway network in 2008/09. A full valuation of the entire state highway network would provide a robust basis for the annual valuations in future years.

Valuation methodology – future developments

- 1.58 Before the 2008 state highway valuation, NZTA's independent valuer reviewed the costs of three large state highway construction projects. The review compared actual project costs with the costs used to value the state highway network. The aim of the review was to identify and quantify areas of significant difference and to determine whether changes to the current valuation are warranted.
- 1.59 The current valuation uses average unit costs. The valuer has expressed concerns that these may not be appropriate for some high-value urban projects. The valuer proposed to introduce "brownfield" factors into the valuation for 2008 to better differentiate the cost of construction in congested/high-value locations from those at "greenfield"/low-value sites.
- 1.60 As a result of the review of actual project costs, the valuer suggested that the valuation include an interim brownfield allowance. The valuer suggested rates of 5% for rural projects and 25% for urban/motorway projects. This would cover:
- traffic management;
 - environmental compliance;
 - utilities;
 - generic increases in construction costs because of the restrictions imposed by the built environment; and
 - the significant costs associated with re-establishing the interface with adjacent properties.
- 1.61 Because this review was only based on three projects in which the actual rates varied significantly, we considered that there was not enough evidence to support applying these higher rates in the 2008 valuation. The valuer and NZTA have accepted our view and have represented that the 2008 carrying value of the network (based on the current methodology and assumptions) is materially correct.
- 1.62 We recommended that NZTA continue to review large projects in the next 12 months with the independent valuer. These reviews are necessary to obtain further evidence to determine whether the potential adjustments to rates are appropriate.

The Kyoto Protocol provision

- 1.63 New Zealand is a signatory to the Kyoto Protocol, which imposes binding emission reduction targets on New Zealand during the First Commitment Period (CP1) from 2008 to 2012.
- 1.64 A provision for New Zealand's net deficit position under the Kyoto Protocol for CP1 was first recognised in the 2005 financial statements. This year, a provision of \$562 million (\$704 million in 2007) has been recognised. Note 26 to the financial statements provides a detailed disclosure about the Kyoto Protocol provision. The Treasury has not recognised any provision or contingent liability for periods beyond 2012 because New Zealand currently has no specific obligations beyond CP1.
- 1.65 The net obligation at 30 June 2008 is based on a deficit of 21.7 million tonnes of carbon (45.5 million tonnes in 2007). This is measured using a carbon price of EUR 12.50 per unit (EUR 8.86 per unit in 2007) and an exchange rate of EUR 0.4829 = \$NZ1 (EUR 0.5726 = \$NZ1 in 2007).
- 1.66 The reduction in the projected deficit of Kyoto Protocol of 23.8 million tonnes is explained in the Net Position Report 2008 (published by the Ministry for the Environment). Emissions are expected to reduce because:
- transport sector emissions are projected to be lower than in 2007 because of lower than projected fuel use and higher fuel prices;
 - agriculture emissions are projected to be lower because of the effects of a drought in early 2008 and a continuing decline in sheep numbers;
 - the rate of deforestation is projected to be lower than in 2007 mainly because of the implementation of the Emissions Trading Scheme (ETS); and
 - there will be an increase in the estimate of carbon removals after implementing recommendations made by an external expert (AEA Technology) who reviewed the methodology.
- 1.67 The Kyoto Protocol provision is the Treasury's best estimate of the likely obligations under the protocol. This best estimate has taken into account the effects of the proposed ETS. The ETS has already affected the forestry sector's intentions and activities, particularly deforestation. The ETS is backdated to 1 January 2008 for the forestry sector. Since balance date, Parliament has passed the Climate Change (Emissions Trading and Renewable Preference) Bill, which will establish the ETS.
- 1.68 Although the provision is Treasury's best estimate at this time, provisions by their nature are more uncertain than most other items in the statement of financial position. Estimates are likely to change as more updated information becomes

available, better systems are implemented, and some uncertainties are reduced. Some of the main aspects of the Kyoto Protocol provision that are likely to fluctuate include:

- the price for each tonne of carbon;
- the exchange rate with the Euro; and
- the various assumptions for calculating emissions and sinks (for example, forecasts of Gross Domestic Product, oil prices, availability of updated statistics, and the effect of the ETS).

1.69 An independent expert last reviewed the assumptions and methodology underlying the projections of the net Kyoto position in 2007. We recommended that the assumptions and methodology underlying the projections be reviewed again during 2008/09.

Discount rates applied to significant liabilities

1.70 The operating balance and net worth of the financial statements are significantly affected by changes in discount rates applied to key liabilities. These liabilities include:

- insurance liabilities – primarily ACC claims (\$20,374 million in 2008), which are accounted for under NZ IFRS 4: *Insurance Contracts*; and
- retirement plan liabilities (net of plan assets) – primarily GSF (\$8,257 million in 2008), which are accounted for under NZ IAS 19: *Employee Benefits*.

1.71 The liability for these portfolios is valued each year using actuarial valuation models, based on a number of key assumptions for the individual portfolio characteristics. A major assumption in measuring the liabilities is the discount rate used in the valuation model.

1.72 Notes 24 and 25 to the financial statements provide comprehensive note disclosures for these liabilities, including key assumptions and their sensitivities. This sensitivity analysis is important given the sensitivity of the valuation models to a movement in discount rates. For example, for the year ended 30 June 2008, if the discount rate was to reduce by 1%, the sensitivity analysis shows an increase in the ACC liability of \$2,095 million and an increase in the GSF liability of \$1,371 million. This would have a corresponding effect on the operating balance.

1.73 ACC and GSF determined the discount rates applied to the ACC liability (6.63% for the following year) and GSF liability (6.95% for the following year) respectively. The small variation between the two can be supported by the slightly different requirements of NZ IFRS 4 (risk-free discount rates based on current observable objective rates that relate to the nature, structure, and term of the future

obligations) and NZ IAS 19 (market yields on government bonds where the currency and term of the bonds is consistent with the currency and estimated term of the employee benefit obligations).

- 1.74 Note 26 to the financial statements also quotes a discount rate of 5.5%. This rate has been applied to provisions for employee entitlements that accrue over a period of time (such as long-service leave). The disclosed rate is not consistent with the requirements of NZ IAS 19 and is based on guidance the Treasury gave to the sector some years ago. In practice, much of the sector is using rates broadly comparable with the requirements of NZ IAS 19 rather than the disclosed rate.
- 1.75 Before completing our audit of the financial statements, we queried this disclosure with the Treasury. We accepted the decision not to amend it on the basis of materiality to the financial statements.
- 1.76 We recommended that the Treasury update its guidance to central government agencies on appropriate discount rates for employee entitlement provisions. In addition, given the sensitivity of the financial statements to the discount rates used by ACC and GSF, we recommended that the Treasury closely monitor the discount rates proposed for liability valuations by ACC and GSF. We recommended that the Treasury confirm that the rates are appropriate and that differences between the two rates are supportable.

Transactions with related parties

- 1.77 Related party disclosures in the financial statements have historically been limited to aggregate information on salaries and allowances paid to Ministers of the Crown. We previously recommended that the Treasury consider how accounting standards on related parties are applied to the financial statements. In our report about the 2005/06 audit of the financial statements, we recommended that this issue be reconsidered when the requirements under NZ IFRS were known.
- 1.78 Under NZ IAS 24: *Related Party Disclosures*, one category of related parties are “key management personnel”, defined as “those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity”. In the context of the Government Reporting Entity, the Treasury has determined that the key management personnel are the Ministers of the Crown who are members of Cabinet. We agree with this assessment.
- 1.79 Note 7 to the financial statements provides the required disclosure of key management personnel compensation. In addition, the following narrative disclosure is provided:

The Cabinet Manual sets out guidance in respect of Ministers' conduct, public duty, and personal interests. Ministers are responsible for ensuring no conflict exists or appears to exist between their personal interests and their public duty. Therefore, there is a clear expectation that Ministers will not influence or affect any transactions and outstanding balances between the Government and themselves or their family, whanau, and close associates.

- 1.80 The intent of this disclosure is to satisfy the requirement of NZ IAS 24 to provide disclosures of any transactions that might have occurred between the Government Reporting Entity and:
- key management personnel;
 - close family members of key management personnel; or
 - entities controlled, jointly controlled, or significantly influenced by members of key management personnel or their close family members.
- 1.81 Although we are not aware of any significant transactions that would require disclosure, there are currently no mechanisms in place to collect information on any such transactions. Information on Ministers' interests is recorded in the Register of Pecuniary Interests. However, this does not include information on family members and their interests. Further, there are no mechanisms to collect information about any transactions between these interests and entities within the Government Reporting Entity.
- 1.82 We recommended that the Treasury consider further how the information to support related party disclosures that comply with NZ IAS 24 (or to confirm that there are no transactions that need to be disclosed) could be collected.

Acquisition of Toll NZ Limited

- 1.83 On 1 July 2008, the Crown purchased 100% of the shares of Toll NZ Limited (since renamed KiwiRail Holdings Limited) for \$690 million. Before the acquisition, assets and operations that are not integral to the rail operation were transferred out of the company.
- 1.84 The Treasury has provided us with legal advice confirming that the transaction occurred on 1 July 2008. Therefore, the transaction does not affect the 2008 financial statements, other than being disclosed as a post-balance date event in Note 34 to the financial statements.
- 1.85 Therefore, the accounting for the transaction will need to be reflected in the 2009 financial statements. This will require determining the fair values of the acquired assets and the assumed liabilities.

- 1.86 We are aware that, in the financial statements for the three months to September 2008, a provisional unaudited assessment of the net fair value of assets and liabilities of \$448 million has been disclosed. We will liaise with the Treasury and KiwiRail Holdings Limited in the coming months to confirm the valuations and accounting treatment.

Part 2

Assessing entities' environment, systems, and controls

- 2.1 In this Part, we report on our 2007/08 assessments of the environment, systems, and controls of government departments, Crown entities (excluding school boards of trustees and tertiary education institutions), and State-owned enterprises.

Background

- 2.2 As part of the annual financial audit, our auditors examine, assess, and grade central government entities' environment, systems, and controls for managing and reporting financial and service performance information. We report these assessments to the entity, the responsible Ministers, and the relevant select committees.
- 2.3 Our auditors examine an entity's environment, systems, and controls in the context of their work in forming an opinion on the financial and service performance statements. The purpose of commenting on these aspects is to highlight the areas for improvement that the audit identified. The grades assigned directly represent the recommendations for improvement as at the end of the financial year.
- 2.4 We introduced a new assessment framework in 2006/07 to improve the transparency, usefulness, and clarity of our reporting. It replaced the framework that we had used for the previous 13 years.
- 2.5 We apply our assessment framework to:
- government departments;
 - Crown entities, excluding school boards of trustees and tertiary education institutions; and
 - State-owned enterprises.

The areas we examine

- 2.6 We assess and report on three areas:
- management control environment;
 - financial information systems and controls; and
 - service performance information and associated systems and controls.
- 2.7 The management control environment is the foundation of the control environment. The areas that our audit may consider are the public entities':
- clarity of strategic planning;
 - communication and enforcement of integrity and ethical values;
 - participation of people with governance responsibilities;

- overall legislative compliance arrangements;
 - major control policies and procedures;
 - risk identification, assessment, and management practices;
 - information systems and communication to support the implementation and maintenance of financial and service delivery intentions and controls;
 - monitoring of policies and processes;
 - commitment to competence;
 - organisational structure and assignment of authority and responsibility; and
 - management philosophy and operating style, and whether they emphasise effectiveness and efficiency.
- 2.8 Financial information systems and controls are the systems and controls (including application-level computer controls) over financial performance and financial reporting.
- 2.9 Service performance information and associated systems and controls refer to the quality of the service performance measures selected for reporting against, and the systems and controls (including application-level computer controls) over service performance reporting.
- 2.10 Examples of areas that our audit may consider under both the financial and service performance systems and controls aspects are:
- appropriateness of information provided and reported;
 - presentation of information in the statement of service performance (SSP);
 - reliability of systems;
 - control activity (including process-level policies and procedures); and
 - monitoring of information.

Our grading system

- 2.11 Auditors base the grades that they assign on deficiencies observed through the audit (that is, the gap between “actual practice” and “how practice should be”), and on the associated recommendations for improvement. Auditors base their conclusions on deficiencies, and the associated recommendations for improvement, on their assessment of how far what the entity does is short of “good practice”. “Good practice” is based on auditors’ professional expertise and judgement, taking into account what is considered appropriate for each entity, given its size, nature, and complexity. Figure 1 shows our grading scale.

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

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

Interpretation of results

- 2.12 Our auditors' approach and the standards they apply reflect the circumstances of each entity in each financial year. Entities vary greatly in size and organisational structure, and sometimes undergo restructuring. Grades for a particular entity may fluctuate from year to year. Some of the factors that may cause fluctuations include changes in the operating environment, standards, good practice expectations, and auditor emphasis. For these reasons, we advise caution when comparing grades between years and between different entities.
- 2.13 How an entity responds to the auditor's recommendations for improvement is more important than the grade change from year to year. A downward shift in grade, for example, may not indicate deterioration – it may just be that the entity has not kept pace with good practice expectations for similar entities between one year and the next. Consequently, the long-term trend in grade movement is a more useful indication of progress than year-to-year grade changes.

The results from 2006/07

- 2.14 We noted in last year's article that we intended to analyse our assessments further, to highlight important issues and trends underlying our assessments and grades.
- 2.15 This further analysis on last year's results indicates that there is a wide variety of factors affecting individual entities, and the auditors' assessment and grading. There were, however, some common themes.
- 2.16 In the district health board sector, we reported last year that 24% of entities needed to improve their management control environment, and that 33% needed to improve their financial information systems and controls. Our analysis of factors behind these grades shows that the single most commonly occurring issue is poor procedures and practices for procurement. This was also a significant issue for those district health boards that we graded as good.

- 2.17 Under our framework, this means that improvements in procurement are necessary for a significant number of district health boards and should be addressed at the earliest reasonable opportunity. For a significant number of other district health boards, improvements in procurement would be beneficial and should be addressed (see Part 5, paragraphs 5.34-5.49).
- 2.18 For the government department sector, we reported last year that 21% needed to improve their management control environment, and 16% needed to improve their financial information systems and controls. From our analysis, there were fewer dominant individual themes within this sector. This partly reflects the diverse nature of government departments.
- 2.19 The quality of procurement procedures and practices was also a theme within the management control environment for the government department sector, but the most frequently occurring issue was legislative compliance. For this issue, we routinely reported that agencies did not have a process for continuous review of, or positive assertion over, their ongoing compliance with relevant legislation.

The results for 2007/08

- 2.20 We assessed the environment, systems, and controls in each of the entities we audited. We graded both the management control environment and the financial information systems and controls. For those entities required to prepare a SSP, we did not grade their service performance information and controls but provided comments on improvements they could make.
- 2.21 We reported the results to the entity (the chief executive and the Board where relevant), the responsible Minister, and the select committee that conducts the entity's financial review.
- 2.22 We have allowed for a transitional period before we start grading service performance information and associated systems and controls, and so have not graded this area in 2006/07 or 2007/08. Since 2006/07, we have placed a greater emphasis on the appropriateness of service performance information. In doing so, we expected the shortcomings identified in our reviews of service performance reporting to affect entities' grades more significantly than they have to date. Our transitional approach allows entities time to adjust to this change of emphasis, and make the necessary improvements.
- 2.23 We intend to begin grading service performance information and associated systems and controls in 2008/09. This will reflect both:
- how appropriately entities specify the measures they will report future performance against (with an emphasis on the development of the entity's

relevant accountability plan for 2009/10 and beyond – for example, its Statement of Intent); and

- entities' reporting of their performance for 2008/09.

2.24 Figure 2 shows a summary of the grades, by type of entity, for the management control environment and financial information system controls. As in 2006/07, we graded no entities as poor either for the management control environment or for the financial information systems and controls.

Figure 2
Summary of grades by type of entity for 2007/08, compared with 2006/07

Summary of grades for 2007/08	Number of entities	Grades received for MCE (%)			Grades received for FISC (%)		
		VG	G	NI	VG	G	NI
Government departments	39	28	59	13	23	62	15
District Health Boards	21	5	71	24	0	67	33
Crown Research Institutes	9	67	33	0	11	89	0
Other Crown entities	65	58	37	5	51	46	3
State-owned enterprises	17	76	12	12	29	71	0

Summary of grades for 2006/07	Number of entities	Grades received for MCE (%)			Grades received for FISC (%)		
		VG	G	NI	VG	G	NI
Government departments	38	13	66	21	18	66	16
District Health Boards	21	0	76	24	0	67	33
Crown Research Institutes	9	56	44	0	11	89	0
Other Crown entities	65	53	42	5	32	63	5
State-owned enterprises	18	66	28	6	17	78	5

Areas covered in our assessment framework are:

- MCE – Management control environment;
- FISC – Financial information systems and controls; and
- SPIASC – Service performance information and associated systems and controls (which was assessed but not graded in the 2006/07 financial year).

Ratings used are VG – Very good; G – Good; NI – Needs improvement; and P – Poor.

The entities included in the above analysis are those referred to under the relevant categories in the Financial Statements of the Government of New Zealand for the Year Ended 30 June 2008 at pages 167 and 168. Government departments exclude Offices of Parliament, the Government Communications Security Bureau, and the Security Intelligence Service. School boards of trustees and tertiary education institutions are not included in the above analysis for other Crown entities. Air New Zealand Limited has been included as if it were a State-owned enterprise. The Electricity Corporation of New Zealand Limited and Terralink New Zealand Limited (in liquidation) have been excluded from the analysis for State-owned enterprises.

The summary includes only one grade per entity, and uses the grades of primary parts of the entities involved. For a small number of entities, and where we deem appropriate on a case-by-case basis, we report separate grades to cover different parts of the entities' operations (for example, where there is a semi-autonomous body operating within the entity).

2.25 Taking all entities that we assessed and graded as a whole, there has been a marginal improvement in grades since 2006/07. The proportion of very good grades has increased in 2007/08 for both the management control environment and for financial information systems and controls. This reflects that entities are improving their grades from good to very good, as the proportion of needs improvement grades is similar in both years for both aspects. This is shown in Figures 3 and 4.

Figure 3
Management control environment for 2007/08, compared with 2006/07

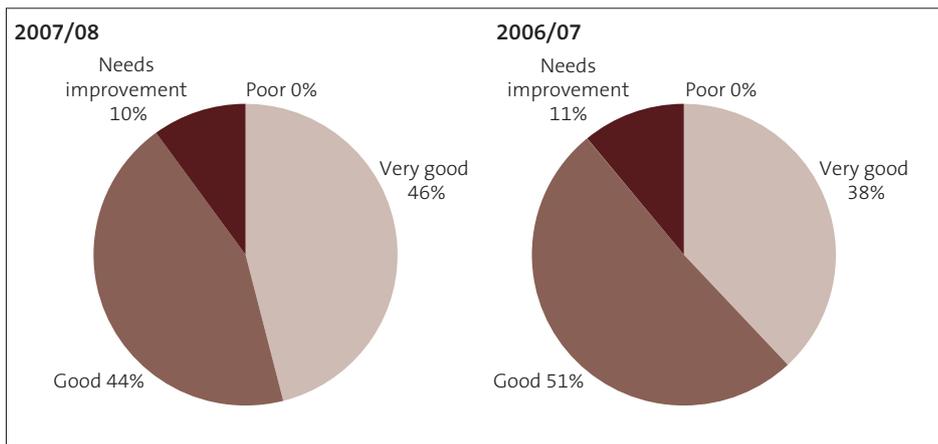
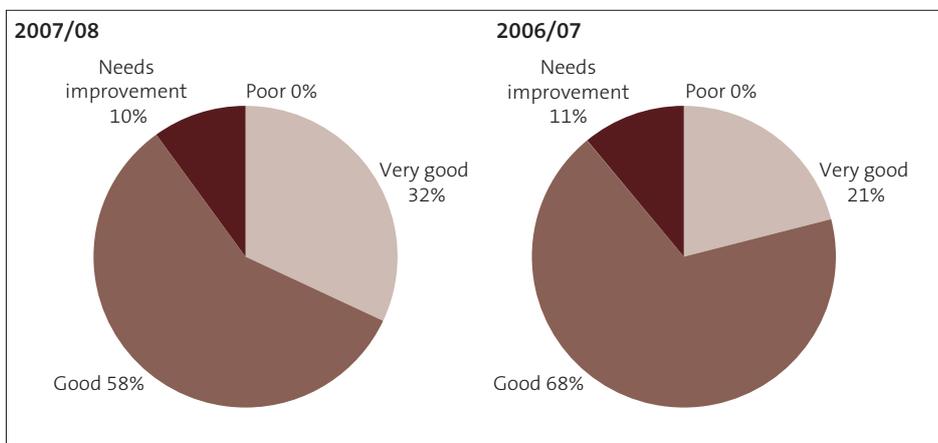


Figure 4
Financial information systems and controls for 2007/08, compared with 2006/07



- 2.26 There are different features and trends within the individual sectors underlying this overall improvement, which we discuss below.
- 2.27 We noted in last year's article that a significant number of district health boards and government departments were graded as needing improvement in both the management control environment and the financial information systems and controls. This remains the case in 2007/08.
- 2.28 For government departments, the 2007/08 grades show some improvement from 2006/07. In 2007/08, for both the management control environment and the financial information systems and controls, a smaller percentage of government departments were graded as needing improvement and a larger percentage were graded as very good.
- 2.29 It remains of concern that 13% and 15% of government departments need to improve their management control environment and their financial information systems and controls, respectively.
- 2.30 In the case of the district health boards (except for one district health board that achieved a very good grade for its management control environment), the 2007/08 results show that the sector did not manage to improve its grades from 2006/07.
- 2.31 Nearly a quarter (24%) of district health boards still need to improve their management control environment, and one-third of district health boards need to improve their financial information systems and controls. This lack of improvement is unsatisfactory.
- 2.32 In the State-owned enterprise sector, the percentage of entities graded as very good for both the management control environment and the financial information systems and controls has increased.
- 2.33 However, in this sector, the percentage of entities graded as needing improvement in the management control environment has doubled. Of State-owned enterprises, 12% – a significant proportion – are now graded as needing improvement in this area.
- 2.34 We expect entities to take appropriate action to address the matters raised by our auditors and to achieve the recommended areas for improvement.
- 2.35 We analysed the issues raised in 2006/07, and the actions taken by agencies to address them during 2007/08. This analysis indicates that most of the issues we raised were addressed, and the agencies are to be commended for this. We now intend to focus on the areas where our recommendations for improvement were not addressed.

Part 3

The Controller function and the appropriation audit

- 3.1 The Controller function and appropriation audit are important aspects of the Auditor-General's work. They support the fundamental principle of Parliamentary control over government expenditure.
- 3.2 In this Part, we briefly outline the public finance principles underpinning this work and the work's main features. We then discuss unappropriated expenditure in 2007/08, and report on some other matters we have had to consider in this area during the past year.

Summary

- 3.3 The circumstances for managing Parliament's control over government expenditure change continually throughout the year. Therefore, several approval mechanisms are in place to provide some flexibility:
- The primary authority for any expenditure comes from an Appropriation Act. The first Appropriation Bill, setting out the detailed Estimates of Appropriation, is introduced with the Budget in May and is usually passed into law in August each year. A second Appropriation Bill, containing supplementary Estimates of Appropriation that update the original estimates, is introduced with the next Budget, and is passed by the end of the financial year.
 - Section 26A of the Public Finance Act 1989 (the Act) enables the Governor-General to approve the transfer of small amounts between output expense appropriations within the same Vote during the year.
 - Section 26B of the Act enables the Minister of Finance to approve expenses or capital expenditure that exceed an existing appropriation in the last three months of the year. The expenses or capital expenditure need to be within the scope of the appropriation and below the greater of \$10,000 or 2% of the total appropriation.
 - Imprest Supply Acts give conditional authority to the Crown to incur expenses or capital expenditure before an appropriation, up to a global maximum and subject to later incorporation in an Appropriation Act. In practice, the Crown controls the use of this authority by requiring Cabinet to approve any particular use of it.
- 3.4 We continue to see instances where departments incur expenditure without the authority of any of these mechanisms. Any expenses or capital expenditure incurred without authority is unauthorised expenditure, and is therefore unlawful. Any unappropriated and unlawful expenditure has to be separately reported and validated in the Appropriation (Financial Review) Act that is passed after each financial year, in keeping with section 26C of the Act.

- 3.5 In 2007/08, there were 32 instances of unauthorised expenditure, which added up to \$567 million of expenditure. In most of these instances, the expenditure was within the scope but more than the amount of an appropriation. Some of these appropriations are for demand-driven expenditure. However, in some instances, the expenditure was outside the scope of an appropriation.
- 3.6 Departments need to understand the importance of appropriation and lawfulness, and the processes within the Act that support them. Departments should also have effective processes to ensure that all public expenditure is within the appropriate bounds.
- 3.7 We continue to emphasise the need for departments to improve their financial forecasting, and to seek authority or approval for expenditure promptly.
- 3.8 Departments should seek guidance and advice from the Treasury. We also encourage departments and appointed auditors to communicate about any potential issues.

Public finance principles

- 3.9 Two important principles govern public expenditure:
- appropriation; and
 - lawfulness of purpose.
- 3.10 The Act defines the system of appropriation, which is the primary means by which Parliament authorises the Executive to use public resources. Under this system, expenses and capital expenditure should be incurred only in keeping with an appropriation or other statutory authority. Departments' net assets should not exceed the limits for which they have authority from Parliament.
- 3.11 Lawfulness of purpose includes, but is wider than, the principle of appropriation. To be lawful, expenses or capital expenditure must be incurred not only in keeping with an appropriation but also within the legal authority or capacity that enables the department to carry out the activity concerned.
- 3.12 Departments must pay particular attention to ensuring that all expenses and capital expenditure are lawful on both counts. They must have effective systems and processes in place to support this aim.
- 3.13 The Treasury provides useful guidance on the system of appropriations on its website (www.treasury.govt.nz). This guidance includes:
- *Putting It Together: An Explanatory Guide to the New Zealand Public Sector Financial Management System*;
 - *A Guide to the Public Finance Act*;

- *A Guide to Appropriations*;
- *Treasury Circular 2007/05: Multi-Year, Revenue Dependent and Department to Department Appropriations*; and
- *Treasury Circular 2006/04: Unappropriated Expenditure – Avoiding Unintended Breaches*.

3.14 In May 2008, the Treasury issued *Treasury Circular 2008/07: Unappropriated Expenses and Capital Expenditure 2007/08*. The circular provided information and templates for the process that departments needed to follow in dealing with unappropriated expenditure in 2007/08. The Treasury has not yet issued the equivalent guidance for 2008/09.

Operating the Controller function

3.15 Sections 65Y to 65ZA of the Act set out the legislative provisions for the Controller function.

3.16 The main features of the Controller function are:

- Departments provide information to the Treasury about the expenses and capital expenditure incurred against the authority available. The Treasury collates and monitors this information throughout the year.
- The Treasury supplies monthly reports¹ to enable the Controller to fulfil the role (section 65Y).
- Throughout the financial year (usually each month), the Office of the Auditor-General and departments' appointed auditors perform the Controller function using standard procedures. They carry out these procedures in keeping with the Auditor-General's Auditing Standard 2: *The Appropriation Audit and the Controller Function (AG-2)* and a Memorandum of Understanding² between the Treasury and the Office of the Auditor-General.
- The Controller can direct a Minister to report to the House of Representatives if the Controller has reason to believe that expenditure has been incurred that is unlawful or not within the scope, amount, or period of any appropriation or other authority (section 65Z).
- The Controller can stop payments from a Crown or departmental bank account, to prevent money being paid out if the Controller believes the payments may be applied for a purpose that is not lawful or outside the scope, amount, or period of appropriation or other authority (section 65ZA).

3.17 The audit work carried out on appropriations supports the formal operation of the Controller function. Section 15(2) of the Public Audit Act 2001 now explicitly

¹ Monthly reporting is not required for July and August.

² The joint understanding and expectations about the role and procedures associated with the Controller function are set out in the *Memorandum of Understanding between the Treasury and the Office of the Auditor-General*.

recognises this work as part of the basic functions of the Auditor-General. The Auditor-General's appointed auditors must carry out an appropriation audit as part of the annual audit of each department, to confirm that:

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

Unappropriated expenditure in 2007/08

- 3.18 Most of the government expenditure during 2007/08 was authorised by appropriations in the usual way.
- 3.19 There were a few transfers in keeping with section 26A of the Act, and a few approvals under section 26B. There were 32 instances of expenditure (adding up to \$567 million) that were not authorised through any of the processes provided by the Act.
- 3.20 In 26 of the 32 instances, expenditure was within the scope of an appropriation but more than the amount authorised by Parliament.³ Some of these expenditures are heavily demand-driven. The total expenditure in excess of authority was \$330 million.
- 3.21 The remaining six instances⁴ were expenditure that was outside the scope of any appropriation. The total expenditure in these cases was \$237 million.
- 3.22 This is a relatively small amount of unauthorised expenditure compared to total government expenditure. However, it is always a concern when government agencies incur expenditure without the necessary authority from Parliament.
- 3.23 Some common factors that have contributed 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.
- 3.24 Some departments also delayed seeking appropriate corrective action once they had identified a breach.

³ These are listed on pages 148-150 of the *Financial Statements of the Government of New Zealand for the Year Ended 30 June 2008*.

⁴ These are listed on page 151 of the *Financial Statements of the Government of New Zealand for the Year Ended 30 June 2008*.

- 3.25 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.

Net asset holdings

- 3.26 Nine departments breached their net asset limits during 2007/08.⁵ This is a significant increase from the two instances in the previous year.
- 3.27 The Act sets a limit on the net assets that departments may hold. Section 22(3) states:

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

- 3.28 We continue to see similar problems arising in this area in the current financial year. It is a complex area, from both a legal and an accounting perspective.
- 3.29 Therefore, departments should take care in projecting net assets, and in monitoring the actual net asset levels throughout the year.

Remeasurements

- 3.30 The Act provides for remeasurements. These are financial transactions that are defined to be excluded from the meaning of expenses used in the Act. Therefore, they do not, unlike other expenses, require an appropriation. The Act also provides authority for a department's net asset level to increase beyond its authorised limit, after the remeasurement of an asset or liability. In these cases, the excess will not be treated as a breach of appropriation. An example of a remeasurement is the revaluation of land and buildings.
- 3.31 Section 2 of the Act defines remeasurements as "revisions of prices or estimates that result from revised expectations of future economic benefits or obligations that change the carrying amount of assets or liabilities". Section 2 also sets out what remeasurements do not include. They do not include, for example, revisions that result from transactions or events directly attributable to the Crown's actions or decisions. For example, the revaluation of student loan receivables after a policy decision to change the applicable interest rate is not a remeasurement. Therefore, it is subject to appropriation limits in the usual way.
- 3.32 In July 2006, the Treasury issued a paper entitled *Measuring Remeasurements* to provide guidance in this area.

⁵ These are listed on page 152 of the *Financial Statements of the Government of New Zealand for the Year Ended 30 June 2008*.

- 3.33 In our Controller function and appropriation audit work, we frequently have to consider whether transactions or events result in a remeasurement. We regularly find that deciding whether transactions result in remeasurements requires careful judgement. The legal and accounting issues are not straightforward.
- 3.34 Therefore, departments need to take care when assessing transactions as remeasurements, and refer to the guidance available from the Treasury in doing so. We also encourage early discussion between departments and appointed auditors, where appropriate.

The significance of appropriation scope

- 3.35 The authority provided by an appropriation is limited to the scope of the appropriation. Departments may not use it for any other purpose.
- 3.36 Departments should take care that they clearly specify the scope of appropriations they administer to provide an effective basis for this authority. Scope specification will meet this objective where it:
- acts as an effective constraint against non-authorised activity; and
 - does not inappropriately constrain activity intended to be authorised.
- 3.37 Conversely, a poorly defined appropriation scope undermines the effectiveness of Parliamentary approval and scrutiny of expenditure.
- 3.38 The Treasury has an ongoing programme of providing guidance and improving the quality of appropriation scope statements. In September 2005, the Treasury issued a paper entitled *Scoping the Scope of Appropriations* to provide guidance for departments in preparing appropriate descriptions, before they include them in the Estimates of Appropriation.
- 3.39 The Treasury promoted clearer and more robust appropriation scope specifications as part of its Review of Accountability Documents work programme. The Treasury also plans to continue to issue relevant guidance.

Part 4

Non-standard audit reports issued in 2008

4.1 In this Part, we report on the non-standard audit reports issued during the 2008 calendar year on the annual financial statements of public entities within our central government portfolio of audits.¹ We report on school boards of trustees separately from the other public entities.²

Why are we reporting this information?

4.2 An audit report is addressed to the readers of an entity's financial statements. In each case, the issues underlying a non-standard audit report are drawn to the attention of the entity and discussed with its governing body, or chief executive in the case of a government department.

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

What is a non-standard audit report?

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

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

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

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

4.6 There are three types of qualified opinion:

- an "adverse" opinion (see paragraph 4.10);
- a "disclaimer of opinion" (see paragraph 4.15); and
- an "except-for" opinion (see paragraph 4.18).

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

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

3 A non-standard audit report is issued in accordance with the Institute of Chartered Accountants of New Zealand Auditing Standard No. 702: *The Audit Report on an Attest Audit*.

- 4.7 The auditor will include an **explanatory paragraph** (see paragraph 4.23) in the audit report to emphasise a matter such as:
- a breach of law; or
 - a fundamental uncertainty.
- 4.8 Auditors are required to ensure that an explanatory paragraph is included in the audit report in such a way that it cannot be mistaken for a qualified opinion.
- 4.9 Figure 5 sets out the decisions an auditor has to make when considering the appropriate form of audit report.

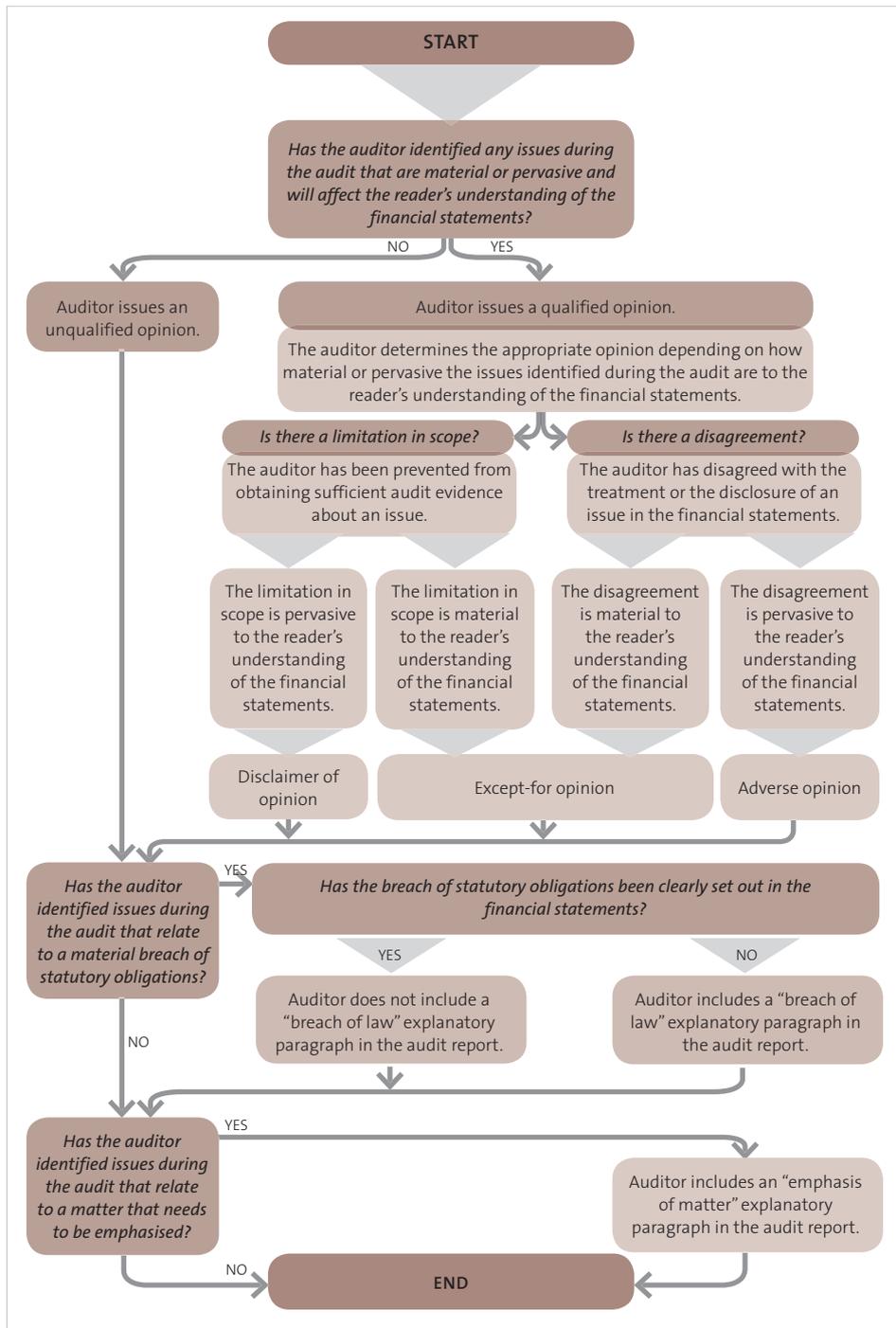
Adverse opinions

- 4.10 An adverse opinion is expressed when the auditor and the entity disagree about the treatment or disclosure of a matter in the financial statements and, in the auditor's judgement, the treatment or disclosure is so material or pervasive that the financial statements are seriously misleading.
- 4.11 An adverse opinion is the most serious type of non-standard audit report.
- 4.12 During 2008, adverse opinions were expressed for three non-school public entities:
- Royal New Zealand Navy Museum Trust Incorporated;
 - RNZAF Museum Trust Board; and
 - Queen Elizabeth II Army Memorial Museum.
- 4.13 The Appendix sets out the details of these adverse opinions.
- 4.14 We are pleased to report that it was not necessary for us to issue adverse opinions on any school boards' financial statements in the 2008 calendar year.

Disclaimers of opinion

- 4.15 A disclaimer of opinion is expressed when the scope of an auditor's examination is limited, and the possible effect of that limitation is so material or pervasive that the auditor has not been able to obtain enough evidence to support an opinion on the financial statements. The auditor is accordingly unable to express an opinion on the financial statements as a whole or on part of them.
- 4.16 During 2008, a disclaimer of opinion was expressed for one school – Te Kura Kaupapa Maori O Ruamata. The Appendix sets out the details of the disclaimer of opinion.
- 4.17 We are pleased to report that it was not necessary for us to issue disclaimers of opinion on any non-school public entity's financial statements in the central government portfolios in the 2008 calendar year.

Figure 5
Deciding on the appropriate form of audit report



Except-for opinions

- 4.18 An except-for opinion is expressed when the auditor reaches one or both of the following conclusions:
- The possible effect of a limitation in the scope of the auditor's examination is (or may be) material but is not significant enough to require a disclaimer of opinion. The opinion is qualified by using the words "except for the effects of any adjustments that might have been found necessary" had the limitation not affected the evidence available to the auditor.
 - The effect of the treatment or disclosure of a matter with which the auditor disagrees is (or may be) material, but is not, in the auditor's judgement, significant enough to require an adverse opinion. The opinion is qualified by using the words "except for the effects of" the matter giving rise to the disagreement.
- 4.19 An except-for opinion can be expressed when the auditor concludes that a breach of statutory obligations has occurred and that the breach is material to the reader's understanding of the financial statements. An example of this is a Crown entity breaching the requirements of the Crown Entities Act 2004 by not including budgeted figures in its financial statements.
- 4.20 During 2008, except-for opinions were expressed for 12 non-school public entities:
- Auckland District Health Board and Group;
 - Christchurch Polytechnic Institute of Technology and Group;
 - Massey University and Group;
 - UCOL International Limited (a subsidiary of Universal College of Learning);
 - Ngati Whakue Educational Endowment Trust Board;
 - Massey Ventures Limited and Group (a subsidiary of Massey University; for financial statement years ended 30 June 2005 to 30 June 2007);
 - Te Wānanga o Aotearoa Te Kuratini o Ngā Waka;
 - MO1 Limited (a subsidiary of Te Wānanga o Aotearoa Te Kuratini o Ngā Waka);
 - Ivey Hall and Memorial Hall 125th Anniversary Appeal Gifting Trust (a trust controlled by Lincoln University);
 - Ivey Hall and Memorial Hall 125th Anniversary Appeal Taxable Activity Trust (a trust controlled by Lincoln University);
 - Wilson Home Trust (a subsidiary of Waitemata District Health Board); and
 - Creative Campus Enterprises Limited (a subsidiary of Massey University).

4.21 During 2008, except-for opinions were expressed for the financial statements of 29 schools:

- Remuera Primary School;
- Wellington Girls' College;
- New Plymouth Girls' High School;
- Wanganui City College;
- Mornington School;
- Te Wharekura Rakaumangamanga;
- St Peter's College (Epsom);
- Wellington East Girls' College;
- St Joseph's School (Upper Hutt);
- Sacred Heart School (Thorndon);
- Huntly West School;
- Mansell Senior School;
- Salford School (for financial statement years ended 31 December 2006 and 2007);
- Kaingaroa Forest School;
- Whareorino School;
- Kiwitahi School;
- Piopio Primary School;
- Karoro School;
- Waihi East School;
- Taumarunui High School and Community Trust;
- Te Kura O Otangarei School;
- Te Whanau A Apanui Area School;
- Piri Piri School;
- Brandon Intermediate School;
- Whanganui Awa School;
- St Matthew's School (Marton);
- St Mary's School (Cambridge);
- St Joseph's Primary School (Opotiki); and
- Carmel College.

4.22 The Appendix sets out the details of these except-for opinions. In some cases, the audit opinion was qualified for more than one reason.

Explanatory paragraphs

- 4.23 In certain circumstances, it may be appropriate for the auditor to include additional comments in the audit report. Through an explanatory paragraph, the auditor emphasises a matter that they consider relevant to a reader's proper understanding of an entity's financial statements.
- 4.24 For example, an explanatory paragraph could draw attention to an entity having breached its statutory obligations for matters that may affect or influence a reader's understanding of the entity's financial statements. In this situation, the audit report would normally draw attention to the breach only if the entity had not clearly disclosed the breach in its financial statements. In most cases, entities choose to disclose a breach in their financial statements.
- 4.25 During 2008, there were five main types of matters emphasised by auditors of non-school public entities in explanatory paragraphs.
- 4.26 The first type of matter is funding for a capital appropriation that was not recognised as an equity transaction. The audit opinion for the University of Auckland included such an explanatory paragraph.
- 4.27 The second type of matter is fundamental uncertainty about the validity of the "going concern" assumption. Entities whose audit reports included such an explanatory paragraph include:
- Capital and Coast District Health Board;
 - New Zealand Institute for Crop and Food Research Limited;
 - Gracelinc Limited (a subsidiary of New Zealand Institute for Crop and Food Research Limited); and
 - Western Institute of Technology at Taranaki and Group.
- 4.28 The third type of matter is financial statements appropriately prepared on the "going concern" assumption because the financial statements contained appropriate disclosures about the use of the "going concern" assumption. Entities whose audit reports included such an explanatory paragraph include:
- Aupouri Maori Trust Board;
 - Cardiff Holdings No.1 Limited (a subsidiary of Genesis Power Limited);
 - Cardiff Holdings No.2 Limited (a subsidiary of Genesis Power Limited);
 - GP No.1 Limited (a subsidiary of Genesis Power Limited);
 - GP No.2 Limited (a subsidiary of Genesis Power Limited);
 - Kupe Holdings Limited (a subsidiary of Genesis Power Limited);
 - Air New Zealand Consulting Limited (a subsidiary of Air New Zealand Limited); and

- NIWA Natural Solutions Limited (a subsidiary of National Institute of Water and Atmospheric Research Limited) for the year ended 30 June 2007.
- 4.29 The fourth type of matter is where the “going concern” assumption was appropriately not used because organisations were disestablished. Entities whose audit reports included such an explanatory paragraph include:
- NIWA Natural Solutions Limited (a subsidiary of National Institute of Water and Atmospheric Research Limited) for the year ended 30 June 2008;
 - Architects Education and Registration Board;
 - Dunedin College of Education;
 - Iso-Trace Limited;
 - Ngai Tahu Ancillary Claims Trust; and
 - Transit New Zealand.
- 4.30 The fifth type of matter is not including budget figures in the financial statements. Entities whose audit reports included such an explanatory paragraph include:
- Immune Solutions Limited (a subsidiary of University of Otago); and
 - Southland District Health Board.
- 4.31 There were no breaches of law noted in the audit reports of non-school public entities.

Schools

- 4.32 Because of the number of non-standard audit reports in each category, we are not listing each school for which an explanatory paragraph was included in its audit report. We are instead reporting the types of explanatory paragraphs that were issued and the number of schools that received each type.
- 4.33 There were two main types of matters emphasised by auditors in explanatory paragraphs:
- serious financial difficulties (22 schools); and
 - school closures (7 schools).
- 4.34 There were six major types of explanatory paragraphs included by auditors for breaches of law:
- expenditure on capital works on proprietor’s land (88 schools);
 - not reporting by 31 May 2008 (76 schools);
 - not having a 10-year property plan (11 schools);
 - not including the required variation statement (9 schools);
 - borrowing without approval (6 schools); and
 - investing in non-approved institutions (5 schools).

- 4.35 Most schools disclose breaches of law in their financial statements. Therefore, the above figures should not be taken as a picture of compliance generally.
- 4.36 In addition, auditors emphasised matters for other reasons for nine schools.
- 4.37 The Appendix contains more information about the explanatory paragraphs that were included in audit reports.

Part 5

Results of district health board audits for 2007/08

- 5.1 The 21 district health boards (DHBs) are fundamental to the delivery of health services in New Zealand. Nearly \$9.032 billion of the just over \$12.240 billion budgeted for government expenditure on health for 2008/09 is to fund health services from DHBs.
- 5.2 The Auditor-General is the auditor of the DHBs and their subsidiary organisations. In this Part, we briefly describe the DHBs and their operating environment, and the results of our annual audits of DHBs for the 2007/08 financial year.

What is the health sector?

- 5.3 The health sector contains 21 DHBs, set up in 2001 under the New Zealand Public Health and Disability Act 2000, which sets out the role and functions of DHBs. They are responsible for providing, or funding the provision of, health and disability services in their district, for the purpose, among others, of:
- improving, promoting, and protecting the health of communities;
 - promoting the integration of health services, especially primary and secondary care services; and
 - promoting effective care or support of those in need of personal health services or disability support.
- 5.4 Also included in the health sector are subsidiary companies that DHBs may have set up individually or jointly – for example, HIQ Limited, which provides information technology services to Capital and Coast and Taranaki DHBs. The DHBs share some of their planning, administrative, and quality assurance functions through shared service agencies and also through District Health Boards New Zealand.
- 5.5 DHBs have also been responsible, since the Primary Health Care Strategy was introduced in 2001, for setting up not-for-profit primary health organisations (PHOs). The DHBs have contracts with the PHOs for delivering and co-ordinating health care services for their enrolled populations. There are now about 80 PHOs around the country, with an enrolled population of about 3.9 million New Zealanders (95% of the population).

How are the district health boards funded and for what?

- 5.6 The overall level of funding appropriated for DHBs is determined by the Budget process, based on the Government's spending priorities. For 2007/08, the funding was distributed to the health of older people (12.8%), mental health (12.1%), personal health care services (33.3%), and residential health and community-based health care services (41.8%).¹

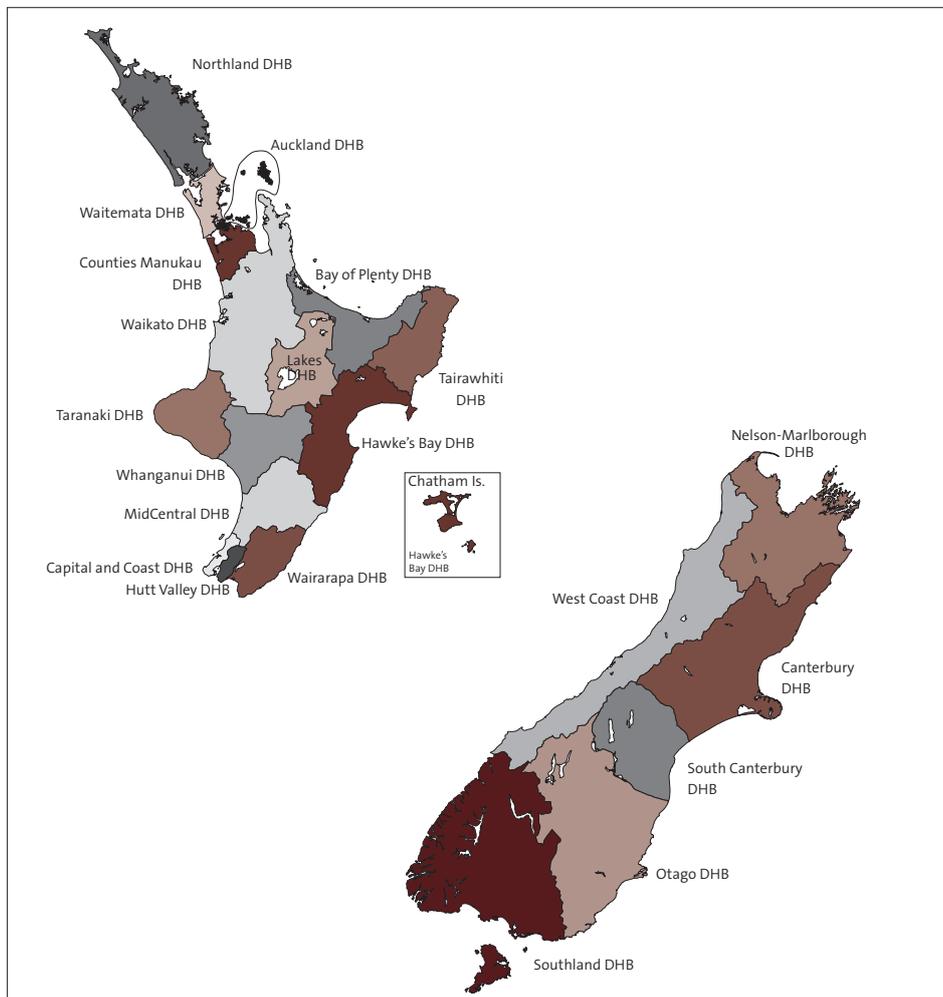
¹ *The Estimates of Appropriations 2007/08*, B.5 Vol.1, page 640.

- 5.7 The amount of funding each DHB gets is determined by the size of its population, with additional socioeconomic and other risk factors taken into account. The funding covers the health and disability services that the DHB provides directly to its population, or indirectly through another provider (such as another DHB, or a private for-profit or not-for-profit provider such as a non-government organisation).

Size of the district health boards

- 5.8 DHBs vary considerably in the amount of funding they receive, and the size of areas and population they serve, as shown in Figures 6 and 7.

Figure 6
District health board areas



Source: Ministry of Health website, www.moh.govt.nz.

Figure 7
Population and funding of district health boards in 2007/08

DHB	Population ^a	Funding ^b \$m
North Island		
Auckland	442,720	839.9
Bay of Plenty	202,765	450.6
Capital and Coast	282,530	509.5
Counties Manukau	455,335	857.8
Hawke's Bay	150,795	334.9
Hutt Valley	138,715	267.1
Lakes	103,015	219.3
MidCentral	164,685	350.9
Northland	150,593	357.5
Tairāwhiti	44,663	107.1
Taranaki	105,103	240.6
Waikato	346,515	715.2
Wairarapa	39,295	93.8
Waitemata	513,840	948.8
Whanganui	62,158	159.8
South Island		
Canterbury	483,945	960.1
Nelson-Marlborough	138,683	294.0
Otago	182,900	397.8
South Canterbury	53,600	128.0
Southland	110,645	223.1
West Coast	30,525	94.9

a Population figures used to calculate 2007/08 population-based funding (Ministry of Health, 4 December 2008).

b *The Estimates of Appropriations 2007/08*, B.5 Vol.1, pages 632-634.

Governance and accountability arrangements

- 5.9 Each DHB is responsible for identifying and providing for its district's health needs, and is required to develop district strategic and annual plans that are consistent with New Zealand's health and disability strategies.² Each year, the DHB also publishes a Statement of Intent (SOI), a high-level, less detailed statement about how the DHB intends to address the health needs of its district. There is also increasing emphasis on inter-district planning and supply of health services.

² See section 38, New Zealand Public Health and Disability Act 2000.

- 5.10 Each DHB is governed by a board of seven elected members, and up to four members appointed by the Minister of Health (the Minister).³ DHBs are directly accountable to the Minister. As Crown Agents under the Crown Entities Act 2004, DHBs are required to give effect to government policy when directed by the Minister.⁴
- 5.11 The monitoring department is the Ministry of Health (the Ministry), which has a monitoring and support capability for DHBs within its Sector Accountability and Funding directorate. The Ministry maintains a monitoring regime with three different levels of intervention – standard monitoring, performance watch, and intensive monitoring.⁵ As at 30 June 2008, there were four DHBs on intensive monitoring (Capital and Coast, Hawke’s Bay, Southland, and Whanganui), and three on performance watch (Auckland, Waitemata, and West Coast). Since then, Auckland DHB has returned to standard monitoring, and Otago DHB has been placed on performance watch.
- 5.12 In addition to intensive Ministry monitoring, the Minister can make changes to how the DHB is governed, to help improve its performance.
- 5.13 This can be by appointing one or more Crown monitors to observe the decision-making processes of the board, to assist the board in understanding the policies and wishes of the Government, and to advise the Minister on any matters about the DHB, the board, or its performance.⁶ During 2007/08, Capital and Coast DHB and Whanganui DHB had Crown monitors in place.
- 5.14 If seriously dissatisfied, the Minister can dismiss the board and appoint a commissioner.⁷ During 2007/08, a commissioner was put in place in Hawke’s Bay DHB.

Annual audit of the health sector

- 5.15 The Auditor-General is the auditor of every public entity. Under section 15 of the Public Audit Act 2001, he audits the financial statements, accounts, and other information that each of the 21 DHBs, their subsidiaries, and District Health Boards New Zealand are required to have audited each year. He does not

³ Section 28(1)(a), Crown Entities Act 2004.

⁴ Section 7(1)(a), Crown Entities Act 2004.

⁵ Briefly stated, standard monitoring is used when a DHB is in a sound financial position, has supported accountability arrangements in place, and is complying with requirements in a timely manner. DHBs are under a performance watch when there is some non-compliance or deterioration in performance. Intensive monitoring occurs when a DHB continues to be non-compliant or deteriorates in the performance watch requirements, or a single event creates a material risk. There are two further intervention stages – intermediate governance action, and direct governance action if the Minister is seriously dissatisfied with the Board’s performance.

⁶ Section 30, New Zealand Public Health and Disability Act 2000.

⁷ Section 31, New Zealand Public Health and Disability Act 2000.

audit the PHOs, because they are not public entities. However, under section 16 of the Public Audit Act 2001, he can look at whether DHBs are fulfilling their responsibilities for primary health care.

- 5.16 The purpose of the annual audit is to give assurance that the public entity's reports fairly reflect its financial and non-financial performance, and do not mislead the reader.

Financial performance of district health boards

- 5.17 Figure 8 sets out the financial performance of the 21 DHBs for the year ended 30 June 2008.

Figure 8

Summary of district health boards' 2007/08 financial performance

DHB	Revenue ^a \$m	Expenditure ^a \$m	Surplus (deficit) ^a \$m	Deficit as % of revenue	Planned surplus (deficit) ^b \$m	Variance to plan \$m
Auckland	1,530.3	1,527.9	2.4 ^c		0.1	2.3
Bay of Plenty	505.3	507.7	(2.4)	0.5%	(2.3)	(0.2)
Canterbury	1,181.0	1,197.8	(16.9)	1.4%	0	(16.8)
Capital and Coast	719.9	760.2	(40.7) ^c	5.7%	(10.9)	(29.8)
Counties Manukau	1,060.6	1,053.4	7.2		(1.4)	8.6
Hawke's Bay	383.9	390.6	(6.7)	1.8%	0	(6.7)
Hutt Valley	363.8	373.3	(9.4)	2.6%	0	(9.4)
Lakes	257.8	252.8	5.0		(2.8)	7.8
MidCentral	452.1	456.2	(4.1)	0.1%	(4.4)	0.3
Nelson-Marlborough	352.3	344.5	7.8		(3.6)	11.4
Northland	409.8	409.0	0.7		(0.0)	0.7
Otago	495.0	500.8	(5.8) ^c	1.2%	(3.3)	(2.5)
South Canterbury	149.6	147.9	1.7		0	1.7
Southland	246.3	249.2	(2.9) ^c	1.2%	(4.3)	1.3
Tairāwhiti	124.7	125.6	(0.8) ^c	2.3%	(0.4)	(0.4)
Taranaki	271.6	272.9	(1.3)	0.5%	(1.9)	0.6
Waikato	907.6	876.9	30.7		0.2	30.5
Wairarapa	110.5	112.2	(1.7)	1.5%	0.0	(1.7)
Waitemata	1,120.0	1,115.4	4.6		(8.3)	12.9
West Coast	111.0	117.3	(6.3)	5.7%	(4.6)	(1.6)
Whanganui	182.1	186.8	(4.7)	2.6%	(1.3)	(3.4)
Totals	10,935.2	10,978.6	(43.4)		(49.3)	

a Audited results.

b From the annual plans of DHBs. Figures provided by the Ministry of Health, December 2008.

c In five cases (Auckland, Capital and Coast, Otago, Southland, and Tairāwhiti DHBs), the surplus(deficit) is affected by including profits from associates that are additional to the revenue shown. For these five DHBs, the surplus(deficit) shown is therefore not the same as revenue less expenditure.

Overall financial stability

- 5.18 The board usually prepares the DHB's financial statements on the basis of the "going concern" assumption (that is, on the basis that the DHB will continue to operate for the foreseeable future).
- 5.19 Sometimes, there are doubts about the appropriateness of the going concern assumption. Doubts can arise for many reasons, including:
- future funding not being agreed;
 - potential for defaulting on loans or breaching borrowing covenants;
 - significant liquidity or cash flow problems; or
 - dependence on the continuing support of the Crown.
- 5.20 Where there are doubts, the board must be able to justify using the going concern assumption.
- 5.21 In some circumstances, to justify using the assumption, the board seeks assurances of financial support from the Crown (through the Minister). Such assurance is usually given in the form of a "letter of comfort". In 2007/08, the Ministers of Health and Finance issued five letters of comfort. These were for:
- Capital and Coast DHB;
 - Otago DHB;
 - Southland DHB;
 - West Coast DHB; and
 - Whanganui DHB.

Audit opinions issued for the year ended 30 June 2008

- 5.22 Capital and Coast DHB received a non-standard audit report⁸ that contained an unqualified audit opinion but referred to future uncertainties about the outcome of negotiations for funding. Additional funding is needed to support this DHB's cash flow requirements for 2010 and beyond, because of significant forecast deficits.
- 5.23 The 2007/08 audit reports for all other DHBs contained unqualified audit opinions.

8 See Part 4.

Environment, systems, and controls

- 5.24 The Auditor-General also comments on the management control environment, and financial and service performance systems and controls of DHBs, to highlight areas for improvement identified during the audit. Grades are assigned that directly represent the recommendations for improvement.⁹ Figures 9, 10, and 11 set out our grades for the management control environment, and financial information systems and controls for the DHBs, for the year ended 30 June 2008.¹⁰
- 5.25 Sixteen of the 21 DHBs were good or better in their management control environment. The rest needed improvement, and none were poor.
- 5.26 Two-thirds were good in their financial information systems and controls. Again, the rest needed improvement, and none were poor.
- 5.27 These results are very similar to the 2006/07 grades.¹¹

Figure 9
Summary of grades for each district health board’s management control environment



9 See Part 2 for more information about the assessment scale.

10 We did not grade service performance information and associated systems and controls for 2007/08.

11 *Central government: Results of the 2006/07 audits*, page 31.

Figure 10
Summary of grades for each district health board’s financial information systems and controls

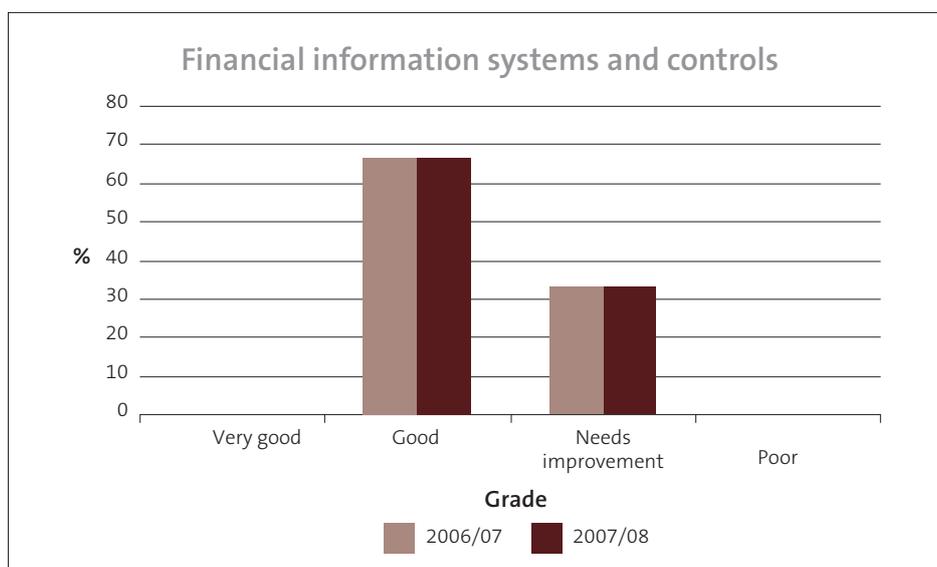


Figure 11
Grades for each district health board

DHB	Management control environment	Financial information systems and controls
Auckland	Very good	Good
Bay of Plenty	Good	Needs improvement
Canterbury	Good	Good
Capital and Coast	Needs improvement	Needs improvement
Counties Manukau	Good	Good
Hawke’s Bay	Needs improvement	Needs improvement
Hutt Valley	Needs improvement	Good
Lakes	Good	Good
MidCentral	Good	Needs improvement
Nelson-Marlborough	Good	Good
Northland	Good	Good
Otago	Good	Good
South Canterbury	Good	Good
Southland	Good	Good
Tairāwhiti	Good	Needs improvement
Taranaki	Good	Good
Waikato	Needs improvement	Needs improvement
Wairarapa	Needs improvement	Good
Waitemata	Good	Good
West Coast	Good	Good
Whanganui	Good	Needs improvement

Key areas of audit focus in the 2007/08 annual audits

5.28 Two key areas of focus for the audits of DHBs in 2007/08 were:

- information about future operating intentions; and
- procurement policies and practice.

Results of review of information about future operating intentions of district health boards

5.29 We want to see continuous improvement in DHBs' SOIs. Each year, we review DHBs' SOIs during the audit. In 2007/08, this was supplemented by a desk-based review of the final 2008/09 SOI. Our aim is for DHBs to have a more consistent and comprehensive approach to performance reporting. A DHB should be using the same performance information as the basis for its statement of service performance (SSP) that managers use to make decisions. DHBs also need to use adequate processes to set the measures – for example, benchmarking or trend analysis – and to consult.

5.30 The focus of our work is on:

- ensuring that the SOI complies with relevant legislative requirements;
- ensuring that the forecast output information in the forecast SSP is consistent with any forecast output information included in the Estimates of Appropriation;
- assessing the “appropriateness” of the performance measures (taking into account comments provided to DHBs on the 2007/08 SOI); and
- considering whether there are any other issues with the measures and targets that may affect the audit opinion on the SSP – in particular, whether the measures can be audited.

5.31 Our review identified that the documents produced could be improved (in some cases significantly) by:

- clearly explaining the links between the services that DHBs are responsible for and the impacts and outcomes that they are seeking to achieve (that is, the “performance story”);
- ensuring that the outcomes described in the SOI are consistent with the statutory definition of an outcome, and are clearly identified;
- ensuring that the outputs described in the SOI relating to the goods and services that the DHB is responsible for providing to third parties are appropriately aggregated into meaningful output classes and cover all the significant services funded (information about internal processes, milestones, and organisational improvements is useful to the reader, but should not be included as outputs in the forecast SSP); and

- including performance measures for both outputs and outcomes. These should cover a number of the dimensions of performance, including quality, quantity, and timeliness, together with targets, baseline data, and other comparative information that will help the reader put the DHB's performance in context.

- 5.32 We continue to work with the monitoring department (the Ministry) and the central agencies (the Treasury and State Services Commission) to provide advice and support to a working group set up by the DHBs in response to our feedback. The working group intends, in particular, to address the definition of outputs and of output classes in the DHB sector. It is also giving attention to the general structure of the SOIs, with the aim of clarifying the performance story. We expect this work to result in improvements to the 2009/10 and 2010/11 SOIs, when we will, for the first time, be grading service performance information and associated systems and controls.
- 5.33 We are aware that the health sector has some particular issues with the number of accountability documents that it is required to produce. The Ministry has been reviewing the sector accountability documents. We intend to discuss with the Ministry and the DHBs how to achieve more clarity in sector accountability documents.

Audit findings on managing procurement

- 5.34 Procurement covers all the business processes associated with purchasing, from policies through to procurement practice. We have a particular interest in the effective and efficient procurement of goods and services when this involves the use of public resources, and have published good practice guidance on procurement.¹²
- 5.35 In last year's report,¹³ we had a number of criticisms of the procurement policies that we examined in the 2006/07 audit. In 2006/07, we looked at a sample group of DHBs' procurement policies and found they needed improvement. We therefore reviewed procurement policies and practices in DHBs during the 2007/08 annual audit (see Part 9).
- 5.36 We considered procurement in its widest sense from business case to contract end, consistent with our guidance. We considered purchasing arrangements (contracts) with providers and suppliers of goods and services for both conventional and relational purchasing,¹⁴ including when purchasing services from non-government organisations. We did not cover grant arrangements, even if those arrangements were documented in a contractual form.

¹² *Procurement guidance for public entities*, June 2008.

¹³ *Central government: Results of the 2006/07 audits*, May 2008, Part 4.

¹⁴ *Procurement guidance for public entities*, June 2008, Part 6.

- 5.37 Procurement expenditure varies widely throughout the DHBs. Some are large entities with total annual expenditure of more than \$1 billion. Others are much smaller, spending only \$100 million annually. However, it is clear that procurement represents the greatest proportion of annual expenditure for all DHBs. This is so whether that proportion is 70%, as it is for one DHB, or only 49%, as it is for those at the lower end of the range. It is therefore crucial to DHBs' effective operation that procurement is well managed.
- 5.38 Because of this, and the level of concern about procurement in the health sector in particular, we carried out a more detailed review of procurement policies and practice in DHBs in 2007/08 and analysed the areas where improvements were required.

Areas for improving procurement policies

- 5.39 We examined nine areas to identify where improvements could be made in procurement policies:
- whether the policies cover all the DHB's procurement activities, who approved the policies, and whether they are available to the relevant staff (that is, status and availability);
 - general provisions (for example, whether they reflect the essential principles set out in our guidance);
 - planning and methods (for example, whether they include an appropriate range of procurement approaches);
 - legal considerations (for example, whether they reflect public law obligations and caution about process-related contract obligations);
 - ethical provisions (for example, whether they deal with conflicts of interest);
 - economic considerations (for example, requirements to ensure value for money);
 - whether they take sustainability into account;
 - risk management (for example, whether they include provisions for identifying, recording, assessing, and managing risks); and
 - processes and management (for example, whether open tendering is required for conventional procurement).
- 5.40 All of the DHBs were deficient in at least one of these areas (see Figure 12).
- 5.41 We assessed which of the nine key areas DHBs were deficient in. Figure 13 sets out our results for the 21 DHBs.

Figure 12
Number of district health boards with procurement policy deficiencies

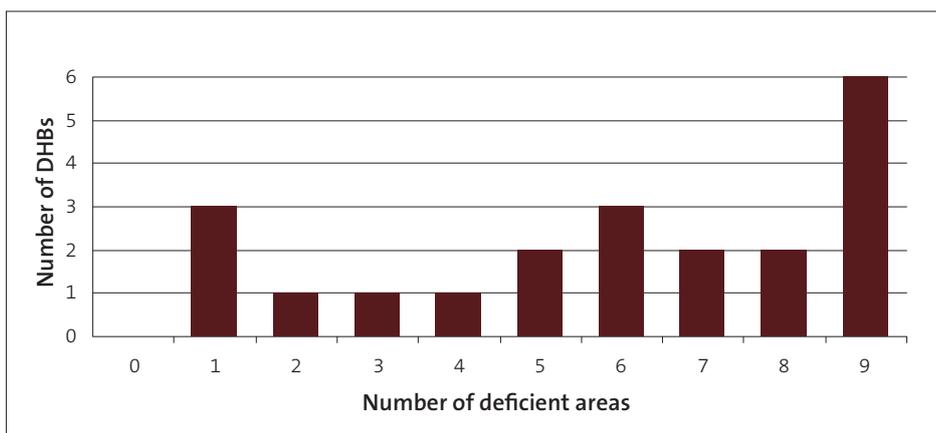
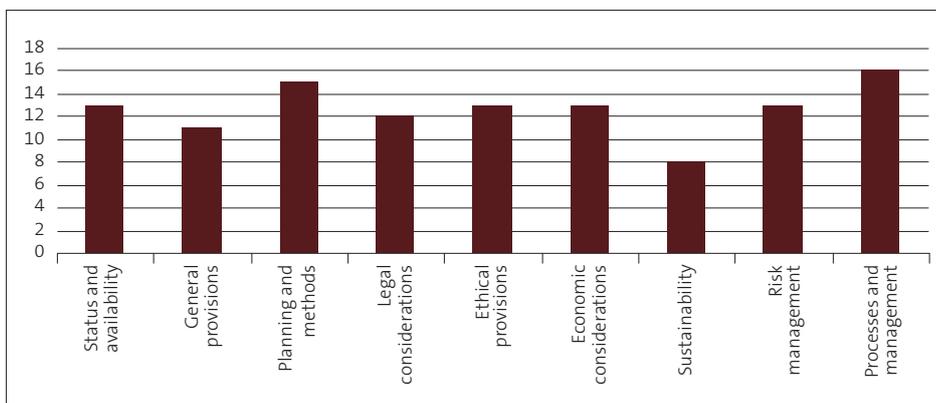


Figure 13
Number of district health boards with procurement policy deficiencies, by type



5.42 Most of the deficiencies in procurement policies were in processes and management, planning and methods, and ethical provisions. In particular, better guidance is needed in the policies about:

- when to tender;
- dealing with late tenders;
- risk management processes;
- managing fraud and corruption risks;
- dealing with gifts and hospitality when they are associated with procurement;

- managing the risk of potentially unfair advantage when former employees seek to be contractors;
- management of intellectual property considerations; and
- obtaining value for money.

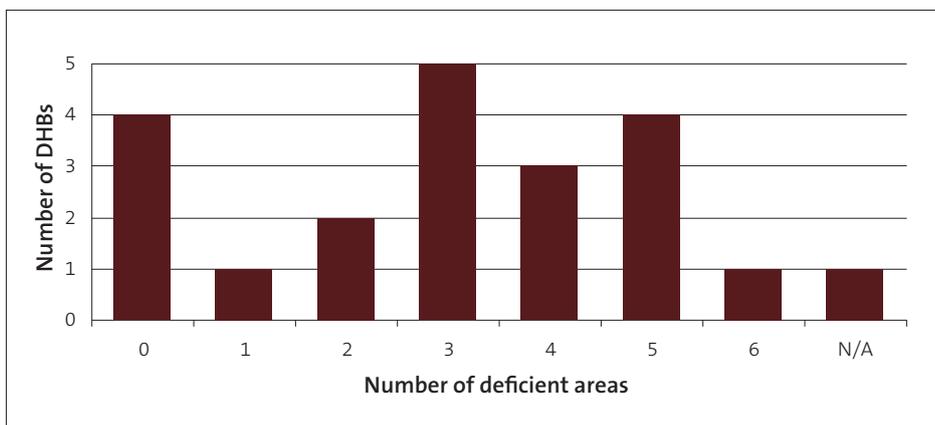
Areas for improving procurement practice

5.43 We assessed procurement practice for the first time in 2007/08. We asked DHBs to complete a self-assessment of their procurement practice based on expenditure with external suppliers and providers, covering six areas:

- management arrangements (for example, structure of procurement management, staff capacity for procurement, management of contract information);
- procurement strategy (for example, strategic planning, selecting a procurement approach to suit the particular circumstances);
- ethical and legal considerations (for example, managing conflicts of interest);
- procurement processes (for example, whether open tendering is used where practical and appropriate, how value for money is achieved);
- ongoing management of contracts (for example, approach to monitoring contracts); and
- continuous improvement (for example, recent improvements, having established some priorities for future improvement).

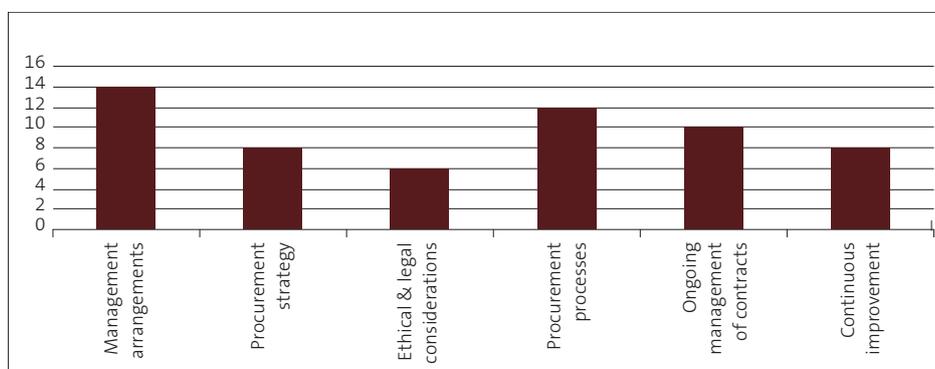
5.44 Figure 14 shows the number of DHBs by the number of areas of deficient procurement practice.

Figure 14
Number of district health boards with deficiencies in procurement practice



5.45 We assessed which of the six areas of procurement practice the 21 DHBs were deficient in. Figure 15 sets out our results.

Figure 15
Number of district health boards with deficiencies in procurement practice, by type



5.46 One particular problem was a lack of consistency between procurement operations in each of the DHB's main areas of activity – planning and funding (buying services from other providers), and providing services. There was also a lack of sharing of available expertise and knowledge across these procurement areas. This means the DHBs are not making the most of staff capacity and a corporate approach. In one DHB in particular, this affected its ability to provide us with information on its procurement operations for all of its activities.

5.47 The self-assessments that DHBs completed, our benchmarking, and our subsequent audit work highlighted the following issues in the six areas of procurement practice:

- Management arrangements:* Procurement does not have the emphasis in DHBs that its value warrants, and there are limited numbers of procurement professionals in DHBs throughout the country. Procurement in DHBs is fragmented between the separate business units and “arms” (all DHBs separate their management of corporate procurement, procurement for providing services, and procurement for funding other providers of services). This is not necessarily an issue if the information systems are appropriate, policies and guidance are clear, and staff are trained and share information. It is not always clear that this is the case. We expected a stronger focus on professional development of existing staff. Apart from the deficiencies already noted, most DHBs have up-to-date procurement policies. How they ensure compliance with their policies is less clear. Most DHBs have a contract

management system, but, despite this, access to good quality management information is limited.

- *Procurement strategy*: Most DHBs are members of joint procurement arrangements, and these offer good potential for leveraging buying power and achieving value for money. However, there is still scope to benchmark the costs actually incurred to indicate areas where some DHBs may be using services more effectively and efficiently. Also, information on the cost of health services the DHB provides is typically more complete than information about the services that it funds others to do. Arrangements for consulting service users to inform procurement decisions – for example, on what products and services to buy – tend to be under-developed.
- *Ethical and legal considerations*: While DHBs increasingly take a proactive approach to managing conflicts of interest, this remains an area that will require vigilance. Most DHBs have a process for managing tenders appropriately, covering aspects such as managing communications, ensuring confidentiality, security, and opening of tenders. Application of the process is somewhat varied.
- *Procurement processes*: All DHBs report that their policy requires a competitive process for purchases above certain thresholds or in certain circumstances. However, there does not appear to be a robust focus on value for money when DHBs do not use a contestable process for procurement. They report that they usually manage and demonstrate value for money through price checking against other DHBs, monitoring service delivery, and quality audits. It is unclear how systematic these processes are. Most DHBs report that they have some contracts with no specified completion date, and no provision to terminate the contract if need be. “Evergreen” contracts are not usually good practice. DHBs should have a structured programme of reviewing such contracts. DHBs should either put contracts on a more conventional basis where appropriate, or make sure that there are mechanisms in place to achieve value for money within the contract’s framework, and identify and manage any inherent risks. Most DHBs have guidance available on what procurement-related records should be kept. However, the retention is often fragmented, with a mixture of hard copy and electronic records that are incomplete.
- *Ongoing management of contracts*: DHBs have contract management arrangements, but there are significantly varying practices in what is done to monitor and manage contractor performance. They could increase the scope, frequency, and consistency with which this is done, and the level of reporting that goes to senior managers and the board. Contract management also needs to be based on risk.

- *Continuous improvement:* All DHBs report recent and ongoing improvements to their procurement systems and processes. Most DHBs have put their efforts into improving procurement systems and processes, recruiting the right staff for key procurement roles, and developing competencies in all their procurement staff. Our work indicates that progress in these three areas needs to continue.

- 5.48 We were pleased to note some improvements in procurement policies and practice in the DHB sector, though there is still a need for further improvement. We have informed the board and management of the individual DHBs of our findings for 2007/08, and will be focusing our audit for 2008/09 on whether DHBs have addressed the areas for improvement.
- 5.49 We are also in the process of carrying out an in-depth performance audit of three DHBs' procurement policies and practice. The performance audit is intended, along with results of our other audit work on procurement, to provide Parliament with an understanding of how effectively these DHBs are managing procurement, and to add value to the sector.

Part 6

Results of 2007 tertiary education institution audits

- 6.1 The New Zealand tertiary education system includes all post-school education and training, from university research to industry training to Adult and Community Education courses. In 2008/09, government expenditure on tertiary education will total about \$2.8 billion (excluding GST).¹
- 6.2 There are 31 public tertiary education institutions (TEIs) providing training, education, and research services in New Zealand. TEIs are Crown entities² independently governed by Councils whose functions are set out in the Education Act 1989. These Councils appoint Chief Executives (or, in the case of universities, Vice-Chancellors) to manage the TEIs.
- 6.3 The Auditor-General is the auditor of all TEIs, and any subsidiary organisations of TEIs.³ This Part provides some background detail on TEIs and their operating environment, and sets out the results of our 2007 annual audits of TEIs. The financial year for TEIs ends on 31 December each year.

What is the tertiary education institution sector?

- 6.4 The TEI sector mainly comprises eight universities, 20 institutes of technology and polytechnics, and three wānanga.⁴ In addition, many TEIs have established subsidiary organisations to carry out activities consistent with the functions and duties of a TEI, having decided that these activities can be more sensibly managed in a separate legal structure. For example, a number of the TEIs have established research companies, scholarship trusts, childcare centres, and student hostel accommodation centres.
- 6.5 The TEI sector has three distinct sub-sectors – universities, institutes of technology and polytechnics, and wānanga. Each TEI sub-sector tends to describe itself as distinct from the other two TEI sub-sectors. Each TEI sub-sector has established a national “umbrella” body to represent the interests of their TEI member organisations, foster collaboration within each of the sub-sectors, and facilitate a point of contact with external stakeholders. These are the New Zealand Vice Chancellors’ Committee, Institutes of Technology and Polytechnics of New Zealand, and Te Tau Ihu. TEIs also maintain relationships in their own right with stakeholders.

1 We have excluded student allowance and student loan amounts, which can be estimated at about \$900 million each year.

2 To preserve the academic integrity of TEIs, only certain provisions of the Crown Entities Act 2004 apply to TEIs. The applicable provisions are set out in Schedule 4 of that Act.

3 Schedule 1 of the Public Audit Act 2001.

4 The 31 TEIs are listed in Figure 18, where their financial performance for the 2007 financial year is summarised.

Governance and accountability arrangements

- 6.6 TEIs are governed by Councils. Most Council members are elected, although four are appointed by the Minister for Tertiary Education. The precise constitution of each TEI Council differs. TEI Councils must consist of not fewer than 12 members nor more than 20 members.⁵ Unlike some other classes of Crown entities, TEIs are not directly accountable to a Minister of the Crown. However, the Crown monitors the performance and viability of the TEI sector through the activities of the Ministry of Education (the Ministry), the Tertiary Education Commission (the Commission), and New Zealand Qualifications Authority (NZQA). We discuss the broad role of each of these agencies in turn below.
- 6.7 In certain circumstances, the Crown may actively support TEI Councils to govern their institutions. Sections 195A to 195D of the Education Act 1989 set out a graduated set of formal intervention powers that allow for different levels of support according to the TEIs' individual situations. The powers range from requiring a TEI to provide specified information about the operation, management, or financial position of the TEI at a given time, to the dissolution of a TEI Council and appointment of a Commissioner to govern a TEI.

Roles and responsibilities of TEIs

- 6.8 Sections 180 and 181 of the Education Act 1989 set out the functions and duties of each TEI Council. These functions include appointing a Chief Executive, and ensuring that TEIs are managed in accordance with their Investment Plans. In discharging their functions, TEI Councils must ensure that TEIs strive to attain the highest standards of excellence in education, training, and research, and operate in a financially responsible manner that ensures the efficient use of resources and the long-term viability of the TEI.
- 6.9 Section 159ABA of the Education Act 1989 sets out the planning, funding, and monitoring framework of the tertiary education sector. This framework currently requires TEIs to prepare Investment Plans that set out TEIs' responses to both the Government's tertiary education priorities and stakeholder needs. The Investment Plans underpin Crown funding for the TEIs. TEIs are also required to prepare an annual report that includes, among other information, a set of audited financial statements and statement of service performance.⁶

What other agencies have a role in the tertiary education institution sector?

- 6.10 Three central government education agencies have a significant influence on the operation of the TEI sector.

⁵ Section 171 of the Education Act 1989.

⁶ Section 154 of the Crown Entities Act 2004, section 220 of the Education Act 1989.

Ministry of Education

- 6.11 The Ministry describes itself as having a leadership role in the tertiary education sector. This includes developing strategic policy for the tertiary education sector, carrying out relevant research and analysis, and monitoring the performance and capacity of the Commission and NZQA. The Ministry has little direct relationship with TEIs.

Tertiary Education Commission

- 6.12 The Commission interacts more directly with TEIs than the Ministry. The Commission is responsible for leading the Government's relationship with the tertiary education sector, and for developing and implementing policy. The Commission implements the Government's Tertiary Education Strategy, incorporating the Statement of Tertiary Education Priorities 2008–2010 (the strategy). The Commission works with TEIs (as well as other providers of tertiary education) to agree Investment Plans that outline how they respond to the strategy.
- 6.13 The Chief Executive of the Commission has legislated responsibilities for monitoring and assessing the operations and ongoing viability of TEIs. To do this, the Commission:
- monitors TEIs' finances, governance, and management;
 - advises the Minister on appointments to TEI Councils;
 - supports the development of TEIs' governance and management capability; and
 - provides statutory intervention advice to the Minister and implements any decisions made.
- 6.14 The Commission meets regularly with most TEIs to discuss their strategies, financial management issues, and risks.

New Zealand Qualifications Authority

- 6.15 NZQA's primary function is to co-ordinate the administration and quality assurance of national qualifications. NZQA performs an overarching quality assurance role in the tertiary education sector (except in the universities),⁷ and is in the process of revising the tertiary sector quality assurance system. NZQA reports that the new system will emphasise its aims to ensure that the tertiary education sector is equipping people with the right skills and abilities to contribute effectively to the economy.

⁷ Quality assurance in the universities is carried out by the New Zealand Vice Chancellors' Committee under sections 241 and 260 of the Education Act 1989.

Recent changes to the operating environment

- 6.16 The operating environment for the tertiary education sector has changed a lot in the last three years. The changes have mainly been to the planning, funding, and quality assurance frameworks governing the tertiary education sector. The focus of the reform process has been on developing a network of education and training provision, with each sub-sector and individual TEI making a distinctive contribution to that network. This is to help avoid unnecessary duplication and maximise efficiency.
- 6.17 The Government sets the broad shape of the network and the details of the strategy in consultation with the TEI sector. The strategy is designed to set out the Government's expectations and priorities for the tertiary education system. The Commission describes the strategy as a five-year blueprint for a collaborative and co-operative tertiary system that contributes to the country's national goals and is closely connected to enterprise and local communities.
- 6.18 Investment Plans are the new funding instrument for TEIs in the reformed environment. TEIs are responsible for responding to government direction and to the needs of their own communities and regional and national stakeholders. They do this by developing and agreeing Investment Plans with the Commission. Investment Plans cover providing education and training and research, and developing new or enhanced capability by each TEI. Government expenditure levels on tertiary education are now more certain, and based on a three-year funding path under the Investment Plan model. The funding path is based on inflation pressures, expected demographic changes, student demand, and competing priorities within and outside the education sector. Funding is introduced to support what is agreed in Investment Plans, and future funding is influenced by how well TEIs perform against their Investment Plans.
- 6.19 The new funding, planning, and quality assurance system was fully introduced in 2008, so 2007 was a transitional year. All TEIs were required to develop Investment Plans for 2008.

How are tertiary education institutions funded?

Tertiary education funding system

- 6.20 The Government sets priorities and determines both the total level of funding and the amount available for each tertiary education sub-sector. During 2008/09, the Government will provide funding of about \$2,789 million⁸ to TEIs, most of which is administered by the Commission. This funding is distributed through a number of different funding mechanisms. Most funding is distributed through a bulk

⁸ Except where noted, all figures in this section are for the 2008/09 financial year, exclude GST, and include capital and operating funding.

funding arrangement, involving a small number of separate but closely related funds discussed in Figure 16. These funds are all linked to Investment Plans and have a three-year baseline that is updated at each Budget.

Figure 16

Description of the broad funding system for the tertiary education sector

The Student Achievement Component (\$1,533 million) is the most significant part of the tertiary funding system. It is the single largest source of revenue for universities, wānanga, and institutes of technology and polytechnics.* It provides subsidies for teaching and learning in mainstream tertiary qualifications (with most learners also paying tuition fees). Allocations are based on total student enrolments agreed in Investment Plans, and are calculated using a sophisticated formula with funding rates that vary significantly by the type of qualification and for each part of the sector.

The Tertiary Education Organisation Component (\$624 million) provides funding (mainly for universities, wānanga, and institutes of technology and polytechnics) to support a range of core roles, capability needs, and innovation not directly related to student enrolments. There are six elements within this component, of which the largest two are:

- The Performance-Based Research Fund (\$236 million), which is used to allocate the bulk of the Government's research funding to TEIs. This fund allocates funding based on assessments of research quality. It aims to raise the quality of research done in the sector and to help ensure that teaching at degree level and above is underpinned by research.
- The TEI Base Investment (\$310 million), which provides funding to help meet the costs of institutional infrastructure and helps focus TEIs on their core roles and distinctive contributions.

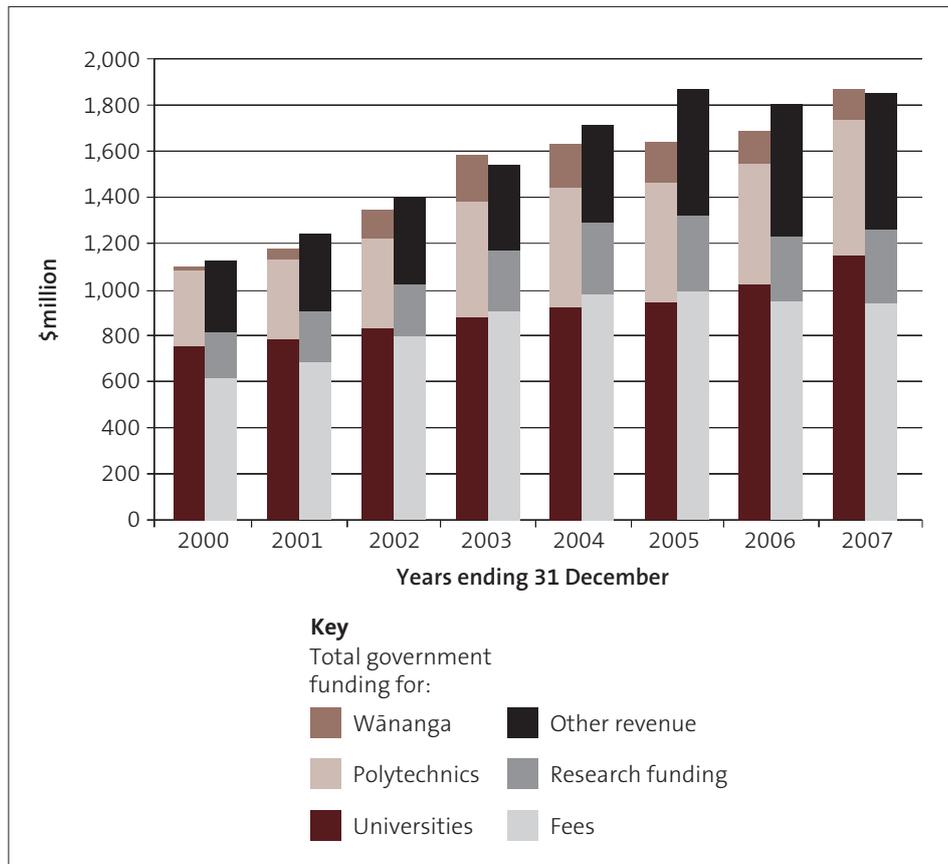
As well as the main bulk-funding arrangements, the Government operates a number of other funds (some of which are allocated through Investment Plans).

* It is also allocated to many private training establishments and other tertiary education providers.

TEI revenue sources

- 6.21 Government funding represents a significant amount of the total funding for TEIs. The actual amount of government funding has increased significantly between 2000 and 2007, although its proportion of the total amount of TEI operating revenue has remained stable at around 50% during that time.
- 6.22 TEIs also receive revenue from sources other than the Government – mainly student fees and income from research. Figure 17 shows the relative split of funding for the TEI sector against each of the main revenue sources (fees, research funding, and other revenue) for 2000 to 2007. It also shows that, while the bulk of tertiary funding goes to universities, followed by polytechnics and then wānanga, there has been some change in the proportions since 2000.

Figure 17
 Funding for the tertiary education institution sector by revenue source, from 2000 to 2007



Summary of tertiary education institutions' 2007 financial performance

6.23 TEIs are required to keep proper accounting records and prepare annual financial statements. Figure 18 summarises the financial performance of the 31 TEIs for the year ended 31 December 2007.

Figure 18
Summary of tertiary education institutions' financial performance for 2007

Tertiary education institutions	Total operating revenue \$m	Total operating expenditure \$m	Surplus/ (Deficit) \$m	
Universities	Auckland University of Technology	222.4	217.4	5.1
	Lincoln University	82.9	84.3	2.8
	Massey University	379.2	370.2	9.1
	University of Auckland	740.8	718.4	22.6
	University of Canterbury	257.5	244.8	14.0
	University of Otago	491.0	458.8	32.1
	University of Waikato	183.7	183.7	0.0
	Victoria University of Wellington	289.4	272.7	16.7
Institutes of Technology and Polytechnics	Aoraki Polytechnic	23.9	22.2	1.6
	Bay of Plenty Polytechnic	33.5	32.8	0.7
	Christchurch Polytechnic Institute of Technology	78.9	72.5	6.4
	Eastern Institute of Technology Hawke's Bay	33.1	32.3	0.8
	Manukau Institute of Technology	85.9	86.9	(1.1)
	Nelson Marlborough Institute of Technology	29.5	29.3	0.2
	Northland Polytechnic	31.2	32.7	(1.5)
	Otago Polytechnic	49.7	49.7	0.1
	Southern Institute of Technology	45.1	39.8	5.3
	Tai Poutini Polytechnic	27.8	27.3	0.5
	Tairāwhiti Polytechnic	21.4	19.9	(0.6)
	Telford Rural Polytechnic	11.5	9.3	2.2
	The Open Polytechnic of New Zealand	58.9	56.4	2.4
	Unitec Institute of Technology	117.9	115.3	2.6
	Universal College of Learning (UCOL)	52.0	49.6	0.1
	Waiariki Institute of Technology	32.2	31.1	1.1
	Waikato Institute of Technology	65.5	66.0	(0.5)
	Wellington Institute of Technology	47.8	45.4	2.0
Western Institute of Technology at Taranaki	21.2	23.8	(3.7)	
Whitireia Community Polytechnic	43.9	43.7	0.1	
Wānanga	Te Wānanga o Aotearoa Te Kuratini o Ngā Waka	119.8	114.3	5.4
	Te Wānanga o Raukawa	18.6	17.8	0.8
	Te Whare Wānanga o Awanuiārangi	16.9	18.3	(1.5)
Totals	3,713.0	3,586.7	125.9	

Source: Education Counts website (www.educationcounts.govt.nz).

Note: The surplus/(deficit) figures also take account of abnormal items. Some totals may not add due to rounding.

Tertiary education institutions' audit results for 2007

- 6.24 The Auditor-General is the auditor of all 31 TEIs, and each of their public entity subsidiaries. He carries out the annual audit of TEIs' financial statements, accounts, and other information that each of the 31 TEIs is required to have audited. The Auditor-General's practice is to appoint auditors to conduct annual audits on his behalf.
- 6.25 In an annual audit, the auditor:
- examines an entity's financial statements, performance information, and other information that must be audited (statement of service performance);
 - assesses the results of that examination against a recognised framework (usually generally accepted accounting practice); and
 - forms and reports an audit opinion.
- 6.26 The audit involves gathering all the information and explanations needed to obtain reasonable assurance that the financial statements and other information do not have material misstatements caused by fraud or error. The auditor also evaluates the overall adequacy of the presentation of information.
- 6.27 We issue audit opinions for each TEI (usually referred to as "the parent accounts"), for each TEI subsidiary that is also a public entity, and for the combined entities that represent the TEI group (usually referred to as "the group accounts").

Audit opinions for the year ended 31 December 2007

- 6.28 We issued unqualified audit opinions for all of the 31 TEIs in 2007. This means that the financial statements that we audited complied with generally accepted accounting practice, and fairly reflected each TEI's financial position and the results of its operations and cash flows for the year ended 31 December 2007. These audit opinions also mean that readers of the TEIs' accounts can be confident that the performance information reported by the TEIs fairly reflects their service performance achievements, as measured against the performance targets adopted for the year ended 31 December 2007.
- 6.29 We issued a number of non-standard audit reports in the broader TEI sector, either on group accounts or on the financial statements of subsidiary entities. Part 4 discusses the detail of these opinions.

Areas of focus in the 2007 annual audit

- 6.30 Each year, we highlight particular areas of focus for each annual audit. For the 2007 annual audit of TEIs, the areas of focus were procurement policies and capital asset management.

Procurement policies

- 6.31 Procurement covers all the business processes associated with purchasing, spanning the whole cycle from identifying needs through to the end of a service contract or the end of the useful life and subsequent disposal of an asset. We expect TEIs to follow good practice when procuring goods or services.
- 6.32 The Government expects public entities to conduct their procurement having regard to:
- the policy principles set out in the Ministry of Economic Development's *Government Procurement in New Zealand, a Policy Guide for Purchasers*;
 - the Auditor-General's June 2008 good practice guide, *Procurement guidance for public entities*; and
 - the Auditor-General's June 2006 good practice guide, *Principles to underpin management by public entities of funding to non-government organisations*.
- 6.33 We asked our auditors to check whether TEIs had policies applicable to their procurement activities, and whether the policies included, at a high level:
- the principles of procurement;
 - the legal and ethical aspects of procurement;
 - the management of risks around procurement; and
 - guidance on procurement planning and processes.
- 6.34 Overall, we were disappointed with the quality of the procurement policies we examined in the TEI sector. There was a broad range of findings. A few TEIs had no procurement policy, while we assessed a number of other TEIs as having poor procurement policies or policies that needed improvement. We reported the findings of this work to TEI Councils in the management letters that accompany our audit opinion.
- 6.35 As part of the 2008 audit, we have asked our auditors to follow up on the extent to which TEIs have addressed the 2007 audit findings and recommendations about procurement. The results of this 2008 audit work will be reported to TEI Councils, TEI management, and us.
- 6.36 We have not yet examined the procurement practices of TEIs. Procurement practice may be an area of audit focus in future years.

Capital asset management

- 6.37 Capital asset management is the process of achieving optimal whole-of-life effectiveness of assets at minimum cost. Where asset management is, or should be, a significant part of an entity's activities, the asset management process should be an important part of the entity's decision-making and management

control environment. The asset information, including depreciation, reported in the financial statements should also be aligned with the underlying information in the asset management plan.

- 6.38 Since 2006, the Treasury has been leading a programme of work around capital asset management in the central government sector. The Commission is leading a set of initiatives in the TEI sector that is aligned to the Treasury's capital asset management agenda. These initiatives are designed to ensure more efficient and effective management of capital assets by TEIs, and a more strategic capital investment in tertiary education by the Government.
- 6.39 Given the size of the collective asset base of the TEI sector (about \$7 billion), the Auditor-General expects TEIs to have an integrated asset management plan in place. As part of the 2007 annual audit, we asked our auditors to determine the extent to which TEIs had an up-to-date integrated asset management plan in place.
- 6.40 Some TEIs had plans for managing their capital assets. Generally, however, these plans did not meet our definition of an integrated asset management plan. Very few TEIs had what we could describe as an integrated asset management plan. This was disappointing, given the value of capital assets that many TEIs manage.
- 6.41 As part of the 2008 audit, we have asked our auditors to follow up on the extent to which our findings and recommendations from the 2007 audit about capital asset management have been addressed. The results of this 2008 audit work will be reported to TEI Councils, TEI management, and us.

Part 7

The status of Māori Trust Board audits

- 7.1 We have previously expressed concerns to Parliament about the audit and accountability arrangements for those Māori Trust Boards (MTBs) governed by the provisions of the Māori Trust Boards Act 1955 (the Act).¹ The legislative framework for the MTB sector has remained largely unchanged during the last 15 years.
- 7.2 The previous Government was considering policy proposals that would have addressed many of the matters we have raised in previous reports to Parliament about the audit and accountability framework for MTBs. Until these policy proposals are reconsidered by the current Government, the Auditor-General will remain the auditor of all MTBs.
- 7.3 This article outlines the status of audits in the MTB sector as at 9 April 2009.

What is the Māori Trust Board sector?

- 7.4 MTBs have functions under section 24 of the Act to manage tribal assets for the general benefit of their beneficiaries. They are able to provide money for the benefit or advancement of their beneficiaries and to apply money towards the promotion of health, social and economic welfare, and education and vocational training.
- 7.5 Section 2 of the Act defines a beneficiary as any person for whose benefit the assets of an MTB are administered under the Act. Part 1 of the Act further defines who constitutes a beneficiary for each of the MTBs governed by the Act. Each definition is slightly different. Generally speaking though, MTB beneficiaries are those persons who have genealogical links to the tribe(s) that the MTB represents.
- 7.6 There has been a gradual reduction in the number of MTBs – from 19 in 1993 to 15 in 2009. The 15 MTBs that were subject to the Act for all or part of the 2007/08 audit period were:
- Aorangi;
 - Hauraki;
 - Maniapoto;
 - Ngāti Whātua ki Orakei;
 - Taranaki;
 - Tauranga-Moana;
 - Te Aupōuri;
 - Te Tai Tokerau;
 - Te Rūnanga o Ngāti Porou;

¹ Reports of the Controller and Auditor-General, *First Report for 1993*, pages 23-26; *First Report for 1995*, pages 99-125; *Second Report for 1998*, pages 57-75; *Central government: Results of the 2005/06 audits*, pages 77-84; and *Central government: Results of the 2006/07 audits*, pages 61-63.

- Te Rūnanga o Ngāti Whātua;
- Tūhoe-Waikaremoana;
- Tūwharetoa;
- Wairoa-Waikaremoana;
- Whakatōhea; and
- Whanganui River.

7.7 These MTBs are public entities under the Public Audit Act 2001, and are therefore audited by the Auditor-General.²

What are the audit arrangements for Māori Trust Boards?

7.8 The Act requires MTBs to prepare annual statements that set out their financial position and financial operations at the end of each financial year. These must be audited by the Auditor-General, who in turn forwards copies of the financial statements and audit report to the Minister of Māori Affairs.³

7.9 The Act does not specify a deadline for providing accounts for audit and completing the annual audit. However, the Auditor-General requests that his auditors complete the annual audit on his behalf within five months of the balance date. Since most MTBs have a balance date of 30 June, this means that their audits are due to be completed by 30 November each year. The audits for the four MTBs with a 31 March balance date are due to be completed by 31 August each year. We regard audits not completed within five months of the balance date as being in arrears.

What is the status of Māori Trust Boards' audits?

7.10 In each of our previous reports to Parliament, we have expressed concern about the timeliness of MTBs' preparation of their financial statements, and how this detracts from the purpose of having audited financial statements. As at 9 April 2009, our audit of financial statements for the 2007/08 year had been completed for only three MTBs – Te Rūnanga O Ngāti Porou, Ngāti Whātua o Orakei, and Wairoa-Waikaremoana. The 2007/08 financial statements had been received for audit from five other MTBs.

7.11 Of the 12 MTBs that had their 2007/08 audit in arrears, eight of them also had audits for earlier years still in arrears. Two MTBs have yet to have an audit opinion issued for the 2003/04 financial year. However, we have received the financial statements for these outstanding 2003/04 audits.

² The Auditor-General is not the statutory auditor of any MTB subsidiary entities. However, he has accepted audit appointment requests for a number of MTB subsidiary entities under section 19 of the Public Audit Act 2001.

³ Section 31 of the Act.

- 7.12 Similarly, progress is being made to bring the audits of other years up to date. We have received financial statements for the three outstanding 2004/05 audits, four of the five outstanding 2005/06 audits, and five of the eight outstanding 2006/07 audits.
- 7.13 Figure 19 shows the total number of audits in arrears, by year.

Figure 19
Status of Māori Trust Board audits as at 9 April 2009

Audit status	2004	2005	2006	2007	2008
Number of MTBs in audit portfolio	17	16	16	15	15
Number of audits completed	15	13	11	7	3
Number of audits in arrears (that is, not completed within five months of balance date)	2	3*	5	8	12

* For Te Rūnanga o Ngāti Whātua, the Board opinion has been issued for 2005, but the Group opinion is still outstanding. We consider, on balance, that it is more accurate to classify that year's audit as in arrears.

- 7.14 The reasons for the audits being in arrears include:
- delays by MTBs or their accountants in producing financial statements for audit;
 - delays by MTBs or their accountants in making the necessary amendments after initial audit work has been completed;
 - delays in completing MTB subsidiary audits that are needed for Group consolidation purposes (as noted in footnote 2, the Auditor-General is not the statutory auditor of MTB subsidiary entities);
 - difficulty in resolving technical accounting and auditing issues, such as the valuation of assets; and
 - competing demands on audit resources when the initial time frames set to complete the audit are not met because of the reasons outlined above.

Are the audit arrangements for Māori Trust Boards appropriate?

- 7.15 In our view, there are a number of shortcomings in the current accountability framework for MTBs. It does not adequately encompass the usual characteristics of modern accountability frameworks, nor does it reflect the current operating environment for MTBs.
- 7.16 As a general principle, we consider that a trust's beneficiaries and its trustees should have a direct accountability relationship. Such an arrangement enables

beneficiaries to hold trustees to account for their performance. As we have reported in previous years, we believe that Parliament and policymakers could usefully consider how this general principle could underpin any reform of the Act.

- 7.17 We also consider that any review of the Act should examine the appropriateness of the audit arrangements. At the same time, the legislation could clarify MTBs' requirements to prepare financial statements that comply with generally accepted accounting practice. This is not explicit in the Act. However, it is a requirement that we impose on MTBs because our audits must comply with the professional auditing standards set by both the New Zealand Institute of Chartered Accountants and the Auditor-General. Setting a statutory time frame within which an audit must be completed would also be desirable.
- 7.18 We understand that the previous Government was considering policy proposals to address these issues before the November 2008 General Election.

Conclusion

- 7.19 Although the number of MTBs governed by the Act has been gradually reducing, this is a slow process. In our view, the accountability framework needs to be changed so that it meets modern standards for holding governing bodies to account for their performance and stewardship of an entity's operations. We again recommend that the new Minister of Māori Affairs and Te Puni Kōkiri give urgent attention to some legislative reform.

Part 8

Statements of Intent and our intentions with performance information

- 8.1 In this Part, we describe the work we carried out in the last year to report on and improve the quality of service performance information.¹ As in 2006/07,² our work included reviewing the forecast performance information for government departments and selected Crown entities.
- 8.2 We also describe our intended work on performance information in 2009/10. For example, we intend to assess performance information and associated systems and controls in the 2008/09 audits and report our assessments to Ministers and select committees.

Background

- 8.3 Non-financial performance reports³ are essential for ensuring that government departments and Crown entities are held accountable to Parliament and the public. In 2008, the Auditor-General reported that, in his view, the overall poor quality of performance reporting by public entities is disappointing and needs to improve significantly.⁴ Improving the quality of information about the performance of public entities should help the public sector to demonstrate its accountability and to continuously improve its effectiveness.
- 8.4 In his 2008 report, the Auditor-General outlined his view of the issues that contribute to the poor quality of performance reporting and the reasons that the public accountability framework is not promoting improved reporting. These included:
- There are no reporting standards in New Zealand for non-financial performance reports. Therefore, every entity needs to prepare and customise its own framework and the elements (primarily outcomes and outputs) within that framework.
 - There is no clear responsibility for professional leadership and oversight. Many parties have an interest in preparing and using performance reports.
 - Relationships between outcomes and outputs are often not predictable or understood. These relationships and expectations change over time, with a range of circumstances and events influencing performance.

1 Service performance information provides primarily non-financial information that records the output delivery performance of a public entity against specified objectives. This information is usually shown in statements of service performance (or equivalent reports) and is compared with information contained in forecast non-financial performance reports. For ease of reading, we use the term "performance information".

2 See *Central government: Results of the 2006/07 audits* for the results of our 2006/07 review.

3 Non-financial performance reports provide primarily non-financial information that records the performance of a public entity against specified objectives. They can encompass a comprehensive range of performance elements (including outcomes, outputs, inputs, and capability), and the information can be presented in various statements.

4 See *The Auditor-General's observations on the quality of performance reporting*.

- Senior managers and governors do not always give external performance reports the attention they merit. Reports are not always aligned to the information governors and managers use to plan and monitor performance. If a public entity does not have a system for collecting and monitoring the range of information used for internal day-to-day management and governance, governors and managers cannot be confident that they are fulfilling their responsibilities.

8.5 The Auditor-General's report concluded that, in his view, improving performance reporting will require deeper, more sustained, and focused attention. This attention should include:

- the Treasury – in consultation with entities with monitoring responsibilities and others with an interest in public sector management – facilitating the preparation of public sector standards for reporting, including considering how such standards are applied and maintained;
- identifying clearer responsibilities among central agencies, entities with monitoring responsibilities, and others interested in public sector management for co-ordination, leadership, and accountability for preparing and improving performance reporting within the public sector;
- central agencies and those with monitoring responsibilities giving consistent messages about the elements of performance reporting and their application, and considering whole-of-government and sector-level needs for information about outcomes, including how these can be identified, co-ordinated, collected, and reported; and
- public entities considering the identifiable users of external performance reports and their needs, so that public sector accountability regimes can better accommodate both internal and external uses of reported information.

Reviews of Statements of Intent

8.6 Since 2005, our reports on the results of central government audits have noted that the quality of government departments' Statements of Intent (SOIs)⁵ varies. We have seen only a small improvement in the overall quality of SOIs since 2004/05.

8.7 We have similar concerns about the quality of Crown entities' information and the lack of clear improvement in the information during 2006-08. However, many Crown entities were required to prepare SOIs under the Crown Entities Act 2004 for the first time in 2006/07. These entities will have been going through a learning process.

8.8 In our report on the results of the 2006/07 audits, we advised that we had decided not to assign grades for the performance aspect within our reporting to Ministers

⁵ As a result of the Review of Accountability Documents for government departments in 2008, this information was contained in the 2008-11 Statements of Intent and the Budget 2008 Information Supporting the Estimates.

and select committees on the 2007/08 annual audits.⁶ This was the second year in which we did not assign grades on the performance aspect in our reporting. We decided not to assign grades because:

- The results from our 2007/08 reviews of SOIs indicated that entities still had to carry out considerable development work.
- We were reviewing and updating our audit methodology and standards for statement of service performance (SSP) information to ensure that these take account of changes in statutory requirements and other guidance.
- The structural and non-structural changes arising from the Treasury's Review of Accountability Documents (ROADs) would require additional effort to adjust the presentation of information, particularly for government departments. Therefore, we anticipated that non-structural changes would not receive the level of effort that, in our view, is needed to achieve the improvements.

8.9 The purpose of our reviews, which we carried out for entities' 2007-10⁷ and 2008-11 SOIs, was to suggest to entities how they could improve their forecast non-financial performance information in future. We commented in our reports to Ministers and select committees on the issues we identified and on the ways our auditors considered performance information should improve. We aligned our expectations on these matters with legislation and the guidance and instructions from the State Services Commission (SSC) and the Treasury.

Overall conclusions from our reviews

8.10 In 2007/08, we reviewed in depth 125 of the 127 SOIs that government departments and Crown entities are required to prepare, where the Auditor-General is required to attest to the SSP in the entity's annual audit report. Two entities had either not prepared an SOI or had not gained Ministerial approval for their SOI at the time this article was prepared. Of the SOIs we reviewed, 30% were for government departments.

8.11 Our overall findings are similar to those in our report on the results of the 2006/07 audits. Again:

- Many entities' performance information did not, in our view, set out coherent performance frameworks showing logical links from the information about the medium-term outcomes sought by the entity to the annual outputs (goods and services) delivered by the entity.
- Many SOIs did not have well-specified, relevant performance measures and standards for both the medium-term and SSP information.

⁶ *Central government: Results of the 2006/07 audits*, page 41.

⁷ We reported the results of these reviews in *Central government: Results of the 2006/07 audits*, page 41.

- In many instances, there was a lack of robust, best estimate-based standards combined with historical or benchmark information that gives context to the anticipated achievement.

- 8.12 In our view, performance information should reflect good management practice. It should clearly articulate strategy, link that strategy to operational and other business plans, and be used to monitor the delivery of operational and business planning, and to evaluate the strategy's effects.
- 8.13 We have now provided detailed feedback on most government departments' and Crown entities' SOIs for two years. In our view, this timeframe should have provided a reasonable opportunity for entities to improve their reporting. We will begin grading and reporting on the quality of performance information in the SOIs during the 2008/09 audits.

Our detailed findings on the 2008-11 Statements of Intent

- 8.14 Our overall conclusion is that the quality of SOIs has not improved between our reviews of the 2007-10 SOIs and the 2008-11 SOIs. Although there appears to have been deterioration in some areas we assessed, undue emphasis should not be placed on our detailed findings, as performance information is by its nature more subjective than financial information.
- 8.15 For the 2007-10 SOIs, we were developing our audit methodology and standards. For the 2008-11 SOIs, we were more experienced in assessing the information. We also anticipated that entities would have reviewed our suggestions for improvement on their 2007-10 performance information and incorporated them into their 2008-11 SOIs.
- 8.16 With the significant ROADS changes being largely implemented as part of the 2008 Budget, the SSC and the Treasury are moving their emphasis to the quality of performance information. Our three agencies are now working on a broader and long-term programme to improve the quality of this information. As a result, we expect to see evidence of improvement in the 2009-12 SOIs.
- 8.17 There are a handful of areas within our reviews in which the results for Crown entities are more positive than those for government departments. Our assessments may reflect that some government departments have a range of roles and outputs, and may not have a single organisational purpose (by contrast with many Crown entities). This makes a coherent and simple account of their performance intentions more difficult to prepare. ROADS may also have affected the 2008-11 SOIs and led to government departments deferring improvements they may have been planning to make. The Treasury has completed a review of

the implementation of ROADs as part of the 2008 Budget Reviews and has issued guidance for the 2009 Budget, including guidance for 2009-12 SOIs. The guidance includes addressing problems in preparing information that were identified through the implementation review.

- 8.18 Figure 20 sets out our expectations and our assessment of the 2008-11 SOIs we reviewed, and compares these results with those from our reviews of the 2007-10 SOIs.

Figure 20
Our assessment of the 2008-11 Statements of Intent we reviewed

Our expectations	Assessment of 2008-11 SOIs	Assessment of 2007-10 SOIs
Medium-term component of the SOI		
Clearly identified outcomes, which provide context for the entity’s role and functions.	About 25% of SOIs had shortcomings in specification of outcomes. Shortcomings varied from the complete absence of outcome information, to information that was difficult to locate or identify, to the substitution of outcome information with internal organisational goals, and to an absence of clarity about the societal change sought.	Over 15% of SOIs had shortcomings in specification of outcomes.
Main measures and standards for outcomes, objectives, or impacts are clearly specified, cover a period of three years, and provide baseline data that places measures and standards in a more meaningful context and allows progress to be tracked.	Nearly 70% of SOIs had missing or unclear main measures or deficiencies in the specification of standards for their main measures. For about 40% of SOIs, we had concerns about the strength or the logic of the relationship between the main measures and standards and what they were intended to measure. As in 2007, many SOIs would benefit by adding baseline data about current state information. In particular, baseline data about the current state of outcomes and intended impacts of outputs is required to allow progress to be tracked over time and achievement evaluated.	Nearly a third of the SOIs had missing or unclear main measures, and another third needed to improve their main measures (in total nearly 70%). Many SOIs would benefit by adding baseline data about the current state of outcomes, objectives, or impacts, and their associated measures.

Our expectations	Assessment of 2008-11 SOIs	Assessment of 2007-10 SOIs
	<p>There was a small difference in our assessments between SOIs of government departments and Crown entities in this area. We assessed a greater proportion of government departments as having deficiencies in their main measures and standards compared with Crown entities, and as being more likely to have measures and standards that we were not sure measured what they were intended to.</p>	
<p style="text-align: center;">▲</p> <p>Description of the output classes and outputs and how the SSP links to the medium term and makes evident the reasons for the entity's outputs and the focus of its reporting.</p> <p style="text-align: center;">▼</p>	<p>Over 50% of SOIs could improve the structure of the forecast SSP and its links to the medium-term component of the SOI. As in 2007, weaknesses in the links ranged from minor to more significant – for example, from the need to clarify layout or the use of diagrams to more significant issues that made links difficult to assess, such as a lack of discussion about how outputs contributed to outcomes.</p> <p>For government departments, the separation of some outcome and output information into the Information Supporting the Estimates with the remainder of the information remaining in the SOI appeared to have a slight impact. There was a small negative change from our 2007 reviews in our assessments of SOIs for government department in the link between medium-term and annual information.</p>	<p>Over 50% of SOIs could improve the structure of the forecast SSP and its links to the medium-term component of the SOI.</p> <p>Weaknesses in the links ranged from minor to more significant – for example, from the need to clarify layout or the use of diagrams to more significant issues that made links difficult to assess, such as a lack of discussion about how outputs contributed to outcomes.</p>
<p>Forecast SSP</p>		
<p>Logically aggregated output classes and outputs, with clearly specified outputs that focus on external impacts.</p>	<p>We had queries about the basis for the identification and aggregation of output classes, and noted that outputs were missing, incomplete, or not well specified, to a varying degree, for nearly 30% of SOIs.</p> <p>We assessed a greater proportion of Crown entities as having deficiencies in their output aggregation compared with government departments.</p>	<p>We had queries about the basis for the identification and aggregation of output classes, and noted that outputs were missing, incomplete, or not well specified, to a varying degree, for nearly 40% of SOIs.</p>

Our expectations	Assessment of 2008-11 SOIs	Assessment of 2007-10 SOIs
	While not specifically included within our reviews, we also noted instances where Crown entities' financial information was not presented using the same groupings as that for performance information or where the expenditure presented in performance information did not total to the expenditure in the financial forecasts.	
Clearly specified performance measures and standards that are relevant and balanced, and provide baseline data that places measures and standards in a meaningful context and allows progress to be tracked.	<p>About 75% of the forecast SSPs had shortcomings in the range and coverage of performance measures and the specification of standards.</p> <p>As in 2007, measures of output quality, in particular, need enhancing. Many SOIs would benefit from the addition of baseline data about current and recent achievements for output delivery.</p> <p>We assessed a greater proportion of government departments as having output measures and standards that we were not sure were relevant to or measured the output identified.</p>	<p>About 60% of the forecast SSPs had shortcomings in the range and coverage of performance measures and the specification of standards.</p> <p>Measures of output quality, in particular, need enhancing.</p> <p>Many SOIs would benefit from the addition of baseline data about current and recent achievement for output delivery.</p>

Our intended work on performance information in 2009/10

- 8.19 Because of our concerns about the current quality of performance information, we have been reviewing and updating our own audit methodology and standards for performance information. Currently, auditors verify the accuracy of entities' SSP information against the forecast statements.
- 8.20 In December 2008, we issued a consultation draft of the Auditor-General's revised auditing standard on performance information (AG-4),⁸ which is available on our website – www.oag.govt.nz. We expect to adopt the revised AG-4 in mid-2009. It will require auditors to report on whether the performance information:
- provides an adequate basis for the assessment of performance; and
 - fairly reflects the entity's performance.

8 The revised AG-4 is intended to apply to those local authorities, government departments, and Crown entities required to prepare an SOI and SSP under sections 139 and 150 of the Crown Entities Act 2004. This excludes the audit of performance reports of other Crown entities (such as tertiary education institutions and those Crown entities required to prepare and report against a statement of corporate intent) whose performance reporting requirements are governed by other legislation.

- 8.21 Our revised AG-4 will be phased into our audit reporting. First we will assign grades for performance information and associated systems and controls in the reports to Ministers and select committees. This is intended to allow the entities and our auditors to prepare and adjust before the revised AG-4 is applied to our audit opinions. Therefore, we intend to:
- assign grades for performance information and associated systems and controls that will include our assessment of the quality of the forecast SOIs under our revised standard beginning with the reports on the 2008/09 and 2009/10 audits; and
 - apply the revised standard to 2010/11 audit opinions.
- 8.22 Ongoing improvement in performance information will require an environment of clear and consistent policy objectives, strong central co-ordination and direction, well-established good management practices, and unwavering willingness to be accountable for results. We expect our intended work on performance information during 2009/10 and beyond, including our work toward greater co-operation and consistency with the Treasury and the SSC, to help provide this environment.

Part 9

Procurement audit work and inquiries

- 9.1 This Part outlines the findings of our 2007/08 annual audit work on procurement policies and practices in government departments, Crown entities, State-owned enterprises (SOEs), and Crown Research Institutes (CRIs). We also summarise the findings of some procurement-related inquiries we carried out in 2007/08.
- 9.2 We report on the procurement of district health boards (DHBs) in Part 5 and tertiary education institutions (TEIs) in Part 6 of this report.

Background

- 9.3 Procurement is all the business processes associated with purchasing goods and services – from identifying needs to the end of a service contract or the end of the useful life of goods and resulting disposal of an asset.
- 9.4 Procurement is a major activity in the public sector. Many public services are achieved through, or with the support of, contracted suppliers of goods and services. Although the values of individual contracts vary widely, many involve large amounts of money.
- 9.5 It is important that public entities have effective procurement policies, procedures, and practices in place. This ensures that public entities achieve best value for money from their procurement, while maintaining probity and public confidence.

Our recent work on funding and procurement

- 9.6 Because procurement is critical for public entities to be effective and efficient, it has been a focus of the Auditor-General's work programme in recent years. In June 2008, we produced two good practice guides on procurement, which are available on our website (www.oag.govt.nz):
- *Public Sector purchases, grants, and gifts: Managing funding arrangements with external parties* is an overarching guide to help public entities select the appropriate funding arrangement and determine the appropriate expectations that apply to the arrangement.
 - *Procurement guidance for public entities* discusses in more detail our expectations for how public entities should plan and manage arrangements to purchase goods or services.
- 9.7 In recent years, we have completed several performance audits on grant programmes.¹ We produced a good practice guide² and a report on a performance

1 For example, *New Zealand Trade and Enterprise: Administration of grant programmes* (2004) and *Te Puni Kōkiri: Administration of grant programmes* (2007). For the full range of reports on funding and grant programmes, visit our website – www.oag.govt.nz.

2 *Principles to underpin management by public entities of funding to non-government organisations* (2006).

audit on funding arrangements with non-government organisations.³ These reports are available on our website.

- 9.8 We have also increased our focus on procurement policies and practices in our annual audit and assurance work. As part of the 2006/07 annual audits, we asked the auditors of government departments, SOEs, Crown entities, and some other entities to review the entities' procurement policies and practices, and to report any concerns.
- 9.9 Based on this work, we concluded that there was considerable room for entities to improve their procurement policies and practices. Most entities had policies and procedures in place. The entities had clearly based their policies on the core principles of value for money, fairness, and openness. However, more than half of the policies needed some improvement. We reported the results of this work in *Central government: Results of the 2006/07 audits*.⁴
- 9.10 Because of our concerns about these findings, and our continuing interest in procurement, we decided to carry out further work on procurement as part of the 2007/08 annual audits.

Annual audit work on procurement

- 9.11 As part of the 2007/08 annual audit, we asked our auditors to check whether public entities had procurement policies that were appropriate for their activities. We also asked our auditors to check whether the policies took into account the expectations in:
- the policy principles set out in *Government Procurement in New Zealand, a Policy Guide for Purchasers* by the Ministry of Economic Development;⁵
 - the *Mandatory Rules for Procurement by Departments* endorsed by Cabinet in April 2006, which are compulsory for all government departments, the New Zealand Police, and the New Zealand Defence Force (other public sector agencies are encouraged to apply the rules as appropriate);⁶ and
 - the Auditor-General's good practice guides.
- 9.12 Public entities' procurement policies should cover:
- the principles of procurement;
 - the legal and ethical aspects of procurement;
 - managing procurement risks; and
 - guidance on procurement planning and processes.

³ *Managing funding to non-government organisations – from principles to practice* (2008).

⁴ See "Part 4: Procurement, grants, and other funding arrangements", pages 33-40.

⁵ See www.med.govt.nz.

⁶ The rules are available at www.med.govt.nz.

- 9.13 For some government departments, procurement is particularly significant to the department's activities. In these cases, we asked the auditor to carry out more in-depth assurance work on procurement practice. We also asked our auditors of DHBs to carry out more in-depth work (see Part 5). Factors that indicate whether procurement is particularly significant include:
- the degree to which the department procures its core areas of service delivery and production of outputs;
 - the size and complexity of procurement decisions;
 - the economic value of procurements;
 - the duration of contracts; and
 - the size of the department.
- 9.14 We asked the auditors to report any deficiencies in public entities' procurement policies and practices to the public entity and to us.

Key findings on procurement policies and practices

Procurement policies

- 9.15 About 61% of government departments, SOEs, Crown entities, and CRIs had procurement policies that were appropriate for the size and nature of the entity, and met good practice.
- 9.16 Our auditors made recommendations for improving the procurement policies for most of the remaining entities. The recommendations ranged from fairly minor – such as including the next date to review the policy – to the need for an organisation to draft and implement a procurement policy.
- 9.17 The auditors recommended to about 13% of the entities that they improve their procurement policies to reflect the Auditor-General's 2008 good practice guide. This guide highlights two parts of procurement: strategic procurement planning, and sustainability in procurement. Public entities need to consider these to keep their policies in line with recent changes in procurement practice. In other cases, the reason to update the policy was to ensure that there was a clear overall objective for procurement, and a set of overarching principles to guide the process.
- 9.18 The most common criticism was that the procurement policies did not cover all the aspects of procurement that reflect good practice. Notable areas for improvement included:
- the principles of procurement, legal and ethical aspects of procurement, risk management, and guidance on procurement planning and processes;
 - administration costs;
 - the receipt, security, opening, and reporting of tenders;

- when a closed tender or proposal may be used;
- a clear policy statement on the entity's relationship with the market to plan market effects into the procurement process;
- specific guidance on the principle of confidentiality; and
- cross-references to other related policies.

9.19 About 8% of entities that we reviewed had not implemented a procurement policy at the time of the 2007/08 annual audit. For Crown entities, this increased to 11%. Our 2007/08 audit work on TEIs (see Part 6 of this report) found that a few TEIs also had no procurement policy in place.

9.20 For most entities that do not yet have procurement policies in place, procurement is not a significant activity. However, we still expect these entities to draft and implement procurement policies and procedures that reflect the value and risk of their procurement practices. These policies and procedures need to be appropriate to public entities' business objectives and operations. A procurement policy should help a public entity to meet ethical standards and act with integrity when procuring goods or services. We have recommended to most of these entities that they implement a procurement policy.

Procurement practice

9.21 Our most common concern about procurement practice in the public entities we reviewed was a lack of documentation of the procurement process. For example, the auditor of a relatively large public entity commented that:

... there is generally poor documentation covering the planning, management, evaluation, and review activities. ... There did not seem to be the most basic items of procurement documentation provided.

9.22 The documentation for procurement processes was not always consistent or easily retrievable, and the approval for the procurement was not always filed.

9.23 Poor documentation of a procurement process could put an organisation at risk if there were legal or other challenges. Poor documentation often makes it more difficult for an organisation to account for its activities if questions arise. Also, the Public Records Act 2005 requires public entities to maintain full and accurate records in keeping with normal, prudent business practice.

9.24 The value and risk of the procurement will determine the nature and amount of documentation that is desirable. However, a public entity should always keep adequate records to:

- show that it followed appropriate processes;
- show that it identified and appropriately managed any potential conflicts of interest;

- respond to queries from unsuccessful suppliers;
- record the outcome of meetings during the procurement process;
- provide evidence of its activities and decision-making for accountability and audit purposes; and
- plan any subsequent procurement.

9.25 Our review of procurement practices also found that public entities were often not consistently applying procurement policies. In one case, the scope of business and project planning varied between different procurement activities without any rational process to determine what was appropriate. In other cases, the lack of consistency was between different groups within the same entity. Clear processes and accessible guidance can help ensure that the procurement policy is consistently applied and is able to support effective decision-making throughout the organisation.

9.26 Government departments received more recommendations for improving procurement practices than Crown entities, SOEs, and CRIs. Specifically, government departments need to improve their conflicts of interest procedures and maintain entity-wide contract management systems.

9.27 A centralised contract management system allows senior management to monitor the nature, size, and compliance of an entity's contracts. In one case, a department had a well-structured contracts register, but was not collecting data so that it could monitor procurement entity-wide. This restricted the department's ability to take a more strategic approach to procurement.

9.28 About 9% of government departments, SOEs, Crown entities, and CRIs need to improve staff training and experience in procurement. In some cases, staff did not know that procurement policies existed or where to find them. Staff training in procurement is a critical part of implementing a procurement policy. Increased staff awareness of good procurement practices can lead to improved quality in procurement activities.

Improvement in procurement policies

9.29 During 2007/08, more government departments had improved their procurement policies than any other group of public entities we reviewed. About 23% of government departments had improved their procurement policies since 2006/07. These results are pleasing. Our review of procurement policies and practices in DHBs also identified pleasing improvements (see Part 5).

9.30 However, we are concerned that two public entities had not improved their procurement policies despite our recommendations for improvement during

2006/07. We have raised this with the management of these entities, and reported to the relevant Ministers and select committees. We have made further recommendations for improvement and will follow up on them in the 2008/09 annual audit. We expect to see improvements in the coming year.

Procurement matters raised in inquiries

- 9.31 We regularly receive requests for inquiries into the procurement processes and decisions of public entities. Often the request comes from a tenderer who is disappointed with the outcome of the process. We do not formally inquire into all such matters. Our usual approach is to briefly review the process that the entity followed to decide whether we see any need to carry out an inquiry. We are more likely to carry out an inquiry if our initial review suggests that there may be systemic problems with the entity's practices than in cases where we identify an isolated concern.
- 9.32 If we decide to inquire into a procurement issue, we will look at the process the public entity followed but not the merits of the decision. It is not our role to second-guess whether an entity made the "right" decision. Our work usually ends when we advise the complainant and the entity of our views on the issues that we examined. However, we may also follow up on the matter during the next annual audit if we have recommended that the entity consider changes to its systems and policies.
- 9.33 During 2007/08, we received 13 requests for inquiries into procurement matters in central and local government, and the health and education sectors. We carried out inquiries into six of these. Most commonly, the requests for an inquiry were about managing conflicts of interest during the procurement process. Sometimes the concerns were based on perceived, rather than actual, conflicts of interest. However, they are a timely reminder to everyone involved in a procurement process to be aware of possible conflicts of interest and to manage them transparently.
- 9.34 We carried out an inquiry into a procurement matter that covered concerns about conflicts of interest and inappropriate practice. A DHB had set out to initiate a joint venture arrangement for service delivery, but this fell through. The DHB proceeded to negotiate new contracts with the current provider. We considered that, at this stage, the DHB should have moved to a competitive tender process. In the health sector, the potential for conflicts of interest is high because of the limited number of experts available. This makes it more likely that these experts will have multiple interests in the sector. In this case, the conflicts of interest of a medical specialist were not well managed. The specialist should not have participated in strategic and decision-making discussions.

- 9.35 Part 10 includes a summary of the results of an inquiry into the Police procurement for stab resistant body armour.

Concluding comments

- 9.36 Overall, we are pleased to see an increase in the number of entities with procurement policies that are appropriate for the size and nature of the entity, and meet good practice. We expect to see entities continuing to improve their policies as they update them to reflect the Auditor-General's 2008 good practice guides. We also expect those entities that do not yet have a procurement policy to implement one.
- 9.37 As updated policies are rolled out, entities should familiarise staff with the principles of procurement, the contents of the policy, the need for complete documentation, and the requirement to consistently apply the policy.
- 9.38 We intend to maintain our level of activity on procurement issues. Procurement policies and practices in the public sector need to improve continuously. The Finance and Expenditure Committee was interested in our work on procurement during the consultation on our 2008/09 work plan. As part of the 2008/09 annual audit, we will follow up with public entities on their progress with implementing our recommendations to improve their procurement policies and practices. We are also considering extending our review of procurement policies and practices to other sectors during future annual audits.
- 9.39 We are also carrying out a performance audit of DHB procurement. This includes examining procurement practices in detail, including funding arrangements with non-government organisations within selected DHBs.
- 9.40 Since the release of our 2008 good practice guides, we have taken the opportunity to promote and explain how to apply the guides to a number of audiences. We will continue to support our good practice guides and our audit work in the coming year.

Part 10

Inquiry requests during 2007/08

- 10.1 During 2007/08, we received about 75 requests for the Auditor-General to investigate the actions of public entities in the central government sector. Nine of these came from members of Parliament. During 2007/08, we completed 78 inquiries, some of which had been carried over from the previous year.
- 10.2 The Auditor-General has a mandate to inquire into a public entity's use of its resources, at his discretion. An inquiry usually involves looking into financial, accountability, governance, or conduct issues.
- 10.3 We do not begin a formal inquiry for every request that we receive, but we consider each request to decide how to proceed appropriately. It might be that the correspondent raises concerns that are not substantive or relevant to the Auditor-General's role, or we might not be the most appropriate authority to consider the issues. On the other hand, we might decide to take the matter further and formally investigate the entity's actions.
- 10.4 In making this decision, we often carry out preliminary enquiries of the auditor and the entity to ensure that we sufficiently understand the background of the issues that have been raised. This preliminary work puts us in a better position to understand the main issues and the extent to which further investigation may be required.
- 10.5 In this Part, we discuss some of the larger inquiries we completed in the central government sector during the year.
- 10.6 In June 2008, we released the terms of reference for an audit and inquiry into a range of integrity concerns arising out of Immigration New Zealand, part of the Department of Labour. This is a substantial piece of work that is ongoing.

Health sector

District health boards

- 10.7 In 2007, the Auditor-General received requests to inquire into the management of contracting activity and conflicts of interest in the Hawke's Bay District Health Board (the Board). We decided not to carry out an inquiry at the time because the Director-General of Health had already announced that an independent review panel would inquire into the same issues. However, we carried out some additional work on procurement and conflict of interest policies and practices in the context of the Board's 2007/08 annual audit. We reported the results of that work to the Board, the Minister of Health, and the Health Committee of the House of Representatives. The Board was taking steps to address the deficiencies we found.

- 10.8 In February 2008, the Minister of Health dismissed the Board and replaced it with a Commissioner and Deputy Commissioner.
- 10.9 The independent review panel released its report on 17 March 2008, and we received further formal requests to carry out an inquiry.
- 10.10 We did not inquire further into past contracting activities and conflicts of interest issues at the Board. Instead, the Auditor-General carried out work in the 2007/08 annual audit, in addition to that already planned on procurement practices for all district health boards (see Part 5 of this report). Again, we reported the results of our work to the Board, the Minister of Health, and the Health Committee of the House of Representatives.
- 10.11 We are also working with the Ministry of Health (the Ministry) as it prepares additional guidance material for district health boards in this area. We continue to promote the guidance and expectations set out in our good practice guides on conflicts of interest and procurement, and our performance audit report completed in 2007 on *Management of conflicts of interest in the three Auckland District Health Boards*.

Ministry of Health

- 10.12 The Auditor-General received some complaints about the Ministry's involvement in problem gambling services.
- 10.13 One complaint was about the Ministry's process and supervision of the providers of these services. In previous annual audit work, we reviewed the systems, policies, and processes that all entities that report to the Government have for funding arrangements with non-government organisations. The goal of this review was to establish how consistent they were with the relevant guidelines of the Treasury and our Office. Contracts for problem gambling services tend to fall into this area, and our review included the Ministry.
- 10.14 At the time, we did not find any significant breaches of the Ministry's policy for such contracts. However, we identified a number of instances where the Ministry could improve the documentation of its monitoring of providers of these services. We maintained a watching brief on the Ministry's progress, but did not consider it necessary to carry out a formal inquiry.
- 10.15 Another complaint was about the Ministry's use of the problem gambling levy funding. We considered:
- whether the Ministry had carried out the required consultation and whether proper Parliamentary authority had been given through the appropriation process;

- the proportion of the departmental costs (departmental output expenses) for the total cost of the problem gambling programme, compared with the proportion of departmental to non-departmental expenses for other new health initiatives over the same period; and
- any variances from the Ministry's budgets (and any reasons for this).

- 10.16 We found that the Ministry's budgets for departmental costs for the problem gambling programme were appropriately consulted about and authorised. The proportion of budgeted departmental costs to overall programme costs were within the range we observed for other health initiatives. The actual departmental expenditure exceeded the budget, and we received satisfactory explanations for the variances from budgets. The Ministry clearly documented actual expenditure on administering the services in most areas. However, the Ministry needed to improve its documentation about public health expenditure on administering the problem gambling programme.
- 10.17 We did not make any formal recommendations to the Ministry. Our follow-up suggests that the Ministry has taken positive steps to address all of our comments.

New Zealand Police

- 10.18 We received a request to review the purchase of stab-resistant body armour by the New Zealand Police (NZ Police). Various concerns were expressed to us, including that the budget had "blown out", that the quality of the body armour appeared to be second grade, that there were mistakes in measurements, and that it was unclear whether the costs disclosed publicly were accurate.
- 10.19 We decided to make some enquires into this matter to establish the facts and our views on the procurement processes that NZ Police had followed.
- 10.20 Our main concern was that NZ Police decided to take its own measurement of staff and provide these measurements to the supplier of the body armour. Under the contract, the supplier could take the measurement for a cost (but with a 99% correct guarantee). If NZ Police used its own measurements, any incorrectly measured vests would be at NZ Police's cost. NZ Police considered the option of having the supplier carry out all measurements, but decided this would be too expensive. The supplier instructed NZ Police on how to correctly measure its staff, but variances in the measurement occurred, and about 2000 new sets of body armour had to be re-ordered because of incorrect measurements. This amounted to about 20% of the total order of body armour.

- 10.21 Correct measurement of officers for the body armour was fundamental to the delivery of the services under the contract. We commented that, in future, NZ Police needs to fully consider the risks when taking on functions under a contract that may be better carried out by the contracted party – particularly where such functions are fundamental to the delivery of services. NZ Police should also ensure that it puts in place appropriate processes to manage such risks.

Funding arrangements for a proposed cuisine school

- 10.22 We were asked to inquire into a proposed international cuisine school for the Wairarapa. The international cuisine school was to be established by the Universal College of Learning (UCOL), as part of a wider Wairarapa Cuisine and Fine Wine (MRI) programme funded by New Zealand Trade and Enterprise (NZTE). Concerns had already been raised with us when UCOL indicated that it would not be proceeding with a cuisine school in the Wairarapa. We carried out extensive preliminary enquiries into this matter, but did not proceed with a formal inquiry.
- 10.23 The business plan for the MRI programme was prepared by Go Wairarapa, which was then the economic development agency for the three Wairarapa district councils. The business plan was prepared after consultation with leaders from the wine and food industries in the Wairarapa and with the support of the three councils. Part of the funding arrangement with NZTE required the three councils to provide \$300,000 towards establishing the infrastructure component of the MRI programme.
- 10.24 Go Wairarapa, and subsequently Grow Wellington, was responsible for administering the MRI contract with NZTE. It subcontracted the cuisine school component to UCOL.
- 10.25 There was no suggestion that the councils' funds were used for purposes other than the purposes for which they were contributed. However, the councils might not have realised that their funding was specifically for the infrastructure component of the MRI programme, and only indirectly for the cuisine school and wine strategy components. Comments from the three councils suggested that the structure of the funding arrangement administered by Go Wairarapa was not clear to them.
- 10.26 UCOL had the authority to decide to change the location of the cuisine school. UCOL was the entity responsible for building the school facilities and obtaining the funding to do so. However, this decision could have been more collaborative. We also noted that there was an "at risk" element to the funding and its success. While the parties intended for there to be a cuisine school operating in the Wairarapa, there was no guarantee that this would be the outcome.

Part 11

Unlawful expenditure by schools – 2009 follow-up

- 11.1 Schools are governed by boards of trustees, made up of members of the local community (usually parents of children attending the school). There are about 2450 schools and 18,000 trustees.
- 11.2 While the board of trustees of each school is a Crown entity in its own right and, as such, has legal obligations, the Ministry of Education (the Ministry) also performs an important role with schools. The Ministry seeks to support good governance and management, develop clear expectations of quality, and provide core infrastructure in the schools sector.¹
- 11.3 The Auditor-General is the statutory auditor of all state schools, and appoints auditors to carry out the audits on his behalf. An important aspect of our audit work is assessing whether public entities, including schools, have complied with the legislation that affects their operations.

The scope of our previous audit work

- 11.4 Since July 2004, we have reported the results of three pieces of audit work on unlawful expenditure in schools. These reports assessed:
- whether payments to school principals for additional duties were lawful and in accordance with any relevant Ministry requirements (our 2004 report);²
 - the extent to which schools complied with the law on a number of financial matters (our 2005 report);³ and
 - the progress the Ministry had made on reducing the incidence of unlawful expenditure since our earlier two reports (our 2007 report).⁴

Our findings

- 11.5 Our 2004 report found examples of unlawful payments to principals made both through the Ministry's central payroll system and locally by schools. We were concerned that boards of trustees were not always complying with their legal obligations and that some principals had received additional remuneration without Ministry approval.
- 11.6 Our 2005 report noted that most schools complied with the law, but that the Ministry needed to take further action to reduce the incidence of non-compliance, particularly by integrated schools where public funds had sometimes been used to provide financial support to private entities.

1 Ministry of Education *Statement of Intent 2004-2009*, (2004).

2 *Central Government: Results of the 2002-03 Audits*, pages 45-65.

3 *Central Government: Results of the 2003-04 Audits*, pages 83-92.

4 *Central government: Results of the 2005/06 audits*, "Part 7: Unlawful expenditure by schools".

- 11.7 Our 2007 report followed up on the Ministry's progress in implementing the recommendations made in our 2004 and 2005 reports. It found that, while the Ministry had taken action on some of the matters raised in our two previous reports, it needed to consider further action to ensure public accountability on the part of school boards for unlawful payments. We made five further recommendations for improvement.

The scope of this Part

- 11.8 In this Part, we follow up on the Ministry's response to the five recommendations made in our 2007 report.

The response to our 2007 report

Review of approvals for additional remuneration

Background information

- 11.9 In July 2004, we reported on the payments made to principals through the Ministry's central payroll system and directly by boards. Our audit work found cases in 11% of secondary schools where additional remuneration to principals had been paid without Ministry approval. Between 2004 and 2007, when we followed up on the Ministry's response to our 2004 recommendations, the Ministry had done significant work to tighten its systems and guidance for approving additional remuneration. We were comfortable in 2007 that most schools now understood the legal requirements on these matters.
- 11.10 Therefore, in 2007, we did not examine the Ministry's systems and processes in the same detail as in the special audit exercise that formed the basis for our 2004 report. However, we noted that 14 of the 90 applications for additional remuneration approved by the Ministry in 2006 did not appear to have been paid through the central payroll system.
- 11.11 In most of these cases, there was no obvious reason why a board should seek and obtain approval for additional remuneration and then decide not to make the payments through the central payroll system. Therefore, we recommended that, as a matter of routine, the Ministry review approvals that have been given to ensure that boards were not making payments locally.
- 11.12 In 2009, we asked the Ministry what action it had taken in response to this recommendation.

The Ministry's response

- 11.13 The Ministry will introduce a process that does not significantly increase compliance costs for schools to follow up on the absence of a payment through the central payroll system.

- 11.14 The process will involve contacting schools, on a six-monthly basis, to follow up payments for which approval has been sought but that were not paid through the payroll. A report would be generated recording school responses and actions taken to address any unlawful expenditure. This process will be introduced by 1 June 2009.

Recovery of unlawful payments to principals

Background information

- 11.15 The terms and conditions of employment for school principals are contained in a collective or individual employment agreement. The Ministry approves all such agreements, which set the amount of remuneration to be paid for normal duties. A principal might also have other responsibilities for which extra remuneration can be paid. Legislation requires that the Ministry approves all such additional remuneration before it is paid, and that it is paid through the Ministry's central payroll system rather than locally by a board.
- 11.16 In July 2004, our analysis of a sample of payments found a significant number of additional payments had been made without Ministry approval. The Ministry and we were concerned about the extent to which unapproved additional remuneration had been paid outside the central payroll system.
- 11.17 We recommended in our 2004 report that the Ministry consider whether recovering the unlawful payments was possible or appropriate. The Ministry commissioned a legal opinion on this matter in 2005, which concluded that the Ministry had no power to require a board to apply for approval of a payment of additional remuneration or to cease making an unlawful payment. The Ministry is also unable to direct a board to take action to recover an unlawful payment. The Minister is unlikely to be able to use their statutory powers of intervention in schools to require a board to take recovery action against an employee, or to replace a board with a Commissioner if a board was not prepared to seek recovery of an unlawful payment.
- 11.18 When we reviewed this situation in 2007, we considered that these arrangements were unsatisfactory. As it stands, a school board can make an unlawful payment to its principal, continue to make such an unlawful payment, and not be required either by legislation or the Ministry to consider recovery. The only recourse that appears to be available to the Ministry in these circumstances is to take action against trustees personally if it can be shown that they did not act in good faith.
- 11.19 Our 2007 report also gave an account of unlawful remuneration to the principal of a school with a roll of about 400 students. In this case, the principal had received unlawful remuneration amounting to \$269,000. The total cost to the

board, including tax and possibly penalties and interest on unpaid tax, could have been nearly \$400,000.

- 11.20 Since these matters were brought to the attention of the board of the school, it acknowledged that it had not complied with the relevant legislation and confirmed that it now fully understood its obligations. It gave the Ministry an assurance that there would be no further breaches.
- 11.21 The Ministry recommended to the board that it take steps to recover the unlawful remuneration. However, the board decided not to take any action, on the grounds that there is no reasonable prospect of recovery.
- 11.22 We considered that this case added further weight to the need for the Ministry to strengthen the arrangements for reducing the incidence of unlawful payments, and to enable recovery action where they occur.
- 11.23 Our 2007 report noted that the Ministry was considering how best to address enforcement and recovery issues. It also noted that this may require a change in legislation to strengthen the Ministry's ability to promote compliance with the current legislation. We recommended that the Ministry conclude its consideration of how best to address issues of enforcement and recovery in relation to unlawful payments made to principals.
- 11.24 We note that, before the Education Act 1989 was amended in 2001, one of the provisions gave the Minister the power to dissolve a board and replace it with a Commissioner if satisfied that the board had taken or intended to take an unlawful action, or had failed or refused or intended to fail or refuse to take an action required by law.
- 11.25 In 2009, we asked the Ministry how it had responded to the above recommendation.

The Ministry's response

- 11.26 There is a proposed amendment to the Education Act due to be considered later this year. The Ministry will provide advice to the Minister to consider changing this Act to provide powers to the Minister to dissolve a Board and replace it with a Commissioner if satisfied that it had taken or intended to take an unlawful action, or had failed or refused or intended to fail or refuse to take an action required by the law.

Payment of remuneration by proprietors of integrated schools

Background information

- 11.27 It first came to our attention in 2004 that the principals of some integrated schools were receiving remuneration from the proprietors of the schools (the owners of the school buildings) in addition to the normal salary payable from public funds. We considered that such arrangements might breach section 7(4) of the Private Schools Conditional Integration Act 1975, which prohibits the payment of additional remuneration by proprietors for normal duties. Therefore, we recommended that the Ministry consider the extent of the remuneration received by the principals of some integrated schools from the school proprietors, whether such payments are lawful, and, if not, how they may be stopped.
- 11.28 The Ministry considered that it has limited ability to identify payments made by proprietors directly to a principal. Any such payments would not be included in a school's annual reporting on its principal's remuneration (which is restricted to remuneration paid by the school) and would be outside the scope of the audit of a school (which does not include reviewing payments made by a proprietor or income received by a principal from third parties).
- 11.29 Therefore, we recommended in 2007 that the Ministry regularly request a statement of all money paid directly to all school staff, the amounts involved, and the reasons for the payments from each proprietor of an integrated school.

The Ministry's response

- 11.30 The Ministry has limited ability to seek this information from integrated schools.
- 11.31 The Ministry is considering using Integration Agreements with these schools to regularly request a statement of all money paid to all school staff, the amounts involved, and the reasons for the payments from each proprietor of an integrated school. The Ministry will report back to us on this proposed response by 30 June 2009.

Guidance for boards of trustees on legislative matters

Background information

- 11.32 Our 2005 report recommended that the Ministry consider providing simple advice to integrated schools, and their proprietors, on specific aspects of the legislation relating to the financial relationship between schools and proprietors. During 2005 and 2006, the Ministry issued a number of additional pieces of guidance on legislation. We considered that this was comprehensive and up to date, but remained concerned that it may not be accessible enough for many of the 18,000 trustees who may have little or no experience in managing a public entity when they first join a board.

11.33 Therefore, in 2007, we recommended that the Ministry issue simple and accessible guidance, directed at inexperienced trustees, on the major financial constraints on the operation of schools – for integrated schools as well.

11.34 In 2009, we asked the Ministry what action had been taken in response to this recommendation.

The Ministry's response

11.35 The Ministry considers that guidance has been made available to trustees through a number of sources including:

- the *Financial Information for Schools Handbook*;
- *Working in Partnership Information for New School Trustees 2007-2010*;
- targeted advice to schools and boards of trustees, such as circulars outlining approval requirements following settlements of collective agreements; and
- support to schools from regional financial advisors.

11.36 In addition, the Ministry is actively working to reconfigure its website to provide school boards of trustees with a “one-stop shop” style of webpage that allows individual members to access needed material and guidance. The Ministry anticipates that the website will be completed and the guidance available by 30 June 2009.

Regularising possible unlawful expenditure by integrated schools

Background information

11.37 We reported in 2005 that about 200 state integrated schools had a breach of law recorded as a note to their financial statements. These breaches were due to historical cases where the boards of state integrated schools used public funds for capital expenditure that was the responsibility of their proprietors.

11.38 The integrated schools appeared to have provided a total of about \$30 million of public funds for the construction or improvement of buildings on proprietors' land. Early in 2004, the Ministry agreed to carry out an exercise to make this expenditure lawful, but this action had still not been taken when we reported in 2007. Therefore, in 2007, we recommended that the Ministry attach a higher priority to regularising the \$30 million of possibly unlawful expenditure incurred by integrated schools on buildings owned by proprietors.

The Ministry's response

11.39 In 2007 and 2008, the Ministry, after consultation with us and the Association of Proprietors of Integrated Schools, took steps to resolve this matter. About \$13.1 million of the total of more than \$30 million of historical expenditure was written

off. The remaining \$17.8 million was regularised in a way that protected the interests of all parties.

- 11.40 Where large expenditure had been incurred, proprietors were asked to recognise the board's interest in that property. This interest is known as an "equitable leasehold interest", which is an unsecured interest in capital assets. The value of the equitable lease will be written off over the economic life of each asset.

Concluding comments

- 11.41 The actions that the Ministry has taken and proposes to take should resolve the issues mentioned in our previous reports. We will continue to monitor progress on the issues to see whether the actions have been effective.

Appendix

Details of the non-standard audit reports issued in 2008

Adverse opinions

Adverse opinions for public entities other than schools

Royal New Zealand Navy Museum Trust Incorporated

Financial statements year ended: 30 June 2007

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

RNZAF Museum Trust Board

Financial statements year ended: 30 June 2008

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

Queen Elizabeth II Army Memorial Museum

Financial statements year ended: 30 June 2008

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

Disclaimers of opinion

Disclaimers of opinion for schools

Te Kura Kaupapa Maori O Ruamata

Financial statements year ended: 31 December 2004

We were unable to form an opinion on the financial statements because there was a limitation in evidence:

- We were unable to obtain enough appropriate audit evidence to support expenditure.
- We were unable to confirm that all related party transactions had been properly recorded and disclosed in the financial statements.
- We were unable to confirm that fundraising and other activities revenue had been properly recorded.
- The Board of Trustees did not provide budgeted figures for the financial year in the financial performance and position statements.

Except-for opinions

Except-for opinions for public entities other than schools

Auckland District Health Board and Group

Financial statements year ended: 30 June 2007

We disagreed with the Health Board not recognising the land and buildings and associated fit-out and services it owns in the Statement of Financial Position at fair value. This is a departure from Financial Reporting Standard No. 3: *Accounting for Property, Plant and Equipment*, which requires the revaluation of all assets within a class of assets to be recorded at fair value. We also reported that, if it were not for the departure from FRS-3, the financial statements would have fairly reflected the Board and group's financial position, results of operations, cash flows, and achievements measured against performance targets for the year.

Christchurch Polytechnic Institute of Technology and Group

Financial statements year ended: 31 December 2007

We disagreed with the Council not preparing consolidated financial statements for the group in accordance with New Zealand Equivalent to International Accounting Standard 27 (NZ IAS 27): *Consolidated and Separate Financial Statements*. Because the Council did not prepare group financial statements in accordance with NZ IAS 27 for the year ended 31 December 2006, there is no comparative information for the group in the 2007 financial statements. We also reported that, if it were not for the departure from NZ IAS 27, the financial statements would have fairly reflected the Institute and group's financial position, results of operations, cash flows, and achievements measured against performance targets for the year.

Massey University and Group

Financial statements year ended: 31 December 2007

Our audit was limited because the University did not carry out a revaluation of land and buildings to ensure that the value of the land and buildings was not materially different to fair value. This is a departure from New Zealand Equivalent to International Accounting Standard 16: *Property, Plant and Equipment*, which requires that entities recognise land and buildings at fair value and carry out revaluations with enough regularity to ensure that the revalued land and buildings are not included at a value that is materially different to fair value.

UCOL International Limited (Universal College of Learning)

Financial statements year ended: 31 December 2007

Our audit was limited because the company was unable to establish the amount of tax-related liabilities to be recognised in its financial statements as required by New Zealand Equivalent to International Accounting Standard 12: *Income Taxes*, or file returns to the Income Tax Department of India for activities carried out in India from 2004 to 2007.

Ngati Whakue Educational Endowment Trust Board

Financial statements year ended: 31 December 2007

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

Massey Ventures Limited and Group (Massey University)*Financial statements years ended: 30 June 2005, 30 June 2006, and 30 June 2007*

Our audit was limited because we were unable to verify that the unaudited financial information of the company's associate was properly recorded and disclosed in the financial statements. The associate, which was not a public entity, is not under the Auditor-General's mandate and its shareholders elected not to have an audit carried out.

Te Wānanga o Aotearoa Te Kuratini o Ngā Waka*Financial statements year ended: 31 December 2006*

Our audit was limited because we were unable to determine whether any adjustments to the comparative information were necessary. The Wānanga and group did not maintain adequate systems and controls to identify all related party transactions between 1 January 2005 and 8 March 2005.

MO1 Limited (Te Wānanga o Aotearoa Te Kuratini o Ngā Waka)*Financial statements year ended: 31 December 2006*

Our audit was limited because we were unable to determine whether any adjustments to the comparative information were necessary. The company did not maintain adequate systems and controls to identify all related party transactions between 1 January 2005 and 8 March 2005.

Ivey Hall and Memorial Hall 125th Anniversary Appeal Gifting Trust (Lincoln University)*Financial statements year ended: 31 December 2007*

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

Ivey Hall and Memorial Hall 125th Anniversary Appeal Taxable Activity Trust (Lincoln University)*Financial statements year ended: 31 December 2007*

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

Wilson Home Trust (Waitemata District Health Board)*Financial statements year ended: 30 June 2007*

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

Creative Campus Enterprises Limited (Massey University)*Financial statements year ended: 31 December 2007*

Our audit was limited because we were unable to verify certain revenue due to limited controls over that revenue. We also noted that the going concern assumption had appropriately not been used in preparing the financial statements because the company was wound up on 31 March 2008.

Except-for opinions for schools

Remuera Primary School

Financial statements year ended: 31 December 2007

We disagreed with the Board of Trustees not preparing group financial statements. This is a departure from New Zealand Equivalent to International Accounting Standard 27: *Consolidated and Separate Financial Statements*, which requires the Board of Trustees to present consolidated financial statements.

Wellington Girls' College

Financial statements year ended: 31 December 2007

We disagreed with the Board of Trustees not preparing group financial statements. This is a departure from New Zealand Equivalent to International Accounting Standard 27: *Consolidated and Separate Financial Statements*, which requires the Board of Trustees to present consolidated financial statements.

New Plymouth Girls' High School

Financial statements year ended: 31 December 2007

We disagreed with the Board of Trustees not preparing group financial statements. This is a departure from New Zealand Equivalent to International Accounting Standard 27: *Consolidated and Separate Financial Statements*, which requires the Board of Trustees to present consolidated financial statements.

Wanganui City College

Financial statements year ended: 31 December 2007

We disagreed with the Board of Trustees not preparing group financial statements. This is a departure from New Zealand Equivalent to International Accounting Standard 27: *Consolidated and Separate Financial Statements*, which requires the Board of Trustees to present consolidated financial statements.

Mornington School

Financial statements year ended: 31 December 2007

We disagreed with the Board of Trustees not preparing group financial statements. This is a departure from New Zealand Equivalent to International Accounting Standard 27: *Consolidated and Separate Financial Statements*, which requires the Board of Trustees to present consolidated financial statements.

Te Wharekura Rakaumangamanga

Financial statements year ended: 31 December 2007

We disagreed with the Board of Trustees not preparing group financial statements. This is a departure from New Zealand Equivalent to International Accounting Standard 27: *Consolidated and Separate Financial Statements*, which requires the Board of Trustees to present consolidated financial statements.

St Peter's College (Epsom)

Financial statements year ended: 31 December 2007

We disagreed with the Board of Trustees not preparing group financial statements. This is a departure from New Zealand Equivalent to International Accounting Standard 27: *Consolidated and Separate Financial Statements*, which requires the Board of Trustees to present consolidated financial statements.

Wellington East Girls' College*Financial statements year ended: 31 December 2007*

We disagreed with the Board of Trustees' decision to increase the amount owing to trusts for bequests received to help restore the capital value of the bequests. This is a departure from New Zealand Equivalent to International Accounting Standard 37: *Provisions, Contingent Liabilities and Contingent Assets*, which requires the amount of provisions to be based on the level of present obligation.

St Joseph's School (Upper Hutt)*Financial statements year ended: 31 December 2007*

Our audit was limited because we were unable to obtain satisfactory evidence to support the cost and the associated grant for the land and building occupied by the school that was recorded in the school's financial statements.

Sacred Heart School (Thorndon)*Financial statements year ended: 31 December 2007*

Our audit was limited because we were unable to obtain satisfactory evidence to support the cost and the associated grant for the land and building occupied by the school that was recorded in the school's financial statements.

Huntly West School*Financial statements year ended: 31 December 2007*

Our audit was limited because we were unable to verify certain transactions. The receipt book was missing, and certain transactions were subject to allegations of theft and fraud.

Mansell Senior School*Financial statements year ended: 31 December 2007*

Our audit was limited because we were unable to verify some expenditure. Some source documentation had been manipulated or destroyed in the course of fraudulent activities.

Salford School*Financial statements years ended: 31 December 2006 and 31 December 2007*

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

Kaingaroa Forest School*Financial statements year ended: 31 December 2006*

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

Whareorino School*Financial statements year ended: 31 December 2007*

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

Kiwitahi School*Financial statements year ended: 31 December 2007*

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

Piopio Primary School*Financial statements year ended: 31 December 2007*

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

Karoro School*Financial statements year ended: 31 December 2007*

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

Waihi East School*Financial statements year ended: 31 December 2007*

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

Taumarunui High School and Community Trust*Financial statements year ended: 31 December 2007*

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

Te Kura O Otangarei School*Financial statements year ended: 31 December 2007*

Our audit was limited because we were unable to verify certain expenses due to not being able to obtain appropriate documentation of those expenses.

Te Whanau A Apanui Area School*Financial statements year ended: 31 December 2007*

Our audit was limited because we were unable to verify certain revenue due to limited controls over the receipt of this revenue. We were also unable to verify certain expenses due to not being able to obtain appropriate documentation of those expenses.

Piri Piri School*Financial statements year ended: 31 December 2007*

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

Brandon Intermediate School*Financial statements year ended: 31 December 2007*

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

Whanganui Awa School*Financial statements year ended: 31 December 2007*

Our audit was limited because the Board of Trustees did not include a provision for cyclical maintenance in the financial statements. This is a departure from its reporting requirements.

St Matthew's School (Marton)*Financial statements year ended: 31 December 2007*

Our audit was limited because the Board of Trustees did not include a provision for cyclical maintenance in the financial statements. This is a departure from its reporting requirements.

St Mary's School (Cambridge)*Financial statements year ended: 31 December 2007*

We disagreed with the Board of Trustees recognising expenditure incurred in previous years on capital works on the proprietor's land as fixed assets. The Ministry did not approve the use of funding for this purpose. Therefore, this expenditure did not meet the criteria and should have been written off. As a consequence, the fixed assets, equity, and surplus of the Board of Trustees were overstated.

St Joseph's Primary School (Opotiki)*Financial statements year ended: 31 December 2007*

We disagreed with the Board of Trustees recognising expenditure incurred in previous years on capital works on the proprietor's land as fixed assets. The use of funding for this purpose was not approved by the Ministry. Therefore, this expenditure did not meet the criteria and should have been written off. As a consequence, the fixed assets, equity, and surplus of the Board of Trustees were overstated.

Carmel College*Financial statements year ended: 31 December 2007*

We disagreed with the Board of Trustees transferring funds to the school's proprietor without appropriate authority.

Explanatory paragraphs

Explanatory paragraphs (emphasis of matter) for public entities other than schools

University of Auckland*Financial statements year ended: 31 December 2007*

We drew readers' attention to the Partnerships for Excellence funding, which was appropriated by the Crown as a capital appropriation for increasing the University's capability and should have been recognised as equity rather than recognised as income in advance. While this amount is not material to the financial statements as a whole, we felt it important to highlight to the readers of the financial statements.

Capital and Coast District Health Board*Financial statements year ended: 30 June 2008*

We drew readers' attention to the disclosures in the financial statements that referred to the uncertainty about the validity of the going concern assumption. The validity of the going concern assumption depended on the Board negotiating additional funding from the Crown to support its cash flow requirements and ensuring that the Board's borrowings requirements do not exceed its available borrowing facilities.

New Zealand Institute for Crop and Food Research Limited*Financial statements year ended: 30 June 2008*

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

GraceLinc Limited (New Zealand Institute for Crop and Food Research Limited)*Financial statements year ended: 30 June 2008*

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

Western Institute of Technology at Taranaki and Group*Financial statements years ended: 31 December 2006 and 31 December 2007*

We drew attention to uncertainties surrounding the going concern assumption. The validity of the going concern assumption depends on the continuing financial support of the Crown in the forms of loans and guarantees.

Aupouri Maori Trust Board*Financial statements year ended: 30 June 2007*

We noted that the financial statements were appropriately prepared on the going concern basis because the Trust Board had confirmed that it would implement a recovery plan to address its financial difficulties.

Cardiff Holdings No.1 Limited (Genesis Power Limited)*Financial statements year ended: 30 June 2008*

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

Cardiff Holdings No.2 Limited (Genesis Power Limited)*Financial statements year ended: 30 June 2008*

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

GP No.1 Limited (Genesis Power Limited)*Financial statements year ended: 30 June 2008*

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

GP No.2 Limited (Genesis Power Limited)*Financial statements year ended: 30 June 2008*

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

Kupe Holdings Limited (Genesis Power Limited)*Financial statements year ended: 30 June 2008*

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

Air New Zealand Consulting Limited (Air New Zealand Limited)*Financial statements year ended: 30 June 2007*

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

NIWA Natural Solutions Limited (National Institute of Water and Atmospheric Research Limited)*Financial statements year ended: 30 June 2007*

We noted that the financial statements were appropriately prepared on the going concern basis because the company had confirmed that it would rely on continued financial support from its parent company.

NIWA Natural Solutions Limited (National Institute of Water and Atmospheric Research Limited)*Financial statements year ended: 30 June 2008*

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

Architects Education and Registration Board*Financial statements year ended: 31 March 2006, and period ended: 30 June 2006*

We noted the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements, because the company was wound up at 30 June 2006.

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

We noted the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements, because the College was merged with the University of Otago on 1 January 2007.

Iso-Trace Limited*Financial statements year ended: 31 December 2007*

We noted the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements, because the company was to cease operations in April 2008.

Ngai Tahu Ancillary Claims Trust*Financial statements year ended: 30 June 2008*

We noted the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements, because the Trust will cease to operate following the transfer of the remaining claim property.

Transit New Zealand*Financial statements year ended: 30 June 2008*

We noted the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements, because the entity was disestablished and merged with Land Transport New Zealand on 1 August 2008.

Immune Solutions Limited (University of Otago)*Financial statements year ended: 31 December 2007*

We noted that the company had disclosed that the budget figures in the financial statements were from an updated budget that were approved by the Board but that did not comply with the Crown Entities Act 2004, which requires the company's financial statements to include the forecast financial statements prepared at the start of the financial year.

Southland District Health Board*Financial statements year ended: 30 June 2008*

We noted that the Health Board had disclosed that the budget figures in the financial statements were from an updated budget that were approved by the Board but that did not comply with the Crown Entities Act 2004, which requires the Health Board's financial statements to include the forecast financial statements prepared at the start of the financial year.

Explanatory paragraphs for schools**Emphasis of matter by type and number****Serious financial difficulties (22 schools)**

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

We noted that 22 schools had included disclosures in their financial statements that outlined their financial difficulties and the actions they are taking to address the factors that had resulted in those difficulties.

Closures (7 schools)

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

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

Breaches of law by type and number**Expenditure on capital works on proprietor's land (88 schools)**

In previous years, some Boards of Trustees had recognised as a fixed asset the expenditure on capital works on land owned by the schools' proprietors. The use of funding for this purpose is not permitted by law unless the Boards of Trustees' financial interests in the capital works have been agreed by the proprietors and the approval of the Ministry of Education has been obtained.

We noted that 84 schools had regularised the expenditure on capital works on proprietors' land by writing it off in accordance with the Ministry of Education's scheme. The other four schools had regularised the expenditure in other ways.

Not reporting by 31 May 2008 (76 schools)

Boards of Trustees have a statutory obligation to issue their audited financial statements by 31 May 2008.

We noted that 76 schools had breached the law by failing to meet this statutory reporting deadline, and had not disclosed the breach in their financial statements.

Not having a ten-year property plan (11 schools)

Boards of Trustees have a statutory obligation to prepare and review annually, and have professionally reviewed every three years, a property plan that includes all the maintenance requirements of the school for a prospective 10-year period.

We noted that 11 schools had breached the law by failing to annually update the 10-year property plan.

Not having a variation statement (9 schools)

Schools are obliged by the Education Act 1989 to include, in their annual reports, statements comparing their performance against their objectives.

We noted that nine schools had breached the law by not including such statements in their annual reports.

Borrowing without approval (6 schools)

Boards of Trustees are not permitted to borrow above a prescribed limit without the approval of the Ministers of Education and Finance.

We noted that six schools had breached the law by not seeking authority from the Ministers for borrowing above the limit.

Investing in non-approved institutions (5 schools)

To safeguard public money, schools may invest their surplus funds only in approved banking and other institutions.

We noted that five schools had breached the law by investing in non-approved banking institutions without the authority of the Ministers of Education and Finance.

Other reasons (9 schools)

Our audit reports included explanatory paragraphs for other reasons:

- Two schools acquired an interest in land without the approval of the Minister of Education.
- Two schools made payments to staff outside the Ministry of Education payroll service.
- One school did not prepare financial statements that disclosed budget figures.
- One school did not exclude proprietor representatives from meetings in which financial arrangements were made between the school and the proprietor.
- One school had a trustee who was interested in contracts with the Board of Trustees under which the total payments made, or to be made, by or on behalf of the Board of Trustees exceeded \$25,000 in any financial year, without the approval of the Minister of Education.
- One school paid its staff in advance without the approval of the Ministry of Education.
- One school enrolled overseas students without being a signatory to the relevant Code of Practice and also did not calculate fees for international students in accordance with the provisions of section 4B of the Education Act 1989 for financial statement years ended 31 December 2006 and 2007.

Publications by the Auditor-General

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

- Workforce planning in Crown Research Institutes
- Draft annual plan 2009/10
- Performance audits from 2007: Follow-up report
- Department of Corrections: Managing offenders on parole
- Housing New Zealand Corporation: Maintenance of state housing
- Annual Report 2007/08
- Ministry of Health: Monitoring the progress of the Primary Health Care Strategy
- Ministry of Education: Supporting professional development for teachers
- Inquiry into the West Coast Development Trust
- Maintaining and renewing the rail network
- Reporting the progress of defence acquisition projects
- Ministry of Education: Monitoring and supporting school boards of trustees
- Charging fees for public sector goods and services
- The Auditor-General's observations on the quality of performance reporting
- Local government: Results of the 2006/07 audits
- Procurement guidance for public entities
- Public sector purchases, grants, and gifts: Managing funding arrangements with external parties
- The Accident Compensation Corporation's leadership in the implementation of the national falls prevention strategy
- Ministry of Social Development: Preventing, detecting, and investigating benefit fraud

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