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Parliamentary paper

Central
government:
Results of the
2009/10 audits
(Volume 1)

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Central government: Results of the 2009/10 audits

Volume 1

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Contents

Auditor-General's overview	5
Part 1 – Introduction	7
Part 2 – Matters arising from the audit of the Government's 2009/10 financial statements	11
Unqualified audit opinion	11
Summary of significant matters arising from the 2009/10 audit	11
The consolidation audit	12
Significant matters arising from the 2009/10 audit	13
Part 3 – Audit results for government departments, Crown research institutes, and State-owned enterprises	23
Background	23
Central government context	26
Audit results for government departments	27
Audit results for Crown research institutes	33
Audit results for State-owned enterprises	36
Part 4 – The Controller function and the appropriation audit	39
Unappropriated expenditure in 2009/10	40
Net asset holdings	41
Unappropriated expenditure in 2010/11	42
Public expenditure principles	42
Operating the Controller function	43
Remeasurements	43
Part 5 – The financial reporting environment and some current financial reporting issues	45
The financial reporting environment in New Zealand	45
Current financial reporting issues in central government	47
Part 6 – Non-standard audit reports issued in 2010	53
Why we report this information	53
What is a non-standard audit report?	53
Adverse opinions	56
Disclaimers of opinion	56
Except-for opinions	56
Explanatory paragraphs	59
Part 7 – Results of tertiary education institution audits for 2009	63
What is the tertiary education institution sector?	63
Roles and responsibilities of tertiary education institutions	64
Other agencies with a role in the tertiary education institution sector	65
Recent changes to the operating environment	66
How tertiary education institutions are funded	67
Tertiary education institutions' financial performance in 2009	69
Tertiary education institutions' audit results for 2009	71
Summary and focus in 2010 audits	75
Part 8 – Payments above a school principal's normal salary	77
The remuneration system	77
Our first review of principals' remuneration	80
Our April 2007 report on progress	81
Our May 2009 report on progress	81
Our most recent review of principals' remuneration	81

Part 9 – Reporting student achievement in primary schools	91
About analysis of variance reports	92
About our review	93
Our overall findings	94
Identifying the board’s strategic goals and why those strategic goals had been chosen	96
Identifying the annual targets and establishing how these annual targets relate to the strategic goals	97
Assessing what outcomes had been achieved for the year and knowing what progress had been made	100
Understanding what had been done to achieve these results, whether the planned action had worked, and if not why not	100
Clearly understanding what the board would be doing next year and being satisfied that appropriate action would be taken	101
Part 10 – Our inquiry work in the central government sector	103
The number of central government inquiries dealt with	103
How we approach requests for inquiries	104
The range of issues we have considered in inquiries	105
Conclusion	112
Appendix – Details of the non-standard audit reports issued in 2010	113
Adverse opinions	113
Disclaimers of opinion	113
Except-for opinions for public entities other than schools	114
Except-for opinions for schools	115
Explanatory paragraphs for public entities other than schools	120
Explanatory paragraphs for schools	125
Figures	
1 – Dates for introducing various sectors into the Emissions Trading Scheme	18
2 – Grading scale for assessing environment, systems, and controls	24
3 – Scope of the three aspects that our auditors examine	25
4 – Government departments – summary of grades for 2009/10	27
5 – Management control environment grades for government departments from 2006/07 to 2009/10, as percentages	28
6 – Financial information systems and controls grades for government departments from 2006/07 to 2009/10, as percentages	28
7 – Comparison of grades for service performance information and associated systems and controls in 2008/09 and 2009/10	31
8 – Crown research institutes – summary of grades for 2009/10	34
9 – Management control environment grades for Crown research institutes from 2006/07 to 2009/10, as percentages	35
10 – Financial information systems and controls grades for Crown research institutes from 2006/07 to 2009/10, as percentages	35
11 – State-owned enterprises – Summary of grades for 2009/10	36
12 – Management control environment grades for State-owned enterprises from 2006/07 to 2009/10, as percentages	37
13 – Financial information systems and controls grades for State-owned enterprises from 2006/07 to 2009/10, as percentages	38
14 – Deciding on the appropriate form of the audit report	55
15 – TEI revenue sources in 2009	68
16 – Surplus/deficit for each individual TEI in 2009	70
17 – Tertiary education institution sector – audits outstanding at 30 June 2010	72
18 – Examples of transactions that do and do not require the Ministry’s approval	79
19 – Inquiry work in central government, 2008-2010	103

Auditor-General's overview

The 2009/10 year has been a challenging one for many public entities. I am very aware that the global economic and financial crisis has focused the Government's attention on measures that can be taken to reduce public sector expenditure – while maintaining and improving core performance. The Government is focused on “delivering better, smarter public services for less”. Entities are expected to improve the quality, effectiveness, and efficiency of the services they provide, with little, if any, increases in budget baselines.

Added to the mix, proposed changes to financial reporting standards and institutional arrangements for accounting and auditing standard setting have implications for the whole public sector.

From my perspective, preparing, using, and reporting quality non-financial performance information is crucial to improving public sector performance. My Office's recent and planned work on performance information reporting has provided opportunities to better connect our work with the performance improvement expected of all public entities.

With these factors considered as a whole, my Office will continue to:

- pursue avenues to improve the public sector while maintaining our independence;
- improve the flow of our collective knowledge; and
- provide assurance about the soundness of management decisions in the public sector.

This year, I have decided to publish the content of this annually produced report in two volumes. This volume is being published before Christmas to improve the timeliness and usefulness of the overview information about our audit work.

I will publish a second volume early in 2011, which will contain information that could not be prepared before Christmas, for a variety of reasons. For example, the second volume will include the results of district health board audits, which are subject to later statutory timeframes than those that apply to government departments.



Lyn Provost
Controller and Auditor-General

9 December 2010

Part 1

Introduction

1.1 The following nine Parts of this report provide an overview of the results of our audits and other work in the central government sector for 2009/10.

1.2 Here we introduce the report as a whole and describe the content of each Part.

Summary of Part 2

1.3 Part 2 discusses the audit of the financial statements of the Government, which is the most significant audit that we carry out.

1.4 The significant matters that Part 2 discusses include:

- the liability for the Retail Deposit Guarantee Scheme;
- the subsequent event disclosures about the Canterbury earthquake;
- discount rates for valuing significant liabilities of the Government;
- disclosures about related parties; and
- adjustments to the financial records of land managed by the Department of Conservation.

1.5 Other matters we have commented on include:

- the review of accounting policies for tax revenue recognition;
- accounting for the Emissions Trading Scheme;
- accounting for the Government's proposal for repairing leaky homes;
- accounting for Treaty of Waitangi settlements that include relativity clauses;
- future enhancements to the state highways valuation methodology; and
- accounting for the Kyoto Protocol.

Summary of Part 3

1.6 Part 3 reports on our 2009/10 audit results and assessments of the environment, systems, and controls of government departments, Crown research institutes, and State-owned enterprises. In our annual audits, we typically assess each public entity's management control environment and its financial systems and controls. Overall, the results for 2009/10 were pleasing. We assessed the management control environment as "very good" or "good" for 92% of government departments, 100% of Crown research institutes (CRIs), and 93% of State-owned enterprises (SOEs). We assessed the financial systems and controls as "very good" or "good" for every government department, CRI, and SOE.

1.7 Last year, we observed that the quality of service performance information and associated systems and controls varied widely between entities. We found

that most entities needed to make improvements in service performance reporting, and we said that we would work closely with them to progress these improvements.

- 1.8 There has been a small improvement in the grades for service performance information and associated systems and controls for government departments in 2009/10 compared with 2008/09. CRIs and SOEs are not graded for service performance reporting, while the results for other Crown entities will be published early next year.
- 1.9 In 2008/09, we revised the Auditor-General's Auditing Standard on auditing performance information. The application of the standard is being phased in from the 2010/11 central government audits.

Summary of Part 4

- 1.10 Part 4 discusses the Controller function and appropriation audit. These are important aspects of the Auditor-General's work because they support the fundamental principle of Parliamentary control over government expenditure. During 2009/10, we found instances of expenditure exceeding appropriation without authority and of net assets exceeding the approved limit. Although the instances represented a decrease from the previous year (both in number and value), departments need to better understand the importance of appropriation and lawfulness, and the processes in the Public Finance Act 1989 that support them.

Summary of Part 5

- 1.11 Part 5 comments on the financial reporting environment in New Zealand and outlines current financial reporting issues, such as disclosures of underlying profits in annual reports, that affect some entities in central government. We are pleased that the debate on changes needed to setting financial reporting standards, particularly for the public sector, seems to be leading to a consensus that the standards need to better deal with the range of entities that report externally.

Summary of Part 6

- 1.12 Part 6 reports on the non-standard audit reports issued on the financial statements of public entities within our central government portfolio of audits during the ten months ended 31 October 2010. During this period, we issued 212 non-standard audit reports (out of the 3024 audit reports that we issued for entities within our central government portfolio). We record the non-standard

audit reports that we issued. These are audit reports that contain a qualified opinion and/or an explanatory paragraph. Within the category of a qualified opinion, we issued two adverse opinions, two disclaimers of opinion, and 51 except-for opinions.

Summary of Part 7

- 1.13 Part 7 presents some background information about the 31 tertiary education institutions (TEIs) and other agencies with a role in the tertiary education sector and their operating environment. We describe how TEIs are funded and set out the results of our annual audits of TEIs for 2009. TEI financial performance improved in 2009 with an overall surplus of 4.3% of a revenue base of about \$4.2 billion (2008: 2.7%). We issued 29 unqualified audit opinions and two except-for qualified audit opinions on TEI group accounts. We also found that the sector has further work to do to improve its procurement policies, its capital asset management practices, and the performance information framework used in investment plans. We will continue to focus on these matters in the 2010 audits.

Summary of Part 8

- 1.14 Part 8 summarises the results of a review of the additional remuneration paid to secondary school principals in the 2009 school year. Additional remuneration is a payment made above the normal salary and, in general, requires prior approval from the Ministry of Education to be lawful.
- 1.15 Our latest review has identified a number of specific areas where additional guidance would be useful and should help reduce the incidence of unlawful payments. The Ministry of Education has also confirmed that, ultimately, in cases of persistent non-compliance by a school board, a statutory intervention can be considered in the context of any risk to the operation of the school.

Summary of Part 9

- 1.16 Part 9 reports on our assessment of how well a sample of primary school boards reported on student achievement in their 2009 annual reports. Since 2003, school boards of trustees have been required to include in their annual report an analysis of variance between the board's targets for what students would achieve (as set out annually in the school's charter) and what actually happened during the year. The goal is for boards to prepare strategic plans, set targets, and report meaningfully against the targets.
- 1.17 We assessed how well a sample of schools reported on student achievement in the analysis of variance reports in their 2009 annual reports. We found that only

15% of schools largely meet the requirements for strategic planning and self-review. Another 72% partly met the requirements, and the remaining 13% had not met the requirements. Based on our work, we have prepared a checklist that we will send to boards for them to assess and improve on the usefulness of their analysis of variance reports.

Summary of Part 10

- 1.18 Part 10 summarises our inquiry work for 2008/09 and 2009/10 and also covers two major inquiries that we have reported on since then. During this period, our inquiry function has come under increasing pressure. There has been an increase in the volume of requests for inquiries and in the scale and complexity of the issues we have been asked to consider.
- 1.19 Part 10 provides information on the number of inquiries requested and carried out. We also summarise the reports we published on our six major inquiries (*Plumbers, Gasfitters, and Drainage Board; NZ Defence Force payments to officers seconded to the United Nations; Certain types of expenditure in Vote Ministerial Services; How the Ministry of Education managed the 2008 national school bus transport tender process; Parliamentary and Ministerial accommodation entitlements; and Immigration matters*).

Part 2

Matters arising from the audit of the Government's 2009/10 financial statements

2.1 In this Part, we report the results of our audit of the *Financial Statements of the Government of New Zealand for the year ended 30 June 2010* (the Government's financial statements) and discuss the significant matters arising from the audit.

Unqualified audit opinion

2.2 The Auditor-General issued the audit report on the Government's financial statements on 30 September 2010.

2.3 The audit report appears on pages 24 and 25 of the Government's financial statements. It includes our unqualified audit 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 2010; and
 - the results of the Government's operations and cashflows for the year ended 30 June 2010.

Summary of significant matters arising from the 2009/10 audit

2.4 We discuss in more detail in the rest of this Part the significant matters arising from the audit, including:

- The Treasury's performance – The Treasury managed the process for preparing the Government's financial statements well. See paragraphs 2.7-2.8.
- Retail Deposit Guarantee Scheme – We are satisfied that the liability recognised for payments under the Scheme is based on reasonable analysis and assumptions. See paragraphs 2.11-2.17.
- Canterbury earthquake – The earthquake in the Canterbury region on 4 September 2010 was a significant event that occurred after balance date but before the Government's financial statements were completed. We are satisfied that the earthquake was a non-adjusting event and that the subsequent events' note disclosure in the Government's financial statements is appropriate and fairly reflects the Treasury's knowledge at 30 September 2010. See paragraphs 2.18-2.20.
- Discount rates – Last year, we reported our concerns about the use of different discount rates for valuing significant liabilities of the Government. We are satisfied that the valuations of the significant liabilities as at 30 June 2010 (in particular, those of the Accident Compensation Corporation and the Government Superannuation Fund) are based on robust, consistent, risk-free discount rates and Consumer Price Index (CPI) assumptions. See paragraphs 2.21-2.26.

- Related parties – Last year, we reported that there was no process to collect all the information about transactions between the Government reporting entity and key management personnel to ensure that disclosures required under NZ IAS 24: *Related Party Disclosures* could be made. We accepted that it was appropriate for the Treasury to wait for the standard-setter's revision to the standard before putting in place such a process. A good process has been implemented, and we are satisfied that adequate related party disclosures have been made in the Government's financial statements for the year ended 30 June 2010. However, there are two aspects that will need further consideration. See paragraphs 2.27-2.30.
- Land managed by the Department of Conservation – A significant project was carried out in 2009/10 to update the Department's financial records for land. We are satisfied that the Government's financial statements at 30 June 2010 fairly reflect the value of Crown land managed by the Department, after adjustments that were made to reflect the updated financial records. The adjustments were large, and the quality of the previous financial records was of concern. It will be important to ensure that the Department maintains accurate financial records for land in the future. See paragraphs 2.31-2.34.

2.5 We have also commented on:

- the review of accounting policies for tax revenue recognition (see paragraphs 2.35-2.37);
- accounting for the Emissions Trading Scheme (see paragraphs 2.38-2.42);
- accounting for the Government's proposal for repairing leaky homes (see paragraphs 2.43-2.45);
- accounting for Treaty of Waitangi settlements that include relativity clauses (see paragraphs 2.46-2.47);
- future enhancements to the state highways valuation methodology (see paragraphs 2.48-2.51); and
- accounting for the Kyoto Protocol (see paragraphs 2.52-2.57).

2.6 The Treasury has accepted the recommendations we have made, and will be working on them, along with other agencies, in 2010/11.

The consolidation audit

The Treasury's performance

2.7 The Treasury proactively dealt with several matters throughout 2009/10, including developing robust, risk-free discount rates and inflation assumptions to use in valuing the significant liabilities of the Government and establishing a process for collecting the information needed for related party disclosures.

- 2.8 The Treasury also proactively managed the consolidation reporting by significant public entities in 2009/10 and prepared the draft financial statements to an excellent standard by the statutory deadline.

Public entity performance

- 2.9 In recent years, we have raised significant concerns about the performance of some public entities in preparing timely and accurate financial information for consolidation. This year, we have seen an improvement in the receipt and accuracy of the returns. However, we continue to be disappointed in the number of “except for” audit clearances received (in other words, clearance of most but not all of the information provided for consolidation) and the number of late audit clearances because of entity non-performance.
- 2.10 We will work with the Treasury to ensure that entities that have not performed or met the required deadlines this year work with us actively to meet the deadline next year, with no “except for” audit clearances. In particular, we and the Treasury will work with those entities that had significant adjustments to their returns.

Significant matters arising from the 2009/10 audit

Retail Deposit Guarantee Scheme – liability based on reasonable analysis/assumptions

- 2.11 We are satisfied that the liability recognised for payments under the Retail Deposit Guarantee Scheme (the Scheme) is based on reasonable analysis and assumptions.
- 2.12 In October 2008, the Government introduced the Scheme. In August 2009, the Government announced that the Scheme would continue until 31 December 2011 with tightened eligibility criteria and additional limitations on its coverage. As at 30 June 2010, 73 financial institutions (2009: 73) had joined the Scheme and the amount of funds subject to the guarantee totalled \$133 billion (2009: \$124 billion). Note 30 of the Government's financial statements discloses detailed information about the Scheme.
- 2.13 As at 30 June 2010, the Government has recorded a liability of \$791 million (2009: \$831 million) for:
- future payments of \$43 million to claimants of entities already in default (2009: \$15 million); and
 - net expected losses of \$748 million for future payments under the Scheme (2009: \$816 million).

- 2.14 The provision for net expected losses has been determined based on the likelihood of default actions triggering the guarantee and the expected loss given default (amounts payable to depositors less assets realised). The Treasury assessed which non-bank financial institutions are likely to call on the Scheme by using financial information from the Reserve Bank of New Zealand and external inspectors engaged to carry out detailed reviews of the financial institutions' loan books, funding arrangements, and operational structures.
- 2.15 After 30 June 2010, receivers have been appointed for three companies within the Scheme – Mutual Finance Limited, Allied Nationwide Finance, and South Canterbury Finance Limited. The inherent risk, and therefore the cost to the Scheme, of these receiverships of \$745 million was recognised in the \$748 million provision for future payments under the Scheme. Of the \$745 million, \$728 million was recognised in 2008/09 and the additional \$17 million in 2009/10.
- 2.16 Last year, we recommended that the high-level approach that had been taken to determining the liability needed to be tested by a fuller analysis of each institution, and further work be done to establish the integrity of the financial information used to determine the provision. We are satisfied that our recommendations have been addressed.
- 2.17 Our Office is currently planning a performance audit examining selected aspects of how the Treasury implemented and managed the Scheme. This work will cover the original, revised, and extended Scheme. We anticipate reporting our findings to Parliament by 30 June 2011.

Canterbury earthquake subsequent event disclosures

- 2.18 The earthquake in the Canterbury region on 4 September 2010 was a significant event that occurred after balance date but before the Government's financial statements were completed. We are satisfied that the earthquake was a non-adjusting event and that the subsequent events' note disclosure in the Government's financial statements is appropriate and fairly reflects the Treasury's knowledge at 30 September 2010.
- 2.19 The Government is likely to incur significant costs because of this earthquake. However, the amount of those costs was not reliably quantifiable at the date of signing the Government's financial statements. We are satisfied that the Treasury is putting in place systems and processes to ensure that the costs to the Government can be monitored and reported accurately in the future.
- 2.20 Given the significance of the earthquake to New Zealand and the Government's financial statements, we expect the Treasury to consider specific disclosures in the

Government's financial statements for 30 June 2011, and we will work with the Treasury to ensure that the disclosures (as required) are agreed early.

Significant long-term liabilities – risk-free discount rates and Consumer Price Index assumptions

- 2.21 Last year, we reported our concerns about the initial use of different discount rates for valuing significant liabilities of the Government. We are pleased that the Treasury completed a substantial project during the year to establish an acceptable methodology for deriving risk-free discount rates and inflation assumptions for use in certain accounting valuations in the Government's financial statements.
- 2.22 We are satisfied that the valuations of the significant liabilities as at 30 June 2010 (in particular, those of the Accident Compensation Corporation and the Government Superannuation Fund) are based on robust, consistent, risk-free discount rates and CPI assumptions. These assumptions were also used to build a risk-adjusted discount rate for use in valuing student loans.
- 2.23 In 2010/11, the Treasury will need to ensure that there is a wider application of these risk-free discount rates and CPI assumptions in the valuations of similar liabilities (such as long service leave and retiring leave liabilities) by other entities within the Government reporting entity.
- 2.24 We considered the appropriateness of the Treasury publication, *Methodology for Risk-free Discount Rates and CPI Assumptions for Accounting Valuation Purposes* (the Methodology), published in July 2010. The Methodology outlines how to determine the risk-free discount rates and CPI assumptions for use in certain accounting valuations.
- 2.25 We considered the table of risk-free discount rates and CPI assumptions as at 30 June 2010 and the associated methodology to be appropriate for the Government to use in valuing insurance claim liabilities (under NZ IFRS 4: *Insurance Contracts*); in valuing employee benefits such as pension obligations, long service leave, and retiring leave (under NZ IAS 19: *Employee Benefits*); and in building a risk-adjusted discount rate for use in valuing student loans (under NZ IAS 39: *Financial Instruments: Recognition and Measurement*).
- 2.26 However, we have highlighted to the Treasury some matters that may be subject to future technical developments and/or different market conditions that the Treasury will need to consider in future revisions of the Methodology. We will continue to monitor these matters in future years.

Collecting information about related party transactions

- 2.27 Last year, we reported that there was no process to collect the information about transactions between the Government reporting entity and key management personnel to ensure that disclosures required under NZ IAS 24: *Related Party Disclosures* could be made. We accepted that it was appropriate for the Treasury to wait for the standard-setter's revision to NZ IAS 24 before putting in place such a process.
- 2.28 During the past year, changes were made to NZ IAS 24 that dealt with the disclosure of transactions with Ministers of the Crown. The only related parties for the Government are key management personnel – being the 28 Ministers of the Crown, their close family members, and entities controlled or jointly controlled by those people.
- 2.29 A good process has now been implemented, and all 28 Ministers of the Crown completed a related parties disclosure form and declaration in September 2010.
- 2.30 We are satisfied that adequate related party disclosures have been made in the Government's financial statements for the year ended 30 June 2010. We note that no disclosures were required to be made based on the declarations made by Ministers. There are some areas that we have recommended the Treasury consider further for the Government's 2010/11 financial statements.

Adjustments to the value of land managed by the Department of Conservation

- 2.31 At 30 June 2009, discrepancies were identified in the financial records of the Crown land managed by the Department of Conservation (the Department). The Department has a comprehensive land register. However, it was maintaining financial and valuation records separately without rigorous processes to reconcile these records with the land register. The Department carried out a project to review its financial records for land to ensure that the records are accurate. This included an improved methodology and process for the revaluation of Crown land.
- 2.32 We are satisfied that the Government's financial statements at 30 June 2010 fairly reflect the value of Crown land managed by the Department, after adjustments that were made to reflect the updated financial records.
- 2.33 The quality of the Department's previous financial reconciliation process for land records was of concern. The review project identified that the value of the Crown land managed by the Department needed to be reduced by a net amount of \$304 million. The size of the underlying adjustments, noted below, was concerning

when compared to the 30 June 2010 Crown land value of \$5,910 million. Those adjustments were:

- a \$1,698 million reduction for valuations previously included that did not relate to Crown land managed by the Department; and
- a \$1,460 million increase for land not previously included in the Department's financial records.

2.34 The review project has resulted in the Department implementing improved business processes. It will be important to ensure that the Department maintains accurate financial records for land in the future.

Review of accounting policies for tax revenue recognition

2.35 We are comfortable that the recognition of taxation revenue under current policies materially complies with generally accepted accounting practice. However, in previous years, we have suggested that the Inland Revenue Department thoroughly review taxation revenue recognition policies with a view to fine-tuning the recognition of taxation revenue, where appropriate. The Inland Revenue Department expects to complete its revenue recognition project by the end of December 2011, and intends to apply any changes to revenue recognition in 2012.

2.36 This is an important project because of the complexities involved and the potential effect on the way the Government recognises its tax revenue.

2.37 We have recommended that the Inland Revenue Department remain focused on achieving the completion date of its revenue recognition project, and that the Treasury closely monitor the progress of the project. Should there be changes to revenue recognition policies, we will consider the financial reporting impact and disclosure requirements (if any) of the changes in the Government's financial statements. Early consideration of any potential changes will be important.

Accounting for the Emissions Trading Scheme

2.38 As the Emissions Trading Scheme (ETS) is extended into new sectors, accounting for the ETS will become significant for the Government's financial statements in the future. There are also a number of refinements and developments required next year, including more regular updates of the carbon price and developing an accounting policy for revenue recognition.

2.39 Since the ETS began, 5.1 million New Zealand Units (NZUs) have been issued to participating foresters. The Crown recognises a liability and expense for these issued NZUs, which represents an obligation to swap the NZUs for internationally

tradable Assigned Amount Units if requested by the participant. Once the scheme is fully operational, there will be units surrendered by participants that will be recognised as revenue and reduce this liability.

- 2.40 We have assessed the systems and the transactions relating to the allocation of units to foresters and have not identified any issues with the reported balances.
- 2.41 We have recommended that:
- A more regular, such as monthly, update of the carbon price be carried out. Currently, the carbon price is updated every six months based on the value of Certified Emission Reduction units that are traded on the European carbon market. However, NZUs issued to, or received from, ETS participants should be valued at fair value at the time of issue. Depending on the volatility of carbon prices, it is unlikely that a six-monthly price update will be a reasonable approximation to the requirement for fair value at the time of issue of NZUs.
 - The Treasury and the Ministry for the Environment work together to develop a suitable accounting policy for the recognition of revenue from units surrendered by participants in the ETS. In particular, this should consider the timing of revenue recognition. At 30 June 2010, no units had been surrendered.
 - The Treasury ensure that revenue recognition policies are consistent across the Government's financial statements. In particular, we note that there are parallels between the collection of NZUs under the ETS and the collection of taxation by the Inland Revenue Department. There is currently no authoritative guidance on accounting for the ETS, although the International Accounting Standards Board has an active project on the issue. Therefore, any accounting policy may be subject to change.
 - The Ministry for the Environment complete its planned review of the carbon pricing methodology in time for it to be implemented by 30 June 2011 (see paragraph 2.55).
- 2.42 The dates for introducing various sectors into the ETS are shown in Figure 1.

Figure 1
Dates for introducing various sectors into the Emissions Trading Scheme

Sector	Date of introduction into the ETS
Forestry	1 January 2008
Stationary energy, industrial processes, liquid fossil fuels	1 July 2010
Synthetic gases, waste	1 January 2013
Agriculture	1 January 2015

Accounting for the Government's proposal for repairing leaky homes

- 2.43 During the year, the Minister for Building and Construction announced the Government's proposal to assist homeowners in getting leaky homes repaired faster by contributing 25% of the agreed repair costs (with affected local authorities also contributing the same amount). The Government proposed that it would provide assistance to homeowners to access bank finance for the remaining agreed repair costs by way of loan guarantees to banks. The Department of Building and Housing is working on the details of how these proposals could work and on obtaining agreement between the Government, local authorities, and banks.
- 2.44 We are satisfied that the proposal has been appropriately disclosed as an unquantifiable contingent liability in the Government's financial statements. We consider it appropriate that no liability be recognised as at 30 June 2010.
- 2.45 We are currently working with the Treasury and the Department of Building and Housing on future accounting for the Government's leaky home proposal.

Accounting for Treaty of Waitangi settlements that include relativity clauses

- 2.46 Because of the uncertainties surrounding measurement of liabilities that may arise under relativity clauses in some Treaty of Waitangi settlements, we agreed with the Treasury that a liability for any relativity payments should not be recognised at 30 June 2010 and that an unquantifiable contingent liability be disclosed in the Government's financial statements. We are satisfied with the contingent liability disclosures.
- 2.47 This matter will need to be monitored closely because the mechanism is expected to be triggered within the next two years, depending on the progress of settlements. When this occurs, and is able to be reliably measured, our view is that an additional liability will need to be recognised in the Government's financial statements. We will continue to work with the Ministry of Justice and the Treasury on this.

Future enhancements to the state highways valuation methodology

- 2.48 We are satisfied that the state highways valuation of \$24.8 billion as at 30 June 2010 is materially correct. However, the methodology used for valuation of the state highways network has remained largely unchanged for 20 years (with acknowledged enhancements to the process). We have previously raised the

need for the New Zealand Transport Authority (NZTA) to review the methodology to ensure that it remains consistent with internationally accepted valuation methodology.

- 2.49 NZTA's independent valuer has previously raised a number of issues with the methodology used for the state highways valuation. The most significant issue is that some of the actual project costs incurred in recent urban projects have been excluded from the valuation. This includes costs such as traffic management, environmental compliance, utilities, a generic increase in construction costs as a result of the restrictions imposed by an urban built-up environment, and the significant costs associated with re-establishing the interface with adjacent properties ("Brownfields"). This has potentially undervalued the network.
- 2.50 NZTA has reviewed the appropriateness of including "Brownfields" costs. The review concluded that it is appropriate to include these costs in future valuations. This approach is applied internationally and to other large infrastructure assets such as the rail network. We understand that NZTA and its valuer are now considering how to incorporate this into future valuations.
- 2.51 We have recommended that NZTA update its valuation methodology to incorporate "Brownfields" costs and complete a review of the reasonableness and validity of the assumptions used in the valuation methodology. These should be done in time to incorporate any methodology changes into the 30 June 2011 valuation.

Accounting for the Kyoto Protocol

- 2.52 We have concluded that the Kyoto asset is materially correct based on the current assumptions and information available.
- 2.53 By its nature, this asset is more uncertain than most other items in the statement of financial position. Fluctuations in the value of the estimate may occur through changes in the assumptions underlying the net carbon emissions, movements in the price of carbon, and exchange rate movements between the market currency (EURO) and the New Zealand dollar. These assumptions are particularly prone to uncertainty.
- 2.54 New Zealand ratified the Kyoto Protocol in December 2002. This international agreement commits New Zealand to reducing its average net emissions of greenhouse gases between 2008 and 2012 (the first commitment period of the Kyoto Protocol or CP1) to 1990 levels or to take responsibility for the difference.

- 2.55 New Zealand's projected balance of Kyoto Protocol units during the first commitment period has increased by 1.6 million tonnes (from a surplus of 9.6 million tonnes in 2009). The two largest factors underlying the increase are:
- Emissions from the agricultural sector are now projected to be 6.4 million tonnes lower than projected in 2009 (a drop of 3.5%). This is attributable to the slower than anticipated recovery from a nationwide drought, and some regions experiencing further drought. The slower than predicted recovery is because of the economic slowdown.
 - This fall in emissions has been largely offset by a fall in net removals from forestry of five million tonnes. Land-use mapping data has shown that the area of eligible Kyoto forests is smaller than previously estimated. This mapping also shows some deforestation of natural forests that had not previously been included in the net position, and this has increased the estimation for deforestation emissions.
- 2.56 We have recommended that the Ministry for the Environment complete its planned review of the carbon pricing methodology in time for it to be implemented by 30 June 2011. The current carbon pricing methodology is based on the value of Certified Emission Reduction units that are traded on the European carbon market. This has previously been agreed as the most appropriate methodology. However, as there have been changes in the carbon market in New Zealand, including the implementation of an ETS, it is appropriate for this methodology to be reviewed.
- 2.57 During 2009/10, an Australian-based firm completed an independent review of the methodology and processes used to determine the projected Kyoto net position. The review found that the projected net emissions are a reasonable estimate of how New Zealand is tracking towards its Kyoto Protocol commitment, and a practical system has been developed for estimating future levels of emissions that reflects New Zealand's national circumstances.

Part 3

Audit results for government departments, Crown research institutes, and State-owned enterprises

- 3.1 In this Part, we report on our 2009/10 audit results and assessments of the environment, systems, and controls of government departments, Crown research institutes (CRIs), and State-owned enterprises (SOEs). We will report on district health boards and other Crown entities in early 2011.
- 3.2 We set out our findings on the management control environment, financial information systems, and (for government departments) service performance information and associated systems and controls.
- 3.3 The Auditor-General has a statutory requirement to attest to the statement of service performance included in the annual reports of government departments and Crown entities (excluding school boards of trustees). There is no such statutory requirement for CRIs and SOEs.

Background

- 3.4 As part of the annual audit, auditors examine, assess, and grade central government entities' environment, systems, and controls for managing and reporting financial and service performance information.
- 3.5 We report our assessments to the entity, the responsible Ministers, and the relevant select committees. We also advise the central agencies (the Treasury, the State Services Commission, and the Department of the Prime Minister and Cabinet) and the relevant monitoring department of our assessments and audit findings.
- 3.6 In 2006/07, we introduced a revised assessment framework to improve the transparency, usefulness, and understandability of our reporting. The framework and commentary is intended to support continual improvement by public entities.
- 3.7 The framework has three areas that we assess and report on:
- the management control environment;
 - financial information systems and controls; and
 - service performance information and associated systems and controls (where applicable).
- 3.8 We explain the three aspects we assess in more detail in Figure 3. Auditors identify deficiencies in each of these aspects, and make recommendations for improvement. The grades assigned directly reflect the recommendations for improvement as at the end of the financial year.

Our grading system

- 3.9 Figure 2 shows our grading scale for assessing environment, systems, and controls.

Figure 2
Grading scale for assessing environment, systems, and controls

Grade	Explanation of grade
Very good	No improvements are necessary.
Good	Improvements would be beneficial and we recommend that the entity address these.
Needs improvement	Improvements are necessary and we recommend that the entity address these at the earliest reasonable opportunity.
Poor	Major improvements are required and we recommend that the entity urgently address these.

- 3.10 Grades for a particular entity may fluctuate from year to year depending on several factors. Some of those factors include changes in the operating environment, in standards, in good practice expectations, and in auditor emphasis. For these reasons, we advise caution when comparing grades between years and between different entities.
- 3.11 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 be that the entity has not kept pace with good practice expectations for similar entities between one year and the next. Consequently, the long-term trend in grade movement is a more useful indication of progress than year-to-year grade changes.
- 3.12 This is the fourth year that we have assessed and graded the management control environment, and financial information systems and controls. It is the second year that we graded service performance information and associated systems and controls of government departments. We discuss service performance information in more detail in paragraphs 3.36-3.53.

Explanation of the scope of the three aspects we examine

- 3.13 Figure 3 outlines the scope of the three aspects that our auditors examine as part of the annual audit.

Figure 3
Scope of the three aspects that our auditors examine

Area	Scope
Management control environment	<p>This is the foundation of the control environment and may include considering:</p> <ul style="list-style-type: none"> • clarity of strategic planning/the way the entity manages and reports performance; • communication and enforcement of integrity and ethical values; • commitment to competence; • participation by those charged with governance – for example, the involvement and influence of Audit Committee and Board (or equivalent); • management philosophy and operating style; • organisational structure; • assignment of authority and responsibility; • human resources policies and practices; • risk assessment and risk management; • key entity-level control policies and procedures; • information systems and communication (including information technology planning and decision-making); • monitoring; and • legislative compliance arrangements.
Financial information systems and controls	<p>These are the systems and controls (including application-level computer controls) over financial performance and financial reporting, and include considering:</p> <ul style="list-style-type: none"> • appropriateness of information provided and reported; • presentation of financial information; • reliability of systems; • control activity (including process-level policies and procedures); and • monitoring.
Service performance information and associated systems and controls	<p>This concerns the quality of the service performance measures selected for reporting against, as well as the systems and controls (including application-level computer controls) over service performance reporting, and includes considering:</p> <ul style="list-style-type: none"> • appropriateness of information provided and reported; • review of the 2010-13 Statement of Intent; • presentation of forecast 2010/11 Statement of Service Performance (SSP) information and the associated information in the Information Supporting the Estimates; • the audit of the actual 2009/10 SSP in the annual report; • reliability of systems; • control activity (including process-level policies and procedures); and • monitoring.

Our assessment system

- 3.14 Auditors base the grades that they assign in their assessment on deficiencies observed through the audit, and on the associated recommendations for improvement. Auditors' conclusions on deficiencies (that is, the gap between "actual practice" and "how practice should be"), and the associated recommendations for improvement, are based on their assessment of how far the entity's practice falls short of good practice. Good practice is based on auditors' professional expertise and judgement, taking into account what is deemed appropriate for each entity, given its size, nature, and complexity. An auditor's professional judgement is informed by many factors, including national and international standards, knowledge of good practice, and standards and expectations for the public sector.
- 3.15 Our auditors' approach and the standards they apply reflect the unique circumstances of each entity in each financial year. Entities vary greatly in size and organisational structure, and sometimes undergo restructuring or other organisational changes.

Central government context

- 3.16 The current central government environmental context is one of ongoing change and fiscal constraint due to the global recession. Government initiatives to improve departments' and the wider state sector's performance, effectiveness, and efficiency include machinery of government changes, alternative approaches to delivering services (for example, greater use of private partnerships), and initiatives to improve the efficiency of back-office services across departments (such as all-of-government procurement).
- 3.17 Change and improvement initiatives can affect organisational capability and capacity. For example, agencies will need to:
- maintain governance and management of core services in addition to change and improvement processes;
 - develop new cross-agency management and accountability arrangements for collaborative across-government initiatives;
 - maintain capacity and capability if restructuring and/or redeploying staff;
 - understand costs and cost drivers, and maintain good financial and strategic management; and
 - maintain effective control environments and be alert to the potential greater risk of frauds.

- 3.18 We will continue to take this environment into consideration in the planning and emphasis of our audits of government agencies.

Audit results for government departments

- 3.19 We audited 39 government departments in 2009/10 – the same number as in 2008/09. Government departments include the Office of the Clerk and the Parliamentary Service, and exclude Offices of Parliament, the Government Communications Security Bureau, and the New Zealand Security Intelligence Service.
- 3.20 We issued unqualified audit reports on all 39 departments for 2009/10. Four of these reports were non-standard¹ and included explanatory paragraphs highlighting that the financial statements had been prepared on a disestablishment basis. These government departments will be disestablished when they are integrated into other government departments.
- 3.21 Figure 4 shows a summary of the grades for our 2009/10 assessments of environment, systems, and controls for the three aspects that we assess.

Figure 4
Government departments – summary of grades for 2009/10

Number of entities graded	Management control environment				Financial information systems and controls				Service performance information and associated systems and controls			
	VG	G	NI	P	VG	G	NI	P	VG	G	NI	P
39	16	20	3	0	16	23	0	0	0	11	25	3

Ratings used are: VG – Very good, G – Good, NI – Needs improvement, P – Poor

- 3.22 Overall, the results for 2009/10 show that government departments have generally sound management control environments and financial information systems and associated controls, which is pleasing to see. However, the results also show that there is still significant room for improvement in service performance information and associated systems and controls.
- 3.23 We discuss the first two aspects (the management control environments and financial information systems and associated controls) together, and the third aspect (service performance information and associated systems and controls) separately.

¹ We report on non-standard audit reports in Part 6.

Management control environment and financial information systems and controls

3.24 Figures 5 and 6 below show the trends in grades for government departments for the four years since we began grading these areas in 2006/07.

Figure 5
Management control environment grades for government departments from 2006/07 to 2009/10, as percentages

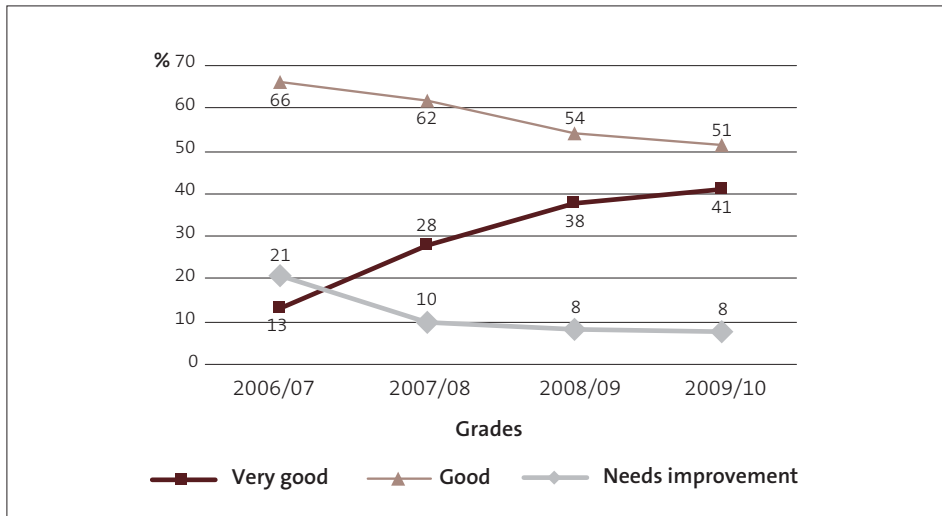
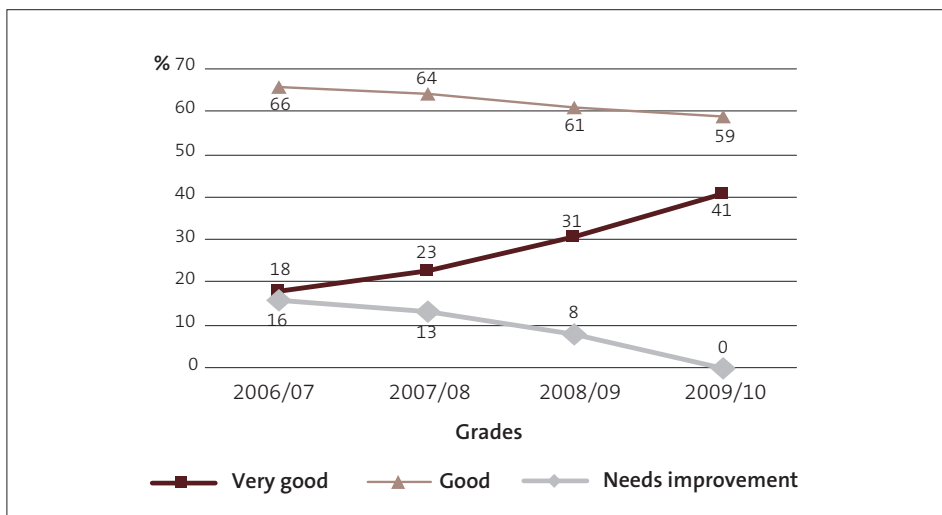


Figure 6
Financial information systems and controls grades for government departments from 2006/07 to 2009/10, as percentages



- 3.25 Both figures show that government departments have improved steadily in management control environments and financial information systems and controls during the past four years.
- 3.26 The proportion of government departments receiving a very good grade for the management control environment increased from 13% in 2006/07 to 41% in 2009/10. For financial information systems and controls, the proportion receiving very good grades increased from 18% in 2006/07 to 41% in 2009/10.
- 3.27 These are significant improvements and show that government departments have responded and continue to respond to auditors' recommendations for improvement.

Results for 2009/10

- 3.28 We assessed all but three government departments as having either very good or good management control environments in 2009/10.
- 3.29 The three government departments that received needs improvement grades were also assessed as needing improvements in 2008/09. Although all three had made some progress in response to the 2008/09 recommendations, they still need to improve their management control environments. However, we note that these government departments all received good grades for their financial information systems and controls in 2009/10.
- 3.30 We are pleased to report that we assessed all government departments as having either very good or good financial information systems and associated controls in 2009/10. The three government departments assessed as needing improvement in 2008/09 responded in full to auditor recommendations and were all graded as good in 2009/10.
- 3.31 Most government departments responded either in full or in part to our 2008/09 recommendations for improvement in both the management control environment and financial information systems and controls.
- 3.32 In our examination of the 2009/10 audit results, we did not identify any significant or common areas for improvement in either the management control environment or financial information systems and controls.
- 3.33 However, in a number of instances, auditors noted the context of organisational change that we discussed above, including:
- changes in organisational form, such as current or impending departmental amalgamations;
 - organisational restructures within departments; and

- reductions in staff numbers, high turnover of staff, and/or loss of key personnel.

- 3.34 For one government department assessed as needing improvement, the auditor noted that changes in key staff were a contributing factor to the deficiencies noted in the management control environment.
- 3.35 As noted above, the importance of maintaining capability and effective controls is heightened in an environment of increased change. Therefore, it is reassuring to report that government departments have continued to maintain sound controls and systems in 2009/10.

Service performance information and associated systems and controls

- 3.36 As part of phasing in improvements to the way we audit service performance information, 2009/10 is the second year that we graded service performance information and associated systems and controls.
- 3.37 Our primary objective in examining service performance information is to assess the quality of the forecast performance reports and supporting systems and controls, and to audit the service performance reported in the 2009/10 annual report.

Background

- 3.38 The Auditor-General is required under the Public Finance Act 1989 to attest to the statement of service performance included in the annual reports of government departments.
- 3.39 We have previously reported on our work of recent years to improve service performance information. This work has had an emphasis on improving auditing standards, methodology, and reporting by appointed auditors.
- 3.40 In 2008/09, we introduced a revision of the Auditor-General's Auditing Standard on auditing performance information, referred to as AG-4 (Revised) – The Audit of Service Performance Reports. The application of the standard is being phased in and will be effective for 20 government departments from 1 July 2010, 12 departments from 1 July 2011, and the remaining departments the following year.²
- 3.41 We allowed for a transitional period before we graded service performance information by not grading in 2006/07 or 2007/08. However, our auditors did assess service performance information in both these years and provided comments to entities about improvements they could make.

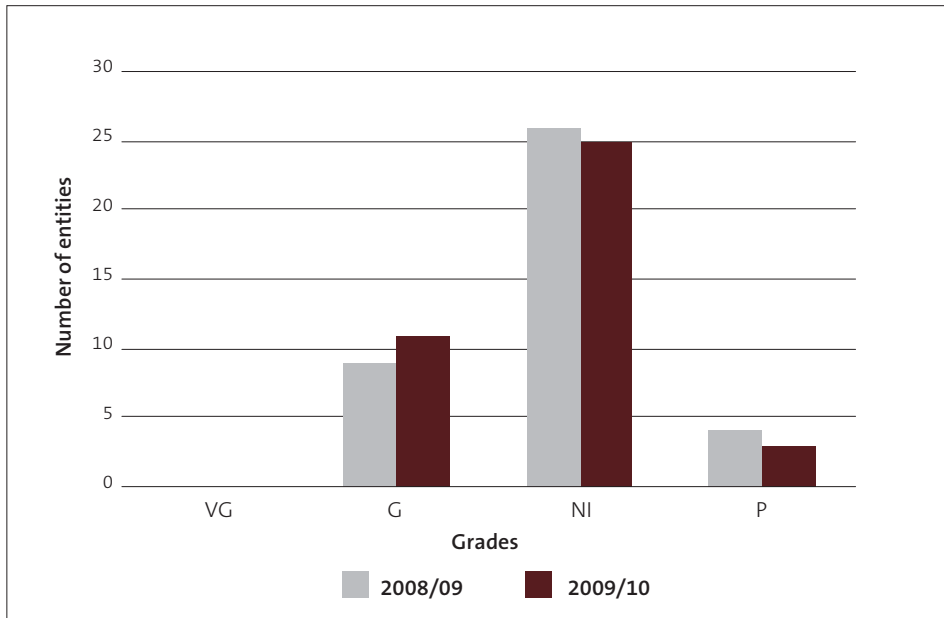
² See Part 5 of *Central government: Results of the 2008/09 audits* for an explanation of the phasing in and categorisation of entities for the application of AG-4 (Revised).

3.42 In reviewing and grading forecast reports, our auditors considered the relevance, reliability, understandability, and comparability of information in presenting a clear and cohesive description of performance. Performance elements (outcomes, impacts, and outputs) and their associated measures and targets should be presented in a clear and informative context.

Results for 2009/10

3.43 There has been a small improvement in the grades for service performance information and associated systems and controls in 2009/10 compared to 2008/09 as shown in Figure 7.

Figure 7
Comparison of grades for service performance information and associated systems and controls in 2008/09 and 2009/10



Ratings used are: VG – Very good, G – Good, NI – Needs improvement, P – Poor.

3.44 Despite the small improvement in the 2009/10 results, the overall spread of grades continues to show that there is much room for improvement. Three government departments received poor grades, and 25 government departments (64%) received needs improvement grades.

3.45 As previously reported, in our view, improving the quality of performance reporting is critical not only for demonstrating accountability but also for improving public sector effectiveness.

- 3.46 Five government departments improved their grades from 2008/09 – two from poor to needs improvement and three from needs improvement to good. The grades of two government departments went down – one from good to needs improvement and one from needs improvement to poor.
- 3.47 As previously explained, grades may fluctuate from year to year depending on a range of factors. We are particularly interested in how government departments respond to auditors' recommendations for improvement. In 2009/10, we found the following:
- Overall, 32 government departments responded in part to recommendations from the 2008/09 audits.
 - Two government departments that responded in full to recommendations for improvement in 2008/09 improved their grades from needs improvement to good in 2009/10.
 - Three of four government departments assessed as poor in 2008/09 and requiring urgent major improvements responded in part to the 2008/09 recommendations. Two of these government departments improved their grades to needs improvement in 2009/10.
 - One government department assessed as poor in 2008/09 did not respond at all to the recommendations in 2008/09 and was again assessed as poor in 2009/10. We are aware of particular circumstances in this instance, which we expect to be addressed in 2010/11.
- 3.48 We examined the recommendations for improvement in the 2009/10 audits of service performance information and identified the following issues that were common across a number of government departments:
- fundamental problems with the performance framework – for example, the relationship between services (outputs) and the impacts they have was not clear;
 - limited or no performance measures or targets for outcomes/impacts;
 - output classes that were not clearly defined; and
 - performance measures for outputs that either were lacking or did not cover all dimensions of performance (timeliness, cost, quality, and quantity).
- 3.49 Consistent with our report on the 2008/09 audit results, we expect entities to take appropriate action to address the matters raised by our auditors in 2009/10 and to achieve the recommended improvement to service performance reporting and associated systems and controls.

- 3.50 We recognise that this is challenging, but consider that it is integral to improving the effectiveness and efficiency of the public sector – both in actual performance and demonstrating it through better accountability. During 2009/10, we worked with central agencies, government departments, and auditors to help lift capability and performance. We will continue this work in 2010/11. Our work programme included:
- focused engagement with a number of selected government departments;
 - publishing examples of better practice in performance reporting; and
 - facilitating workshops.
- 3.51 Forthcoming publications on performance reporting by our Office are:
- a new report giving examples of better practice in the central government sector, which we will publish on our website (www.oag.govt.nz);
 - a report on a longitudinal case study of certain entities' performance reporting over five years; and
 - an overview report of our work on performance information in both central and local government.
- 3.52 In 2009/10, the local government sector was the first to have audit reports issued under AG-4 (Revised). We will report on these results in 2011. However, preliminary analysis shows that the number of qualified audit opinions was lower than expected. We issued three qualified except-for opinions where our service performance work was limited because data was incomplete or not collected for significant performance measures. In many cases, local government entities were able to fix potential issues to better report their performance on a basis consistent with AG-4 (Revised).
- 3.53 AG-4 (Revised) will apply to the audit reports of 20 government departments in 2010/11. A range of issues could affect these audit reports. In many cases, the improvements recommended are not substantial and we expect that improvements will be made. However, given the number of departments that need to make improvements, there may be some qualified audit opinions. We will continue to work with government departments to understand their business and help them to better align performance information and reporting with legislative and accounting requirements and with good practice.

Audit results for Crown research institutes

- 3.54 We audited eight CRIs in 2009/10 – the same number as in 2008/09. The number of CRIs reduced from nine in 2007/08 to eight in 2008/09 after two CRIs were amalgamated.

- 3.55 We issued unqualified audit opinions on all eight CRIs for 2009/10. We report on non-standard audit reports more fully in Part 6.
- 3.56 Figure 8 shows a summary of the grades for 2009/10 for the two areas we assess. As the Auditor-General is not required to attest to CRIs' service performance, we do not assess and grade this area.

Figure 8
Crown research institutes – summary of grades for 2009/10

Number of entities graded	Management control environment				Financial information systems and controls			
	VG	G	NI	P	VG	G	NI	P
8	8	0	0	0	1	7	0	0

Ratings used are: VG – Very good, G – Good, NI – Needs improvement, P – Poor.

- 3.57 We are again pleased to report that auditor assessments for 2009/10 continue to show strong performance by the CRIs.
- 3.58 All eight CRIs had their management control environments assessed as very good in 2009/10. These results are commendable, especially as grades can fluctuate from year to year depending on a range of factors.
- 3.59 The two CRIs that received good grades for their management control environments in 2008/09 responded fully to our recommendations for beneficial improvement. Both were assessed as very good in 2009/10.
- 3.60 In 2009/10, one CRI was assessed as very good for its financial information systems and controls. The other seven were assessed as good. Five CRIs responded in part, and two in full, to auditor recommendations in 2008/09 for beneficial improvement to financial information systems and controls.
- 3.61 Figures 9 and 10 show the trends in grades for CRIs for the four years since 2006/07.

Figure 9
Management control environment grades for Crown research institutes from 2006/07 to 2009/10, as percentages

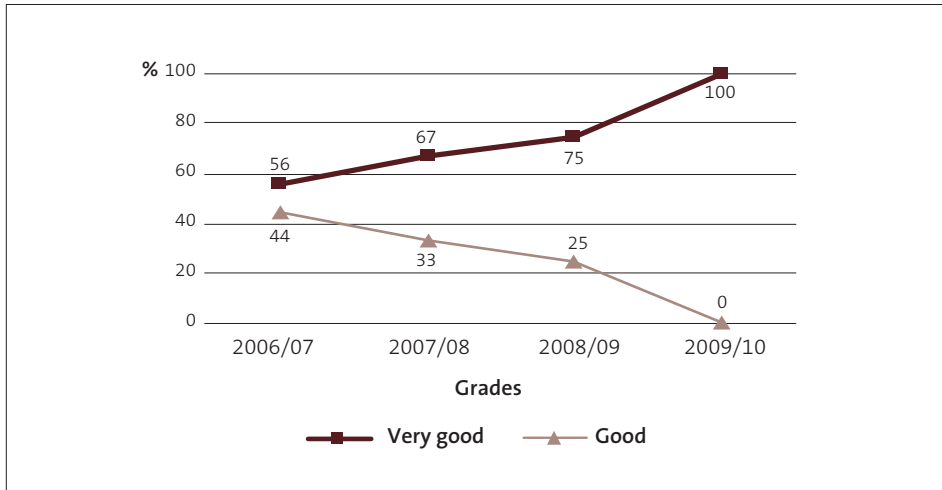
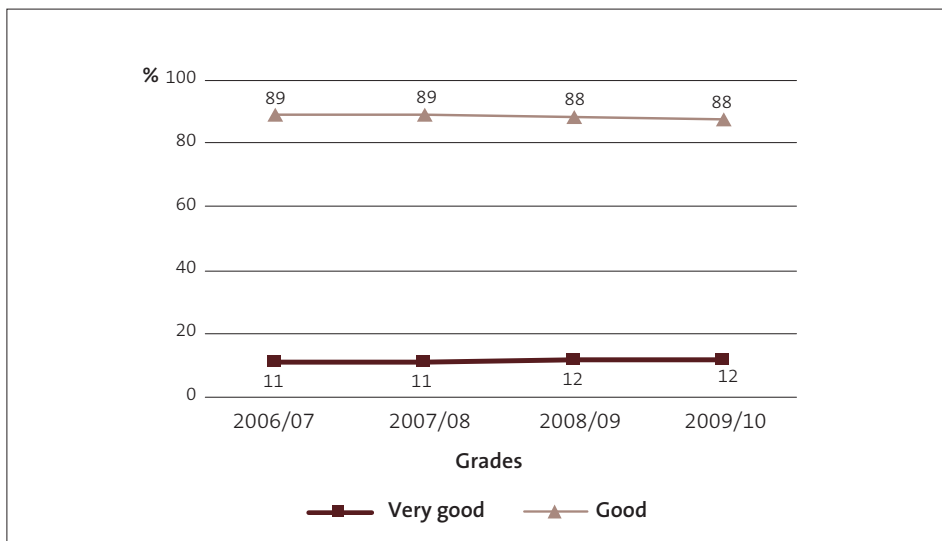


Figure 10
Financial information systems and controls grades for Crown research institutes from 2006/07 to 2009/10, as percentages



3.62 Assessments and grades since 2006/07 have all been either good or very good for both aspects. These consistent results show that CRIs have maintained sound environments, systems, and controls during the past four years.

- 3.63 Significant change is under way in the CRI sector with the implementation of the recommendations of the Crown Research Institute Taskforce on *How to enhance the value of New Zealand's investment in Crown Research Institutes*.³ Changes to CRI funding, accountability, and performance reporting are expected to be in place from 1 July 2011. We are monitoring these developments and expect to adjust our audit emphasis for audits from 1 July 2011 in response to these changes.

Audit results for State-owned enterprises

- 3.64 We report on 2009/10 audit results for 15 SOEs – compared to 17 SOEs in 2008/09.⁴
- 3.65 We issued unqualified audit opinions on all 15 SOEs for 2009/10.
- 3.66 Figure 11 shows a summary of the grades for the two areas we assess for 2009/10. Because the Auditor-General is not required to attest to SOEs' service performance, we do not assess and grade this aspect.

Figure 11
State-owned enterprises – Summary of grades for 2009/10

Number of entities graded	Management control environment				Financial information systems and controls			
	VG	G	NI	P	VG	G	NI	P
15	12	2	1	0	6	9	0	0

Ratings used are: VG – Very good, G – Good, NI – Needs improvement, P – Poor.

- 3.67 The results in 2009/10 show that, overall, SOEs have sound management control environments and financial information systems and controls.
- 3.68 In 2009/10, all but one SOE received either a very good or a good grade for the two aspects we grade. One SOE received a needs improvement grade for its management control environment. Although this SOE's grade was unchanged from 2008/09, we note that it made good progress during the past year in responding to our recommendations for improvement. Improvements made by this SOE resulted in its grade for financial information systems and controls moving from a needs improvement in 2008/09 to a good in 2009/10.

3 Available at www.morst.govt.nz/current-work/CRI-Taskforce/Final-Report/.

4 One SOE (Timberlands West Coast Limited) is being wound up and is therefore not included. Another has a 30 September 2010 balance date, and audit results had not been reported at the time of publication. Air New Zealand Limited has been included as if it were an SOE.

- 3.69 In 2009/10, five SOEs responded in full and four responded in part to the 2008/09 recommendations for improvement to financial information systems and controls. One SOE responded in full and two responded in part to recommendations for improvement to the management control environment.
- 3.70 Figures 12 and 13 show the trends in grades for SOEs for the four years since 2006/07.

Figure 12
Management control environment grades for State-owned enterprises from 2006/07 to 2009/10, as percentages

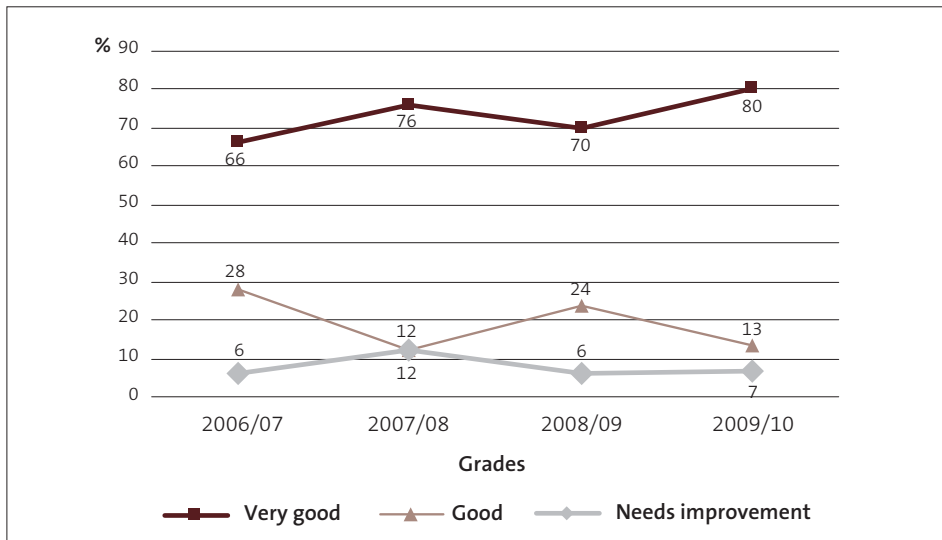
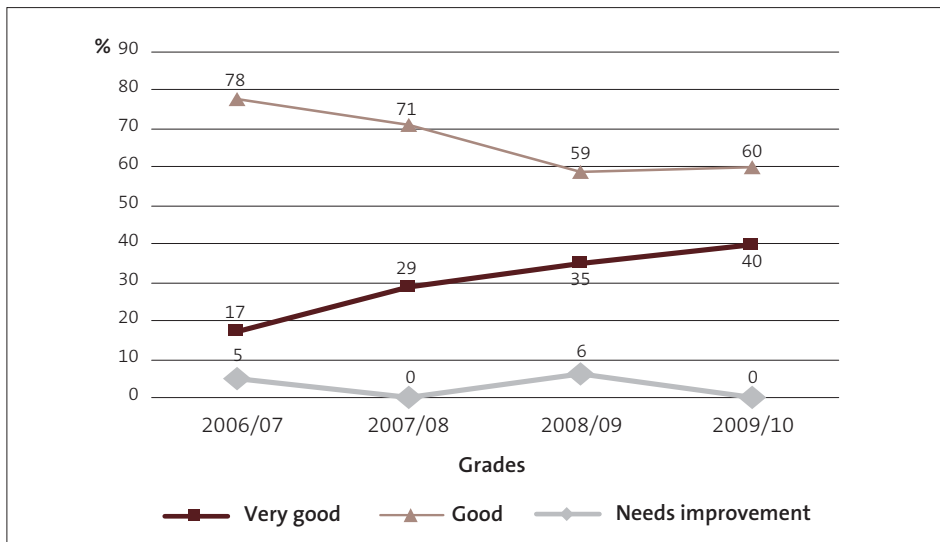


Figure 13
Financial information systems and controls grades for State-owned enterprises from 2006/07 to 2009/10, as percentages



3.71 Figures 12 and 13 show a steady increase in very good grades for both aspects we grade since 2006/07. We are pleased to note the trends in the SOE sector for general improvement in both aspects and that entities have been responsive to their auditors' feedback for improvement.

Part 4

The Controller function and the appropriation audit

- 4.1 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.
- 4.2 In this Part, we briefly outline the public finance principles underpinning this work and the work's main features. We also discuss unappropriated expenditure in 2009/10 and for the early parts of 2010/11, and report on some other matters we have had to consider recently.

Summary

- 4.3 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 following year's Budget, and is passed by the end of the financial year.
- 4.4 There are several approval mechanisms in place to provide some flexibility for the Executive in responding to change through revised expenditure between Appropriation Acts:
- 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. To be approved under section 26B, 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.
- 4.5 In addition to these mechanisms, section 25 of the Act provides additional powers to the Minister of Finance to approve expenses and capital expenditure in the event of an emergency.
- 4.6 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. Under section 26C of the Act, 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.

4.7 During 2009/10, there were:

- 27 identified instances of expenditure exceeding appropriation without authority, with the excess amounting to more than \$234 million (2008/09: 39 instances amounting to excess expenditure of more than \$927 million). Some of these instances related to prior years; and
- 2 instances of net assets exceeding the approved limited, the excess amounting to more than \$2 million.

4.8 This represents a decrease from the previous year in both number and value of such instances, and represents a small part of total government expenditure.

4.9 However, departments need to understand the importance of appropriation and lawfulness, and the processes within the Act that support them.

4.10 We continue to emphasise the need for departments, with support from the Treasury, to have effective procedures to ensure that all public expenditure is within the appropriate bounds, and to seek relevant expenditure authority or approval promptly.

Unappropriated expenditure in 2009/10

4.11 Most government expenditure during 2009/10 was authorised by appropriations in the usual way.

4.12 There were four instances of expenditure exceeding appropriation (with the excess amounting to \$10.509 million) that were approved under section 26B.

4.13 There were also two instances of expenditure exceeding appropriation (the excess amounting to \$10.941 million) but with authority of an Imprest Supply Act.⁵

4.14 There were 27 instances of expenditure that exceeded appropriation (the excess amounting to \$234.844 million) without the authority of any of the approval processes provided by the Act.

4.15 In 13 of the 27 instances, expenditure was within the scope of an appropriation but more than the amount authorised by Parliament.⁶ Total expenditure in excess of authority was more than \$199 million. Some of these instances related to expenditure that is subject to fluctuations in demand.

⁵ These are listed on page 155 of *Financial Statements of the Government of New Zealand for the Year Ended 30 June 2010*.

⁶ These are listed on page 156 of *Financial Statements of the Government of New Zealand for the Year Ended 30 June 2010*.

- 4.16 The other 14 instances⁷ involved expenditure that was outside the scope or without appropriation. The total expenditure in these instances was more than \$35 million. Ten of these instances related to previous years, following reviews of the appropriation scope, and the associated accounting treatment, in the 2009/10 financial year.
- 4.17 Expenditure in excess of appropriation and without authority is a relatively small proportion of overall government expenditure.
- 4.18 However, it is still a concern when government agencies incur expenditure without the necessary authority from Parliament. We were disappointed to note a number of instances where Departments should have been more pro-active in forecasting demand-driven expenditure. It was also disappointing to note a number of instances where the full accounting costs of contracts, and their appropriation impacts, had not been fully understood before they were entered into.
- 4.19 We continue to encourage departments to pay closer attention to ensuring that they have authority before incurring any expenditure. We also continue to work with the Treasury to provide better guidance and support through the administrative systems that support the Crown's financial management.

Net asset holdings

- 4.20 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).*
- 4.21 A breach of a department's net asset limit is treated as a breach of appropriation.
- 4.22 Two departments breached their net asset limits during 2009/10,⁸ the same number as in the previous year. These breaches (amounting to \$2.285 million) were without the authority of an Imprest Supply Act.
- 4.23 This aspect of appropriations is complex, from both a legal and an accounting perspective. Accordingly, Departments need to continue taking care in applying the net asset requirements of the Act.

⁷ These are listed on page 157 of the *Financial Statements of the Government of New Zealand for the Year Ended 30 June 2010*.

⁸ These are listed on page 158 of the *Financial Statements of the Government of New Zealand for the Year Ended 30 June 2010*.

Unappropriated expenditure in 2010/11

- 4.24 In the first four months of the 2010/11 financial year, and at the time of writing this Part several other potential instances of unappropriated expenditure were being investigated.
- 4.25 These potential instances of unappropriated expenditure in the early part of 2010/11 do not suggest any features that are significantly different from those reflected in the instances for 2009/10.

Public expenditure principles

- 4.26 Two important principles govern public expenditure:
- appropriation; and
 - lawfulness of purpose.
- 4.27 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 within an appropriation or other statutory authority. Departments' net assets should not exceed the limits for which they have authority from Parliament.
- 4.28 Lawfulness of purpose includes, but is wider than, the principle of appropriation. To be lawful, expenses and capital expenditure must be incurred not only within an appropriation but also within the legal authority or capacity that enables the department to carry out the activity concerned.
- 4.29 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.
- 4.30 The Treasury provides useful guidance on the system of appropriations on its website (www.treasury.govt.nz). This guidance includes:
- *Guide to the Public Finance Act*;
 - *Guide to Appropriations*;
 - *Treasury Circular 2007/05: Multi-Year, Revenue Dependent and Department to Department Appropriations*;
 - *Treasury Circular 2006/04: Unappropriated Expenditure – Avoiding Unintended Breaches*; and
 - *Treasury Instructions*.

Operating the Controller function

- 4.31 Sections 65Y to 65ZA of the Act set out the legislative provisions for the Controller function. Its main features are:
- Departments provide information to the Treasury about the expenses and capital expenditure incurred against the authorities available. The Treasury collates and monitors this information throughout the year.
 - The Treasury supplies monthly reports⁹ 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* and a Memorandum of Understanding¹⁰ 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 is not within the scope, amount, or period of any appropriation or other authority (section 65ZA).
- 4.32 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 recognises this audit work as part of the basic functions of the Auditor-General.
- 4.33 The Auditor-General's appointed auditors must carry out an appropriation audit in conjunction with 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.

Remeasurements

- 4.34 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, unlike other expenses, they do not require an appropriation.

⁹ Monthly reporting is not required for July and August.

¹⁰ 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*.

- 4.35 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.
- 4.36 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. For example, they do not include revisions that result from transactions or events directly attributable to the Crown's actions or decisions. Thus, revaluing student loan receivables after a policy decision to change the applicable interest rate is not a remeasurement, and is therefore subject to appropriation limits in the usual way.
- 4.37 In July 2006, the Treasury issued Measuring Remeasurements to provide guidance on the subject.
- 4.38 In our Controller function and appropriation audit work, we frequently have to consider whether transactions or events result in a remeasurement. This requires careful judgement, and the legal and accounting issues are not straightforward.
- 4.39 Departments therefore need to take care when assessing transactions as remeasurements, and refer to the guidance available from the Treasury in doing so. We also encourage early discussion between departments and appointed auditors, where appropriate.

Part 5

The financial reporting environment and some current financial reporting issues

5.1 In this Part, we:

- comment on the financial reporting environment in New Zealand, including work the Ministry of Economic Development (the Ministry) and the Accounting Standards Review Board (ASRB) are carrying out to shape the future financial reporting environment; and
- outline current financial reporting issues that affect some entities in central government.

The financial reporting environment in New Zealand

5.2 In June 2009, we published a discussion paper entitled *The Auditor-General's views on setting financial reporting standards for the public sector*. In that paper, we expressed concerns about the ongoing suitability of New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) for many entities in the public sector. Our hope was that the discussion paper would promote constructive debate about changes needed to setting financial reporting standards, particularly for the public sector.

5.3 During the 18 months since that report was published, the debate that we sought has been occurring. We note in particular the following:

- In September 2009, both the Ministry and the ASRB released for comment discussion documents about the statutory framework for financial reporting.¹¹
- The Finance and Expenditure Committee of Parliament has acknowledged the importance of financial reporting in the public sector, and has had the Ministry, ASRB, the Treasury, and us appear on different occasions to discuss the financial reporting framework and financial reporting standards.
- There have been a number of conferences and seminars about the future of financial reporting in New Zealand, at which both the Ministry and ASRB have been prominent.

5.4 We are pleased that the debate looks to have led to consensus that change is needed to the setting of financial reporting standards in New Zealand. There appears to be consensus that one body should be responsible for all aspects of setting financial reporting standards, and that the financial reporting standards need to change to better deal with the range of entities that report externally. The debate is now about the extent of change to standards, and whether separate standards may be needed for different types of entity.

¹¹ The Ministry's discussion document was entitled *The Statutory Framework for Financial Reporting*. It can be downloaded from the Ministry's website – www.med.govt.nz. The ASRB discussion document, which was a companion to the Ministry's document, was entitled *Proposed Application of Accounting and Assurance Standards under the Proposed New Statutory Framework for Financial Reporting*. It can be downloaded from the ASRB's website – www.asrb.co.nz.

Work the Ministry of Economic Development and the Accounting Standards Review Board are carrying out

- 5.5 The discussion documents released for comment by the Ministry and ASRB have formed the basis for changes to the setting of financial reporting standards, including changes to the standards for the public sector.
- 5.6 The Ministry's discussion document considered the circumstances under which the law should impose requirements on entities to prepare, publish, and obtain assurance on general purpose financial reports. The ASRB document outlined its tentative proposals on the accounting standards to be used by entities required to prepare general purpose financial reports under the Ministry's document, and the level of assurance that should be provided on those reports.
- 5.7 Our comments in this Part about the work the Ministry and ASRB are carrying out are limited to the financial reporting aspects of the discussion documents. Since the end of January 2010, when the documents closed for comment, both the Ministry and ASRB have been carrying out work that we expect will lead to change.
- 5.8 The Ministry has been drafting legislation¹² that, if enacted, would consolidate the functions for setting financial reporting standards into one statutory board. The statutory board would be a reconstituted ASRB to be known as the External Reporting Board, or XRB for short. The XRB would be responsible for setting strategy as well as designing and approving financial reporting standards.
- 5.9 The Ministry is also drafting legislation that would establish which entities are required to publish general purpose financial reports. A principles-based approach would be applied in determining those entities, and that approach would result in changes to the current requirements. However, the changes would not affect entities in the public sector, which would continue to be required to publish general purpose financial reports.
- 5.10 The ASRB has considered the submissions it received on its discussion document. It has created a work programme that includes in-depth consideration of the main issues that will inform the decisions about the form of the new financial reporting framework. Some of these issues include:
- whether there should be a single set or multiple sets of financial reporting standards;
 - the viability of both International Public Sector Accounting Standards (IPSAS) and enhanced NZ IFRS for application by entities in the New Zealand public sector;

12 The draft legislation is the Auditor Regulation and External Reporting Bill, and it is currently before the Commerce Committee.

- tiers of reporting and the criteria for allocating entities to the various tiers; and
 - the extent to which New Zealand and Australian financial reporting standards should be converged.
- 5.11 The ASRB provides regular updates on its website about its deliberations on the above and other issues. As part of its deliberations, the ASRB has tentatively confirmed that user needs should be the primary criterion for assessing alternative frameworks. It has also tentatively decided that only financial reporting standards for profit-oriented entities should be converged with Australia at this stage.
- 5.12 The ASRB has not formed any views on whether there should be a single set or multiple sets of financial reporting standards. However, it has noted that both IPSAS and enhanced NZ IFRS are viable alternatives for financial reporting standards for the public sector. Also, it has not yet deliberated on tiers of reporting and the criteria for allocating entities to tiers.
- 5.13 We are pleased to see user needs as the primary criterion. We are also pleased to see that the ASRB considers IPSAS a viable set of standards for the public sector. We have been advocating using IPSAS as the basis for financial reporting standards in the public sector for 18 months.
- 5.14 The ASRB is expected to continue its deliberations and form its views on the various issues. It is then expected to consult further on the changes that it proposes the XRB would formally adopt after it is established.

Current financial reporting issues in central government

- 5.15 There are a number of current financial reporting issues that affect some entities in central government. We comment on seven of these issues in this section. The issues are:
- the complexity of financial reports;
 - service performance reporting;
 - underlying profit disclosures;
 - accounting for income tax;
 - related party transaction disclosures;
 - hedge accounting; and
 - proposed changes to financial reporting standards.

Complexity of financial reports

- 5.16 The introduction of NZ IFRS has resulted in generally more complex and much larger financial reports because of the amount of information that is now required to be disclosed. Complexity and excessive disclosures are a problem because members of governing bodies and other people who use financial reports often find it difficult to understand the information. Complexity has also led some entities to require external help to be able to prepare their financial reports, which comes at a cost.
- 5.17 In the public sector, the main reason entities are required to prepare financial reports is to account for their use of public funds, and, to a lesser extent, to help readers of the reports to make decisions. Therefore, in our view, clear, straightforward information is going to best discharge this accountability obligation.
- 5.18 We would like to see financial reports simplified as much as possible, including fewer disclosures. However, given the current approach to setting financial reporting standards, and the time it would take for any changes to be effective, the issues of complexity and excessive disclosures are likely to continue for some time yet.

Service performance reporting

- 5.19 Many entities are required to report on their service performance. It is generally recognised that this reporting could be improved. Improved reporting on service performance fits well with the Government's desire for better effectiveness, efficiency, and value for money from the public sector.
- 5.20 Service performance reports are a crucial part of accountability documents in the public sector. It is important that the service performance reports work with the financial statements to convey a coherent and consistent picture of each entity's performance. This is because true accountability requires transparency about financial and service performance, and an appropriate relationship between the two.
- 5.21 We have been seeking improvements to service performance reporting for a number of years, and we are pleased to see changes occurring. We discuss our work on service performance reporting in Part 3.

Underlying profit disclosures

- 5.22 A number of the more commercial entities in the public sector have been including and commenting on underlying profit amounts in their annual reports. The underlying profit amount is different to the profit in the financial statements, which is based on accounting requirements in NZ IFRS.¹³ The term “underlying profit” is not defined in financial reporting standards, but it typically excludes the effects of accounting for changes in the value of financial instruments and “one-off” transactions.
- 5.23 We understand that the more commercial entities are reporting such amounts in response to the complexity of financial reports, combined with concern that their financial reports based on NZ IFRS are not fairly reflecting their performance. These entities see the requirements to recognise fair value movements as complicating their financial reports, which is why they make adjustments to exclude the effects of those movements. Also, the economic downturn has resulted in impairments, restructurings, and other so-called one-off costs. By removing these movements and costs entities believe they are better reflecting underlying financial performance.
- 5.24 Although we encourage entities to include information in their annual reports that is likely to be relevant to users, we have some unease about the practice of disclosing underlying profits. Reasons for our unease include:
- There is no guidance on what underlying profit is, or how it is arrived at, and therefore inconsistent practices could occur among different entities.
 - Underlying profit often receives significant prominence in the annual report, and could overshadow financial information based on NZ IFRS.
 - Underlying profit is not always clearly labelled as supplementary information additional to that required by NZ IFRS.
- 5.25 We are aware that, internationally, standard setters are re-considering how best to present income in financial statements. It is not clear whether that work will result in information that better presents the financial performance of entities, so that the need for underlying profit disclosures is eliminated or at least reduced.

Accounting for income tax

- 5.26 The removal of tax deductions for depreciation on buildings has had a significant effect on the financial statements of entities that both own buildings and pay tax. The effect is a significant increase in both the tax expense and deferred tax liability recognised in financial statements of such entities.

¹³ Terminology other than “underlying profit” may be used to describe a profit amount that differs to the profit based on NZ IFRS. Examples of such terminology include “underlying result”, “underlying earnings”, “normalised result”, “result before non-recurring items”, and “result before significant items”.

- 5.27 Many people, including preparers of financial statements, have been very critical of the financial reporting standard that requires the recognition of larger deferred tax liabilities. They consider that the increase in the deferred tax liability does not represent the underlying economic reality of the removal of tax deductions for depreciation on buildings.
- 5.28 Unfortunately, in contrast to many other financial reporting standards dealing with other assets and liabilities, the standard on income taxation does not allow for the discounting of deferred taxation balances. The lack of ability to discount appears to be at the heart of the issue.
- 5.29 Although the removal of tax deductions for depreciation on buildings brought the issue to light again in the financial year to 30 June 2010, the issue with the standard has existed since it was adopted at the end of 2004. Given the current approach to setting financial reporting standards, the issue will continue to exist until changes are made to the international financial reporting standard on tax.

Related party transaction disclosures

- 5.30 Related party transactions, as defined in financial reporting standards, do not necessarily capture all the transactions that, in our view, affect the accountability of public sector entities. In the public sector, entities can have many and varied relationships with both individuals and other entities. Some disclosures about such relationships are likely to be relevant to people using the financial statements of an entity to hold the entity to account.
- 5.31 In our view, related party disclosures need to strike a balance between:
- not requiring disclosure of information that does not materially affect the accountability of public sector entities; and
 - requiring disclosure of information that is of likely interest to Parliament and the public, and that materially affects the accountability of public sector entities.
- 5.32 Since NZ IFRS was adopted, we have had some concerns with the standard on disclosure of related party transactions for the public sector. Our concerns stem from the standard being written from the perspective of multinational companies accessing international capital markets, with only minor changes of relevance to many entities in the public sector. It is not clear how aspects of the standard apply in a public sector context.
- 5.33 The standard was revised in the last year and will become mandatory during the next couple of years. The revised standard can be applied early, and some entities in the public sector did that in 2010. The revised standard has a section

on government-related entities that is an improvement on the current standard. However, the revised standard has also changed the definition of related parties, which, in our view, inappropriately limits what is considered to be a related party.

- 5.34 The current standard has a definition that is broader and recognises more entities or individuals as related parties than the definition in the revised standard. For example, the definition in the revised standard appears to exclude entities outside of government that have some influence over an entity in government. Such relationships in the public sector can involve transactions that, in our view, should be disclosed.

Hedge accounting

- 5.35 The requirements in financial reporting standards that need to be followed for entities to hedge account derivative transactions¹⁴ are stringent, particularly for entities that infrequently use derivatives. Those entities are unlikely to have systems or processes to meet the requirements of the standard, and therefore may choose not to hedge account, or may overlook the requirements that would allow the entities to hedge account. In either case, hedge accounting is not applied even though it may best reflect the underlying economic reality of the transactions.
- 5.36 We acknowledge that it is important to be careful about applying hedge accounting, particularly given the ease with which derivative transactions can be entered into and the possibility of speculative derivative transactions. However, the stringent requirements mean that entities have no room for judgement about when hedge accounting may be appropriately used for derivative transactions.
- 5.37 We would prefer the standard to allow more room for judgement, because in our view that would better serve the entities that use derivatives infrequently and the users of the financial statements of those entities. Given the current approach to setting financial reporting standards, this issue will continue to exist until changes are made to the international financial reporting standard on financial instruments.

14 Derivative transactions are transactions to be settled in the future that require no or only a small initial investment, and where the value changes in response to changes to an external variable such as an interest rate, commodity price, foreign exchange rate, or consumer price index. Common derivative transactions include foreign exchange contracts and interest rate swaps. Such transactions can provide an entity with some level of certainty for the underlying transaction, commitment, asset, or liability. Hedge accounting recognises the offsetting effects on surplus or deficit of changes in the fair value of the derivative and the underlying transaction, commitment, asset, or liability.

Proposed changes to financial reporting standards

- 5.38 In July 2010, a proposal was published to change a number of standards within NZ IFRS in the interests of aligning New Zealand and Australian financial reporting standards for profit-oriented entities. The proposed changes affected all aspects of financial reporting, including recognition, measurement, presentation, and disclosure. The proposed changes would mainly result in the undoing of previous changes New Zealand made to IFRS when establishing NZ IFRS. In other words, the proposed changes would more closely align NZ IFRS to IFRS. Other changes would result in some requirements being moved to a new standard.
- 5.39 We reviewed the proposed changes. We were concerned that, although the motivation was to align New Zealand and Australian financial reporting standards for profit-oriented entities, most of the proposals inadvertently affected all other entities. We provided detailed comments on the proposals, which can be summarised as follows:
- Proposals affecting recognition, measurement, and presentation are not in the best interests of high quality financial information for those that use financial statements.
 - Proposals to relocate unrelated specific New Zealand requirements to one New Zealand standard are not helpful to preparers of financial statements.
 - Proposals to remove minor disclosure requirements and low-level guidance do not appear to affect those that use financial statements in a significant way.
- 5.40 The proposals have not yet been finalised and, therefore, do not currently affect the financial statements of entities in the public sector. We hope that the proposals will be reconsidered rather than finalised as proposed, because of our concern that many of them are not in the best interests of either those that use financial statements or those that prepare them.

Part 6

Non-standard audit reports issued in 2010

- 6.1 In this Part, we report on the non-standard audit reports issued on the financial statements of public entities within our central government portfolio of audits during the ten months ended 31 October 2010.¹⁵ We issued 3024 audit reports within our central government portfolio within that time, 212 of which were non-standard.
- 6.2 The financial statements of school boards of trustees are part of our central government portfolio of audits.¹⁶ In the following text, we discuss schools separately from the other public entities.

Why we report this information

- 6.3 An audit report is addressed to the readers of an entity's financial statements. However, all public entities are ultimately accountable to Parliament for their use of public money and their use of any statutory powers or other authority given to them by Parliament. Therefore, we consider it important to draw Parliament's attention to the matters that give rise to non-standard audit reports.
- 6.4 In each case, the issues underlying a non-standard audit report are drawn to the attention of the entity and discussed with its governing body, or chief executive in the case of a government department.

What is a non-standard audit report?

- 6.5 A non-standard audit report¹⁷ is one that contains:
- a qualified opinion; and/or
 - an explanatory paragraph.
- 6.6 The introduction of New Zealand equivalents to International Auditing Standards will change the terminology used to describe types of non-standard audit reports. Future non-standard audit report articles will use the new terminology.

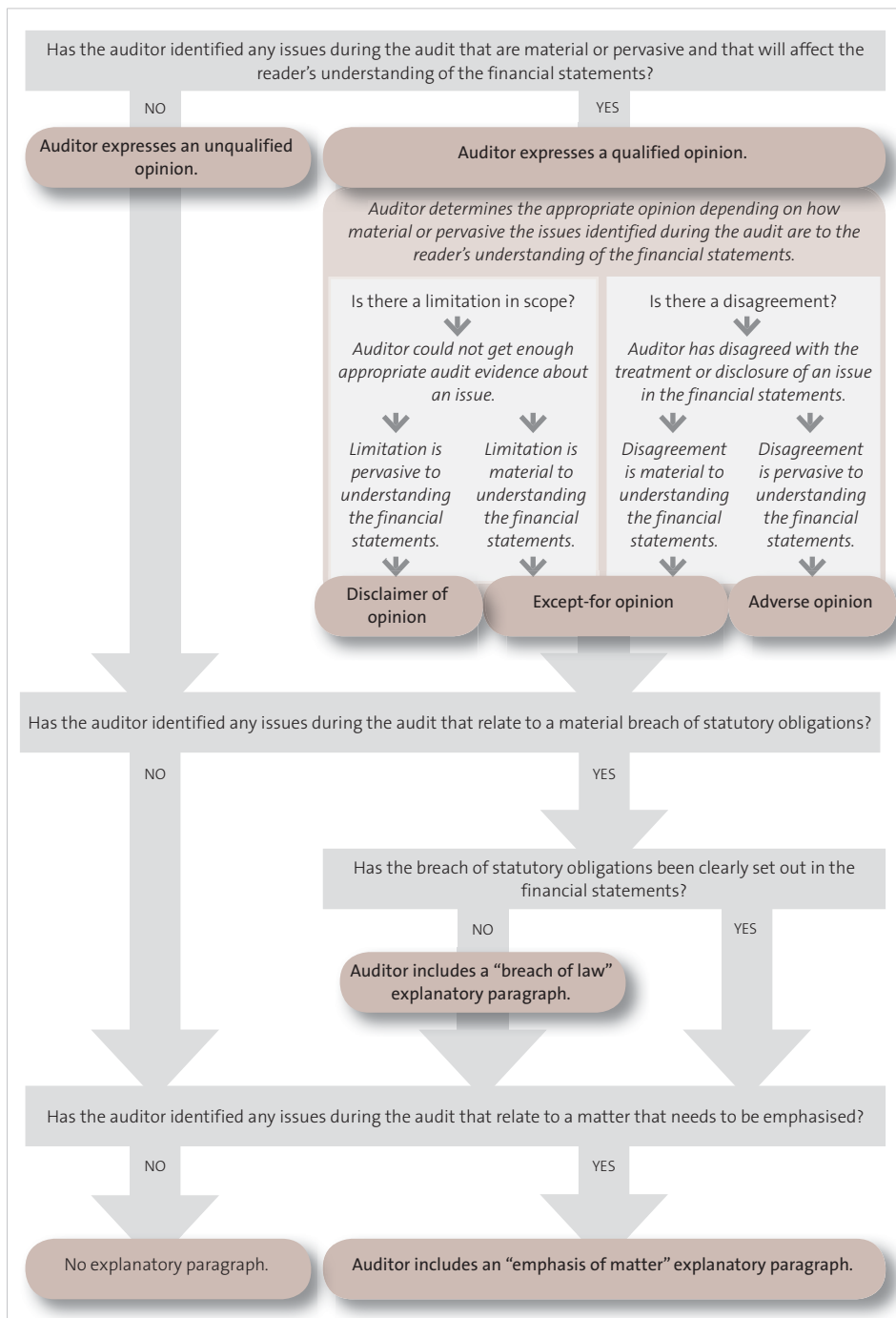
¹⁵ We report separately on entities within the local government portfolio in our yearly report on the results of audits for that sector.

¹⁶ 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 and, as such, is obliged to prepare annual financial statements in accordance with generally accepted accounting practice.

¹⁷ 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*.

- 6.7 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 appropriate evidence to support, and accordingly is unable to express, an opinion on the financial statements or a part of the financial statements.
- 6.8 There are three types of qualified opinion:
- an “adverse” opinion (see paragraphs 6.12-6.13);
 - a “disclaimer of opinion” (see paragraph 6.17); and
 - an “except-for” opinion (see paragraphs 6.20-6.21).
- 6.9 The auditor will include an **explanatory paragraph** (see paragraphs 6.25-6.26) in the audit report to draw attention to matters such as:
- a breach of law; or
 - a fundamental uncertainty.
- 6.10 Auditors have to include an explanatory paragraph in the audit report in such a way that it cannot be mistaken for a qualified opinion.
- 6.11 Figure 14 outlines the decisions that an auditor has to make when considering the appropriate form of the audit report.

Figure 14
Deciding on the appropriate form of the audit report



Note: This flowchart is based on the requirements of the Institute of Chartered Accountants of New Zealand Auditing Standard No. 702: *The Audit Report on an Attest Audit*. We have not based it on the International Standard on Auditing (New Zealand) because that standard applies to audits of financial statements for periods beginning on or after 1 October 2009.

Adverse opinions

- 6.12 An adverse opinion is the most serious type of non-standard audit report.
- 6.13 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.
- 6.14 During 2010, we expressed an adverse opinion for two public entities:
- Royal New Zealand Navy Museum Trust Incorporated; and
 - RNZAF Museum Trust Board.
- 6.15 The Appendix sets out the details of the adverse opinions.
- 6.16 We are pleased to report that it was not necessary for us to express an adverse opinion on any school boards' financial statements in the 2010 calendar year.

Disclaimers of opinion

- 6.17 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 appropriate evidence to support an opinion on the financial statements. The auditor is accordingly unable to express an opinion on the financial statements or on part of it.
- 6.18 During 2010, a disclaimer of opinion was expressed for one school – Te Kura Kaupapa Māori o Ruamata – for two years ended 31 December 2006 and 31 December 2007. The Appendix sets out the details of the disclaimer of opinion.
- 6.19 We are pleased to report that it was not necessary for us to express a disclaimer of opinion on any non-school public entity's financial statements in the central government portfolio in 2010.

Except-for opinions

- 6.20 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.

- 6.21 An except-for opinion is also expressed when the auditor concludes that a breach of statutory obligations has occurred and that the breach is material to the reader’s understanding of the financial statements. An example of this is where a Crown entity has breached the requirements of the Crown Entities Act 2004 because it has not included budgeted figures in its financial statements.
- 6.22 During 2010, we expressed except-for opinions on the financial statements or performance information of the following 11 non-school public entities:
- New Zealand Fire Service Commission;
 - Christchurch Polytechnic Institute of Technology and Group;
 - Wellington Institute of Technology;
 - UCOL International Limited (a subsidiary of Universal College of Learning, or UCOL);
 - Massey Ventures Limited and Group (a subsidiary of Massey University);
 - Whitireia Performing Arts Company Limited (a subsidiary of Whitireia Community Polytechnic);
 - Ivey Hall and Memorial Hall 125th Anniversary Appeal Taxable Activity Trust (a trust controlled by Lincoln University);
 - Ivey Hall and Memorial Hall 125th Anniversary Appeal Gifting Trust (a trust controlled by Lincoln University);
 - Wilson Home Trust (a trust for which the Waitemata District Health Board is the sole and permanent trustee);
 - Auckland DHB Charitable Trust (a trust controlled by Auckland District Health Board); and
 - Gisborne Laundry Services (associated with Tairāwhiti District Health Board).
- 6.23 We also expressed except-for opinions on the financial statements of the following 38 schools:
- Wellington Girls’ College;
 - New Plymouth Girls’ High School;
 - Te Wharekura o Rakaumangamanga;
 - Wanganui City College;
 - Wellington East Girls’ College;
 - Puni School;
 - Hato Paora College (two years ended 31 December 2008 and 31 December 2009);

- Saint Peter's College (Palmerston North);
- Pakuranga Health Camp School;
- Mayfield Primary School;
- Tirohia School (two years ended 31 December 2008 and 31 December 2009);
- Birchville School;
- Devon Intermediate School;
- Freyberg Community School;
- Hokitika School;
- Kiwitahi School;
- Makauri School;
- Mangapapa School;
- Motu School;
- Ohuka School;
- Red Beach School;
- Saint Joseph's Catholic School (Paeroa);
- Tangowahine School;
- Taumarunui High School & Community Trust;
- Te Kura Kaupapa Māori o Te Rawhiti Roa;
- Te Kura Kaupapa Māori o Takapau;
- Tongariro Area School;
- Upper Hutt School;
- Weber School;
- Whatatutu School;
- Moanataiari School;
- Woodstock School;
- Te Kura Kaupapa Māori o Waiuku (year ended 31 December 2008);
- Ross Intermediate;
- Allenvale Special School and Resource Centre;
- Taikura Rudolf Steiner School;
- Parkside Christian SDA School; and
- Te Tipua School.

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

Explanatory paragraphs

- 6.25 In certain circumstances, it may be appropriate for the auditor to include additional comments in the audit report. The auditor draws attention to a matter that they consider relevant to a reader's proper understanding of an entity's financial statements through an explanatory paragraph.
- 6.26 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.
- 6.27 During 2010, we used six main types of explanatory paragraphs for non-school public entities.
- 6.28 The first type of explanatory paragraph related to funding from a capital appropriation that was not recognised as an equity transaction. The audit opinion for the University of Auckland and Group included such an explanatory paragraph.
- 6.29 The second type of explanatory paragraph related to the existence of a high degree of uncertainty about the value of unlisted mortgage-backed securities that could have a material effect on the statement of financial performance and the statement of financial position. The audit opinion for the Public Trust and Group included such an explanatory paragraph.
- 6.30 The third type of explanatory paragraph related to the reduction made by a Board to the valuation of buildings carried out by an independent valuer that was not material to the financial statements as a whole. The audit opinion for MidCentral District Health Board and Group included such an explanatory paragraph.
- 6.31 The fourth type of explanatory paragraph related to serious financial difficulties faced by the entity. The audit opinion for Whanganui District Health Board included such an explanatory paragraph.
- 6.32 The fifth type of explanatory paragraph related to financial statements being appropriately prepared on the "going concern" assumption because the financial statements contained appropriate disclosures about the use of the going concern assumption. The audit opinion for Tairāwhiti Polytechnic included such an explanatory paragraph.
- 6.33 The sixth type of explanatory paragraph related to the "going concern" assumption being appropriately not used because entities were disestablished

or expected to be disestablished in the near future. The following entities' audit reports included such an explanatory paragraph:

- Archives New Zealand;
- Electoral Commission;
- Electricity Commission;
- Environmental Risk Management Authority;
- Foundation for Research, Science and Technology;
- Ministry of Research, Science and Technology;
- New Zealand Food Safety Authority;
- Securities Commission;
- National Library of New Zealand;
- Otago District Health Board;
- Southland District Health Board;
- New Zealand School of Fisheries Limited (a subsidiary of Nelson Marlborough Institute of Technology);
- The Nelson Academy Limited (a subsidiary of Nelson Marlborough Institute of Technology);
- Nelson Marlborough Institute of Technology International Limited (a subsidiary of Nelson Marlborough Institute of Technology);
- iPredict Limited and Group (a subsidiary of Victoria University of Wellington);
- Predictions Clearing Limited (a subsidiary of Victoria University of Wellington);
- MVLONE Limited (a subsidiary of Massey University);
- MVLTWO Limited (a subsidiary of Massey University);
- Public Trust Investment Funds Balanced Income Fund (a fund of Public Trust);
- Public Trust Group Investment Funds (PTIF) – Feeder Funds (a fund of Public Trust);
- Public Trust Group Investment Funds (GIF) – Investing Funds (a fund of Public Trust);
- Woodville Windfarm Limited (a subsidiary of Meridian Energy);
- Bay of Plenty Provincial Patriotic Council; and
- Southland Provincial Patriotic Council.

Schools

- 6.34 Because of the number of explanatory paragraphs included in audit reports for schools, we are not listing each school separately. We have instead reported the types of explanatory paragraphs that were issued and the number of schools that received each type.
- 6.35 There were seven main types of explanatory paragraphs:
- breaches of law for not reporting by 31 May 2010 (42 schools);
 - closures of entities (four schools and 23 transport networks, which are public entities controlled by schools);
 - serious financial difficulties (19 schools);
 - breaches of law for borrowing above the permitted limit without approval (14 schools);
 - breaches of law for not having a 10-year property plan (eight schools);
 - breaches of law for not submitting financial statements for audit by 31 March 2010 (eight schools); and
 - breaches of law for not including the required analysis of variance reports (six schools).
- 6.36 In addition, we emphasised matters in explanatory paragraphs for other reasons for 29 schools.
- 6.37 Many of the explanatory paragraphs included in audit reports for schools relate to breaches of law. We report on breaches of law if schools do not disclose the breaches of law in their financial statements. As it happens, most schools disclose breaches of law in their financial statements. Therefore, the list of audit reports that refer to breaches is not a complete list of the breaches of law by schools – there were many more breaches than we report.
- 6.38 The Appendix contains more information about the explanatory paragraphs that were included in audit reports.

Part 7

Results of tertiary education institution audits for 2009

7.1 This Part provides some background information about tertiary education institutions (TEIs) and their operating environment. It sets out the results of our annual audits of TEIs for 2009.

7.2 The financial year for TEIs ends on 31 December each year. This aligns with their academic teaching year.

What is the tertiary education institution sector?

7.3 The New Zealand tertiary education system includes all post-school education and training, from university research and diploma and degree study courses to industry training. In 2009/10, government expenditure on tertiary education was about \$2.8 billion (excluding GST).¹⁸ The tertiary education sector includes both public TEIs and private sector providers.

7.4 The Government sets policy and priorities for the tertiary education sector through its Tertiary Education Strategy and by designing the funding system.

7.5 There are 31 public tertiary education institutions providing training, education, and research services.¹⁹ We discuss the other agencies with a role in the tertiary education sector later in this Part.

7.6 The TEI sector has three distinct sub-sectors:

- universities (eight);
- institutes of technology and polytechnics (20); and
- wānanga (three).

7.7 Each TEI sub-sector tends to describe itself as distinct from the other two TEI sub-sectors. The TEI sub-sectors have set up “umbrella” bodies to represent the interests of their member organisations, foster collaboration, and facilitate a point of contact with external stakeholders. TEIs also maintain relationships with stakeholders in their own right.

7.8 In addition, many TEIs have set up 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 TEIs have set up research companies, scholarship trusts, childcare centres, and student hostel accommodation centres. In 2009, there were 108 entities controlled or owned by TEIs.

¹⁸ We have excluded student support initiatives (for example, student allowance and student loan amounts), which are estimated at about \$1.1 billion – see www.minedu.govt.nz.

¹⁹ Figure 16 lists the 31 TEIs.

- 7.9 TEIs are Crown entities²⁰ independently governed by councils whose functions are set out in the Education Act 1989 (the Act). The precise constitution of each TEI council differs. For the 2009 financial year, each TEI council consisted of not fewer than 12 members nor more than 20 members. Most councillors are elected or appointed by stakeholder groups, although four are appointed by the Minister for Tertiary Education (the Minister). We note that the Education (Polytechnics) Amendment Act 2009 has changed the constitution of councils for institutes of technology and polytechnics, with effect from 1 May 2010. The constitution of these councils reduced from 12-20 members to eight. Four members are appointed by the Minister and the other four members by the institutes of technology and polytechnics, in keeping with their statutes.²¹
- 7.10 Unlike some other classes of Crown entities, TEIs are not directly accountable to a Minister. 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 (TEC), and the New Zealand Qualifications Authority (NZQA).
- 7.11 In certain circumstances, the Crown may actively support TEI councils to govern their institutions. Sections 195A to 195D and 222A to 222E of the Act 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 dissolving the TEI council and appointing a Commissioner to govern the TEI.

Roles and responsibilities of tertiary education institutions

- 7.12 Section 159ABA of the Act sets out the planning, funding, and monitoring framework of the tertiary education sector. This framework requires TEIs to prepare plans (currently called investment plans) that set out TEIs' responses to the Government's tertiary education priorities and to stakeholder needs. The investment plans establish the levels of Crown funding for 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.
- 7.13 Sections 180 and 181 of the Act set out the functions and duties of each TEI council. These functions include appointing a chief executive and ensuring that TEIs are managed in keeping 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

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

21 See section 222AA of the Education Act 1989.

responsible manner that ensures the efficient use of resources and the long-term viability of the TEI.

Other agencies with a role in the tertiary education institution sector

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

Ministry of Education

- 7.15 The Ministry prepares strategic policy for the tertiary education sector, carries out relevant research and analysis, and monitors the performance and capacity of TEC and NZQA. The Ministry has little direct relationship with TEIs.

The Tertiary Education Commission

- 7.16 TEC interacts more directly with TEIs than the Ministry. TEC is responsible for leading the Government's relationship with the tertiary education sector. TEC implements the Government's Tertiary Education Strategy. TEC works with TEIs (and also the private providers of tertiary education) to agree investment plans that outline how they respond to the strategy.
- 7.17 TEC's chief executive has statutory responsibilities for monitoring and assessing the operations and ongoing viability of TEIs. To do this, TEC:
- monitors TEIs' financial, educational, governance, and management performance;
 - advises the Minister on appointments to TEI councils; and
 - provides statutory intervention advice to the Minister and implements any decisions made by the Minister.
- 7.18 TEC meets regularly with TEIs to discuss their strategies, performance issues, and risks.

New Zealand Qualifications Authority

- 7.19 NZQA has responsibilities in both the secondary and tertiary education sectors. NZQA administers the National Certificates of Educational Achievement for secondary school students and is responsible for the quality assurance of non-university tertiary training providers.
- 7.20 NZQA has implemented a revised approach to quality assurance in the tertiary sector. There are three key components to the approach – regulatory arrangements, self-assessment, and external evaluation and review.

- 7.21 Further information about these quality assurance and monitoring processes can be found on NZQA's website.²²

Recent changes to the operating environment

- 7.22 In recent years, significant policy changes have been implemented in the tertiary education sector and further work is under way to give effect to government policies. Changes already made affect the role of TEIs, the ways TEIs are funded, and the way quality assurance is carried out. Further changes will be implemented in the next five years, with an immediate focus in 2010 on the institutes of technology and polytechnics sub-sector. The focus of the ongoing reform process is to make tertiary education more relevant and more efficient, so that it meets the needs of students, the labour market, and the economy.²³
- 7.23 In December 2009, the Government released its Tertiary Education Strategy 2010–2015. The strategy outlines the Government's priorities for the next five years and how it will achieve them.
- 7.24 The global economic downturn and recession in New Zealand provides the context for the Government's tertiary education year priorities for the next three to five years. The priorities are:
- increasing the number of young people (aged under 25) achieving qualifications at levels four and above, particularly degrees;
 - increasing the number of Māori students enjoying success at higher levels;
 - increasing the number of Pasifika students achieving at higher levels;
 - increasing the number of young people moving successfully from school into tertiary education;
 - improving literacy, language, and numeracy and skills outcomes from levels one to three study;
 - improving the educational and financial performance of providers; and
 - strengthening research outcomes.²⁴
- 7.25 The Government has said that it is unable to provide significant funding increases to meet the growing demand for tertiary education. It has also said that it will need to move funding away from low-quality qualifications (such as those with low completion rates or poor educational or labour market outcomes) to

²² See www.nzqa.govt.nz/providers-partners/.

²³ *Tertiary Education Strategy 2010–2015*, "Minister's Foreword", www.minedu.govt.nz/TertiaryEducationStrategy.

²⁴ *Tertiary Education Strategy 2010–2015*, "Priorities".

fund growth in high-quality qualifications that “benefit New Zealanders” and contribute to economic growth.

- 7.26 To achieve the short-term priorities and long-term direction, the Government wants the tertiary education sector to:
- target priority groups;
 - improve system performance; and
 - support high-quality research that helps to drive innovation.
- 7.27 Tertiary providers are expected to manage costs, seek efficiency gains, ensure that the qualifications they offer best meet student and employer needs, and explore additional sources of revenue. A key driver to improve the efficiency of public investment in tertiary education is to improve course and qualification completion rates.
- 7.28 In March 2010, the Government announced that it would introduce performance-linked funding to the tertiary education system from 2011. The TEC is currently consulting on options for making payments under the performance-linked funding framework and options for measuring the qualification completion (programme completion) indicator.²⁵
- 7.29 Another development is mergers between some TEIs – for example, Tairāwhiti Polytechnic and the Eastern Institute of Technology and Telford Rural Polytechnic with Lincoln University.²⁶
- 7.30 In 2010, the TEC continued to work with institutes of technology and polytechnics that needed to make cost reductions to be viable from 2011.²⁷

How tertiary education institutions are funded

Tertiary education institution revenue sources

- 7.31 TEIs receive revenue from government funding, research income, fees, and other sources. Government funding accounted for 50.6% of total TEI revenue in 2009. The breakdown by TEI sub-sector is shown in Figure 15.

²⁵ See www.tec.govt.nz/Tertiary-Sector/Reviews-and-consultation/performance-linked-funding/.

²⁶ See www.beehive.govt.nz/release/eit-and-tairawhiti-polytechs-merge-0 and www.beehive.govt.nz/release/telford-polytech-merge-lincoln-university.

²⁷ *Tertiary Education Report: Introduction to the Key Issues in Tertiary Education*, February 2010, TEC, available on the TEC website www.tec.govt.nz.

Figure 15
TEI revenue sources in 2009

	Government funding \$ million	Non-government funding \$ million	Total \$ million
Universities	1,297	1,663	2,960
Institutes of technology and polytechnics	648	373	1,021
Wānanga	169	27	196
Total	2,114	2,063	4,177

Source: TEC website – 2009 financial information for TEIs.

Tertiary education funding system

- 7.32 The Government determines both the total level of funding and the amount available for each tertiary education sub-sector.
- 7.33 Around 90% of tertiary education funding is distributed by bulk funding for three main purposes:
- mainstream teaching and learning;
 - research; and
 - targeted training and industry training.
- 7.34 The remainder of the funding provides some capability funding for TEIs and scholarship funding for students.

Funds for mainstream teaching and learning

- 7.35 The two main sources of government funding for mainstream teaching and learning are as follows:
- Student Achievement Component (SAC) funding is the core of the tertiary funding system. For 2009/10, \$1.6 billion of SAC funding was allocated. It is the single largest source of revenue for universities, institutes of technology and polytechnics, and wānanga. It is also allocated to many private training providers and other tertiary education providers. It funds the cost of teaching and learning, and a wide range of mainstream qualifications from foundation to postgraduate level. The amount of SAC funding is agreed in investment plans for each TEI and is calculated from an agreed volume of students and mix of courses.
 - TEI Base Investment provides funding to ensure that universities, institutes of technology and polytechnics, and wānanga have the capability to provide quality and relevant research and education. The funding is available only to

public education institutions and is intended to support TEIs' capability to focus on their core roles. The TEI Base Investment was worth \$334 million in 2009/10.

Funds for research

- 7.36 The main funding for research is provided through the performance-based research fund. This is designed to promote excellence in research and research-based teaching and learning. The fund was worth \$236 million in 2009/10 and is allocated and approved through the investment plan process.

Funds for targeted training and industry training

- 7.37 The Industry Training Fund (\$167.8 million in 2009/10) funds Industry Training Organisations to, among other things, develop national qualifications and deliver workplace learning.

Tertiary education institutions' financial performance in 2009

- 7.38 TEI financial performance improved in 2009, with an overall surplus of 4.3% of a revenue base of about \$4.2 billion (2.7% in 2008).
- 7.39 Figure 16 shows the surplus/deficit for each individual TEI in 2009, as a percentage of revenue, compared to the previous year.²⁸
- 7.40 All sub-sector surpluses were above the 3% TEC guideline, with institutes of technology and polytechnics reporting a surplus of 6.3%, universities a surplus of 3.4%, and wānanga a surplus of 7.4%.
- 7.41 The TEC reports that the improved financial situation is because of an increase in student enrolments and government funding, and improved management of TEIs' financial performance.²⁹

28 The amounts are taken from the audited financial statements of each individual TEI. Where the TEI has subsidiaries, the amounts are for the TEI group.

29 Further information on the financial performance of TEIs is available on the TEC website www.tec.govt.nz.

Figure 16
Surplus/deficit for each individual TEI in 2009

	2009 Surplus/ (deficit)* \$000	2009 As a % of revenue	2008 As a % of revenue
Auckland University of Technology	8,108	3.1	2.2
Lincoln University	(2,796)	(3.1)	(1.5)
Massey University	2,282	0.6	1.3
University of Auckland	28,537	3.4	3.2
University of Canterbury	9,055	3.2	5.6
University of Otago	31,098	5.6	3.6
University of Waikato	10,741	5.2	(0.9)
Victoria University of Wellington	12,803	4.1	3.2
Aoraki Polytechnic	4,322	15.8	10.8
Bay of Plenty Polytechnic	8,598	19.5	5.6
Christchurch Polytechnic Institute of Technology	9,152	10.7	9.6
Eastern Institute of Technology Hawke's Bay	2,021	5.1	3.6
Manukau Institute of Technology	4,503	4.6	3.2
Nelson Marlborough Institute of Technology	1,726	3.3	3.1
Northland Polytechnic	1,901	4.9	(3.3)
Otago Polytechnic	749	1.4	(0.7)
Southern Institute of Technology	3,641	8.1	13.3
Tai Poutini Polytechnic	377	1.4	(6.2)
Tairāwhiti Polytechnic	1,468	8.6	(19.9)
Telford Rural Polytechnic	834	6.8	16.3
The Open Polytechnic of New Zealand	2,466	4.4	1.1
Unitec New Zealand	8,432	6.4	(0.1)
Universal College of Learning (UCOL)	2,032	3.7	(1.9)
Wairiki Institute of Technology	4,425	10.3	2.4
Waikato Institute of Technology	1,442	2.0	0.9
Wellington Institute of Technology	3,747	7.6	1.3
Western Institute of Technology at Taranaki	1,211	5.1	(11.6)
Whitireia Community Polytechnic	1,515	3.0	(1.1)
Te Wānanga O Aotearoa Te Kuratini O Nga Waka	8,125	5.4	4.6
Te Wānanga O Raukawa	3,770	17.1	12.9
Te Whare Wānanga O Awanuiārangi	2,476	10.2	9.1

* The surplus/(deficit) figures take into account unusual and abnormal items.

Tertiary education institutions' audit results for 2009

- 7.42 The Auditor-General is the auditor of all TEIs and each of their public entity subsidiaries. The Auditor-General carries out the annual audit of TEIs' financial statements and other information that each of the 31 TEIs and their subsidiaries are required to have audited. The Auditor-General's practice is to appoint auditors to conduct annual audits on her behalf.
- 7.43 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 comprise the TEI group (usually referred to as "the group accounts").

Audit opinions for the year ended 31 December 2009

- 7.44 We have issued unqualified audit opinions for 29 of the 31 TEI group accounts in 2009. This means that the financial statements that we audited complied with generally accepted accounting practice and fairly reflected each TEI group's financial position and the results of its operations and cash flows for the year ended 31 December 2009. 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 2009.
- 7.45 We issued "except for" qualified audit opinions for two of the 31 TEI group accounts in 2009 – for Christchurch Polytechnic Institute of Technology and Wellington Institute of Technology. The qualifications were specific to the circumstances of each TEI.
- 7.46 The unqualified audit opinions of two TEIs (University of Auckland and Tairāwhiti Polytechnic) contained explanatory paragraphs.
- 7.47 We provide more detail about each of these "non-standard" audit opinions in Part 6 of this report.
- 7.48 We also issued a number of non-standard audit opinions in the broader TEI sector – on the financial statements of subsidiary public entities. Part 6 also discusses the detail of these opinions.

Audit timeliness

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

- 7.50 For the 2009 TEI audits, the statutory deadline was 30 April 2010.³⁰ Audits of all but one of the 31 TEI group accounts were completed within this deadline.
- 7.51 Figure 17 shows a pleasing decrease in audit arrears in the TEI sector when compared with the previous year.³¹

Figure 17
Tertiary education institution sector – audits outstanding at 30 June 2010

Total audits due in 2009/10	Arrears at 30 June 2010	Arrears at 30 June 2009	Arrears at 30 June 2008
140	32 (23%)	42 (31%)	23 (19%)

Source: Controller and Auditor-General, *Annual Report 2009/10*, page 33.

- 7.52 In the main, it is the timeliness of TEI subsidiary audits that affects the TEI sector's audit arrears figures. We asked our Appointed Auditors to work closely with TEIs during the 2009 audits to bring any public entity subsidiary audit arrears up to date, and to ensure the timely completion of all TEI sector 2009 audits. We also reinforced this message for 2010 audits.

Focus in 2009 audits

- 7.53 Each year, we identify particular aspects to focus on during the audit. We discuss some of these below. We have focused on procurement and capital asset management since 2007.

Procurement

- 7.54 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 public sector practice when procuring goods or services.
- 7.55 We have issued the following good practice guides on procurement:
- *Procurement guidance for public entities* (June 2008);
 - *Public sector purchases, grants, and gifts: Managing funding arrangements with external parties* (June 2008); and
 - *Principles to underpin management by public entities of funding to non-government organisations* (June 2006).
- 7.56 Other good practice guidance is available from the Ministry of Economic Development's website.

30 See section 156(2)(b) of the Crown Entities Act 2004.

31 Each arrears figure includes all outstanding audits, including any audits from prior years. The arrears percentages have been calculated using the total number of TEI audits due at 30 June for each year reported.

- 7.57 In 2008, on the whole, we were disappointed with the sector's progress in improving the quality of their procurement policies. A few TEIs still had no procurement policy. Some of our 2007 audit recommendations had been addressed, but a large number of TEIs needed to make further improvements to align their policies with good public sector practice. Therefore, in 2009, we asked our auditors to follow up on the findings and recommendations from the 2008 audit, including the extent to which the TEI has:
- compared its policies and procedures for funding arrangements and procurement against good practice guidance; and
 - made changes as a result of the comparison.
- 7.58 We found, from the 30 entities checked, that five TEIs were assessed as having no issues with their funding arrangements and procurement. Of the remaining 25 entities:
- 17 entities were still in the process of updating their procurement policies; and
 - six entities had yet to update their procurement policies.
- 7.59 Auditors had also noted the need to improve existing policies.
- 7.60 In our view, the sector has further work to do to improve its procurement policies. Our auditors will continue to follow up on any outstanding recommendations for improvement in 2010.

Capital asset management

- 7.61 TEIs own and manage a substantial portfolio of capital assets. Net assets in the TEI sector in 2009 totalled \$7,540 million. Since 2007, the Treasury has been leading a work programme about capital asset management in the central government sector. The TEC is leading a set of initiatives in the TEI sector that is aligned to the Treasury's capital asset management work programme. These initiatives include the TEC working collaboratively with the TEI sector to encourage stronger capital asset management planning practices, and to seek better information on the TEI capital asset management stock. The TEC has been preparing an industry standard for capital asset management practices in the polytechnic subsector and intends to carry out similar work in the near future in the university and wānanga subsectors.
- 7.62 Capital asset management is the process of achieving optimal whole-of-life effectiveness of assets at minimal 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 be aligned with the underlying information in the asset management plan.

- 7.63 Given the value of the asset base of the TEI sector, the Auditor-General expects TEIs to have comprehensive capital asset management plans in place.
- 7.64 The findings of our previous audits suggest that, while asset-related transactions are fairly reflected in financial statements, TEIs do not, as a general rule, have comprehensive asset management plans. There was still much work to be done for the TEI sector's capital asset management practices to meet standards of good public sector practice.
- 7.65 Therefore, as part of the 2009 audit, we asked our auditors to follow up on the extent to which TEIs have addressed our 2008 audit findings and recommendations about capital asset management.
- 7.66 In 2009, auditors identified the following matters with 22 entities:
- 15 entities were updating their integrated capital asset management policies; and
 - seven entities do not have an integrated capital asset management policy and have yet to begin to develop one.
- 7.67 This shows that there is work under way in many TEIs to update their capital asset management policies and plans, but there is still much work to be done for the TEI sector's capital asset management practices to meet standards of good public sector practice.
- Service performance reporting**
- 7.68 TEIs' statements of service performance (SSPs) are required to report on their performance compared with the proposed outcomes described in their investment plans. That requirement is set out in section 220(2B) of the Education Act 1989.
- 7.69 The measures to be included in TEIs' SSPs have essentially been decided up until the 2011 year because they have been approved as part of TEIs' current investment plans.
- 7.70 In 2009, we expected our annual audit work to focus on:
- determining whether the SSP fairly reflects the performance measures and targets outlined in the investment plan adopted at the start of the financial year; and
 - checking the reported levels of achievement for the significant performance measures.

- 7.71 We also expected auditors to suggest improvements to the SSP, where such improvements can be made without changes to the performance measures (for example, providing meaningful explanations for variances between actual performance against targets, especially when targets have not been met).
- 7.72 In the past few years, we have increased our audit emphasis on performance reporting in both central and local government. We have generally found the quality of performance information to be disappointing. We consider that improving service performance information and reporting is crucial in helping to improve the effectiveness and efficiency of public sector entities and in demonstrating accountability for their performance.³²
- 7.73 We also consider that the performance information framework used in investment plans can and should be improved. We have been working with the TEC in 2010 to achieve a performance information framework in 2011 investment plans that promotes enhanced service performance reporting by TEIs.
- 7.74 In the 2009 annual audits of TEIs, auditors identified a range of issues with the SSPs of 15 entities. The issues included:
- inappropriate performance measures;
 - lack of meaningful explanations of the performance measures;
 - performance measures and targets from the 2008-10 investment plan that were not included in the SSP; and
 - a lack of robust systems for capturing and verifying non-financial performance information.
- 7.75 Service performance reporting will continue to be a focus in 2010 audits, as we discuss below.

Summary and focus in 2010 audits

- 7.76 We will focus on some of the same matters (for example, management of capital assets and service performance reporting) in the 2010 audits to ensure that TEIs continue to make the necessary improvements.
- 7.77 Ongoing policy changes in the tertiary education sector may further affect some TEIs' viability. Our auditors will need to understand the actions TEIs have taken, or plan to take, to respond to the changes, and satisfy themselves of the validity of the going concern assumption.
- 7.78 As discussed above, there are a significant number of subsidiary entities in the TEI sector. Subsidiary entities can result in additional compliance costs for the parent

³² Our views on the importance and the quality of performance information and reporting are set out in our June 2008 discussion paper, *The Auditor-General's observations on the quality of performance reporting*.

entity, and can place greater pressure on the parent entity to properly govern the group of entities.

- 7.79 We are interested in TEI councils' ongoing oversight of subsidiaries, both at a governance and management level. We have asked our auditors of TEIs to collect some information in 2010 audits on practices, including the "upwards" reporting by TEI subsidiary entities to the TEI parent.
- 7.80 We will report our findings to individual TEIs and in our annual report to Parliament on the results of the 2010/11 central government audits.

Part 8

Payments above a school principal's normal salary

- 8.1 This Part summarises the results of a review of the additional remuneration paid to secondary school principals in the 2009 school year. "Additional remuneration" means payments that were above the school principals' normal salaries. In general, additional remuneration from a school board of trustees (a board) to a principal requires prior approval by the Ministry of Education (the Ministry). Payments made by a board without the required approval are unlawful.
- 8.2 Overall, the value of unlawful additional remuneration has probably decreased since we carried out a similar review about six years ago. We cannot be more definitive because the two reviews were not carried out on exactly the same basis. A direct comparison is not possible.
- 8.3 The Ministry and the New Zealand School Trustees Association (NZSTA) have put some effort into educating boards about the rules on additional remuneration. Our latest review has identified a number of specific areas where additional guidance on what is regarded as remuneration rather than reimbursement of business expenses would be useful.
- 8.4 On the question of recovering unlawful payments, we note that the Ministry has now concluded that changes to the Education Act 1989 are not warranted. The Ministry has confirmed that, ultimately, in cases of persistent non-compliance by a board, a statutory intervention can be considered if there is any risk to the operation of the school.
- 8.5 We have shared the findings of this review and our concerns with the Ministry. In our view, the proposed improved guidance to schools will be of benefit and should help reduce the incidence of unlawful payments. We also agree with the actions intended to maintain the transparency of payments by proprietors and to encourage compliance with the expectation that consideration will be given to recovering funds that have been wrongfully paid or used.
- 8.6 The Ministry has not commented on the other issues that we raised about payments by proprietors of integrated schools – that is, the possibility that some payments may be unlawful, the higher amounts paid than would be allowed for non-integrated schools, and the management of conflicts of interests. We consider that the Ministry should address these issues further.

The remuneration system

- 8.7 There are about 2450 state schools, which vary considerably in size and location – from small rural schools with a single teacher to large inner-city schools with more than 2500 students.

- 8.8 Schools are governed by boards of trustees, made up of members of the local community (mainly parents of children attending the school). There are about 18,000 trustees, who are appointed through elections held every three years.
- 8.9 Principals are responsible for the overall management and professional leadership of the school. Their remuneration is set by collective agreements or individual employment agreements based on the collective. The Ministry approves these agreements, which set out how much a principal will be paid to carry out their normal duties.
- 8.10 The salaries of principals for normal duties depend on factors such as the number of students and teachers in the school. The salaries vary from about \$80,000 to about \$160,000 a year.
- 8.11 Principals may also receive additional remuneration when they have other responsibilities, such as:
- managing a residential/boarding hostel;
 - recruiting and managing many overseas students;
 - managing a significant initiative that earns extra revenue for the school and is in addition to the principal's normal role;
 - managing a school that is considered an exemplar of practice that results in other schools seeking information and advice; or
 - implementing a significant change process.
- 8.12 The Ministry has to approve all additional remuneration. This approval process is commonly referred to as concurrence. Figure 18 describes the sorts of transactions that are considered remuneration (and require the approval of the Ministry) and those that are not remuneration (and do not require Ministry approval).

Figure 18
Examples of transactions that do and do not require the Ministry's approval

Transactions or arrangements that are remuneration and require Ministry approval
Payments for additional responsibilities, bonuses, and incentive payments (as lump sums or allowances).
Personal expense payments, e.g. medical and other private insurance, telephone, broadband (where not used for school-related purposes), general household expenses, clothing, and personal grooming.
Payments intended to cover school-related expenses personally incurred by the principal but where no supporting documentation has been provided of the expenditure incurred.
Allowances (other than payments or reimbursements of school-related expenses), e.g. gym, airline clubs, or general club memberships where membership is not school-related.
Use of motor vehicles for private purposes, including all running costs.
Use of a school house at below market rental.
Contributions to superannuation funds, and any other retirement benefits (except for medical retirement for secondary principals).
Additional leave entitlements.
Transactions that are not remuneration and do not require Ministry approval
Reasonable expenses incurred, with the approval of the board of trustees, for professional development, including fees for attending conferences and seminars.
Reimbursement of travel expenses incurred on school-related matters such as meetings, visits to camps, interviews, class trips, and conferences.
Payments for items such as professional publications, equipment, materials, entertainment, social expenses, gifts, meals, compassionate expenses, and koha for school-related matters for which supporting third-party documentation has been provided.
Subscriptions and membership fees to professional organisations relevant to school-related activities (this does not include fees for trade unions).
Fees for attendance at board of trustees meetings, which are paid to principals in their capacity as a member of the board of trustees.

- 8.13 The main factor that the Ministry considers when approving additional remuneration is whether the principal has additional responsibilities above those that normally form part of a principal's job. Payments recognising performance, recruitment, or retention are unlikely to be approved, because the Ministry considers that they are factored into the employment agreements. Additional benefits such as cars, insurance, and expense accounts are also unlikely to be approved. Approval is not required for the reimbursement of work-related expenses on an actual and reasonable basis.
- 8.14 The maximum additional remuneration that the Ministry will approve is restricted currently to 15% of the principal's salary for normal duties. Therefore, the maximum additional remuneration is likely to be no more than \$24,000 a year.

Approvals are granted for one school year at a time. If a board wishes to continue providing additional remuneration, it has to apply each year for approval.

- 8.15 For the 2009 school year, the Ministry approved additional remuneration for about 63 (15%) of the 420 principals of secondary schools.³³ The total value of the additional remuneration was about \$785,000, with an average of about \$12,500. The amount of the additional remuneration approved varied from \$3,000 to \$21,000.

Our first review of principals' remuneration

- 8.16 In June 2004, we reported³⁴ on a special exercise that we had asked our appointed auditors to carry out at secondary schools. We found that some boards were paying additional remuneration without the Ministry's approval. In our opinion, 46 boards (11%) had paid additional remuneration to their principals without Ministry approval. The total value of these payments was at least \$210,000.
- 8.17 We and the Ministry were concerned about the extent of unapproved additional remuneration. The Ministry told us that it planned to investigate the payments, and indicated that it might consider recovering some of the money, based on legal advice and analysis of the facts of each case.
- 8.18 The Ministry also told us that it would ensure that all future guidance to boards would be clear about the need to obtain approval for additional remuneration.
- 8.19 We also reported that the principals of some integrated schools received remuneration from the school proprietors³⁵ as well as receiving their normal salary. We were concerned that such arrangements might breach section 7(4) of the Private Schools Conditional Integration Act 1975, which requires proprietors (as part of the integration agreement) to agree not to give board employees any remuneration additional to that provided for under the Act or more favourable conditions of service.

33 We did not ask our appointed auditors to look at the additional remuneration paid to the 2000 or so primary school principals because of their large number and our view that the risks are less.

34 Office of the Auditor-General (2004), *Central government: Results of the 2002-03 audits*, "Part 4: Payments for Additional Remuneration to School Principals", Wellington.

35 Integrated schools used to be private schools. They have proprietors who own the land and buildings of the school, maintain its special character (such as its religious nature), and appoint representatives to the board of trustees.

Our April 2007 report on progress

- 8.20 In April 2007, we reported³⁶ on the Ministry's progress in addressing the concerns that we had identified in our first review. We were pleased to report that the Ministry had taken action to prevent unlawful remuneration payments through the central payroll system. It had also followed up with schools where we had identified examples of unlawful expenditure, and reminded all schools of the requirement to get the Ministry's approval for any additional remuneration.
- 8.21 We noted the unsatisfactory situation that a board can make an unlawful payment to its principal, and continue to make unlawful payments, and not be required by either legislation or the Ministry to consider recovering that money. The Ministry had obtained a legal opinion in December 2005 about whether it was possible or appropriate for the Ministry, rather than the responsible board, to pursue recovery. We reported that the Ministry continued to consider how to address enforcement and recovery issues, including the possibility of a change in legislation.
- 8.22 We also noted that the Ministry had not finished considering what action to take about the payments made by some proprietors to the principals of integrated schools.

Our May 2009 report on progress

- 8.23 In May 2009, we reported again³⁷ on the Ministry's progress in addressing our concerns.
- 8.24 With regard to recovering unlawful remuneration paid to principals, the Ministry told us that it was considering recommending a change of legislation to broaden the grounds on which an intervention could be considered.
- 8.25 With regard to payments to the principals of integrated schools by proprietors, the Ministry told us that it was continuing to consider whether to request a statement from each proprietor of any money paid.

Our most recent review of principals' remuneration

- 8.26 Because of concerns at a particular school,³⁸ which arose in the early part of 2009, the Ministry asked that we carry out another special exercise, similar to the one we reported on in June 2004.

36 Office of the Auditor-General (2007), *Central government: Results of the 2005/06 audits*, "Part 7: Unlawful expenditure by schools", Wellington.

37 Office of the Auditor-General (2009), *Central government: Results of the 2007/08 audits*, "Part 11: Unlawful expenditure by schools – 2009 follow-up", Wellington.

38 Hamilton's Fraser High School.

- 8.27 As part of the 2009 school audits, our appointed auditors reviewed whether the principals of the 420 secondary (and composite) schools had received additional remuneration and, if so, whether the boards had the Ministry's approval to provide that additional remuneration. We received the results of 411 of these reviews and shared them with the Ministry, so that it could consider whether any action is necessary. We have not received the results for the remaining nine schools because the audits have not been completed.

What did we find?

- 8.28 In 329 of the 411 schools (80%), the appointed auditors reported that either the principal had not received any additional remuneration or the additional remuneration they received had been approved by the Ministry.
- 8.29 At 82 schools (20%), the appointed auditors found that either additional remuneration had been paid without approval or it was not clear whether some payments were remuneration that would need the Ministry's approval – for example, because the guidance is not precise enough.
- 8.30 In most of these cases, the additional payments were not of large value. However, the underlying principles are still important. First, payments that are remuneration are only lawful if they are approved. All public entities must take their legal responsibilities seriously. Second, there is always heightened sensitivity around payments that could create private benefits, even if they are genuine business expenses. These payments need to be managed with extra care to ensure that they can withstand public scrutiny. Therefore, it is a concern when it is unclear whether a payment is for a business expense or is effectively remuneration. Third, in some circumstances, the reimbursement of a private expense may be a crime and subject to prosecution by the police.

Home telephone and internet

- 8.31 The most common form of additional payment at these schools was paying the principal's home telephone or internet bill. At 52 of the 411 schools (13%), the principal was reimbursed for part or all of their home telephone and/or internet costs. The maximum amount reimbursed was \$2,500 in the year. The Ministry has confirmed that the cost of telephone and internet rental is additional remuneration requiring its approval unless the facility is installed for only work-related activities.
- 8.32 In our view, to reduce the variability of practice, it would be useful for the Ministry to clarify the circumstances where a school may meet some or all of the costs of a principal's home telephone and internet use as a business expense.

Use of a car

- 8.33 At 11 of the 411 schools (3%), principals can use a car that the school pays for. In one case, the cost of the leased car, which is also used for school purposes, is about \$10,000 a year. Some principals take the school car home every night and at weekends for security reasons because there is no garage at the school. In some cases, the principal is allowed to use the car for their own purposes, and in others the principal is allowed to drive the car only to and from the school.
- 8.34 Again, to reduce the variability of practice, we consider it would be useful for the Ministry to clarify the circumstances where a school may allow a principal to use a car that the school pays for.

Insurance

- 8.35 Six boards paid the premiums for various insurance policies for their principals. Examples of the premiums are \$3,500 for income protection, \$3,000 for medical insurance, and \$750 for life insurance.
- 8.36 We also noticed that one of the principals' representative bodies is offering a legal support scheme for principals at a cost of about \$300 a year. In some schools, the board has paid the premium for this insurance. The Ministry has confirmed that boards need to seek its approval before paying this premium because it regards the scheme as providing a personal rather than a work-related benefit.

Koru Club and Rotary Club membership

- 8.37 Seven principals had their Koru Club membership paid by their boards. In one case, the payment was \$745. A further four principals had been reimbursed their membership of the Rotary Club. We have been told that the Ministry has reviewed its position on Koru Club memberships and is now prepared to give approval where a principal makes enough work-related flights in a year.

Other remuneration

- 8.38 Sixteen principals received other forms of additional remuneration without the Ministry's approval. Those forms of additional remuneration included:
- subsidised or free accommodation provided by the board;
 - an expense account of \$2,000 a year for personal expenses such as gym membership fees;
 - an overseas travel allowance of \$4,200; and
 - \$6,000 for house master duties in connection with a hostel.

Remuneration from the proprietors of integrated schools

- 8.39 In our June 2004 report, we mentioned that the principals of some integrated schools received additional remuneration from the proprietor. We were concerned that some of this remuneration could be inconsistent with the Private Schools Conditional Integration Act 1975. The Act requires proprietors, as part of the integration agreement, to agree not to give board employees additional remuneration other than under the Act or more favourable conditions of employment.
- 8.40 In our April 2007 report, we concluded that the current arrangements did not allow the Ministry to monitor compliance with legislation, because it would not know whether a principal received any additional remuneration from a proprietor for carrying out the normal duties of a principal. We recommended that the Ministry regularly ask each proprietor for a statement of all money paid directly to all school staff, the amounts involved, and the reasons for the payments. The Ministry confirmed that it would consider whether it would be appropriate to include a provision to this effect in its integration agreements (which are agreements that proprietors have to sign to receive funding from the Ministry).
- 8.41 In June 2009, the Ministry said that it was considering issuing a newsletter on the matter.
- 8.42 Some schools have a boarding hostel for their students. Where a hostel is the responsibility of the board, the Ministry may approve additional remuneration for the principal of up to 15% of their normal salary for managing the hostel. Where a hostel is the responsibility of the proprietor, the principal may have an employment contract with the proprietor. If they do, the amount of the additional remuneration is not subject to Ministry approval or restricted to 15% of the normal salary.
- 8.43 In our recent review, we noted that one principal receives remuneration from the proprietor of \$31,500 for managing a hostel, which is 28% of their normal salary or about \$14,500 more than the Ministry might have approved if the hostel were owned by the board. Another principal in a similar position receives \$22,500 a year, which is about \$4,000 more than the Ministry might have approved.
- 8.44 At two other integrated schools, the principal received remuneration from the board for managing the proprietor's hostel, with the approval of the Ministry, and they also received remuneration from the proprietor for what appear to be the same duties, possibly on the basis that the two bodies were sharing the costs. One principal received \$13,300 from the board and \$20,000 from the proprietor. The other principal received \$11,300 from the board and \$26,000 from the proprietor.

- 8.45 The Ministry has declined approval for these boards to pay further amounts. For the first school, it has considered whether the board should pursue recovery of the funds and concluded that the circumstances mean that recovery is not practicable or appropriate.
- 8.46 At another two integrated schools, the proprietor is paying the principals additional remuneration. The descriptions of these payments raise some questions. For example, one principal receives \$10,000 for “special character”, \$10,000 for “senior college”, \$15,000 in a proprietor’s performance payment, and \$5,000 for incidental entertainment costs and mileage allowance. The payments total \$40,000 a year. The other principal received similar payments totalling \$29,000. A further principal of another school received similar payments from the proprietor of \$14,300 and was provided with a rent-free house.
- 8.47 Because these benefits were not provided by the schools’ boards, they did not need the approval of the Ministry. Nor are we able to gather detailed information on them. However, from the summary information we have gathered, it is not clear to us what these payments were for and whether they were consistent with the Private Schools Conditional Integration Act 1975. They may raise questions about how the relevant provision in the Act is being applied and enforced.
- 8.48 The relationships between a principal, board, and proprietor can also become more complex if a principal is personally receiving substantial payments from a proprietor for additional duties or activities. This adds a need to manage a personal financial interest to an already complex situation. The potential for a conflict of interest creates additional risk for all parties, and it could require the principal to withdraw from participating in some board decisions. The principal’s interest in continuing to receive the payment from the proprietor may create an incentive to act in a way that may not be in the best interest of the board. In a previous inquiry into a school, we have stated that it is better for the most senior employee to be solely concerned with the interests of their public employer.
- 8.49 We note that the transparency of, and accountability for, these payments has decreased because the applicable financial reporting standards have been revised. There is no longer a requirement for boards to disclose in their financial statements any payments from proprietors to their principals. The relevant financial reporting standard is NZ IAS 24: *Related Party Disclosures*.
- 8.50 An earlier version of the standard defined related parties in such a way that included proprietors of integrated schools, because they have a significant influence over boards. However, a revision in November 2009 amended the definition so that, in our view, proprietors are no longer considered to be related parties. The Ministry has confirmed that it will consider using its statutory

powers to require boards of integrated schools to include information on financial transactions with proprietors in their financial statements. This would maintain the current transparency. However, the completeness of the information would depend on the voluntary disclosure by principals, because boards would not necessarily know about such payments.

Payments from other third parties

- 8.51 We also identified that a school principal (not of an integrated school) is receiving payments from a third party. The school community has established a charitable trust. The school does not control the trust but helps it raise funds. From the funds raised with the help of the school, the trust makes payments to the school's employees, including a leadership award of \$11,265 a year to the principal. The payments to the school employees are not assessable for tax purposes, because they are distributions to the beneficiaries of a charitable trust. The Inland Revenue Department has confirmed this position.
- 8.52 We have discussed this issue with the Ministry. The Ministry says that the payments do not form part of the teachers' normal remuneration and, because they do not come from their employer, the Ministry does not need to approve the payments.
- 8.53 The Ministry's central control of remuneration is designed in part to help maintain pay parity between schools. If schemes of this kind became widespread, there is a risk that they would undermine this policy objective. That is, charitable trusts could be established so that they are not controlled by schools, the schools could help the trusts with raising funds from the local community, and then the trusts could make payments to the school employees without the Ministry's approval and without paying tax.
- 8.54 The Ministry considers that there will be few schools in a position to establish a similar arrangement. It does not intend to take any action on the matter.

Recovery of unlawful payments

- 8.55 Our general expectation is that a public entity will consider whether to attempt to recover money if its funds have been wrongfully paid or used. This includes where remuneration has been paid inappropriately. There may be situations where it is unfair or impractical to insist that money wrongfully paid is repaid and where wrongful payments should not (or cannot) be recovered. Much depends on the circumstances of each case.
- 8.56 For this reason, we consider that the entity concerned, acting on its own legal advice, has to decide whether to seek to recover the money. The entity needs to consider the matter and decide what course of action is justified.

- 8.57 Applying this general expectation to the school's situation is made more complex because the board may have approved the additional and wrongful remuneration. The board may be unwilling to revisit its decision to make the payments. In such cases, we have asked whether there is anything the Ministry can do to address the misuse of funds.
- 8.58 Our June 2004 report noted that the Ministry was going to follow up the examples of unlawful expenditure that we had identified and consider whether it was possible or appropriate for the Ministry to seek to recover the money instead of the board. Our April 2007 report noted that the Ministry obtained a legal opinion on the matter in December 2005. In summary, that opinion said:
- It was appropriate for the Ministry to consider how to prevent and recover unlawful payments.
 - However, the Ministry has no power to require a board to apply for approval of a payment of additional remuneration or to cease making an unlawful payment. Also, it is unable to direct a board to take action to recover an unlawful payment. A 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.
 - Trustees might be personally liable for an unlawful payment they had made if it could be demonstrated that they did not act in good faith – for example, if they made the payment knowing it to be unlawful.
- 8.59 In our April 2007 report, we noted that the Ministry had considered the legal opinion and remained concerned that the principle of equality of remuneration for all state schools could be undermined if boards did not comply with its rules. We noted that the Ministry was considering how best to address enforcement and recovery issues, and that this might require a change in legislation to strengthen its ability to promote compliance with the current legislation. In this context, we noted that the legislation that existed before 2001 allowed a board to be replaced by a commissioner in wider circumstances than those currently allowed for.
- 8.60 We expressed the view that the current arrangements were unsatisfactory. A board can make an unlawful payment to its principal, continue to make unlawful payments, and not be required by either legislation or the Ministry to consider recovering the money. The only recourse that appeared to be available to the Ministry in these circumstances was to take action against trustees personally if it could be demonstrated that they had not acted in good faith.

- 8.61 In June 2009, the Ministry confirmed that it was continuing to consider whether to seek amendments to the Education Act 1989 to allow a commissioner to be appointed when there is an unlawful act.
- 8.62 In May 2010, the Ministry told us that it would not be pursuing an amendment to the Education Act. The Ministry considers that there have not been enough incidents to warrant legislative change and that placing an emphasis on preventing unlawful activity would be of greater benefit.
- 8.63 In June 2010, we asked the Ministry to clarify whether it shared our expectation that boards should be considering recovery when unlawful remuneration has been paid. The Ministry expressed its frustration that boards continued to make unlawful payments. When cases of possible non-compliance are brought to the Ministry's attention, the Ministry seeks clarification from the board. If the Ministry establishes that the board has not complied, it invites the board to apply for approval. If approval is either declined or not sought in such cases, and non-compliance persists, the Ministry's practice (without specific statutory powers) is to write to the board to remind them unequivocally of their obligations. Ultimately, in cases of persistent non-compliance, a statutory intervention can be considered if there is any risk to the operation of the school.
- 8.64 The Ministry has also confirmed that it will try to raise the level of understanding among boards and principals about the importance of always applying for approval for additional remuneration.
- 8.65 We acknowledge the legislative and other constraints faced by the Ministry, and that its role is largely limited to encouraging the responsible board to give proper consideration to recovery when unlawful remuneration has been paid. We also acknowledge that an increased emphasis on prevention of unlawful payments would be beneficial.
- 8.66 However, we are also of the view that the Ministry should take an active role in promoting consideration of recovery by the responsible board in cases that come to its attention. It could also usefully communicate this expectation to boards more generally.

Actions to be taken

- 8.67 We gave the Ministry an opportunity to comment on our findings and to explain the actions it intends to take to reduce the incidence of unlawful remuneration and address the other matters we found.
- 8.68 For the most common forms of possible unlawful remuneration (such as home telephone, internet, car, and insurance expenses), we expect the Ministry, in

keeping with its established practice, to seek clarification from the relevant boards in due course, once it has finalised its future advice.

- 8.69 The Ministry told us that, as a matter of course, it checks and updates its advice to boards on approval for additional remuneration and benefits to principals following each principal collective agreement settlement. The Ministry has begun to do this piece of work in anticipation of new collective agreements replacing the existing collective agreements.
- 8.70 A particular focus of this update for the Ministry is to ensure that its advice is more accessible to trustees. This is to include reviewing the wording to ensure that plain English is used where possible, offering more examples and providing check lists for employers, and placing the material in more locations.
- 8.71 The Ministry is anticipating making the following points in that advice, some of which are amendments to its current advice:
- That reimbursement of home telephone or internet charges will only be approved where a business case can be made by the school. Examples of this will include the full or part reimbursement of a home telephone line where it is allocated to the role, and where it is promoted to the school community.
 - The Ministry is aware that some principals take a vehicle home after hours because the school has no suitable storage facilities, or because the principal attends school activities, such as sport, after hours. This sort of use does not require approval. However, personal use, such as access to the car for non-work-related use during weekends, school holidays, and after hours would not be approved. Schools allowing this should seek reimbursement of the costs from the principal.
 - Approval will not be granted for personal insurance premiums or legal support schemes.
- 8.72 The Ministry has also confirmed that it will consider requiring boards of integrated schools to disclose the financial transactions with proprietors in their financial statements. This will help maintain the current transparency of any remuneration received from proprietors by principals. The Ministry has not commented on the other issues raised concerning payments by proprietors – for example, the possibility of some of the payments being unlawful, equality of remuneration for all state schools, and the proper management of conflicts of interest.
- 8.73 The Ministry is also to publish a finance circular on the need for boards to consider recovery of unlawful payments. This should ensure that boards are aware of the general expectation that they consider recovering the money if an unlawful payment is made.

Part 9

Reporting student achievement in primary schools

- 9.1 Amendments to the Education Act 1989 (the Act) in 2001 require school boards of trustees (boards) to include in their annual report an analysis of any variance between the board's targets for what students would achieve (as set out annually in the school's charter) and what actually happened during the year.
- 9.2 The goal was that boards would prepare strategic plans, set targets, and report meaningfully on them – with a commitment to better outcomes for students informing all decision-making and resource allocation decisions at the school.
- 9.3 We assessed how well a sample of primary school boards reported on student achievement in the analysis of variance in their 2009 annual reports. We did so because we are interested in improving how public entities report on their performance and because the Ministry of Education (the Ministry) has not reviewed the effectiveness of the analysis of variance reports since the requirements were introduced.
- 9.4 Based on our work, we have produced a checklist for boards to use to assess and improve on the usefulness of their analysis of variance reports. We will send the checklist to schools in early 2011. The checklist is shown at the end of this Part.
- 9.5 Next year, we intend to build on this work. We will assess how well boards use information to underpin their strategic planning and self-review, and how coherently the school focuses its efforts on student achievement (including aligning resources, policies, and practices). We will also look at how well boards use and respond to assessment data.

Summary of our findings

- 9.6 Only 15% of the boards in our sample were largely meeting the requirements. These boards had related the annual targets to the board's strategic goals and better analysed what had or had not worked well this year, and on the basis of this information had planned what would be done next year.
- 9.7 We found that 72% of the boards in our sample were partly meeting the requirements for strategic planning and self-review. The analysis of variance reports prepared by these boards had clear annual targets and data measuring student achievement against the targets.
- 9.8 The remaining 13% of the boards in our sample had not met the requirements because the boards had not or only partly completed their analysis of variance reports.

- 9.9 There was wide disparity in the ease with which the boards communicated what they were doing in their analysis of variance reports. While some reports were very clear, others were quite difficult to understand. Boards need to think more carefully about their target audiences and tailor the information in the reports to their audiences.

About analysis of variance reports

- 9.10 According to the Ministry of Education (the Ministry), the analysis of variance is:
*... a vital part of the board's annual report... [It] is a primary opportunity for the board to inform its community on how the school is performing in regard to student achievement against the targets set by the board in its strategic and annual plan. The presentation of the Analysis of Variance is a key indicator as to whether the board has student achievement plans in place, and is able to measure actual achievement against these targets.*³⁹
- 9.11 The amendments to the Act in 2001 were aimed at making student outcomes a priority for boards. From 2003, boards have had to include three- to five-year strategic goals for student achievement in their school charters.⁴⁰ The school charters also have to contain annual targets for improved student achievement (or steps towards the strategic goal).
- 9.12 The Act requires each school to include in its annual report an analysis of any variance between the planned aims, objectives, directions, priorities, or targets (as set out in the school charter) and what the school has actually achieved during the year. The analysis of variance describes for the community how the school has addressed the board's priorities and how successful the school's approach has been. The analysis of variance should also provide the basis for plans for the coming year.
- 9.13 When the requirements for planning and self-review were introduced, it was expected that, once the process became embedded in board and management thinking, student achievement would inform all decision-making and resource allocation decisions within a school.

Content and format of the analysis of variance reports

- 9.14 The Ministry produced a series of circulars on "Planning for better student outcomes" during 2003. These circulars explained the new school planning and reporting process, the need for self-review and planning for improvement, and the

³⁹ In the Finance Education circular for the period 31 October 2008 to 31 October 2009.

⁴⁰ The Education Act 1989 requires every school to have a charter. The charter communicates the school's vision and direction, its goals for the long and short term, and its approach to meeting its legal responsibilities. It also outlines the school's approach to meeting its legal responsibilities and to meeting national and local priorities for education.

reporting and accountability requirements. The circulars also provided examples of good planning and reporting practice.

- 9.15 There is no set format for the content of the analysis of variance reports.
- 9.16 We used the information in the circulars to extract what we consider to be a set of good practice principles. We use these principles to assess board performance in the detailed findings section of this Part (see paragraphs 9.28-9.50).

About our review

- 9.17 The requirements for strategic planning and self-review have been in place for seven years, and there has been no formal review of how well these arrangements are working. We noted in our June 2008 report⁴¹ on the Ministry's monitoring and support of boards that the Ministry was not systematically reviewing the analysis of variance reports to establish whether boards adequately understand and demonstrate their compliance with the National Education Guidelines.
- 9.18 When we provide the information in this Part to schools, it will be the first feedback boards will have received on the analysis of variance reports, so our intention is to:
- assess how well the reports are fulfilling their intended purpose;
 - more clearly set out the principles of good practice for the content of the reports;
 - provide constructive suggestions to boards on how they could improve their reports (illustrated with good practice that we have identified); and
 - highlight matters that need care when boards are preparing the reports.

How we did our review

- 9.19 We selected a sample of 90 primary schools (both contributing and non-contributing⁴²) out of total of 1898 primary schools. The method that we used to select our sample was designed to cover all deciles⁴³ and sizes of schools. To do this, we obtained a list of all contributing and non-contributing primary schools from the Education Counts website.⁴⁴ The list included the number of children enrolled in each school and the school's decile. We then split the schools into three groups – large (those schools with 300 enrolled students or more), medium (those

41 *Ministry of Education: Monitoring and supporting school boards of trustees* (June 2008), www.oag.govt.nz.

42 Primary schools that cater for students from years 0 to 8 are called non-contributing schools or full primary schools. Schools that cater only for students to year 6 are called contributing schools.

43 A school's decile indicates the extent to which it draws its students from low socio-economic communities. Decile 1 schools are the 10% of schools with the highest proportion of students from low socio-economic communities. Decile 10 schools are the 10% of schools with the lowest proportion of these students.

44 See www.educationcounts.govt.nz.

schools with 100 to 299 enrolled students), and small (those schools with fewer than 100 enrolled students). Within each group, we selected 30 schools, including schools from each decile and also from the different regions in New Zealand.

- 9.20 We assessed the quality of each school's analysis of variance report for the year ended 2009. We were particularly interested in whether a reader of the analysis of variance report (we took the view of a parent) could easily:
- identify the board's strategic goals and know from reading the report why the board had chosen these strategic goals;
 - identify the annual targets and how these annual targets relate to the strategic goals;
 - assess what outcomes had been achieved for the year and know what progress had been made;
 - understand what had been done to achieve these results, whether the planned action had worked, and if not why not; and
 - clearly understand what the board would be doing next year in response to its analysis of the results and be satisfied that the board was taking the appropriate action to achieve its strategic goals.
- 9.21 We did not read the schools' charter documents, because they are not published in the annual reports and most schools do not publish them on their websites. Therefore, the analysis of variance report has to stand alone and be able to be read and understood without the school charter.

Our overall findings

- 9.22 The quality of the analysis of variance reports prepared by boards in our sample varied widely. Some of the boards had clearly put a lot of thought and effort into preparing the analysis of variance report, while others appear to have treated it as more of a compliance exercise. We did not see any noticeable difference in the quality of the analysis of variance report between different sizes and deciles of schools.
- 9.23 We found that 15% of the boards in our sample had very good analysis of variance reports. In reading these reports, we considered that they had embraced the requirements for strategic planning and self-review. Their analysis of variance reports were focused on informing and engaging parents and other community members in what the school was trying to achieve for students and the progress the students were making. These reports had clear strategic goals (although the goals could be better linked to the charter). The board had set annual targets that were relevant to these goals. The reports detailed the action that the school planned to take to achieve the targets and analysed the student outcomes to

establish whether the action was effective. The results from the current year were then used as a basis for the next year's planning.

- 9.24 We found that 72% of boards in our sample were partly meeting the requirements for strategic planning and self-review. The analysis of variance reports prepared by these boards had clear annual targets and data measuring student achievement against the targets. However, to fully meet the requirements, these boards needed to better relate the annual targets to their strategic goals and better analyse what did or did not work well this year and, on the basis of this information, plan what would be done next year.
- 9.25 We found that 13% of boards in our sample had not engaged with the requirements for strategic planning and self-review. For example, one board had not prepared an analysis of variance report for 2009 but had used the 2007 version and dated it 2009. In another four instances, the boards had prepared annual targets but had not reported what they had achieved against the targets. In two other instances, the boards' analysis of variance reports comprised pages and pages of student achievement data. However, the boards had not provided any targets or any analysis to help the reader interpret what the annual achievement data actually meant.
- 9.26 There was wide disparity in the ease with which the boards in our sample communicated what they were doing in their analysis of variance reports. Some reports were easier to read and understand than others.
- 9.27 The boards that we reviewed were using a wide variety of styles and formats for the analysis of variance reports. Some boards preferred a narrative report, while others used a table. We did not find that any particular style worked better than another. What was important was:
- that the board targeted the contents of the analysis of variance report to the parents and community members;
 - whether the analysis of variance report contained meaningful headings to step the reader through the report (for example, one board had used the following headings: Why this target? What did we do? How did we resource it? What did we achieve? What do we believe made the difference? Where to next?);
 - that any graphs and tables used were kept simple and included a brief explanation of what the data meant;
 - that boards were frank about student achievement and had analysed why a programme had or had not worked; and
 - that a plan for the next year had been established and the reader was satisfied from the data and analysis provided that this was the appropriate thing to do.

Identifying the board's strategic goals and why those strategic goals had been chosen

Extracted principle of good practice

The analysis of variance report clearly articulates the board's strategic goal(s), establishes the link between the strategic goal reported on and the school's annual charter, and has a short explanation of why the board chose these goals.

- 9.28 We consider that information about the board's strategic goals should be included in the analysis of variance report so that the report can be read without the reader having to locate a copy of the school's charter. During our review, we noted that most of the schools in our sample did not have a copy of their charter on their website.
- 9.29 We found that 58% of the boards in our sample included their strategic goals in their analysis of variance reports. However, only 15% of these boards (9% of the total sample) had established a link between the strategic goals in their analysis of variance reports and the strategic planning section in their charters.
- 9.30 Most often, the link to the strategic goals was made through an introductory section in the analysis of variance report. This section included a brief statement that the goals were contained in the school charter, why the goals had been chosen (for example, through an analysis of the available achievement data), and who had been consulted in deciding on the goals (for example, staff, educational providers, and parent groups).
- 9.31 One school included the annual planning section of its charter at the beginning of its analysis of variance report. Another school included the school's vision statement, its values, and its goals, with a target established for each goal. We consider that this is a good way to set the tone of the analysis of variance report, because it provides the reader with an understanding of the values that the school considers important.
-

Extracted principle of good practice

The goals set by the board are measurable. This is necessary so that the board and the reader are able to establish when the goals are achieved.

- 9.32 We found that 58% of the boards in our sample had included goals. However, only 3% of those boards had set measurable goals. For example:
- *Students who achieve successfully in literacy, to National Standards expectations.*
 - *Raise student achievement in mathematics to National Standards.*

- 9.33 For most of the measures chosen by boards, it was difficult to establish how the board would know when the goal had been achieved. Most of the strategic goals set by boards included measures to “increase”, “improve”, “develop”, and “maximise” student achievement. However, because there was no target level, it was difficult to determine how boards would know when their goals had been achieved. We also noted a small sample of boards that had chosen strategic goals that would be more appropriate as part of the school’s vision or mission statement. For example:
- *To have high quality student achievement.*
 - *To develop essential knowledge and skills to enable all students to progress and succeed.*
 - *Quality learning comes with quality teaching.*
 - *To have well developed literacy skills which will enable them to understand and become more aware of the world around them.*
 - *Our children to develop strong skills and understanding in literacy and numeracy with students able to see the relevance to everyday life.*

Identifying the annual targets and establishing how these annual targets relate to the strategic goals

Extracted principle of good practice

The board sets annual student achievement targets, which are included in the analysis of variance report.

- 9.34 We were pleased to find that about 87% of the boards in our sample had set annual targets and included the targets in their analysis of variance reports. In fact, one board had gone as far as choosing two targets:
- *A challenging target – 100% of students will be working at their age-appropriate stage.*
 - *A comfortable target – 80% of students will be working at their age-appropriate stage.*
- 9.35 Of the 13% of boards in our sample that did not have targets, 44% had measured the student achievement level at the beginning of the year and then again at the end of the year and reported the difference. There was, however, no expectation about what the level of improvement would be. Thirty-three percent of these boards had reported student achievement data at the end of the year, and the remaining 23% of these boards had no targets or student achievement data.

- 9.36 Most of the boards in our sample chose student achievement targets to improve literacy (these included reading, comprehension, and writing) and to improve numeracy. However, about 26% of the boards in our sample chose targets in other curriculum areas – for example:
- fitness/swimming;
 - self-management; and
 - behaviour modification/emotional needs.
- 9.37 The most popular other targets were Information and Communication Technologies (ICT) and interacting with the environment.

Extracted principle of good practice

The board's annual student achievement targets measure the achievement of the board's strategic goal(s).

- 9.38 Of boards that had set strategic goals (58% of the total sample), 67% had targets that measured their strategic goals.
- 9.39 Some schools had difficulty setting targets to measure their strategic goals because their goals were at too high a level or too wide. For example, one school had a strategic goal "To develop essential knowledge and skills to enable students to progress and succeed". The target set was "To significantly reduce, or eliminate, the groups of children who are well below their chronological reading age". In another example, the board had set a target "For all cohorts to make 10% increase in children at or above expectations in school-wide data gathering". However, they had only measured numeracy.

Extracted principle of good practice

The student achievement targets are measurable.

- 9.40 Of the 87% of boards that had set annual student achievement targets, we consider that 17% of them would have had difficulty in measuring whether the targets had been achieved because the targets were not quantified. Most of these boards had used targets that involved "increasing", "reducing", or "improving". For example, a board had set the target "we will improve student achievement in written language by the end of the year". In our view, this target could have been improved by identifying the level of expected improvement. For example, another board had set out the expected level of student improvement. The board's goal was "that at least 75% of our year 2, year 4 and year 6 children will be displaying

accurate sentence structure at or above the expected national level by the end of 2009”.

- 9.41 We noted examples where boards had set targets to “achieve at or above expectations”, or measured targets as a percentage of “expectations”. Because the board did not state what the level of expectations were, the reader was not able to tell how well the children were achieving.

Extracted principle of good practice

The student achievement targets are based on board analysis of past data.

- 9.42 We found that 14% of boards in our sample had used student achievement data from the previous two to three years in setting their annual targets, 40% of the boards had used data from the current year, and 21% used data from the 2008 year (this data was student achievement data from tests conducted in February or March of the current year or the end of the previous year). We were concerned to note that a quarter (25%) of boards in our sample had not used historical data when setting their targets.
- 9.43 Only 34% of the boards that had not used historical data were able to measure student achievement. This was because the target was a percentage achievement by the end of the year. For example, one board had a target “That 90% of year 3-6 children will be able to read and show understanding of material at or above their chronological age”. This was able to be tested and measured at the end of the year. The remaining 66% either did not have an annual target or the achievement of the annual target was not able to be measured because the target was based on “increasing” or “improving” on current student achievement and no baseline data was provided.
- 9.44 Only one board in our sample had included longitudinal data (covering the past 10 years) in its analysis of variance report. Because the strategic goals are based on a three- to five-year period, the annual targets and measure of results should reflect movement towards the strategic goals.

Assessing what outcomes had been achieved for the year and knowing what progress had been made

Extracted principle of good practice

The board's analysis of variance report clearly shows how the school has performed against the board's annual targets. The idea of the analysis of variance report is that the school will analyse whether the expected progress has been made.

- 9.45 In 62% of the boards in our sample, the outcome of what had been achieved against the targets was clear and easy to understand. For 13%, we were able to determine what the outcomes were after interpretation or analysis on the reader's part, but for 17% the outcomes could not be determined.
- 9.46 For the remaining 7% of the boards in our sample, the boards had not recorded any outcomes in their analysis of variance reports.⁴⁵

Understanding what had been done to achieve these results, whether the planned action had worked, and if not why not

Extracted principle of good practice

The board's analysis of variance report details what the school has done to achieve the target and assesses the effect that the actions have had on the outcome – for example, identifying what has worked and why it has been successful or alternatively what has not worked and why it has not been successful.

- 9.47 Just over half of the boards in our sample included details of what action they had taken to achieve their targets in their analysis of variance reports. We also considered that we could work out what had been done, with some difficulty, in a further 6%. However, 38% of the boards in our sample did not have any details of what was done.
- 9.48 We were disappointed to find that only 30% of the boards in our sample had provided any analysis of what actions had worked or not worked and why. We consider that this is important because investigating the reasons for the differences between the actual student achievement outcomes and what was planned provides the board with a basis for deciding whether, and in what areas,

⁴⁵ For rounding reasons, the percentages add up to 99 rather than 100.

professional programmes and resources need to be different in next year's plans. It is an important aspect of the school's ongoing cycle of self-review.

Clearly understanding what the board would be doing next year and being satisfied that appropriate action would be taken

Extracted principle of good practice

Boards have used the analysis of variance to establish the targets and focus for the next year.

- 9.49 One of the main purposes of the analysis of variance report is to provide the basis for plans for the coming year. We were disappointed to find that only 50% of boards had set out what was planned for the next year. Two of the boards had gone as far as setting out the board's plans and targets for the 2010 year.
- 9.50 Of the 50%, a half of the boards had provided enough analysis or explanation of the future plans to convince the reader that it was the logical course of action to take.

Checklist for boards of trustees – good practice for analysis of variance reports

Overall	
Has your board considered the best way to communicate the analysis of variance to your parents and school community?	<input type="checkbox"/>
Does the analysis of variance report contain clear headings and explanations to allow readers to easily navigate their way through and understand the contents of the report?	<input type="checkbox"/>
Strategic goals	
Does the analysis of variance report identify your board's strategic goals and briefly explain that the goals are included in the school charter and why these strategic goals have been chosen?	<input type="checkbox"/>
Are your board's goals S.M.A.R.T (specific, measurable, attainable, realistic, and timely)?	<input type="checkbox"/>

Annual student achievement targets	
Does the analysis of variance report clearly set out the annual student achievement targets?	<input type="checkbox"/>
Do the annual student achievement targets measure the attainment of the board's strategic goals?	<input type="checkbox"/>
Are your board's annual targets S.M.A.R.T? <i>Make sure you have set out what your achievement expectations are..</i>	<input type="checkbox"/>
Are the targets stated in language that is easily understood by parents and the school community and do you explain technical terms – for example, “stanine”, “critical”, and “at risk levels”?	<input type="checkbox"/>
Have you used targets that will enable parents and the school community to gauge how well your school is doing in providing a safe and effective teaching and learning environment?	<input type="checkbox"/>
Student achievement results	
Does the analysis of variance report clearly say what progress has been made against the annual targets? <i>Be careful not to overload the analysis of variance report with graphs and tables of student achievement data. Where these are used, provide a simple explanation of what information the tables and graphs are showing.</i> <i>Be frank about poor progress – do not try to hide it.</i> <i>Be careful not to name or identify individual students when reporting on student achievement data. (Note: some target groups are so small that individual students may be able to be identified.)</i>	<input type="checkbox"/>
For ease of reading and understanding, are the targets and the results in close proximity and are the targets and results expressed in the same terms? For example, if the target is 80%, the result should be 76% rather than 68 out of 89 students.	<input type="checkbox"/>
Analysis of results	
Does the analysis of variance report clearly explain what school staff had done to achieve these results and what effect the programmes have had on student achievement?	<input type="checkbox"/>
Has your board considered including longitudinal data? <i>The strategic goals are based on a three- to five-year period – so the annual targets and measure of results should reflect movement towards the strategic goals.</i>	<input type="checkbox"/>
Where progress is less than what your board had planned, do you say the reasons why and what action your board and school staff will take to correct it?	<input type="checkbox"/>
Next year	
Does your board's analysis of variance report set out what your school staff will be doing next year in response to the board's analysis of the results and the board's strategic goals?	<input type="checkbox"/>
Would the reader be satisfied that your board and school staff are taking the appropriate action to achieve its strategic goals?	<input type="checkbox"/>

Part 10

Our inquiry work in the central government sector

- 10.1 In our recent annual reports to Parliament, we have noted that the inquiries function of the Office is coming under increasing pressure. The volume of requests has increased and, more significantly, the scale and complexity of the issues we are being asked to consider has also increased.
- 10.2 We last commented on inquiries in the report on our central government work for 2007/08. In 2008/09 and 2009/10, our work was dominated by a number of large and high-profile inquiries that we were asked to carry out by public entities or by their responsible Ministers.
- 10.3 In this Part, we discuss:
- the number of inquiries in the central government sector that we have dealt with in the last two years;
 - how we approach requests for inquiries; and
 - the issues we have considered in inquiries during the last two years.

The number of central government inquiries dealt with

- 10.4 Figure 19 shows the number of requests for inquiries in the central government sector during the last two years, and the nature of our response. For both of these years, central government matters provided just under one quarter of our total work on inquiries.

Figure 19
Inquiry work in central government, 2008-2010

	2008/09	2009/10
Total requests: central government (received and carried forward from previous year)	84	92
No inquiry	45	40
Routine inquiry*	22	35
Significant inquiry*	10	4
Major inquiry*	1	3
Total inquiry responses	78	82
Carried forward to following year	6	10

*See paragraphs 10.11-10.12 for an explanation of these terms.

- 10.5 One of those carried forward at the end of 2009/10 is our inquiry into the administration of certain types of expenditure in Vote Ministerial Services. We published a first report on this inquiry in March 2010, and we expect to publish the final report in December 2010.

- 10.6 In addition, two long-running and major inquiries were nearing completion at the end of June and have since had reports published. In July 2010 we published a report on the payments the New Zealand Defence Force made to officers seconded to the United Nations, and in August 2010 we published a report on our inquiry into the Plumbers, Gasfitters, and Drainlayers Board.

How we approach requests for inquiries

The Auditor-General's inquiry role

- 10.7 Our primary function is to audit the approximately 4000 public entities in the public sector. We have some discretionary capacity to examine in more detail issues of concern that are raised with us, but there are limits to that capacity. We receive a large number of requests for inquiries each year. Often, if an issue is a matter of public controversy, we receive a number of requests about it. We consider them carefully to decide the most appropriate way to proceed.
- 10.8 Some requests raise issues that are outside our mandate, have not yet been raised directly with the relevant public entity, or are better dealt with by another organisation. In such cases, we advise correspondents that we cannot assist, and may suggest other steps they could take.
- 10.9 For those requests that we decide are correctly directed to us, we consider each one to determine the most appropriate way to proceed. We examine requests to identify whether the issues raised suggest financial impropriety, problems with the organisation's overall governance and management, or other systemic or significant concerns that may be important for the organisation or the sector, or of general public interest. Other factors we consider include the seriousness of the issues raised, whether we have the resources and technical skills to consider the issues, and whether the issues may be better addressed through other avenues. We do not see ourselves as an avenue for resolving individual complaints or concerns about how a public entity has handled a particular matter. Rather, our focus is on whether there may be organisational or systemic problems that need examination.
- 10.10 As a result, many requests do not result in us carrying out a formal or in-depth inquiry. More often, we will carry out enough preliminary work to be able to understand the problem and to gain assurance that the issues are or will be addressed by those directly responsible. We are then able to respond to the correspondent with an assurance that the matters are being appropriately dealt with by others.

How we classify inquiries

- 10.11 We classify inquiries into three categories – “routine”, “significant”, and “major” – depending on the seriousness of the issues raised and the level of response required by us. A routine inquiry involves straightforward issues, and can often be carried out either by a review of documents or through correspondence and discussion with the public entity. It will not usually result in a published report. We always advise the correspondent of our conclusions and the reasons for them, and in some instances we advise the public entity of the matter. As noted, much of this routine work can be concluded by referring the issue back to the responsible organisation.
- 10.12 Significant and major inquiries involve more complex issues and may attract a broader level of public interest and attention. During these inquiries, we will often review the entity’s files and may also formally interview people. We sometimes report the results of these inquiries publicly, as well as advise the correspondent and the entity.

The limits of our role

- 10.13 The correspondence we receive shows that many people do not understand the role of the Auditor-General and its limits. For example, we get a wide range of requests asking us to:
- intervene in decision-making by local authorities;
 - injunct or stop activities and contracts;
 - make a judgement about the legality of actions; or
 - review individual decisions with which the correspondent disagrees.
- 10.14 It is often not our role to consider or review the matters raised, or we have no power to provide the response that is sought. In such cases, our response inevitably disappoints the correspondent and adds to their frustration.
- 10.15 Therefore, we are working to improve the information we make available about the role of the Auditor-General and our approach to requests for inquiries, so that it is easier for people to understand when we can usefully get involved and why.

The range of issues we have considered in inquiries

Routine and significant inquiries

- 10.16 We have looked at a wide range of issues and organisations in our inquiry work during the last two years. For example, we have carried out significant pieces of work about:

- the way in which purchase advisers were engaged for Ministers;
- procurement and conflict of interest questions in the health sector;
- procurement processes in the transport sector;
- regulatory activity by the Civil Aviation Authority; and
- the management of contracts and accountability for the use of funds in the tertiary education sector.

10.17 Our more general workload, on routine matters, has spanned many parts of central government activity, from taxation questions to the funding of retirement villages. Common topics of complaint include the management of procurement processes and other contracting activity, financial accountability when third parties such as non-government organisations are contracted to deliver services for the government, immigration and Accident Compensation Corporation matters, and concerns about the behaviour of individual officials and allegations of fraud.

10.18 In the remainder of this Part, we discuss the major inquiries we have carried out in the central government sector during the last two years. Five of these six major inquiries were as a result of requests from Ministers. All of these inquiries have been significant pieces of work for us, and have involved a considerable amount of work by our staff and those in the organisations that we were examining.

Inquiry into the Plumbers, Gasfitters, and Drainlayers Board (August 2010)

10.19 In September 2008, the then Minister for Building and Construction asked the then Auditor-General to consider carrying out an inquiry into the Plumbers, Gasfitters, and Drainlayers Board (the Board). The request was prompted by concerns about the number and nature of complaints received by the Minister and the Department of Building and Housing, many of which suggested that the Board was not carrying out its core functions adequately.

10.20 During 2008/09, we examined in some detail how the Board was carrying out its functions under the Plumbers, Gasfitters, and Drainlayers Act 1976. We found problems with how it was carrying out most of its functions. The problems differed for the various functions, but included unclear or non-existent policies, poor communication, poor processes, decisions and policies that were not clearly well grounded in the legislation, and little awareness of the need to embed basic administrative law disciplines into the Board's everyday work and decision-making.

- 10.21 We also talked to many individuals and organisations working in the building and construction sector about their interactions with the Board. We encountered a sector that was characterised by suspicion and discontent. Many plumbers and gasfitters we spoke to were unhappy with the work of the Board at many levels.
- 10.22 Our report acknowledged that the members of the Board had worked hard since 2008 to address the problems. It had put in place many initiatives to improve the organisation's management and communication with the sector, and to tackle the high failure rate for examinations.
- 10.23 However, we regard the problems with the Board's activities as deep seated. The changes that have been introduced by the Board are a good beginning, but are not yet enough. Some of the matters that concerned us about the Board's operations under the Plumbers, Gasfitters, and Drainlayers Act 1976 continue to present risks with the introduction of the Plumbers, Gasfitters, and Drainlayers Act 2006. In addition, the Board has significant challenges for the future, including:
- changing its organisational culture;
 - developing the Board's capacity and capability to better manage emerging challenges;
 - ensuring that it acts lawfully;
 - producing comprehensive, clear, and practical policies and procedures; and
 - rebuilding trust in the Board.
- 10.24 The Board has accepted our report and committed to implementing all of our recommendations. We understand that the Minister and the Department of Building and Housing are monitoring the Board's progress. We will carry out some follow-up work in due course, to assess whether the necessary level of change has been achieved.

Inquiry into New Zealand Defence Force payments to officers seconded to the United Nations (July 2010)

- 10.25 In 2008, the Minister of Defence asked the then Auditor-General to inquire into a number of matters associated with the payment of accommodation assistance by the New Zealand Defence Force (NZDF) to four officers whom it seconded to the United Nations Department of Peacekeeping Operations in New York.
- 10.26 A military Court of Inquiry had already investigated and reported on how four officers seconded to the United Nations (UN) over a number of years had wrongly claimed accommodation assistance by submitting false declarations. This practice enabled them to receive additional accommodation assistance from the NZDF outside the terms of the UN secondment. The request to the Auditor-General

asked us to look more deeply at the causes of the problem, and in particular to identify whether anyone in the NZDF had encouraged or condoned the wrongdoing.

- 10.27 The inquiry found that this issue had arisen because of poor policy development and other failures at critical points. The issue had been mismanaged from start to finish. The policy process was slow at every point and provided advice that was either flawed or totally wrong. Administrative and disciplinary responses were also slow.
- 10.28 The inquiry also found that the rationale on which NZDF had decided to pay the seconded officers NZDF accommodation assistance was incorrect. In its initial analysis, NZDF had compared the financial positions of NZDF officers posted to New York on NZDF conditions with NZDF officers seconded to the UN in New York. It had determined that the seconded officers would be significantly worse off if they were paid only through the UN system, with indicative figures suggesting that the difference might be as much as \$100,000 a year. We found that, in fact, the seconded officers would have been in a generally comparable financial position under the standard UN conditions, and may have even been better off sometimes. Therefore, there was no need to pay the seconded officers NZDF accommodation assistance, and the problems that ensued could have been avoided.
- 10.29 The inquiry considered what had caused the problems to arise and how they could persist for so long when so many people in NZDF knew that what was being done was wrong. We concluded that three aspects of the organisational culture in NZDF headquarters contributed to the problem:
- a strong silo mentality, which enabled people to see the issue as someone else's problem;
 - the military discipline of hierarchy and command lines, which enabled people to see it as inappropriate for them to question decisions apparently made by their superiors; and
 - a general desire for practical solutions to problems, and an inadequate recognition of when those solutions may conflict with fundamental public sector values of integrity and legality.
- 10.30 NZDF accepted the findings of the report, and undertook to act on all of our recommendations. It had already begun to overhaul its personnel policy-making processes and to restructure its head office to promote better collaboration and clearer accountability.

- 10.31 In an NZDF report released in October 2010, resulting from a Court of Inquiry into the employment of Mr Stephen Wilce, the Chief of the Defence Force noted that there were parallels between the two issues – in particular, the question of whether NZDF was receptive enough to the concerns that were raised with it. He stated that he has directed relevant managers to draw up procedures to ensure that concerns about bad behaviour by members of the NZDF can be elevated to the appropriate level for rapid resolution.⁴⁶

Inquiry into certain types of expenditure in Vote Ministerial Services: Part 1 (March 2010)

- 10.32 On 2 March 2010, the Auditor-General released terms of reference for an inquiry into certain types of expenditure in Vote Ministerial Services that provide or could provide private benefit to a Minister. The inquiry was initiated by the Auditor-General after receiving separate requests from the Prime Minister, Mr Phil Heatley MP, and the Department of Internal Affairs.
- 10.33 The purpose of the inquiry was to:
- audit the spending by Mr Heatley’s ministerial office from when he became a Minister in November 2008 to when he resigned from his ministerial portfolios for Housing and Fisheries on 25 February 2010;
 - review the rules, policies, and procedures to see whether they are appropriate and effective, and identify any improvements that could be made; and
 - consider any other matters that the Auditor-General considers relate to, or arise from, the above.
- 10.34 The report addressed the first part of our inquiry’s terms of reference. It summarised the general principles that apply to public spending where there could be private benefit and our overall findings and conclusions, followed by a detailed report about our audit of Mr Heatley’s ministerial office spending.
- 10.35 Mr Heatley’s overall ministerial office spending was reasonable compared to spending incurred by other ministerial offices for the period we looked at. We found that a total of \$1,402 of Mr Heatley’s spending – \$608 in Vote Ministerial Services and \$794 in Vote Parliamentary Services – was outside the rules. In all cases, Mr Heatley thought that the spending was within the rules, but he did not understand the rules correctly. In the case of the spending in Vote Parliamentary Service, the Parliamentary Service was also administering a rule incorrectly for members of Parliament, and Mr Heatley is not the only member who will have been affected.

⁴⁶ *Report of Court of Inquiry into the Circumstances in which Mr Stephen Wilce was employed as Director of the Defence Technology Agency*, October 2010, page 55, available on www.nzdf.mil.nz.

- 10.36 We expect to publish a second report on the remaining terms of reference, namely the adequacy of the rules, policies, and procedures supporting administration of this spending, in December 2010.

How the Ministry of Education managed the 2008 national school bus transport tender process (October 2009)

- 10.37 In February 2009, we announced the terms of reference for our inquiry into how the Ministry of Education managed the 2008 national school bus transport tender process (the 2008 bus tender process). Our inquiry examined:
- how the Ministry prepared its overall procurement strategy and Request for Proposal (RFP) for the 2008 bus tender process;
 - the extent to which the RFP reflected the Ministry's earlier consultation with stakeholders, where appropriate, and the clarity with which any important changes to the RFP were communicated to stakeholders;
 - the extent to which Ministry staff, contractors, and the Tender Evaluation Committee correctly and consistently applied the RFP rules; and
 - the extent to which the Ministry responded promptly and effectively when concerns were expressed about aspects of the 2008 bus tender process.
- 10.38 Overall, the Ministry's procurement approach was sound. No process is perfect, and we identified improvements that we expect the Ministry to make in any subsequent bus tender processes. The errors and inconsistencies we found did not, in our view, undermine the overall outcome of the 2008 bus tender process. However, we commented that the Ministry should strengthen the quality assurance arrangements in subsequent bus tender processes.

Inquiry into Parliamentary and Ministerial accommodation entitlements (October 2009)

- 10.39 In September 2009, the Auditor-General received a number of requests to inquire into the way Parliamentary and Ministerial accommodation entitlements and how they had been applied to Hon Bill English.
- 10.40 In relation to reimbursement of accommodation costs by the Parliamentary Service and Mr English's "primary place of residence", we concluded that Mr English had correctly completed the declarations he was required to as a member of Parliament, and provided other information on his accommodation arrangements, to claim Wellington accommodation costs. The Parliamentary Service or successive Speakers had considered and approved as appropriate Mr English's various declarations and claims relating to his "primary place of residence" and accommodation costs. That Mr English was being reimbursed for

the cost of renting a house owned by his family trust was not exceptional, and the administrative system now includes protections such as a market evaluation of rent.

- 10.41 In relation to the provision of a ministerial residence, we concluded that Ministerial Services had not considered the status of a home owned by a family trust until Mr English asked whether Ministerial Services could take over the lease of the property he was already renting from a family trust. Ministerial Services asked Mr English to sign a declaration that he did not have a pecuniary interest in the family trust. He signed the declaration, and attached a copy of the advice he had received about what amounted to a beneficial interest in a trust for the purposes of Standing Orders.
- 10.42 Having received that declaration, Ministerial Services got a market evaluation of the rent, took over the existing rental agreement, and provided the house as a ministerial residence. In our view, the advice that Mr English relied on to make his declaration was not applicable to this situation and was based on too narrow a test for the Ministerial Services' situation. We considered that Mr English did have an indirect financial interest in the trust.
- 10.43 At Mr English's request, the rental agreement between Ministerial Services and the trust ended, and Mr English reimbursed the rent and other costs that had been paid.
- 10.44 The Prime Minister then announced that a new policy was to be implemented under which Ministerial Services would no longer provide accommodation directly for Ministers. Instead, Ministerial Services now simply provides a fixed level of financial assistance to Ministers, who make their own accommodation arrangements. This approach means that the question of whether a Minister has a personal financial interest in a property is no longer relevant.

Inquiry into immigration matters (two reports) (May 2009)

- 10.45 In May 2008, the then Prime Minister and the then Minister of Immigration requested that we carry out an inquiry into a range of integrity concerns arising out of Immigration New Zealand, which is part of the Department of Labour. The request was in response to various concerns that had been discussed in the public domain. This inquiry did not find widespread integrity and probity issues within Immigration New Zealand. However, the inquiry did identify a need for the Department of Labour to improve the systems and processes that Immigration New Zealand used to support staff who make visa and permit decisions, and some organisational issues of concern. Volume 1 of the report included a list of 20 recommendations addressing these various concerns.

- 10.46 Volume 2 of the report set out our findings on the public sector recruitment processes involving Ms Mary-Anne Thompson and the handling of recruitment-related concerns. We found that, in general, the recruitment processes that had involved Ms Thompson throughout most of her public sector career had been in keeping with standard practices at the time. The process for her recruitment into the Department of Labour in 2004 deviated from standard good practice expectations in some respects. With the benefit of hindsight, we considered that those who had identified questions about her qualifications should have done more to investigate them or draw them to the attention of others.
- 10.47 Since we reported in May 2009, the Department of Labour has begun a range of projects to implement our recommendations. We intend to carry out further work to follow up on the Department's response to our recommendations at an appropriate time. Ms Thompson pleaded guilty to criminal charges in relation to the use of a curriculum vitae with false information in February 2010.

Conclusion

- 10.48 Across our inquiry work in central and local government, we have noted that both the number and complexity of the issues being raised with us are increasing. There has also been a trend for organisations, either through the responsible Minister or chief executive, to ask the Auditor-General to inquire when issues first emerge, rather than waiting for others to request an investigation.
- 10.49 We are happy to accommodate such requests, but note that the number of major inquiries of this kind under way during the last two years has had a significant effect on our resources. Major inquiries of this kind, examining systemic and cultural issues, can also take some time.
- 10.50 We note that several of the major inquiries we have recently completed have raised concerns about systemic and cultural issues within organisations. They serve to remind public sector leaders that it is important to be vigilant about values, organisational culture, and basic systems. It is possible for practice to drift away from its roots and for individual decisions to start to go awry, especially in long-standing areas of activity.

Appendix

Details of the non-standard audit reports issued in 2010

Adverse opinions

Royal New Zealand Navy Museum Trust Incorporated

Financial statements year ended: 30 June 2009

We disagreed with the Board 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 revenue because of limited controls over that revenue.

RNZAF Museum Trust Board

Financial statements year ended: 30 June 2010

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.

Disclaimers of opinion

Te Kura Kaupapa Māori o Ruamata

Financial statements years ended: 31 December 2006 and 31 December 2007

We were unable to form an opinion on the financial statements because of the following limitations in scope:

- we were unable to obtain enough appropriate audit evidence to support all 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 whether some revenue had been properly recorded because of limited controls over that revenue;
- the Board of Trustees did not provide budgeted figures for the financial year in the financial performance and position statements; and
- the Board of Trustees did not maintain proper minutes of Board meetings.

Except-for opinions for public entities other than schools

New Zealand Fire Service Commission

Financial statements and statement of service performance year ended: 30 June 2010

Our audit was limited because performance data was not collected for some performance measures from September to December 2009 due to industrial action by firefighters.

Christchurch Polytechnic Institute of Technology and Group

Financial statements and performance information year ended: 31 December 2009

Our audit was limited because the comparative information in the financial statements did not comply with New Zealand International Accounting Standard 27: *Consolidated and Separate Financial Statements* (NZ IAS 27) – the group financial statements for 2008 did not include the financial position and results of operations and cash flows of Otautahi Education Development Trust (the Trust), a subsidiary of the Polytechnic. The Trust has been included in the group financial statements in accordance with NZ IAS 27 for the first time for the year ended 31 December 2009.

Wellington Institute of Technology

Financial statements and performance information year ended: 31 December 2009

We disagreed with the accounting treatment used in the previous year to account for quality reinvestment programme funding as revenue and as a net receivable in the financial statements in the comparative information. In our opinion, the quality reinvestment programme funding should have been treated as a contribution from the Crown in the 2009 financial statements.

UCOL International Limited (Universal College of Learning)

Financial statements year ended: 31 December 2009

Our audit was limited because the company was unable to establish the amount of tax-related liabilities to be recognised in the financial statements, as required by New Zealand Equivalent to International Accounting Standard No. 12: *Income Taxes*. This was due to the company being unable to file returns to the Income Tax Department of India for activities carried out in India from 2004 to 2008.

Massey Ventures Limited and Group (Massey University)

Financial statements year ended: 31 December 2009

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

Whitireia Performing Arts Company Limited (Whitireia Community Polytechnic)

Financial statements year ended: 31 December 2009

Our audit was limited because we were unable to verify some revenue due to limited control over that revenue. The company also failed to comply with the law because it did not maintain adequate accounting records to enable the financial statements of the company to be readily and properly audited.

Ivey Hall and Memorial Hall 125th Anniversary Appeal Taxable Activity Trust (Lincoln University)

Financial statements year ended: 31 December 2009

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

Ivey Hall and Memorial Hall 125th Anniversary Appeal Gifting Trust (Lincoln University)*Financial statements year ended: 31 December 2009*

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

Wilson Home Trust (Waitemata District Health Board)*Financial statements year ended: 30 June 2008*

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

Auckland DHB Charitable Trust (Auckland District Health Board)*Financial statements year ended: 30 June 2009*

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

Gisborne Laundry Services (Tairāwhiti District Health Board)*Financial statements year ended: 30 June 2007 and 30 June 2008*

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

Except-for opinions for schools

Wellington Girls' College*Financial statements year ended: 31 December 2009*

We disagreed with the Board of Trustees not preparing group financial statements to consolidate the financial statements of its controlled entity, the Wellington Girls' College Charitable Foundation. This is a departure from New Zealand Equivalent to International Accounting Standard No. 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 2009*

We disagreed with the Board of Trustees not preparing group financial statements to consolidate the financial statements of its controlled entity, the New Plymouth Girls High School Centenary Trust Board. This is a departure from New Zealand Equivalent to International Accounting Standard No. 27: *Consolidated and Separate Financial Statements*, which requires the Board of Trustees to present consolidated financial statements.

Te Wharekura o Rakaumangamanga*Financial statements year ended: 31 December 2009*

We disagreed with the Board of Trustees not preparing group financial statements to consolidate the financial statements of its controlled entity, Te Wharekura O Rakaumangamanga Foundation Charitable Trust. This is a departure from New Zealand Equivalent to International Accounting Standard No. 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 2009

We disagreed with the Board of Trustees not preparing group financial statements to consolidate the financial statements of its subsidiary, the College House Hostel Trust. This is a departure from New Zealand Equivalent to International Accounting Standard No. 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 2009

We disagreed with the decision of the Board of Trustees 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 provisions to be valued at their present obligation.

Puni School

Financial statements year ended: 31 December 2009

The Board did not report the budget figures for the Statement of Financial Position and the Statement of Changes in Equity. This is a departure from statutory reporting requirements.

Hato Paora College

Financial statements years ended: 31 December 2008 and 31 December 2009

Our audits were limited because we could not establish whether decisions made by the governing body of the College were appropriate as the College had not been managed by a properly constituted Board of Trustees. The governing body was comprised of representatives of the Board of Trustees and the proprietor. This is a breach of sections 75 and 94 of the Education Act 1989, which specify that a Board of Trustees is responsible for the management of a school and specify how a Board of Trustees should be constituted.

In our 31 December 2008 audit report, we disagreed with the governing body recognising expenditure for capital works on land owned by the proprietor as an asset. The use of funding for this purpose is not permitted by law unless the Board's financial interest in the capital works has been agreed and the approval of the Ministry of Education has been obtained. The Board's financial interest is not the subject of an agreement with the proprietor and the Ministry of Education has not granted the approval. Therefore, the expenditure was unlawful and the fixed assets, equity, and surplus of the College were overstated.

Saint Peter's College (Palmerston North)

Financial statements year ended: 31 December 2009

We disagreed with the Board of Trustees recognising expenditure incurred in 2008 for capital works on land owned by the College proprietor as an asset. The use of funding for this purpose is not permitted by law unless the Board's financial interest in the capital works has been agreed and the approval of the Ministry of Education has been obtained. The Board's financial interest is not the subject of an agreement with the proprietor and the Ministry of Education has not granted the approval. Therefore, the expenditure was unlawful and did not meet the criteria for the Board to recognise it as a fixed asset and should be written off. As a result, the fixed assets and equity of the College were overstated.

Pakuranga Health Camp School

Financial statements year ended: 31 December 2009

Our audit was limited because the notional lease grant and expenditure had been omitted from the financial statements due to the uncertainty associated with the ownership of the school property. The inclusion of the notional lease from the use of land and buildings and the associated grant income in the Income Statement is generally recognised as necessary to fairly reflect the magnitude of the school's operations. The effect of this omission is that the total income and total expenses are understated but this has no impact on the net surplus for the year. This was a departure from the statutory reporting requirements of section 87(3) of the Education Act 1989.

Mayfield Primary School

Financial statements year ended: 31 December 2009

Our work was limited because of an unresolved investigation into certain transactions between the school and a related party. There were no practical audit procedures to determine the effect of the investigation until a conclusion has been reached.

Tirohia School

Financial statements years ended: 31 December 2007 and 31 December 2008

Our audit was limited because we were unable to verify some revenue due to limited controls over that revenue and we were unable to verify the adequacy of the provision for cyclical maintenance. In our opinion, the provision did not adequately estimate the cost of maintenance or the required painting cycles and is materially understated. The effect of the understatement is to understate expenditure and understate liabilities.

Birchville School

Financial statements year ended: 31 December 2009

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

Devon Intermediate School

Financial statements year ended: 31 December 2009

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

Freyberg Community School

Financial statements year ended: 31 December 2009

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

Hokitika School

Financial statements year ended: 31 December 2009

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

Kiwitahi School

Financial statements year ended: 31 December 2009

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

Makauri School

Financial statements year ended: 31 December 2009

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

Mangapapa School

Financial statements year ended: 31 December 2009

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

Motu School

Financial statements year ended: 31 December 2009

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

Ohuka School

Financial statements year ended: 31 December 2009

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

Red Beach School

Financial statements year ended: 31 December 2009

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

Saint Joseph's Catholic School (Paeroa)

Financial statements year ended: 31 December 2009

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

Tangowahine School

Financial statements year ended: 31 December 2009

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

Taumarunui High School & Community Trust

Financial statements year ended: 31 December 2009

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

Te Kura Kaupapa Māori o Te Rawhiti Roa

Financial statements year ended: 31 December 2009

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

Te Kura Kaupapa Māori o Takapau

Financial statements year ended: 31 December 2009

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

Tongariro Area School

Financial statements year ended: 31 December 2009

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

Upper Hutt School

Financial statements year ended: 31 December 2009

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

Weber School

Financial statements year ended: 31 December 2009

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

Whatatutu School

Financial statements year ended: 31 December 2009

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

Moanataiari School

Financial statements year ended: 31 December 2009

Our audit was limited because we were unable to verify some revenue due to a lack of records for that revenue.

Woodstock School

Financial statements year ended: 31 December 2009

Our audit was limited because we were unable to verify some revenue due to a lack of records for that revenue.

Te Kura Kaupapa Māori o Waiuku

Financial statements year ended: 31 December 2008

Our audit was limited because we were unable to verify some revenue due to limited controls over that revenue and certain accounting records were not available for inspection.

Ross Intermediate

Financial statements year ended: 31 December 2009

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

Allenvale Special School and Resource Centre

Financial statements year ended: 31 December 2009

Our audit was limited because the results of an investigation into the financial management of the school were not known at the completion of the audit.

Taikura Rudolf Steiner School

Financial statements year ended: 31 December 2009

We disagreed with the Board of Trustees making an unlawful transfer of Crown money to a third party.

Parkside Christian SDA School

Financial statements year ended: 31 December 2009

We disagreed with the Board of Trustees making an unlawful transfer of Crown money to its proprietor.

Te Tipua School

Financial statements year ended: 31 December 2009

We disagreed with the Board of Trustees not including the surplus on its transport operation, which was Crown money held on behalf of the School, as a current asset in the Statement of Financial Position.

Explanatory paragraphs for public entities other than schools

University of Auckland and Group

Financial statements and performance information year ended: 31 December 2009

We drew readers' attention to the disclosures in the financial statements about the Partnerships for Excellence funding in 2009, which was provided by the Crown as a capital appropriation for increasing the University's capability. This should have been recognised as equity in nature and not recognised as income in advance. In addition, the relevant research contract funding should have been recognised as a capital contribution from the Crown in 2009 rather than partly as revenue and partly as a liability. Although these amounts are not material to the financial statements as a whole, we felt it important to highlight the disclosures to the readers of the financial statements.

Public Trust and Group

Financial statements and statement of service performance year ended: 30 June 2010

We drew readers' attention to the disclosures in the financial statements about the value of unlisted mortgage-backed securities of \$29.3 million for which there was not an active liquid market and for which no quoted price was available. Although the fair value of these investments was based on the best available information, without an active, liquid market and quoted market prices a high degree of uncertainty existed about that value, which could have a material effect on the Statement of Comprehensive Income and Statement of Financial Position.

MidCentral District Health Board and Group

Financial statements and statement of service performance year ended: 30 June 2010

We drew readers' attention to the disclosures in the financial statements about the 5% reduction the Board made to the valuation of buildings carried out by the independent valuer as at 30 June 2009 and which was included in the 30 June 2010 balance. This is not supported by the New Zealand Equivalent to International Accounting Standard No. 16 *Property, Plant and Equipment*, which requires valuations to be either carried out by or reviewed by an independent valuer. The reduction made by the Board was not included in the valuation provided by the independent valuer. There was no information subsequent to 30 June 2009 to support this adjustment. However, the reduction is not material to the financial statements as a whole.

Whanganui District Health Board

Financial statements and statement of service performance year ended: 30 June 2010

We drew readers' attention to the serious financial difficulties of the Board. The Health Board was managing the situation and, subject to deficit support, there would be enough cash flow generated from operating activities to meet the investing and financing cash flow requirements as set out in the Board's Statement of Intent. The Crown has indicated that it would provide such support where necessary to maintain the Board's viability.

Tairāwhiti Polytechnic

Financial statements and performance information year ended: 31 December 2009

We noted the disclosures in the financial statements that referred to the going concern assumption appropriately being used in preparing the financial statements. The Polytechnic was pursuing merger talks with Eastern Institute of Technology and changes were taking place in the tertiary education sector that would result in a loss of government funding in the future that could affect the viability of the institution as an independent entity in the next two to three years.

Archives New Zealand

Financial statements and statement of service performance year ended: 30 June 2010

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 will amalgamate into the Department of Internal Affairs.

Electoral Commission

Financial statements and statement of service performance year ended: 31 December 2010

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 of the Government's decision to transfer the functions of the Commission to the new Electoral Commission, after new legislation was enacted on 21 May 2010.

Electricity Commission

Financial statements and statement of service performance year ended: 30 June 2010

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 of the Government's decision to transfer the functions, powers, assets, contractual obligations, and entitlements of the Commission to the Electricity Authority on 1 November 2010, as a result of the Electricity Industry Act 2010.

Environmental Risk Management Authority

Financial statements and statement of service performance year ended: 30 June 2010

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 of the Government's decision to transfer the functions of the Authority to the Environmental Protection Authority in 2011, after the legislation to implement these changes is enacted.

Foundation for Research, Science and Technology

Financial statements and statement of service performance year ended: 30 June 2010

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 of the Government's decision to transfer the functions of the Foundation to the Ministry of Science and Innovation in 2011, after the legislation to implement these changes is enacted.

Ministry of Research, Science and Technology

Financial statements and statement of service performance year ended: 30 June 2010

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 of the Government's decision to transfer the functions of the Ministry to the Ministry of Science and Innovation in 2011, after the legislation to implement these changes is enacted.

New Zealand Food Safety Authority

Financial statements and statement of service performance year ended: 30 June 2010

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 of the Government's decision to merge the Authority with the Ministry of Agriculture and Fisheries on 1 July 2010.

Securities Commission

Financial statements and statement of service performance year ended: 30 June 2010

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 of the Government's decision to transfer the functions of the Commission to the proposed Financial Markets Authority and to disestablish the Commission in 2011, after the legislation to implement these changes is enacted.

National Library of New Zealand

Financial statements and statement of service performance year ended: 30 June 2010

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 of the Government's decision to merge the functions of the National Library with the Department of Internal Affairs and Archives New Zealand and to disestablish the National Library in 2011, after the legislation to implement these changes is enacted.

Otago District Health Board

Financial statements and statement of service performance period ended: 30 April 2010

We noted the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements because the Board was merged with Southland District Health Board on 30 April 2010, according to an Order in Council made under the Health Sector (Transfers) Act 1993. The Order in Council transferred the Board's assets and liabilities to the Southern District Health Board, which will continue to provide the same services provided by the Board. Therefore, no adjustments have been made to the financial statements because of the dissolution basis of preparation.

Southland District Health Board

Financial statements and statement of service performance period ended: 30 April 2010

We noted the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements because the Board was merged with Otago District Health Board on 30 April 2010, according to an Order in Council made under the Health Sector (Transfers) Act 1993. The Order in Council transferred the Board's assets and liabilities to the Southern District Health Board, which will continue to provide the same services provided by the Board. Therefore, no adjustments have been made to the financial statements because of the dissolution basis of preparation.

New Zealand School of Fisheries Limited (Nelson Marlborough Institute of Technology)

Financial statements year ended: 31 December 2009

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 disestablished after 31 December 2009.

The Nelson Academy Limited (Nelson Marlborough Institute of Technology)

Financial statements year ended: 31 December 2009

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 disestablished after 31 December 2009.

Nelson Marlborough Institute of Technology International Limited (Nelson Marlborough Institute of Technology)

Financial statements year ended: 31 December 2009

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 disestablished after 31 December 2009.

iPredict Limited and Group (Victoria University of Wellington)

Financial statements year ended: 31 December 2009

We noted the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements because the company had negative equity at the time of the financial statements being approved and no letter of support had been received from shareholders.

Predictions Clearing Limited (Victoria University of Wellington)

Financial statements year ended: 31 December 2009

We noted the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements because the company had negative equity at the time of the financial statements being approved and no letter of support had been received from shareholders.

MVLONE Limited and Group (Massey University)

Financial statements years ended: 31 December 2008 and 31 December 2009

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 disestablished after 31 December 2009.

MVLTWO Limited (Massey University)

Financial statements years ended: 31 December 2008 and 31 December 2009

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 disestablished after 31 December 2009.

Public Trust Investment Funds Balanced Income Fund (Public Trust)

Financial statements year ended: 31 March 2010

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 Fund was to be closed in the next financial year (and the fund transferred to a new fund structure).

Public Trust Group Investment Funds (GIF) - Feeder Funds (Public Trust)

Financial statements years ended: 15 March 2009 and 15 March 2010

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 Fund was to be closed in the next financial year (and the fund transferred to a new fund structure).

Public Trust Group Investment Funds (PTIF) - Investing Funds (Public Trust)

Financial statements year ended: 31 March 2010

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 Fund was to be closed in the next financial year (and the fund transferred to a new fund structure).

Woodville Windfarm Limited (Meridian Energy)

Financial statements year ended: 31 December 2009

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 Directors filed a request with the Companies Office to have the company removed from the register.

Bay of Plenty Provincial Patriotic Council

Financial statements period ended: 30 November 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 entity closed on 30 November 2006. The financial statements were prepared for a 14-month period until the date of disestablishment. This is a departure from section 40 of the Patriotic and Canteen Funds Act 1947, which requires the Council to prepare its accounts for the year ended 30 September each year.

Southland Provincial Patriotic Council

Financial statements year ended: 30 September 2009

We noted the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements because the Council was disestablished by resolution on 15 December 2005. Assets and liabilities are still held by the Council until a final decision is made as to where these assets and liabilities will vest.

Explanatory paragraphs for schools

Breaches of law for not reporting by 31 May 2010 (42 schools)

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

We noted that 42 schools had breached the law by failing to meet this statutory reporting deadline, and had chosen not to disclose the breach in their financial statements.

Closures of entities (four schools and 23 transport networks)

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 four closed schools and 23 closed transport networks (which are public entities controlled by schools) had prepared their financial statements on an appropriate basis.

Serious financial difficulties (19 schools)

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

We noted that 19 schools had included disclosures in their financial statements that outlined their financial difficulties and the actions they were taking to address the factors that had resulted in those difficulties.

Breaches of law for borrowing above the permitted limit without approval (14 schools)

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

Fourteen schools had breached the law by not seeking authority from the joint Ministers for borrowing above the permitted limit and had chosen not to disclose the breach in their financial statements.

Breaches of law for not having a 10-year property plan (eight 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.

Eight schools had breached the law by failing to update the 10-year property plan annually and had chosen not to disclose the breach in their financial statements.

Breaches of law for not submitting financial statements for audit by 31 March 2010 (eight schools)

Boards of Trustees have a statutory obligation to submit their financial statements for audit by 31 March.

Eight schools had breached the law by failing to submit their financial statements for audit by 31 March 2010 and had chosen not to disclose the breach in their financial statements.

Breaches of law for not including the required analysis of variance reports (six schools)

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

Six schools had breached the law by not including this analysis in their annual reports and had chosen not to disclose the breach in their financial statements.

Other reasons (29 schools)

Our audit reports included emphasis of matter paragraphs for other reasons:

- Three schools failed to keep proper accounting records.
- Three integrated schools were in a process to modify the documentation to comply with the Ministry of Education's guidelines on local fundraising by boards and proprietors.
- Three schools invested in non-approved banking institutions without the authority of the Ministers of Education and Finance.
- Two schools depended on the Minister of Education's decision and community consultation about whether to close.
- Two schools paid their staff in advance without the approval of the Ministry of Education.
- Two schools acquired an interest in land without the approval of the Minister of Education.
- One school was using a bank account that was not under its direct control and authority.
- One school had trustees who were 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 a financial year, without the approval of the Minister of Education.
- One school was disposing of a building, which was unlawfully recognised as fixed assets expenditure on capital works on land owned by the school's proprietor.
- One school was seeking approval from the Ministry of Education to recognise the Board of Trustees' interest in the proprietor's premises.
- One school was reviewing its fixed asset register to establish whether to retain several assets listed at nil value.
- One school granted a license to occupy certain school buildings and part of the school field to third parties without the approval of the Minister of Education.
- One school had two permanently appointed staff serving on the Board of Trustees during the year.
- One school did not exclude a member with a declared conflict of interest from board meetings to consider and discuss matters in the area where the conflict existed and payments exceeded the approval from the Secretary for Education.
- One school had disclosed a prior year transaction where there were questions over its appropriateness.
- One school spent a large amount of money on an overseas trip for some students and adults, which was considered wasteful and showed a lack of probity.
- One school paid remuneration which was approved by the Ministry of Education to the principal for duties relating to professional and pastoral leadership and management of a hostel that was owned by the proprietor – who also paid him for the same duties.
- One school had a significant number of related party transactions between the school, the proprietor, and a kindergarten.
- One school had funds owing to the Ministry of Education that had not been reconciled between various projects.
- One school had its 2008 comparative figures in the financial statements amended to correct errors that overstated equity and fixed assets.

Note: Includes any explanatory paragraphs and breaches of law in the qualified audit reports above.

Publications by the Auditor-General

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

- Matters arising from Auckland Council's planning document
- How the Department of Internal Affairs manages spending that could give personal benefit to Ministers
- Department of Internal Affairs: Administration of two grant schemes
- Inquiry into payments to chief executives of dissolving local authorities in Auckland
- Guidance for members of local authorities about the Local Authorities (Members' Interests) Act 1968
- Annual Report 2009/10
- Effectiveness of the Get Checked diabetes programme
- Spending on supplies and services by district health boards: Learning from examples
- New Zealand Transport Agency: Information and planning for maintaining and renewing the state highway network
- District health boards: Availability and accessibility of after-hours services
- Matters arising from the 2009-19 long-term council community plans
- Inquiry into the Plumbers, Gasfitters, and Drainlayers Board
- Inland Revenue Department: Managing child support debt
- Inquiry into New Zealand Defence Force payments to officers seconded to the United Nations
- The Civil Aviation Authority's progress with improving certification and surveillance
- Annual Plan 2010/11
- Response of the New Zealand Police to the Commission of Inquiry into Police Conduct: Second monitoring report

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