



CONTROLLER AND AUDITOR-GENERAL

Tumuaki o te Mana Arotake

B.29[11a]

Parliamentary paper

Central government: Results of the 2009/10 audits (Volume 2)

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Central government: Results of the 2009/10 audits

Volume 2

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Auditor-General's overview

I am pleased to present the second volume of our report on the results of our annual audits in the central government sector. This report provides some useful information about the results of our audits for 2009/10 of district health boards and other Crown entities. It also reports on the improving status of our audits of Māori Trust Boards.

The 2009/10 year was a challenging year for many central government entities, with a number of changes under way focused on reducing expenditure and improving performance. It is heartening to see that many district health boards and other Crown entities continued to maintain sound control environments during this time of change.

It is also heartening that there has been some improvement in non-financial performance reporting. There remain some common aspects that need to improve, particularly the need for better outcome and impact information, and output measures that cover all significant aspects of performance.

My Office is continuing with a range of initiatives to help public entities to improve their non-financial performance reporting, such as issuing good practice guidance. In my view, improving the quality of non-financial performance reporting is crucial – not only for demonstrating accountability but also for improving public sector effectiveness.



Lyn Provost
Controller and Auditor-General

14 March 2011

Part 1

Introduction

- 1.1 Each year, we publish information about the results of our audits and other work in the central government sector. For the 2009/10 year, we have published the content of this annually produced report in two volumes. We published Volume 1 before Christmas. This second volume includes information about the results of our audits in sectors that are subject to later statutory time frames for reporting and auditing. It should be read in conjunction with Volume 1.
- 1.2 Volume 2 completes our reporting of the 2009/10 audit results for the central government sector.

Summary of Part 2

- 1.3 In Part 2, we report on our 2009/10 assessments of the management control environment, information systems, and controls of 66 Crown entities. The results continued to be positive and show further improvement on previous years.
- 1.4 The 2009/10 results of our assessment of the **management control environment** were consistent with 2008/09, with 95% of Crown entities assessed as “very good” or “good” (it was 94% in 2008/09).
- 1.5 The results of our assessment of the **financial information systems and controls** were particularly positive. Although 96% of Crown entities were graded as “very good” or “good” in 2009/10, compared to 97% in 2008/09, there was a significant increase in the number of Crown entities receiving a grade of “very good” – from 52% to 64%.
- 1.6 Finally, the grades for **service performance information and associated systems and controls** improved notably from 2008/09, with 13 (20%) of the Crown entities receiving improved grades.
- 1.7 These results are particularly welcome in the context of the ongoing changes and improvement initiatives in central government. In Volume 1, we described the potential effect of such initiatives on public entities’ capability and capacity, including the need for those entities to:
 - manage core services along with change and improvement processes;
 - maintain capacity and capability in the event of restructuring and/or staff redeployment;
 - understand costs and cost drivers, and maintain good financial and strategic management; and
 - maintain effective control environments and be alert to a potentially greater risk of fraud.

- 1.8 Six audits in 2009/10 were of Crown entities that were due to be disestablished. All these Crown entities maintained sound management control environments in 2009/10.

Summary of Part 3

- 1.9 Part 3 presents some background information on the health sector. It summarises some of the challenges the sector is facing, and sets out some recent changes in the sector – including changes to accountability arrangements. We have previously reported on the need for the range of planning and accountability documents used in the health sector to be reviewed.
- 1.10 We describe the financial performance of each district health board (DHB) in 2009/10. The results show that DHBs continue to face considerable financial pressures, which are not likely to reduce in the short term.
- 1.11 We report on our 2009/10 audit assessments of the management control environment, information systems, and controls of DHBs. We assessed most DHBs as “good” for the management control environment and for financial information systems and controls. However, it is disappointing that DHBs have not shown the steady improvement in these aspects during the past four years that we have seen in other types of public entities.
- 1.12 In 2008/09, we assessed all DHBs’ service performance information and associated systems and controls as “poor/needs improvement” because DHBs did not identify clearly and comprehensively the services that they delivered. Also, the quality of their performance measures for the outcomes they achieved and for the services they provided was poor. Many DHBs have been carrying out extensive work to improve their non-financial performance reporting. For 2009/10, we concluded that the quality of DHBs’ non-financial reporting has improved. We graded 60% of DHBs as “needs improvement” and 40% as “poor”. We will continue to work with the health sector to help improve the quality of DHBs’ reporting.
- 1.13 Part 3 also reports on our follow-up of previous audit findings about DHBs’ procurement policies and practices. Overall, DHBs have shown some improvement, particularly in their procurement policies.

Summary of Part 4

- 1.14 Part 4 sets out some background information about Māori Trust Boards and their audit arrangements. We have previously been concerned about the timeliness with which audits are completed and the number of audits in arrears. There are many reasons for delays in completing audits. It is pleasing to see that timeliness improved in 2009/10, although it remains low compared to other sectors that we audit. However, there has been a substantial reduction in the number of audits in arrears – from 35 two years ago to 13 (as at 28 February 2011).
- 1.15 We have previously reported to Parliament about shortcomings in the current accountability framework for Māori Trust Boards. We are pleased that there is now a Bill before Parliament that addresses our concerns. The Māori Purposes Bill provides for a direct accountability relationship between each trust's beneficiaries and Board. It also requires Boards to prepare an annual report (including financial statements that comply with generally accepted accounting practice) and establishes a statutory time frame within which an audit must be completed.

Part 2

Results of Crown entity audits

- 2.1 In December 2010, we reported on the 2009/10 audit results for government departments, Crown research institutes (CRIIs), and State-owned enterprises (SOEs) in *Central government: Results of the 2009/10 audits (Volume 1)*.¹
- 2.2 In Volume 1, we set out the background and framework that our auditors use to examine, assess, and grade central government entities' environment, systems, and controls for managing and reporting financial and service performance information. We also describe the scope of the three aspects that we assess and the associated grading system.
- 2.3 In this Part, we report on our 2009/10 audit results and assessments of the management control environment, information systems, and controls of Crown entities.

Summary: Audit results for Crown entities

- 2.4 We audited 66 Crown entities in 2009/10 – one more than in 2008/09 because of the Real Estate Agents Authority's creation.
- 2.5 We issued 65 unqualified audit reports and one qualified report on those Crown entities. We issued a qualified report, with an “except-for” opinion, on the New Zealand Fire Service Commission because we were unable to form an opinion on the completeness of service performance information for four months of 2009/10 due to industrial action by firefighters. We set out details of our audit opinion in Part 6 of Volume 1.
- 2.6 Seven of the 65 unqualified reports we issued were non-standard.² Six of these included explanatory paragraphs highlighting that the financial statements had been prepared on a disestablishment basis, because those Crown entities were due to be disestablished and integrated into new or existing government entities.³
- 2.7 Figure 1 shows a summary of the grades for our 2009/10 assessments of environment, systems, and controls for the three aspects that we assess.

1 Office of the Auditor-General, *Central government: Results of the 2009/10 audits (Volume 1)*, December 2010, available at www.oag.govt.nz/central-govt/2009-10/.

2 We report on non-standard audit reports issued in 2009/10 in Part 6 of Volume 1.

3 The six Crown entities are the Electoral Commission; Electricity Commission; Environmental Risk Management Authority; Foundation for Research, Science and Technology; Legal Services Agency; and Securities Commission.

Figure 1
Summary of Crown entities' grades for 2009/10

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	24	3	0	42	21	3	0	1	28	35	1

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

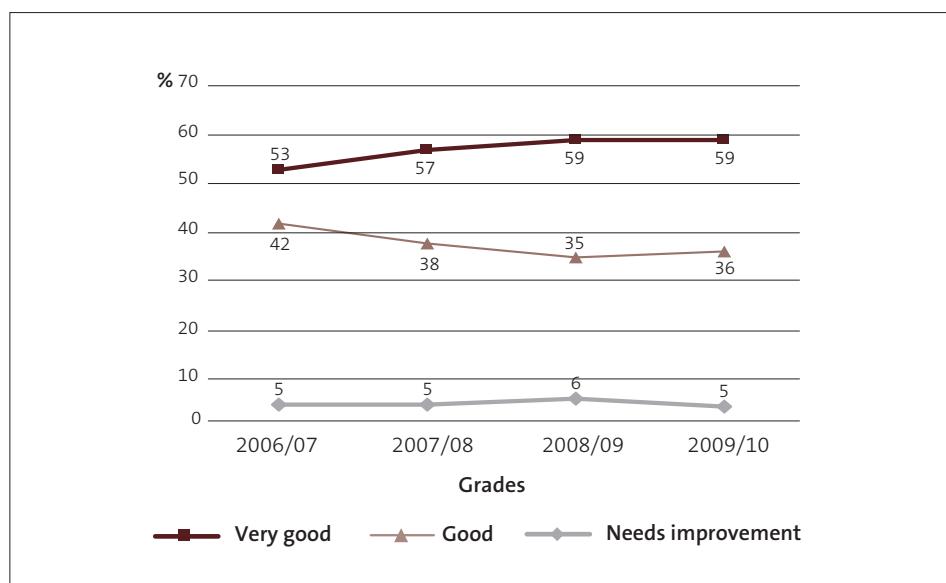
* We did not grade this aspect for one Crown entity that was due to be disestablished in early 2010/11.

- 2.8 Overall, the results for 2009/10 are pleasing. They show that Crown entities have sound management control environments and financial information systems and associated controls. The results also show notable improvements in the grades for service performance information and associated systems and controls, including the first “very good” grade and 28 “good” grades – six more than in 2008/09.
- 2.9 We set out below our findings on the management control environment, financial information systems, and service performance information and associated systems and controls for Crown entities.

Assessment of management control environment

- 2.10 Figure 2 shows the trends in grades for Crown entities' management control environment for the four years since we began grading in 2006/07.

Figure 2
Grades for Crown entities' management control environment from 2006/07 to 2009/10, as percentages



- 2.11 Figure 2 shows that Crown entities' management control environment grades have not changed much in the past four years. There has been an overall 6% increase in "very good" grades and corresponding decrease in "good" grades since 2006/07.
- 2.12 Each year, an average of three or four entities have been assessed as needing to improve their management control environments, but they are different entities in different years. Grades for a particular entity may fluctuate from year to year because of changes in, for example:
- the entity's operating environment;
 - standards;
 - good practice expectations; and/or
 - auditor emphasis.

Results for 2009/10

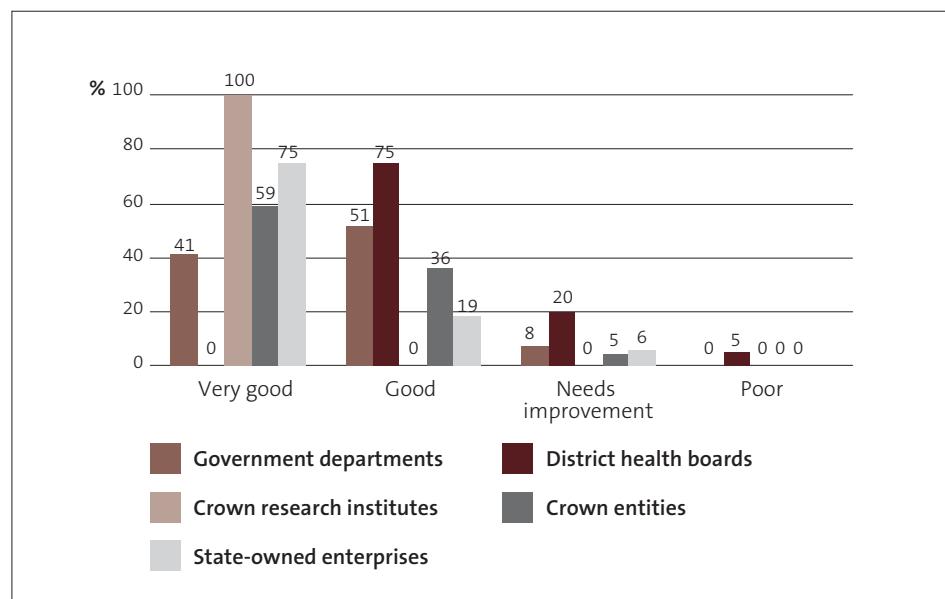
- 2.13 In 2009/10, we assessed all but three Crown entities as having either "very good" or "good" management control environments. We issued "very good" grades to 59% of Crown entities, the same proportion as in 2008/09.
- 2.14 Of the 65 entities assessed in 2008/09, 53 remained on the same grade and 12 entities had grade changes, with seven entities improving their grades and five receiving lower grades. As noted in paragraph 2.11, fluctuations in grades occur from year to year. This change is not unusual or of concern, given that most grades are "good" or "very good".
- 2.15 In 2008/09, auditors recommended improvements to the management control environments of 26 Crown entities. All 26 entities responded either fully or in part to these recommendations in 2009/10.
- 2.16 In our examination of the 2009/10 audit results, we identified three main areas for improvement in Crown entities. Auditors recommended that:
- nine Crown entities review their sensitive expenditure policy;
 - seven entities ensure that their conflicts of interest registers are kept updated; and
 - seven entities improve/implement their risk management policies/systems.
- 2.17 Maintaining and implementing up-to-date policies and systems is an integral aspect of an effective management control environment. This is particularly the case for public entities, which face increased scrutiny about the efficient and appropriate use of public funds. Crown entities must be able to assure Parliament and the public that their policies and practices follow best practice.

- 2.18 In Volume 1, we discussed the central government context of ongoing change and fiscal constraint. This includes government initiatives to improve the state sector's performance, effectiveness, and efficiency, such as alternative approaches to delivering services. We also outlined how change and improvement initiatives can affect organisational capability and capacity, and heighten the need for public entities to manage core services and maintain effective control environments.
- 2.19 As noted above, six audits in 2009/10 were of Crown entities due to be disestablished. We note that two of these entities received "very good" grades for their management control environments and the other four received "good" grades. It is reassuring that, in this context of change, these entities – and Crown entities overall – maintained sound management control environments in 2009/10.

Sector comparison

- 2.20 Figure 3 compares Crown entities' grades for management control environment in 2009/10 with the equivalent grades for other central government sector entities.

Figure 3
Grades for management control environment by type of entity, 2009/10, as percentages



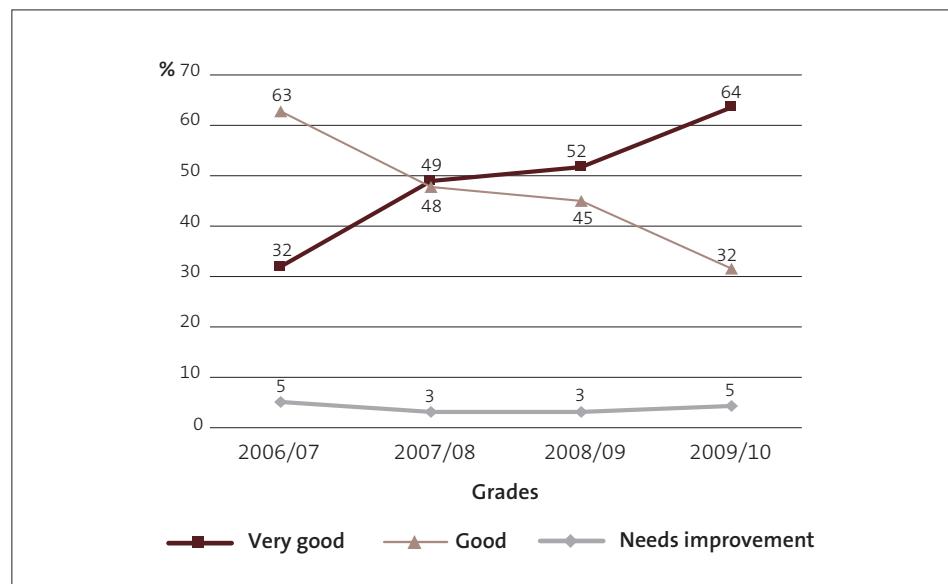
Note: Percentage figures have been rounded and may not add up to 100.

- 2.21 In Volume 1, we reported on the management control environments of CRIs, SOEs, and government departments. Figure 3 shows that, in 2009/10, Crown entities performed better than government departments and district health boards but not as well as CRIs and SOEs.

Assessment of financial information systems and associated controls

- 2.22 Figure 4 below shows the trends in grades for Crown entities' financial information systems and associated controls during the four years since we began grading in 2006/07.

Figure 4
Grades for Crown entities' financial information systems and associated controls from 2006/07 to 2009/10, as percentages



Note: Percentage figures have been rounded and may not add up to 100.

- 2.23 Figure 4 shows that Crown entities have steadily improved their financial information systems and controls during the past four years.
- 2.24 During the four-year period, our auditors have recommended to Crown entities how they could improve. The percentage of Crown entities receiving a "very good" grade doubled from 32% in 2006/07 to 64% in 2009/10. It is pleasing to see this significant improvement.

Results for 2009/10

- 2.25 In 2009/10, we assessed all but three Crown entities as having either “good” or “very good” financial information systems and controls.
- 2.26 We are pleased to report a significant improvement in 2009/10. Auditors assessed 42 Crown entities as having “very good” financial information systems and controls. The equivalent figure in 2008/09 was 34.
- 2.27 In 2008/09, auditors recommended improvements to the financial information systems and controls of 31 Crown entities. Thirty of these entities responded either fully or in part to these recommendations.
- 2.28 In 2009/10, auditors recommended that 13 Crown entities ensure that they strengthen internal control over financial processes, including the quality of internal independent review. This is the most common area for improvement we identified in our examination of the 2009/10 audit results. It is important because a lack of independent review can lead to errors and/or opportunities for fraud.
- 2.29 The overall improvement in Crown entities’ financial information systems and controls is reassuring in the current context of change and fiscal constraint in the central government sector.

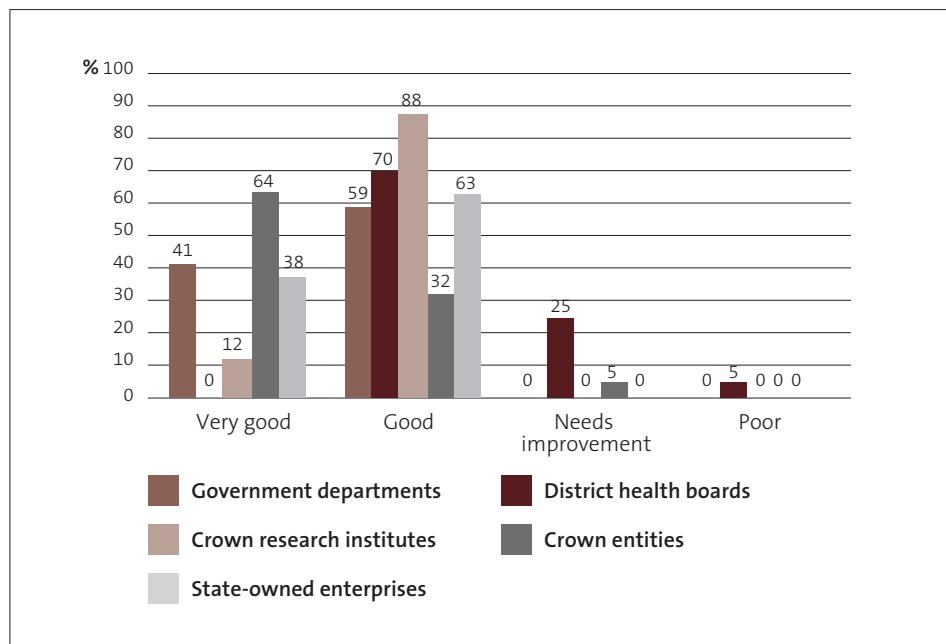
Sector comparison

- 2.30 Figure 5 compares Crown entities’ grades for financial information systems and associated controls in 2009/10 with the grades of other central government sector entities.
- 2.31 Figure 5 shows that Crown entities had the largest proportion of “very good” grades for their financial information systems and controls in 2009/10.

Assessment of service performance information and associated systems and controls

- 2.32 There are statutory requirements for the Auditor-General to attest to the statement of service performance in the annual reports of Crown entities (excluding school boards of trustees) and government departments. This requirement includes DHBs. There is no such requirement for CRIs and SOEs.
- 2.33 Volume 1 sets out the background to our work to improve the way we audit non-financial performance information. This work includes phasing in the Auditor-General’s revised auditing standard on auditing performance information, referred to as AG-4 (Revised) – *The Audit of Service Performance Reports*.

Figure 5
Grades for financial information systems and associated controls by type of entity, 2009/10, as percentages



Note: Percentage figures have been rounded and may not add to 100.

- 2.34 The revised standard will be effective for nine Crown entities from 1 July 2010, 21 entities from 1 July 2011, and the remaining Crown entities from 1 July 2012.⁴
- 2.35 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 non-financial performance reported in the 2009/10 annual report. Our auditors considered the relevance, reliability, understandability, and comparability of information in presenting a clear and cohesive description of performance.
- 2.36 As we have reported before, we consider that improving the quality of non-financial performance reporting is critical not only for demonstrating accountability but also for improving public sector effectiveness.

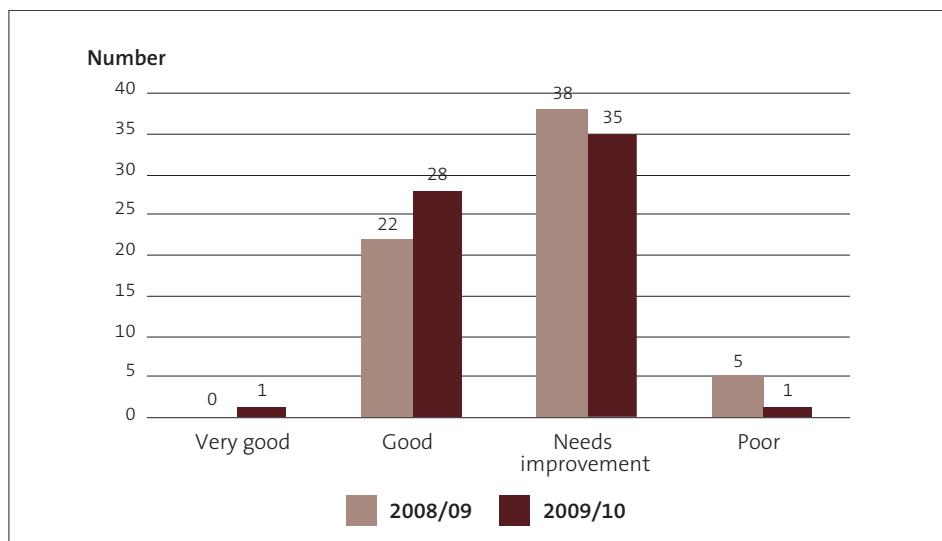
Results for 2009/10

- 2.37 The 2009/10 financial year is the second for which we have graded service performance information and associated systems and controls.

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

- 2.38 Crown entities' grades for service performance information and associated systems and controls in 2009/10 have improved notably compared with 2008/09, as shown in Figure 6.

Figure 6
Comparison of grades for service performance information and associated systems and controls in 2008/09 and 2009/10



- 2.39 In 2009/10, the Crown Health Financing Agency was the first entity in the central government sector to receive a "very good" grade for service performance information and associated systems and controls. We issued only one "poor" grade to a Crown entity in 2009/10. We issued three in 2008/09.
- 2.40 During 2009/10, we worked with central agencies, auditors, and central government entities to help lift capability and the quality of non-financial performance information. Our work included:
- providing focused support to government agencies, including 13 Crown entities;
 - publishing examples of better practice in performance reporting; and
 - facilitating workshops to strengthen knowledge and understanding of specific areas of non-financial performance information.

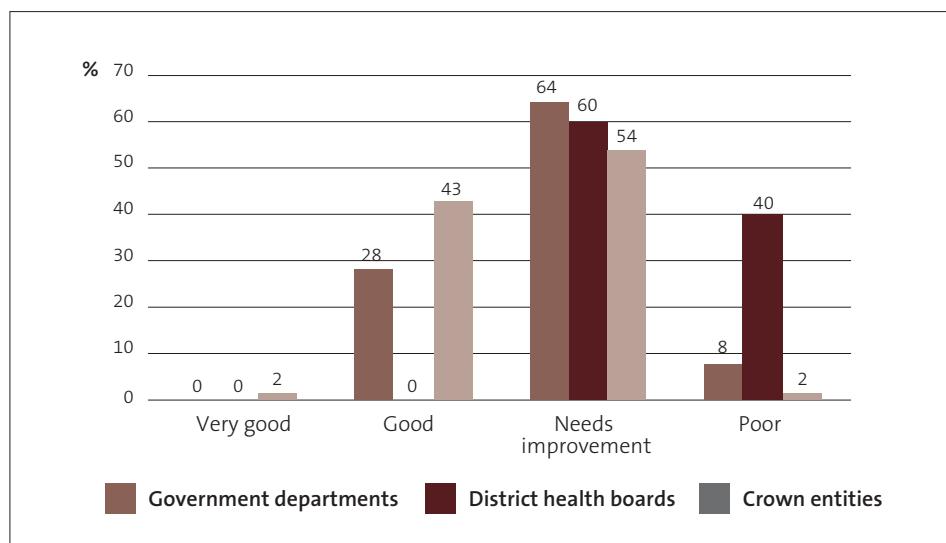
- 2.41 Thirteen Crown entities, including five entities that received focused support, improved their grades for service performance information and associated systems and controls from 2008/09:
- three went from “poor” to “needs improvement”;
 - eight went from “needs improvement” to “good”;
 - one went from “poor” to “good”; and
 - one went from “good” to “very good”.
- 2.42 Two Crown entities dropped grades from “good” in 2008/09 to “needs improvement” in 2009/10. However, overall, Crown entities have made significant improvement.
- 2.43 We are particularly interested in how Crown entities respond to auditor recommendations for improvement. In 2009/10, seven Crown entities responded in full and 52 responded in part to recommendations from the 2008/09 audits. We are aware of the work that Crown entities are putting into reporting their performance, including measuring the performance of services and the impacts/outcomes of those services. We expect to see more improvement as Crown entities build on this work and continue to respond to auditor recommendations.
- 2.44 The common areas that we identified for improvement for Crown entities in the 2009/10 audits of non-financial performance information are similar to those identified for government departments. They include:
- the need to clarify and/or simplify the performance framework – for example, the relationship between services (outputs) and impacts is not always clear;
 - the need to introduce or improve performance measures for outputs that cover timeliness, cost, quality, and quantity; and
 - the need to introduce or improve performance measures or targets for outcomes/impacts.
- 2.45 AG-4 (Revised) will apply to the audit reports of nine Crown entities in 2010/11. Three of these entities received “needs improvement” grades and six received “good” grades in 2009/10 (including one improved from “needs improvement” and one improved from “poor” in 2008/09). Many issues can affect the audit reports. In many cases, the improvements required are not substantial. We expect that further improvements will be made.

Sector comparison

- 2.46 Figure 7 compares Crown entities’ grades for service performance information and associated systems and controls in 2009/10 with those of some other central government sector entities.

Figure 7

Grades for service performance information and associated systems and controls for some central government sector entities, 2009/10, as percentages



Note: Percentages have been rounded and may not add up to 100.

- 2.47 In 2009/10, 54% of Crown entities received a “needs improvement” grade compared with 64% of government departments. Three government departments received “poor” grades compared with one Crown entity.
- 2.48 Figure 7 shows that Crown entities have performed notably better than other central government sectors in 2009/10. Several reasons are likely for the difference, some of which may not be general throughout the Crown entities. Contributing factors may include the nature of services that most Crown entities provide. These are typically narrower in scope, more easily articulated, and possibly more easily measured than some services provided by government departments.
- 2.49 We are encouraged by the progress that Crown entities have made in improving their non-financial performance reporting in 2009/10. We will continue to monitor audit findings and trends to try to understand the reasons particular sectors have stronger performance. We will continue to work with central government agencies to understand their businesses and help them to better align performance information and reporting with legislative and accounting requirements, and good practice.

Part 3

Results of district health board audits

- 3.1 In this Part, we discuss the challenges the health system is facing, and set out some recent changes in the district health board (DHB) sector including those to accountability arrangements.
- 3.2 We also outline the financial performance of DHBs in 2009/10 and discuss their financial sustainability.
- 3.3 Finally, we outline the results of our assessment of the management control environment, financial and non-financial systems and controls of each DHB in 2009/10, and discuss our audit findings on procurement policies and practices, and asset management planning.

Summary of challenges facing the health system

- 3.4 The public health and disability system faces serious challenges. Costs are rising because improved technologies are available and an ageing population brings increased demand for services. There are international shortages of skilled clinical specialists.
- 3.5 To ensure that there is a clear focus on these challenges, the Government established the National Health Board within the Ministry of Health (the Ministry) in October 2009. The National Health Board supervises the \$10 billion or so of public funding spent on public hospital and primary health care by DHBs.⁵ It also manages the national planning and funding of all IT, workforce planning, and capital investment in the DHB sector.
- 3.6 The appropriations for Vote Health continue to increase. However, the rate of increase is slowing, and there is less in the Budget for new initiatives. Vote Health 2009/10 had appropriations totalling over \$12.9 billion, including almost \$752 million for new policy initiatives. This was an increase of 7.4% from the 2008/09 Supplementary Estimates. The Vote has again increased in 2010/11 to over \$13.5 billion, including \$512 million in new operating and capital initiatives. The increase this time was 6.7% from the 2009/10 Supplementary Estimates.
- 3.7 About three-quarters of Vote Health is funding for the health services provided by district health boards (DHBs). The overall funding that DHBs are allocated is based on the Government's spending priorities during the budgeting process. The size of the district's population determines the amount that individual DHBs receive, with additional socio-economic and other risk factors taken into account. The funding covers the health and disability services that the DHB provides directly to its population or indirectly through another provider (such as another DHB, a

⁵ *Health Sector Information Supporting the Estimates of Appropriations for the Government of New Zealand for the year ending 30 June 2011*, parliamentary paper B.5A Vol.6, page 8.

not-for-profit Primary Health Organisation (PHO), or a private for-profit or not-for-profit provider such as a non-government organisation).

- 3.8 The Government expects there to be increased financial pressure on the health services. It has started reviewing expenditure line by line to identify funding that could be better used in other areas, particularly frontline health services.

Changes in the health sector since the 2008/09 audits

Fewer district health boards

- 3.9 There are now 20 DHBs, one fewer than in 2008/09. In response to issues with their financial and clinical sustainability, Otago and Southland DHBs merged during 2009/10 to become Southern DHB. Figure 8 shows, for each DHB, its population at 30 June 2009, and 2009/10 funding.

Figure 8
Population and funding of district health boards in 2009/10

District health board	Population*	Funding** \$million
North Island		
Auckland	444,100	930.1
Bay of Plenty	207,700	523.2
Capital and Coast	288,100	569.2
Counties Manukau	481,700	1,004.8
Hawke's Bay	153,900	378.2
Hutt Valley	142,700	308.6
Lakes	101,800	244.6
MidCentral	166,000	396.9
Northland	155,800	418.0
Tairawhiti	46,200	124.0
Taranaki	108,300	266.2
Waikato	360,000	840.5
Wairarapa	39,900	105.0
Waitemata	528,500	1,047.7
Whanganui	63,200	180.5
South Island		
Canterbury	502,000	1,079.1
Nelson-Marlborough	136,800	324.1
South Canterbury	55,600	143.4
Southern	300,400	681.5***
West Coast	32,600	106.8
Totals	4,315,300	9,672.6

- * Statistics New Zealand estimate, 30 June 2009.
- ** 2009/10 budgeted appropriation, *Supplementary Estimates of Appropriations 2009/10*, pages 645-655.
- *** Southern DHB was established on 1 May 2010, by amalgamating the Otago and Southland DHBs. The funding figure used is the sum of the 2009/10 budgeted figures (*Supplementary Estimates*) for Otago, Southern, and Southland DHBs.

Fewer Primary Health Organisations

- 3.10 Under the Primary Health Care Strategy, DHBs initially set up about 80 PHOs. However, this number had reduced to 55 by 31 January 2011. The number is decreasing further as DHBs consider rationalisation at the request of the Minister of Health (the Minister).

Changes to the accountability framework

- 3.11 DHBs are responsible for identifying and providing for the health needs of their district. They have been required to prepare district strategic and annual plans that are consistent with New Zealand's health and disability strategies. In our last report on the health sector, we included an article on the accountability framework in which we recommended that the range of planning and accountability documents in the sector be reviewed.⁶
- 3.12 Under a recent amendment to legislation, each DHB is now required to prepare an annual plan. This will remove the requirement for a District Strategic Plan and a District Annual Plan. The amendment empowers the Minister to require regional planning, and DHBs are increasingly expected to prepare regional plans for health services and resourcing. The new annual plan will include the elements of the Statement of Intent (SOI) – a high-level, less detailed statement about how the DHB intends to address the health needs of its district.

More cross-DHB governance

- 3.13 Each DHB is governed by a board of up to 11 members. Seven of these are elected every three years, and four are appointed by the Minister. The Minister also appoints a Chair from among the 11.
- 3.14 The last DHB elections were held in October 2010. At that time, the Minister appointed four board chairs with responsibilities in more than one DHB. He also appointed 10 board members to more than one DHB board.

⁶ *Central government: Results of the 2008/09 audits*, parliamentary paper B.29[10a], Part 7.

Accountability arrangements in 2009/10

- 3.15 The monitoring department for DHBs is the Ministry, which both monitors and supports DHBs through its National Health Board business unit.
- 3.16 The monitoring regime for 2009/10 had three different levels of intervention – standard monitoring, performance watch, and intensive monitoring.
- 3.17 The Minister can, in addition to intensive monitoring, change how the DHB is governed to help improve its performance. To do this, the Minister appoints one or more Crown monitors to observe the decision-making processes of the board, to help the board understand the policies and wishes of the Government, and to advise the Minister on any matters about the DHB, the board, or its performance. If seriously dissatisfied, the Minister can dismiss the board and appoint a commissioner.
- 3.18 As at 31 December 2010, those DHBs on intensive monitoring were Capital and Coast, Southern, West Coast, and Whanganui DHBs. At the same time in 2009, there were also four, the only difference being Southland instead of Southern DHB. Those on performance watch as at 31 December 2010 were Hutt Valley, MidCentral, Taranaki, Wairarapa, and Waitemata DHBs. At the same time in 2009, only four were on performance watch. Only Hutt Valley and Waitemata DHBs were on performance watch in December of both years.
- 3.19 As at 31 December 2010, Capital and Coast and Hutt Valley DHBs had a joint Crown monitor, and Southern DHB had a Crown monitor. A commissioner was in place in Hawke's Bay DHB during 2009/10 until replaced with a board after the October 2010 elections. Whanganui DHB had two Crown monitors for the first half of 2009/10.

Annual audit

- 3.20 Under section 15 of the Public Audit Act 2001, the Auditor-General audits the financial statements, accounts, and other information that each of the 20 DHBs and their subsidiaries are required to have audited each year. The Auditor-General does not audit the PHOs, because they are not public entities. The purpose of the annual audit is to give assurance that an entity's reports fairly reflect its financial and non-financial performance, and do not mislead the reader.

Financial performance of district health boards

- 3.21 Figure 9 sets out the financial performance of the 20 DHBs for the year ended 30 June 2010.

Figure 9
Summary of DHBs' 2009/10 financial performance

District health board	Revenue* \$million	Expenditure* \$million	Surplus (deficit)* \$million	Deficit as % of revenue	Planned Surplus (deficit)** \$million	Variance to plan*** \$million
Auckland	1,711.9	1,711.7	0.3		0.0	0.3
Bay of Plenty	590.1	591.5	(1.4)	0.2%	(1.9)	0.4
Canterbury	1,331.8	1,340.6	(8.8)	0.7%	(9.0)	0.2
Capital and Coast	841.4	888.9	(47.5)	5.6%	(47.7)	0.2
Counties Manukau	1,216.4	1,216.2	0.2		(3.0)	3.1
Hawke's Bay	434.1	439.6	(5.5)	1.3%	(4.9)	(0.5)
Hutt Valley	423.4	427.5	(4.5)	1.1%	(4.6)	0.0
Lakes	291.7	288.7	3.0		(1.0)	4.0
MidCentral	509.9	519.3	(9.4)	1.8%	(3.5)	(5.9)
Nelson-Marlborough	381.5	386.9	(5.4)	1.4%	(5.9)	0.5
Northland	474.9	474.3	0.6		0.0	0.6
South Canterbury	165.6	165.2	0.4		(0.4)	0.8
Southern****	813.0	827.8	(14.8)	1.8%	(15.2)	6.8
Tairawhiti	146.1	146.9	(0.5)	0.4%	(0.3)	(0.3)
Taranaki	305.8	308.6	(3.0)	1.0%	(2.1)	(0.9)
Waikato	1,074.9	1,056.1	18.8		10.0	8.8
Wairarapa	123.4	128.1	(4.7)	3.8%	(0.9)	(3.9)
Waitomatā	1,262.2	1,270.1	(7.9)	0.6%	(9.9)	2.0
West Coast	127.3	135.0	(7.7)	6.1%	(7.6)	(0.1)
Whanganui	207.7	211.9	(4.2)	2.0%	(7.6)	3.4
Totals	12,433.2	12,535.2	(102.1)		(115.4)	

* From DHB annual reports. The surplus/deficit figure does not include revaluations. Also, where the surplus (deficit) figure is affected by profits from joint ventures or associates, it will not be the same as revenue less expenditure. There may be some small differences in the totals due to rounding.

** From DHB annual reports.

*** There may be some small differences due to rounding.

**** Includes the two months results for Southern DHB and 10 months for the former Otago and Southland DHBs.

Financial sustainability

- 3.22 Figure 9 shows that 17 of the 20 DHBs had budgeted for a deficit for 2009/10.
- 3.23 The DHB sector is facing considerable financial pressures. These pressures are not likely to reduce in the short term, as the Government has indicated a continual tightening of funding increases during the next several years. Additionally, financial sustainability is an increasing concern given the ageing population, significant building and clinical equipment replacement costs, remuneration pressures, and public expectations of the health sector.
- 3.24 The financial performance of the DHB sector for 2009/10 was an overall deficit of \$102.1 million (2008/09 deficit: \$155.1 million), against a budgeted deficit of \$115.4 million. Although the aggregate deficit for the sector is lower for 2009/10 than for 2008/09, we are concerned that 14 out of 20 DHBs were in deficit in 2009/10, compared with 13 out of 21 in 2008/09. The highest deficit, both budget and actual, was Capital and Coast DHB (\$47.5 million).
- 3.25 DHBs have been actively working to make savings and set up a sustainable model of service delivery that will allow them to achieve a break-even position. However, this is unlikely in the short term. Figure 10 summarises the actual and forecast financial position for the DHB sector from 2008/09 to 2012/13.

Figure 10
Actual and forecast financial position for the DHB sector

	2008/09	2009/10	2010/11	2011/12	2012/13
	Actual \$million	Actual \$million	Estimated \$million	Forecast \$million	Forecast \$million
Total deficit	(155.1)	(102.1)	(76.5)	(39.9)	(17.0)

- 3.26 As part of the 2009/10 audit, all appointed auditors considered the appropriate application of the going concern assumption for individual DHBs. The individual DHBs and our auditors relied on a “letter of comfort” from the Ministers of Health and Finance in concluding that the going concern assumption was appropriate for Capital and Coast, Southern, Wairarapa, West Coast, and Whanganui DHBs.

Assessment of environment, systems, and controls in district health boards

- 3.27 As part of the annual audits, the Auditor-General also comments on DHBs' management control environment, financial information systems and controls, and service performance information and associated systems and controls, to highlight areas for improvement. We assign grades that directly represent the recommendations for improvement.
- 3.28 Part 3 of Volume 1 of our report to Parliament on the results of the 2009/10 central government audits sets out the environment systems and controls framework, and the grades we use.⁷
- 3.29 Our auditors' approach and the standards they apply reflect the unique circumstances of each DHB in each financial year. DHBs vary in size and organisational structure, and sometimes undergo restructuring or other organisational changes.
- 3.30 Grades for a particular DHB may fluctuate from year to year. Some of the factors that may cause fluctuations include changes in the operating environment, standards, good practice expectations, auditor emphasis, and whether the entity has 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. For these reasons, we advise caution when comparing grades between years.
- 3.31 Figures 11-13 set out our grades for DHBs' management control environment, and financial information systems and controls, for the year ended 30 June 2010 and the three previous years. We discuss changes in non-financial performance reporting more fully in the following section.
- 3.32 Our auditors assessed most of the DHBs as "good" for the management control environment and for financial information systems and controls (see Figure 11) for 2009/10. The rating of "poor" for Whanganui DHB for 2009/10 was related to a deficiency arising when its computer system was upgraded.

⁷ Central government: *Results of the 2009/10 audits (Volume 1)*, December 2010, available at www.oag.nz/central-govt/2009-10/.

Figure 11
Summary of district health boards' 2009/10 grades for environment, systems, and controls

District health board	Management control environment	Financial information systems and controls	Service performance information and associated systems and controls
Auckland	Good	Good	Needs improvement
Bay of Plenty	Good	Good	Needs improvement
Canterbury	Good	Good	Needs improvement
Capital and Coast	Needs improvement	Needs improvement	Poor
Counties Manukau	Good	Good	Needs improvement
Hawke's Bay	Good	Good	Needs improvement
Hutt Valley	Good	Needs improvement	Needs improvement
Lakes	Needs improvement	Needs improvement	Needs improvement
MidCentral	Good	Needs improvement	Needs improvement
Nelson-Marlborough	Good	Good	Needs improvement
Northland	Good	Good	Needs improvement
South Canterbury	Good	Good	Needs improvement
Southern	Good	Good	Poor
Tairawhiti	Needs improvement	Needs improvement	Poor
Taranaki	Good	Good	Needs improvement
Waikato	Needs improvement	Good	Poor
Wairarapa	Good	Good	Poor
Waitemata	Good	Good	Poor
West Coast	Good	Good	Poor
Whanganui	Poor	Poor	Poor

- 3.33 We are disappointed that results for management control environment and financial information systems and controls for DHBs have not altered to any extent during the last four years (see Figures 12 and 13). Most SOEs and other Crown entities achieved a “very good” rating for management control environment during the last four years. Many were also rated “very good” for financial information systems and controls for 2009/10, showing steady improvement during the last four years (see Part 2).

Figure 12
Assessment of management control environment 2006/07 to 2009/10

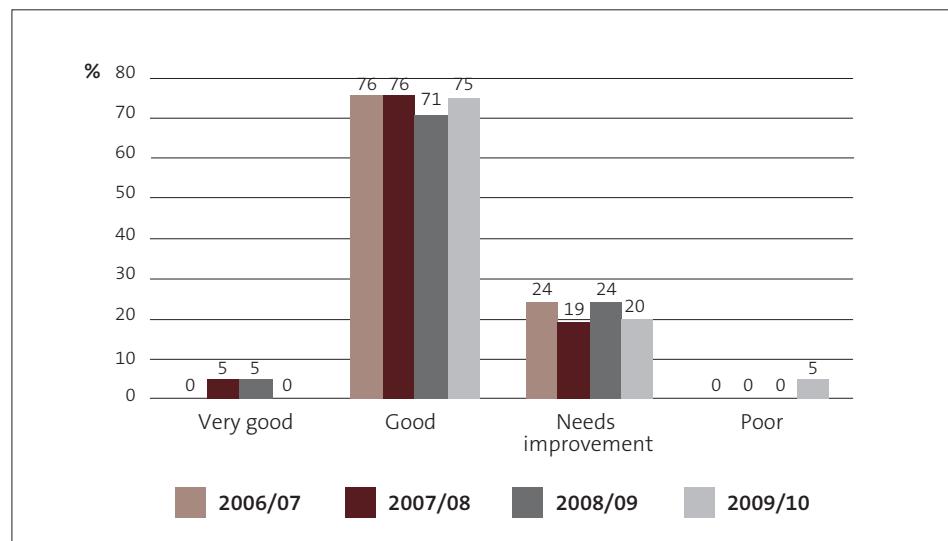
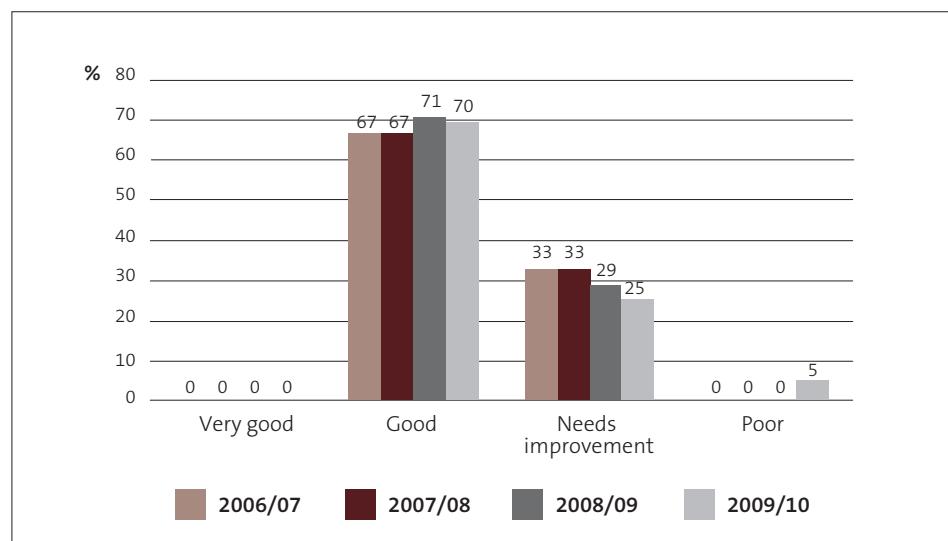


Figure 13
Assessment of financial information systems and controls 2006/07 to 2009/10



Non-financial performance reporting

- 3.34 In 2008/09, we issued a grade for entities' service performance information and associated systems and controls for the first time. We graded all DHBs as "poor/needs improvement". DHBs did not identify clearly or comprehensively the services that they delivered, and the quality of measures for outcomes and for the services provided was poor.
- 3.35 We have graded DHBs' non-financial reporting for the second time in 2009/10. We are aware that the DHB sector is carrying out extensive work to improve DHBs' non-financial reporting, and accountability frameworks and guidance.
- 3.36 Our focus in the 2009/10 audit was on whether each DHB's service performance information presented a clear, logical, understandable, integrated, and cohesive performance story in an informative context. Relevance to the DHB's strategic priorities should also be apparent. Performance reports produced to a satisfactory standard should provide a basis for assessing the DHB's efficiency (of service delivery) and effectiveness (in achieving intended outcomes). The link between financial information and good quality non-financial performance information should provide a basis for assessing cost-effectiveness.
- 3.37 In our 2009/10 audit of DHB non-financial performance reporting, we concluded that, overall, the quality of DHBs' non-financial performance reporting had improved. However, this is not yet reflected well in the ratings, with no DHB achieving a "good" rating. Improvements were evident in the following areas:
- The DHBs were generally better than in previous years at describing services.
 - Most were reporting more, though not necessarily better, performance measures.
 - Some were showing aspects of better practice, which are being used as examples for the sector of:
 - clearer, more cohesive logical frameworks; and
 - more clarity about the difference between outputs and impacts/outcomes.
- 3.38 Figure 14 shows the audit results for 2008/9 and 2009/10.

Figure 14

Service performance information and associated systems and controls 2008/09 and 2009/10

Grade	Number (%) of DHBs	
	2008/09	2009/10
Very good	0	0
Good	0	0
Needs improvement	-	12 (60%)
Poor/needs improvement	21 (100%)	-
Poor	-	8 (40%)

- 3.39 The main areas for improvement are:
- Most DHBs are still not good at explaining the services they deliver.
 - Many DHBs still do not have main measures of outcomes.
 - Many DHBs do not adequately cover all their significant services, and are not describing outputs concisely and with enough detail.
 - Measures of service quality in all DHBs' SOIs are deficient.
 - There is a lack of comparative performance information, especially trends.

Procurement policies and practice

- 3.40 Procurement is critical to the effectiveness and efficiency of DHBs. It covers all the business processes associated with purchasing supplies and health services and the management of contracts for those supplies and services. DHBs have a significant level of procurement activity.
- 3.41 In past years, appointed auditors have reviewed DHBs' procurement policies and practices. Although procurement policies and practices are improving, this continues to be an area of risk. Our 2009/10 annual audit work included a follow-up of issues raised previously as part of individual audits. We summarise below the findings from that work. Some DHB procurement policies and practices still need to be improved.
- 3.42 In September 2010, we published *Spending on supplies and services by district health boards: Learning from examples*.⁸ Our report was based on systematic work in all DHBs as part of the annual audit and more in-depth work with five DHBs.

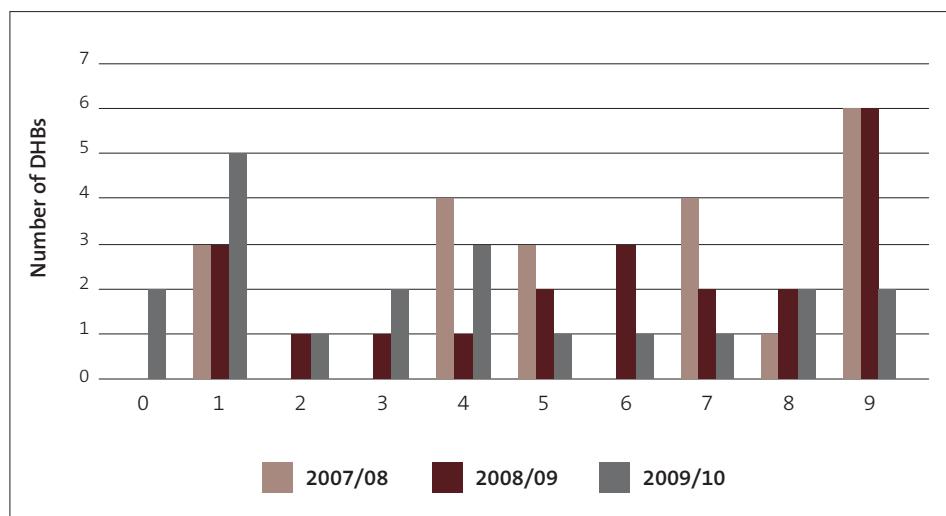
Improving procurement policies

- 3.43 There are nine key aspects to procurement policies. These are status/availability, general provisions, planning and methods, legal considerations, ethical provisions, economic considerations, sustainability, risk management, and processes and

8 See www.oag.govt.nz/2010/dhbs-spending.

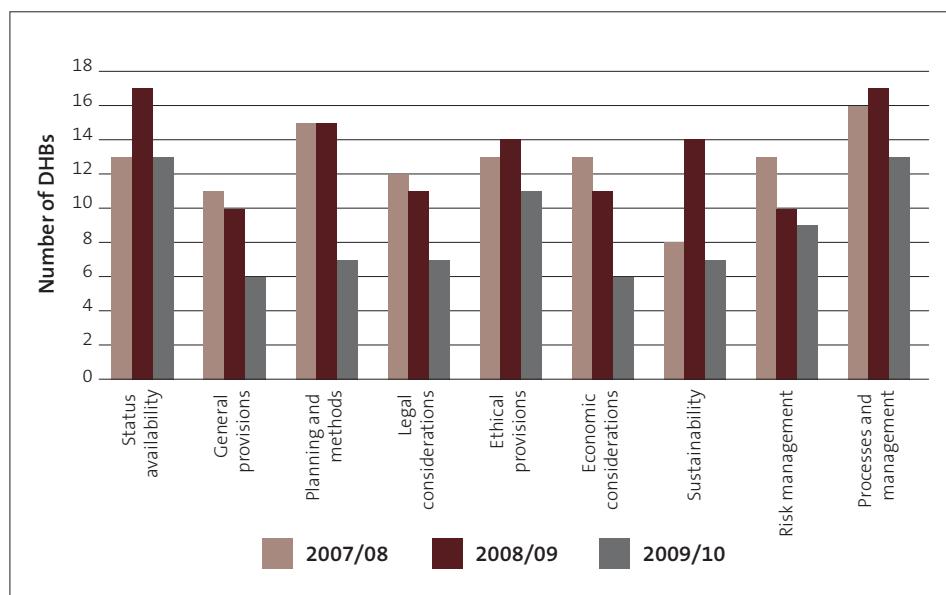
management. Figure 15 shows that, in the nine key aspects, DHBs had fewer deficiencies than previously, and two DHBs had no deficiencies. However, two DHBs were still deficient in all nine areas.

Figure 15
Number of deficient aspects of procurement policy



- 3.44 We examined each of the nine key aspects of procurement policy, and we note that fewer DHBs had deficiencies in each aspect, when compared to earlier years.
- 3.45 Figure 16 shows the particular areas in which DHB procurement policies were deficient.

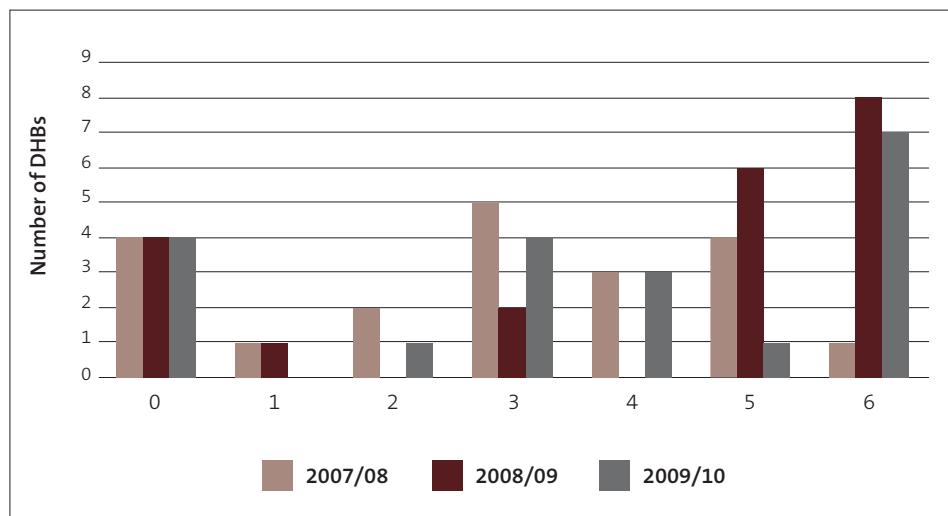
Figure 16
Number of district health boards with procurement policy deficiencies, by aspect



Improving procurement practice

3.46 Six aspects of procurement practice have been identified as representing best practice. These are management arrangements, procurement strategy, ethical and legal considerations, procurement processes, ongoing management of contracts, and continuous improvement. One fewer DHB had deficiencies in all six areas of procurement practice than last year, but, overall, there has been little change from past years. In Figure 17, we show the number of DHBs with deficient aspects of procurement practice.

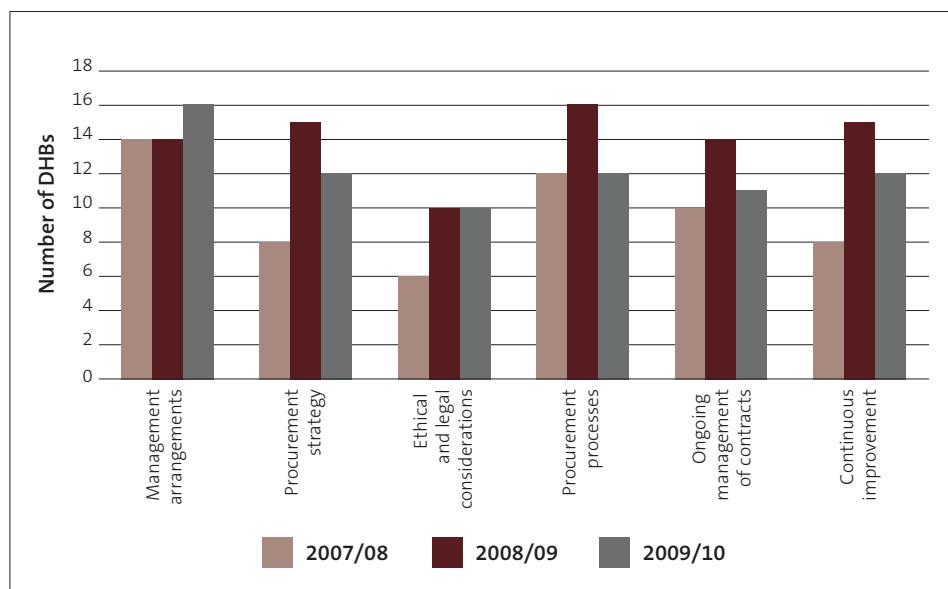
Figure 17
Number of deficient aspects of procurement practice



Note that we include 2007/08 data for 20 out of 21 DHBs.

- 3.47 The number of DHBs with deficiencies in their procurement strategy and processes and management of contracts has reduced (see Figure 18), and more DHBs now use a continuous improvement approach.

Figure 18
Number of district health boards with procurement practice deficiencies, by aspect



Asset management planning

- 3.48 Our auditors have been reviewing asset⁹ management plans prepared by DHBs to check that information aligns with asset information in the financial statements. They also checked whether the asset management planning was an appropriate part of each DHB's management control framework.
- 3.49 DHBs manage assets with a net book value of \$4.6 billion¹⁰ and a replacement value of \$7 billion¹¹. Good asset management is the process of achieving whole-of-life effectiveness of assets at least cost. It requires the DHB to manage a clear strategy for future capital and operating expenditure on the assets to address the risk of ineffective spending and asset failure.
- 3.50 During the 2008/09 and 2009/10 annual audits, our auditors reviewed and provided feedback to the DHBs on their asset management planning. Our recommendations to DHBs in 2009/10 included:
- ensuring that there is quality asset management planning to underpin the business, and ultimately delivering appropriate levels of service;
 - ensuring that the asset management plan contained the financial forecasts;
 - updating the asset management plan to reflect the current asset base, and hospital redevelopments;
 - reviewing asset information for asset type, age, size, location, performance, monitoring and condition, maintenance history, and cost; and
 - improving the asset management life-cycle approaches (for example, lowest long-term costs rather than short-term savings) when making asset management decisions.
- 3.51 In addition, auditors reviewed all of the DHBs' plans jointly for quality and completeness. Overall, the plans did not put service levels at the heart of asset management planning. They focused on capital planning rather than considering all the types of expenditure needed on the assets. In some cases, the plans did not set out a sustainable approach to funding work required on the assets.
- 3.52 This high-level desktop review also found that six DHBs had asset management plans that met a good standard of quality and completeness, nine DHBs had plans that largely met Ministry requirements, and only five DHBs had plans that generally did not meet the requirements. We intend to carry out further work in 2011/12 to examine the extent to which the quality of asset planning is reflected in the actual quality of asset management at district, regional, and national levels.

9 "Asset" comprises all of the DHB's physical components (property, plant, and equipment) that have value, enable services to be provided, and have an economic life (Source: *NAMS International Infrastructure Management Manual*, 2006 Edition).

10 From the annual reports of the 20 DHBs.

11 Transitional DHB National Asset Management Plan, November 2009, page 29.

- 3.53 Accuracy of information about a DHB's assets is critical to a good asset management plan. Recording the details of the condition and expected life of assets allows decisions to be made about which assets need to be retained, redeveloped, modified, used for other purposes, or disposed of. We expect all DHBs to be working towards setting up and maintaining comprehensive asset information.
- 3.54 During the 2009/10 annual audits, our auditors' recommendations to DHBs included reviewing asset information for asset type, age, size, location, performance, monitoring and condition, maintenance history, and cost.

Learning from examples

- 3.55 DHBs have, generally, shown small but promising improvements in the areas of non-financial performance reporting and in procurement policies and practice. We are pleased to note, in particular, the improvements in procurement policies.
- 3.56 We have summarised our observations in these areas into two "learning from examples" publications, aimed at sharing better practice within the sector. These are: *Spending on supplies and services by district health boards: Learning from examples* (September 2010), and *District health boards: Learning from 2010-13 Statements of Intent* (February 2011). We intend to look further in the coming year at the area of asset management.
- 3.57 We remain concerned that such a large proportion of the DHBs were in deficit at the end of the 2009/10 financial year. However, the estimated deficit for 2010/11 and for the two out-years is reducing. We will monitor the financial performance of the DHBs and any implications that might have for the sustainability of their services.

Part 4

The status of Māori Trust Board audits

- 4.1 In this Part, we report on the current status of audits for those Māori Trust Boards (the Boards) governed by the provisions of the Māori Trust Boards Act 1955 (the Act). We set out:
- what Māori Trust Boards are;
 - the Boards' audit arrangements and the status of the audits; and
 - changes proposed to those arrangements.

Background

- 4.2 We have previously been concerned about the timeliness of the completion of the audits governed by the Act, and the number of audits in arrears. We have continued to work with the Boards to complete the audits. It is pleasing to see that there are many fewer audits in arrears since our last report to Parliament, though the timeliness with which these audits are completed still needs to improve further.
- 4.3 We also discuss the policy changes proposed in legislation introduced to Parliament in November 2010. The legislation addresses the concerns we have expressed over many years about the audit and accountability arrangements for Boards.

What is the Māori Trust Board sector?

- 4.4 Boards manage tribal assets for the general benefit of their beneficiaries. They are able to provide money for the benefit or advancement of their beneficiaries and to use the money for promoting health, and social and economic welfare, and for providing education and vocational training.
- 4.5 The number of Boards subject to the Act has gradually reduced – from 19 in 1993 to 15 in 2010. The 15 Boards subject to the Act for the 2009/10 audit period were:
- Aorangi;
 - Hauraki;
 - Maniapoto;
 - Ngāti Whātua o Orakei;
 - Taranaki;
 - Tauranga-Moana;
 - Te Aupōuri;
 - Te Tai Tokerau;
 - Te Rūnanga o Ngāti Porou;

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

What are the audit arrangements for Māori Trust Boards?

- 4.6 Under current legislation, Boards are public entities under the Public Audit Act 2001. They are therefore audited by the Auditor-General.¹²
- 4.7 The Act requires Boards to prepare annual statements that set out their financial position and financial operations at the end of each financial year. These must be audited by the Auditor-General, who in turn forwards copies of the financial statements and audit reports to the Minister of Māori Affairs.
- 4.8 The Act does not specify a deadline for providing accounts for audit and completing the annual audit. However, the Auditor-General requests that her auditors complete the annual audit on her behalf within five months of the balance date. Nine Boards have a balance date of 30 June, which means that their audits should be completed by 30 November each year. Five have a balance date of 31 March (so the audits should be completed by 31 August) and one a balance date of 30 September (so the audit should be completed by the end of February). We regard audits not completed within five months of the balance date as being late and those that remain uncompleted as being in arrears.
- 4.9 We have often expressed our concern about the timeliness with which Boards prepare their financial statements, and how this detracts from the purpose of having audited financial statements. Improving the timeliness of Board audits has been a focus in recent years.
- 4.10 Figure 19 shows the timeliness of audit completion over the last three years. Figure 20 shows the number of audits in arrears as at 28 February 2011, compared to the same time in 2009, as noted when we last reported to Parliament on the status of these audits.

¹² The Auditor-General is not the statutory auditor of any Māori Trust Board subsidiary entities. However, she has accepted audit appointment requests for some Māori Trust Board subsidiaries under section 19 of the Public Audit Act 2001.

Figure 19
Timeliness of audit completion

	2009/10	2008/09	2007/08
Percentage of audits completed on time	33%	13%	13%

Figure 20
Māori Trust Board audits in arrears as at 28 February in 2011 and 2009

	28 February 2011	28 February 2009
Number of audits in arrears	13	35

- 4.11 The figures show that the timeliness of completion of audits improved in 2009/10, although it remains low compared to other sectors we audit. However, there has been a pleasing reduction in the number of audits in arrears, compared to the situation two years ago.
- 4.12 As of 28 February 2011, we had completed the audit of eight of the 15 Boards for the 2009/10 year.
- 4.13 Five Boards also had audits for earlier years still in arrears.
- 4.14 The reasons for the audits being in arrears include:
- delays by Boards or their accountants in producing financial statements for audit;
 - delays by Boards or their accountants in making the necessary amendments after initial audit work has been completed;
 - delays in completing the Board subsidiary audits needed for Group consolidation purposes;
 - difficulty resolving technical accounting and auditing issues, such as the valuation of assets; and
 - competing demands on audit resources when the initial time frames set to complete the audit are not met because of the reasons outlined above.
- 4.15 The oldest audits in arrears at 28 February 2011 are for the 2007/08 financial year. Good progress is being made on many of the outstanding audits.

Changes proposed to the audit arrangements for Māori Trust Boards

- 4.16 We have reported before about shortcomings in the current accountability framework for Boards. In our view, the current framework does not adequately cover the usual characteristics of modern accountability frameworks, nor does it reflect the current operating environment for Boards.
- 4.17 Our main concern has been that each trust's beneficiaries and Board should have a direct accountability relationship. Such an arrangement would enable beneficiaries to hold Board members to account for their performance. We also suggested that any review of the Act should examine and clarify the audit arrangements.
- 4.18 We have previously recommended that the Minister of Māori Affairs and Te Puni Kōkiri give urgent attention to reforming the legislation for Boards.
- 4.19 We are pleased to note that there is now a Bill before Parliament that addresses these issues. The Māori Purposes Bill (the Bill) was introduced into Parliament in November 2010 and referred to the Māori Affairs Committee. The Committee has called for submissions and is due to report to the House by 16 May 2011.
- 4.20 We consider that the Bill (as introduced) will address our concerns with the current accountability arrangements for Boards. It provides for a direct accountability relationship between each trust's Board and beneficiaries. It also requires Boards to prepare an annual report, including financial statements that comply with generally accepted accounting practice. The Bill also establishes a statutory time frame within which an audit must be completed.
- 4.21 The Bill removes Boards from the definition of a public entity under the Public Audit Act, with the result that the Auditor-General will no longer be the auditor of Boards. Instead, the audit will be carried out by a chartered accountant or someone eligible to act as an auditor under the provisions of the Companies Act 1993.
- 4.22 We welcome the reforms to the accountability framework for Boards as contained in the Bill.

Publications by the Auditor-General

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

- District health boards: Learning from 2010-13 Statements of Intent
- Central government: Case studies in reporting forecast performance information
- Matters arising from Auckland Council's planning document
- Central government: Results of the 2009/10 audits (Volume 1)
- How the Department of Internal Affairs manages spending that could give personal benefit to Ministers
- Sport and Recreation New Zealand: Improving how it measures its performance
- 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

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