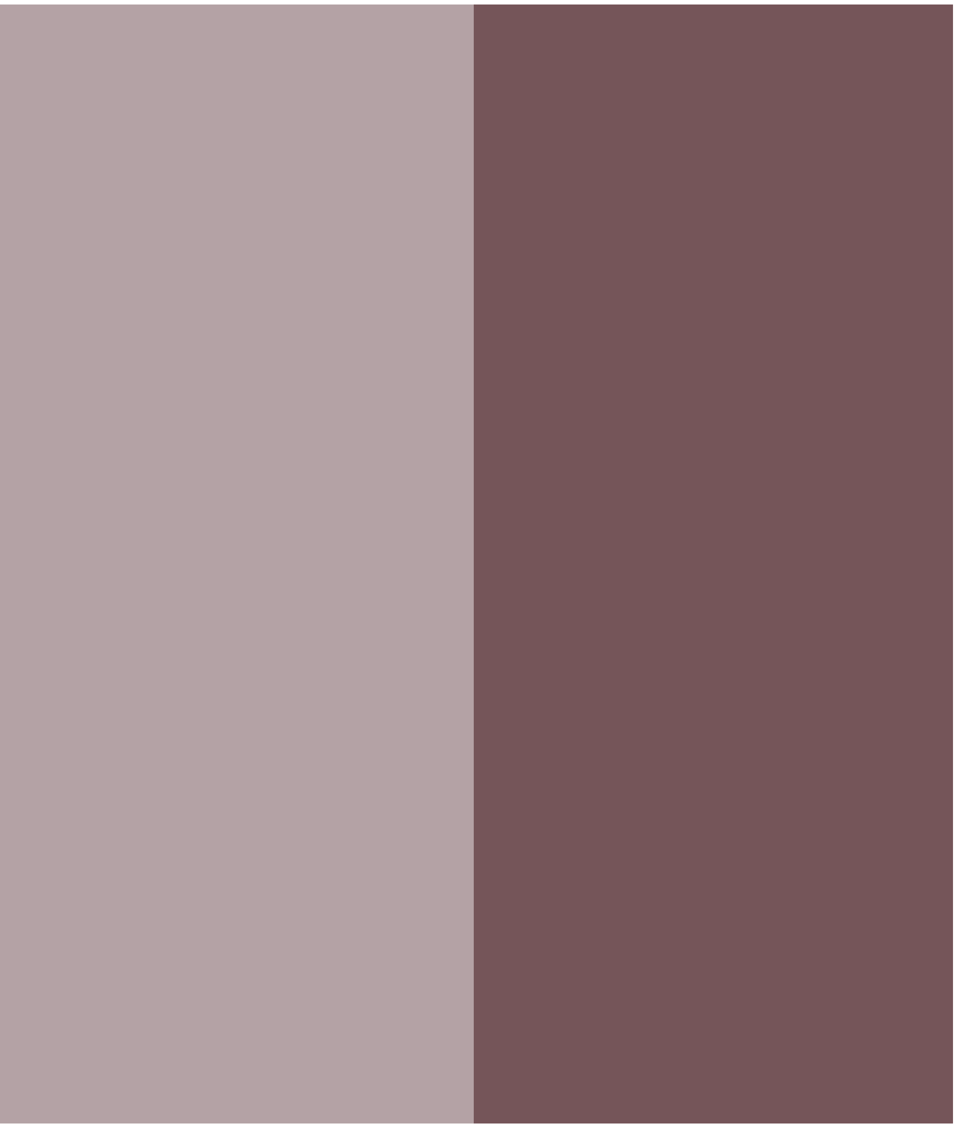
Controller and Auditor-General
Tumuaki o te Mana Arotake

B.29[20k]

Central government: Results of the 2019/20 audits



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Central government: Results of the 2019/20 audits

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Auditor-General's overview

E ngā mana, e ngā reo, e ngā karangarangatanga maha o te motu, tēnā koutou.

It has been an extraordinary year. However, despite the disruption and uncertainty, our system of public sector financial management, including transparent financial reporting by government, has been maintained. This is testimony to the strength of that system, which has been built over many years. It has also highlighted an aspect of the system that I consider can be further strengthened.

Responding to Covid-19

The scale, speed, and effects of the lockdowns and the wider Covid-19 response have defined this year. My Office focused on helping maintain the quality of financial reporting and confirming that appropriate spending authority was in place for Covid-related expenditure.

It is critical, now more than ever, that there is independent assurance over New Zealand's public financial management system. In times of great uncertainty, Parliament and the public need assurance about how public money is being spent.

The effects of Covid-19 will be long lasting, with many effects not yet apparent. Parliament's authorisation of Covid-related expenditure has given the Government scope to spend a significant amount of public money for its Covid-19 response. Given the size and nature of the funding signalled through the Covid-19 Response and Recovery Fund, I expect robust accountability to Parliament and the public about expenditure incurred and the remaining funds available.

The Government's financial statements and reporting to Parliament

I issued an unmodified audit opinion on the Government's financial statements for 2019/20. The preparation and audit of the Government's financial statements faced significant challenges because of the increased uncertainty, complexity, and disruption caused by Covid-19.

Public organisations had to deal with changes to how they operated, to their spending, and, in many cases, to their revenue. I was supportive of the various legislative amendments made to extend the 30 June 2020 statutory reporting time frames by up to two months for most public organisations.

Despite these challenges, the Government's financial statements provide clear and transparent information about the state of the Government's finances at 30 June 2020. The preparation and audit of these statements are important for many reasons, not least of which is maintaining the country's international reputation for world-class public financial management practices.

As a consequence of my decision to prioritise quality reporting and audits over timeliness, I signed the audit report on the Government's financial statements on 5 November 2020. This was a few weeks after the date stipulated in the Public Finance Act 1989.

The Government's financial statements were significantly affected by the response to Covid-19 (see the diagram after my overview). Substantial increases in borrowing during the year resulted in liabilities increasing by $56 billion. The total assets the Government owns increased to $393 billion (2018/19: $365 billion). At 30 June 2020, the Government's net worth is $28 billion less than the previous year. In short, the Government spent substantially more than it received as it managed the response to Covid-19.

In my view, this level of debt, much of which will be paid back by future generations, coupled with increases in forecast expenditure requires the Government to improve its reporting to Parliament and the public about the effectiveness of government programmes and expenditure more generally.

Performance reporting needs to improve

At one level, New Zealand operates a robust and transparent financial reporting and accountability system. The Government's financial statements and financial reporting by individual public organisations provide a clear, comprehensive, and cohesive account of government spending, which is independently audited.

However, it is time for reporting on all-of-government performance to improve. The public expects more than just robust financial reporting by government. There needs to be at least the same focus on reporting to the public on what was achieved for the public money spent.

There are three broad aspects of performance reporting where improvements are, in my opinion, required.

The first aspect, and the most fundamental, is robust reporting on all-of-government performance. As part of the accountability of government to Parliament and the public for the spending of public funds, there should be robust and independently assured reporting on what services have been delivered and what has been achieved. This should enable the public to get a picture of what, overall, they are receiving for the public money being spent. Ultimately, this is what matters.

The second is reporting on initiatives that involve multiple public organisations. The current reporting approach is often siloed and focused on the activities and spending of individual organisations. For example, our audits of Whānau Ora and the Provincial Growth Fund (noting the range of organisations involved) found that public reporting did not provide an adequate overview of spending on the initiatives as a whole and what was achieved with that money.

The third is at an agency level. Too much reporting is "widget" focused. Although, as Auditor-General, I encourage organisations to measure things accurately, it is also important for an organisation to say what it has achieved rather than how busy it has been. For example, a public organisation reporting on the number of contracts it has approved also needs to clearly explain what public benefit will come from these contracts.

Covid-19 has been a catalyst for change in many parts of our society. The Government is also pursuing a change agenda in the public sector more generally. Placing accountability to Parliament and the public, including improved reporting on the performance of government, as a key element of these reforms will be critical for building and maintaining trust and confidence.

Reporting on the Government's Covid-related expenditure

With public trust and confidence a priority in the Covid-19 operating environment, I have reported on the Covid-related financial approvals and spending. Through my regular Controller updates, I intend to continue these updates and to highlight areas where information for Parliament and the public could be improved.

Acknowledgments

Many public servants have done extraordinarily well to help New Zealand avoid the worst consequences of Covid-19. Public organisations have managed significant challenges through difficult times. Among many other more obvious achievements, I particularly acknowledge the extraordinary work of the Treasury and my auditors in the preparation and audit of the Government's financial statements and related entities.

Our high-quality public financial management system performed well under its most significant challenge in modern times. It has, and will continue to, serve the country well as the recovery from Covid-19 continues.

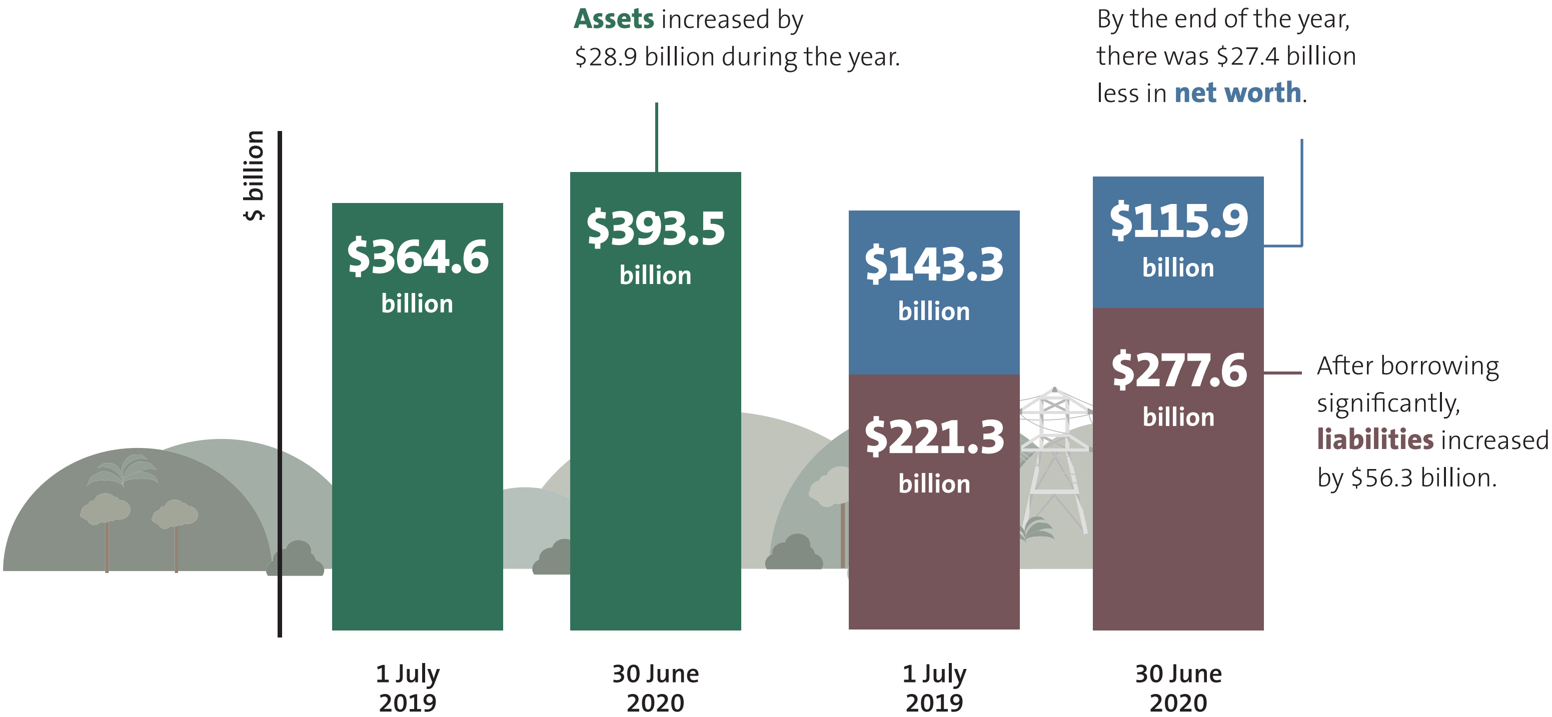
Nāku noa, nā

John Ryan
Controller and Auditor-General

17 December 2020

SNAPSHOT

Auditing the Government's financial statements



Net worth

If we look at it for each person...

The drop in total net worth (or "equity") is significant. The Government has borrowed more, largely to cover the many costs of the response to Covid-19.

Based on a population of 5 million, each of us started the year with a "share" of the Government's net worth of about $28,600 – and it has dropped by about $5,400 to $23,200.

Covid-19 has affected the Government's finances more than the Canterbury earthquakes and more than the global financial crisis.
See page 10

Challenges in valuing Government assets

The Government owns a lot of land and buildings. Their ***value has been difficult to determine*** since Covid-19. *See page 17*

Given Covid-19, it is more difficult to estimate how the economy will perform and ***how much tax might be collected***. *See page 14*

Working out the ***value of the electricity generation companies*** majority-owned by the Government relies on significant assumptions, like what the price of electricity might be and how much will be generated. *See page 18*

The ***value of some assets increased***, like the state highways that Waka Kotahi (New Zealand Transport Agency) maintains. *See page 17*

There has been a ***sizeable increase in ACC's investments and in superannuation funds*** available to future generations. *See page 21*

Less air travel reduced the value of the Government's investment in Air New Zealand Limited – and ***reduced the value of its aircraft***. *See page 24*

There is increased uncertainty about how much of the ***student loan debt*** will be collected. *See page 19*

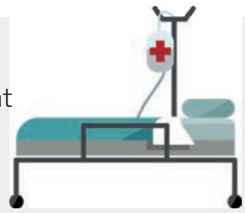
It's difficult to know what the ***repayment rate*** will be for the small business loan scheme set up to support businesses affected by Covid-19. *See page 20*

Liabilities increased, many in response to Covid-19

The Government's ***decision to buy back bonds*** has lowered ongoing borrowing costs but meant a loss of $3.3 billion recorded in the Government's financial statements. *See page 15*

Many district health boards and schools have still not calculated how much they ***need to pay their staff*** for money owed under the Holidays Act 2003. The uncertainty is considerable, and the delay concerning. *See page 23*

The amount ACC estimates it might need to ***pay in the future*** for injuries went up. *See page 21*



The Government ***borrowed a lot more***, and spent it mostly on Covid-related costs, like the wage subsidy scheme. *See page 26*

1 The operating environment for central government

Rapid change and increased expectations

1.1 Central government's operating environment fundamentally changed in 2019/20. The Government's response to Covid-19 has affected its ability to progress its well-being agenda and has put further demands, pressure, and expectations on public services.

1.2 Parliament authorised substantial funding for the Government to respond to Covid-19. That authorisation has given the Government significant scope to spend public money without requiring Parliament's approval of the detail. As a result, increased accountability and quality reporting are required so that Parliament and the public can understand what is being achieved with the money being spent.

Wellbeing Budget 2019 and the Government's priorities

1.3 The Government published *The Wellbeing Budget 2019* (Budget 2019) in May 2019. Budget 2019 signalled a new approach to solving the long-term challenges facing the country and what the public values.

1.4 The Government's main priorities were stated as:

- taking mental health seriously;
- breaking the cycle on child poverty and domestic violence;
- supporting Māori and Pasifika aspirations; and
- investing in crucial national infrastructure, such as new hospitals and schools.

1.5 The Government planned to do this while:

- managing its finances responsibly; and
- addressing long-term economic challenges, such as building a sustainable economy and preparing for the jobs of the future.

1.6 To deliver on these commitments, the Government increased the annual operating allowance in Budget 2019 from $2.4 billion to $3.8 billion. It also added a further $1.7 billion to the multi-year capital allowance for future Budgets. This meant the multi-year capital allowance totalled $14.8 billion in Budget 2019.

The emergence and effects of Covid-19

1.7 The Government's priorities fundamentally shifted in the second half of 2019/20. Many public organisations, businesses, and communities faced deep uncertainty after the emergence of Covid-19.

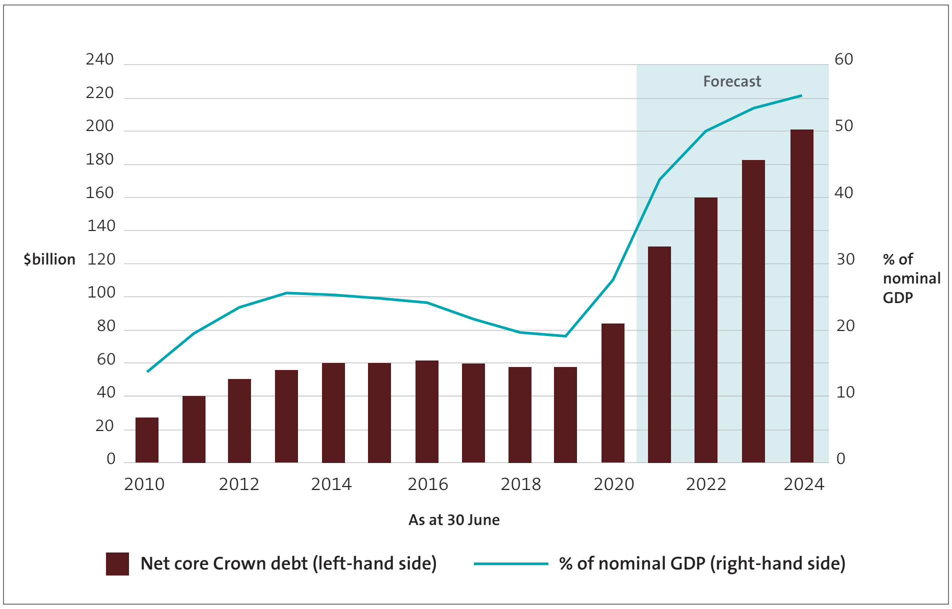
1.8 The risk of a pandemic in the country and its potential effect on people's health, the economy, and the Government's fiscal situation became the main concerns of 2019/20. The funding approved in Budget 2019 was also not enough for the Government to properly respond to Covid-19.

1.9 In March 2020, Parliament authorised up to $52 billion more spending than the $129.5 billion already authorised for 2019/20. Much of this additional authorisation was for the Covid-19 response.

1.10 The effects of Covid-19 will be long-lasting, with many not yet apparent. Figure 1 illustrates this point, including in forecast figures. Figures 2 and 3 show the effect of Covid-19 on net worth and net operating balance and compares them with other shocks (the global financial crisis and the Canterbury earthquakes) since 2005/06. The Treasury describes the change as follows:

> *The Government's strong balance sheet position prior to the COVID-19 pandemic has enabled the Government to absorb the fiscal impact from COVID-19 by increasing debt and running down net worth. From the start of the 2019/20 fiscal year, net core Crown debt increases by around $143 billion by 2023/24 to be $201.1 billion. Over the same period, net worth decreases by around $100 billion to be $43.5 billion in 2023/24. As a share of GDP, net core Crown debt continues to rise and reaches 55.3% by 2023/24.*[1]

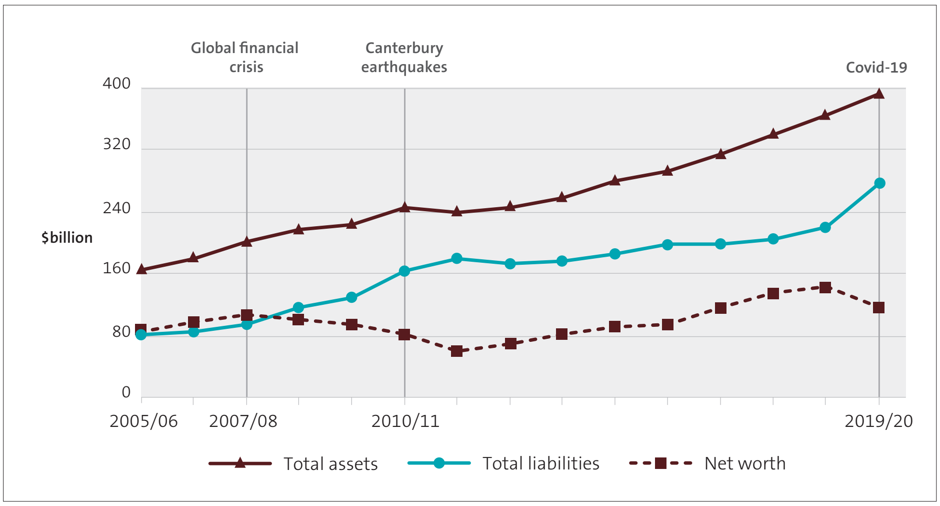
Figure 1
Net core Crown debt, 2009/10 to 2023/24



Source: Adapted from the Treasury (2020), *Pre-election economic and fiscal update 2020*.

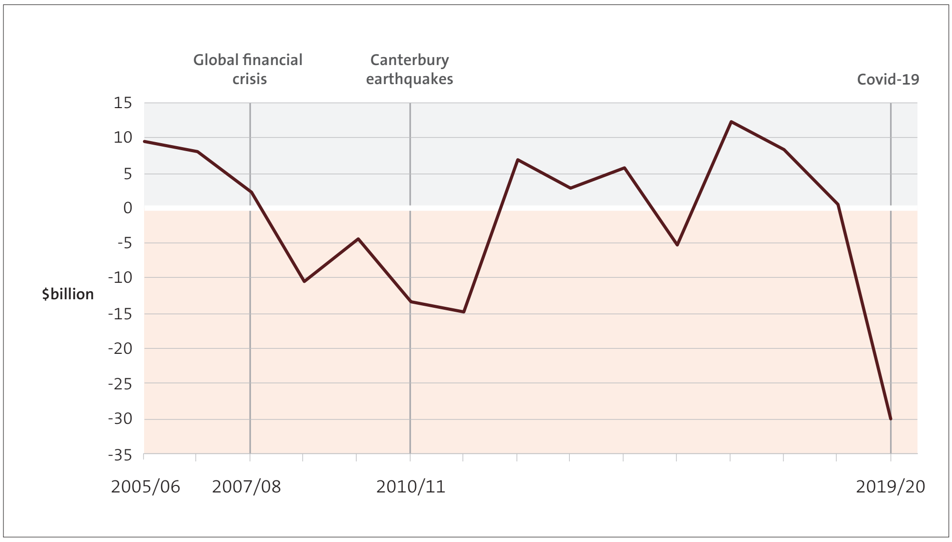
1 The Treasury (2020), *Pre-election economic and fiscal update 2020*, Wellington, page 5.

Figure 2
Total assets, liabilities, and net worth, 2005/06 to 2019/20



Source: Adapted from the Treasury (2020), *Pre-election economic and fiscal update 2020*.

Figure 3
Net operating balance, 2005/06 to 2019/20



Source: Adapted from the Treasury (2020), *Pre-election economic and fiscal update 2020*.

1.11 Parliament has given the Government considerable scope to decide how it funds its response to Covid-19.

1.12 The Government's economic priorities shifted to preserving jobs and protecting people's livelihoods. It introduced a new wage subsidy scheme to support workers and other schemes to support the community at large and businesses.

Our work on Covid-related expenditure

1.13 Although much of the newly authorised Covid-related expenditure was announced in 2019/20, it will be incurred in 2020/21 and beyond. Given the significant amount of spending, we will continue to give special attention to Covid-related expenditure.

1.14 How the Covid-19 response will fully affect public organisations is uncertain. We want to understand the continuing effects of the Covid-19 response on public organisations and what this means for the Government's financial statements, control environment, capabilities, and operations.

1.15 A key focus of all our 30 June 2020 audits has been to assess the effects of Covid-19. The effects have been wide-ranging on assets, liabilities, revenues, and expenses. Creating robust financial statements in this context, and the audit of them, has been challenging. We have encouraged public organisations to disclose the effects of Covid-19 in their financial statements and for most public organisations we have emphasised the disclosures in our audit reports.

1.16 In April 2020, we initiated our broader work programme on Covid-19. We carried out a rapid review of the Ministry of Health's management of personal protective equipment (PPE). In times of great uncertainty, people need to have trust and confidence in the systems and arrangements set up to support them. At that time, there was a high level of public interest in, and uncertainty about, PPE supply and distribution.

1.17 To be sufficiently prepared, we recommended that the health and disability sector have a clear understanding of what PPE it has, where it is held, and to whom it should be provided. The sector also needs a way of forecasting demand as well as a scalable system for procuring and distributing stock. This will provide some assurance that the right PPE is getting to the right people, at the right place, and at the right time.

1.18 As with all the work that we do, we wanted our PPE review to help improve the resilience of the systems that support critical public services. We also wanted to help those systems prepare for similar events that could emerge at any time. Although the Ministry of Health's response to our PPE review was positive, we remain concerned about whether the health and disability sector is sufficiently prepared for a second wave of Covid-19 or another pandemic.

1.19 Our current work on Covid-related expenditure also includes:

- assessing how the wage subsidy scheme has been managed;
- reviewing significant public investment decision-making processes;
- considering the approach to the Provincial Growth Fund reset; and
- reviewing the central government response to Covid-19.

1.20 We will also continue publishing regular Controller updates and looking at how Covid-related expenditure is monitored. We have prioritised Covid-related work and it is likely that new work on Covid-19 matters will occur over the next few years; some of which is already described in our annual plan.

1.21 The Covid-19 response brought about new ways of working and changes to public organisations' operating environments. Staff moved between public organisations to help with the Covid-19 response, for example, the New Zealand Defence Force supported, and continues to support, managed isolation and quarantine facilities.

1.22 There have been many lessons identified in the way the public sector has responded to Covid-19. The Government's future reform agenda presents an opportunity to learn from these lessons to maintain and build public trust and confidence.

Change continues in central government

1.23 Significant legislative changes and reviews that took place in 2019/20 will affect central government organisations. We continue to take an interest in how proposed changes will be embedded and whether they will deliver the outcomes for the public that Parliament intended.

1.24 Reviews over the last few years in tax, welfare, education, training, and, more recently, the health and disability sector, show that the Government continues to pursue a significant policy and change agenda in an operating environment affected by Covid-19. We will continue to comment on proposals and monitor the effects of all changes made.

1.25 Demands and expectations continue to increase on the public sector and are becoming more complex. In this and any environment, it is important to get the basics right. In Part 4, we discuss the need for improving performance reporting, which is made more important given the level of spending, projected benefits, and costs that have occurred as a result of Covid-19.

Public service reforms

1.26 A significant piece of legislation affecting central government in 2020 was the Public Service Act 2020, enacted in August 2020. The Act repealed and replaced the State Sector Act 1988. The Public Finance Act 1989 was also amended to recognise and enable the new organisational arrangements provided for in the Public Service Act.

1.27 The Public Service Act aims to enable the public service to deliver improved outcomes and better services by creating a modern, agile, and adaptive public service. The Act:

- provides a more flexible set of options for how the public service can organise to better respond to specific priorities;
- allows public servants to move between public organisations more easily;
- clearly establishes the purpose, principles, and values of an apolitical public service, as well as its role in government formation;
- supports the Crown in its commitment to, and its relationship with, Māori;
- strengthens leadership across the public service and, in particular, provides for system and future-focused leadership; and
- shifts the focus from state services to public services, changing the name of the State Services Commission to Te Kawa Mataaho Public Service Commission.

1.28 The Public Service Act calls for a more unified public service that is focused on public organisations working together as stewards of the public's intergenerational well-being.

1.29 We made a submission during the consultation period for this legislation. In our submission to the Governance and Administration Committee, we stressed the need for clarity about accountability arrangements (to Parliament and the public) from the outset. It is important that accountability arrangements help to improve Parliament and the public's trust and confidence in the public sector. Clear accountabilities also support effective reporting on performance.

1.30 Through the Public Service Act, new organisational arrangements can be created to respond to cross-government issues. These arrangements are designed to introduce flexibility and enable greater collaboration on policy issues and common outcomes throughout the public service.

1.31 We support work in the public sector that seeks to strengthen performance, accountability, and the transparency of public organisations.

1.32 We have significant interest in any changes that may be proposed to the public financial management system, and we will continue to seek appropriate opportunities to work with the Treasury and Parliament as work progresses.

2

Our audit of the Government's financial statements

2.1 Our audit report on the Government's financial statements provides independent assurance that the financial statements present fairly the Government's financial performance and position. Confidence in the reliability of government reporting allows Parliament, the public, and the international community to confidently scrutinise the Government's financial performance.

2.2 The audit report included an unmodified opinion and a description of the key audit matters arising during the audit.

2.3 Each year we review whether the previous year's key audit matters remain relevant and consider any new matters that should be included in the audit report. For this year, we needed to carefully consider the effects of Covid-19 on the key audit matters.

2.4 The key audit matters in the audit report for the year ended 30 June 2020 were:

- recognising other persons' and corporate tax revenue;
- recognising a loss on the large-scale asset purchase programme;
- valuing property, plant, and equipment;
- valuing financial assets where market data is not available (including student loans and the small business cashflow (loan) scheme);
- valuing insurance liabilities, superannuation liabilities, and veterans' disability entitlements liabilities; and
- entitlements under the Holidays Act 2003.

2.5 Overall, we were satisfied that the balances and disclosures in the Government's financial statements relating to these matters were reasonable and appropriate.

Key audit matters

Recognising other persons' and corporate tax revenue

2.6 The Government recognised other persons' tax revenue of $7.1 billion and corporate tax revenue of $12.1 billion for the year ended 30 June 2020.

2.7 Other persons' and corporate tax revenue for the year was estimated because the final income tax owed for a year is known only when a tax return is filed. Filing could happen more than a year after the tax year.

2.8 The estimation process relies on macro-economic forecasts about how the economy will perform. It also relies on assumptions about how these macro-economic forecasts relate to taxable profits of taxpayers.

2.9 Because of Covid-19, there is increased uncertainty about how the economy will perform. Therefore, judgements were made about the economy's performance, which were used to estimate tax revenue.

2.10 We reviewed the systems, processes, and controls for receiving and reviewing provisional and final tax returns, tax assessments, and tax revenue. This included understanding the Inland Revenue Department's (Inland Revenue) information technology system for managing tax. We also:

- assessed the controls for significant reconciliation processes;
- tested the underlying data used in the tax revenue estimation models;
- reviewed the main assumptions and judgements used to estimate tax revenue from other persons and corporates; and
- assessed the reasonableness of the most important variables in the models, given the effect of Covid-19 on the economy.

2.11 We used independent economic experts to assess the main assumptions about the future (such as economic growth), and tested how sensitive the estimates were to changes in the main assumptions. The independent economic experts also considered alternative macro-economic indicators that could reliably estimate other persons' and corporate tax revenue. We were satisfied that the macro-economic indicator used was reasonable.

2.12 As a result of the audit work, we were satisfied that other persons' and corporate tax revenue for the year ended 30 June 2020 were reasonable and that the disclosures were appropriate.

Recognising a loss on the large-scale asset purchase programme

2.13 In response to the effect of Covid-19 on the economy, the Reserve Bank of New Zealand (Reserve Bank) implemented a large-scale asset purchase programme. This programme involved repurchasing New Zealand Government Bonds (NZGBs) and Local Government Funding Agency bonds. The programme's intended effect was to increase money supply, decrease interest rates, and stimulate the economy.

2.14 The Reserve Bank purchased $21.0 billion of NZGBs and $964 million of Local Government Funding Agency bonds on the secondary market up to 30 June 2020. We broadly summarise the large-scale asset purchase programme's effect on the Government's financial statements below:

- A loss of $3.3 billion is reported in the financial statements. The loss represents the difference between the price paid by the Reserve Bank to acquire the NZGBs and the carrying value of the bonds in the Government's financial statements at the date of repurchase.

- A net increase in settlement deposits (borrowings) retail banks have with the Reserve Bank from $6.9 billion at 30 June 2019 to $23.0 billion at 30 June 2020.
- The benefit of lower borrowing costs (interest expenses) in the current year and expected for the future as the fixed interest rate payable on the NZGBs is replaced by the lower floating Official Cash Rate (currently 0.25%) payable on bank settlement deposit account borrowings.

2.15 During the audit, we discussed with the Treasury whether gains or losses arising from the large-scale asset purchases in the statement of financial performance should be included in the operating balance before gains and losses. Our view was that the loss of $3.3 billion represented an operating expense of the Government.

2.16 The operating balance before gains and losses is included in the financial commentary and other fiscal indicators. However, the Treasury removed it from the statement of financial performance in the Government's financial statements.

2.17 A model was prepared to calculate the difference between the price paid to re-purchase the bonds and the value of the bonds in the Government's financial records at the date of each transaction. A "first in first out" method was applied, which assumes that the bonds purchased first were the bonds issued earliest.

2.18 We agreed the bond information in the model to the Treasury and Reserve Bank systems, tested the accuracy of key calculations in the model, and assessed whether the "first in first out" method was correctly applied.

2.19 As a result of the audit work, we were satisfied that the calculation of the loss on the large-scale asset purchase programme for the year ended 30 June 2020 was reasonable and that the disclosures were appropriate.

Valuing property, plant, and equipment

2.20 The Government owned physical assets of $186.5 billion at 30 June 2020. Considerable judgement is needed to determine the value of some of these assets because there are inherent uncertainties in valuing them.

2.21 Valuers have considered the economic effects of Covid-19 on significant estimates and judgements. These include economic indicators for interest rates and inflation, cash flow forecasts, any changes in levels of service, and replacement costs.

2.22 Assets that needed significant judgement to determine their value as at 30 June 2020 included land and buildings, state highways, and electricity generation assets. We discuss each in more detail.

Land and buildings

2.23 Land and buildings were valued at $102.9 billion at 30 June 2020. Calculating the fair value of land and buildings requires a range of valuation methods and assumptions.

2.24 The economic impact of Covid-19 had a significant effect on the assumptions made when assessing the value of land and buildings. Several valuers have identified that, although land and property prices had not changed significantly, there had been limited market information available since the Covid-19 lockdown period. It is difficult to predict what the short-term and long-term effects on values will be.

2.25 We examined how land and buildings are valued, the significant estimates and assumptions used, and how reasonable they were. We confirmed the competence, capabilities, and objectivity of the valuers, challenged the main assumptions, and assessed the valuation procedures. We considered whether there were any limitations placed on the valuers.

2.26 We considered how valuers took the economic impact of Covid-19 into account and the effect of any estimation uncertainties on the final valuations. We also checked that the revaluation movements and reversals of previous impairments were correctly accounted for.

2.27 As a result of the audit work, we were satisfied that the value of land and buildings at 30 June 2020 was reasonable and that the disclosures were appropriate.

State highways

2.28 The state highways (excluding land) were valued at $39.4 billion at 30 June 2020. The value of the state highways cannot be measured precisely. Significant estimates and assumptions are made, including assumptions about quantities and rates used to construct the state highways, the remaining useful life of the assets, and the unit costs to apply. Changes to the underlying estimates and assumptions can cause a material movement in the valuation of the state highways.

2.29 Work done during the last three years has improved the quality of the data used in the valuations, but uncertainties with the valuation remain.

2.30 We examined how the state highways are valued, the significant estimates and assumptions used, and their reasonableness. We confirmed the competence, capabilities, and objectivity of the valuer, challenged the valuer's main assumptions, and assessed the valuation procedures (including the information extracted from databases). We considered whether there were any limitations placed on the valuer and whether centrally calculated rates applied to the valuation were appropriate.

2.31 We confirmed that key controls were operating over the systems and processes used to record costs and other asset information about the state highways. We also considered how the valuer took the economic impact of Covid-19 into account and the effect of any estimation uncertainties on the final valuations.

2.32 As a result of the audit work, we were satisfied that the value of the state highways at 30 June 2020 was reasonable and that the disclosures were appropriate.

Electricity generation assets

2.33 The electricity generation assets were valued at $17.1 billion at 30 June 2020. Valuing electricity generation assets is complicated and relies on significant assumptions about the future prices of electricity, generation costs, and how much electricity will be generated. Each of these assumptions affects the others.

2.34 These assumptions are sensitive to small changes that can have a significant effect on the value of the electricity generation assets.

2.35 We examined how electricity generation assets are valued. We confirmed the competence, capabilities, and objectivity of the valuers, tested their procedures for carrying out the valuations (including the information they used), and challenged their main assumptions and judgements. Where the data was available, we compared the forecast prices of electricity to the expected longer-term wholesale prices and market data.

2.36 We considered how the valuers took the economic impact of Covid-19 into account in the valuations and the effect of any estimation uncertainties on the value of electricity generation assets.

2.37 On 9 July 2020, there was an announcement about the planned wind down of the New Zealand Aluminium Smelter at Tiwai Point. We agreed that the value of the electricity generation assets should not be adjusted as a result of the announcement, given that it was after the balance date of the Government's financial statements (30 June 2020).

2.38 As a result of the audit work, we were satisfied that the value of electricity generation assets at 30 June 2020 was reasonable and that the disclosures were appropriate.

Valuing financial assets where market data is not available

2.39 The Government had financial assets that were valued where market data is not available of $18.6 billion at 30 June 2020. These financial assets include loans, investments and deposits, including student loans, and the small business cashflow (loan) scheme, which we discuss separately (see paragraphs 2.47-2.53).

2.40 When there is no quoted market price for a financial asset, the value of the asset is estimated using an appropriate technique, such as a valuation model. These models are usually complex, using inputs from market data when available. Otherwise inputs are derived from non-market data, which requires greater judgement.

2.41 We reviewed the valuation techniques, controls, and inputs used to determine the value of financial assets where market data was not available. We tested the internal controls over data entered into financial systems for these assets and assessed the controls and valuation approaches applied where a fund manager carried out the valuation. We compared the fair value of financial assets to independent information, investigated any significant variances, and assessed the appropriateness of the inputs used in the valuation.

Student loans

2.42 At 30 June 2020, student loans from the Government were valued at $10.4 billion. Student loans are measured using actuarial models, which reflect current student loan policy and macro-economic assumptions. The value is sensitive to changes in several assumptions, including future income levels, repayment behaviour, inflation, and discount rates.

2.43 There is added uncertainty now about how Covid-19 might affect student loan repayments and the limited availability of repayment data during the economic downturn. Adjustments were made to the valuation to reflect assumptions about employment, overseas compliance, and the associated economic recovery period.

2.44 We tested a sample of student loan applications during the year to ensure that they were correctly paid out. We tested the internal controls over student loans entered into financial systems and actuarial models used by the valuer, checked that the underlying information used in the valuation was correctly extracted from the system, and assessed the controls and valuation approaches applied by the valuer.

2.45 We performed a retrospective review of the actual receipts of student loans in previous years against previous year cash flow forecasts, to consider whether there was any estimation bias.

2.46 We engaged an independent expert to review the main assumptions in the student loans model, including a review of the cash flow forecasts used to determine the fair value of loans, and adjustments for employment and overseas non-compliance due to Covid-19.

Small business cashflow (loan) scheme

2.47 The small business cashflow (loan) scheme was introduced to support businesses and organisations affected by a loss of actual or predicted revenue as a result of Covid-19.

2.48 The small business cashflow (loan) scheme provides five-year loans to eligible small businesses. Those businesses are not charged interest if the loan is fully repaid within one year. Otherwise, the interest rate is 3% for outstanding amounts from the inception of the loan. Repayments are not required in the first two years, but voluntary payments can still be made during this period.

2.49 The small business cashflow (loan) scheme was anticipated to provide loans of up to $5.2 billion. At 30 June 2020, $1.42 billion had been advanced. The value after applying an assumed default rate and discount rate was $737 million.

2.50 Because the small business cashflow (loan) scheme is new, there is no data available to determine the likely rates of repayment or default, and limited data to determine discount rates used in the valuation model at 30 June 2020. It is also difficult to predict how Covid-19 will affect the ability of businesses to repay the loans. The external valuer stated in their valuation report that the uncertain and volatile nature of future debt repayments means that there is significant uncertainty in estimating the fair value of the loans.

2.51 We considered the appropriateness of the main assumptions used in the valuation and reviewed how estimation uncertainties due to Covid-19 were reflected in the valuation process.

2.52 We used an independent economic expert to assess whether the approach to estimating the default rate was appropriate. The estimated default loss rate was reasonable, based on current economic forecasts and other available data.

2.53 As a result of the audit work on financial assets where market data was not available, we were satisfied that the value of those assets at 30 June 2020, including student loans and the small business cashflow (loan) scheme, was reasonable and that the disclosures were appropriate.

Valuing insurance liabilities, superannuation liabilities, and veterans' disability entitlements liabilities

2.54 The Government had an outstanding claims liability for the Accident Compensation Corporation (ACC) valued at $61.5 billion, an unfunded liability for public servants' superannuation entitlements valued at $14.0 billion, and a veterans' disability entitlements liability of $3.5 billion at 30 June 2020.

2.55 Determining the value of the Government's long-term liabilities is complicated. Actuaries estimate the amounts based on assumptions about the future (including the economic effects of Covid-19). There are uncertainties inherent in the valuations of each of these liabilities.

The Accident Compensation Corporation's outstanding claims liability

2.56 The assumptions used to determine the value of ACC's outstanding claims liability include assumptions about discount rates, risk margins, the effects of inflation and innovation on future medical costs, and how long it will take people to recover from injuries.

2.57 We examined how ACC's outstanding claims liability is valued. We also reviewed ACC's main assumptions about each significant type of claim to see whether these were appropriate, including the effects of Covid-19 on these assumptions and estimation uncertainties.

2.58 We tested the systems and controls and, in particular, tested the process for recording claims in detail. We tested the main assumptions by considering past claims. We assessed the reasonableness of forecasts by looking at the evidence supporting them. We used an independent actuary to review the scope, approach, and reasonableness of the estimated liability.

2.59 We tested the reconciliations of the underlying claims data with ACC's systems, examined the sensitivity analysis for movements in the main assumptions, and reviewed the related financial statement disclosures.

Superannuation liability

2.60 The Government's unfunded liability for public servants' superannuation entitlements for members of the Government Superannuation Fund (the Fund) has been valued by an independent actuary.

2.61 The value of the unfunded liability for public servants' superannuation entitlements for members of the Fund is sensitive to the value of the Fund's assets, expected rates of salary increases for members of the Fund, and estimated inflation and discount rates. The Fund's assets, which are mainly equities and bonds, are traded in markets. Changes in the prices of these equities and bonds affect the amount of the unfunded liability.

2.62 We examined how the Government's unfunded liability for public servants' superannuation entitlements was valued. We confirmed the competence, capabilities, and objectivity of the actuary and tested their procedures. We engaged our own actuary to review the main assumptions, judgements, and procedures used to value the unfunded liability.

2.63 We tested the main controls that ensure that membership data used in the actuary's valuation was complete and accurate. We assessed the appropriateness of the main assumptions used to estimate the value of the unfunded liability, including the expected rates of salary increases, against external benchmarks.

2.64 We tested the design, implementation, and operating effectiveness of key controls for investments of the Fund. We obtained an understanding of the valuation techniques and inputs used by the respective fund managers to value the investments. The value of the funds was reconciled to the latest valuation reports. Any movements between the last valuation date and the year-end data were checked against supporting documentation. We also considered the estimated return on assets owned by the Fund.

Veterans' disability entitlements liability

2.65 The Government recognised a veterans' disability entitlements liability at 30 June 2020 because it had to adopt a new accounting standard during the year (PBE IPSAS 39 *Employee Benefits*).

2.66 The value of the veterans' disability entitlements liability is subject to uncertainty because of possible deficiencies in the underlying data used to make the estimate, the extent to which veterans will take up their full entitlement, the discount rate, the inflation rate, and changes in mortality rates.

2.67 We reviewed the method used to calculate the liability and confirmed the competence, capabilities, and objectivity of the actuary. We also used an independent actuary to review the main assumptions, judgements, and procedures used to value the liability. We tested controls over the data used in the actuary's valuation. We also reviewed the accounting entries to recognise the change in accounting policy, including the restatement of the comparative figures for 2019.

Work we did for each of the types of liability

2.68 The Government's financial statements set out the sensitivity of assumptions. Changes in these assumptions can have a large effect on the amount of these liabilities and the level of actuarial gains and losses.

2.69 We evaluated the appropriateness of the main assumptions (such as inflation and discount rates) used in valuing the long-term liabilities. For discount rates and inflation assumptions, the Treasury determines a table of risk-free discount rates and inflation assumptions each year using an agreed methodology. We had an independent expert review the Treasury's risk-free discount rates and inflation assumptions.

2.70 As a result of the audit work, we were satisfied that the table of discount rates and inflation assumptions were appropriate for use in accounting valuations in the Government's financial statements. We were also satisfied that each of the long-term liabilities at 30 June 2020, as described above, were reasonable and that the disclosures were appropriate.

Entitlements under the Holidays Act 2003

2.71 We have noted before the slow progress by some public organisations to resolve historical non-compliance issues with the Holidays Act 2003. We know that some organisations have settled the liability to current and past employees, but it is important that the issues are addressed and that the liability is settled across all of government.

2.72 A number of public organisations have started or completed a review of current and historical payroll calculations to ensure that they have complied with the legislation. Where possible, provision has been made in the Government's financial statements for obligations arising from these reviews where settlement has not been made.

2.73 For certain public organisations, particularly district health boards and schools, complexities mean it is taking longer to calculate the amounts owed to each individual. District health boards and schools are significant employers, and the amounts needed to settle these obligations remain uncertain.

2.74 For the public organisations most significantly affected, we considered the progress made in resolving the payroll calculation issues.

2.75 For those public organisations that had a provision, we assessed the approach used to calculate the provision. We also reviewed the processes followed for calculating a provision and tested a sample of transactions. We considered the completeness of the data used for calculating a provision. We assessed the competence, capabilities, and objectivity of independent experts who were involved in the calculations and challenged the main assumptions and judgements made in calculating the provision, including the consideration of Covid-19 on the valuation.

2.76 For those public organisations that did not have a provision, we verified that they could not reasonably quantify an amount. We also reviewed the disclosures made in the financial statements.

2.77 As a result of the audit work, we were satisfied that the provision for entitlements under the Holidays Act 2003 at 30 June 2020 was reasonable. Where a liability cannot be reliably measured, the contingent liability disclosures were appropriate.

Other audit matters

Impairment of Air New Zealand Limited's aircraft and goodwill

2.78 The aviation sector has been significantly affected by Covid-19 because travel has been significantly restricted. This has resulted in an impairment to the value of Air New Zealand Limited's (Air New Zealand) aircraft and an impairment to the value of the goodwill on the Government's investment in Air New Zealand being recognised.

2.79 At 31 March 2020, the Treasury formed a view that there were indicators that the value of goodwill on the investment in Air New Zealand in the Treasury's financial statements was impaired based on:

- a decline in the value of Air New Zealand shares;
- an announcement of a restructure by the Chief Executive Officer;
- a significant decline (almost 95%) in revenue due to restrictions on international and domestic flights; and
- the Crown announcement of an intention to provide additional liquidity support in the form of a stand-by loan facility of up to $900 million.

2.80 At 31 March 2020, Air New Zealand's share price indicated a fair value of the Crown's holding of $499 million, which is $292 million less than the investment carrying value of $791 million. We considered that the fair value of the investment based on the 31 March share price was likely the best indication of value at 31 March.

2.81 We assessed the appropriateness of the residual values of aircraft and the impairment in value of aircraft and related assets. We confirmed the competency and independence of the valuation expert that Air New Zealand used and discussed with them their approach and assumptions made in determining the relevant aircraft values. We had our internal valuation specialists assist in evaluating the assumptions.

2.82 We reviewed the Treasury's assessment of the carrying value of goodwill related to the Government's investment in Air New Zealand. We further considered the implications of Air New Zealand's announcements about large-scale workforce reduction and restructuring for international services in response to Covid-19.

2.83 As a result of the audit work, we were satisfied that the impairment of aircraft and goodwill and their carrying values were appropriately reflected in the Government's financial statements.

Institutes of technology and polytechnics

2.84 The 16 institutes of technology and polytechnics became subsidiaries of Te Pūkenga (New Zealand Institute of Skills and Technology) on 1 April 2020. Te Pūkenga will design a sustainable and regional public network of vocational education that will provide both work-based, off-the-job, and online vocational learning and training.

2.85 Te Pūkenga's subsidiaries are considered to be controlled by the Government from 1 April 2020, and have been consolidated on a line-by-line basis in the Government's financial statements.

2.86 We assessed the appropriateness of Te Pūkenga and its subsidiaries being consolidated on a line-by-line basis rather than on an equity accounting basis. We tested the property, plant, and equipment asset balances. We also tested the consolidation journals and the accounting treatment of the adjustments to equity.

2.87 We were satisfied that Te Pūkenga and its subsidiaries have been appropriately consolidated in the Government's financial statements.

Changes in accounting standards

2.88 The Treasury adopted two new accounting standards: PBE IPSAS 35 *Consolidated Financial Statements* and PBE IPSAS 39 *Employee Benefits* when preparing the Government's financial statements. These standards mainly affected information reported by the New Zealand Super Fund and the New Zealand Defence Force.

2.89 The New Zealand Super Fund is no longer required to consolidate investments that it has a controlling interest in. This has affected the measurement and presentation of information in the Government's financial statements, including comparative figures and note disclosures.

2.90 The New Zealand Defence Force had to account for its veterans' disability entitlements liability for the first time at 30 June 2020.

2.91 We reviewed the restated comparatives and reclassifications and the disclosures in the Government's financial statements that included PBE IPSAS 35 *Consolidated Financial Statements* and PBE IPSAS 39 *Employee Benefits* requirements.

2.92 We were satisfied that the new accounting standards had been appropriately applied and that the disclosures were appropriate.

Accounting for the wage support subsidy for Covid-19

2.93 The wage support subsidy was aimed at helping to keep workers employed during the Covid-19 lockdown.

2.94 The size and speed at which the wage subsidy for Covid-19 was implemented and the high-trust nature of the scheme made it difficult to assess compliance with the criteria for funding.

2.95 A follow-up process to identify recoverable claims is under way, and it is important that the approach and extent of follow-up is adequate to reduce the risk of fraud.

2.96 We examined the processes, systems, and controls in place for the administration and post-payment assurance processes over the wage subsidy scheme. We also tested a sample of transactions for the wage subsidy scheme to determine whether the payments were materially correct and incurred within the scope of the appropriations.

2.97 We tested a sample of post-payment assurance processes completed to ensure that recoveries were made appropriately.

2.98 We were satisfied that the wage support subsidy is appropriately reflected in the Government's financial statements.

Valuing the Emissions Trading Scheme liability

2.99 The valuation of the liability under the Government's Emissions Trading Scheme (the Scheme) presents a risk due to its public interest, its accounting impact, the degree of judgement involved, and the inherent uncertainty due to the many governance and co-operation agreements in place between organisations.

2.100 We examined the governance and co-operation arrangements in place between the public organisations with administrative responsibilities for parts of the Scheme and the controls over the Scheme's systems.

2.101 We also reviewed the processes applied to value carbon units and the methodology and source information applied in valuation models.

2.102 We were satisfied that the valuation of the Scheme's liability at 30 June 2020 is materially correct.

Overriding internal controls

2.103 There is an inherent risk in every organisation of fraud resulting from management override of internal controls. People in management positions are in a unique position to commit fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.

2.104 We examined the controls for collecting financial information from public organisations included in the Government's financial statements and the adjustments to that information for consolidation purposes. We also tested the appropriateness of journal entries and other adjustments made in the preparation of the financial statements through review of journals and disclosures.

2.105 We reviewed significant accounting estimates for bias, and engaged specialists to assist with those reviews, where appropriate.

2.106 We were satisfied that the risk of management override of internal controls for the Government's financial statements has been adequately mitigated.

Improving disclosures

2.107 The effects of Covid-19 on the Government's financial statements were pervasive. We expected there to be relevant commentary and disclosures to help readers better understand the effects of the increased uncertainty as a result of Covid-19.

2.108 We reviewed the note disclosures in the Government's financial statements to ensure that they conveyed the appropriate information to readers in a way that is accessible and adds to the overall understanding of the financial statements.

2.109 We also reviewed the Covid-19 commentary to ensure that it was relevant and understandable to the readers of the financial statements.

2.110 We were satisfied that the effects of Covid-19 on the Government are adequately disclosed in the Government's financial statements.

Reporting of unappropriated expenditure

2.111 The Statement of Unappropriated Expenditure in the Government's financial statements is an important summary of all unappropriated expenditure incurred in the financial year.

2.112 We noted an increase in the number of instances and amount of unappropriated expenditure during the year ended 30 June 2020 compared to the previous year, which we discuss in Part 3.

2.113 During our audit, we assessed the accuracy and completeness of the disclosure of the unappropriated expenditure. This included confirming that the final listing of unappropriated expenditure, and any expenditure incurred against section 25 of the Public Finance Act, was correctly reported in the Government's financial statements. The audit included confirming the completeness and accuracy of all disclosed unappropriated expenditure with the relevant public organisations.

2.114 We recommended that the Treasury work with appropriation holders and finance teams to improve awareness and understanding of the appropriation system. We also recommended that the Treasury ensure that appropriations are properly set up and approved and the accounting for expenditure against appropriations is correct.

2.115 Overall, we were satisfied that the Statement of Unappropriated Expenditure was reasonable and that the disclosures were appropriate.

The Controller function

3

3.1 The Controller function is an important part of the Auditor-General's work. It supports the fundamental principle of Parliamentary control over government expenditure.

3.2 The importance of this function is reinforced by the current increased levels of government spending for the Covid-19 response. Since March 2020, the Controller function has focused on Covid-related expenditure because of the significant funding available for responding to Covid-19 and the long-term implications of this expenditure.

3.3 Under the country's constitutional and legal system, the Government needs Parliament's approval to:

- make laws;
- impose taxes on people to raise public funds;
- borrow money; and
- spend public money.[2]

3.4 Parliament's approval to incur expenditure is mainly provided through appropriations,[3] which are authorised in advance through the annual Budget process and annual Acts of Parliament. When the Government wants to incur expenditure not yet authorised in an Appropriation Act, it can draw on the Parliamentary authority provided in an Imprest Supply Act. Expenditure can be authorised in advance through permanent legislation. Expenditure can also be validated retrospectively.

3.5 In 2019/20, the Government incurred a large amount of expenditure without Parliament's authority. It is disappointing that $725 million of the $915 million of unappropriated expenditure resulted from the improper management of expense transfers between years and other administrative errors. Government departments need to improve how they manage their expenditure within the authority provided by Parliament.

3.6 In this Part, we discuss:

- why the Controller work is important;
- how much public expenditure was unappropriated in 2019/20;
- whether Covid-19 affected the level of unappropriated expenditure;
- how 2019/20 compared with previous years; and
- the need for better management of expenditure requiring appropriation.

2 Section 22 of the Constitution Act 1986.

3 Appropriations are authorities from Parliament that specify what the Crown may incur expenditure on (specific areas of expenditure). Most appropriations specify limits in terms of the type of expenditure (the nature of the spending), scope (what the money can be used for), dollar amount (the maximum that can be spent), and period (the time frame for which the authority is given).

Why the Controller work is important

3.7 Appropriations ensure that Parliament, on behalf of the public, has adequate control over how the Government plans to spend public money. It also ensures that the Government can be held to account for how it has used that money.

3.8 Most of the Crown's funding is obtained through taxes. The public should expect assurance that the Government is spending public money as intended by Parliament.

3.9 As the Controller, the Auditor-General helps maintain the transparency and legitimacy of the public finance system. The Auditor-General provides an important check on the system on behalf of Parliament and the public by providing independent assurance that the Government's spending is within authority. The Auditor-General also provides assurance that any government spending without authority has been identified and dealt with appropriately. As an Officer of Parliament, the Auditor-General is independent of the Government.

3.10 In the Appendix, we explain how public expenditure is authorised, who is responsible for managing it, and the Controller's role in checking it.

How much public expenditure was unappropriated in 2019/20?

3.11 The Government's financial statements report 25 instances of unappropriated expenditure (2018/19: 17). Expenditure incurred above or beyond appropriation in 2019/20 was $915 million (2018/19: $206 million). Figure 4 shows a breakdown of unappropriated expenditure categories.[4]

Figure 4
Unappropriated expenditure incurred during the year ended 30 June 2020

Category	Unappropriated expenditure by category	2019/20 Number	2019/20 $million*	2019/20 Votes
A	Approved by the Minister of Finance under section 26B of the Public Finance Act 1989.	1	0	Attorney-General
B	With Cabinet authority to use imprest supply but in excess of appropriation prior to the end of the financial year.	2	15	Conservation; Revenue
C	With Cabinet authority to use imprest supply but without appropriation prior to the end of the financial year.	0	0	Not applicable

4 New Zealand Government (2020), *Financial Statements of the Government of New Zealand for the year ended 30 June 2020*, pages 148 to 156.

Category	Unappropriated expenditure by category	2019/20 Number	2019/20 $million*	2019/20 Votes
D	In excess of appropriation and without prior Cabinet authority to use imprest supply.	13	701	Arts, Culture and Heritage; Building and Construction; Customs; Conservation; Defence Force; Environment; Justice; Prime Minister and Cabinet; Revenue
E	Outside scope of an appropriation and without prior Cabinet authority to use imprest supply.	2	1	Arts, Culture and Heritage; Environment
F	Without appropriation and without prior Cabinet authority to use imprest supply.	7	198	Business, Science and Innovation; Corrections; Defence; Foreign Affairs; Housing and Urban Development; Prime Minister and Cabinet; Tertiary Education
	Total	**25**	**915**	

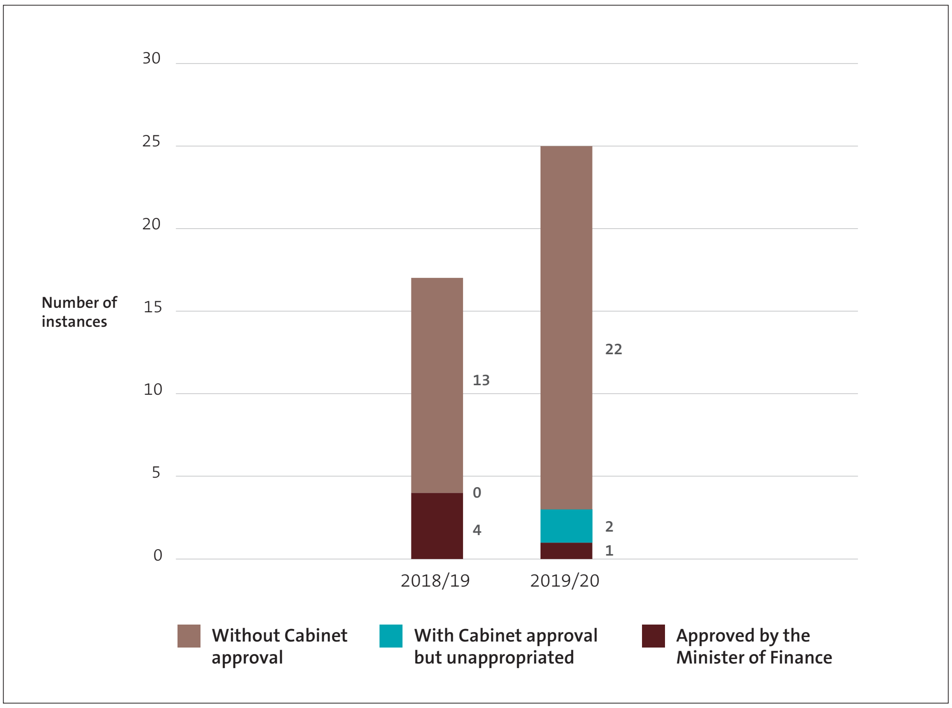
* Amounts are rounded to the nearest million. The amount in Category A was $449,000.

3.12 Unappropriated expenditure shown in Figure 4 was in three broad categories:

- **Approved by the Minister of Finance** (Category A): Small overruns of expenditure in the last three months of the financial year, which were within $10,000 or 2% of the appropriation, and were approved by the Minister of Finance under section 26B of the Public Finance Act.
- **With Cabinet approval** (Categories B and C): Expenditure incurred above or beyond the appropriation limits, with Cabinet authority to use imprest supply but not authorised by Parliament in an Appropriation Act before the end of the financial year.
- **Without prior Cabinet approval** (Categories D, E, and F): Expenditure incurred above or beyond the appropriation limits without any authority at the time it was incurred.

3.13 Figure 5 shows the number of instances of unappropriated expenditure for 2019/20 compared with 2018/19.

Figure 5
Number of instances of unappropriated expenditure for the year ended 30 June 2020



Some unappropriated expenditure is lawful (Category A)

3.14 Section 26B of the Public Finance Act provides some flexibility for small expenditure overruns in the last three months of the financial year when it is generally too late to have additional expenditure (incurred under imprest supply) in the Appropriation (Supplementary Estimates) Act. It allows the Minister of Finance to approve excess spending of up to the greater of $10,000 or 2% of the appropriation if it is incurred between April and June (inclusive).

3.15 Although unappropriated, authorisation under section 26B makes this expenditure lawful. It then remains to be "confirmed" (rather than "validated") in the next Appropriation (Confirmation and Validation) Act. There are usually no more than a few items approved by the Minister of Finance each year.

3.16 During 2019/20, the Minister of Finance authorised one instance of unappropriated expenditure of $449,000 (2018/19: four instances amounting to

$11 million). The Crown Law Office received approval to exceed its appropriation (under Vote Attorney-General) for legal advice. Activity increased more than anticipated due to the need to support the Government's response to Covid-19. Expenses exceeded the $23 million limit by $449,000.

Unappropriated expenditure incurred without Parliament's authority (Categories B-F)

3.17 Of the 25 instances of unappropriated expenditure in 2019/20, 24 were unlawful because the expenditure had not been authorised by an Act of Parliament (2018/19: 13 instances). This expenditure remains unappropriated and unlawful until it is validated by Parliament in an Appropriation Act, which is ordinarily enacted during May.[5]

3.18 The second Imprest Supply Act for the year provides interim authority for expenditure additional to that authorised in the Budget, within a specified spending limit. Expenditure under imprest supply must receive Cabinet approval before it is incurred. Because the authority is temporary, this expenditure must also be included in the Appropriation (Supplementary Estimates) Bill for the year in order to be appropriated before the end of the year, when the Bill is enacted. However, if such expenditure is not included in the Bill, then it is unappropriated and remains so until Parliament validates it.

3.19 In two of the 24 instances, government departments sought and received Cabinet's approval to increase their appropriations through the Supplementary Estimates[6] and to incur expenditure under imprest supply in the meantime (see Figure 5). Although they received Cabinet approval for the expenditure, the government departments did not submit the figures for the Supplementary Estimates Bill and so Parliament was unable to authorise the expenditure before the end of the financial year.

3.20 Most instances of unappropriated expenditure are incurred without any prior authority. In rare instances, these result from unseen events (for example, costs of immediate responses to natural disasters or other emergencies). But in most instances, these can be avoided with better planning and management.

3.21 The remaining 22 instances of unappropriated expenditure are those in which government departments incurred expenditure that was unauthorised by Parliament and not approved by Cabinet under the requirements for using imprest supply. This is a significant increase on non-Cabinet approved expenditure from the previous year (2018/19: 13 instances).

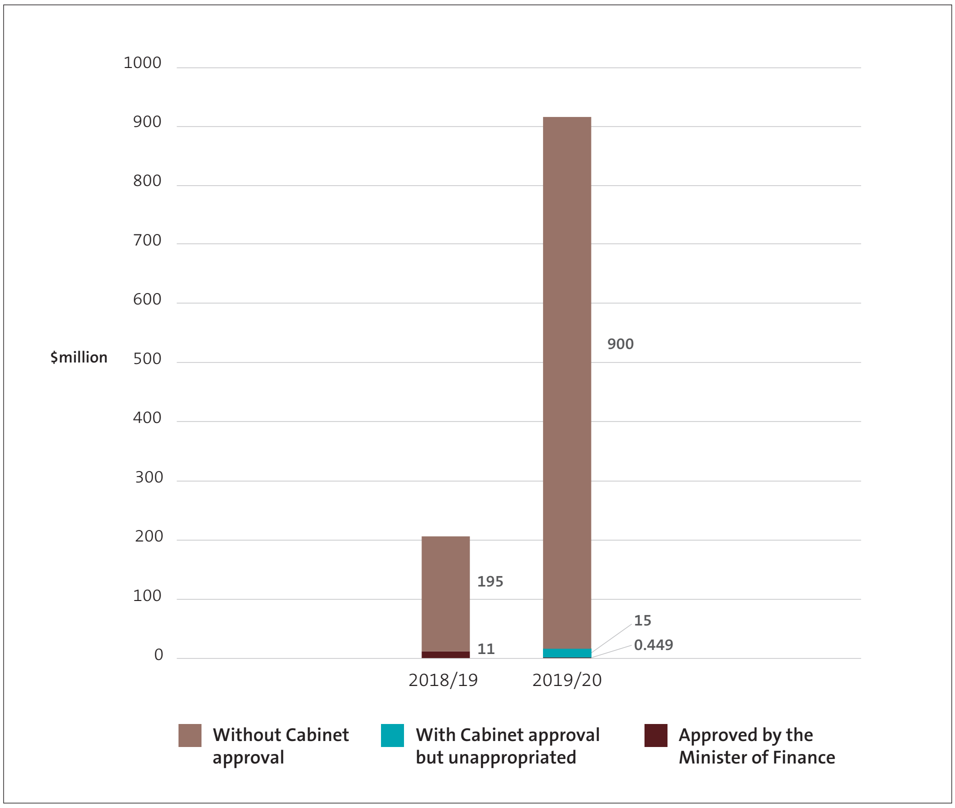
5 The Confirmation and Validation Bill to verify the unappropriated expenditure from 2019/20 is expected to be passed in May 2021.

6 The Appropriation (2019/20 Supplementary Estimates) Act was enacted in June 2020.

3.22 Although the number of occurrences of unappropriated expenditure increased by nearly 50% in 2019/20, the value of unappropriated expenditure more than quadrupled. In 2018/19, the value of unappropriated expenditure was $206 million. In 2019/20, it was $915 million.

3.23 Figure 6 compares the dollar amounts of unappropriated expenditure for 2018/19 and 2019/20. The amount of unappropriated expenditure incurred without prior Cabinet approval to use imprest supply increased from $195 million in 2018/19 to $900 million in 2019/20.

Figure 6
Amount of unappropriated expenditure incurred without prior Cabinet approval for the year ended 30 June 2020

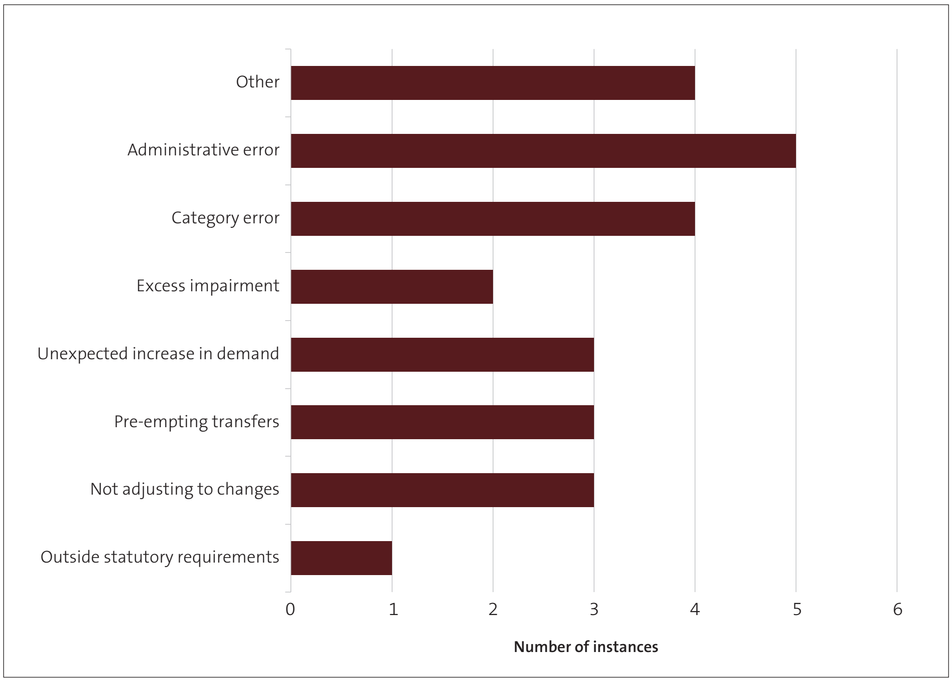


Why was the expenditure unappropriated?

3.24 From the explanations provided in the 2019/20 Government's financial statements, we have put the 25 instances into eight categories that describe why the unappropriated expenditure came about:

1. Expenditure was outside statutory requirements.
2. Not adjusting to changes (that is, the government department did not seek to increase its spending authority to adjust to changes in its operating environment).
3. Pre-empting transfers (that is, the government department incurred expenditure based on "in principle" funding transfers from the previous year before the transfers were confirmed and authorised).
4. An unexpected increase in demand for services.
5. Excess impairment expense for some assets (for example, loan write-downs).
6. Category error (that is, applying an incorrect appropriation category to the expenditure).
7. Administrative error.
8. Other.

Figure 7
Reasons for unappropriated expenditure in 2019/20, by number of instances



3.25 Figure 7 shows that the most common reason for unappropriated expenditure was because of administrative errors. The second most common reason was because the government department did not have the type of appropriation required to authorise the type of expenditure incurred (category error).

3.26 **Outside statutory requirements:** The Ministry for the Environment incurred expenditure outside statutory requirements. The Ministry pays territorial local authorities 50% of the value of the Waste Disposal Levy collected by the authorities to fund their waste management and minimisation plans. To be eligible for this funding from the Ministry, the territorial local authorities must review their plans according to statutory requirements (including time frames). The Ministry made payments to some territorial authorities that had not met some of the statutory requirements. Therefore, these payments, which amounted to $1.3 million, were unauthorised and unlawful.

3.27 **Not adjusting to changes:** In three cases, government departments did not ensure that their spending authority kept pace with increases in costs. The Department of Conservation had insufficient appropriation to cover increased rates costs for the year. The New Zealand Defence Force exceeded two appropriations: Veterans Support Entitlement costs were higher than forecast as were Assessment, Treatments, and Rehabilitation costs due to a change in accounting standards.

3.28 **Pre-empting transfers:** We have previously urged government departments to better manage the transfer of funding authority between years. In 2019/20, three government departments[7] received “in principle expense transfers” from 2018/19 but incurred $9.8 million of expenditure in anticipation of those transfers before they had been approved.

3.29 **Unexpected increase in demand:** Crown Law (see paragraph 3.46), the Ministry for the Environment, and the Department of the Prime Minister and Cabinet (DPMC) (see paragraph 3.47) all experienced an unexpected increase in demand for services, which led to unappropriated expenditure.

3.30 **Excess impairment:** Impairment to the book value of the National War Memorial resulted in an expense that exceeded the Ministry for Culture and Heritage’s appropriation for the depreciation of Crown-owned assets. An actuarial valuation of legal aid debt resulted in an impairment expense that exceeded the Ministry of Justice’s appropriation for it.

3.31 **Category error:** Four government departments incurred unappropriated expenditure because they did not have the right type of appropriation to authorise the expenditure. The government departments were the Ministry of Housing and Urban Development (see paragraph 3.40), Ministry of Foreign Affairs

7 The three departments were the Ministry of Business, Innovation and Employment; the Department of Corrections; and the New Zealand Customs Service.

and Trade (see paragraph 3.49), Ministry for Culture and Heritage (see paragraph 3.50), and Ministry of Defence (see paragraph 3.52).

3.32 **Administrative error:** Three government departments were responsible for five instances of unappropriated expenditure as a result of administrative error when seeking additional authority from Cabinet and, subsequently, Parliament. The government departments included Inland Revenue (see paragraphs 3.35 and 3.39) and DPMC (see paragraph 3.38). Most of the unappropriated expenditure for 2019/20 ($715.7 million) came about through such errors.

3.33 **Other** reasons for unappropriated expenditure include:

- an unavoidable $151.8 million expense to the Crown resulting from a constructive obligation to decommission the Tui Oil Field (see paragraph 3.36);
- excess maintenance costs for the seismic strengthening of the National War Memorial's Carillon Tower ($6.7 million under Vote Arts, Culture and Heritage);
- the cost of facilitating asset transfers as part of a Treaty of Waitangi settlement, which exceeded appropriation by $2 million under Vote Conservation; and
- work needed under the Management of Historic Heritage appropriation (also through Vote Conservation) resulted in excess expenditure of $344,000.

Five instances account for almost all unappropriated expenditure

Two instances account for 90% of the unappropriated expenditure

3.34 Two instances make up 90% of the unappropriated expenditure:

- Inland Revenue's impairment of debt and debt write-offs ($676.8 million); and
- the costs to the Ministry of Business, Innovation and Employment of decommissioning the Tui Oil Field ($151.8 million).

3.35 As a result of Covid-19's effect on the economy, Inland Revenue increased the amount of taxpayer debt written off and further impaired the value of taxpayer debt. It sought and gained Cabinet's approval to increase the relevant appropriation to cover the expense but, in an administrative oversight, did not seek Cabinet's express approval to use imprest supply in the meantime. Impairments and write-offs totalling $1,356.8 million were therefore incurred against an authority of $680 million, resulting in $676.8 million in unappropriated expenditure.

3.36 In late December 2019, Tamarind Taranaki Limited was placed in liquidation. This company was the operator of the Tui Oil Field, off the coast of Taranaki. It is usual for the operator to carry the liability to decommission an oil field in a way that ensures no harm to the marine and coastal environment. However, with the company liquidated, a constructive obligation for decommissioning the oil field fell to the Crown. The obligation created an immediate expense to the Crown, which, because this was an unanticipated event, was not authorised in advance through an appropriation. Although Cabinet approved a new appropriation in February 2020 under Vote Business, Science and Innovation for oil field decommissioning, the estimated decommissioning cost of $151.8 million had been incurred in December 2019 without appropriation.

Other items of unappropriated expenditure

3.37 Three instances make up 5% of the unappropriated expenditure:

- The Government's "Unite Against Covid-19" media campaign ($18 million).
- Inland Revenue's write-down of the value of student loans ($15.1 million).
- Expenditure for deferred payments for land sales administered by the Ministry of Housing and Urban Development ($14.8 million).

3.38 In response to Covid-19, DPMC established an all-of-government response co-ordination team. This team was responsible for leading the "Unite Against Covid-19" publicity campaign. Cabinet had approved the expenditure, but an administrative oversight meant that DPMC did not have an appropriation that would authorise the expenditure. As a result, the $18 million spent on the campaign in 2019/20 was unappropriated.

3.39 When the Crown provides loans, they must be recorded in the financial statements at their "fair value". This often means that the initial carrying amount of the loan asset needs to be written down to its fair value, with the amount of write-down constituting an impairment expense. For Covid-19, Inland Revenue knew that it would need to increase the write-downs for student loans. It secured Cabinet's approval to increase the appropriation that authorises the impairment expense. Although the increase in expenses was initially authorised under imprest supply, it was not included in the Appropriation (Supplementary Estimates) Bill and therefore was not appropriated by Parliament before the end of the financial year. This resulted in an unappropriated expense of $15.1 million.

3.40 When the Ministry of Housing and Urban Development (HUD) sold land on behalf of the Crown to developers under the Land for Housing Programme, it offered them deferred settlement terms of up to 360 days from the date of the title transfer. HUD considered it had an operating expenditure appropriation to authorise this activity. The developers are a type of trade debtor to the Crown, and the Ministry considered it was extending a form of trade credit to the purchasers. Under the Public Finance Act, trade credit can be extended for up to 90 days, but a deferred settlement for a longer period constitutes a loan. This loan requires the Minister of Finance's approval, and the expenditure must be authorised under a capital expenditure appropriation. Although HUD had the necessary approval from the Minister of Finance, its Vote had appropriations only for operating expenditure. Because the Vote did not include a capital expenditure appropriation for the lending, it resulted in $14.8 million of capital expenditure being unappropriated in 2019/20.

3.41 The amount of unappropriated expenditure in 2019/20 ($915 million) is historically high (see paragraph 3.54 and Figure 9). However, about 95% of the unappropriated expenditure (in the five cases mentioned above) resulted from:

- the cost to the Crown of an unavoidable constructive obligation;
- a misunderstanding about the appropriation category required; and
- administrative errors (that is, errors in the paperwork supporting the approval of the expenditure).

3.42 In some of those cases more careful management was needed.

Did Covid-19 affect the level of unappropriated expenditure?

The Government's Covid-19 response

3.43 We have been monitoring the expenditure authorised and incurred as part of the Government's response to Covid-19. During 2020, we published regular Controller updates (and other reports related to Covid-19) on our website. We consider it necessary to focus on Covid-related expenditure, given the substantial funding available for responding to Covid-19, the long-term implications for government debt, the speed of the Government's emergency response, and the extraordinary conditions under which the public sector has operated, particularly in the early stages of the Covid-19 lockdown.

3.44 Based on data received from the Treasury earlier in 2020, we determined that Cabinet approved about $26 billion for new appropriations created exclusively for the Covid-19 response and, of that, an estimated $15 billion was incurred by 30 June 2020. About $3.3 billion was authorised to top up existing appropriations to help with the Covid-19 response.

3.45 In our view, little of the unappropriated expenditure in 2019/20 was related to the Government's Covid-19 response. According to our analysis, five of the 25 instances of unappropriated expenditure related to the Covid-19 response, constituting $24.5 million of the $915 million unappropriated.

3.46 The increased demand for legal advice in response to Covid-19 in the last quarter of the financial year led to Crown Law exceeding its Legal Advice and Representation appropriation by $449,000. The Minister of Finance authorised this unappropriated expenditure under section 26B of the Public Finance Act.

3.47 In another instance of increased demand, the Government established a $25 million appropriation for 2019/20 to support local authorities and Civil Defence Emergency Management groups for costs they incurred in providing urgent community support. Support payments exceeded the appropriation in Vote Prime Minister and Cabinet by $3.8 million.

3.48 In two instances, expenditure on the Covid-19 response was applied as intended but the appropriations that were presumed to provide authority for the expenditure were the wrong category of appropriation.

3.49 The Ministry of Foreign Affairs and Trade (MFAT) has for many years provided financial assistance by advancing money to New Zealanders in distress overseas. The terms of the advances have required them to be repaid promptly, usually within 30 days. This activity increased considerably in 2019/20 to help New Zealanders stuck overseas because of Covid-19. The advances were charged against MFAT's "Consular Services" expense appropriation but, because of the repayment terms, they constituted short-term loans, which instead required a capital expenditure authority. There was no non-departmental capital expenditure appropriation in Vote Foreign Affairs to cover the loans and, therefore, the expenditure of nearly $2.2 million was unappropriated. After realising the problem, MFAT immediately arranged for Cabinet to establish the required appropriation and an additional appropriation for expenses, such as foregone interest and any loan write-offs.

3.50 During 2019/20, in response to the economic effects of Covid-19, the Government decided to pay local media businesses in advance to run advertisements in 2020/21. However, because the advanced payments were interest free, they needed to be accounted for as concessionary loans. As a result, the carrying value of the loans had to be written down to reflect their fair value. The Ministry for Culture and Heritage charged the expense ($121,000) against the Grants and Subsidies appropriation, the scope of which does not authorise this type of expense.

3.51 The fifth, and largest, instance of unappropriated expenditure because of Covid-19 was the $18 million of expenditure for the "Unite Against Covid-19" publicity campaign. This was unappropriated because of an administrative error.

Consequences of Covid-19

3.52 As well as the five instances where the response to Covid-19 resulted in unappropriated expenditure, we have identified three instances related indirectly to the effect of Covid-19 on the economy and society:

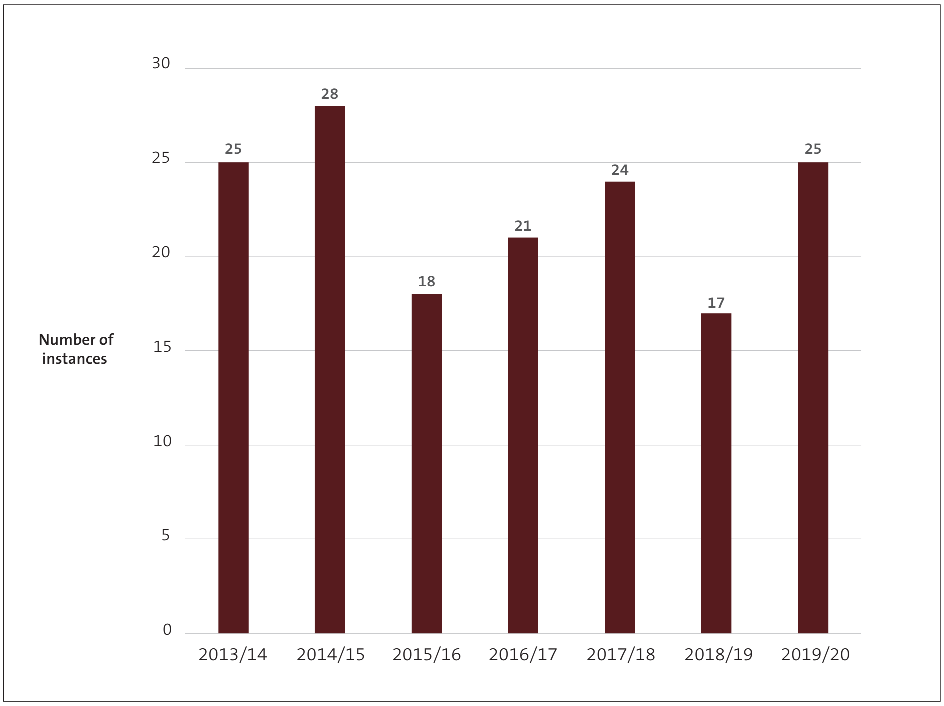
- During the lockdown, the Ministry of Defence had to compensate a construction contracting firm that was unable to work. The normal construction costs were, as expected, authorised under a capital expenditure appropriation. However, the compensation costs ($1.4 million) could not be capitalised, and the Ministry had no operating expense appropriation to cover this sort of abnormal expenditure caused by the response to Covid-19.

- The other two instances relate to the economic effect of Covid-19 on the value of the Crown debtors. Inland Revenue needed to reduce the book value of debt owed to the Crown (that is, increase the expense of impairing the book value) for tax debt and student loans. Administrative oversights resulted in $692 million of unappropriated expenditure (see paragraphs 3.35 and 3.39).

How does 2019/20 compare with previous years?

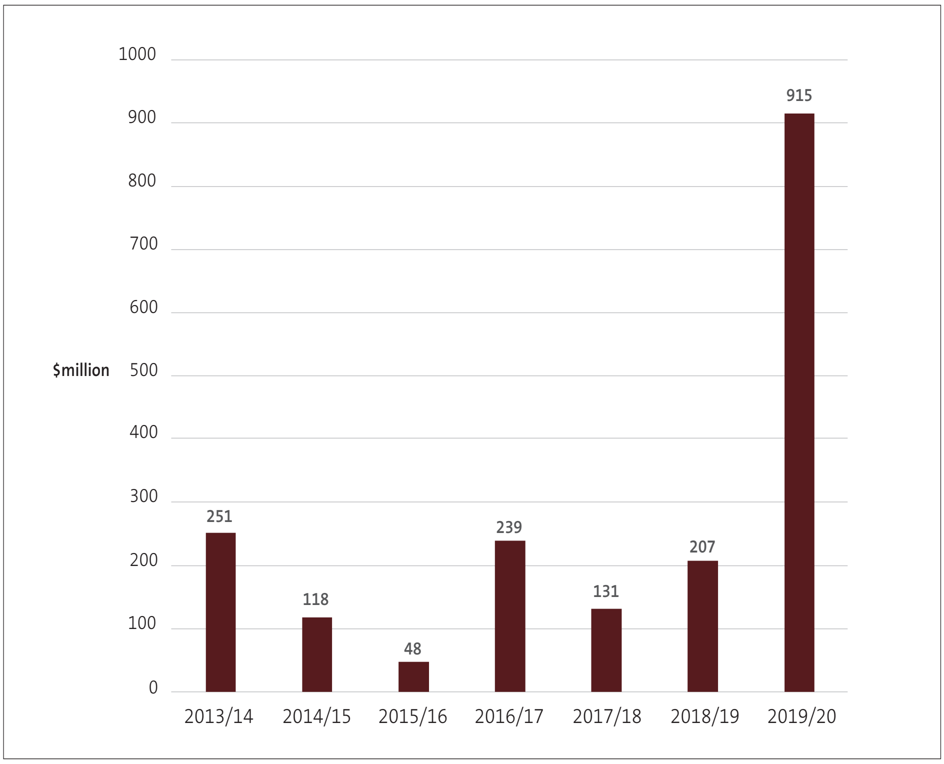
3.53 Figure 8 shows that the frequency of instances of unappropriated expenditure had fluctuated during the last seven years. Since 2014/15, when there was a peak of 28 cases of unappropriated expenditure, there have been notably fewer instances until the 25 cases in 2019/20.

Figure 8
Number of instances of unappropriated expenditure, from 2013/14 to 2019/20



3.54 Figure 9 shows the dollar amount of unappropriated expenditure incurred during the last seven years.

Figure 9
Amount of unappropriated expenditure, from 2013/14 to 2019/20



Better management is needed

3.55 When the Government wishes to incur expenditure not yet authorised in an Appropriation Act, it can use Parliamentary authority provided in an Imprest Supply Act. Whereas Appropriation Acts specify public expenditure by way of the limits attached to appropriations, Imprest Supply Acts do not include these limits.

3.56 Recently, the amount of public expenditure Parliament has authorised through Imprest Supply Acts has increased considerably. In 2018/19, the second Imprest Supply Act[8] authorised up to $16.3 billion. In 2019/20, the second Imprest Supply Act authorised up to $17.3 billion, which was boosted by a further $52 billion through a third Imprest Supply Act in March 2020. This was mainly in response to Covid-19. For 2020/21, Parliament has authorised $56.5 billion under the second Imprest Supply Act.

8 We have not referred to the first Imprest Supply Acts for each year because those Acts are primarily to enable the Government to incur expenditure in lieu of Budget legislation being enacted.

3.57 Expenditure incurred under imprest supply is authorised by Parliament after the fact, in the Appropriation (Supplementary Estimates) Bill, which is normally passed each June. The expenditure is reported to Parliament as a *fait accompli* and receives only limited attention. As such, with imprest supply Parliament has given the Government considerable scope to incur large sums of expenditure without prior scrutiny or specification.

3.58 In return for this freedom, we expect government departments to manage their expenditure in strict accordance with Cabinet's rules. It is therefore disappointing that $725 million of the $915 million of unappropriated expenditure resulted from not adhering to the requirements for managing expenditure under imprest supply.

4 Improving government performance reporting

4.1 In this Part, we set out our observations about performance reporting across government.

4.2 Performance reporting is fundamental to building and maintaining trust and confidence in the public sector. Each year, government departments and Crown entities in central government are required, under the Public Finance Act and the Crown Entities Act 2004, to report on their performance through preparing and presenting an annual report to Parliament.

4.3 An annual report is important for Parliament and the public to hold government departments and Crown entities to account.

4.4 An annual report is required to report on financial performance as well as end-of-year service performance reporting against the public organisation's annual performance objectives. It also includes progress against the public organisation's strategic intentions and financial management responsibilities.

4.5 As part of the annual audit, we are required to audit the financial statements and end-of-year service performance reporting.

4.6 Effective performance reporting should fairly reflect the underlying performance of public organisations and, when considered in aggregate, the public sector more generally. It should be timely, relevant, meaningful, and enable Parliament and the public to make an informed assessment of performance.

4.7 The Government's response to Covid-19, including the significant increase in spending, has further increased the importance of building and maintaining trust in how effectively the Government is spending and how it needs to engage with the public to support effective public accountability.

4.8 Although there are instances of good performance reporting throughout the public sector, there are, in our view, considerable opportunities to improve.

Reporting at an all-of-government level

4.9 In June 2020, the Public Finance Act was amended to introduce requirements that the Government set out its well-being objectives on an annual basis to guide its Budget decisions. The amendment also required the Treasury to periodically report on well-being.

4.10 Our submission on this amendment noted that there should be cohesive and comprehensive reporting to Parliament and the public on how the Government is performing and progressing against its well-being goals, which should be independently assured.

4.11 If this reporting and other service performance reporting was presented in conjunction with the reporting on the Government's financial statements, this would tell a richer, more comprehensive, and more cohesive story of what the public receives from government spending. It would provide a basis for Parliament and the public to understand the services being provided and the impacts and outcomes the Government is achieving.

Reporting for initiatives that involve multiple organisations

4.12 When auditing government initiatives that involve multiple public organisations working together, we often find that their reporting approach is siloed and focused on the activities and spending of individual organisations.

4.13 For example, our audits of Whānau Ora and the Provincial Growth Fund (noting the range of organisations involved) found that the reporting did not, from the start, provide an adequate overview of the initiative as a whole or what was achieved with that money.

4.14 We recommend more cohesive and comprehensive reporting for these types of cross-organisation initiatives. Requirements for this reporting should be included when new initiatives are established. This would enable more effective accountability to Parliament and the public.

4.15 The Public Service Act and the amendments to the Public Finance Act enable the formal establishment of "specified agencies" such as interdepartmental ventures and interdepartmental boards to support more joined-up services and reporting throughout the public sector. We remain interested in seeing how accountability and reporting processes for these new types of public sector agencies will be established.

Reporting at an organisation level

4.16 Our annual audits have found that public organisations' reporting on progress against strategic and annual performance objectives and financial management responsibilities generally comply with legislative requirements.

4.17 Public organisations generally use performance frameworks as the basis for telling their performance story. They have tried different measures and approaches to how they can provide overviews of their performance and what they have achieved.

4.18 Although there are challenges inherent in good performance reporting, we consider that substantive improvements are still needed.

4.19 Currently, the reporting focuses too heavily on reporting plans, activities, and services without any clear account of how those activities result in value for money and make a difference to the lives of New Zealanders. There should also be a better connection between the financial and non-financial reporting.

4.20 We also observed many instances of highly technical reporting and measures that few members of the public would likely understand. Performance reporting that is not relevant or understandable to most people has little value.

4.21 The public sector's reporting needs to connect with the public better. Engaging with the public should be a fundamental part of what the public sector does. Public organisations should consider this when they report on their performance.

4.22 Performance reporting needs to be presented in a timely and accessible way that Parliament and the public can understand.

4.23 Many annual reports still do not provide cohesive and comprehensive performance reporting. The reporting is often fragmented and does not clearly connect to the public organisation's strategic objectives, annual performance objectives, and use of public money.

4.24 The public is not only the recipient of public services, but it also has a long-term interest in other matters such as outcomes, risk management, integrity, and the prudent use of public resources. As a result, the public expects to see information about how well public organisations are managing their operations, and resources, to meet challenges of today and in the future.

4.25 As well as maintaining its strengths in financial reporting and accountability, the public sector needs to improve how it accounts for its performance. This presents both an enormous challenge and opportunity.

Starting the change process

4.26 Significant improvement is needed if Parliament and the public are to fully understand and scrutinise public sector performance and, in particular, the stewardship of the many complex, long-term, and intractable problems facing New Zealand.

4.27 Meeting this challenge needs to start with making performance reporting matter.

4.28 During the past 30 years, the public sector has established a robust and transparent financial management system. There needs to be the same focus and effort on how the public sector reports on, and is held accountable for, its performance.

4.29 Performance reporting cannot be seen as a compliance exercise or secondary to financial reporting. It should be properly integrated into how the public sector reports on its spending and enable the public to have confidence that it is receiving value for money.

4.30 This will need clear and co-ordinated leadership. Legislation, standards, and guidance, as well as our approach to providing assurance, will need to provide the right frameworks, incentives, and capability to improve performance and effective public accountability. There needs to be a clear focus on meeting the expectations and needs of Parliament and the public.

4.31 What the public expects of the Government is evolving. This will likely require developing a richer understanding of how the public sector considers performance, what public value it provides, and how it provides that value.

4.32 Doing more of the same will not likely achieve the improvement needed. The public sector will need to consider more innovative approaches to how it reports on its performance.

4.33 We have started seeing promising innovations in the public sector, such as online and integrated reporting, that aim to address some of the issues that we have identified.

4.34 It will be important for us to learn from these innovations and what is happening in other countries. My Office will continue to review how performance reporting is evolving across the public sector.

4.35 Covid-19 has been a catalyst for change in many parts of our society. The Government is also pursuing a change agenda in the public sector more generally. Placing accountability to Parliament and the public as a key element of these reforms will be critical for building and maintaining trust and confidence in government and in helping to address the many challenges that will emerge as a result of Covid-19.

Appendix
How appropriations work

Who approves the spending of public money and how?

Each year, the Government puts forward its spending proposals for the coming financial year in the Budget (usually in May). It formally presents its proposed Budget to Parliament in the Appropriation (Estimates) Bill, along with various explanatory documents. This is the first appropriation Bill for the financial year.

The Bill sets out estimates of what will be spent under each ministerial portfolio. In general, every ministerial portfolio associated with a department has a corresponding "Vote" in the Budget (for example, Vote Health sets out all the spending in the health portfolio). Each Vote is made up of several specific appropriations. Each appropriation sets out:

- the maximum amount of spending being approved;
- the scope (that is, what the money can be used for); and
- the date on which the appropriation lapses (most appropriations last for one year).

Once Parliament has considered and passed the Bill, it becomes law as an Act. In general, any spending outside what has been approved in this Act of Parliament will be unlawful.

The Budget generally does not become law until several weeks into the financial year.

If the Appropriation (Estimates) Bill is not passed before the financial year begins, how can the Government spend money lawfully in the meantime?

The Appropriation (Estimates) Bill needs to be passed within four months of Budget Day. From 1 July until the Bill becomes law, the Government must continue to operate and spend public money. To cover this period, interim authority is provided through an Imprest Supply Act, which is enacted before the financial year begins. The first annual Imprest Supply Act therefore allows the Government to incur expenditure before the Budget for that year is enacted in legislation. The spending authority under this Imprest Supply Act is repealed when the Appropriation (Estimates) Act comes into force.

There are usually at least two Imprest Supply Acts in a financial year.

What happens if things change during the year?

The changing nature of government activities and unexpected demands means that it is rarely possible to foresee all future expenses and capital expenditure. The system recognises the need for some flexibility to respond to changing events.

A second Imprest Supply Act for the year is enacted, usually at the same time as the Appropriation (Estimates) Act. This provides authority for spending that might not have been envisaged when the Budget estimates were finalised. It remains in force until the end of the financial year to provide authority for unexpected spending. Mainly to authorise expenditure for the Government's Covid-19 response, 2019/20 was an exception because Parliament passed a third Imprest Supply Act in March 2020.

Cabinet requires that any use of imprest supply must be authorised by a specific Cabinet decision (or, in some instances, by approval of joint ministers under delegation from Cabinet). But Imprest Supply Acts provide only "interim" authority. To remain lawful, all expenditure incurred under an Imprest Supply Act must be approved by Parliament under an Appropriation Act passed before the end of the financial year. Expenditure under the second Imprest Supply Act is typically appropriated through a second appropriation Bill, the Appropriation (Supplementary Estimates) Bill, which is usually enacted in June. This Bill allows the Government to update the initial estimates in the Budget and get legislative approval for those changes (which include expenditure already incurred under imprest supply).

If expenditure under the authority of an Imprest Supply Act is incurred too late in the financial year to be authorised through the Appropriation (Supplementary Estimates) Bill, then at 30 June it becomes "unappropriated expenditure". It must be validated by Parliament through a third appropriation Bill, the Appropriation (Confirmation and Validation) Bill, in the next financial year.[9]

The Public Finance Act includes several other mechanisms for approving minor changes to the spending authorities approved by Parliament. For example, there is limited scope for the Governor-General to approve, by Order in Council, transfers between appropriations in a Vote.[10] To provide further flexibility during the final three months of the year, the Public Finance Act authorises the Minister of Finance to approve a limited amount of extra spending within the scope of an existing appropriation.[11] Flexibility under these mechanisms is subject to confirmation by Parliament through the Appropriation (Confirmation and Validation) Bill.

9 Section 26C of the Public Finance Act. The Appropriation (Confirmation and Validation) Bill, which is introduced after the end of the financial year, allows Parliament to retrospectively confirm or validate all unappropriated expenditure incurred during the year.

10 Section 26A of the Public Finance Act.

11 Section 26B of the Public Finance Act.

Sections 25 and 25A of the Public Finance Act also authorise the Government to spend public money outside appropriations in emergency situations, subject to confirmation by Parliament through the Appropriation (Confirmation and Validation) Bill.

Does that mean any spending outside the revised Budget (Supplementary Estimates) is unlawful?

Such expenditure can be unlawful, but not always. It could still be lawful if it is covered by some other authority – for example, a relevant section in the Public Finance Act or by another Act of Parliament. However, expenditure incurred under Cabinet authority to use imprest supply, but not included in an Appropriation Act at the end of the financial year, becomes unappropriated and remains unlawful until it is validated by Parliament.

Does the Auditor-General have a role in the Budget process?

No. The Government prepares the Budget. The Minister of Finance and the Treasury co-ordinate the work of the various government departments and individual Ministers to put together a set of spending proposals for the Government as a whole. The Auditor-General is not part of the Government nor are they answerable to Ministers, and so has no role in this process.[12] The Auditor-General does not audit the Budget.

Once the Government has presented its proposed Budget to Parliament, individual select committees consider the proposals in the various Votes. The Auditor-General's staff provide advice to the select committees to assist their scrutiny of the spending proposals in the Budget estimates.

Parliament then votes on whether to pass the Appropriation (Estimates) Bill. Votes on Budget and spending matters are automatically regarded as confidence matters. That means that, if a Government cannot persuade a majority of Parliament to support its spending plans, then it does not have enough support to continue as the Government.

Who spends the money and how?

All public money must be held in a Crown or departmental bank account. The Treasury is responsible for managing Crown bank accounts unless it delegates responsibility to a department to operate as an agent of the Crown. Government departments are responsible for managing departmental bank accounts.

12 There is a special process for working out the budget for Officers of Parliament (such as the Auditor-General) to ensure that the funding decisions are made by Parliament and not the Government. The Auditor-General is involved in this process in their capacity as the chief executive of their own Office.

Each department forecasts its cash requirements based on its budget and agrees cash payment schedules with the Treasury. The Treasury is responsible for disbursing cash to government departments during the year in keeping with those schedules. Responsibility for how that cash is applied rests with the government departments' chief executives.

The government departments are responsible for paying non-departmental providers (for example, Crown entities funded from their Votes) and for their own departmental spending.

The public financial management system operates on an "accrual" rather than a cash basis of accounting. This means that expenditure is accounted for when it is incurred (that is, when there is an obligation to pay), as opposed to when the payment is made. To keep within Budget limits, government departments need to manage expenditure on an "accrual" basis.

Who is responsible for ensuring that public money is spent correctly?

Departmental chief executives are responsible under the Public Finance Act for the financial management and performance of their department. This includes ensuring that they have both the funding authority and the necessary legal mandate before incurring expenses or capital expenditure.[13]

Government departments are required to report regularly to the Treasury on the expenses and capital expenditure incurred by the department against the appropriation or other statutory authority provided. The first report for the financial year is provided in October (covering the previous July to September period) and then monthly after that. This and other financial information is used to compile the monthly financial statements of the Government.

The Treasury is also required to report to the Controller all expenditure incurred compared with the appropriation (or other authority) and all expenditure incurred without authority or in excess of the authority given. This is carried out monthly, beginning in October each year, in co-ordination with the requirements in the paragraph above.

13 Section 34(1)(a) of the Public Finance Act.

Who checks whether government departments are spending money lawfully and within authority?

This is where the role of the Controller comes in. To check and verify the spending, the Auditor-General's Controller team:

- reviews the Treasury's monthly reports;
- carries out tests on the financial information (provided by the Treasury from the Crown Financial Information System);
- checks that Cabinet's authority for changes to budgets are correctly applied;
- reports back to the Treasury highlighting any issues (including unappropriated expenditure), comments on actions needed to confirm or validate any unappropriated expenditure, and advises on any further action that the Treasury or the department needs to take to resolve outstanding issues; and
- confers with the relevant auditors about issues affecting the government departments they audit.

As well as auditing government departments' financial statements, the Auditor-General is responsible for auditing the appropriations administered by each department (the appropriation audit).

Through the appropriation audit of each department, our auditors look at systems and some transactions to check that public money was spent as Parliament intended. If an appointed auditor detects spending outside authority through the appropriation audit work, then the auditor will discuss the matter with the government department, advise the department about reporting the matter and taking corrective action, and inform the Controller. The appointed auditor will also check whether the department properly reports the matter in its financial statements.

Expenditure above or beyond the appropriation limits

The public finance system provides some flexibility to how public expenditure is authorised. This is necessary to:

- allow the Government to incur expenditure not covered at the time by Appropriation Acts, including to allow for unanticipated expenditure during the year as circumstances change (through imprest supply);
- allow for immediate expenditure in declared emergencies (sections 25 and 25A of the Public Finance Act); and
- provide for the approval of relatively small amounts of expenditure in excess of appropriation without needing approval from Parliament (sections 26A and 26B of the Public Finance Act).

However, in general, when government departments do not get approval for expenditure before it is incurred, it is unlawful. Expenditure approved by Cabinet under imprest supply will also be unlawful if Parliament has not appropriated it before the end of the financial year.

We have urged government departments to seek early approval as soon as they have identified the need for previously unanticipated expenditure, so that any expenditure over and above that authorised in an Appropriation (Estimates) Act can be authorised by Cabinet before the event and subsequently authorised by Parliament in an Appropriation (Supplementary Estimates) Act.

Ministers need to report unappropriated expenditure to Parliament and, for that spending to be lawful, must seek Parliament's retrospective approval of unappropriated expenditure through an Appropriation (Confirmation and Validation) Bill.

Expenditure outside the bounds of the appropriations tends to be relatively small, although in 2019/20 it was more than four times higher than the previous year. Unappropriated expenditure of $915 million for 2019/20 was 0.60% of the Government's final budgeted amount, compared with 0.19% in 2018/19. The increase in the value of unappropriated expenditure in 2019/20 can be attributed to a small number of items and is largely due to errors in the administration supporting the approval of the expenditure.

How does the Controller deal with expenditure incurred outside appropriation limits?

When government departments become aware of potentially unappropriated expenditure, they are expected to immediately tell their appointed auditor, the Treasury, and their Responsible aMinister (who will need to seek additional authority for the expenditure). The department should provide the Treasury with an explanation of the issue as well as an explanation of actions taken to resolve it, for example, to gain additional authority in advance to avoid unappropriated expenditure or to seek validation of any already unappropriated expenditure through an Appropriation (Confirmation and Validation) Act.

Auditors might detect potentially unappropriated expenditure through their audit process, as might the Treasury through its financial management and budgeting work. After collating information from government departments each month, the Treasury provides its monthly report to the Controller highlighting actual, expected, and potentially unappropriated expenditure. The Controller then carries out the work we described in Part 3.

The Controller monitors all matters that come to their attention until they are resolved and will often, through their auditors, advise government departments on any corrective action required. For expenditure that is confirmed as being unappropriated, corrective action includes disclosing the facts in the affected departments' annual financial statements (and the Government's financial statements). After the end of the financial year, the Auditor-General audits the departments' and the Government's financial statements to ensure that all unappropriated expenditure is correctly disclosed.

If a government department does not take the action required to prevent continuing unauthorised spending, then the Controller can write to the department's chief executive or the relevant Minister directing that no further expenditure can be incurred under the affected appropriation until approval has been obtained.

If the government department still fails to obtain the correct approval, then the Controller can direct the Minister, the Treasury, and the department to stop payments from the relevant bank account and direct the Minister to report to the House of Representatives. This would be an unusual sanction and used only in exceptional circumstances.[14]

14 Sections 65Z and 65ZA of the Public Finance Act.

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