CONTROLLER AND AUDITOR-GENERAL
Tumuaki o te Mana Arotake

B.29[22h]

Observations from our central government audits: 2021/22

Photo acknowledgement:
Lynley Jenkins

Observations from our central government audits: 2021/22

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

December 2022

Contents

Auditor-General's overview

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

The public's trust in government depends on its demonstration of competency, reliability, and honesty in its use of public money and resources. To help the public sector maintain an informed, trusting, and enduring connection with the public it serves, Parliament and the public need to understand what government is seeking to achieve, what is being spent, and what progress is being made.

As I have raised several times this year, I am concerned that the way public organisations report on their spending and performance has limited relevance to an increasingly diverse, dynamic, and connected society and does not answer the questions in which Parliament and the public are most interested. Others, including the Parliamentary Commissioner for the Environment and the Productivity Commission, have raised similar concerns.

A government's goals are often broad and long term. They frequently require a range of different organisations to work together. Current public sector reporting focuses almost entirely on the reporting of individual public organisations. Although improvements are still needed at this level, even more improvements are needed at the whole-of-government level and for reporting on major initiatives or funds, whether these are carried out by individual organisations or jointly.

We simply are not getting the information that allows us to understand the performance of the government at multiple levels or that enables Parliament and the public to hold government to account for that performance.

In my view, this type of improved public accountability should sit alongside improved performance as the driver for public sector reform. Without accountability to Parliament and the public being at the centre of reform and change, we risk a loss of trust in New Zealand's system of public management and in the public sector more generally.

I am therefore pleased that over the past year there has been some progress on improved system-level reporting and accountability. This includes the Treasury's revised reporting on Covid-19 expenditure through the Covid Response and Recovery Fund and the steps now being taken to improve reporting on climate change initiatives through the Climate Emergency Response Fund.

I also acknowledge efforts to improve cross-agency collaboration on complex, often long-standing, issues through new arrangements like interdepartmental executive boards. However, although these boards may make it easier for government agencies to work together, it is too often left for Parliament and the public to try to piece together information to answer questions of public accountability and to understand what has been spent and what has been achieved. This is because it is very difficult to do so from the information currently reported publicly.

Public accountability should not be an afterthought. There are times when the public sector responds well to the accountability requirements of Parliament. However, without legislative change to mandate better reporting, the risk remains of reporting not meeting the needs of Parliament and the public.

Recent reform of public service legislation enables public agencies to work in new ways. In my view, reform is now required of the Public Finance Act to ensure that the public sector meets the accountability requirements of a 21st century New Zealand. This will not be a small task, but given the importance of public trust in government, it is, in my view, both an urgent and a critical one.

Central government audits

My central government audits involve about 450 public organisations, including government departments, Crown entities, State-owned enterprises, and a range of others.

The most significant central government audit is my audit of the *Financial Statements of the Government of New Zealand for the Year Ended 30 June 2022* (the Government's financial statements). On 30 September 2022, I issued my audit report on these financial statements, which included an unmodified opinion and described several key audit matters arising during the audit. There were two audit matters I note in particular:

- The first is that the provision for employee entitlements in the Government's financial statements includes $2.1 billion for amounts owing to employees who have been paid less than their legal entitlements under the Holidays Act 2003. By way of comparison, this is more than twice the $800 million announced in Budget 2022 for the cost of living payment. It concerns me that thousands of public sector employees have been underpaid over many years and continue to be wrongly paid when on annual leave. This is both an ethical and a financial issue. It requires strong central agency leadership to ensure that it is resolved.
- The second is reporting on the Government's climate change commitments, which could have significant financial implications. I was pleased to see additional disclosure included in the Government's financial statements this year, as well as the separate note disclosures about the Emissions Trading Scheme. However, strong system leadership will also be needed to help the

Government and public organisations to use consistent and appropriate financial, service performance, and other reporting practices in what is an evolving area.

Through my Controller work, I provide assurance about whether public expenditure is within the authority provided by Parliament. Where it is not, it needs to be reported to Parliament and dealt with appropriately. I am pleased to note that the Government's financial statements report a historically low number of instances of unappropriated expenditure for 2021/22 (12 instances). This marks a continuation of the historical low reported for 2020/21.

Errors continue to be made that result in unappropriated expenditure. For the most part, the errors are inadvertent and due to administrative oversights. However, a greater concern to me is when unlawful payments have been made over long periods and, when discovered, are not immediately corrected. One such example is included in the 12 instances reported for 2021/22.

New areas for independent assurance

In the future, my Office will provide independent assurance on the New Zealand Health Plan and on the reporting of performance against that plan. This is a key aspect of the health reforms, and the work of my Office will provide additional assurance to Parliament and the public on the health information as publicly reported.

The Finance and Expenditure Committee has also considered increased independent assurance on aspects of the proposed new water services entities.

I am confident that our work in these new areas will support and enhance the already robust assurance processes in place over other parts of the public financial management system.

Integrity and the pressure to deliver

There is continuing pressure on the public service workforce to meet the Government's priorities and deliver on an active reform agenda in the face of significant challenges.

Increased staff turnover is affecting many public sector organisations. This, together with the pressure to deliver, creates additional risks to ensuring that integrity is maintained and sound processes are followed when spending public money. We have seen with the cost of living payment the impact of prioritising speed and expediency over accuracy and quality. We have also commented on the need for processes supporting funding decisions to be clear and for strong post-payment assurance where there are high trust processes used.

We have been encouraged when agencies have used our work and guidance to improve processes and systems and we will continue to actively share good practice and insights from our work.

Acknowledgements

Communities across New Zealand continue to be well served by a dedicated public service operating in a challenging environment. I acknowledge and thank the public servants who work tirelessly to make our lives better.

I thank my staff and the private sector auditors who work on my behalf. They have continued to show commitment and resilience in carrying out their work in circumstances still defined by high levels of uncertainty. They have retained their focus on providing high-quality audits at a time when the need for independent assurance is more apparent than ever.

Finally, I again thank Parliament for its ongoing interest in the work we do and for its support of my Office. I greatly appreciate it.

Nāku noa, nā

John Ryan
Controller and Auditor-General | Tumuaki o te Mana Arotake

7 December 2022

Auditing the Government's financial statements

Revenue and expenditure has gone up

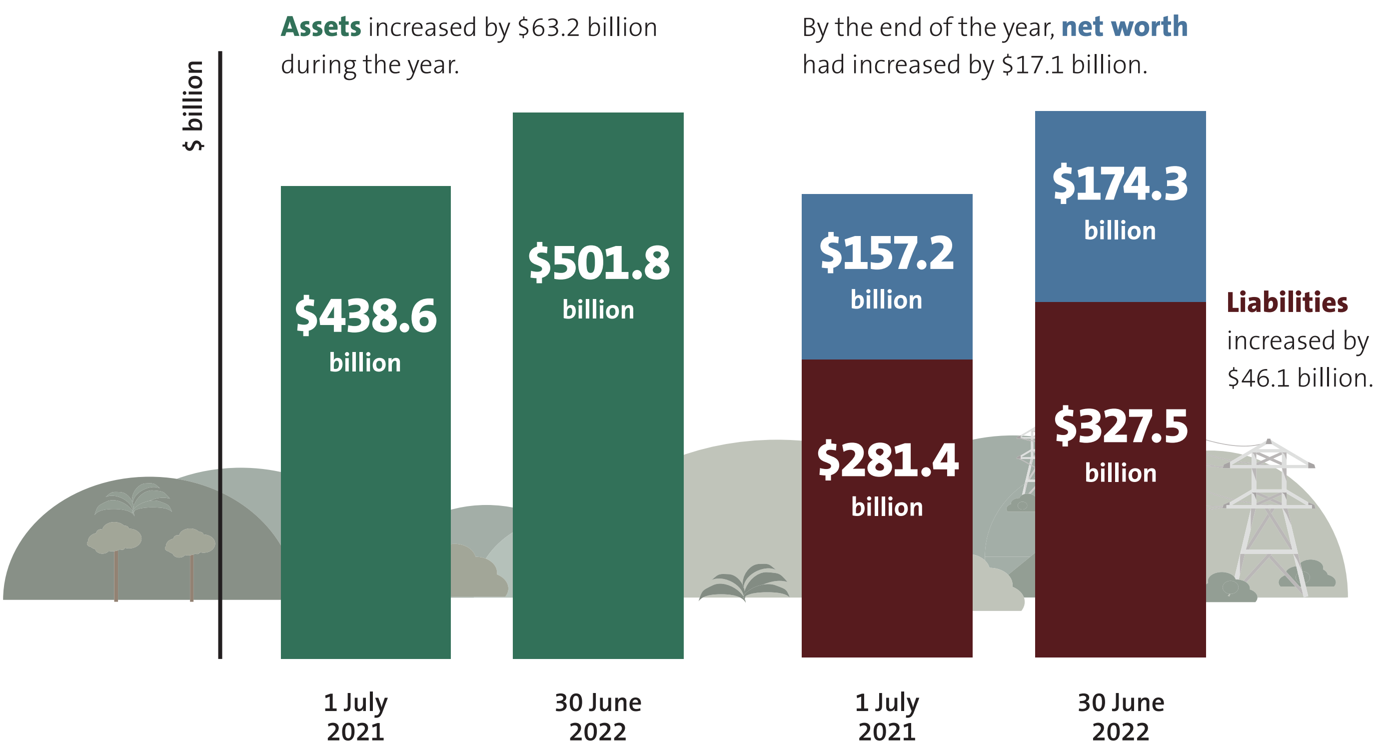
Government expenditure: $17.2 billion higher than 2020/21.

Government revenue: $12.3 billion higher than 2020/21.

Net losses from the valuation of some financial assets and liabilities of $6.7 billion (2020/21: gains of $21 billion).

Net worth is up

Based on a population of 5 million, each of us saw our "share" of the Government's net worth increase by about $3,500 to $34,900 (2020/21: increase of about $8,200).



Who’s included in the Government’s financial statements?

The Government’s financial statements consolidate the financial information of ***2656 public organisations***, including 2585 Crown entities (such as schools and Crown research institutes), 37 government departments, and 12 State-owned enterprises (such as New Zealand Post).

Assets increased significantly in value

Government ***assets increased by $63.2 billion*** during 2021/22.

Physical assets (housing, highways, and land) increased by $29 billion in value.

These physical assets account for nearly half the value of all assets ($249 billion of $502 billion).

The Government acquired ***$11.8 billion of new assets*** – mostly improvements to schools, hospitals, and the state highway network.

The ***value of shares dropped*** by $2 billion. This was mainly due to market conditions.

Liabilities increased significantly

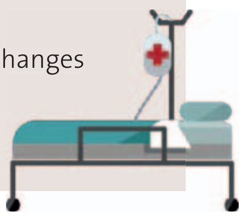
Government liabilities ***increased by $46.1 billion*** during 2021/22.

The increase was mostly due to ***increased borrowing*** of $42 billion to $204 billion ($18 billion of new bonds to fund government operations and $8.7 billion of lending by the Reserve Bank to help manage retail interest rates).

Retirement liabilities decreased due to changes to the underlying assumptions used in the calculations. Higher interest rates lower the value of these liabilities.

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 amount ACC estimates it might need to ***pay in the future*** for injuries decreased by $5 billion because of changes in assumptions and interest rates.



1 The operating environment for central government

1.1 In this Part, we describe the central government operating environment, including:

- a changing economic and fiscal context;
- challenges facing the public sector, including:
  - the continuing effects of the Covid-19 pandemic, including inflationary and supply chain pressures;
  - public sector reforms;
  - bringing Māori perspectives into decision-making;
  - addressing climate change; and
  - the increasing use of misinformation and challenges to trust and confidence in government.

1.2 We also briefly summarise the scope of our annual audit work in central government.

A changing economic and fiscal context

1.3 Disruption of production and international trade patterns associated with the Covid-19 pandemic were a feature of the reporting period. This contributed to sharp increases in global fuel and food costs. These factors arguably exacerbated long-standing global economic and political challenges. Central banks in many countries, including New Zealand, responded to inflationary pressure by increasing interest rates.

1.4 Although New Zealand's borders have reopened, the country continues to experience labour shortages in key sectors.

1.5 In March 2022, we noted in our commentary on the Treasury's long-term fiscal statement that:

> *During the next 40 years, New Zealanders will face a wide range of complex challenges and opportunities. Understanding what challenges and opportunities could significantly affect the government's long-term financial sustainability is critical to supporting and informing the government's strategic decisions in the Budget. It is also important for improving the quality and depth of public information and engagement.*[1]

1.6 As well as the Covid-19 pandemic, other challenges that increase uncertainty and risk range from climate change, biosecurity risks, changing demographics, increasing prevalence of misinformation, to international tensions.

1 Office of the Auditor-General (2022), *Commentary on He Tirohanga Mokopuna 2021*, Part 3, oag.parliament.nz.

Challenges facing the public sector

The Covid-19 response

1.7 The pandemic is likely to have lasting effects on the public sector. These include:

- the challenge of continuing to provide key services while clearing the backlogs that result from the Covid-19 response (such as we have experienced in the audit profession);
- existing service issues that the Covid-19 pandemic has exacerbated, such as school attendance; and
- more general operating issues, such as staff turnover, supply chain constraints, and inflationary pressures.

Public sector reforms

1.8 Several major reforms are under way across the public sector, including in health, tertiary education, broadcasting, water management, and resource management. The Government is also considering the findings from the Ministerial review into the future for local government.

1.9 At the same time, there is considerable increased investment in responding to, and adapting to, climate change. In Part 2, we discuss the Treasury's approach to accounting for the Government's commitments made as part of the Paris Agreement. The commitments that have been made are potentially financially significant.

1.10 These reforms may increase the pressure on core services, given the context of general operating issues such as staff turnover. This is likely to continue for some time. The reforms also affect our work. For example, the health sector reforms require the Auditor-General to audit both the New Zealand Health Plan and the reporting of progress against it.

1.11 The Public Service Act 2020 changed the way that public organisations are expected to work together through formal structures such as cross-government initiatives and interdepartmental executive boards.[2] It also set new expectations for the public service – in particular, for its stewardship responsibilities and its support for the Māori–Crown relationship. New joint arrangements present additional reporting opportunities to ensure that there is appropriate accountability over both spending and the progress being made in improved outcomes.

1.12 The operating environment of central government is complex, with a range of organisations involved in achieving inter-related outcomes. That complexity

2 This is a new model of public service agency that brings chief executives together to collaborate on complex, multi-agency issues.

increases as new outcomes and additional organisational and governance arrangements are added. This makes clear reporting and accountabilities even more important. There have also been changes to the public finance system through the introduction of "clusters".[3] These are intended to support inter-agency collaboration, help Ministers to collectively direct spending and make trade-offs between related areas, support medium-term planning, and put a greater focus on value for money.

1.13 We expect the costs and benefits of these reforms will face increased attention from Parliament and the public as they are implemented in the coming years.

1.14 There are opportunities for the reforms to improve accountability and reporting arrangements, especially if those arrangements are established early in the reform process.

1.15 The success of the reforms will likely affect public confidence in the public sector and in the Government. High-quality information about the effects of the reforms will be important, which is why we will be looking at performance information in sectors undergoing major change in 2022/23.

Greater inclusion of Māori perspectives

1.16 Central government agencies have invested significant resources in how to include Māori perspectives in their decision-making. This has affected how the public sector operates.[4]

1.17 Te ao Māori is an integral part of our national identity, and New Zealand is now entering a post-settlement phase. About 90 Treaty settlements have been signed in the last three decades, and many of the reports of the Waitangi Tribunal are now moving to address contemporary issues.

1.18 This means that almost any aspect of government could come under the Waitangi Tribunal's scrutiny. Those inquiries will likely centre on outcomes for Māori and Māori–Crown relations.

1.19 The principle of partnership that underpins the relationship between Māori and the Crown has evolved over time, along with the principles of participation and protection. Some parts of the public sector have applied these principles for many years.

1.20 Many public organisations are working out how to incorporate, or have already incorporated, tikanga and Māori values into their management systems. Several public organisations have cultural capability as part of their strategic planning

3 The Government is piloting the establishment of two clusters of agencies in the justice and natural resources sectors.

4 See, for example, section 14 of the Public Service Act 2020.

and have established senior positions or cultural perspective units in their organisations as a way of including Māori perspectives in their decision-making.

Addressing climate change

1.21 Our audit of the *Financial Statements of the Government of New Zealand for the Year Ended 30 June 2022* (the Government's financial statements) included a focus on the Government's climate change commitments.[5] New Zealand has made significant commitments to reducing carbon emissions, which could have significant financial implications for the Government. Under the Paris Agreement, the Government has a commitment to reduce net greenhouse emissions to 50% below gross 2005 levels by 2030.

1.22 To meet these commitments, central government agencies are changing policy and legislative settings, regulatory interventions, and leadership practices. At the same time, there are planning, funding, and investing activities to reduce the public sector's own carbon emissions and environmental impact.

1.23 We also have new responsibilities in relation to public organisations' climate reporting. These responsibilities include auditing disclosures about greenhouse gas emissions in climate statements prepared by the public organisations with climate reporting obligations. We have an important role in providing an independent view on the reliability of the disclosures made.

1.24 We note the additional disclosure included in the Government's financial statements this year, as well as the separate note disclosures about the Emissions Trading Scheme. As changes might be made quickly or with short notice, strong system leadership will be needed to help public organisations to use consistent financial, service performance, and other reporting practices.

The rise of the use of misinformation

1.25 New Zealanders are relying more on online platforms, including social media, for news, information, and social interaction.

1.26 These platforms can improve access to information, make it easier to connect with people, and raise awareness of issues. However, the amount of information online and the range of possible sources of information can make it harder for people to judge its quality or accuracy.

1.27 By providing transparent, accurate, and accessible information, the public sector can play an important role in this online environment. This is a message we have included in recent reports, such as those on public accountability, our commentary on *He Tirohanga Mokopuna 2021*, and on the cost of living payment, where we

5 The Treasury (2022), *Financial Statements of the Government of New Zealand for the year ended 30 June 2022*, Wellington.

highlighted the importance of high-quality information and the good stewardship of public funds.

1.28 The importance of our role as a source of trustworthy information is also more apparent. Our work supports Parliament and the public to understand how the public sector is performing and whether it is operating with integrity. We will continue to provide resources to support good practice in the public sector. We will also be promoting the guidance we released in June 2022 to support public sector leaders in building and maintaining a culture of integrity in their organisations.

Our central government audit work

1.29 The Covid-19 pandemic compounded many of the challenges that the audit profession already faced. In particular, the response to Covid-19 restricted the international flow of auditors (who the New Zealand audit profession had relied on during peak workload periods), reduced staff availability to carry out audits, and made audits more complex. It also created significant challenges for those who prepare financial statements and performance information to complete the work in a timely manner and provide auditors with good quality information to audit.

1.30 In 2021, Parliament passed a bill to extend by two months the statutory reporting time frames in the Crown Entities Act 2004, applying until the end of 2022. This enabled us to better manage the effects of the auditor shortage and Covid-19 without compromising audit quality.

1.31 Our central government audits involve about 450 public organisations, including large government departments such as the Ministry of Education and the Department of Corrections, Crown entities such as the Civil Aviation Authority, State-owned enterprises such as New Zealand Post, and a range of others, such as Crown companies and membership organisations like the Chiropractic Board. This work calls on the professional expertise of our appointed auditors from Audit New Zealand and other contracted audit service providers.

1.32 We completed all significant 30 June year-end audits by the statutory reporting deadline of 30 September 2022.

1.33 The number of non-standard audit reports issued in 2022 was similar to 2021.[6] Eighteen non-standard audit reports had been issued by the middle of November in 2021 and 17 in 2022.

6 A non-standard audit report is one that contains a qualified audit opinion and/or an explanatory paragraph.

1.34 Normally, non-standard audit reports are issued when there are uncertainties or other matters that our auditor has chosen to highlight about a public organisation's information, for example, a lack of controls or limitations of scope over asset valuations.

1.35 Our most significant central government audit is our audit of the Government's financial statements, which we discuss in Part 2.

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 this information allows Parliament, the public, and the international community to confidently scrutinise the Government's financial performance and position.

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

2.3 The key audit matters included in our audit report on the Government's financial statements for the year ended 30 June 2022 were:

- entitlements under the Holidays Act 2003;
- climate change:
  - obligations arising from emissions reduction targets;
  - Emissions Trading Scheme liability;
- calculating the value of tax revenue from other persons and companies;
- valuing property, plant, and equipment:
  - land;
  - state highways;
  - electricity generation assets;
- valuing financial assets where market data is not available:
  - student loans; and
- valuing insurance liabilities and superannuation liabilities:
  - Accident Compensation Corporation's outstanding claims liability; and
  - Government Superannuation Fund's unfunded liability.

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

Entitlements under the Holidays Act 2003

2.5 The provision for employee entitlements in the Government's financial statements includes $2.1 billion for amounts owing to employees who have been paid less than their legal entitlements under the Holidays Act 2003.

2.6 We have reported this as a key audit matter since 2018 and progress on this complex matter has been slow. Some employees are still being paid incorrect amounts when leave is taken or paid out.

2.7 Many public and private sector organisations have had challenges in interpreting the Holidays Act 2003 and paying employees amounts that comply with the legislation. Since this issue was first identified, many organisations have calculated the historical amounts owing, paid these to staff, and fixed systems so that staff are subsequently paid at the correct rates. However, two significant parts of the public sector, health and education, have not yet achieved this.

2.8 Applying the legislation to complex employment arrangements requires a good understanding of both the legislation and employees' contractual terms. It often requires judgement, and negotiation and agreement with employee representatives.

2.9 This provision is for those public organisations that have not yet finished determining the amounts they owe to staff but have been able to make a sufficiently reliable estimate. For some of these organisations, there is significant uncertainty in estimating the final amounts owed and the time frame for resolution and payment.

2.10 The provision for former district health boards is $1.7 billion. This provision is based on work done over several years that involved selecting a small sample of former and current employees, applying assumptions, and calculating a provision by extrapolating the result over the known population.

2.11 The liability for two former district health boards was recalculated this year based on a revised, nationally agreed approach. The recalculation was prepared by a professional firm engaged specifically to carry out the calculations based on agreed assumptions.

2.12 As outlined in the Government's financial statements, if an obligation cannot be reasonably measured at 30 June 2022, disclosure is made of an unquantified contingent liability.

2.13 For the organisations most significantly affected, we considered the progress made during the year in resolving the payroll calculation issues. In some key areas, such as in the health and education sectors, only limited progress had been made.

2.14 We reviewed the changes in the provision since the previous year and considered the adequacy of support for any significant movements.

2.15 For the former district health board's revised calculations, we:

- obtained an understanding of the changes made to methodology, assumptions, and sample sizes compared to the previous estimate, and the updated employee information; and
- considered the expertise of the professional firm engaged to undertake the calculations.

2.16 We also considered whether the effect of the two former district health boards' recalculations, if applied to the provisions of the other former district health boards, might result in a materially different overall provision.

2.17 For those organisations in the education sector that have a contingent liability rather than a provision, we assessed management's judgement and support for not being able to reliably estimate the liability.

2.18 We reviewed the disclosures about the provision and contingent liability for compliance with relevant financial reporting standards.

2.19 As a result of the audit work, we are satisfied that the provision for entitlements under the Holidays Act 2003 at 30 June 2022 is reasonable and that where a liability cannot be reliably measured, the contingent liability disclosures are appropriate.

The Government's response to climate change

2.20 The Government declared a climate emergency and has committed to emissions reductions targets, by international treaty, domestic legislation, or policy announcement.

Obligations arising from emissions reduction targets

2.21 As disclosed in the Government's financial statements, the Government has not recognised any liabilities in relation to its commitments to achieve its carbon targets, including its updated Paris Agreement commitment to reduce net greenhouse emissions to 50% below gross 2005 levels by 2030.

2.22 To meet its international commitments, New Zealand will need to reduce its domestic emissions and purchase carbon credits from international markets. The amount of carbon credits required will depend on the extent of domestic emissions reductions. The cost of the carbon credits will depend on carbon prices at the time.

2.23 There is no financial reporting standard that explicitly sets out whether or how nations should recognise their carbon reduction commitments in their financial statements. Determining at what point a liability should be recognised requires judgement.

2.24 We reviewed the Treasury's assessment of whether a liability should be recognised for committed emissions reductions targets. The Treasury's assessment noted that there is no enforceable obligation in the Paris Agreement and, unlike the Kyoto Protocol (for which a liability was recognised), there is no settlement mechanism.

2.25 We considered whether the nature of the Paris Agreement meant a liability should be recognised. It is challenging determining whether the Government has an obligation that should be recognised as a liability. The matter requires judgement and consideration of factors such as the ability of the Government to modify or change the obligation before it must be met.

2.26 We reviewed the annual financial statements of other governments to see whether they had recognised a liability for their Paris Agreement commitments.

2.27 As a result of the audit work, we are satisfied that not recognising a liability for the Government's emissions reductions targets is, at this time, a reasonable interpretation of the financial reporting standards and that the disclosures are appropriate.

Emissions Trading Scheme liability

2.28 As outlined in the Government's financial statements, the New Zealand Emissions Trading Scheme liability was $11.3 billion at 30 June 2022. This liability represents the quantity of New Zealand Units on issue at the prevailing market price.

2.29 Administering and accounting for the Emissions Trading Scheme presents a significant audit risk due to its public interest, its accounting impact, and the degree of judgement and inherent uncertainty involved.

2.30 Under the accounting policy for the Emissions Trading Scheme, a liability (and related expense) is recognised for the carbon units issued (for example, to foresters for carbon sequestration from forest growth) and a reduction in the liability and revenue for carbon units surrendered to meet emissions obligations. This has a significant impact on the Government's financial statements.

2.31 Because the Emissions Trading Scheme operates according to the calendar year, an estimate is required to be made for carbon emissions and sequestration that occurs in January to June of the financial year. These estimates require significant judgement and are subject to high levels of inherent uncertainty.

2.32 A significant estimate is the amount of carbon sequestration by post-1989 forests for which carbon units have been earned but an emissions return has not yet been submitted. As post-1989 foresters are required to submit a mandatory return only once every five years, the accrual for post-1989 forest growth is significant and based on forecast forest growth over the period.

2.33 We reviewed the governance and co-operation arrangements in place between the agencies with administrative responsibilities for parts of the Emissions Trading Scheme. We updated our understanding of the Emissions Trading Scheme systems and processes. We tested key controls over Emissions Trading Scheme registrations and return processing, including both carbon unit surrenders and allocations.

2.34 We carried out substantive analytical procedures over Emissions Trading Scheme revenue and expenditure and tested reconciliations between the Emissions Trading Scheme systems. We reviewed the appropriateness of the methodology, data, and assumptions used to estimate Emissions Trading Scheme accruals. We confirmed the carbon unit price at 30 June 2022 to market price information.

2.35 As a result of the audit work, we are satisfied that the Emissions Trading Scheme liability at 30 June 2022 is reasonable and that the disclosures are appropriate.

Calculating the value of tax revenue from other persons and companies

2.36 The Government recognised other persons tax revenue of $11.1 billion and companies tax revenue of $20.0 billion.

2.37 Tax revenue for the year from other persons and companies 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 end of the tax year.

2.38 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.

2.39 As a result of the Covid-19 pandemic and other matters affecting the economy, there is increased uncertainty about how the New Zealand economy will perform. Therefore, judgements were made about the performance of the economy, and they were used to estimate tax revenue.

2.40 Estimating tax revenue is inherently uncertain and judgement is used to estimate the:

- performance of the New Zealand and global economy and how it relates to tax revenue;
- amount of tax to be collected from provisional taxpayers who have not yet filed their final tax return; and
- amount of tax revenue where payments have been received but no provisional or final tax return has been filed.

2.41 We reviewed the systems, processes, and controls for receiving and reviewing provisional and final tax returns, tax assessments, and tax revenue. This included understanding Inland Revenue's information technology system used to manage tax.

2.42 We tested the underlying data used in the tax revenue estimation models to confirm that it was relevant and used appropriately. We reviewed the main judgements and assumptions applied in the models and considered the sensitivity of the models to changes in assumptions.

2.43 We used independent economic experts to assess the main assumptions about the future (such as economic growth), which could cause a material adjustment to tax revenue from other persons and companies.

2.44 We were satisfied with the ongoing appropriateness of net operating surplus as a macro-economic indicator to estimate tax revenue from other persons and companies.

2.45 We reviewed any changes in tax policy in terms of the likely impact on tax revenue recognition. We also:

- carried out a retrospective review of the 2021 tax estimation to tax return information received from taxpayers to assess the robustness of the methodology used to estimate tax revenue;
- reviewed the accounting adjustments to tax revenue processed by Inland Revenue;
- reviewed the year-end procedures and testing carried out by Inland Revenue for significant taxpayers, and any adjustments arising from this review by Inland Revenue; and
- reviewed the relevant disclosures.

2.46 As a result of the audit work, we are satisfied that other persons' tax revenue and companies tax revenue for the year ended 30 June 2022 are reasonable and that the disclosures are appropriate.

Valuing property, plant, and equipment

2.47 The Government owns property, plant, and equipment with a carrying value of $249.2 billion at 30 June 2022.

2.48 Revaluations are carried out regularly, or when there is a material difference between fair value and carrying value. Considerable judgement is needed in determining the valuation approaches and assumptions for some of these assets.

2.49 Valuers have considered the impact of prevailing economic conditions on the significant estimates and judgements applied in the valuation process, such as the effect of interest rates and inflation on market values and replacement costs.

2.50 For assets valued using the optimised depreciated replacement cost approach, supply chain disruptions and labour supply constraints have caused increases in construction costs, which affected valuations. Valuers have needed to assess the extent to which these cost changes are short-term or ongoing and need to be taken into account for cost-based valuations.

2.51 The property, plant, and equipment identified below needed significant judgements and assumptions to determine their fair value.

Land

2.52 Land was valued at $84.7 billion at 30 June 2022.

2.53 The land portfolio included in the Government's financial statements is used for different purposes. Different valuation approaches have been applied that take into consideration the highest and best use of the land. It requires judgement to determine the most appropriate approach to take.

2.54 Approaches used include market-based sales evidence, rateable valuations of adjacent land, and sales indices.

2.55 The highly judgemental and subjective nature of the valuations coupled with the significance of the asset class in the Government's financial statements results in this being a significant audit focus.

2.56 We assessed the appropriateness of the valuation approach applied by independent valuers or the public organisations themselves.

2.57 We confirmed the competence, capabilities, and objectivity of the independent valuers, considered the valuers' main assumptions, and tested that information provided to the independent valuers was consistent with the information held by organisations.

2.58 We considered and discussed with valuers how economic and property market conditions had affected their valuation and how legislative change that would allow for more intensive development in some urban areas had been considered.

2.59 Where organisations used an index to confirm that there has been no material movement in their land values or as a basis for recording a valuation movement, we assessed the appropriateness of the index used to other external data sources and compared the retrospective accuracy of indices applied in previous periods.

2.60 As a result of the audit work, we are satisfied that the value of land at 30 June 2022 is reasonable and that the disclosures are appropriate.

State highways

2.61 The state highways (excluding land) were valued at $51.9 billion at 30 June 2022 by an independent valuer.

2.62 The value of the state highways cannot be measured precisely due to the unique nature of the state highway network. 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.

2.63 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, considered the valuer's main assumptions, and assessed the valuation procedures. We considered whether there were any limitations placed on the valuer and whether centrally calculated rates applied to the valuation were appropriate.

2.64 We confirmed that key controls were operating over the systems and processes used to record costs and other asset information about the state highways.

2.65 We considered how the valuer took the current economic environment into account, including the judgements applied in assessing whether recent cost increases are temporary or reflect sustainable market conditions that need to be taken into account in assessing replacement cost rates.

2.66 As a result of the audit work, we are satisfied that the value of the state highways at 30 June 2022 is reasonable and that the disclosures are appropriate.

Electricity generation assets

2.67 Electricity generation assets were valued at $19.0 billion at 30 June 2022.

2.68 Valuing electricity generation assets is complicated and relies on significant assumptions about the future prices of electricity, generation costs, generation capacity, and demand. Each of these assumptions affects the others.

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

2.70 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 considered their main assumptions and judgements.

2.71 We considered the reasonableness of valuation approaches and assumptions. We tested the sensitivity of the main assumptions to confirm that they were reasonable.

2.72 We compared the forecast prices of electricity to the expected longer-term wholesale prices and market data, where it was available.

2.73 We considered how the valuers took the current economic environment into account in the valuations and the effect of any estimation uncertainties on the final valuations of electricity generation assets.

2.74 We also considered whether the valuers took into account the future of the New Zealand Aluminium Smelter at Tiwai Point in determining their valuation assumptions.

2.75 As a result of the audit work, we are satisfied that the value of electricity generation assets at 30 June 2022 is reasonable and that the disclosures are appropriate.

Valuing financial assets where market data is not available

2.76 The financial statements included financial assets that were valued using significant non-observable inputs (that is, where market data is not available) of $22.7 billion at 30 June 2022.

2.77 These financial assets include loans (including student loans, discussed below), investments, and deposits.

2.78 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.

2.79 Based on a sample of investments, we reviewed the valuation techniques and tested the controls and inputs used to determine the value of financial assets where market data is not available.

2.80 Taking into account the nature of the selected financial assets, the valuation techniques adopted, and the uncertainties in determining values, we:

- tested the relevant internal controls over data entered into financial systems for these assets;
- assessed valuation approaches applied where a fund manager carries out the valuation;

- compared the fair value of financial assets to independent information and investigated any significant differences; and
- assessed the appropriateness of the inputs used in the valuation where market data is not available.

2.81 As a result of the audit work, we are satisfied that the value of financial assets where market data is not available at 30 June 2022 is reasonable and that the disclosures are appropriate.

Student loans

2.82 The Government had advanced student loans with a value of $9.2 billion as at 30 June 2022.

2.83 Student loans are measured using actuarial and predictive models, which reflect current student loan policy and macro-economic assumptions.

2.84 The value is sensitive to changes in several assumptions, including future income levels, repayment behaviour, inflation, and discount rates.

2.85 There is also uncertainty about how Covid-19 and other matters affecting the economy might affect student loan repayments.

2.86 For student loans, we:

- tested a sample of student loan applications during the year to ensure that loans were correctly paid out;
- 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;
- used an independent expert to review the main assumptions in the student loans model, including a review of the cash flow forecasts, and the risk-free discount rate and risk premium used to determine the fair value of loans, and adjustments for employment and overseas non-compliance;
- assessed the controls and valuation approaches applied by the valuer and tested the operational effectiveness of controls over the valuation model;
- carried out a retrospective review of the actual repayments of student loans in previous years against prior year cash flow forecasts to consider whether there was any estimation bias; and
- reviewed the relevant disclosures.

2.87 As a result of the audit work, we are satisfied that the value of student loans at 30 June 2022 is reasonable and that the disclosures are appropriate.

Valuing insurance liabilities and superannuation liabilities

2.88 The Government has significant liabilities from Accident Compensation Corporation (ACC) insurance claims and public servants' superannuation entitlements at 30 June 2022.

2.89 Estimating the values of these liabilities is complicated, and there are inherent uncertainties in the valuations.

2.90 The calculations use risk-free discount rates information and consumer price index (CPI) assumptions, which are made publicly available by the Treasury.

2.91 We engaged an independent expert to consider the appropriateness of the Treasury's risk-free discount rates and CPI assumptions. This included assessing the:

- appropriateness of the methodology, including the reasonableness of the Treasury's conclusions related to the ongoing reviews of selected aspects of the methodology;
- application of the methodology in determining the risk-free discount rates and CPI assumptions; and
- accuracy of the calculations.

2.92 As a result of the audit work, we are satisfied that the risk-free discount rates and CPI assumptions are appropriate for use in valuing these liabilities at 30 June 2022.

Accident Compensation Corporation's outstanding claims liability

2.93 The outstanding claims liability of ACC has been valued at $50.3 billion at 30 June 2022 by an independent actuary.

2.94 Assumptions used to determine the value of the outstanding claims liability include:

- the discount rate used to get a present value of expected claims payments;
- the risk margin for the inherent uncertainty in the estimate of the present value of expected claims payments;
- the effects of inflation and innovation on future medical costs; and
- how long it will take people to recover (length of rehabilitation) from injuries.

2.95 Assumptions are closely linked and cannot be viewed in isolation. Changes in assumptions can have a large effect on the value of the outstanding claims liability (and the gain or loss that is recognised).

2.96 We examined how ACC's outstanding claims liability is valued. We confirmed the competence, capabilities, and objectivity of the actuary, and tested their procedures.

2.97 We assessed the reasonableness of the methodology applied. We confirmed compliance of the accounting treatment with the relevant accounting standards. We also reviewed ACC's main assumptions about each significant type of claim to see whether these were appropriate. The impact of Covid-19 on these assumptions and estimation uncertainties was considered minimal.

2.98 We tested the systems and controls and, in particular, tested the process for recording claims.

2.99 We tested the main assumptions by considering past claims. We assessed the reasonableness of forecasts that differed from past experience by looking at the evidence supporting the forecasts.

2.100 We engaged an actuary to review the scope, approach, and reasonableness of the estimated liability.

2.101 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.

2.102 As a result of the audit work, we are satisfied that ACC's outstanding claims liability at 30 June 2022 is reasonable and that the disclosures are appropriate.

Government Superannuation Fund's unfunded liability

2.103 The Government's unfunded liability for public servants' superannuation entitlements for past and current members of the Government Superannuation Fund (the Fund) has been valued at $8.8 billion at 30 June 2022 by an independent actuary.

2.104 The value of the unfunded liability is sensitive to the value of the Fund's assets, expected rates of salary increases for members of the Fund, demographic assumptions, and estimated inflation and discount rates. The Fund's assets, which are mainly shares and bonds, are traded in markets. Changes in the prices of these shares and bonds affect the amount of the unfunded liability.

2.105 The assumptions are closely linked and cannot be viewed in isolation. Changes in assumptions can have a significant effect on the value of the unfunded liability.

2.106 We examined how the Government's unfunded liability for public servants' superannuation entitlements is valued. We confirmed the competence, capabilities, and objectivity of the actuary, and tested their procedures.

2.107 We engaged an actuary to review the procedures used to value the unfunded liability and to review the main assumptions and judgements, including the expected rates of salary increases, against external benchmarks.

2.108 We tested the main controls that ensure that membership data used in the actuary's valuation is complete and accurate.

2.109 We tested the design and implementation of key controls over investments. We obtained an understanding of the valuation techniques and inputs used by the respective fund managers to value the investments and tested a sample of investments carried at fair value. The values of the funds were reconciled to the latest valuation reports. Any movements between the last valuation date and the year-end data were checked against supporting documentation.

2.110 As a result of the audit work, we are satisfied that the Government's unfunded liability for public servants' superannuation entitlements at 30 June 2022 is reasonable and that the disclosures are appropriate.

Other audit matters

Electricity network assets

2.111 The electricity network assets comprising the national grid are currently recorded at cost, which differs from the valuation approach in the rest of the sector. As with the rail network assets, we have accepted a different valuation approach at an entity and Government financial statements level.

2.112 We are comfortable that a revaluation approach for this asset class is not necessary in the financial statements for broader consistency with the other major assets classes as generally accepted accounting practice (GAAP) does not require this, nor does GAAP require disclosure of the fair value of property, plant, and equipment if it is carried under the cost model. Further, it was noted that depreciated cost is similar to the fair value for the electricity distribution network.

Emissions Trading Scheme

2.113 The valuation of the Government's liability in relation to the Emissions Trading Scheme presents a risk due to its public interest, its accounting impact, the degree of judgement involved, and inherent uncertainty due to the myriad of governance and co-operation agreements in place between agencies.

2.114 This matter has now been treated as a key audit matter in the audit report and, as a result of the audit work, we were satisfied that the Emissions Trading Scheme values are fairly stated in the Government's financial statements.

Reform programmes

2.115 In October 2021, the Government announced it would introduce legislation to establish four publicly owned water services entities to take over responsibilities for service delivery and infrastructure from local authorities from 1 July 2024. The impact of these reforms, once legislated, is likely to mean that neither the Crown nor local authorities will control the water services entities.

2.116 At this stage we do not consider these reforms to have any effect on the Government's financial statements.

Management of spending against appropriations

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

2.118 The number of instances of unappropriated expenditure was 12 in both 2020/21 and 2021/22. A number of these breaches were due to technical issues (including the manner in which appropriations were set up), lack of appropriate approvals, or incorrect accounting treatment.

2.119 In our view, the instances of unappropriated expenditure reflect a lack of knowledge about how to manage appropriations in the public sector and in some finance teams. We are concerned that the constitutional significance of appropriations is not well understood.

2.120 We also note that the Public Service Act 2020 makes provision for functional leadership and governance structure across public organisations. This will affect which organisations are responsible for spending within appropriations.

2.121 We reviewed the controller function reports prepared by the Treasury's Central Controller Team and ensured that all unappropriated expenditure identified in these reports is reported in the Statement of Unappropriated Expenditure.

2.122 We confirmed with the Central Controller Team that the final listing of unappropriated expenditure is correctly reported in the Statement of Unappropriated Expenditure.

2.123 We confirmed the completeness and accuracy of actual unappropriated expenditure directly with the Appointed Auditors of the relevant public organisations.

2.124 We confirmed with the Appointed Auditors of organisations that had disclosed no unappropriated expenditure in the Statement of Unappropriated Expenditure that no unappropriated expenditure has been incurred.

2.125 We identified no areas of concern.

2.126 As a result of the audit work, we are satisfied that the Statement of Unappropriated Expenditure is accurate, complete, and consistent with what is reported in the individual public organisations' own annual reports.

Ongoing improvement in note disclosures

2.127 One benefit of the significant amount of work completed last year to understand the impact of Covid-19 on the Government's financial statements was the improvements made to the note disclosures about key assumptions and judgements. In 2019, the disclosures about the state highway valuation were also enhanced. These enhanced disclosures greatly assist the readers of the Government's financial statements to understand the basis and risks inherent in this valuation process.

2.128 Other complex disclosures in the Government's financial statements would benefit from a similar detailed consideration.

2.129 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. We also reviewed the Covid-19 commentary and disclosures to ensure that it was relevant and understandable to the readers of the financial statements and focused on key assumptions and judgements.

2.130 We noted an improvement in the disclosure about ACC claims insurance liability. We also noted that the Government's financial statements introduced a separate note on the Emissions Trading Scheme.

2.131 As a result of the audit work, we are satisfied with the progress that has been made with the note disclosures, although we note that further improvements can be made.

City Rail Link Limited

2.132 City Rail Link Limited (CRL Limited) is a Crown entity (in the Public Finance Act, a schedule 4A entity) jointly owned by the Crown and Auckland Council that was established to lead the development of the City Rail Link in Auckland. Final ownership of specific City Rail Link assets is yet to be agreed on.

2.133 From 2019/20 onwards, assets started to transfer from CRL Limited to Auckland Council (and in turn to Auckland Transport) or KiwiRail. Further asset transfers occurred in 2021/22. When decisions are made about final ownership of the assets, there could be challenging technical accounting treatment and appropriation implications.

2.134 It is also important to consider whether there are any indicators of impairment in the Crown's investment in CRL Limited. As a result of the agreements with Auckland Council, CRL Limited is continuing to report as a joint venture in the Government's financial statements and is, therefore, equity accounted. We are satisfied that this is adequately disclosed in the Government's financial statements.

2.135 During the year, CRL Limited received claims from the primary contractor (the Link Alliance) for Covid-19-related costs. These claims are subject to an independent review before negotiation between the parties. Any settlement has the potential to increase the Crown's contribution to the project.

2.136 As a result of the audit work, we are satisfied that this is adequately disclosed as a contingent liability at 30 June 2022.

Commentary

2.137 The commentary on the Government's financial statements (the commentary) is not covered by our audit opinion, but it does help tell the story of the Government's performance and forms a substantial part of the Government's financial statements as a whole.

2.138 The commentary should reflect the financial performance of the Government reporting entity and focus primarily on information within the Government's financial statements.

2.139 This year's commentary focused on the Government's fiscal strategy, key fiscal measures, financial statement summary, and the impacts of Covid-19.

2.140 We have reviewed the commentary and concluded that it provides a balanced view on the Government's financial statements, with a focus on the overall financial performance (as opposed to previous years, where the focus was on the Core Crown segment).

Management override of internal controls

2.141 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 perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Auditing standards require us to treat this as a risk on every audit.

2.142 We examined the controls for collecting financial information from public organisations included in the Government Reporting Entity and the adjustments to that information for consolidation purposes. We tested the appropriateness of journal entries, and other adjustments made in the preparation of the Government's financial statements, by reviewing journals and disclosures.

2.143 We reviewed significant accounting estimates for bias and engaged specialists to assist with those reviews, where appropriate. We were satisfied that the Government's financial statements were not materially misstated due to management override of controls.

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 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.[7]

3.3 Parliament's approval to incur expenditure is mainly provided through appropriations,[8] 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. Some expenditure can also be approved retrospectively.

3.4 The incidence of unappropriated expenditure reached a historical low in 2020/21. This continued in 2021/22, with 12 instances reported in the Government's financial statements. The amount of unappropriated expenditure as a percentage of the Government's budget also remained constant, at 0.09% of the budgeted spend.

3.5 In this Part, we discuss:

- why the Controller work is important;
- how much public expenditure was unappropriated in 2021/22;
- why the expenditure was unappropriated;
- how 2021/22 compared with previous years; and
- a summary of work we carried out in 2021/22 to discharge the Controller function.

7 Section 22 of the Constitution Act 1986.

8 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

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

3.7 Most of the Crown's funding is obtained through taxes. Parliament and the public are entitled to assurance that the Government is spending public money as authorised by Parliament.[9]

3.8 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 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.

3.9 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 incurred in 2021/22 was unappropriated?

3.10 The Government's financial statements for the year ended 30 June 2022 report 12 instances of unappropriated expenditure (2020/21: 12). Expenditure incurred above or beyond appropriation[10] for 2021/22 was $162.5 million (2020/21: $133.7 million). Figure 1 shows a breakdown of unappropriated expenditure categories.[11]

9 That is, it is within the type, scope, dollar amount, and period limits authorised by Parliament.

10 That is, in excess of the maximum amount or outside the scope authorised by Parliament.

11 The Treasury (2022), *Financial Statements of the Government of New Zealand for the year ended 30 June 2022*, Wellington, pages 158-162.

Figure 1
Unappropriated expenditure incurred for the year ended 30 June 2022

Category	Unappropriated expenditure by category	2021/22 Number	2021/22 $million*	2021/22 Votes
A	Approved by the Minister of Finance under section 26B of the Public Finance Act 1989.	1	0	Māori Development
B	With Cabinet authority to use imprest supply but in excess of appropriation prior to the end of the financial year.	1	3	Conservation
C	With Cabinet authority to use imprest supply but without appropriation prior to the end of the financial year.	-	-	
D	In excess of appropriation and without prior Cabinet authority to use imprest supply.	5	19	Conservation; Ombudsmen; Social Development; Finance
E	Outside scope of an appropriation and without prior Cabinet authority to use imprest supply.	2	24	Foreign Affairs, Social Development
F	Without appropriation and without prior Cabinet authority to use imprest supply.	3	115	Revenue; Business, Science and Innovation
	Total	**12**	**162**	

* Amounts are rounded to the nearest million.

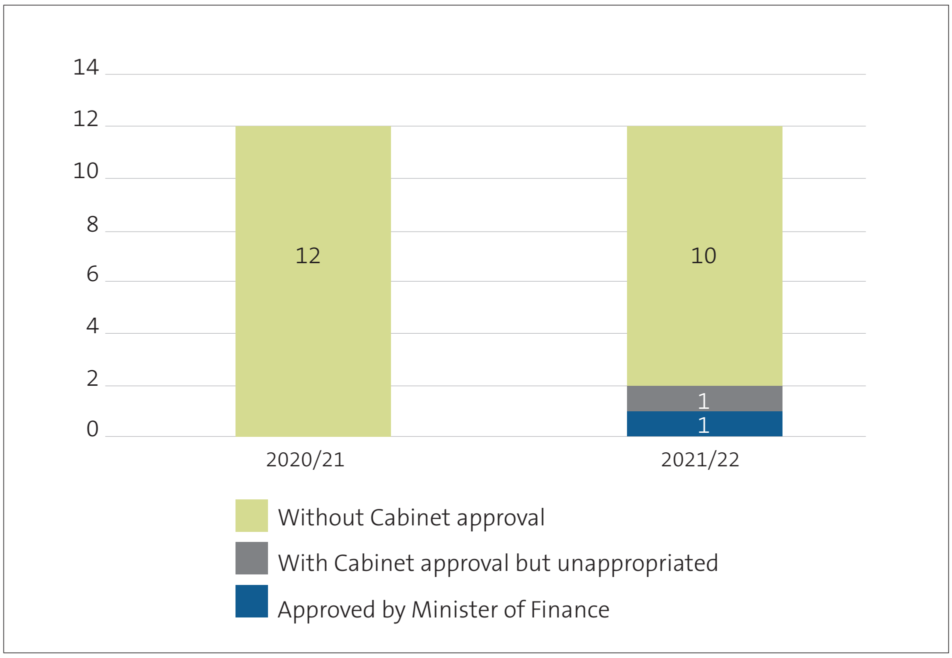
3.11 The unappropriated expenditure categories shown in Figure 1 fall into three broader categories:

- Approved by the Minister of Finance (Category A): Small overruns of expenditure in the last three months of the financial year (that is, within $10,000 or 2% of the appropriation) may be approved by the Minister of Finance under section 26B of the Public Finance Act. Although unappropriated, expenditure approved under section 26B is lawful. There was one instance of unappropriated expenditure authorised under this section for 2021/22 (2020/21: No instances).
- With Cabinet approval (Categories B and C): When it is anticipated that expenditure will be incurred above or beyond the appropriation limits, departments should seek prior Cabinet approval to use imprest supply for the spending not covered by appropriations.

- However, the use of imprest supply is only an interim authority (it expires on 30 June each year), so all spending using this authority must also be appropriated through an Act of Parliament by 30 June (see the Appendix for how appropriations work).
- Sometimes Cabinet's approval to use imprest supply is obtained but the extra spending is not included in an Appropriation Act[12] before the end of the financial year, so the spending remains unappropriated.
- There was one instance of unappropriated expenditure in this section in 2021/22 (2020/21: No instances).
- Without prior Cabinet approval (Categories D, E, and F).
- For 2021/22, the Government's financial statements report 10 instances of expenditure incurred above or beyond the appropriation limits without any authority at the time it was incurred, that is, without Parliamentary appropriation and without Cabinet's prior approval to use imprest supply (2020/21: 12 instances).

3.12 Figure 2 shows a continuation in 2021/22 of the low number of instances of unappropriated expenditure (see Figure 5 for a seven-year time series), with two fewer instances of expenditure without prior Cabinet approval than for 2020/21.

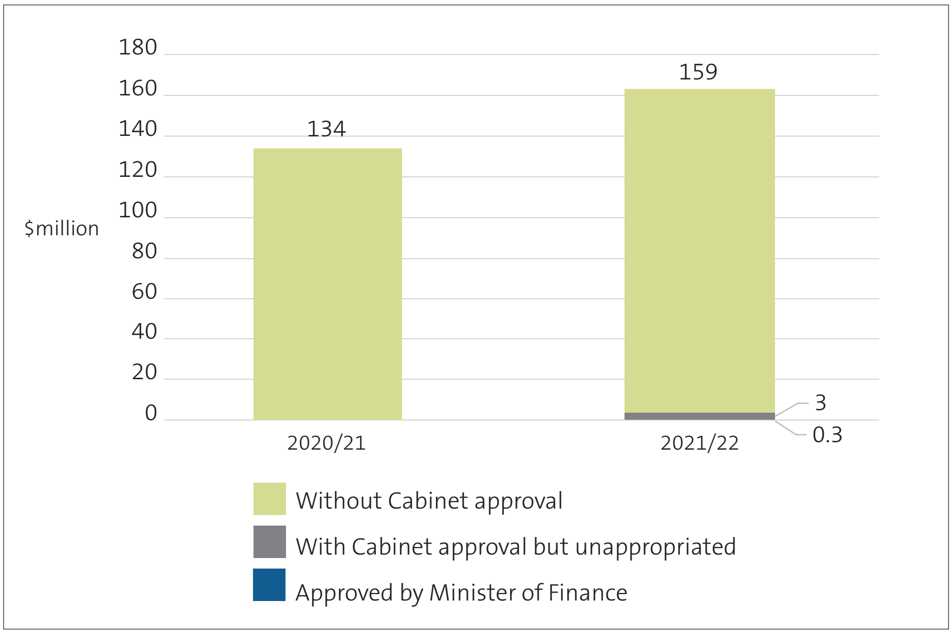
Figure 2
Number of instances of unappropriated expenditure for the year ended 30 June 2022



12 Normally through the annual Appropriation (Supplementary Estimates) Act.

3.13 Figure 3 compares the dollar amounts of unappropriated expenditure for 2020/21 and 2021/22. The amount of unappropriated expenditure increased from $134 million for 2020/21 to just over $162 million for 2021/22.[13]

Figure 3
Amount of unappropriated expenditure for the year ended 30 June 2022



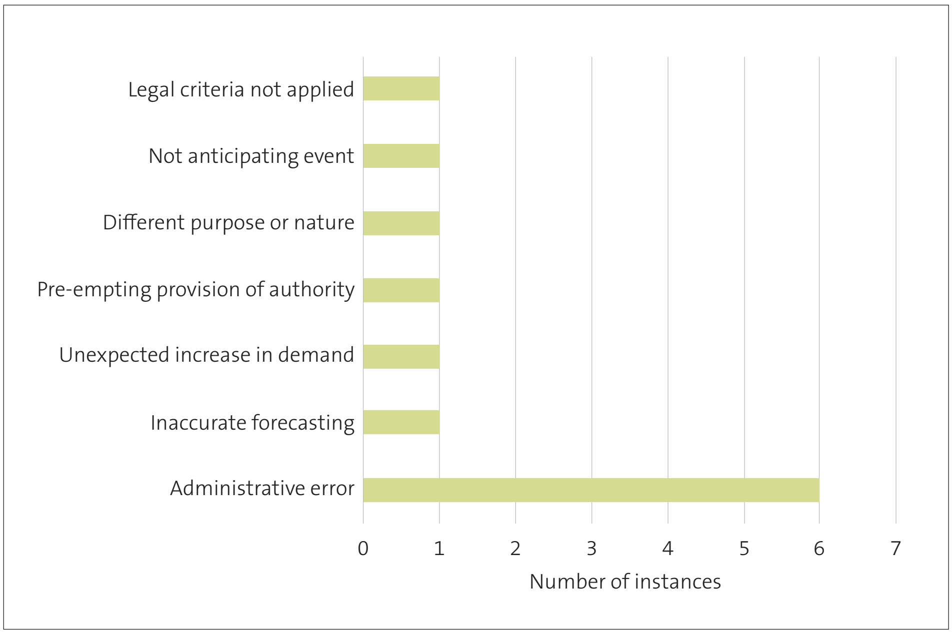
3.14 Expenditure outside the bounds of the appropriations tends to be relatively low. Unappropriated expenditure of $162 million for 2021/22 was 0.09% of the Government's final budgeted expenditure for that year, the same percentage as in 2020/21.

Why was the expenditure unappropriated?

3.15 We assigned the instances of unappropriated expenditure into seven categories that describe why the unappropriated expenditure came about (Figure 4). Administrative errors feature heavily. Six of the 12 instances resulted from administrative oversights and accounted for 75% of the $162 million of unappropriated expenditure.

13 The Treasury (2022), *Financial Statements of the Government of New Zealand for the year ended 30 June 2022*, Wellington, page 158.

Figure 4
Reasons for unappropriated expenditure in 2021/22, by number of instances



Legal criteria not applied

3.16 The Social Security Act 2018 provides for accommodation assistance payments to eligible recipients, in accordance with criteria set out in the Act or in delegated legislation made under the Act. Most of the accommodation assistance is in the form of the Accommodation Supplement, which was established on 1 July 1993.

3.17 Since the payment was introduced in 1993, the Ministry of Social Development (the Ministry) has been applying different payment criteria from that laid out in legislation. This means that some of the payments made over the last 29 years have been unlawful under the Social Security Act and are, consequently, unappropriated. Specifically, the Ministry has been paying the grant at the single rate to "community-based partners" when it should have been paying them at the (usually lower) couples' rate.[14]

3.18 In May 2019, the Ministry became aware that its approach to paying this grant to community-based partners was unlawful. Until 2019, it was operating in the belief that it was complying with the legislation. After learning that its approach was not supported by the legislation, the Ministry has continued to make the unlawful payments. It told us that it considers its approach to be consistent with the original intent of the policy for the Accommodation Supplement.

14 Community-based partners are recipients who reside in the community and whose partners are in residential care.

3.19 In March 2022, the Ministry became aware that its practice had led to a breach not only of the Social Security Act but also of the Public Finance Act, because payments to community-based partners were outside the scope of the Accommodation Assistance appropriation. After learning that its payments were unappropriated, the Ministry proposed changes to the legislation that would bring the law into line with its current practice. However, the Ministry's proposal involved continuing to make the unlawful and unappropriated payments for at least a further 14 months.

3.20 Our auditors were informed in May 2022, at the same time that the Ministry was considering its options to resolve the issue. After receiving key documents from the Ministry in September 2022, our Controller team advised the Ministry that the Controller considered that the situation was unacceptable and should be resolved urgently. The Controller wrote to the Ministry in October 2022 expressing his concerns and outlining his expectation for urgent action.

3.21 For the historical expenditure, we consider it impracticable for the Ministry to identify every unappropriated payment back to 1993. The Ministry's financial statements for 2021/22, and the Government's financial statements for 2021/22, disclose the amount of unappropriated expenditure for the last five years. The financial statements also disclose that expenditure has been incurred unlawfully since 1993. In our view, these disclosures provide enough transparency about the nature and extent of the unauthorised expenditure.

3.22 Unappropriated expenditure on the Accommodation Supplement was $5.9 million for the last five years, including $1.5 million for 2021/22. Unappropriated payments continued until 25 November 2022, when amendments to the Social Security Act and Regulations made the current practice lawful.

Not anticipating an event

3.23 From time to time, the majority Crown-owned energy companies will issue new shares as part of their dividend reinvestment plans. The Crown's participation in these plans is necessary to ensure that it maintains its majority shareholding. Parliament authorises the Crown's reinvestment in the energy companies through a specific appropriation in Vote Finance.

3.24 Meridian Energy Limited announced on 30 March 2021 that it would apply a dividend reinvestment plan to its next dividend payment, in October 2021. On 15 October 2021, the company paid a dividend, resulting in the Crown receiving new shares valued at $33 million. However, the appropriation that authorises such reinvestments had not been increased to cover this event. The authority available at the time was only $21.3 million, which meant that $11.7 million of the investment was unappropriated expenditure.

Different purpose or nature

3.25 The New Zealand Antarctic Institute, which runs Scott Base, received spending authority under Vote Foreign Affairs to maintain the Scott Base buildings and services infrastructure.

3.26 Funding received in Budget 2021 was intended for the redevelopment of Scott Base. Redevelopment work is of a different nature from maintenance work, but redevelopment costs were not within the appropriation scope.[15] The scope needed to be amended to provide authority for this expenditure, but it was not. Consequently, $23 million of redevelopment costs were unappropriated.

Pre-empting provision of authority

3.27 Unappropriated expenditure can occur when departments seek expenditure transfers from one year to the next. We have previously urged government departments to better manage the transfer of spending authority between years.

3.28 If activities authorised for a particular financial year are delayed or otherwise deferred, it is common for government departments to request an in-principle expense transfer (and associated funding) to the following financial year. If the transfer is granted in principle, the department must seek confirmation of the transfer during that (following) financial year. If confirmed, the department will need to seek approval under imprest supply to incur the expenditure, unless the spending is already covered by the Budget Act for that year.

3.29 Between-year expense transfers are usually confirmed – and authorised under an Imprest Supply Act – in October of each year, after the departments' financial statements have been audited and published. However, if the expenditure needs to take place before then, the departments need to ensure that the correct financial authority has been provided in time.

3.30 One such instance arose in 2021/22 under the Vote Conservation appropriation for the vesting of reserves. The transfer of a Reserve to a third party had been delayed from 2020/21 to 2021/22, and the Department of Conservation had requested an expense transfer from 2020/21 to 2021/22 to cover it. However, the land transfer was finalised in September 2021, before the expense transfer and the authority to use imprest supply had been approved in October 2021. This resulted in $3.1 million of unappropriated expenditure.

15 The appropriation scope statement sets out the legal boundary of what an appropriation can be used for and, by omission, what it cannot.

Unexpected increase in demand

3.31 Social housing tenants' Income Related Rent costs are based on their income. If their income decreases, a reassessment of what they are entitled to is likely to result in a reimbursement of overpaid rent. Vote Social Development includes an appropriation that expressly authorises these reimbursements.

3.32 The Covid-19 pandemic led to an increasing number of tenants experiencing reduced hours of work (and therefore reduced income) or loss of employment. By April 2022, reimbursements had exceeded the authorised amount. The Ministry of Social Development obtained extra spending authority under imprest supply in mid-April to ensure that future reimbursements were authorised. However, $171,000 had been paid in excess of appropriation before the imprest supply authority was received.

Inaccurate forecasting

3.33 Vote Māori Development includes an appropriation, *Rōpū Whakahaere, Rōpū Hapori Māori | Community and Māori Governance Organisations*, which authorises expenditure to support Māori community and governance organisations.

3.34 After Budget 2021, Parliament authorised $19.875 million for this activity but this was reduced by $450,000 in the updated Budget as funds were diverted to the Covid-19 response. Consequently, Parliament authorised the lower amount of $19.425 million through the Supplementary Estimates Act.

3.35 However, a review by Te Puni Kōkiri of its forecast expenditure on commitments identified that it would need spending authority closer to the original budget for that appropriation. The department sought and received the Minister of Finance's approval, under section 26B of the Public Finance Act, to incur $342,000 in excess of the $19.425 million authorised.

Administrative error

3.36 Half of the unappropriated expenditure instances resulted from administrative errors. Six instances of unappropriated expenditure have resulted from four administrative oversights, in Vote Conservation; Vote Revenue; Vote Business, Science and Innovation; and Vote Ombudsman.

3.37 The *Community Conservation Funds* appropriation authorises the payment of grants for community groups and private landowners to carry out work on public and private land; to assist with pest and weed control, fencing, and other biodiversity management actions; and to support community biodiversity restoration initiatives. In updating its Budget, the Government planned to reduce the level of spending authority for this appropriation through the Supplementary Estimates Act. The reduction was inadvertently made twice, and this resulted in expenditure exceeding the final appropriated amount by $6.8 million.

3.38 The Department of Conservation sought and obtained Cabinet authority to use imprest supply. Up to that point, $3.5 million had been incurred without Cabinet authority, with $3.3 million incurred with Cabinet authority but nonetheless unappropriated.[16]

3.39 By 28 June 2021, Cabinet had agreed to reactivate the Covid-19 Resurgence Support Payment scheme following a shift to higher alert levels. The purpose of the scheme (administered by Inland Revenue) was to help alleviate the economic effects of the alert level requirements on businesses.

3.40 Budget 2021 did not provide for this expenditure in Vote Revenue, so Inland Revenue needed to obtain approval to use the interim authority available under the Imprest Supply Act. Because the wording of the initial recommendation to Cabinet to reactivate the scheme in July 2021 omitted the request for imprest supply, there was no financial authority in place when the payments began. The oversight was identified in early July 2021 and imprest supply authority was provided on 15 July. By then, $4.77 million had been paid without authority. Payments after that date were made with the correct authority.

3.41 Two multi-year appropriations under Vote Business, Science and Innovation were set to expire on 30 June 2021. They each provided authority for three years of infrastructure spending (from 2018 to 2021) for *Regional Digital Connectivity Improvements* and *Broadband Investment*. The Ministry of Business, Innovation and Employment obtained Ministerial approval to extend the period of the two appropriations by a further year.

3.42 The Ministerial approval then needed to be reflected in a special clause in the Supplementary Estimates Act[17] to provide the legal authority for the extension. However, the Treasury omitted to include the clause in the Supplementary Estimates Bill, which meant the legal expiry date for the appropriations remained as 30 June 2021.

3.43 The Treasury error was identified in mid-2022, by which time the Ministry of Business, Innovation and Employment had incurred expenditure (since 1 July 2021) within the scopes of each of the expired appropriations. Expenditure of $33 million on regional digital connectivity improvements was unappropriated, as was $77.5 million on broadband investment.

3.44 The Office of the Ombudsman obtained approval for an additional capital injection in 2021/22, which was authorised in June 2022 through the Supplementary Estimates Act.[18] The Office drew down the capital injection

16 Because the unappropriated expenditure is split between two categories in the Financial Statements of the Government, it has been counted as two instances.

17 Appropriation (2020/21 Supplementary Estimates) Act 2021.

18 Appropriation (2021/22 Supplementary Estimates) Act 2022.

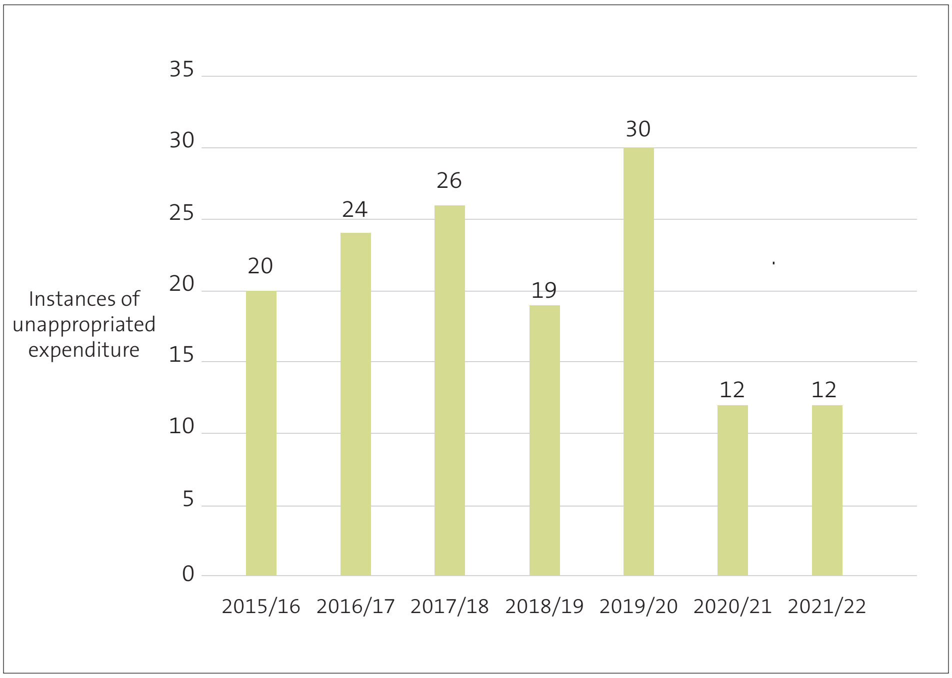
($568,000) in May 2022 before the Act came into force. It could have legally accessed the capital funding in May had interim authority under the Imprest Supply Act been in place at the time. This oversight resulted in the capital injection being unauthorised. The Ombudsman returned the funding to the Crown after the error had been identified.

How does 2021/22 compare with previous years?

3.45 The significant decrease in the number of instances of unappropriated expenditure in 2020/21 held constant in 2021/22. The Government's financial statements for the year ended 30 June 2022 report 12 instances of unappropriated expenditure which, along with the 2020/21 figure, represents a historical low.

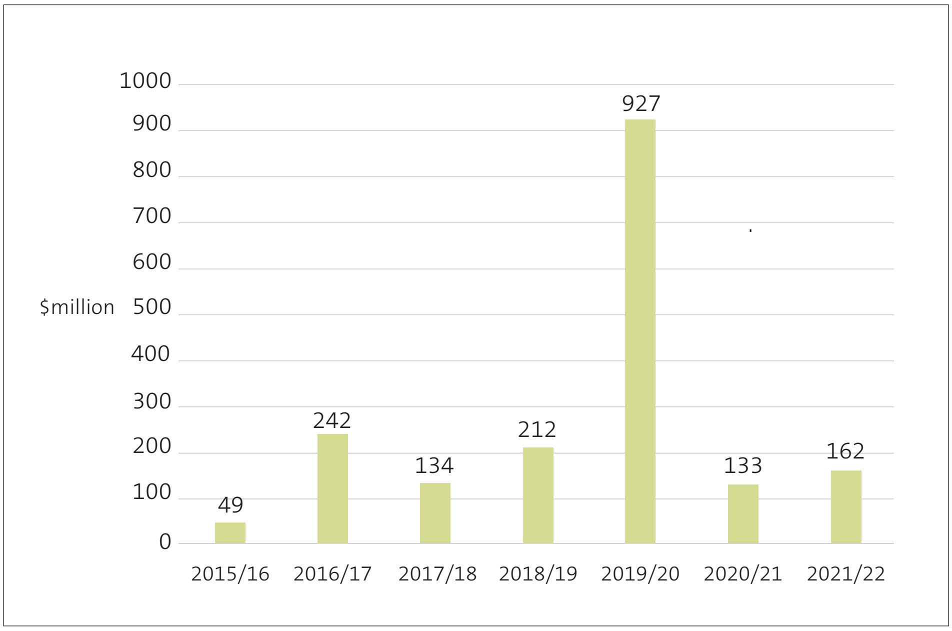
3.46 For the last two years, the annual number of instances is down to around half of those in the five years before (Figure 5).

Figure 5
Number of instances of unappropriated expenditure, from 2015/16 to 2021/22



3.47 Figure 6 shows the dollar amount of unappropriated expenditure incurred during the last seven years. The dollar amount of unappropriated expenditure tends not to correlate with the number of instances. Apart from an outlier year (2019/20), which is mostly attributable to one instance ($676.8 million), the value of unappropriated expenditure follows the usual fluctuations over time.

Figure 6
Amount of unappropriated expenditure, from 2015/16 to 2021/22



Work carried out to discharge the Controller function

3.48 During the year, we carried out our core Controller work through our regular monitoring (with the Treasury) of expenditure against appropriations.[19] As part of this work, we check that government expenditure incurred under the authority of the Imprest Supply Acts (see the Appendix) has not exceeded the spending limits authorised under those Acts. We also check that Cabinet approvals to use imprest supply have been properly authorised.

3.49 Other core Controller activity involves our audits of appropriations and audits of the Government's financial statements and of individual government departments.[20]

3.50 We published website reports on observations and findings from our monitoring of government expenditure, including a half-year report on expenditure against appropriations. We also published a website report on how changes are made and approved to the Government's Budget between the annual Budgets, how they are scrutinised and authorised through the Supplementary Estimates, and the Controller and Auditor-General's role in monitoring these approvals.

19 Under section 65Y of the Public Finance Act 1989.

20 Under section 15 of the Public Audit Act 2001.

3.51 The authority to incur expenses or capital expenditure provided by an appropriation is limited to the scope of the appropriation and may not be used for any other purpose.[21] The scope statement of an appropriation establishes the legal boundary of what an appropriation can be used for and, by omission, what it cannot. It is intended to provide an effective constraint against unauthorised activity while not inappropriately constraining activity intended to be authorised.

3.52 Several government departments provide services, including development assistance, to other countries. The Controller needs to be able to provide assurance to Parliament and the public that any public money applied for the benefit of foreign jurisdictions has been authorised by Parliament.

3.53 During 2021 and 2022, we discussed with the Treasury whether overseas assistance spending was covered by the appropriation scopes in all instances. We expect government departments to ensure that any overseas expenditure is covered by their appropriations, and we will be asking our auditors to give attention to this as part of their audit work.

3.54 We again participated in the Treasury's Finance Development Programme of seminars to government department finance professionals. We highlighted the importance of Parliamentary control of Crown spending, how the Controller function supports New Zealand's constitutional arrangements, why it is important to avoid incurring public expenditure without the proper authority, and some of the common problems that can lead to unappropriated expenditure.

21 Section 9 of the Public Finance Act 1989.

4 Improving how the government reports on its performance

4.1 In this Part, we set out our observations about performance reporting across central government. These observations build on our previous observations about how the public sector reports on its performance.[22]

4.2 Performance reporting is about showing what has been achieved with public money. Effective performance reporting is essential to building and maintaining trust and confidence in the public sector and, arguably, a government's ongoing social licence to operate.

4.3 Each year, the government spends about $130 billion to $150 billion of public money (noting that a large part of recent increased spending is Covid-19 related). However, at the multiple levels at which a government operates, it is often not clear what outcomes and objectives are being sought, how the government intends to achieve its objectives through its spending, and what is being achieved.

4.4 As we have previously commented, Parliament and the public care as much about what difference the government makes for New Zealanders as they do about whether public money has been spent appropriately. Not being clear about what is achieved with that spending creates a significant risk to maintaining the public's trust and confidence.

4.5 The Minister of Finance made comments to the House of Representatives that acknowledged the issues that we raised in last year's report.[23] The Minister also indicated, based on our report, a commitment to consider a better approach. While that was encouraging, we would like to see substantive progress to address the broad issues that we raised last year.

4.6 Parts of our public finance and accountability system, such as how the government reports on and is held to account for its finances, continue to operate and serve New Zealand well. However, public sector information and accountability processes for performance are falling short of what is expected by Parliament and the public in the 21st century.

4.7 Given the importance of improving performance reporting to build and maintain the trust and confidence of the public, there needs to be a much more concerted and systematic approach to improving how the government reports on its performance. This should include a comprehensive review of public finance legislation and associated accountability systems that ends with greater clarity on accountabilities, key outcomes, and easily understood public reporting on progress.

22 Auditors-General have been raising concerns about performance reporting for many years. See oag.parliament.nz/reports/performance-reporting for a list of our publications on this topic.

23 See New Zealand Parliament, "Debate on the 202021 Annual Reviews - Committee Stage - Video 3", at vimeo.com.

New service performance reporting standards

4.8 In 2022, the External Reporting Board brought into effect a new accounting standard for public benefit entities' service performance reporting (PBE FRS 48). The standard applies to Tier 1 and Tier 2 public benefit entities[24] and sets out generally accepted accounting practice (GAAP), which public organisations are statutorily required to comply with as part of their performance reporting.

4.9 The new standard presents an opportunity for public organisations to improve their performance reporting within the context of current system settings and to report on how they are making a difference for New Zealanders in a way that is meaningful to Parliament and the public.

4.10 We are expecting to see public organisations improve their performance reporting so that it better reflects their performance. Public organisations will need to carefully consider how they apply the standard and should also make use of the good practice guidance that we recently published in conjunction with the Treasury.

Reporting at an all-of-government level

4.11 A government's goals are often broad and span different organisations in the public sector. However, the current system of performance reporting focuses almost completely on the reporting of individual public organisations. This results in fragmented information on what progress the government is making.

4.12 For a government to be held to account, it is critical that it is clear and specific about:

- what outcomes it is seeking to achieve and how performance will be assessed;
- how it intends to achieve these outcomes through its spending; and
- how it has performed and what has been spent to achieve that level of performance.

4.13 Recent reports from the Parliamentary Commissioner for the Environment and the Productivity Commission reinforce the need to significantly improve how the government reports on, and is held to account for, its performance and spending.[25]

4.14 As the Commissioner notes, Parliament and the public should be able to readily understand what progress is being made through the about $2 billion of environmental spending each year.

24 See xrb.govt.nz.

25 Parliamentary Commissioner for the Environment (2022), *Environmental reporting, research and investment – Do we know if we're making a difference?*, at pce.parliament.nz.

4.15 In our view, these issues equally apply more widely to the government's broader goals and to the about $130 billion to $150 billion of spending by the government each year.

4.16 There is an opportunity for the government to build on the Treasury's Living Standards Framework and well-being reporting to identify the specific objectives and outcomes that it is aiming to achieve across a range of core areas (such as education, health, and transport).

4.17 If, for example, a government were required, through changes to system settings and legislation, to set out how it intends to achieve its outcomes through the Budget – and to produce a consolidated all-of-government report on what is being achieved, alongside the annual Government's financial statements – the public and Parliament would have a fuller account of what difference the government is making for New Zealanders.

Reporting at a sector level and on major initiatives

4.18 Improvements are also needed for reporting on major initiatives or funds, whether these are produced by individual public organisations or jointly by public organisations working together.

4.19 Alongside the core ongoing services delivered by public organisations, major initiatives across government often play a significant role in how the government intends to make a difference for New Zealanders, and have a high level of public interest (for example, road safety initiatives).

4.20 In the case of major initiatives involving multiple public organisations (such as the Provincial Growth Fund), we see the same issue noted earlier in relation to a government's broad goals. The reporting is spread across the different organisations' reports, and there is often no consolidated reporting.

4.21 In last year's report, we also highlighted that when major new initiatives are announced through the annual budget, the way in which the spending for these initiatives is authorised often makes it difficult to track spending against the initiatives.

4.22 There are system constraints that currently do not enable the government to clearly report on public spending and what is being achieved. The only circumstance where it is possible to determine the actual expenditure incurred for a particular initiative is when there is a "one-to-one" relationship between the initiative and the authorising appropriation. Although this sometimes happens, such as the Wage Subsidy Scheme and the Small Business Cashflow Scheme, it is not the norm.

4.23 However, many new policy initiatives in the Budget have a "one-to-many" or a "many-to-one" relationship with the spending authority provided through appropriations. In these instances, the actual expenditure for any initiative will either be spread across several appropriations or not be separated from other expenditure related to the larger appropriation.

4.24 We also found that the performance information for the appropriation was often not tailored to reflect the distinctive features of the initiative.

4.25 In general, there is no legislative requirement for the public sector to report on progress against major policy initiatives, even though they often play a significant role in how the government intends to achieve its objectives.

4.26 The statutory requirements for central government organisations require them to report on progress against their strategic intentions and their annual service performance expectations. There is no statutory requirement to report on the spending associated with major initiatives or the impacts of these initiatives approved through the Budget. Current reporting tends to be done inconsistently and to variable quality.

4.27 The issues in how a government is required to report on major initiatives apply not only to new policy initiatives and the initiatives of this Government. They are long-standing issues that have arisen for previous governments and how they have reported on both new and existing initiatives.

4.28 In response to the concerns that we previously raised about this, the Treasury told us that it intends to publish consolidated reporting on how public money is being spent and what is being achieved through the Climate Emergency Response Fund.

4.29 This is a positive step. However, it applies to only a limited part of the Government's spending.

4.30 In our view, current reporting requirements do not do enough to encourage governments and public organisations to report on how public money is being spent and what is being achieved through major initiatives. In our view, legislative changes are needed as part of reviewing the current statutory reporting requirements for the public sector.

4.31 The current Government has been pursuing a significant reform programme across the public sector. This has included:

- merging institutes of technology and polytechnics into Te Pūkenga;
- establishing Te Whatu Ora – Health New Zealand and Te Aka Whai Ora – Māori Health Authority;

- reforming three waters services; and
- reforming the Resource Management Act.

4.32 Alongside the reforms to parts of the public sector, the Government's reform programme has also included:

- changes to Public Service Act, in part to enable interdepartmental executive boards and other joint arrangements to support a more joined-up public sector; and
- modernising the public finance system that has focused on piloting clusters and a multi-year funding approach in the justice and natural resources sectors.

4.33 Although a focus of the reforms generally has been to improve how the public sector operates, in our view, they also provide an important opportunity to improve how the public sector reports on, and is held to account for, its performance. Performance reporting could usefully include an evaluation of the effectiveness of the reforms themselves.

Modernising the public finance system and clusters

4.34 The Minister of Finance has noted that addressing our concerns would likely require significant reform to the public finance and accountability system and that this was at the centre of the Government's work to modernise this system.

4.35 The primary focus of this work so far has been to pilot clusters and a multi-year funding approach in the justice and natural resources sectors. The pilots are aimed at supporting a more joined-up and flexible approach to public financial management to achieving the priorities of the two different sectors.

4.36 Performance reporting by the clusters is still being developed. However, the Treasury told us that the clusters will be reporting on progress against major initiatives as part of their performance reporting in response to the issues we have previously raised.

4.37 Although we are encouraged to see these improvements, we have yet to see the more general direction of the modernisation work beyond the focus on clusters. In particular, we have yet to see how the Government intends to make broader and more systemic improvements to how it reports on its performance.

Reforms of the vocational education and health and disability sectors

4.38 The reforms of the vocational education and health and disability sectors have also provided opportunity to improve how the public sector reports on, and is held to account for, its performance.

4.39 In the case of the reform of vocational education sector, an ongoing concern for us has been how Te Pūkenga reports on its performance.

4.40 Our audit of the first annual report from Te Pūkenga raised concerns about whether it was providing meaningful information about its performance. We noted in our report *Tertiary education institutions: What we saw in 2021* that Te Pūkenga did not have a performance and accountability framework that was ready to be implemented. As at December 2022, we understand that still to be the case.

4.41 After the fundamental reform of the health sector, which took effect on 1 July 2022, we are closely monitoring how the sector and individual agencies will report on their performance. We will have responsibility for the audit of the New Zealand Health Plan, the key planning document for the health sector from 2024 onwards. In the meantime, we will audit the reporting by Te Whatu Ora and Te Aka Whai Ora against the Interim Health Plan in both 2023 and 2024.

4.42 The Interim Health Plan was launched on 28 October 2022. It included the proposed priorities for the health sector for 2022/23 and 2023/24. We have an interest in the health sector's new accountability arrangements and its approach to performance reporting. We will look for whether the sector is providing more meaningful reporting on service delivery and whether the reporting helps with assessment of how the sector is improving health outcomes, including for different population groups and across regions.

4.43 For sectors undergoing reform, we intend to publish data showing how the performance information has changed and the extent to which the reforms have led to improved performance and improved reporting.

Interdepartmental executive boards

4.44 Recent changes to the Public Service Act also provide an opportunity for the public sector to improve how it reports on its performance. These changes enable the public sector to establish interdepartmental executive boards and joint ventures to support more aligned and co-ordinated strategic policy, planning, and budgeting for specific issues that involve the work of public organisations across the public sector.

4.45 In our view, the planning and reporting of the interdepartmental executive boards provide an opportunity to bring together key performance information across different areas and different public organisations to explain what progress is being made on those issues that are important to New Zealanders.

4.46 The interdepartmental executive boards are currently in the early stages of reporting on their performance. Although it is too early to assess the overall quality of the reporting by the interdepartmental executive boards, there are indications that several are developing frameworks and approaches to show how organisations across the public sector are making a difference on issues cutting across the public sector. We will watch these developments with interest.

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.

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 Act, the Appropriation (Supplementary Estimates) Act, which is usually enacted in June. This 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) Act, then as at 30 June it becomes "unappropriated expenditure". It must be validated by Parliament through a third appropriation Act, the Appropriation (Confirmation and Validation) Act, in the next financial year.[26]

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.[27] 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.[28] Flexibility under these mechanisms is subject to confirmation by Parliament through the Appropriation (Confirmation and Validation) Bill.

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.

26 Section 26C of the Public Finance Act 1989. 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.

27 Section 26A of the Public Finance Act 1989.

28 Section 26B of the Public Finance Act 1989.

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 they have no role in this process.[29] 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.

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.

29 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.

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.[30]

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.

Who checks whether government departments are spending money lawfully 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

30 Section 34(1)(a) of the Public Finance Act 1989.

- 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 the Appropriation (Estimates) Act can be authorised by Cabinet before the event and subsequently authorised by Parliament in the 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.

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 Minister (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.[31]

31 Sections 65Z and 65ZA of the Public Finance Act 1989.

About our publications

All available on our website

The Auditor-General's reports are available in HTML and PDF format, and often as an epub, on our website – oag.parliament.nz. We also group reports (for example, by sector, by topic, and by year) to make it easier for you to find content of interest to you.

Our staff are also blogging about our work – see oag.parliament.nz/blog.

Notification of new reports

We offer facilities on our website for people to be notified when new reports and public statements are added to the website. The home page has links to our RSS feed, Twitter account, Facebook page, and email subscribers service.

Sustainable publishing

The Office of the Auditor-General has a policy of sustainable publishing practices. This report is printed on environmentally responsible paper stocks manufactured under the environmental management system standard AS/NZS ISO 14001:2004 using Elemental Chlorine Free (ECF) pulp sourced from sustainable well-managed forests.

Processes for manufacture include use of vegetable-based inks and water-based sealants, with disposal and/or recycling of waste materials according to best business practices.

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

Telephone: (04) 917 1500

Email: reports@oag.parliament.nz
Website: www.oag.parliament.nz