

THE AUDITOR-GENERAL'S AUDITING STANDARD 4 (REVISED)

THE AUDIT OF SERVICE PERFORMANCE REPORTS

Contents

	Page
Introduction	3 - 8301
Objectives	3 - 8301
Scope of this Standard	3 - 8301
Applicability	3 - 8304
Effective Date	3 - 8304
Definitions	3 - 8305
Requirements – Planning the Audit	3 - 8310
Requirements – The Forecast Non-financial Performance Report	3 - 8312
Draft Report - Fieldwork	3 - 8312
Draft Report - Reporting	3 - 8312
Published Report - Fieldwork	3 - 8313
Published Report - Reporting	3 - 8313
Requirements – Audit of the Service Performance Report	3 - 8314
Planning	3 - 8314
Fieldwork	3 - 8314
Reporting	3 - 8315
Application and Other Explanatory Material	3 - 8318
Planning the Audit	3 - 8318
The Forecast Non-financial Performance Report	3 - 8318
Audit of the Service Performance Report	3 - 8330
Appendix 1 - Criteria for the Preparation of Service Performance Reports	3 - 8336
Appendix 2 - Example of Unmodified Audit Report for a Crown Entity	3 - 8341

Introduction

Objectives

1. The objective of the auditor in relation to the audit of service performance reports is to form an opinion on whether the service performance report complies with generally accepted accounting practice (GAAP) and fairly reflects the service performance of the entity for the period.
2. The auditor's opinion on the service performance report is formed in the context of the information provided in the non-financial performance report: Service performance reporting is concerned not only with reporting how well services are delivered (output delivery performance) but also with how effective the services are at achieving the entity's service objectives (achievement of impacts and outcomes). Therefore, in performing the audit work necessary to form an audit opinion on the service performance report, the Appointed Auditor will be required to assess how well the service performance information is presented in the context of the information on outcomes, impacts, and other objectives presented in the non-financial performance report. The non-financial performance report, together with other information in the annual report, should provide the information necessary to enable an informed assessment to be made of the entity's performance during the financial year.
3. Because the content of the service performance report is usually determined in advance as part of the forecast non-financial report (e.g. the statement of intent, statement of forecast service performance, or long-term council community plan (LTCCP)), the Appointed Auditor is also required to consider the appropriateness of the content of the forecast non-financial performance report. The Appointed Auditor is required to report these assessments to entity management in a timely manner to foster continued improvement.

Scope of this Standard

4. The Appointed Auditor is required to form an opinion, and report, on any service performance report required by legislation to be prepared and audited.
5. This Standard deals specifically with the Appointed Auditor's responsibilities under the Public Finance Act 1989, the Crown Entities Act 2004, and the Local Government Act 2002 for the audit of service performance reports.
6. The Standard also addresses the Appointed Auditor's responsibilities to undertake work necessary to support the audit of service performance reports, including:

- (a) Understanding the entity's environment, framework, and processes for strategic and operational planning, managing, reporting, and evaluating to determine whether the entity's service performance objectives and achievements are adequately reflected in the service performance report; and
 - (b) Evaluating the statutory forecast non-financial performance report to determine whether it provides an adequate framework for reporting service performance.
7. This Standard requires auditors to consider whether such information provides an appropriate context and reporting framework necessary to allow for an informed assessment of service performance. The Appointed Auditor's responsibility regarding performance information within the annual report but located outside the service performance report is determined by ISA (NZ) 720: *The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements*.
8. The audit opinion on the service performance report is concerned with whether the service performance report complies with GAAP and fairly reflects the entity's service performance for the period. Among other things, this requires the auditor to both:
- (a) Draw a conclusion on the appropriateness of the content of the service performance report, and
 - (b) Verify that content.
9. Where the audit of an entity's service performance report is not required by statute, and it is unaudited but included in the entity's annual report, the Appointed Auditor's responsibility for the service performance report is limited to following the requirements of ISA (NZ) 720: *The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements*.

Non-financial Performance Reports and Service Performance Reports

10. The performance of public entities is reported in both financial and non-financial terms in the annual report. "Non-financial performance" covers a wide range of subject matter that comes within the definition of performance (see Definitions). In undertaking their responsibilities under this Standard, Appointed Auditors will be chiefly concerned with the non-financial performance report elements of outcomes, impacts, and outputs (together with their respective performance measures). "Service performance" is a narrower concept than non-financial performance and refers only to outputs (see Definitions).
11. This Standard requires Appointed Auditors to evaluate and conclude on several aspects of the (more comprehensive) *non-financial* performance report. Although their responsibility for issuing the audit opinion relates only to the *service* performance report (as published

within the entity's annual report), the Appointed Auditor will need to consider the higher level elements (e.g. outcomes, impacts) to determine whether there is sufficient context for the service performance report and whether it is presented within an adequate framework. The context and framework within which the service performance report is presented should, among other things, explain why the services are being delivered (i.e. the intended outcomes) and provide a basis for assessing the efficiency and effectiveness of the service delivery.

Criteria for the Preparation and Evaluation of Service Performance Reports

12. High-level requirements for the preparation of service performance reports are specified in the entity's relevant legislation, and some guidance is provided by central agencies. In addition, the main sources of GAAP relevant to service performance reports are:
 - (a) *The New Zealand Equivalent to the IASB Framework for the Preparation and Presentation of Financial Statements (NZ Framework)*;
 - (b) *NZ IAS-1: Presentation of Financial Statements*; and
 - (c) *TPA-9: Service Performance Reporting*.

13. The *NZ Framework* provides the conceptual underpinning for service performance reporting. *NZ IAS-1* sets out the mandatory requirements for service performance reporting; it requires the description and disclosure of outputs and the disclosure of outcomes where practicable and appropriate. *TPA-9* provides guidance on the specification, measurement, and reporting of service performance.

14. GAAP states that non-financial performance reports should have the qualities of relevance, reliability, understandability, and comparability. This Standard provides guidance on the meaning of these qualities as they apply to non-financial performance reports (see paragraphs A15 to A25). Important criteria for the preparation of service performance reports are provided at Appendix 1.

15. In forming an opinion on the service performance report, the Appointed Auditor will need to evaluate its appropriateness against the criteria outlined in legislation and GAAP. To do so, the Appointed Auditor is required to consider the (forecast and historical) non-financial performance reports as a whole, together with essential contextual information (e.g. legislative mandate; strategic and operational objectives; as well as the reported outcomes, impact, and output information).

Applicability

16. Compliance with this Standard is mandatory for Appointed Auditors who carry out annual audits on behalf of the Auditor-General.

Effective Date

17. This Standard is effective for audits of service performance reports of
- (a) Local authorities for periods beginning on or after 1 July 2009;¹
 - (b) Government departments for periods beginning on or after 1 July 2010; and
 - (c) Crown entities required to prepare a statement of intent and statement of service performance under sections 139 and 151 of the Crown Entities Act 2004² for periods beginning on or after 1 July 2010.

¹ Excluding Council Controlled Organisations

² This excludes the audit of service performance reports for other Crown entities whose service performance reporting requirements are governed by other legislation (e.g. Crown Research Institutes and Tertiary Education Institutions).

Definitions

18. For the purpose of this Standard, the following terms have the meanings attributed below:

- (a) *Appropriateness* – Appropriateness refers to the usefulness or suitability of various aspects of the non-financial performance report and can be used in relation to:
- (i) The non-financial performance reporting framework;
 - (ii) The elements reported;
 - (iii) The performance measures; and
 - (iv) The targeted levels of performance or historical results.

In assessing whether the service performance report is appropriate, consideration is given to whether the information is relevant to the interests of users, reliable (i.e. faithfully represented, supportable, neutral, complete, and balanced), understandable, and comparable. The subject matter should be sufficiently appropriate to allow for an informed assessment of the entity's service performance.

- (b) *Dimensions of performance* – Dimensions of performance are the aspects or properties of performance that may be captured by a particular performance measure. They include, but are not limited to, quantity, quality, timeliness, location, and cost.
- (c) *Elements of non-financial performance reporting* – Elements of non-financial performance reporting include inputs, outputs, impacts, and outcomes, which can be measured for the purpose of reporting and assessing the entity's performance.
- (d) *Impacts* – Impacts are the contributions made to an outcome by a specified set of outputs. Often referred to as "intermediate outcomes", they represent the relatively immediate or direct effect on stakeholders of the entity's outputs.
- (e) *Inputs* – Inputs are the resources used by the entity to produce its outputs.
- (f) *Management* – Management is defined broadly as meaning the governing body, audit committee, individual member of the governing body, officer(s) and/or other person(s) having responsibility for planning and directing the activities of an entity.
- (g) *Non-financial performance reporting framework* – For the purpose of published, statutory accountability reports, a non-financial performance reporting framework will typically comprise the following components:

- (i) A medium-term component that incorporates an outcome-oriented statement of intended or actual achievements, which should include information on the entity's objectives, outcomes, impacts, and operating intentions, together with related performance measures and targets and other information required by legislation and generally accepted accounting practice (GAAP).
- (ii) An annual component that incorporates a service performance report (often referred to as a "statement of service performance" or "SSP") – an output-oriented statement of forecast or historical service (i.e. output) delivery, together with related performance measures and targets and other information required by legislation and GAAP.

To constitute a "framework", these components need to provide enough context and links (a) to strategic-level information and (b) within and between the information in the two components to provide a coherent structure for reporting. They need to clearly demonstrate the rationale for, and the relationships among, the contextual information, elements, performance measures, and performance targets. The framework, including the two components described above, should be evident both in the forecast non-financial performance report and in the historical (or "actual") non-financial performance report. The historical non-financial performance report is typically included in the annual report and should report historical outcome and output performance against the targets set in the forecast non-financial performance report, together with related performance measures and targets and other information required by legislation and GAAP.

- (h) *Non-financial performance reports* – Non-financial performance reports are reports to users that provide primarily non-financial information that records the performance of an entity against specified objectives. They can encompass a comprehensive range of performance elements (incl. outcomes, impacts, outputs, inputs, and capability), and the information can be presented in various statements (e.g. Information Supporting the Estimates of Appropriation, Statements of Intent, Statements of Corporate Intent, LTCCPs, annual plans, statements of service performance, and other statements within annual reports).

"Service performance reports" are non-financial reports concerned primarily with the reporting of output performance information.

Non-financial performance reports can be:

- (i) *Forecast* performance reports, which are before-the-event or “ex ante” statements that express intended, expected, or targeted performance for the period; or
- (ii) *Historical* performance reports, which are after-the-event or “ex post” statements that report results or achievements for the period, ideally against the forecast levels of performance.

- (i) *Outcomes* – Outcomes refer to changes in the state, condition, impacts on, or consequences for the community, society, economy, or environment resulting from the existence and operations of the reporting entity. (The outcomes sought provide the rationale for the range of outputs delivered by the entity.)
- (j) *Output classes* – Output classes are groups of outputs of a similar nature. (They are sometimes referred to as “groups of activities”).
- (k) *Outputs* – Outputs are the goods and services produced by the reporting entity. The term refers only to the goods and services produced for third parties; it excludes goods and services consumed within the reporting entity (such as services provided by legal, research, HR, and IT functions to other functional areas within the same entity, which are often referred to as “internal outputs”).

(The Local Government Act 2002 uses the term, “activity” to refer to goods and services. The term “outputs” is used in this Standard to refer to goods and services, and the term “activity” carries its common meaning.)

- (l) *Performance* – Performance refers to how well an entity performs against its objectives. It is a comprehensive concept, as performance can relate to a wide range of elements, such as outcomes (including impacts or other intermediate-level outcomes), outputs, inputs, and capability. Performance may also be expressed in relational terms, such as efficiency (i.e. relationship of inputs to outputs) or effectiveness (i.e. relationship of outputs to outcomes).

The term “service performance” relates specifically to outputs.

- (m) *Performance measures* – Performance measures are the specific criteria or means used to measure performance (most commonly of output production and achievement of impacts and outcomes). They may be expressed as (but are not limited to) absolute numbers, percentages, ratios, point estimates, or ranges. They might also be qualitative in nature.

Examples of output performance measures might include the following:

- (i) The average waiting time for radiation treatment;
- (ii) The number of hectares of public reserve per head of population;
- (iii) The percentage of investigations completed within x months of receiving notification of an event; and
- (iv) The percentage of decisions overturned on appeal.

- (n) *Performance targets* – Performance targets are the specific levels of performance (usually relating to outputs produced and outcomes achieved) that the entity aims to meet.

Various pronouncements and literature on performance reporting often use the term “performance standards” to refer to levels of planned performance. This term carries the nuance of levels determined by legislative or other mandatory requirements; by contrast the term “targets” is often reserved for levels that are aspirational or otherwise discretionary. This Standard uses the term “targets” as an over-arching concept to describe performance levels and, therefore, the term “performance targets” encompasses the notion of “performance standards”.

Examples of output performance targets, based on the examples of performance measures in (m) above, might include the following:

- (i) Ninety per cent of patients wait less than 10 weeks between first assessment and treatment;
- (ii) At least 1.7 hectares of public reserve per 1,000 people;
- (iii) Eighty five per cent of investigations are completed within five months of receiving notification of an event; and
- (iv) Less than five per cent of decisions are overturned on appeal.

- (o) *Service performance reports* – Service performance reports are reports to users that provide primarily non-financial information that records the output delivery performance of an entity against specified measures and targets. This information is usually shown in statements of service performance (or equivalent reports) and is compared with information contained in forecast non-financial performance reports (e.g. Information Supporting the Estimates of Appropriation, Statements of Intent, Statements of Corporate Intent, LTCCPs, and annual plans).

Service performance is concerned not only with how well services are delivered (output delivery performance) but also with how effective the services are at achieving the entity’s objectives (achievement of impacts and outcomes). Service

performance reports should therefore provide some link to impact and outcome information.

- (p) *Stakeholders* – Stakeholders are the primary users of an entity’s financial and non-financial performance reports and are those to whom the entity is primarily accountable (e.g. Parliament, taxpayers, and ratepayers).
- (q) *Users* – Users are those persons who rely on published (i.e. external), general purpose reports as their major source of financial and non-financial information about the entity. For this purpose, users are assumed to have a reasonable knowledge and willingness to study the reported information with reasonable diligence.

In relation to the public sector, specific users of published, general purpose non-financial performance reports may include customers (i.e. the recipients of public goods or services), funders and financial supporters (incl. taxpayers and ratepayers), elected or appointed representatives (e.g. Members of Parliament and Select Committees), and interested members of the public (e.g. media commentators, academics and other analysts, and members of relevant professional or community groups).

Although governors (e.g. Ministers and local authority councillors), central agencies, other monitoring agencies, some grant providers, and entities’ management are also users of published reports, they have access to, or are able to request, additional financial and non-financial performance information (i.e. special purpose reports) in carrying out their governance, monitoring, or management responsibilities.

Requirements – Planning the Audit

19. In accordance with the Auditor-General's Statements, the Appointed Auditor must be conversant with the statute(s) governing the entity, in particular with the laws and regulations that specify the form, content, preparation, publication, and audit of the non-financial performance report, and assess whether they have been met. (Ref: Para. A1)
20. The Appointed Auditor must gain an understanding of the nature and purpose of the entity, in accordance with the Auditor-General's Statements. This is necessary, among other things, to assist the Appointed Auditor to assess the entity's approach to performance management, provide a basis for assessing the quality of its non-financial performance report, and plan the audit approach. (Ref: Para. A2)
21. The Appointed Auditor must assess the management control environment and obtain an understanding of how its non-financial performance information fits within it. This involves gaining an appreciation of the policies, processes, systems, and structures employed by the entity for planning, managing, reporting, and evaluating its overall performance. (Ref: Para. A3)
22. When planning the audit of the service performance report, the Appointed Auditor must consider the current state of the entity and its environment. The Appointed Auditor must consider any changes affecting the entity's management control environment since their most recent assessment and consider the implications of those changes for planning the audit approach and the nature and extent of audit procedures.
23. Specifically, the Appointed Auditor must consider:
 - (a) How the entity views the relationships between the various elements of performance (i.e. inputs, outputs, and outcomes, including impacts and other intermediate outcomes); and
 - (b) The entity's performance priorities.

The Appointed Auditor's understanding of the way the entity manages and reports its performance is essential for informing their views on the appropriateness of the forecast non-financial performance report.

24. The Appointed Auditor must also consider the entity's audit history, including recent audit reports and reports to management in relation to matters affecting the entity's non-financial performance report.

25. The Appointed Auditor must consider the implications of the matters referred to in paragraphs 19 to 24 above for planning the audit approach and the nature and extent of audit procedures.

Requirements – The Forecast Non-financial Performance Report

Draft Report - Fieldwork

26. The Appointed Auditor must seek to obtain a copy of the draft forecast non-financial performance report prior to its approval.
27. If the draft report is obtained in sufficient time to enable the Appointed Auditor to consider the report and the entity to respond to the Appointed Auditor's comments, then the Appointed Auditor must form a preliminary view about:
- (a) Whether the draft forecast non-financial performance report provides an adequate framework for reporting service performance; and
 - (b) Whether the draft forecast service performance report complies with GAAP and provides an adequate basis for fairly reflecting the service performance of the entity. In doing so, the Appointed Auditor must consider whether the forecast outputs, the performance measures attached to those outputs, and the performance targets are appropriate.

The Appointed Auditor's views should be formed in the context of the matters referred to in paragraphs 19 to 24 above. (Ref: Para. A4-A44)

Draft Report - Reporting

28. If the Appointed Auditor considers that:
- (a) The draft forecast non-financial performance report does not provide an adequate framework for reporting service performance; or
 - (b) The draft forecast service performance report fails to comply with GAAP or otherwise fails to provide an adequate basis for fairly reflecting the service performance of the entity to the extent it is likely to affect the user's ability to make an informed assessment of entity performance;
- then the Appointed Auditor must notify the OAG and discuss their concerns with management at the earliest opportunity. This may provide the entity with the opportunity to make improvements before the forecast non-financial performance report is finalised.
29. If the Appointed Auditor has grounds for concern about the draft forecast non-financial performance report but is in doubt as to the seriousness of those concerns, then the Appointed Auditor must confer with the OAG before discussing the concerns with entity management.

Published Report - Fieldwork

30. After the forecast non-financial performance report has been finalised, the Appointed Auditor must determine whether it provides an adequate framework for reporting service performance.
31. The Appointed Auditor must determine whether the forecast service performance report complies with GAAP and provides an adequate basis for fairly reflecting the service performance of the entity. In doing so, the Appointed Auditor must assess whether the forecast outputs, the performance measures attached to those outputs, and the performance targets are appropriate. (Ref: Para. A4-A44)
32. The Appointed Auditor's determination concerning the appropriateness of the non-financial performance report should be formed in the context of the matters referred to in paragraphs 19 to 24 above.

Published Report - Reporting

33. If the Appointed Auditor determines that:
 - (a) The forecast non-financial performance report does not provide an adequate framework for reporting service performance; or
 - (b) The forecast service performance report fails to comply with GAAP or otherwise fails to provide an adequate basis for fairly reflecting the service performance of the entity to the extent it is likely to affect the user's ability to make an informed assessment of entity performance;then the Appointed Auditor must notify the OAG and report the matter to entity management in the management report. This may provide the entity with the opportunity to make improvements to the service performance report intended for inclusion in the annual report for that period or to the forecast non-financial performance report for the following period.
34. If the Appointed Auditor has grounds for concern about the forecast non-financial performance report but is in doubt as to the seriousness of those concerns, then the Appointed Auditor must confer with the OAG before reporting such matters to entity management.
35. The Appointed Auditor's judgement on the appropriateness of the forecast service performance report must be taken into account when forming their audit opinion on the (historical) service performance report at the conclusion of the audit.

Requirements – Audit of the Service Performance Report

Planning

36. The Appointed Auditor must consider their conclusions on:
- (a) The entity's management control environment and the way the entity manages and reports performance;
 - (b) The adequacy of the forecast non-financial performance report; and
 - (c) Specifically, the appropriateness of the forecast service performance report when planning the audit of the service performance report.

Materiality

37. The Appointed Auditor must determine the material outputs and performance measures for the purpose of audit testing. (Ref: Para. A16 and A45-A46)
38. The Appointed Auditor must establish a basis and level for determining planning materiality that will be applied in the determination of those outputs that are of audit interest. The Appointed Auditor is required to establish a planning materiality level for performance measures associated with material outputs. The level determined is to reflect the level of misstatement that would be accepted by the Appointed Auditor before they consider that the users' judgement would be impaired. The level should be expressed in terms of the appropriate unit of measurement and be documented.

Fieldwork

Obtaining Audit Evidence

39. The Appointed Auditor must obtain sufficient, appropriate audit evidence in relation to all material outputs and performance measures in accordance with ISA (NZ) 500: *Audit Evidence*. (Ref: Para. A47-A50)

Changes in Material Outputs, Performance Measures, or Targets

40. The Appointed Auditor must check whether there have been any changes to material outputs, performance measures, or targets reported against during the reporting period from those presented in the forecast service performance report.
41. Where the selection of material outputs has been altered or material performance measures or targets have been amended during the reporting period, the Appointed Auditor

must ensure that the changes have been approved and adequately explained within the service performance report. (Ref: Para. A51-A56)

Management Commentary

42. Where management commentary is included within the service performance report, the Appointed Auditor must evaluate such management commentary to determine the relevance of the commentary to the audited service performance information and its reliability.
43. Professional judgement is to be exercised as to the level of assurance required over the management commentary.
44. Where there are material reported variances between forecast and historical service performance, the Appointed Auditor must consider the explanations given for those variances and assess their reasonableness. If no explanation is given, then the Appointed Auditor must determine whether the absence of explanation is likely to materially affect the users' ability to make an informed assessment of entity performance.
45. Where the Appointed Auditor considers that the management commentary is misleading or inconsistent with information contained in the service performance report or other parts of the annual report, they must request management to justify their commentary or reconcile, remedy, or remove the misleading or inconsistent statements, as appropriate. (Ref: Para. A57-A61)

Allocation of Costs

46. The auditor must obtain reasonable assurance that costs have been appropriately allocated to each material output or output class. The cost allocation method, and the application of that method, should result in the service performance report presenting a fair reflection of the cost of each output or output class. (Ref: Para. A62-A63)

Reporting

Fieldwork Conclusion

47. The Appointed Auditor must consider the (forecast and historical) non-financial performance reports as a whole, together with any other relevant financial and non-financial information, for the purpose of determining the appropriateness of the service performance report. The Appointed Auditor's determination will be based on their conclusion about

whether the service performance report complies with GAAP and fairly reflects the entity's service performance for the year. Specific regard should be given to the appropriateness of the outputs selected by the entity for reporting, the performance measures attached to those outputs, the performance targets set, and the historical results reported. (Ref: Para. A64-A65)

48. The Appointed Auditor will have drawn conclusions on the appropriateness of the service performance report when evaluating the forecast service performance report. The Appointed Auditor must therefore take into account any significant differences between the forecast and historical service performance reports for the period.
49. The Appointed Auditor must also consider any of the matters referred to in paragraphs 40 to 45 as well as any other matters arising during the course of the audit that may affect their opinion on the appropriateness of the service performance report.
50. If the Appointed Auditor has serious concerns about the service performance report, whether it is about the appropriateness of the content selected for reporting or the verification of that content, then the Appointed Auditor must notify the OAG at the earliest opportunity.
51. If the Appointed Auditor has grounds for concern about the service performance report but is in doubt as to the seriousness of those concerns, then the Appointed Auditor must confer with the OAG before forming their audit opinion or otherwise reporting such matters to entity management.

The Audit Report

52. The Appointed Auditor must form an opinion on whether the service performance report:
 - (a) Complies with GAAP in New Zealand; and
 - (b) Fairly reflects the entity's service performance for the year, including:
 - (i) Its performance achieved as compared with the forecast targets outlined in the forecast service performance report for the financial year; and
 - (ii) Its revenue earned and output expenses incurred as compared with the forecast revenues and output expenses outlined in the forecast service performance report for the financial year. (Ref: Para. A66)
53. The Appointed Auditor must consider modifying the audit report if the errors or specific circumstances identified, individually or collectively, are material. (Ref: Para. A67)

54. The Appointed Auditor must consider the impact on the audit report of non-compliance with laws and regulations by applying both this Standard and the Auditor-General's Statements.

55. If the Appointed Auditor at any stage seriously considers modification of the service performance report for a fundamental reason that could result in an adverse opinion or disclaimer, the Appointed Auditor must make a submission to the OAG Opinions Review Committee in accordance with the applicable Auditor-General's Statements and Standards.

Reporting to Entity Management

56. The Appointed Auditor must include in their management report(s) commentary on modifications made and on any other matters that were substantive but did not result in modification, including matters identified or reported to management at earlier stages of the audit. (Ref: Para. A67)

Application and Other Explanatory Material

Planning the Audit (Ref: Para 19-25)

- A1. Statutes governing public entities' non-financial performance reporting requirements include the Public Finance Act 1989, Crown Entities Act 2004, Local Government Act 2002, and may also include the entity's enabling Act.
- A2. In gaining an understanding of the entity, the Appointed Auditor will also need to consider the entity's (external and internal) business environment, any changes in that environment, and the possible implications for the audit.
- A3. In assessing the management control environment, the Appointed Auditor needs to understand:
- (a) The entity's approach to formulating strategy, its strategic planning processes, and the links to operations, in terms of planning, management, and reporting flows;
 - (b) Its processes for:
 - (i) specifying outcomes and impacts, outputs, resources, and processes for service delivery;
 - (ii) setting goals, objectives, and targets;
 - (iii) establishing business plans and budgets;
 - (iv) measuring and reporting performance throughout the different levels within (and outside) the entity.
 - (c) How the entity assesses its performance information needs for the purposes of management decision making and accountability;
 - (d) How the entity designs, implements, and reviews the information systems that support its information requirements.

This understanding is essential for determining whether the entity's performance objectives and achievements are adequately reflected in the (forecast and historical) non-financial performance reports.

The Forecast Non-financial Performance Report (Ref: Para 26-35)

- A4. The Appointed Auditor is to request the draft forecast non-financial performance report at an early enough stage to allow the auditor time to consider the report and provide comments to the entity and for the entity to take those comments into account when finalising the report. Whether the Appointed Auditor is able to undertake this work will depend on the entity making the draft report available within a reasonable time prior to the report being formally approved. The extensiveness of the auditor's examination of the draft report will depend on the extent of the draft report's completeness. The early consideration

of the draft report is primarily for the benefit of the entity, in that it provides the opportunity for improvement before the report is finalised. The Appointed Auditor's work on the draft report should be taken into account when reviewing the final forecast non-financial performance report. In undertaking this work on the draft or final report, the Appointed Auditor should consider:

- (a) How well the forecast non-financial performance report links to the entity's overall performance management and reporting arrangements;
- (b) The process for establishing and selecting the reported elements (primarily outcomes, impacts, and outputs), performance measures, and targets; and
- (c) The content of the report (e.g. the outcomes, impacts, outputs selected for reporting and their respective performance measures and targets) and how well they represent the entity's strategic and operational performance objectives.

A5. The long-term goals and objectives of public entities are generally set out in their legislation and strategic plans. The forecast non-financial performance report should reflect the entity's performance management arrangements, objectives and priorities, and it should show how the annual targets contribute towards the long-term goals. The logic for the existence of activities and outputs should be clear and understandable.

A6. The performance reports to be produced, and the specific elements to be reported on, will differ among entities depending on their governing legislation. The Appointed Auditor needs to be familiar with the specific reporting requirements relating to the entity. For most entities reporting under the Public Finance Act, Crown Entities Act, or Local Government Act, a non-financial performance reporting framework will include:

- (a) A forecast performance report of intended outcomes or impacts:
 - (i) These reports are presented in Statements of Intent, LTCCPs, and like documents;
 - (ii) They are aimed at specifying what the entity hopes to achieve in terms of its effect on third parties, that is, how it aims to influence or contribute to changes in society (or a sector of society) as a result of the services it delivers; and
 - (iii) The reports usually cover the medium term;
- (b) A forecast performance report of planned outputs:
 - (i) These reports are presented in Information Supporting the Estimates of Appropriation, Statements of Intent, LTCCPs, and like documents;
 - (ii) They are aimed at specifying the types and levels of service the entity plans to deliver to third parties;
 - (iii) The reports are usually annual or cover the short term and are often presented as a "statement of forecast service performance" or "forecast SSP";

- (c) A historical performance report of actual outcomes or impacts achieved:
 - (i) These reports are to be presented in the entities' annual report;
 - (ii) They report outcomes or impacts achieved against the performance intentions outlined in the medium-term, outcome-oriented part of the forecast report;
 - (iii) The annual report should disclose any other information necessary to enable an informed assessment of the entity's performance. (This could include descriptions of identified effects of the entity's interventions, including unintended consequences.);
 - (d) A historical service performance report of outputs delivered:
 - (i) These reports are presented within the entities' annual reports;
 - (ii) They report service performance delivered against the performance targets outlined in the forecast SSP;
 - (iii) They relate to the financial year covered by the annual report.
- A7. The forecast reports referred to in A6 (a) and A6 (b) above may be presented together as part of the same report or presented in separate documents, depending on the entity's reporting requirements.
- A8. In addition to reports A6 (a) and A6 (b) being coherent within themselves, an adequate performance reporting framework requires that they are coherent in relation to each other. Each statement should demonstrate the links to the other so that the user is able to ascertain which of the entity's output classes contribute to which of the outcomes. Such links are necessary for enabling users to assess the effectiveness of the entity's service delivery.
- A9. The non-financial performance report should clearly and accurately describe, classify, and group together the various elements of non-financial performance. For example, the reporting of outcomes should be clearly distinct from the reporting of outputs (although the two should be linked). A range of performance measures and targets will be attached to the types of elements the entity is required by legislation to report against (e.g. outcomes, impacts, outputs, inputs, or other objectives if expressly required).
- A10. The non-financial performance report should include sufficient contextual information (e.g. on the entity's statutory role and function, strategic goals, government and Ministerial priorities, external and internal risks and responses, and other information required by legislation or GAAP). It should also demonstrate logical links between such contextual information and the main components of the forecast performance reports, (e.g. reports on intended outcomes/impacts and reports of planned outputs). This information provides a frame of reference for the entity to demonstrate the appropriateness of its output reporting.

- A11. The specific outcomes, output classes and outputs within each class, performance measures, and targets selected for external reporting purposes are confirmed at the stage at which the entity draws up its forecast non-financial performance report (e.g. the SOI, LTCCP, Annual Plan or Estimates etc), which may take place up to six months before the start of the reporting period to which it relates. The choice of outputs reported against and the nature of measures and targets chosen by an entity may have significant implications for audit work. For example, the appropriateness of measures chosen and the auditability of systems used to record performance data are both of major concern to the Appointed Auditor. As a consequence, the timing of the entity's planning process has an impact on the timing of audit work.
- A12. The Appointed Auditor should address the following matters:
- (a) Consider whether the entity is using the same non-financial performance information that managers use to make decisions and monitor performance as the basis for its external, published non-financial performance report. The Appointed Auditor should therefore consider the entity's environment (and any changes in that environment), its management control environment, and performance management arrangements and consider what they would expect to see in the non-financial performance report. It is important for the Appointed Auditor to consider what should be included in the report, rather than simply validating the content that is included.
 - (b) Evaluate the adequacy of processes used to establish the selection of elements and their respective performance measures and targets, for example, whether adequate consultation (within or outside the entity) is being undertaken.
 - (c) Determine whether the entity is complying with laws and regulations for non-financial performance reports.
 - (d) Determine the "appropriateness" of the selected outputs and output classes, performance measures, and targets. The appropriateness of performance targets will usually be determined by considering the process for setting them.
 - (e) Consider whether there are any other issues in relation to the non-financial performance report, selection of outputs, performance measures, and targets that may impact on the audit opinion – in particular, the auditability of the measures.

Qualitative Characteristics of Non-financial Performance Reports

- A13. High-level requirements are specified in the entity's relevant legislation, and some guidance is provided by central agencies and GAAP. GAAP states that non-financial performance reports should have the qualities of relevance, reliability, understandability, and comparability. As part of forming an opinion on whether the service performance

report is fairly reflected, the Appointed Auditor will therefore need to determine whether the reported outputs, performance measures, and targets/results are appropriate (i.e. relevant, reliable, understandable, and comparable). Determining the extent to which the appropriateness of the output information is demonstrated in the service performance report will involve analysing the various components of the non-financial performance reporting framework, including relevant contextual (e.g. legislative, strategic, and outcomes) information, and checking for credible links, internal logic, and consistency.

- A14. The qualitative characteristics of relevance, reliability, understandability, and comparability apply generally to all types of non-financial performance report. An explanation of the qualitative characteristics is provided at paragraphs A15 to A25 below. The Appointed Auditor should also apply these characteristics when assessing the appropriateness of:
- (a) The reported outputs;
 - (b) The dimensions of performance to be measured and, therefore, the performance measures selected;
 - (c) The levels of performance aspired to (i.e. the performance targets); and
 - (d) The results achieved.
- A15. To be *relevant*, the report (including the elements, performance measures, and targets or results, as applicable) should:
- (a) Be presented within the context of the entity's strategic objectives, past performance, and current environment (incl. government themes, as appropriate and other themes and considerations, such as sustainable development);
 - (b) Show clear and logical links between entity-level objectives (and themes), outcomes, outputs, performance measures, and performance targets (so that the rationale for the selection of elements, measures, and targets is evident);
 - (c) Meet the information requirements of users (incl. by reporting different levels and layers of information) and be useful for decision making, as appropriate; and
 - (d) Be clearly linked to the financial information, including significant areas of planned expenditure.
- A16. The relevance of information is affected by its nature and materiality. An output or output performance measure is considered "material" if, when reporting performance, it:
- (a) Relates to the primary functions or purposes of the entity (i.e. its "reason for being");
 - (b) Relates to an output that could be of significant national or community interest or interest to the public, including the media;
 - (c) Relates to an output of significant risk to the public (for example, performance measures relating to purity of water supply) or an output that could have a negative effect on social, economic, or environmental wellbeing;

- (d) Could contain errors or omissions that, individually or collectively, affect the service performance report by altering the user's perception in a way that is likely to influence their assessment of entity performance or their decision making;
 - (e) Could contain errors or omissions that could adversely affect the reputation of the entity or Parliament, if they were to remain undetected (for example, relating to illegal acts);
 - (f) Relates to an output that is financially significant; or
 - (g) Relates to an output target that may have a significant effect on management performance rewards.
- A17. To be *reliable*, the reports (including the elements, performance measures, and targets or results, as applicable) should be:
- (a) Faithfully represented and supportable:
 - (i) They are measurable;
 - (ii) They represent what they purport to, or are expected to, represent (i.e. they represent the substance of transactions and events);
 - (iii) Informed users would reach the same, or similar, conclusions on the choice of elements and performance measures; and
 - (iv) Free from material error (i.e. they are accurate or capable of having their accuracy determined within an acceptable range of precision or certainty – i.e. free from errors of method and errors of application).
 - (b) Neutral (i.e. free from bias in the selection, measurement, and disclosure of the elements, performance measures, and performance targets).
 - (c) Complete and balanced:
 - (i) Comprehensive enough, aggregated where appropriate and reasonable (with the basis for aggregation clearly specified); and
 - (ii) Cover the significant activities and all important aspects (including identifying the important dimensions of performance), and give them suitable emphasis, to fairly reflect their significance to the entity's performance.
- A18. Biased reporting or distorted presentation of performance measures will not portray a complete picture of all significant activities. On the other hand, giving equal weighting to performance measures that vary greatly in their significance may also fail to portray a sense of proportion representative of the entity's activities. In this sense, "completeness" relates more to the need for a rounded and proportionate view of performance rather than to an overly comprehensive and voluminous set of performance measures, which can swamp the user and detract from the usefulness of the report.

- A19. The use of external references and external assessment can enhance objectivity in performance measurement. For example, measuring performance against external benchmarks, standards, or predetermined criteria may provide more objectivity in the choice of measure than measures derived internally (i.e. within the entity). Also, the use of external (i.e. third) parties to measure and assess historical performance may provide more objectivity than if performance were measured and assessed internally (i.e. by entity staff). However, while aspiring to high levels of objectivity is desirable, it may not always be realistic or appropriate depending on the nature of the output and the relevance of the measures sought.
- A20. To be *understandable*, the reports (including the elements, performance measures, and targets or results, as applicable) should:
- (a) Have a clear format and layout;
 - (b) Be presented in a way that engages the user, for example, by creating visual interest through the use of charts, tables, and symbols;
 - (c) Classify reported items clearly and logically;
 - (d) Be coherent, with easy-to-follow links between the different parts;
 - (e) Be presented within the context of the entity's strategic objectives, past performance, and current environment (incl. government themes, as appropriate and other themes and considerations, such as sustainable development);
 - (f) Show clear, logical, and easy-to-follow links among entity-level objectives, outcomes, outputs, performance measures, and performance targets;
 - (g) Be clear and concise in their content; and
 - (h) Be easy to read, expressed in plain English, and use words and terms suitable for users (with adequate explanations of acronyms, jargon, and technical terms).
- A21. The level of detail should be such that users can readily understand the key issues.
- A22. To be *comparable*, the reports should be presented to allow users to identify similarities and differences and to track progress:
- (a) Most importantly, of historical performance against forecast performance; as well as
 - (b) Across different reporting periods and to identify trends.
- This requires the reports to be consistent in their format, layout, and in the way information is classified, as well as in the selection, measurement, and disclosure of elements and related information.
- A23. It is also desirable that reports are presented to allow users to identify similarities and differences among different entities, where appropriate and practicable.

- A24. Appointed Auditors should encourage entities to:
- (a) Develop performance measures that are consistent over time;
 - (b) Include long-term targets, where relevant; and
 - (c) Reorient the focus of reporting by including information that enables users to track the entity's progress in meeting both its annual and long-term goals.

This will enable performance in the current reporting period to be assessed in the context of the entity's longer-term objectives. Note that, generally, such comparisons form the starting point for further questions from users of non-financial performance reports, rather than providing definitive answers.

- A25. The information in the reports should also be timely and economical. Therefore, the Appointed Auditor should be mindful of the need for a balance between the cost and benefits of producing the information as well as a balance among the qualitative characteristics.

Outcomes and Impacts

- A26. There is rarely a single cause-and-effect relationship between outputs and outcomes. Often, several outputs relate to one outcome and the reverse may also be true. The primary links may need to be set out in the non-financial performance report, as far as is practicable without sacrificing clarity.
- A27. Outcomes are usually not completely under the control of a single entity or totally under the control of a group of entities. For instance, where the outcomes being sought by an entity revolve around complex social questions, such as the crime rate, each outcome would usually result from a variety of factors including, for example, the activities of all agencies responsible for:
- (a) Economic development and employment;
 - (b) Provision of adequate and equitable social welfare and security;
 - (c) Provision of education and training; and
 - (d) Policing, prosecution, sentencing, imprisonment, and rehabilitation.
- A28. It is therefore important that public entities recognise the importance of reporting outcomes they expect to influence and contribute to by their output delivery, even though they do not "control" the outcome. Entities can provide a rich set of information by reporting outcome achievement at various levels (e.g. high-level societal outcomes, lower level intermediate outcomes, and immediate outcomes/impacts over which the entity has a stronger influence or closer control). The relationship of the output performance of multiple agencies to the various levels of outcome achievement can provide useful information for assessing public sector performance and for future policy setting.

Appropriateness of Reported Outputs, Performance Measures, and Targets

A29. It is the responsibility of the entity to determine the reported outputs and output classes and to develop “appropriate” performance measures and targets (although, in some instances, significant performance benchmarks may be determined by legislation or regulation, e.g. statutory timeframes for approvals). It is the Appointed Auditor’s responsibility to consider whether:

- (a) The reported outputs, taken as a whole, fairly represent and reflect the services provided by the entity; and
- (b) The performance measures, taken as a whole, fairly reflect the performance of the entity.

It should be stressed, however, that the Appointed Auditor’s assessment of appropriateness should particularly take into account the requirements of users.

A30. If the reported outputs or performance measures do not fairly reflect the services provided by, or the performance of, the entity, then the audit opinion and the management report may be affected.

A31. While the following procedures should not be regarded as complete, they provide the Appointed Auditor with some guidance for assessing the appropriateness of the performance measures and targets:

- (a) *Ascertain how users’ views have been taken into account:* As a minimum, the Appointed Auditor should assess whether management has identified significant user groups, whether they have consulted with them, and what the outcome of those consultations was.

The auditor is interested in the views of users of the non-financial performance report to assist in forming a view on the appropriateness of the performance measures and targets. In doing so, it may be necessary for the auditor to ask outcome-oriented questions about the nature of the information provided to users to help them understand the extent to which the entity has achieved its goals. Although this presumes a knowledgeable and informed set of users, the auditor may wish to focus on a significant user group, such as select committees (central government), as representatives of the wider user group.

- (b) *Examine policy or outcome statements:* By examining policy or outcome statements of the entity, the Appointed Auditor may be able to gain evidence to

support the entity's assertions that the reported outputs, performance measures, and targets in the forecast service performance report are appropriate.

The auditor should also consider any output or purchase agreements or equivalent contractual documents between the entity and the controlling entity, agency, individual, or Minister, as well as the outcome statements of policy setting and funding agencies within the same sector.

- (c) *Assess process*: If an appropriate process is in place, appropriate reporting of outputs, performance measures, and targets should result. The Appointed Auditor could therefore evaluate the appropriateness of the process used by the entity to develop and refine its reported outputs and performance measures.

Output Dimensions

A32. The Appointed Auditor will have a particular concern with the dimensions of the outputs being reported. Generally, the following five dimensions commonly are used in establishing performance measures for outputs or output classes:

- (a) *Quality* – how well it is provided;
- (b) *Quantity* – how much is provided;
- (c) *Cost* – how much delivery costs;
- (d) *Timeliness* – when it is provided; and
- (e) *Location* – where it is provided.

A33. Not all the five dimensions will be applicable for each output or output class measured, for example, location is often not reported when it is self evident. However, there is a rebuttable presumption that quality will be a dimension that is measured and reported. Appointed Auditors should use their judgement in assessing which of the dimensions are applicable in each case.

A34. Where one or more of the dimensions are absent, the Appointed Auditor should assess whether the reasons for the exclusion are justified. Where, in the auditor's opinion, such an exclusion is not justified, they should seek further explanations from management. If still not fully satisfied, they are to consider its implications for the audit report or reporting to management.

A35. Performance measures for all dimensions of performance should be robust. The service performance reports should disclose sufficient information on what is being measured and how it is being measured.

Measures of Output Quality

- A36. Performance measures of output quality can be contrasted in various ways:
- (a) Direct versus indirect measures;
 - (b) Quantitative versus judgemental (qualitative) criteria; and
 - (c) Expert assessment versus lay person's assessment.
- A37. Direct measures of output quality measure the properties or attributes inherent within the service itself. They could be said to result from the direct observation of the service delivery or from data that record dimensions of the service delivered. Indirect measures also aim to capture information about the properties or attributes of a service but are derived by methods other than direct observation (e.g. they can be derived from the results of survey questionnaires about user perceptions or experience of the quality of service received, which reflect the "eye of the customer").
- A38. Direct measures of output quality are likely to be more objective than, and are therefore usually preferable to, indirect measures. Nevertheless, indirect measures such as stakeholder or customer perceptions can provide relevant information when the surveys are well designed and conducted and the results are interpreted with sufficient caution. Direct measures of output quality should be used if possible, but they can be usefully supplemented by indirect measures, such as customer perception of the service. A public entity needs, at least, to consult stakeholders and ask what they value (a) to inform the selection of direct measures of quality and (b) to help establish relevant questions for gauging stakeholder or customer perceptions of output quality.
- A39. Often output quality will be expressed in a range of explicit, easily quantifiable, and objectively verifiable specifications or technical standards. For outputs for which quality is not so easily quantifiable, a more judgemental (or qualitative) approach is needed to assess the quality of the service. Quantitative measures that are readily observable are likely to provide a more objective means of assessing performance than qualitative measures based on individual judgement. However, measures that are more easily quantifiable and measurable may not necessarily constitute the more relevant measures of service quality. Therefore entities need to consider which types of measure would best capture the more relevant aspects of output quality.
- A40. Many aspects of output quality are readily observable to the lay person (e.g. customer, service provider, or other stakeholder – the "eye of the customer"), while other aspects require an expert assessment (the "eye of the expert"). These perspectives apply to both quantitative and qualitative approaches to assessing output quality. The lay person is often able to directly observe and interpret the technical specifications of the output and thereby

determine the level of quality achieved; in other instances the lay person may provide a more subjective judgement of output quality based on their experience (e.g. their opinion of how good the service was). By contrast, some qualities expressed as quantifiable, technical specifications may require expert reading, analysis and interpretation. In other instances, an expert may be required to provide a judgemental (or qualitative) assessment of service quality. (One example is peer review, in which service quality is determined by an expert, who observes the service delivery and applies their professional judgement to assess the service, based on their expert knowledge and experience.)

- A41. No particular combination of the above approaches to deriving measures or assessing output quality is of itself “correct”. Entities may choose to measure and report on the basis of several approaches and should prefer objective measures to subjective measures, subject to ensuring the more relevant properties of the output are captured by the performance measures. A range of different approaches to measuring output quality can be useful for providing confirmatory evidence or simply providing a different perspective. The Appointed Auditor should assess whether entities have considered a range of approaches to measuring quality before selecting the measures.
- A42. The judgement involved in the audit of quality is such that the Appointed Auditor should have appropriate knowledge and skills to undertake work in this area.

Measures of Inputs, Processes, or a Combination of Elements

- A43. As a general rule, entities should not report on inputs (other than the financial costs of outputs) or processes within their service performance reports. However, in some instances, entities may report input or process measures (or a combination of elements, e.g. ratio of outputs to inputs) as a proxy for unobservable or difficult-to-measure outputs. Sometimes process measures can provide useful and important information relating to output quality.
- A44. Input or process measures should be reported as proxies for output measures in service performance statements only when it is impracticable to measure the output. Where entities provide input or process measures as a proxy for output measures in the service performance report, the Appointed Auditor needs to consider:
- (a) Whether there is sufficient justification for not providing output measures; and
 - (b) Whether the input or process measures are appropriate, considering their relevance, reliability, understandability, and comparability.

Audit of the Service Performance Report (Ref: Para 36-46)

Materiality (Ref: Para 37-38)

- A45. Materiality, in the context of service performance reports, relates to both:
- (a) The importance of the outputs and performance measures (or collection of outputs and performance measures) to providing a relevant and reliable representation of the entity's performance (refer paragraph A16); and
 - (b) The level of mis-statement of reported results that would be accepted by the Appointed Auditor before they consider the user's judgement would be impaired.
- A46. In assessing the entity's material outputs and performance measures for the purpose of audit testing, the Appointed Auditor should take into account their conclusions on the forecast service performance report (and the related guidance at paragraph A16) and consider the following points:
- (a) Determination of material outputs and measures should be made only after discussions with the entity, the governing body (and, if necessary and appropriate, Parliamentary select committees, politicians or councillors); and
 - (b) Determination of material outputs and measures should be consistent with the auditor's knowledge of the political environment and information gleaned from sources such as minutes of meetings, media reports, and the like.

Obtaining Audit Evidence (Ref: Para 39)

- A47. In gaining assurance on outputs, the full range of normal audit procedures will usually be available to the Appointed Auditor.
- A48. The mix of audit tests may vary compared with the mix used in regard to the financial information, but the non-financial aspects of a service performance report do not in themselves alter the level of evidence required.
- A49. Audit procedures that may be applied to gain the required level of assurance when auditing service performance reports include:
- (a) Testing and evaluating the systems, processes and controls that capture, record, analyse and monitor the information;
 - (b) Performing analytical procedures on the information; and
 - (c) Performing other substantive or re performance tests.
- A50. The quality of the systems used to record and control results, and the nature and quality of evidence available about the reported measures, may have an effect on the mix of tests

used. For instance, weak recording or control systems may force the Appointed Auditor to use a substantive rather than a systems-based approach.

Changes in Material Outputs, Performance Measures, or Targets (Ref: Para 40-41)

- A51. Outputs and their performance measures and targets for Government departments and Offices of Parliament are published in the Annual Estimates. The Appointed Auditor is to check that material outputs, performance measures, and targets agree to these published statements. Where changes are noted, the auditor should ensure that the change has been approved and published in the Supplementary Estimates.
- A52. The requirements for Crown entities are specified in the Crown Entities Act 2004, in sections 138 to 149 concerning the preparation and amendment of the Statement of Intent.
- A53. Where applicable, the Appointed Auditor should check that, where outputs, performance measures or targets refer to standards outside the published measures (for example, those relating to a standard agreed with the Minister), those external standards have also not changed significantly during the period.
- A54. In addition to checking that the changes have been properly authorised, the Appointed Auditor should be satisfied with the reasons for any change. Changes relating solely to how performance is measured should improve the measurement of performance. The Appointed Auditor should be wary of unnecessary or unsupported changes that give the appearance of an improved result, in a similar fashion to changes in accounting policies that are used to manipulate financial results. Such changes are not acceptable.
- A55. Consistency of measures between periods is valuable and, in some cases, it is a legislative requirement that the service performance report includes comparative data for the previous financial period. However, improvement in the quality of material performance measures is more important than inter-period consistency.
- A56. Where the Appointed Auditor considers that additional information about changes to reported outputs, output classes, performance measures, or targets should be disclosed for the service performance report to be fairly stated, they should request that the report disclose (as a minimum) the nature of and reasons for the changes.

Management Commentary (Ref: Para 42-45)

- A57. Management commentary generally features in annual reports in one of three forms:

- (a) Within the service performance report as a substitute for output reporting (this is generally not acceptable);
 - (b) Within the service performance report as an aide to understanding the report (this is to be encouraged); and
 - (c) Outside the audited sections of the annual report.
- A58. Management commentary is generally unacceptable as a substitute for (or alternative to) output performance measures, although it may be justified when new performance measures or baselines are in the process of being established. Management commentary may be used to inform users of intended improvements in reporting performance measures. As such, the commentary may provide useful information while the entity is consulting on, or deriving, the new performance measures or until such time as there are sufficient data for reporting against the new performance measures.
- A59. Where the entity seeks to use management commentary as an alternative to performance measures, the Appointed Auditor should consider modifying the audit report.
- A60. Management commentary should be included in, or along with, the service performance report to assist users' interpretation of achievements that are not otherwise evident from the performance measures. Such management commentary forms part of the reported performance measures.
- A61. The Appointed Auditor's responsibility for commentary included in the part of the annual report not subject to audit is limited to following the requirements of ISA (NZ) 720: The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements.

Allocation of Costs (Ref: Para 46)

- A62. The full and fair allocation of costs to outputs is one of the cornerstones of an efficient management control system. The information such systems generate should enable stakeholders and management to make decisions concerning resource use, budgetary implications, output pricing, and the extent of cross-subsidisation. Therefore, such systems can have a considerable effect on the disclosures in service performance reports.
- A63. The audit focus should be on the underlying assumptions and the system. Therefore the Appointed Auditor is likely to concentrate on:
- (a) Testing the reasonableness of the underlying assumptions;
 - (b) Ensuring the method of allocation is reasonable and supportable. (The allocation of overheads should follow a cause and effect relationship. The factors that cause

the consumption of overheads are called “cost drivers”. Although some proportion of overhead will not be traceable to a particular output, the aim is to identify a causal link wherever possible. Activity-based costing will be relevant for achieving a more accurate costing of outputs in some cases); and

- (c) Ensuring that there is consistency of treatment within the audit period (i.e. costs are allocated on the same basis as funds are appropriated or budgeted), and between audit periods where applicable.

Fieldwork Conclusion (Ref: Para 47-51)

A64. With the benefit of having completed the field work, the Appointed Auditor should consider their earlier judgement about the adequacy of the non-financial performance report and, in particular, the appropriateness of service performance report content. To form an opinion on the fair presentation of the service performance report, the auditor should consider the non-financial performance reports as a whole, including the forecast non-financial performance report as well any other relevant non-financial performance information included within the annual report but located outside the audited sections of the annual report.

A65. The Appointed Auditor needs to consider whether the service performance report is presented within the context of the overall performance management framework. In forming the audit opinion, the Appointed Auditor needs to determine whether the service performance report complies with GAAP and fairly reflects the entity’s service performance for the financial year. In order to do so, the Appointed Auditor should obtain an overview of the framework for the non-financial performance report, giving particular attention to the links (as relevant) between the following aspects:

- (a) Contextual information (including the entity’s role, purpose, function, and strategic objectives);
- (b) Annual, medium-term, and longer-term information;
- (c) The elements of the reports (i.e. outcomes, impacts, objectives, outputs, and inputs);
- (d) Performance measures, targets, and results (including consideration of the effect of unadjusted errors of misstatement and omission);
- (e) Management commentary within and outside the audited statements; and
- (f) The appropriateness of the service performance report content in light of the information in (a) to (e) above.

The Audit Report (Ref: Para 52-55)

- A66. The Appointed Auditor's opinion on whether the service performance report complies with GAAP and fairly reflects the entity's performance for the financial year is dependent on:
- (a) The content of the service performance report appropriately reflecting the entity's outputs, output delivery objectives, and results. This information should be reported within a context that makes evident the relevance of the outputs and the performance measures to the impacts and outcomes sought; and
 - (b) The verification of that content, with regard to the content being relevant, reliable, understandable, and comparable.

Circumstances that Affect Reporting (Ref: Para 52-56)

- A67. The specific circumstances that may influence the decision on whether to modify the audit report and affect reporting to management or the OAG with respect to the service performance report, include the following:
- (a) The reporting of outputs and output classes, performance measures, or results fails to comply with GAAP or otherwise fails to fairly reflect the service performance of the entity to the extent that it is likely to materially affect the user's ability to make an informed assessment of entity performance, for any of the following reasons:
 - (i) Material outputs, performance measures, targets, or results are omitted; and
 - (ii) Material outputs, performance measures, targets, or results are inappropriate (e.g. they do not satisfy the qualities of relevance, reliability, understandability, or comparability).In such circumstances, the Appointed Auditor will need to consider whether to issue a modified (adverse or qualified) opinion.
 - (b) Material outputs, performance measures, targets, or results are considered appropriate but are poorly presented. In such circumstances, the Appointed Auditor will need to consider whether to report the issue to entity management.
 - (c) Results reported for material performance measures do not meet the requisite evidential criteria, the systems or processes for controlling and recording performance information are deficient, or results reported for material performance measures cannot be substantiated. In such circumstances, the Appointed Auditor will need to consider whether to issue a modified (disclaimer or qualified) opinion.

- (d) Laws and regulations for approval, format, publication and circulation of plans and service performance reports are not being followed, for example where performance measures or targets have not been legally and properly approved. In such circumstances, the Appointed Auditor will need to consider whether a legislative breach should be reported or whether to report the issue to entity management.

- (e) Changes made to material performance measures during the reporting period have not been legally or properly approved, or the changed measure is less appropriate, or the change has not been adequately explained in the service performance report. In such circumstances, the Appointed Auditor will need to consider whether a legislative breach should be reported or whether to issue a modified opinion, as appropriate.

- (f) Management commentary within the service performance report is used as a substitute for output performance measures. In such circumstances, the Appointed Auditor will need to consider whether to issue a modified (adverse or qualified) opinion or whether to report the issue to entity management.

- (g) Management commentary within the service performance report is used as an aide to understanding the report but the commentary or explanations given are insufficient, inconsistent, or misleading. In such circumstances, the Appointed Auditor will need to consider whether to issue a modified (disclaimer or qualified) opinion or whether to report the issue to entity management.

Appendix 1 - Criteria for the Preparation of Service Performance Reports

- 1.1 This Appendix outlines important criteria prescribed by legislation and generally accepted accounting practice (GAAP) for the preparation of service performance reports.
- 1.2 Auditors are required to evaluate the appropriateness of service performance reports with regard to the recognition, measurement, and disclosure of output information. The evaluation of appropriateness should be made against the criteria for the preparation of service performance reports included in this Appendix.

Legislation

- 1.3 The legislative requirements for entities whose service performance reports are audited in accordance with AG-4 comprise:
- The Public Finance Act 1989;
 - The Crown Entities Act 2004; or
 - The Local Government Act 2002.

- 1.4 The annual report (which includes the service performance report) should enable users to make an informed assessment of entity performance:

“The annual report must provide the information that is necessary to enable an informed assessment to be made of the [entity’s] performance during the financial year (including an assessment against the intentions, measures, and standards set out at the start of the financial year in the information on the [entity’s] future operating intentions...)” [Section 45 (2) PFA. Consistent with s151 (2) CEA]

- 1.5 The requirements for the content of the service performance report are as follows:

“A[n entity’s] statement of service performance must -

- (a) be prepared in accordance with generally accepted accounting practice; and*
- (b) describe each class of outputs supplied by the [entity] during the financial year; and*
- (c) include, for each class of outputs, -*
 - (i) the standards of delivery performance achieved by the [entity], as compared with the forecast standards included in the [entity’s] statement of forecast service performance at the start of the financial year; and*
 - (ii) the actual revenue earned and output expenses incurred, as compared with the expected revenues and proposed output expenses included in the [entity’s] statement of forecast service performance at the start of the financial year.”*

[Section 45A PFA. Consistent with s153 (1) CEA and s15 of Sched 10 Part 3 of the LGA]

Treasury guidance on the legislation

- 1.6 Elements reported as outputs in the service performance report should meet the statutory definition of outputs. However, links to impact and outcome information should be provided so that service performance information is presented within the wider context of what the service delivery is intended to achieve.

“The statement of service performance should not report on internal departmental activities or intermediate products consumed in-house.”

“The PFA requires departments to provide output performance information in their statement of service performance. However, to provide context, departments are encouraged to include impact, outcome and information on the achievement of objectives in their statement of service performance.”

[Preparing the Annual Report: Guidance and Requirements for Departments, July 2009, pp 15-16]

“The CEA requires Crown entities to provide output performance information in their statement of service performance. However, to provide a coherent account of achievement, entities are encouraged to include information on their contribution to achievement of impacts, outcomes and objectives in their statement of service performance.”

[Guidance and Requirements for Crown Entities: Preparing the Annual Report, 2008, pp 15-16]

Generally accepted accounting practice (GAAP)

- 1.7 The main sources of GAAP relevant to service performance reports are:
- *New Zealand Equivalent to the IASB Framework for the Preparation and Presentation of Financial Statements*, June 2005;
 - *NZ IAS 1: Presentation of Financial Statements*, November 2007; and
 - *TPA-9: Service Performance Reporting*, revised November 2007.

- 1.8 The qualitative characteristics of non-financial performance reports are the same as those applying to financial reports.

“The quality of the information presented in the non-financial and supplementary information should be considered with regard to the qualitative characteristics and

constraints on those qualitative characteristics discussed in paragraphs 24 to 45 of this NZ Framework”

[Paragraph NZ 101.3, New Zealand Equivalent to the IASB Framework for the Preparation and Presentation of Financial Statements]

1.9 Paragraphs 24 to 45 of the *Framework* refer to the following four qualitative characteristics:

1. Understandability;
2. Relevance (including reference to materiality);
3. Reliability; and
4. Comparability.

1.10 Paragraphs 24 to 45 of the *Framework* identify the following constraints on relevant and reliable information:

1. Timeliness;
2. Balance between benefit and cost; and
3. Balance between qualitative characteristics.

1.11 The Auditor-General's interpretation of, and guidance on, how these four qualitative characteristics (and constraints) apply to the non-financial performance reports of public entities is outlined in AG-4 paragraphs A15 to A25.

1.12 It is an expectation under GAAP that service performance reports will provide a true and fair view, or fairly present, the entity's service performance.

“...the application of the principal qualitative characteristics ... normally results in financial statements that convey what is generally understood as a true and fair view of, or as presenting fairly such information.”

[Paragraph 47, New Zealand Equivalent to the IASB Framework for the Preparation and Presentation of Financial Statements]

1.13 The mandatory (standard) requirements for service performance reporting, as required by NZ IAS 1, are as follows:

“NZ 138.1 Where a statement of service performance is presented it shall describe and disclose the outputs of an entity. Similar individual outputs may be aggregated.

NZ 138.2 *This Standard refers to the statement in paragraph NZ 138.1 as a “statement of service performance”. The statement might, however, be*

differently named in legislation. The aim of such statements, by whatever name called, remains the providing of:

- (a) narrative and statistics on the entity's performance in supplying goods and services; and*
- (b) information on the effects on the community of the entity's existence and operations.*

...

NZ 138.4 The elements of service performance are inputs, outputs and outcomes. Where relevant and appropriate for users of the entity's financial report, each output disclosed in the statement of service performance is to be described in terms of the output's:

- (a) quantity;*
- (b) quality;*
- (c) time; and*
- (d) location.*

The cost of each output is to be described and disclosed.

NZ 138.5 The information used to describe service performance is to be selected so as to provide a complete description of delivery of each output (or aggregation of outputs) reported, but without undue emphasis on easily measured dimensions, and without resulting in an overload of only partially relevant statistics.

NZ 138.6 For each output disclosed in a statement of service performance, where practical and appropriate, the outcome(s) to which the output is intended to contribute is to be disclosed.

NZ 138.7 The statement of service performance shall present both projected service performance and actual service performance.

NZ 138.8 Projected service performance is described by presenting projected outputs at the beginning of the period which an entity aimed to produce by the end of the period. These projected outputs will often be derived from the annual or corporate plan.

NZ 138.9 To report the degree of success in achieving objectives, it is necessary to present both projected and actual results together with full disclosures of any changes in objectives during the period.

NZ 138.10 *Actual and projected service performance are to be reported consistently with one another. The information is to be sufficiently specific for performance to be assessed.”*

[NZ IAS 1, Presentation of Financial Statements]

- 1.14 Service performance reports should focus on the reporting of outputs. Other elements should not be reported in the service performance report as if they were outputs.

“It is important to distinguish outputs from:

- (a) Inputs;*
- (b) Outcomes;*
- (c) Management systems;*
- (d) Internal outputs; and*
- (e) Processes.*

None of the above items are final goods or services and should not be regarded as outputs. Except as contextual information, they should not be included in service performance reporting or described as outputs ...”

“None of the above items are outputs. They should therefore not be described as outputs. This does not imply that measurement of the above items is unimportant for internal management purposes, but rather that external users of service performance information need information about results rather than efforts.”

[TPA-9, paragraphs 4.6, 4.7, and 4.21]

Appendix 2 - Example of Unmodified Audit Report for a Crown Entity

[Firm's Letterhead]

AUDIT REPORT

**TO THE READERS OF
[NAME OF CROWN ENTITY]'S
FINANCIAL STATEMENTS AND STATEMENT OF SERVICE PERFORMANCE
FOR THE YEAR ENDED 30 JUNE 200[X]**

The Auditor-General is the auditor of [Name of Crown Entity] (the [entity type]). The Auditor-General has appointed me, [Name of Appointed Auditor], using the staff and resources of [Name of Auditing Firm], to carry out the audit on his behalf. The audit covers the financial statements and statement of service performance included in the annual report of the [entity type] for the year ended 30 June 200[X].

Unmodified Opinion

In our opinion:

- The financial statements of the [entity type] on pages [...] to [...]:
 - comply with generally accepted accounting practice in New Zealand; and
 - fairly reflect:
 - the [entity type]'s financial position as at 30 June 200[X]; and
 - the results of its operations and cash flows for the year ended on that date.

- The statement of service performance of the [entity type] on pages [...] to [...]:
 - complies with generally accepted accounting practice in New Zealand; and
 - fairly reflects the [entity type's] service performance for the year, including:

- its performance achieved as compared with the forecast targets outlined in the statement of forecast service performance for the financial year; and
- its revenue earned and output expenses incurred as compared with the forecast revenues and output expenses outlined in the statement of forecast service performance for the financial year.

The audit was completed on [date], and is the date at which our opinion is expressed.

The basis of our opinion is explained below. In addition, we outline the responsibilities of the [governing body] and the Auditor, and explain our independence.

Basis of Opinion

We carried out the audit in accordance with the Auditor-General's Auditing Standards, which incorporate the New Zealand Auditing Standards.

We planned and performed the audit to obtain all the information and explanations we considered necessary in order to obtain reasonable assurance that the financial statements and statement of service performance did not have material misstatements, whether caused by fraud or error.

Material misstatements are differences or omissions of amounts and disclosures that would affect a reader's overall understanding of the financial statements and statement of service performance. If we had found material misstatements that were not corrected, we would have referred to them in our opinion.

The audit involved performing procedures to test the information presented in the financial statements and statement of service performance. We assessed the results of those procedures in forming our opinion.

Audit procedures generally include:

- determining whether significant financial and management controls are working and can be relied on to produce complete and accurate data;
- verifying samples of transactions and account balances;
- performing analyses to identify anomalies in the reported data;
- reviewing significant estimates and judgements made by the [governing body];

- confirming year-end balances;
- determining whether accounting policies are appropriate and consistently applied;
- determining the appropriateness of the content and measures in the statement of service performance; and
- determining whether all financial statement and statement of service performance disclosures are adequate.

We did not examine every transaction, nor do we guarantee complete accuracy of the financial statements and statement of service performance.

We evaluated the overall adequacy of the presentation of information in the financial statements and statement of service performance. In evaluating the adequacy of the statement of service performance, we considered its presentation within the context of the [entity type's] overall performance management framework, including how its outputs are intended to have an impact on its stated outcomes. We considered whether the information provided is sufficient to enable an informed assessment of the [entity type's] service performance during the financial year. We obtained all the information and explanations we required to support our opinion above.

Responsibilities of the [governing body] and the Auditor

The [governing body] is responsible for preparing the financial statements and statement of service performance in accordance with generally accepted accounting practice in New Zealand. The financial statements must fairly reflect the financial position of the [entity type] as at 30 June 200[X] and the results of its operations and cash flows for the year ended on that date. The statement of service performance must fairly reflect the [entity type]'s service performance, including its performance achieved as compared with the forecast targets outlined in the forecast statement of service performance. It must also fairly reflect the revenue earned and expenses incurred as compared with the forecast revenue and expenses outlined in the forecast statement of service performance. The [governing body]'s responsibilities arise from the Crown Entities Act 2004 [and name of relevant Act(s)].

We are responsible for expressing an independent opinion on the financial statements and statement of service performance and reporting that opinion to you. This responsibility arises from section 15 of the Public Audit Act 2001 and the Crown Entities Act 2004.

Independence

When carrying out the audit we followed the independence requirements of the Auditor-General, which incorporate the independence requirements of the Institute of Chartered Accountants of New Zealand.

Other than the audit, we have no relationship with or interests in the [entity type].³

[Signature of Appointed Auditor]

[Name of Appointed Auditor]

[Name of Auditing Firm]

On behalf of the Auditor-General

[City], New Zealand

³ If other relationships exist, this paragraph should be replaced with the following paragraph:
“In addition to the audit we have carried out assignments in the areas of [insert description of assignments], which are compatible with those independence requirements. Other than the audit and these assignments, we have no relationship with or interests in the Department.” (Refer Appendix 2 of ICANZ’s AS-702, AG-702 and AG-COE: Independence for guidance.)