

# Joint Treasury/Office of the Controller and Auditor-General Report to FEC: Audit of Public Services Provided by Non-Governmental Organisations (NGOs)

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## Introduction

The Committee has asked for comment on the existing powers of the Auditor-General to obtain information from non-governmental organisations (“NGOs”) when auditing public entities. Also, the Minister in charge of the Audit Department has asked the Office of the Controller and Auditor-General (OAG) to provide draft legislation to the Committee concerning the ability of the Auditor-General to “monitor and report on” public money provided by a public entity to an NGO as a private provider. The issue has not been raised in any submissions on the Bill. However, it was mentioned by a number of members during the First Reading debate.

Our advice is summarised below:

- Treasury and the OAG do not think that there is currently a need to extend the Auditor-General’s functions or powers to enable the audit or examination of an NGO concerning its use of taxpayer funds; and
- The Committee is invited to consider the need for provisions which, to avoid doubt, specify in more detail the existing functions and powers of the Auditor-General concerning NGOs. However, Treasury and the OAG advise that additional provisions are unnecessary, because:
  - The Auditor-General’s existing functions and powers, as set out in the Bill, are sufficiently clear;
  - Additional provisions would not greatly add to the existing provisions, and would cause duplication; and
  - There is a risk that the courts would use specific provisions to interpret the scope of the general functions and powers, in a manner that is not anticipated.

## The Issue

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The issue is the “reach” of the Auditor-General’s functions and powers to services which:

- are provided by NGOs; and
- use “taxpayer funds”<sup>1</sup>.

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<sup>1</sup> We use this term in the sense of funds which *originated from* the taxpayer (or ratepayer, as the case may be), whether or not they are “public money” in the narrow legal sense.

Normally, the Auditor-General is the auditor of a public entity which provides taxpayer funds to an NGO, but is not the auditor of the NGO itself.

An accountability question arises if the NGO fails to:

- provide the services; or
- provide the services to the required standard; or
- account satisfactorily for its use of the taxpayer funds.

The question is what, if any, role the Auditor-General should have in securing that accountability.

## Existing Accountability Arrangements

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An NGO could provide public services in one of three ways:

- on contract to a public entity (i.e., where a public entity *purchases* public services, which are delivered by an NGO under the terms of a legally enforceable contract);
- under an arrangement (for example, a purchase agreement, partnership agreement, or memorandum of understanding) which reflects the parties' mutual understandings but is something less than a legally enforceable contract; or
- using taxpayer funds which have been granted to it (i.e., where a public entity simply *funds* the provision of the service, and the service is delivered by another person).

The accountability of the NGO may vary according to which method is used. In simple terms, however:

- the NGO is accountable *to the public entity*, under its contract or arrangement with the public entity (in a purchase situation) or the conditions (if any) of the grant (in a funding situation); and
- the public entity is accountable *to Parliament, a Minister, or the public* for its actions in making the contract or grant, and monitoring or enforcing the terms and conditions, and for any failure to do so appropriately.

Public audit is one of the means by which the public entity's accountability to Parliament, Ministers and the public is assured.

There are three broad types of public audit activity specified in the Bill:

- the *annual financial audit*, during which the Auditor-General can examine the contract or grant, as a transaction which is reflected in the public entity's financial statements, and the entity's systems and procedures for specifying and monitoring contracts or grants;

- a *performance audit*, which enables the Auditor-General to examine such matters as whether:
  - the public entity has carried out its activities effectively and efficiently;
  - the resources of the public entity have been wasted;
  - an act or omission by a public entity or by officials (such as failure to enter into appropriate contracting arrangements) shows any lack of probity or financial prudence;
- an *inquiry* into a public entity's use of its resources in contracting out services or making grants of taxpayer funds to an NGO.

However, the Auditor-General has no role in determining, from an examination of the NGO's records, whether it has performed its obligations under the contract, arrangement or grant. Enforcement of the contract, or recovery of the taxpayer funds in the event of non-performance, is a matter for the public entity.

## Expanding the Auditor-General's Reach

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Some Australian state and Canadian legislation enables their Auditors-General, on request of a Minister or the Executive, to examine or inquire into the use of taxpayer funds by an NGO.

The New Zealand Auditor-General already has power to "follow" taxpayer funds into an NGO – by seeking information from the NGO about whether it has, in fact, performed a contract or provided services. However, this power can only be exercised for the purpose of an audit of (or inquiry concerning) the public entity that made the funds available to the NGO.

It would be a much bigger step for the Auditor-General to have the function of auditing the NGO's expenditure, or examining or inquiring into the adequacy of its performance in providing public services. An NGO will usually have its own financial auditor, and it would not be appropriate to supplant that role (either in whole or in part) without a strong justification.

Financial audit of an NGO by the public auditor may be justified if Parliament lacked confidence in the ability of a public entity to secure the accountability of an NGO contractually, whether for its use of taxpayer funds or for its performance in delivering public services.

This ought to be a rare occurrence. However, there is always a risk that a public entity will fail to specify sufficient conditions in a contract, arrangement, or grant with an NGO. And, where the taxpayer funds were provided under an arrangement that is not legally enforceable, the only sanction available to the public entity in the event of non-performance may be to withhold future funding.

In many instances, this should be an effective sanction. But when such failures do occur, the responsibility – and the accountability for the “problem” – rest with the public entity.

The key to securing accountability of an NGO is in the design of the instrument under which taxpayer funds are provided, and the specification of what is expected from the NGO in exchange for the funds.

Contract design and specification is not a precise or constant art. It requires a balance between two competing tensions. An over-precise specification can lead to unnecessary agency costs both for the purchaser or grantor (in terms of contractual, monitoring and compliance-related costs – including auditing) and for the supplier (in terms of performance measurement and reporting). A deficient specification incurs the risk that inadequate performance by the supplier against the purchaser’s actual – but imprecisely specified – intentions may go undetected or unremedied.

The optimal balance may also be influenced by the prevailing level of public and political expectation. This can be expected to fluctuate over time. The increased interest shown in public entities’ contracting practices over the past couple of years may be a good example of this fluctuation.

However, Parliament should be able to expect that each public entity which contracts service provision to NGOs, or makes grants of taxpayer funds for public services, has sound practice in respect of its:

- design of policy on service delivery;
- choice of the method of service delivery;
- appointment of the service provider;
- specification of monitoring and enforcement provisions in the contract, arrangement or grant (to the extent that the choice of service delivery permits);
- actual performance in monitoring and enforcement; and
- evaluation of the impact of the actual service delivery.

The development of NGO capability (currently a priority in the Closing the Gaps programme) is an element of the first three of these areas.

In our view the emphasis of the public audit legislation should be on making public entities accountable in these respects. The Auditor-General should not ordinarily be expected to fill an accountability gap in relation to an NGO.

The Auditor-General also has a role in encouraging best practice. As he said in his *Annual Report 2000*, commenting on the request that he investigate allegations concerning the Waipareira Trust:

*From the work we did in the public entities contracting with the Trust, it was apparent that there is a consistent lack of good quality specification and monitoring of the performance of non-governmental organisations (NGOs) by the entities funding them.*

*I recommended that the Government develop guidance for contracting with NGOs – especially for the delivery of health and social services. It is encouraging that the Government has accepted this recommendation, and the work is to be led by the Treasury in consultation with the State Services Commission and ourselves.*

The guidelines for contracting with NGOs currently being developed by Treasury will be in the form of reasonably high-level principles and have a particular focus on contracting with the voluntary and community sector. They will also provide guidance on the choice between contracting and other funding arrangements available to the Crown (e.g. grants).

Positive guidance was also a major objective of reports in 1998 and 1999 by the Auditor-General, concerning the Papakura District Council water franchise and the contracting out of regulatory functions by the Queenstown Lakes District Council.

The Australian National Audit Office has placed a similar emphasis on improving the practices of public agencies in their management of contracts with the private sector.<sup>2</sup>

Treasury and the OAG do not think that there is currently a need to extend the Auditor-General's functions or powers to enable the audit or examination of an NGO concerning its use of taxpayer funds.

## Specifying Existing Functions and Powers in More Detail

The alternative approach is to specify the Auditor-General's existing functions and powers in more detail. One possible criticism of the Bill is that, although it is deliberately drafted in wide terms, its lack of specificity overlooks:

- the extent to which public services are contracted out or devolved through grants; and
- the potential for confusion as to the extent of the Auditor-General's functions in respect of those services.

Greater specification, by way of elaboration of generally prescribed functions and powers, could:

- reinforce the need for public entities to adopt sound practices in respect of NGOs;
- clarify the Auditor-General's role in cases of NGO accountability failure; and

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<sup>2</sup> See, for example, the best practice guide entitled *Selecting Suppliers: Managing the Risk* (October 1998).

- reduce the potential for public and political uncertainty about the function of public audit and the boundary between the public and private sectors.

Greater specification could, in particular, clarify the status of information that the Auditor-General obtains from an NGO in the course of an audit or inquiry involving a public entity. Generally, that information should be used only for the purpose of the audit or inquiry. Sometimes, however, it may also be appropriate for the Auditor-General to include the information itself in a report – for example, where the public entity itself has been unable to obtain information about a contractual failure by an NGO, and there is no information in the public domain about what has happened to the taxpayer funds involved.

Any specific provisions should be included only to avoid doubt. A disadvantage of such provisions is that they may lose relevance over time. They can also have unintended effects. For example, if the courts interpret the scope of a general, non-specific power with reference to a specific power.

## Draft Clauses

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The objective of the draft clauses below is to specify, to avoid doubt, the meaning of the general provisions of the Bill in the NGO context.

### **18A Outputs and services delivered by other persons or entities**

To avoid doubt, the functions of the Auditor-General under **sections 14 to 18** [*ie the auditing functions*] extend to activities, acts and omissions of a public entity concerning:

- (a) the provision of funding or the making of any grant to another person or entity, to enable that person or entity to deliver outputs or services to the public or a section of the public;
- (b) the making of any agreement with another person or entity, in return for the person or entity providing services, or arranging for the provision of services, to the public or a section of the public [*NZ Public Health and Disability Bill cl 20(1)*]; and
- (c) the public entity's:
  - (i) administration of any such funding provision, grant, or agreement;
  - (ii) monitoring and enforcement of any applicable terms and conditions;
  - (iii) measurement of the other person's or entity's performance of the functions or delivery of the outputs or services; and
  - (iv) identification and evaluation of outcomes.

### **30 Disclosure by Auditor-General**

(2A) To avoid doubt, a disclosure under **subsection (2)** [*general power to disclose such information as considered appropriate*] may include any information which:

- (a) relates to functions, outputs or services of a kind referred to in **section 18A(a) or (b)**; and
- (b) has been obtained in exercise of any of the powers under this Part.

The Committee is invited to consider the need for these provisions.

## Recommendation

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Treasury and the OAG advise that additional provisions are unnecessary, because:

- The Auditor-General's functions and powers, as set out in the Bill, are sufficiently clear;
- Additional provisions would not greatly add to the existing provisions and would cause duplication; and
- There is a risk that the courts would use the specific provisions to interpret the scope of the general provisions, in a manner that is not anticipated.

Parliamentary Counsel agrees with this advice.