

Central Government: Results of the 2002-03 Audits

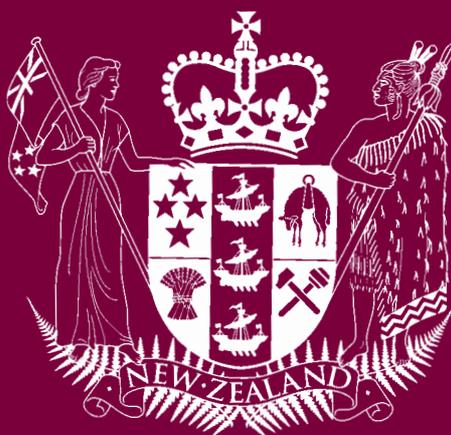


**Report of the
Controller and Auditor-General**

Tumuaki o te Mana Arotake

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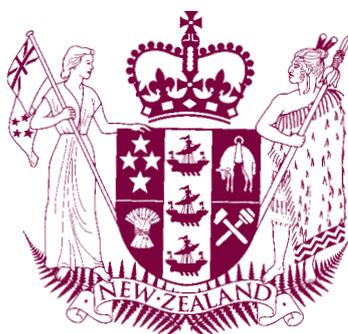
Tumuaki o te Mana Arotake

on

**Central Government:
Results of the
2002-03 Audits**

**Presented to the House of Representatives pursuant
to section 20 of the Public Audit Act 2001**





Rt Hon Jonathan Hunt
Speaker
House of Representatives
WELLINGTON

Mr Speaker

I am pleased to forward this report to you for presentation to the House of Representatives pursuant to section 20 of the Public Audit Act 2001.

Yours sincerely

A handwritten signature in black ink, appearing to read 'K B Brady', written in a cursive style.

K B Brady
Controller and Auditor-General

Wellington
23 June 2004

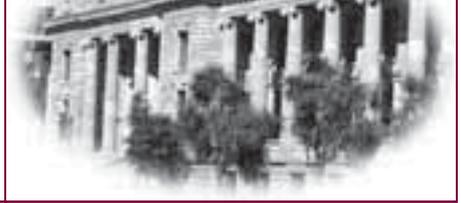




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Introduction

This report serves two broad purposes:

- it constitutes our “annual report” on the audits for 2002-03 of the Crown and its sub-entities – mainly as reflected in the *Financial Statements of the Government of New Zealand for the Year Ended 30 June 2003* (the *Financial Statements*), parliamentary paper B.11, 2003; and
- it brings to attention a number of other matters (related both directly and indirectly to events occurring in the financial year 2002-03) that we believe warrant consideration by Parliament.

Part One (pages 9-21) deals with the Government’s *Financial Statements* as audited and presented to the House. Specific topics addressed include:

- **consolidation issues;**
- **valuation issues;**
- **application of standards based on International Financial Reporting Standards; and**
- **resolution of issues previously raised.**

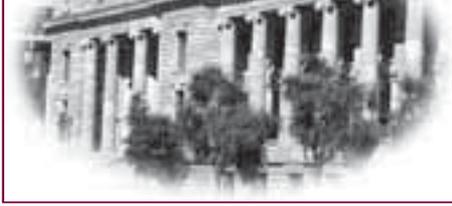
Part Two (pages 23-32) deals with the results of our audits of government departments for the year ended 30 June 2003. We include our usual:

- commentary on the audit opinions on the departments’ financial reports; and
- assessments of the departments’ financial and service performance management.

Part Three (pages 33-43) sets out details of the non-standard audit reports we issued during the period 1 July 2002 to 31 December 2003 on the financial reports of:

- entities that are part of the Crown reporting entity; and
- other public entities not within the local government portfolio.





INTRODUCTION

Part Four (pages 45-65) outlines the requirements relating to payment of remuneration and other payments to school principals, and describes work we undertook to ascertain the practices and extent of compliance by school boards of trustees in respect of the various forms of payment made.

Part Five (pages 67-76) comments on pending changes to Financial Reporting Standards, with particular reference to possible consequences for public sector entities.

Part Six (pages 77-103) gives the current status of follow-up action on previous reports we have made to Parliament.





Part One

The 2002-03 Audited Financial Statements of the Government

1



- 1.1 The Auditor-General issued the audit opinion on the *Financial Statements of the Government of New Zealand for the Year Ended 30 June 2003* (the *Financial Statements*) on 18 September 2003. This is the same date on which the Minister of Finance, and the Secretary to the Treasury, signed their Statement of Responsibility for the *Financial Statements*.

Unqualified Opinion Issued

- 1.2 The audit report appears on pages 20-21 of the *Financial Statements*. The report includes our unqualified opinion that those statements:
- *comply with generally accepted accounting practice in New Zealand; and*
 - *fairly reflect:*
 - *the Government of New Zealand's financial position as at 30 June 2003; and*
 - *the results of its operations and cash flows for the year ended on that date.*
- 1.3 As in previous years, the Treasury has provided a comprehensive commentary on the financial performance and position, which is presented on pages 6-17 of the *Financial Statements*.
- 1.4 In addition to that commentary, we draw attention to the following significant items reflected in the reported results.

Consolidation Issues

- 1.5 The *Financial Statements* have been prepared on a fully consolidated basis for the first time for the year ended 30 June 2003. The Treasury has put significant effort into establishing systems and processes to capture and accurately report fully consolidated information. In general, the move to full consolidation went very smoothly.





THE 2002-03 AUDITED FINANCIAL STATEMENTS OF THE GOVERNMENT

Financial Reporting Standard No. 37: Consolidating Investments in Subsidiaries

ONE

- 1.6 Financial Reporting Standard No. 37: *Consolidating Investments in Subsidiaries* (FRS-37) came into effect for the 30 June 2003 *Financial Statements*, and is one of the drivers behind the switch to full consolidation. A significant aspect of FRS-37 is a revised set of tests to determine which entities are controlled and hence subject to consolidation within the *Financial Statements*.
- 1.7 The FRS-37 control test contains two limbs – a “power” limb and a “benefit” limb. When both limbs are satisfied, then an entity is controlled for the purposes of financial reporting.
- 1.8 The application of the control test to the Crown has proved difficult, particularly in cases where legislation provides entities with statutory autonomy and independence such as Tertiary Education Institutions (TEIs). Reaching a consensus on the application of the control test for TEIs has been a complex and time-consuming issue. Although the Treasury has been working on the issue since late-2001, the accounting treatment adopted in the 2003 *Financial Statements* was resolved only during the year-end audit.
- 1.9 The accounting treatment that the Treasury has adopted in the *Financial Statements* is to equity account for TEIs based on a 100% interest, rather than using line-by-line consolidation. This approach is based on a view that the control test is not satisfied because the Crown does not have the ability to determine the financing and operating policies of TEIs. However, the Crown’s relationship with TEIs does meet the “significant influence” test necessary for equity accounting under Financial Reporting Standard No. 38: *Accounting for Investments in Associates*. As the Crown’s interest in the TEIs’ residual assets is 100%, the somewhat unusual accounting policy adopted is 100% equity accounting for TEIs. This approach and the reasons for it are set out in Note 13 to the *Financial Statements*.
- 1.10 The accounting treatment adopted in the 2003 *Financial Statements* is based on a strict interpretation of the mandatory elements within FRS-37, rather than a more comprehensive interpretation of the standard that could be formed from reading the mandatory elements and the accompanying commentary paragraphs.





THE 2002-03 AUDITED FINANCIAL STATEMENTS OF THE GOVERNMENT

B.29[04a]

ONE

- 1.11 In our view, line-by-line consolidation is the treatment that best reflects the substance of the relationship between the Crown and the TEIs, and the intent of FRS-37. We have accepted equity accounting for TEIs, as the treatment does arguably comply with a strict interpretation of the mandatory elements within FRS-37, and because of the additional disclosures provided in Note 13 to the *Financial Statements*.
- 1.12 The additional disclosures enable readers to understand the effect on the financial statements if a line-by-line treatment had been adopted for TEIs. With these additional disclosures, we have accepted that the financial statements remain fairly stated.
- 1.13 The interpretation of FRS-37 adopted in relation to the TEIs had the potential to affect the accounting treatment for a number of other entities within the *Financial Statements*. Because of the late resolution of the TEI consolidation issue, the timetable was tight for analysis of the effect on other entities. This led to some difficulties in agreeing the correct treatment within the Crown reporting timetables.
- 1.14 As a result of this analysis, the financial statements of Offices of Parliament were removed from the consolidated *Financial Statements*. This was done because these entities do not meet the test for Crown control given their statutory independence, and the fact that the House of Representatives determines their appointments and budgets. Because of their small size, the removal of these entities has not had a significant effect on the *Financial Statements*.
- 1.15 We are aware that the Treasury has initiated discussions with standard-setters to seek clarification on the application of the control test in FRS-37 in the Crown context, and that the Financial Reporting Standards Board of the Institute of Chartered Accountants of New Zealand has agreed to consider the issue. It should also be noted that, in the future, the adoption of standards based on International Financial Reporting Standards (see pages 67-76) might again change the control test to be applied.
- 1.16 The Government is also proposing legislative change in the Public Finance (State Sector Management) Bill to incorporate a wider definition of the Crown reporting entity.
- 1.17 The timetable for the legislative change and any amendments to FRS-37 is not yet clear, and neither is it certain to happen. In any event, it is unlikely that there will be sufficient progress to enable any change in the treatment in the 2004 *Financial Statements*. We will monitor developments in this area, and provide input to the change processes.





THE 2002-03 AUDITED FINANCIAL STATEMENTS OF THE GOVERNMENT

Ministry of Health – Consolidation of District Health Boards

ONE

- 1.18 Last year, we highlighted the problems that arose in obtaining assurance over the accuracy of the consolidated financial results of District Health Boards (DHBs).¹ Although there has been some improvement on this issue compared to 2001-02, the quality of the processes and controls in place at the Ministry of Health (the Ministry) for the collection, consolidation, and reporting of the results to the Treasury remained below the expected standard.
- 1.19 The main problems that arose this year were:
- lack of appropriate quality control by the Ministry and the DHBs relating to the information reported for the *Financial Statements*; and
 - lack of expected controls for data collection and consolidation processes at the Ministry, to ensure accurate and reliable consolidation, with an appropriate audit trail.
- 1.20 As in the previous year, the significant issues that were encountered caused delays in the sign-off of the DHB consolidation by the Ministry's auditors. Despite the difficulties, we were eventually able to gain assurance that the DHB information needed for the *Financial Statements* was materially correct.
- 1.21 We have recommended that the Treasury ensure that the processes used to collect and consolidate the DHB financial information are reviewed, and that robust processes with appropriate quality controls are in place for the 2004 *Financial Statements*.
- 1.22 We note that progress has been made to put in place the necessary process improvements for the 2004 audit. We will continue to monitor developments and provide input to the change processes.

¹ *Central Government: Results of the 2001-02 Audits*, parliamentary paper B.29[03a], pages 15-16.





Valuation Issues

- 1.23 Financial Reporting Standard No.3: *Accounting for Property, Plant and Equipment* (FRS-3) was, subject to transitional provisions, first applicable for the 2002 *Financial Statements*. During the 2002 audit, we found that many entities and valuers struggled to meet the requirements of this standard. We were pleased to note that the significant issues that arose in this area in 2002 have now been resolved, and that there were few new significant issues arising this year in relation to valuations of property, plant and equipment.
- 1.24 The Treasury has been active in providing useful valuation guidance for the tertiary and health sectors during the past year. In addition, the review group for DHB valuations (comprising representatives from the Auditor-General's Office, the Treasury, the Ministry of Health, DHBs, and valuers) has proved valuable in providing a good level of quality, particularly with respect to consistency of valuation methodology.

ONE

Land and Buildings Not Currently Revalued

- 1.25 The Crown accounting policy is that land and buildings are revalued to fair value at least every five years. The Treasury has provided guidance to entities that land and buildings with a book value of less than \$50 million do not have to be revalued, on the grounds of materiality.
- 1.26 During our audit, we became aware that some entities have a carrying value for the land and buildings slightly less than \$50 million but the disclosed rating valuations are significantly greater than the carrying value. Although rating valuations are not acceptable as fair valuations under FRS-3, they do give an indication that the fair value of these assets is likely to be significantly greater than the carrying value.
- 1.27 We were satisfied that adjustment to the 2003 *Financial Statements* was not necessary because of materiality considerations. However, we have recommended that the Treasury review the reasonableness of the \$50 million threshold for revaluation of land and buildings for all the entities in the *Financial Statements*.





THE 2002-03 AUDITED FINANCIAL STATEMENTS OF THE GOVERNMENT

Ministry for the Environment – Assets and Liabilities

ONE

- 1.28 In 2002, we raised the issue of identifying and accounting for environmental obligations with respect to landholdings.² We reported that, in general, we were satisfied with what had been done to identify and account for environmental obligations.
- 1.29 We highlighted our remaining concern regarding the accounting for environmental liabilities associated with abandoned contaminated land (“orphan sites”). Our concern was that the approach adopted by the Ministry for the Environment (MfE) was to recognise a liability for only the annual amount of funding provided to the local authority when the funding agreement is signed, rather than recognising the liability for the full (not just annual) obligation (actual or constructive) to contribute to the remediation of the orphan site.
- 1.30 In addition, during the 2003 audit, a separate issue was identified in relation to certain landholdings of MfE that are not recognised in MfE’s Schedule of Crown Assets, and possible associated environmental liabilities that are also not accounted for. This issue has resulted in a qualification of the audit opinion on MfE. However, we were satisfied that the financial effect of these two issues was not material to the *Financial Statements*.
- 1.31 We have recommended that the Treasury maintain an active interest in the resolution of issues relating to MfE landholdings and environmental liabilities. We will continue to monitor progress in 2003-04.

Student Loans Valuation

- 1.32 In 2002, we again raised our concerns as to the valuation of the outstanding balance of the student loan scheme and, in particular, the methodology used to determine the provision for doubtful debts.³ We recommended that the Treasury determine an actuarial valuation for the scheme as soon as possible.
- 1.33 During the 2003 year, significant progress was made, and a fair value of \$5,592 million was disclosed in note 9 to the *Financial Statements*. This fair value is slightly in excess of the carrying value (net of provisions) of the student loan portfolio of \$5,370 million. We understand that it is intended to provide ongoing disclosure of the fair value in future *Financial Statements*.

² Ibid, pages 19-20.

³ Ibid, pages 18-19.





- 1.34 Independent actuaries calculated the fair value, based on a new integrated data set of students' educational and demographic information, with data on loans and incomes. The fair valuation model considers current debt owed by borrowers of various characteristics, including assumptions regarding their future income.
- 1.35 This has been the first attempt at determining a fair value for the student loan scheme. The fair value model contains a number of significant assumptions determined by the actuaries, based on their professional experience and the data available. Some of these assumptions will become more accurate as the loan scheme matures and further data becomes available. One of the critical assumptions is the discount rate, which is based on the after-tax risk-free rate, plus a risk premium. A 1% shift in the assumed discount rate alters the fair value by about \$200 million.
- 1.36 Generally accepted accounting practice (GAAP) currently requires the disclosure of the fair value of financial assets such as the student loan scheme, but it does not currently require that financial assets be accounted for at fair value. GAAP for financial assets will change in the coming years with the move to standards based on International Financial Reporting Standards, but it is not yet clear whether new standards will require a change to accounting for the loan scheme at fair value.
- 1.37 We agree that a fair value for the student loan scheme should continue to be determined and disclosed in the *Financial Statements* on an annual basis, and recommend that the Treasury monitor developments in IFRS with respect to accounting for similar financial assets.

Accounting for Financial Instruments

- 1.38 In 2002, we noted that there were a number of areas where the Crown's accounting policies and disclosures for financial instruments needed to be reviewed to ensure that they remained in line with the latest developments in GAAP for financial instruments.⁴ Some of the specific issues that we raised last year have yet to be fully addressed. These include:
- inconsistencies between the accounting treatment of advances and their associated hedging;
 - whether all tactical trading activities should be reported on a mark-to-market basis; and

4 Ibid, pages 20-21.





THE 2002-03 AUDITED FINANCIAL STATEMENTS OF THE GOVERNMENT

- inconsistencies between the accounting treatment of foreign currency debt (at modified historical cost) and foreign currency assets (at market value).

ONE

- 1.39 A major effort is being made internationally to update IFRS on accounting for financial instruments. An updated standard is likely to have a significant effect on the accounting policies of entities such as the New Zealand Debt Management Office (NZDMO) and the Reserve Bank of New Zealand. Entities within the Crown reporting entity will need to start planning now to meet the requirements of IFRS-based standards.
- 1.40 We understand that the NZDMO has undertaken a “strategic accounting review” to address the accounting policy issues associated with its financial instruments, and that there is a timetable in place to address the issues that we have identified. We will continue to monitor progress in addressing those issues.

Fair Value of Debtor Portfolios

- 1.41 As well as the fair valuation of the student loan scheme (see paragraphs 1.32-1.37), there are other significant debtor portfolios in the *Financial Statements* which are valued on a historical cost basis but for which no fair value disclosure is made. These include portfolios where the debts are of such a nature that collection takes place over a significant period of time (for example: fines debtors and benefit recovery debtors). Unlike the student loan scheme, some of these debts do not accrue interest, and may have a fair value significantly less than their carrying value.
- 1.42 We have recommended that the Treasury provide guidance to departments on accounting for these debtor portfolios. We note, however, that the Treasury does not intend to change existing Crown accounting policies at this stage. We will continue to discuss this issue with the Treasury, including the possibility of additional note disclosures.





Application of Standards Based on International Financial Reporting Standards

ONE

- 1.43 In December 2002, the Accounting Standards Review Board (ASRB) announced that International Financial Reporting Standards (IFRS) will apply to financial reporting by both public and private sector entities for reporting periods starting on or after 1 January 2007, with the option of adoption from as early as 2005.
- 1.44 In August 2003, the Government announced that IFRS would be implemented in the *Financial Statements* as part of the 2007 Budget. This means that the first audited *Financial Statements* under IFRS will be for the year ending 30 June 2008 (with comparative figures to 30 June 2007 restated in accordance with IFRS-based standards).
- 1.45 The reasons for not adopting at the earlier 2005 date are primarily associated with the significant revisions to IFRS-based standards that are currently under way, and which will continue to be in progress for some time. We support the decision to implement IFRS-based standards in the *Financial Statements* from the 2007 Budget.
- 1.46 We understand that some State-owned enterprises are planning to adopt IFRS-based standards at the earlier date. It will be important that these entities are able to report information in accordance with both the existing Crown accounting policies and IFRS-based standards, until the *Financial Statements* are also prepared on an IFRS basis.
- 1.47 Given the revision process currently in progress for IFRS standards, the effect on the *Financial Statements* of adopting IFRS-based standards is not yet clear. Areas where change is currently expected include:
- the presentation of financial performance;
 - the treatment of goodwill;
 - accounting for financial instruments (see paragraphs 1.38-1.40); and
 - business combinations (see paragraphs 1.6-1.17).
- 1.48 We have recommended that the Treasury continue to plan for the adoption of IFRS-based standards from the 2007 Budget, and that it continue to provide the necessary input into the standard-setting process to ensure that IFRS-based standards are appropriate and relevant to the New Zealand public sector environment. We will continue to work closely with the Treasury on these issues.





THE 2002-03 AUDITED FINANCIAL STATEMENTS OF THE GOVERNMENT

- 1.49 We discuss the implications of the change to NZ IFRS in more detail on pages 67-76.

ONE

Resolution of Issues Raised Previously

Department of Conservation Assets

- 1.50 In 2002, we encountered a number of significant issues in relation to property, plant and equipment under the control of the Department of Conservation (DOC). These issues resulted in a qualification of the audit opinion on the financial statements of DOC. The most significant of these issues from a Crown perspective was the failure to account for boundary fences on the conservation estate. A mixture of ownership and valuation issues associated with these assets was not resolved before the 2002 *Financial Statements* were signed. The omission of these assets was highlighted in Note 11 to the 2002 *Financial Statements*.
- 1.51 We are pleased to note that DOC has addressed these issues in the 2002-03 year. This included valuing a statistical sample of fencing assets and extrapolating to provide a total value (net of depreciation) of \$94 million, which has been disclosed in Note 12 to the 2003 *Financial Statements*.

Crown Research Institute Databases and Reference Collections

- 1.52 During the 2001-02 audit, we raised the issue of the Crown Research Institute (CRI) databases and reference collections. These are held and managed by CRIs but have not been included in either their statement of financial position or the Crown's (they were transferred from the Crown to the CRIs at nil value in 1992). Insufficient information was available to provide a reliable value for recognition of these assets, and additional disclosure was included in Note 11 to the 2002 *Financial Statements* to highlight the non-recognition of these assets.





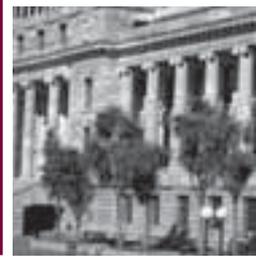
- 1.53 During 2003, the CRI sector undertook a review of their collections, and consulted with independent external valuers as to how the collections that met the definition of assets should be valued. In a number of cases, it was determined by the valuers that no appropriate methodology or expertise to value these collections existed at this time. Our auditors have reviewed and concurred with the approach taken by each CRI. Additional disclosure has been provided in Note 12 to the 2003 *Financial Statements*, as to the nature of these collections and the reasons why they remain at nil value.

ONE

Tertiary Education Institutions – Crown-owned Land and Buildings

- 1.54 During the 2001-02 audit, we noted that tertiary education institutions' Crown-owned land and buildings were carried at valuations based on rateable values. As noted in paragraph 1.26 on page 15, this treatment is not acceptable under FRS-3.
- 1.55 These assets were due for revaluation at 31 December 2002, and we recommended that the Treasury liaise with the Ministry of Education to ensure that the asset revaluations were carried out in accordance with FRS-3.
- 1.56 During the 2002-03 year, TEI Crown-owned land and buildings were revalued in accordance with the requirements of FRS-3. We have reviewed the valuation and consider it to be appropriate.





Part Two

Government Departments – Results of the 2002-03 Audits

2



Introduction

2.1 This article reports on the results of the 2002-03 audits of 43 government departments.¹ Its purpose is to inform Parliament of the assurance given by the audits in relation to:

- the quality of financial reports; and
- the financial and performance management of departments.

TWO

Audit Opinions Issued

2.2 The Public Finance Act 1989 (the Act) specifies departments' responsibilities in fulfilling the requirements for general purpose financial reporting. Sections 34A(3) and 35(3) of the Act require departments to prepare their financial statements in accordance with generally accepted accounting practice (GAAP).²

2.3 Section 38(1) of the Act and section 15 of the Public Audit Act 2001 set out the responsibility of the Auditor-General to issue an audit opinion on the financial statements of each department.

2.4 To form an opinion on the financial statements of departments, our audits are conducted in accordance with Auditing Standards published by the Auditor-General under section 23 of the Public Audit Act, which incorporate the auditing standards issued by the Institute of Chartered Accountants of New Zealand. The audits are planned and performed so as to obtain all the information and explanations considered necessary in order to provide sufficient evidence to give reasonable assurance that the financial statements are free from material mis-statements, whether caused by fraud or error. In forming our opinion, we also evaluate the overall adequacy of the presentation of information in the financial statements.

2.5 Of the 43 government departments audited, 41 received audit reports containing an unqualified audit opinion, as shown in Figure 2.1 on the next page.

1 Comprising the 43 departments listed on page 96 of the *Financial Statements*, plus the Office of the Ombudsmen and the Commissioner for the Environment, but excluding the two Security and Intelligence departments, and the Auditor-General.

2 Generally accepted accounting practice is defined in section 2(1) of the Public Finance Act 1989.





GOVERNMENT DEPARTMENTS – RESULTS OF THE 2002-03 AUDITS

*Figure 2.1
Analysis of Audit Opinions 1999-2003*

TWO	Year Ended 30 June	2003	2002	2001	2000	1999
	Unqualified opinions	41	42	44	43	42
	Qualified opinions	2	1	-	-	-
	Total audit opinions issued	43	43	44	43	42

The total number of departments reduced to 43 in 2002 with the amalgamation of the Department of Work and Income into the Ministry for Social Development.

Qualified Audit Opinions

2.6 As shown in Figure 2.1 above, qualified audit opinions were issued on the financial statements for two departments. They were the Department of Conservation and the Ministry for the Environment.

Department of Conservation

2.7 The Department of Conservation received a qualified audit opinion for the previous year, in respect of its valuation of visitor assets and recognition of fencing assets.³ Those matters were corrected in the financial statements for the year ended 30 June 2003, and the qualification for the 2003 year related only to the comparative information shown, i.e. the figures for the previous year. See also paragraphs 1.50-1.51 on page 20.

Ministry for the Environment

2.8 When the Ministry of Works and Development was disestablished in 1988, the Ministry for the Environment (MfE) inherited the function of being the land-holding department for about 860 land parcels totalling about 4300 hectares. The land includes river control reserves located on river and canal banks taken for flood protection purposes, and six soil conservation reserves. Except for one former soil conservation reserve for which the MfE has direct responsibility, the reserves are controlled and managed by Regional Councils.

³ See our detailed explanation in *Central Government: Results of the 2001-02 Audits*, parliamentary paper B.29[03a], pages 26-27.





- 2.9 The holding of this land on behalf of the Crown constitutes a non-departmental activity by the MfE, and the Treasury instructed departments to disclose non-departmental activities in the form of schedules to their annual financial statements from the year ended 30 June 2003 onwards. In preparing information on non-departmental activities for these schedules, departments are required to comply with GAAP.
- 2.10 The Ministry did not recognise the value of the land referred to in paragraph 2.8 in its non-departmental schedule of assets. Nor did it recognise the value of any obligations it has in respect of those landholdings in the non-departmental schedule of liabilities. These failures resulted in non-compliance with two financial reporting standards (FRS) that are part of GAAP.
- 2.11 Non-recognition of the landholdings was a departure from Financial Reporting Standard No. 3: *Accounting for Property, Plant and Equipment*. Not providing for any obligations that have arisen in respect of the landholdings was a departure from Financial Reporting Standard No. 15: *Provisions, Contingent Liabilities and Contingent Assets*.
- 2.12 The effect of these departures was to mis-state the schedules of non-departmental assets and liabilities. Any adjustment to those schedules would have a consequential effect on the schedules of non-departmental revenue and expenditure.
- 2.13 Our audit opinion accordingly included a qualification relating to the effect of not recognising the value of landholdings and any associated obligations in the non-departmental schedules. See also paragraphs 1.28-1.31 on page 16.

Financial and Service Performance Management

- 2.14 Since 1994, we have reported our assessments of certain aspects of management to the chief executive and to stakeholders in each department (such as the responsible minister, and the select committee which conducts the financial review of the department).
- 2.15 While conducting the annual audit, our auditors examine five aspects of financial management and service performance management. The purpose of this exercise is to identify specific areas of management where there are weaknesses, and to make recommendations to eliminate those weaknesses.





GOVERNMENT DEPARTMENTS – RESULTS OF THE 2002-03 AUDITS

Financial Management

TWO

2.16 We assess the following aspects of financial management:

- *Financial control systems* – the systems for monitoring expenditure and the management of assets.
- *Financial management information systems* – the systems for recording, reporting, and protecting financial information.
- *Financial management control environment* – management’s attitude, policies, and practices for overseeing and controlling financial performance.

Service Performance Management

2.17 Aspects of the management of service performance that we assess and report fall into two broad areas:

- *Service performance information and information systems* – this covers the adequacy of monitoring and control systems for service performance information, the accuracy of the information produced by those systems, and whether the performance measures in the statement of service performance are being used as a management tool.
- *Service performance management control environment* – this covers the existence of quality assurance procedures, the adequacy of operational policies and decisions, and the extent to which self-review of non-financial performance is taking place.





The Rating System

2.18 The rating system we use for the five management aspects is as follows:

Assessment Term	Further Explanation
Excellent	Works very well. No scope for cost-beneficial improvement identified.
Good	Works well; few or minor improvements only needed to rate as excellent. We would have recommended improvements only where benefits exceeded costs.
Satisfactory	Works well enough, but improvements desirable. We would have recommended improvements (while having regard for costs and benefits) to be made during the coming year.
Just Adequate	Does work, but not at all well. We would have recommended improvements to be made as soon as possible.
Not Adequate	Does not work; needs complete review. We would have recommended major improvements to be made urgently.
Not Applicable	Not examined or assessed. Comments should explain why.

TWO

The Results

- 2.19 We assessed financial management and service performance management in each of the 43 departments. A summary of the assessments (215 in total – 5 for each department) is given in Figure 2.2 on the next page.
- 2.20 The 90 assessments of “excellent” (41.9%) show a further level of improvement in the latest year, and the combined total of 188 assessments (87.4%) that were either “excellent” or “good” show a similar improvement from the previous year. This indicates commendable achievement by the departments concerned.
- 2.21 No assessments of “just adequate” were issued in 2003, compared with one in 2002.
- 2.22 By way of further analysis, we compared our assessments for 2002-03 and 2001-02 for each of the 43 departments. The overall results are summarised in Figure 2.3 on page 31.



Figure 2.2
Summary of Assessments of Aspects of Financial Management and Service Performance Management in Departments for 2002-03

Aspect Assessed	Excellent No.	Excellent %	Good No.	Good %	Satisfactory No.	Satisfactory %	Just Adequate No.	Just Adequate %	Not Adequate No.	Total No.
FCS	20	47	17	40	6	14	0	0	0	43
FMIS	19	44	20	47	4	9	0	0	0	43
FMCE	20	47	17	40	6	14	0	0	0	43
SPIS	12	28	24	56	7	16	0	0	0	43
SPMCE	19	44	20	47	4	9	0	0	0	43
Totals 2003	90	42	98	46	27	13	0	0	0	215
2002	85	40	97	45	32	15	1	0	0	215
2001	85	39	101	46	30	14	4	2	0	220

Key

- Financial Control Systems
- Financial Management Information Systems
- Financial Management Control Environment
- Service Performance Information Systems
- Service Performance Management Control Environment





*Figure 2.3
Assessments for 2002-03 compared to 2001-02*

Aspects Assessed*	Higher	Same	Lower	Total
FCS	3	39	1	43
FMIS	1	41	1	43
FMCE	3	39	1	43
SPIS	4	39	0	43
SPMCE	2	41	0	43
Totals	13	199	3	215
%	6.0	92.6	1.4	100.0

TWO

* See Figure 2.2 for key to abbreviations.

2.23 The noteworthy features of the results shown in Figure 2.3 are:

- A very high proportion (92.6%) of the assessments were maintained at the level of the previous year.
- 13 of the assessments (6.0%) were higher in 2002-03 than in 2001-02.
- 3 of the assessments (1.4%) were lower than in 2001-02.

2.24 The fact that 13 assessments were higher than in the 2001-02 year, compared with only 3 that were lower, confirms continuing overall improvement among departments. As we have observed previously, the trend to higher assessments restricts the scope for improvements of the same magnitude as in earlier years.

2.25 While theoretically possible, it is in practice difficult, for a variety of reasons, for all departments to attain a rating of “Excellent” for all aspects assessed. The reasons may include:

- periodic restructuring;
- complexity of departmental operations; and
- sheer size of operations.





GOVERNMENT DEPARTMENTS – RESULTS OF THE 2002-03 AUDITS

TWO

- 2.26 Our auditors will nevertheless be continuing to assist and encourage departments to make improvements, principally through the management letter issued at the end of an audit. For their part, chief executives and their staff will no doubt be motivated to continue striving for improvements.
- 2.27 We have now reported our assessments of management performance to Parliament and its select committees for each of the past 10 years. Our assessments have often been of considerable interest and are perceived as having high value to select committees when conducting their financial reviews of departments.
- 2.28 However, departments vary greatly in size and organisational structure. When we first reported results of the assessments to select committees, we took care to alert committees to those differences and urged them not to make comparisons between departments without being mindful of considerations (such as those mentioned in paragraph 2.26 above) which could explain reported differences in performance. Caution should continue to be exercised in using the assessments.
- 2.29 We have identified the need to refresh the five management aspects and consider the possibility of applying them in other sectors in the future. This is a specific area of research and development that we plan to undertake in 2004-05.





Part Three

Non-standard Audit Reports Issued

3



- 3.1 Last year, we reported on the non-standard audit reports issued on the annual financial reports of entities that are part of the Crown reporting entity, and other public entities not within the local government portfolio. We have not this year named the public entities for which we issued a non-standard audit report, but it is our intention to do so next year.
- 3.2 This article covers non-standard audit reports issued during the period 1 July 2002 to 31 March 2004, and outlines the nature of those reports.

Why Are We Reporting This Information?

- 3.3 An audit report is addressed to the readers of an entity's financial report. However, all public entities are in one sense or another creatures of statute and, therefore, are also accountable to Parliament. We consider it important to draw Parliament's attention to the range of matters that give rise to non-standard audit reports.
- 3.4 In each case, the issues underlying a non-standard audit report are drawn to the attention of the entity and discussed with its governing body.

What Is a Non-standard Audit Report?

- 3.5 A non-standard audit report¹ is one that contains:
- a **qualified audit opinion**; and/or
 - an **explanatory paragraph**.
- 3.6 The auditor expresses a **qualified audit opinion** because of a disagreement or a limitation on scope. The type of opinion will be either an "adverse" opinion (see paragraphs 3.09-3.10), or a "disclaimer of opinion" (see paragraph 3.11), or an "except-for" opinion (see paragraph 3.12).
- 3.7 The auditor will include an **explanatory paragraph** (see paragraphs 3.13-3.14) in the audit report in order to draw attention to:
- a breach of law; or
 - a fundamental uncertainty.

¹ A non-standard audit report is issued in accordance with the Institute of Chartered Accountants of New Zealand Auditing Standard No. 702: *The Audit Report on an Attest Audit (AS-702)*.





NON-STANDARD AUDIT REPORTS ISSUED

- 3.8 An explanatory paragraph is included in the audit report in such a way that it cannot be mistaken for a qualification of the opinion.

THREE

“Adverse” Opinion

- 3.9 An “adverse” opinion is expressed when there is disagreement between the auditor and the entity about the treatment or disclosure of a matter in the financial report and, in the auditor’s judgement, the treatment or disclosure is so material or pervasive that the report is seriously misleading.
- 3.10 Expression of an “adverse” opinion represents the most serious type of non-standard audit report.

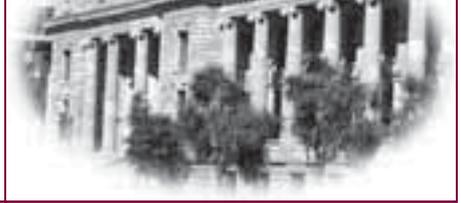
“Disclaimer of Opinion”

- 3.11 A “disclaimer of opinion” is expressed when the possible effect of a limitation on the scope of the auditor’s examination is so material or pervasive that the auditor has not been able to obtain sufficient evidence to support, and accordingly is unable to express, an opinion on the financial report.

“Except-For” Opinion

- 3.12 An “except-for” opinion is expressed when the auditor concludes that either:
- the possible effect of a limitation on the scope of the auditor’s examination is, or may be, material but is not so significant as to require a “disclaimer of opinion” – in which case the opinion is qualified by using the words “except for the effects of any adjustments that might have been found necessary” had the limitation not affected the evidence available to the auditor; or
 - the effect of the treatment or disclosure of a matter with which the auditor disagrees is, or may be, material but is not, in the auditor’s judgement, so significant as to require an “adverse” opinion – in which case the opinion is qualified by using the words “except for the effects of” the matter giving rise to the disagreement.





Explanatory Paragraph

- 3.13 In certain circumstances, it may be appropriate for the auditor to include in the audit report additional comment, by way of an explanatory paragraph, to draw attention to a matter that is regarded as relevant to a proper understanding of the basis of opinion on the financial report.
- 3.14 For example, it could be relevant to draw attention to the entity having breached its statutory obligations, or to a fundamental uncertainty which might make the going concern assumption inappropriate.

THREE





NON-STANDARD AUDIT REPORTS ISSUED

Summary of the Non-Standard Audit Reports Issued

THREE

The following table outlines the number and nature of non-standard audit reports issued during the period 1 July 2002 to 31 March 2004.

“Adverse” Opinions

Class of Entity	No. of Entities	Reason for Opinion
State-owned Enterprise	1 ²	We disagreed with the accounting treatment of provisions for claims and litigation relating to previous operations of the business. These provisions did not constitute a liability and were departures from generally accepted accounting practice.
Crown Entity	1	We disagreed with the going concern basis being used to prepare the financial statements because a decision had been made to close the main operating activity of a subsidiary entity. We also reported that had the going concern assumption been appropriate, the financial statements would have fairly reflected the financial position of the entity and the results of its operations.
Crown Entity – Subsidiary	1	We disagreed with the going concern basis being used to prepare the financial statements because a decision had been made to close the main operating activity of the entity. We also reported that, had the going concern assumption been appropriate, the financial statements would have fairly reflected the financial position of the entity and the results of its operations.
Education – Polytechnic Subsidiary	1	We disagreed with the going concern basis being used to prepare the financial report because the entity was unable to continue as a going concern without continuing financial support from its parent entity, and the parent entity had not committed itself to providing this support.

² For financial reports for two years.





NON-STANDARD AUDIT REPORTS ISSUED

B.29[04a]

“Full Disclaimers of Opinion”

Class of Entity	No. of Entities	Reason for Opinion
Education – University and Wananga Subsidiary	1	We were unable to form an opinion on whether the financial statements were fairly stated because there was no reliable financial information about the financial performance or financial position of the entity’s associate.

THREE

“Partial Disclaimers of Opinion”

Class of Entity	No. of Entities	Reason for Opinion
Statutory Body Subsidiary	23	We were unable to form an opinion as to whether the Statement of Financial Performance was fairly stated because the financial statements of the entity had not previously been audited. The Statement of Financial Position, in our opinion, was fairly stated.
Statutory Body Subsidiary	6	We were unable to form an opinion as to whether the Statement of Financial Performance was fairly stated because the financial statements of the entity had not previously been audited. The Statement of Financial Position, in our opinion, was fairly stated. In addition, we drew attention to uncertainties surrounding the going concern assumption. The validity of the going concern assumption was dependent on the continued financial support of the parent entity.





NON-STANDARD AUDIT REPORTS ISSUED

“Except-For” Opinions

THREE

Class of Entity	No. of Entities	Reason for Opinion
Government Department	1	We disagreed with the Department’s non recognition of its land holdings on behalf of the Crown and any associated liabilities in its non-departmental schedules. These are departures from Financial Reporting Standard No. 3: <i>Accounting for Property, Plant and Equipment (FRS-3)</i> and Financial Reporting Standard No. 15: <i>Provisions, Contingent Liabilities and Contingent Assets</i> .
Government Department	1 ³	We disagreed with the Department’s valuation of visitor assets, as the valuation did not take into account the effect of removal and/or reduction in service level of these assets on their remaining lives and rates of depreciation. In addition, the Department did not recognise fencing assets and the associated depreciation expense and capital charge in the financial statements, as required by FRS-3.
Health – District Health Board	1	We disagreed with the Board’s valuation of its buildings because the revaluation was not at component level as required by FRS-3.
Health – District Health Board Subsidiary	2 ⁴	We were unable to verify revenue from donations because of limited control over those revenues.
Health – Health Miscellaneous	1	We were unable to verify revenue from donations because of limited control over those revenues.
Māori Trust Board	1 ⁵	The Board did not consolidate the results of operations and cashflows or financial position of its subsidiary. This was a departure from Statement of Accounting Practice No. 8: <i>Accounting for Business Combinations</i> .
Māori Trust Board	1 ⁶	We were unable to obtain confirmation of the valuation of an investment.

... continued on the next page.

- 3 For financial reports for two years. The qualification for the second year related only to the comparative information shown.
- 4 In one case, for financial reports for two years.
- 5 For financial reports for three years.
- 6 For financial reports for two years.





NON-STANDARD AUDIT REPORTS ISSUED

B.29[04a]

THREE

Class of Entity	No. of Entities	Reason for Opinion
Māori Trust Board Subsidiary ⁷	2	We disagreed with the accounting treatment of a provision for screening and immunisation services. The provision did not constitute a liability and was a departure from generally accepted accounting practice.
Education – University and Wananga Subsidiary	1	We were unable to verify liquor revenue because of limited control over the receipt of this revenue.
Education – Rural Education Activities Programme (REAP)	1	We were unable to obtain independent confirmation or sufficient audit evidence to satisfy ourselves as to the accuracy of the figures presented in the Statement of Service Performance.
Education – REAP	1	We were unable to locate some of the accounting records, and some funds were misappropriated during the year. As a result, we were unable to establish with certainty the amount of the misappropriated funds, and were unable to obtain sufficient evidence to substantiate certain revenue items.
Education – REAP	1	The Executive Committee did not provide budgeted figures in the Statement of Financial Position (breaching a requirement of the Education Act 1989).
Education – Other Crown Entity	1	The entity had not completed a Statement of Intent for the year, as required by the Public Finance Act 1989. As there were no formal performance targets, we were unable to assess the entity's service performance.
Education – Miscellaneous	1 ⁸	We disagreed with the valuation of certain land. The valuation was not in accordance with Statement of Standard Accounting Practice No. 17: <i>Accounting for Investment Properties and Properties Intended for Sale</i> , which requires investment property to be valued at net current value.
Statutory Body	1	We were unable to verify revenues from door-to-door collections because of limited controls over those revenues.

7 Subsidiaries of Māori Trust Boards are not public entities under the Public Audit Act 2001. In this case, the Auditor-General accepted appointment as the entity's auditor under section 19 of the Act.

8 For financial reports for two years.





NON-STANDARD AUDIT REPORTS ISSUED

Explanatory Paragraphs

THREE

Class of Entity	No. of Entities	Reason for Opinion
Government Department	2 ⁹	We drew attention to the fact that the going concern basis had not been used in preparing the financial report.*
Education – Polytechnic	1 ¹⁰	We drew attention to uncertainties surrounding the going concern assumption. The validity of the going concern assumption was dependent on the successful conclusion of the Council's ongoing negotiations with its banker for borrowing.
Education – Polytechnic	1 ¹¹	We drew attention to the fact that the going concern assumption depended on the continuing financial support of the Crown.
Education – Polytechnic	1	We drew attention to the fact that the going concern basis had not been used in preparing the financial report.* In addition, the Council had not complied with the State Sector Act 1988 by not obtaining concurrence from the State Services Commissioner to pay a lump sum payment to the Chief Executive Officer. In our opinion, this payment was unlawful.
Education – College of Education	1	We highlighted that the validity of the going concern assumption depends on the nature of a proposal for the College to amalgamate with another TEI.
Statutory Body	1 ¹²	We drew attention to the uncertainty about the future status of the entity.
Statutory Body	1	We drew attention to the uncertainty about the future status of the entity. The validity of the going concern assumption depended on both the potential outcome of litigation and the potential dissolution of the entity, which are both fundamental uncertainties.
Crown Entity	3 ¹³	We drew attention to the fact that the going concern basis had not been used in preparing the financial report.*
Crown Entity – Subsidiary	1	We drew attention to the fact that the going concern basis had not been used in preparing the financial report.*

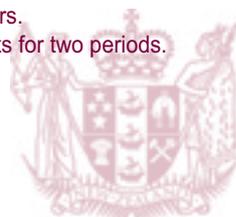
9 In one case, for financial reports for two years.

10 For financial reports for two years.

11 For financial reports for three years.

12 For financial reports for two years.

13 In two cases, for financial reports for two periods.





NON-STANDARD AUDIT REPORTS ISSUED

B.29[04a]

Class of Entity	No. of Entities	Reason for Opinion
Health – District Health Board Subsidiary	5 ¹⁴	We drew attention to the fact that the going concern basis had not been used in preparing the financial report.*
Education – Polytechnic	1	We drew attention to the fact that the going concern basis had not been used in preparing the financial report.*
Education – Polytechnic Subsidiary	2	We drew attention to the fact that the going concern basis had not been used in preparing the financial report.*
Education – Other Crown Entity	3 ¹⁵	We drew attention to the fact that the going concern basis had not been used in preparing the financial report.*
Education – Miscellaneous	1	We drew attention to the fact that the going concern basis had not been used in preparing the financial report.*
Statutory Body	1	We drew attention to the fact that the going concern basis had not been used in preparing the financial report.*
Producer Board	2	We drew attention to the fact that the going concern basis had not been used in preparing the financial report.*

THREE

*Justified, because in each case the entity was ceasing to exist.

14 In two cases, for financial reports for two years.

15 In one case, for financial reports for two years.





Part Four

Payments for Additional Remuneration to School Principals

4



Introduction

FOUR

- 4.1 During our audit of the 2001 annual financial reports of school Boards of Trustees, we became aware of certain transactions in a particular school that were a cause for concern. Our concerns were heightened when we were told that these transactions were “customary” among schools.
- 4.2 The transactions included:
- payments out of Board funds for the cost of items of clothing and personal grooming services incurred by the principal; and
 - lump-sum payments to the principal to meet school-related expenditure for which no supporting documentation had been retained.
- 4.3 We carried out a special audit of the transactions at the school, which we completed in November 2002. We concluded that, although the Board had approved the transactions in good faith, the transactions were in the nature of remuneration that:
- required the prior concurrence of the Secretary for Education; and
 - incurred a taxation liability on the part of the Board that it had not recorded.
- 4.4 We also found some instances of expenses incurred by the principal and paid for by the Board that, in our view, did not represent an appropriate use of Board funds.
- 4.5 We discussed the matter with the Ministry of Education (the Ministry), which shared our concerns, and decided to look at the extent of the practices we had observed and the degree of compliance with the applicable legal and other requirements. If the result was to find that the practices were widespread, we would work with the Ministry and other interest groups to establish what would be best practice for the payment of additional remuneration to principals.





PAYMENTS FOR ADDITIONAL REMUNERATION TO SCHOOL PRINCIPALS

FOUR

The Basis for Determining Principals' Remuneration

- 4.6 The terms and conditions of employment for all school principals are set down in either:
- one of two collective agreements, as negotiated between the Ministry and the primary or secondary teachers' unions¹; or
 - for principals who do not belong to the relevant union, an Individual Employment Agreement, approved by the Ministry.
- 4.7 A principal is responsible for the overall management and professional leadership of the school. The management role covers such responsibilities as:
- the educational success of the school;
 - the professional performance and development of its staff;
 - the administration of daily school life; and
 - maintaining effective communication between all members of the school's community.
- 4.8 Those responsibilities are classed as "normal duties", the rate of salary for which is determined mostly by reference to the 'U-grade' of the school², the number of teachers supervised, and whether the decile rating of the school is from 1 to 4.
- 4.9 Depending on the circumstances of the school, the principal might also have other responsibilities – such as supervising a boarding hostel or managing an international student programme³. These responsibilities are classed as "additional duties", for which extra remuneration can be paid.
- 4.10 A school Board of Trustees is a Crown entity in its own right and, as such, has legal obligations.

1 The New Zealand Educational Institute and the Post Primary Teachers Association.

2 Every school is graded from "U1" to "U14" on the basis of roll size – U1 being a school with between 1 and 50 students, and U14 being a school with more than 2000 students.

3 International student programmes have been an area of particular growth. The number of foreign fee-paying students in New Zealand schools has increased from 7200 in 2000, to 15,000 in 2002. These programmes provide locally raised income that schools can use to supplement their operational funding, but they may also require additional management input from the principal.





How is Principals' Remuneration Paid?

- 4.11 The Ministry requires all remuneration to be paid through its central system. This means that additional remuneration requires the Ministry's consent.
- 4.12 The Ministry refers to the consent as "concurrence", but for convenience we refer to it here as "Ministry approval".

FOUR

Salary Paid Fortnightly

- 4.13 The remuneration for normal duties is paid in the form of salary on a fortnightly basis.
- 4.14 Schools receive an annual entitlement of Government funding that is dedicated to paying staff salaries. This entitlement is centrally resourced and is administered through the Ministry's central payroll system. It is separate from the operational funding that the Government provides quarterly to schools to pay for day-to-day activities.
- 4.15 A private service provider administers the Ministry's central payroll system. It is the biggest payroll in the country, paying 2700 principals and almost 80,000 teachers and support staff every fortnight. The service provider staff are based at four regional payroll service centres. They process salary payments, respond to payroll-related enquiries, and provide personnel clerical services.

Payment for Additional Duties

- 4.16 Payments for additional duties must also be made through the Ministry's central payroll system. But, because the purpose and amount of the payments are dependent on the circumstances of the school, they are not directly provided for in the collective agreements.
- 4.17 Unlike the salary for normal duties, the cost of this additional remuneration has to be met out of a Board's operational funding.





PAYMENTS FOR ADDITIONAL REMUNERATION TO SCHOOL PRINCIPALS

FOUR

Reimbursement for Job-related Expenses

- 4.18 The collective agreements stipulate that reimbursement should be made for actual and reasonable out-of-pocket expenses incurred in the proper performance of the principal's duties. Payments for expenses are made by a Board out of its operational funding and are subject to the internal policies of the school.
- 4.19 Reimbursing payments do not require the approval of the Ministry and can be paid directly to the principal without being processed through the Ministry's central payroll system.
- 4.20 Nevertheless, the Ministry has set out its expectations for the reimbursement of expenses in its *Financial Information for Schools Handbook*. The key expectation is that schools will have formal policies in place for the authorisation and payment of expenses – including that:
- the Board or the Chairperson should authorise the expenditure; and
 - reimbursing payments should be supported by suppliers' invoices that show full details of the expenditure.
- 4.21 Reimbursing payments for expenses that cannot be clearly identified as work-related (i.e. through documentary evidence) could be considered to be for personal expenses and, therefore, part of the recipient's remuneration. If such a payment were made, it would have to go through the Ministry's central payroll system, and would require the approval of the Secretary for Education.
- 4.22 In Figure 4.1 on the next page, we give examples of payments that do and do not constitute remuneration.





PAYMENTS FOR ADDITIONAL REMUNERATION TO SCHOOL PRINCIPALS

B.29[04a]

Figure 4.1
Examples of Remuneration

Transactions or Arrangements that Constitute Remuneration and Require Ministry Approval

FOUR

Payments for additional responsibilities, bonuses, and incentive payments.

Personal expense payments – e.g. medical and other private insurance, telephone (where not used for school-related purposes), and general household expenses. This includes payments for clothing and personal grooming.

Payments intended to cover school-related expenses incurred personally by the principal, but where no supporting documentation has been provided of the actual expenditure incurred.

Allowances (other than payments or reimbursements of specific school-related expenses) – e.g. gym or club memberships where membership is not school-related.

Use of motor vehicles for private purposes, including all running costs.

Use of a school house at below market rental.

Contributions to superannuation funds, and any other retirement benefits.

Transactions or Arrangements that Do Not Constitute Remuneration or Require Ministry Approval

Reimbursement of expenses incurred in relation to professional development, including fees for attending conferences and seminars.

Reimbursement of travel expenses incurred on school-related matters such as meetings, visits to camps, interviews, class trips, and conferences.

Payments for professional publications, equipment, materials, entertainment, social expenses, gifts, meals, compassionate expenses, koha, etc. for school-related matters, for which supporting third-party documentation has been provided.

Subscriptions and membership fees to professional organisations relevant to school-related activities (this does not include fees for trade unions).





PAYMENTS FOR ADDITIONAL REMUNERATION TO SCHOOL PRINCIPALS

FOUR

Obtaining Approval to Pay Additional Remuneration

- 4.23 The Secretary for Education has delegated the authority to grant Ministry approval for the payment of additional remuneration to the Ministry's Industrial Relations Unit (IR Unit). The IR Unit is also responsible for negotiating and interpreting collective employment agreements, and dealing with related employment issues on behalf of the Ministry.
- 4.24 The IR Unit considers applications from Boards of Trustees that wish to pay additional remuneration against a policy framework that is set by the Minister of Education. The facts of each particular case are taken into account and a Board may be asked to provide more information about its application. The IR Unit has the discretion to approve or decline any application.

Specific Ministry Policies and Procedures

- 4.25 The Ministry first outlined the broad factors it considers when Boards apply for approval to pay additional remuneration in a December 2000 circular to Boards of Trustees.⁴ This information was reiterated to Boards with the settlement of the new collective agreements that took place in October 2002, and again in September 2003.
- 4.26 The key determinant that staff of the IR Unit look for when assessing an application is that a Board can show that the proposed enhancements to the principal's remuneration compensate the principal for additional responsibilities – over and above those that normally form part of a principal's job.
- 4.27 The Ministry's guidance has stated that additional benefits such as cars, insurance, and "expense accounts" are unlikely to be approved. These were previously acceptable, if Boards could demonstrate affordability, but they have subsequently been excluded with the cessation of the bulk-funding regime in 2000.⁵

4 From time to time, the Ministry issues 'Circulars' to all schools. These are intended to advise Boards and their staff of the Ministry's current requirements on a range of issues, including industrial relations, resourcing, and finance (including annual reporting).

5 Bulk funding of teachers' salaries was a funding option made available to Boards of Trustees under repealed provisions in the Education Act 1989. This option allowed Boards to self-manage their staff funding. After the 2000 Amendment Act, bulk funding was dropped as an option for Boards from January 2001. All Boards are now funded in the same way, with centralised resourcing for their teachers' salaries.





PAYMENTS FOR ADDITIONAL REMUNERATION TO SCHOOL PRINCIPALS

B.29[04a]

FOUR

- 4.28 Payments recognising performance, recruitment and retention, or the decile level for the school are also unlikely to be approved. The Ministry considers that these aspects of performance are factored into the remuneration formula included in the two collective agreements.
- 4.29 Approvals are granted only for one school year at a time. If a Board wishes to continue providing additional remuneration, it has to reapply for approval annually.
- 4.30 According to the Ministry's policies, all applications for approval must include:
- detailed information and/or supporting documents from the Board that explain the principal's additional responsibilities;
 - the specific amount of the additional payment the Board is seeking to make;
 - written acknowledgement that the Board accepts the liability for the payment and has the financial capacity to make the payment, without detriment to its other activities; and
 - where approval is sought for payments to principals employed on an Individual Employment Agreement (IEA) that provides for better terms and conditions than the collective agreements, a copy of the draft IEA with proposed amendments and/or additions.
- 4.31 The Ministry exercises discretion as to the value of additional remuneration that it will approve. It takes the principal's normal duties salary (see paragraph 4.8 on page 48) into consideration when making this decision, and may decide to approve a smaller sum than that requested by the Board.
- 4.32 The Ministry logs in a register the applications received and the responses issued. When the Ministry has approved an application, a letter is sent to the Board of Trustees confirming the nature of the approval. The letter generally confirms the approved amount of the additional payment and the school year to which the approval applies.
- 4.33 As a control on the payment of additional remuneration, the Ministry requires Boards to provide a copy of the approval letter to their local payroll service centre before the payments are made.
- 4.34 The key steps in the approval process, as it is intended to operate, are illustrated in Figure 4.2 on the following page.

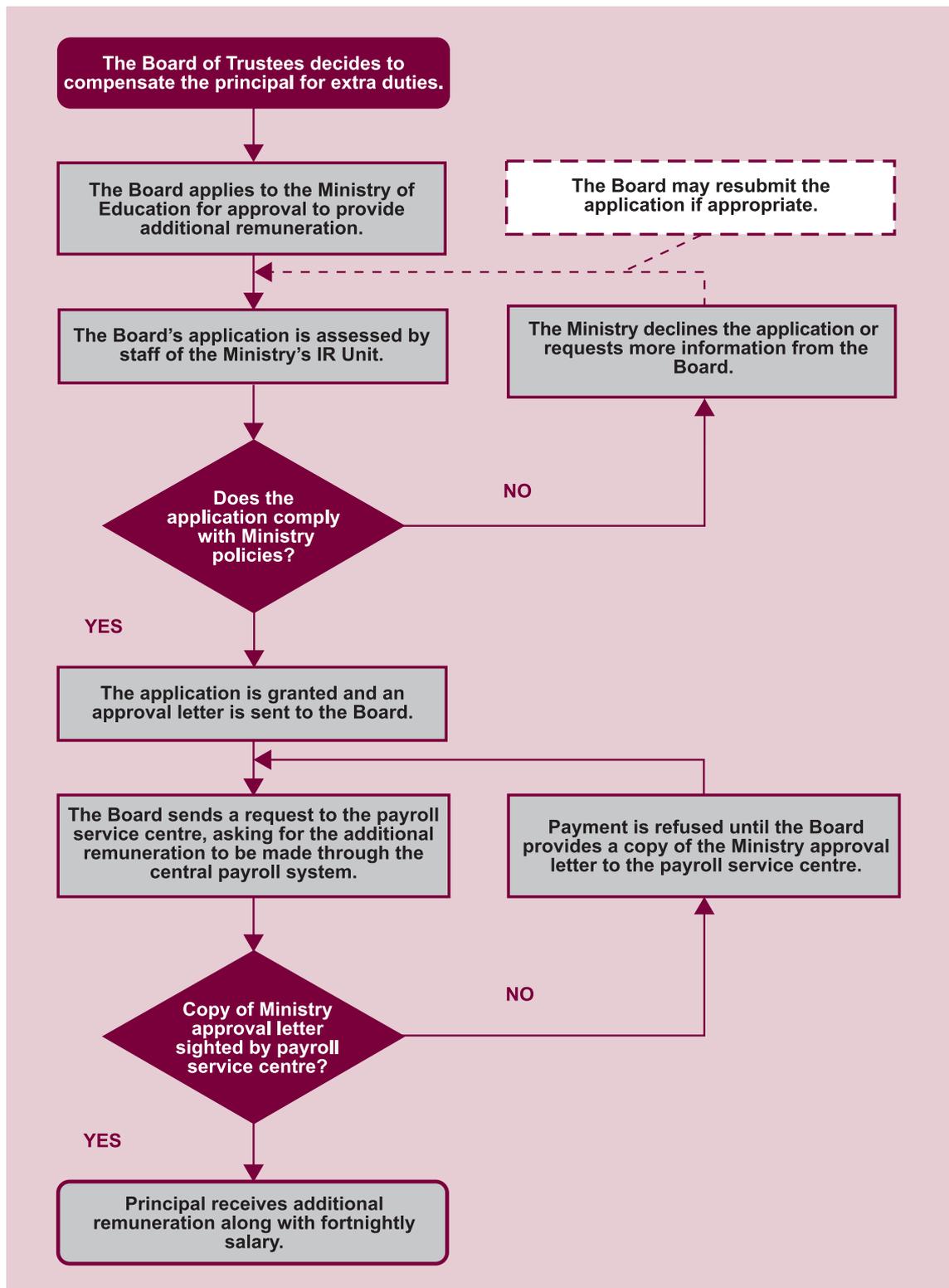




PAYMENTS FOR ADDITIONAL REMUNERATION TO SCHOOL PRINCIPALS

Figure 4.2
Key Steps in the Process for Approving Additional
Remuneration Paid to a Principal

FOUR





The Scope of Our Examination

- 4.35 We sought to find out the extent and kind of payments principals were receiving for additional duties, and whether the payments were in accordance with the Education Act 1989 and any relevant Ministry requirements.
- 4.36 The basis of our examination was payments made to principals in the school financial year 1 January to 31 December 2002. We looked separately at payments through the Ministry's central payroll system and payments directly by Boards of Trustees.
- 4.37 As a result of early indications that a number of payments had been made without the required Ministry approval, including some that were in breach of the Education Act, we also:
- examined the Ministry's written advice to Boards regarding the requirement for additional remuneration to be approved;
 - talked to the relevant Ministry staff to gain an overview of the approval process; and
 - compared the information we obtained on the policies and procedures for approval against our collected evidence.

FOUR

Payments Through the Ministry's Central Payroll System

- 4.38 We selected 70 payments for remuneration other than the regular fortnightly salary payments for normal duties that had been made through the central payroll system between 1 January and 31 December 2002.
- 4.39 We selected the 70 payments from among those that (either individually or as a type) involved significant amounts of money and where (based on the descriptive information available about each payment) it appeared that Ministry approval might be required. The 70 payments had a total value of \$521,560 and were made to 54 principals.





PAYMENTS FOR ADDITIONAL REMUNERATION TO SCHOOL PRINCIPALS

FOUR

- 4.40 We then examined the 70 payments and the systems and processes used to action them. The IR Unit and the Ministry's Contracts and Resourcing Division⁶ assisted us by providing documentary evidence for each payment. The Ministry also provided us with further evidence from the files of the respective payroll service centres in relation to each of the payments.
- 4.41 Documents we sighted included:
- payroll print-outs showing details of payments made;
 - applications from Boards and approval letters from the Ministry for the 2002 payments;
 - historical applications and approval letters where approval had been granted for payments in previous years; and
 - correspondence between schools and payroll service centres.
- 4.42 We examined the available documentation for each payment to establish whether the appropriate approval had been sought by the Board and granted by the Ministry.

Our Findings

- 4.43 Of the 54 principals, 45 had received payments with Ministry approval at a total value of \$458,343. The remaining 9 principals had received additional remuneration to a total value of \$63,217 without the required Ministry approval.
- 4.44 The payments to the 9 principals were:
- a \$10,600 rebate on the rental of the principal's residence;
 - \$10,500 for acting as a support officer for international fee paying students;
 - nearly \$9,000 for acting as a Community Education Liaison Co-ordinator;
 - a "car reimbursement" of \$1,000 a month paid for 10 months of each year;
 - a "travel allowance" of \$282 a fortnight from January to September;

6 The division of the Ministry with responsibility for overseeing the central payroll system.





PAYMENTS FOR ADDITIONAL REMUNERATION TO SCHOOL PRINCIPALS

B.29[04a]

- a “term allowance” of \$2,000 for three terms;
- an annual “extra pay” of nearly \$6,000 approved by the Board;
- \$4,500 for involvement in a special literacy project; and
- a lump-sum payment of \$1,826 for health insurance costs.

FOUR

4.45 Our findings highlighted three issues about additional payments through the central payroll system:

- **The Board had not sought Ministry approval.** We did not seek to establish why approval had not been sought – which might have been through oversight or incorrectly assessing that approval was not required – but the failure was a clear breach by the Boards of a legal obligation.
- **The principal had authorised the payment (2 cases).** As the principal’s employer, the Board must give its authority to any additional remuneration. The principal has no authority to act unilaterally.
- **Payroll service centres did not always sight approval letters.** The Ministry has an internal control intended to prevent the payment of unapproved additional remuneration by requiring the Board to provide the payroll service centre with a copy of the approval letter from the IR Unit before the payment can be made. However, our review of documentation relating to the 70 payments showed that not all Boards had provided, and payroll service centres had not always insisted on receiving, evidence of Ministry approval before making the additional payment.

4.46 As a result of this last finding, the Ministry has reminded the payroll service centres of their obligation to sight approvals, and is considering new protocols with the private service provider. The Ministry told us that it intends to look at instituting new monitoring reports to check principals’ remuneration on a payday basis.

4.47 The Ministry is also to follow up these examples of unlawful expenditure and consider whether recovery of the payments would be possible or appropriate. In our view, the Ministry should also consider whether any other unlawful payments have been made centrally, which possibly should be subject to recovery action.





PAYMENTS FOR ADDITIONAL REMUNERATION TO SCHOOL PRINCIPALS

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4.48 In September 2003, new collective agreements for primary, secondary, and area school principals were signed. The Ministry has informed us that all additional remuneration made through the central payroll system for each principal covered by the prior agreements⁷ has therefore ceased to be paid. The Ministry has informed all Boards that new approvals will need to be sought before any further additional remuneration payments can be initiated.

Payments Made Directly by Boards

4.49 Assessing the existence and extent of any additional remuneration paid directly by Boards to principals (i.e. not through the Ministry's central payroll system) would have involved examining transactions at all 2582 schools.⁸ We decided to limit our examination to the 402 secondary schools.⁹

Our Findings

4.50 Our auditors identified 119 separate instances of possible additional remuneration to secondary school principals that had been made outside of the central payroll system and for which the Boards had not sought Ministry approval. The 119 instances involved payments to 72 of the 402 principals.

4.51 The values of the 119 payments ranged from under \$500 to about \$23,000. The list below sets out some of the types of payments made:

- about \$23,000 for time spent on implementing a video conferencing project for the school;
- an expense allowance of \$577 a fortnight;
- a travel subsidy of \$850 a month for 12 months;
- a \$10,000 performance bonus;
- motor vehicle expenses (in one case the school leased a car for the principal who had free use of the vehicle at all times, at a cost of nearly \$9,000 a year);

7 Either as a member of the respective teacher's union, or under an Individual Employment Agreement.

8 This number includes all State and State Integrated Schools, but excludes Private Schools.

9 The scope of this phase of the audit covered secondary schools (of which there are 316) and composite/area schools (of which there are 86). Composite/area schools combine primary, intermediate, and secondary schooling at one, predominantly rural, location. For ease of understanding we use "secondary schools" to describe this group of 402 schools.





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- a \$5,000 annual payment for duties relating to a school farm and hostel;
- medical expenses and health insurance – which involved the reimbursement of \$2,000 a year for health insurance.
- a clothing allowance of \$1,500 a year; and
- payment of airline club membership fees.

4.52 We also became aware that principals of some integrated schools¹⁰ received remuneration from the school proprietors in addition to the normal duties salary payable in terms of the applicable employment agreement funded by the Ministry. Arrangements of this nature may be in breach of section 7(4) of the Private Schools Conditional Integration Act 1975. The Ministry is considering how to identify the extent of these payments and, if unlawful, how they may be stopped.

4.53 Some Boards of Trustees are paying additional remuneration other than through the Ministry's central payroll system. Of the 119 payments identified, in our opinion 62 constituted additional remuneration requiring Ministry approval and, consequently, the 46 Boards that made the payments acted in breach of section 89 of the Education Act 1989. The total value of these payments was at least \$210,000.

4.54 None of the 62 payments met the Ministry's criteria and were unlikely to have been approved even if the Boards had sought approval. In that case, the payments should not have been made under any circumstances.

4.55 The status of a further 51 of the 119 payments needs further investigation before it can be determined whether or not they constitute additional remuneration and, if so, whether or not they might comply with the Ministry's approval criteria. For 30 of the 51 payments that could be reimbursements for actual and reasonable business expenses¹¹, the decision will be based on whether the Board and the principal can clearly show that to be the case.

10 Integrated schools provide education of a "special character" in line with a particular religious or philosophical belief. They receive an operational funding grant from the state education system under an integration agreement between the Minister of Education and the proprietors of the school.

11 For example, by providing evidence such as receipts and car log books.





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- 4.56 Of the remaining 6 payments, the Ministry informed us that 3 did not require its approval¹², and the other 3 had received retrospective approval since our examination began.
- 4.57 Both the Ministry and we are concerned about the extent to which unapproved additional remuneration has been paid outside of the central payroll system. We consider that there are no reasons that would excuse Boards for not complying with the legislative and other requirements. That 11% of secondary school Boards made these payments in 2002 is a significant finding, and we note that this figure could increase depending on further investigation of the 51 other payments.
- 4.58 Contracts between a Board and the principal that provide for additional remuneration could be illegal without Ministry approval. The Ministry told us that it plans to investigate the payments we have identified, and has indicated that it may consider legal avenues for recovery on the basis of further legal advice and on an analysis of the facts of each case, or group of cases.
- 4.59 We are concerned that the Ministry has taken a long time to initiate its investigation, given that we first raised the cases of additional remuneration with it in July 2003. This delay may make it harder to obtain full information on the payments and to pursue recovery where appropriate. Also, the length of time may encourage principals and Boards of Trustees to believe that such payments are proper.
- 4.60 However, we are pleased to note that some positive action is now being taken. The Ministry will be exploring ways to tighten its monitoring procedures over the payment of additional remuneration, and we consider that this, together with a requirement on Boards to disclose remuneration in their financial statements for the year ended 31 December 2004, will ensure that future monitoring is more robust.
- 4.61 The Education Review Office (ERO) is aware of our findings, and has told us that it will require the Board of each school being reviewed in 2004-05 to attest in its Board Assurance Statement that it complies with section 89 of the Education Act when providing additional remuneration to the principal.¹³ The ERO intends to audit this statement and will inform us of the results of this exercise in July 2005.

12 These relate to provisions for special leave for the purpose of professional development as provided for in the Secondary School Principals' Collective Agreement.

13 As part of the review process, the Education Review Office (ERO) asks the Board of Trustees of each school to complete a self-audit checklist and a Board Assurance Statement. The information in each of these documents assists the ERO in the scoping and planning of the review.





The Ministry's Approval Process

FOUR

4.62 As a result of finding instances of additional remuneration being paid without Ministry approval and outside of the central payroll system, we decided to examine the way in which the Ministry's approval process operates. This involved looking at:

- the guidance that the Ministry has issued to Boards; and,
- what internal policies and procedures the Ministry had in place for the administration of its approval function.

4.63 Administering the statutory approval process is one of the roles of the IR Unit. According to the Ministry's records, there have been 232 applications for approval since November 2000.

4.64 Advice provided by the Ministry to Boards of Trustees on the policies and procedures of the approval process is currently found in seven key documents. These documents do not deal solely with the requirement for approval, but with a number of other issues current at the time of publication. The documents are listed in Figure 4.3 below:

*Figure 4.3
Key Documents for the Approval Process*

Date	Ministry Document
4 December 2000	Circular 2000/30 – Bargaining Issues: Settlement of Collective Agreements for Principals
31 August 2001	Circular 2001/17 – Collective Agreements for Primary Teachers and Principals, 2001-2003
6 September 2002	Circular 2002/20 – Collective Agreement Settlements and Variation: Principals and Teachers
4 October 2002	Letter to Boards of all State and State Integrated Schools – Implementation of Secondary School Principals' Collective Agreement, 2001-2003
3 October 2003	Circular 2003/16 – 2003 Annual Reporting Circular
3 October 2003	Circular 2003/17 – Primary and Secondary Principals' Collective Agreement Settlements
10 October 2003	Letter to Boards/Principals where the principals are not members of the relevant unions.



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- 4.65 In our view, the guidance on the approval requirement could, on the whole, have been clearer. We have discussed our view with the Ministry, which has indicated to us that every effort will be made to ensure that the requirement for approval is clearly communicated to Boards in the future. Boards now receive advice on the requirement for approval through the Ministry's Annual Reporting Circular, and the Ministry has said that it will include the requirement in a future update of the *School Resourcing Handbook*.
- 4.66 The Ministry has told us that all future guidance will be unequivocal about the prohibition on unapproved additional remuneration. We believe it would be useful for the critical points to be summarised in a single document prepared specifically for Boards of Trustees.
- 4.67 The Ministry has policies and processes in place to help ensure the smooth and efficient running of the approval function. However, these could be enhanced in some respects – in particular:
- Although there are written guidelines for the IR Unit staff to follow when assessing applications for approvals, we were told that there are only informal quality assurance procedures in place. It is important that approvals are consistent and have a clear audit trail to support them. And, because the approval process has the element of discretion, it is also important that the IR Unit can show the basis on which that discretion is exercised, and that it is exercised consistently. The lack of formal procedures to review approvals, however, results in an increased risk of IR Unit staff assessing applications inconsistently.
 - The Ministry's record of applications and responses was found to be incomplete and not wholly accurate. We viewed the Ministry's entire record of applications and compared it to copies of letters sent by Boards to payroll service centres.¹⁴ Among the letters that the Ministry provided to us as supporting evidence for payments were 16 that did not have corresponding entries in the Ministry's record of applications and responses. These letters were dated from March 2000 through to November 2003, and consisted of 14 granting approval and 2 requesting further information from the Board.

¹⁴ This record includes 232 applications dating back to November 2000.





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- The Ministry had approved some applications despite the Board not meeting a specific approval criterion. Five approvals, dated from December 2001 through to March 2003, were granted even though the application did not comply with the requirement for Boards to confirm that the proposed payments were affordable and sustainable. In our view, this requirement is important as it shows an acceptance by the Board of its responsibility for the payments. The Ministry's current practice of stating in approval letters "... that the financial liability for the payment rests with the Board" does not in our view achieve the same recognition of onus as a statement from the Board.

FOUR

Potential Taxation Issues for Boards of Trustees

- 4.68 Boards of Trustees paying additional remuneration outside of the central payroll system without Ministry consent must nevertheless ensure that any relevant taxation issues are addressed.
- 4.69 To the extent that a Board of Trustees has provided a "fringe benefit" to a principal, it will be liable for fringe benefit tax on the amount concerned. Further, for cash amounts paid to principals, the Boards must generally deduct PAYE from the amount paid where the cash amount is "monetary remuneration" under the Income Tax Act 1994.
- 4.70 In relation to the 119 payments made outside of the central payroll system, in our view 97 of them potentially had tax implications, which not all of the Boards of Trustees appeared to have addressed. Failure to comply with the Education Act by ensuring that all additional payments are made through the central payroll system exposes Boards to potential tax liability issues that could prove costly.





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Probity Issues Attaching to Additional Remuneration Payments

FOUR

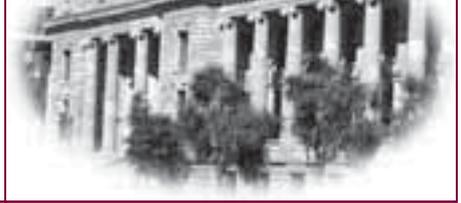
- 4.71 Consistent with the public accountability of Boards of Trustees as Crown Entities, the Ministry has published some guidance for Boards and school management on issues of probity. This guidance makes it clear that all funds received by the school, whether locally raised or from the public purse, must be spent in the best interests of students.¹⁵
- 4.72 We identified some payments that may not have conformed to the guidance. For example, we observed:
- three instances where the principal was paid between \$10,000 and \$11,000 in performance bonuses; and
 - three instances where gifts to retiring principals had values of more than \$10,000.
- 4.73 As noted in paragraph 4.28 on page 53, the Ministry considers that performance is factored into the remuneration formula in the collective employment agreements and that it is unlikely to approve the payment of bonuses. In addition, we believe that retirement gifts of the size noted above are excessive, and are out of step with wider community expectations for the responsible use of public funds.

Concluding Comments

- 4.74 Boards of Trustees must comply with the following obligations when providing additional remuneration to their principals:
- Ministry of Education approval must be sought and obtained; and
 - all payments must be made through the Ministry's central payroll system.
- 4.75 We are concerned that Boards of Trustees are not always complying with their legal obligations and that some principals have received additional remuneration without Ministry approval.

¹⁵ Circular 2003/16 – Annual Reporting Circular, page 7.





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- 4.76 The Ministry's approval function could be improved by:
- ensuring that payroll service centres do not make payments for which there is no approval;
 - issuing clearer guidance to Boards of Trustees; and
 - strengthening various internal policies and procedures.
- 4.77 We are pleased that the Ministry has given us firm assurances that our concerns will be appropriately addressed.
- 4.78 Boards of Trustees have the primary responsibility for ensuring that principals are remunerated in accordance with the obligations noted above. We have discussed with the Ministry and the ERO strategies for following up unapproved additional remuneration, and intend to maintain a close watch on this issue through our annual audit of Boards' financial reports.

FOUR





Part Five

Changes To Financial Reporting Standards

5



- 5.1 For many years, government departments, Crown entities, State-owned enterprises, and other public entities have been required to present their financial statements in accordance with generally accepted accounting practice (GAAP). GAAP means:
- approved financial reporting standards, so far as those standards apply to the entity; and
 - in relation to matters for which no provision is made in approved financial reporting standards and that are not subject to any applicable rule of law, accounting policies that are appropriate in relation to the entity and have authoritative support within the accounting profession in New Zealand.
- 5.2 The Accounting Standards Review Board (ASRB) has responsibility under the Financial Reporting Act 1993 to approve financial reporting standards. All existing financial reporting standards have been developed by the Financial Reporting Standards Board of the Institute of Chartered Accountants of New Zealand (FRSB) before being approved by the ASRB.
- 5.3 For the last decade, financial reporting standards in New Zealand have been sector-neutral. Sector-neutral standards are standards developed with regard to, and which establish standards and guidance for, the full range of entities to which they apply. The credibility of our public sector financial reporting has undoubtedly been enhanced by the fact that the same standards are applied by all entities.
- 5.4 In December 2002, the ASRB announced its decision that New Zealand entities would be required to apply new standards based on International Financial Reporting Standards (IFRS)¹ for reporting periods beginning on or after 1 January 2007. Entities would have the option to apply the new standards from periods starting on or after 1 January 2005. The timetable was driven by a desire to allow the corporate sector in New Zealand to make the transition, if desired, at the same time as Australia and Europe.

1 The term IFRS is used to refer to International Accounting Standards Board (IASB) standards. The standards comprise:

- International Accounting Standards (IASs), inherited by the IASB from its predecessor body, the International Accounting Standards Committee (IASC), and the interpretations of those standards.
- International Financial Reporting Standards (IFRS) – the new standards being issued by the IASB, and the interpretations of those standards.





CHANGES TO FINANCIAL REPORTING STANDARDS

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- 5.5 IFRS apply only to profit-oriented entities. We understand that the new New Zealand standards to be based on IFRS will be called New Zealand International Financial Reporting Standards (NZ IFRS)². The format, language, and structure of IFRS will be preserved in NZ IFRS, but the ASRB has decided that a single set of standards should exist in New Zealand for application to all entities. Retention of a single set of standards retains some of the benefits of sector-neutral standards, most notably efficiency in application of the standards (in that preparers and auditors will have a better understanding of single set of standards) and efficiency in preparation of standards.
- 5.6 In order that the standards can be applied by what the ASRB calls public benefit entities³ (including almost all public sector entities), additional measurement and recognition requirements will be introduced, and additional or amended disclosure requirements may be established. It is possible that additional or amended disclosure requirements may apply to profit-oriented entities as well.
- 5.7 In June 2003, we raised concerns with the ASRB that inadequate consideration was being given to the effects of the changes to standards on public sector reporting in New Zealand. After discussion, the ASRB established the following guidelines to be used in adapting IFRS in New Zealand:
- The IFRS disclosure requirements cannot be reduced for profit-oriented entities.
 - Additional disclosure requirements can be introduced for all entities.
 - The IFRS recognition and measurement requirements for profit-oriented entities cannot be changed.
 - Recognition and measurement requirements can be amended for public benefit entities, with a rebuttable presumption that amendments will be made for differences between IFRS and the corresponding International Public Sector Accounting Standard (IPSAS)⁴ or existing New Zealand Financial Reporting Standards (FRS), based on the IPSAS or FRS as applicable.

2 NZ IFRS will comprise:

- New Zealand International Accounting Standards (NZ IASs), and the interpretations of those standards.
- New Zealand International Financial Reporting Standards (NZ IFRSs), and the interpretations of those standards.

3 Public benefit entities are entities whose primary objective is to provide goods or services for a community or a social benefit, and where any risk capital has been provided with a view to supporting that primary objective rather than for a financial return to equity shareholders.

4 IPSAS are developed and issued by the Public Sector Committee of the International Federation of Accountants for application to public sector entities.





- Introduction of guidance materials for public benefit entities should be based on the same principles as apply to introduction of recognition and measurement requirements as outlined above.
- Elimination of options in IFRS is permitted for all entities, on a case-by-case basis. Where an IFRS permits options that are not allowed in existing FRS, a strong argument would need to be made in order for the ASRB to agree to the retention of such options in the NZ IFRS. In reaching a view on this issue, the ASRB will be mindful of the approach adopted by the Australian Accounting Standards Board⁵.

FIVE

- 5.8 During the past year, the FRSB has been developing the new standards to be based on IFRS. To date it has issued 37 exposure drafts of new standards, typically with each exposure draft being available for a two-month period for public comment.
- 5.9 It is unclear at present exactly what the new standards will mean for public sector entities. The full effect will become clearer towards the end of 2004. But, as further changes will be made in IFRS for application in 2006 and beyond, there may be further effects by the time public sector entities need to comply with the new standards for the first time.

Adoption of NZ IFRS by the Crown

- 5.10 In August 2003, the Government announced that NZ IFRS would be implemented in the Crown financial statements as part of the 2007 Budget. This means that the first set of audited Crown financial statements reported under NZ IFRS will be for the year ending 30 June 2008 (with comparatives for the year ending 30 June 2007 also based on NZ IFRS). This means the Crown will have to restate its opening balance sheet as at 1 July 2006. This also means that the 2007 Budget (published around May 2007) will also need to be prepared under NZ IFRS.
- 5.11 We understand that most entities consolidated into the Crown financial statements will be following the Crown's timetable for adopting NZ IFRS. However, should entities adopt earlier, they will need to continue reporting to the Crown under the existing FRS framework. That is, these entities need to be able to report under both the NZ IFRS (for their own reporting) and FRS (for consolidation purposes) frameworks until the year ending 30 June 2007.

⁵ One of the functions of the ASRB is to liaise with the Australian Accounting Standards Board with a view to harmonising New Zealand and Australian financial reporting standards (section 24, Financial Reporting Act 1993).





Our Concerns

FIVE

5.12 We have a number of concerns about the transition to the new standards, including:

- the process being followed;
- the possible content of the standards; and
- the effect on the public sector.

The Transition Process

5.13 In order to meet the same timetable as adopted in Australia and Europe, the new standards need to be in place in the very near future to enable entities to comply for periods starting on or after 1 January 2005 (necessitating an opening statement of financial position at 1 January 2004 for the earliest adopters). This has meant the complete set of standards is being changed in an 18-month period. This tight timetable has placed enormous pressure on the accounting standard-setting boards (the ASRB and FRSB) but has, in our view, placed an impossible burden on those being asked to comment on the standards. As a result, the number of submissions has been very low.

5.14 We have commented on most of the proposed standards. The Treasury has also provided submissions on the exposure drafts issued to date. We have worked with the Treasury to ensure cohesive and co-ordinated consideration is given to public sector issues. Nevertheless, the breadth and depth of our consideration has been far less than for previous new standards. We acknowledge and accept responsibility on behalf of the broader public sector to consider the effect of the proposed standards, but we have found it difficult to contribute at the level we would have liked. The end result of the speed of the process must inevitably be that the quality of the final standards is compromised.





Possible Content of the Standards

FIVE

- 5.15 Notwithstanding the establishment of the ASRB Guidelines described in paragraph 5.7 (see pages 70-71), we still have concerns that the issues relevant to public sector entities are not being given sufficient consideration at the appropriate point in the process. In our view, lack of appropriate consideration could lead to standards being issued that contain inappropriate requirements for public sector entities, or do not have sufficient guidance to ensure appropriate and consistent application of some requirements.
- 5.16 There have been exposure drafts issued with proposed requirements for public sector entities that simply do not make sense. A good example of such an exposure draft is ED NZ IAS 16: *Property, Plant and Equipment*. The exposure draft proposed that:
- where property, plant and equipment are revalued, there would be disclosure of the carrying amount that would have been recognised had the assets been carried under the cost method; and
 - revaluation movements would be accounted for on an individual basis rather than within classes (groups) of assets.
- 5.17 Many public sector entities do not have the records to enable them to disclose, for assets that are revalued, the carrying amount of those assets under the cost method. In any event, we see no value in that disclosure for users of financial reports. The expense of seeking to obtain the cost information, or some arbitrary alternative based on the carrying value when first adopting accrual accounting or NZ IFRS, cannot meet any cost/benefit test that might be applied.
- 5.18 Accounting for revaluation movements on an individual asset basis may not be able to be done by public sector entities because of a lack of information held in relation to individual asset movements in the past.
- 5.19 We and others have argued strenuously against these proposals. We now understand that both of these proposed requirements will be changed in the final standard so that they are optional for public sector entities. Such changes are very welcome.
- 5.20 However, given that these two matters were considered in the development of the current New Zealand Financial Reporting Standard – FRS-3: *Accounting for Property, Plant and Equipment* – and the International Public Sector Accounting Standard – IPSAS 17: *Property, Plant and Equipment* – and were not requirements in either of those standards, we question the





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FIVE

robustness of the process for development of the exposure drafts of NZ IFRS. It appears that the requirements applicable to profit-oriented entities were to be imposed on public benefit entities without regard to their different circumstances.

- 5.21 There have also been exposure drafts issued that do not retain the extensive and valuable guidance in current New Zealand financial reporting standards that are of relevance particularly to public sector entities. Again, a good example of such an exposure draft is ED NZ IAS 16. It is proposed that that exposure draft contain only some of the extensive valuation guidance currently in FRS-3. We are concerned that invaluable guidance, built up over a decade based on our experience as the first country to apply accrual accounting in the public sector, could disappear on approval of a new standard.
- 5.22 We are also concerned about the likely content of other standards, including, in particular, the standard dealing with consolidations. Our existing standards FRS-36: *Accounting for Acquisitions Resulting in Combinations of Entities or Operations*, and FRS-37: *Consolidating Investments in Subsidiaries* include extensive guidance that has been built up through the experience of applying consolidation principles in the public sector over the last decade. The nature of relationships and arrangements between entities frequently differs markedly between the public sector and the private sector, so this guidance can be and has proven very useful in seeking to apply the standards.
- 5.23 We are concerned at the risk that much of this guidance may be lost, and that there could be broader effects – for example, in regard to the Auditor-General’s mandate, which is determined by the definition of public entities in the Public Audit Act 2001. That definition relies in part on the requirements of any approved financial reporting standard (currently FRS-37). It is important that any such broader issues are properly considered in the development of the standards.
- 5.24 Significant adoption challenges for some entities will also arise from the adoption of the international financial instruments and income tax standards. New Zealand does not have a financial reporting standard dealing with accounting for financial instruments. (Financial Reporting Standard No. 31: *Disclosure of Information about Financial Instruments* only deals with disclosure of information about financial instruments.) In relation to accounting for income tax, the requirements in the international standard (currently on issue as exposure draft ED NZ IAS 12 *Income Taxes*) represent a substantial change from the current New Zealand standard, SSAP-12 *Accounting for Income Tax*.





Effect on the Public Sector

FIVE

- 5.25 We are also concerned about the effect of the change to NZ IFRS on public sector entities. The change has been driven by profit-oriented entities operating in international markets or which have subsidiaries in other jurisdictions or which are subsidiaries of companies in other jurisdictions. In our view, the change to NZ IFRS will not result in any immediate net benefits to the users of financial reports of public sector entities.
- 5.26 We acknowledge that the adoption of IFRS-based standards will fill some gaps in the existing financial reporting requirements. The most notable gaps filled include recognition and measurement of financial instruments and accounting for revenue of an exchange nature. Standards on these matters are welcome.
- 5.27 However, important issues of relevance to the users of reports of public sector entities – such as how to properly account for non-exchange transactions and how to report broader (non-financial) measures of performance – have received no attention in the past few years. The latter has been a concern for us for many years, and we are disappointed at the absence of any progress.
- 5.28 The change to NZ IFRS raises concerns because it will:
- force all public sector entities to focus once again on the core financial aspects of their reporting rather than the more complex and broader aspects of performance reporting;
 - demand additional training of entities and auditors to enable the change to be made in a reasonable fashion;
 - result in costs – costs which will arise without concomitant benefits for most public sector entities; and
 - require effort without any real improvement in the quality of information for users of the reports of public sector entities.





CHANGES TO FINANCIAL REPORTING STANDARDS

Summary

FIVE

- 5.29 We have made a major and ongoing commitment to the quality of financial reporting by public sector entities. We will continue to do so through representation on the FRSB⁶, by providing guidance to auditors on new requirements, and by making submissions on proposals that may affect public sector entities.
- 5.30 However, we are concerned that the speed of the process, and the limited consideration of the needs of the users of public sector reports, will adversely affect the quality of reporting over the coming years.
- 5.31 We will continue to monitor developments and work with the sector as best we are able. To this end, the Auditor-General has recently established a Project Steering Committee to lead our response to the change to NZ IFRS.

6 As the auditor of the Accounting Standards Review Board, no member of the Auditor-General's staff is able to be a member of that Board, so our input is made through the FRSB.





Part Six

Status of Follow-up Action on Previous Reports

6



STATUS OF FOLLOW-UP ACTION ON PREVIOUS REPORTS

B.29[04a]

SIX

- 6.1 The Auditor-General reports on a broad range of topics and issues within the public sector. Parliament is the primary audience for these reports. By their nature, however, these reports are usually focussed on the Executive. This focus may be on:
- single agencies; or
 - multiple agencies; and/or
 - central agencies (the Treasury, the State Services Commission, and the Department of the Prime Minister and Cabinet).
- 6.2 For formal consideration of our reports by the House, we have been reliant on relevant subject select committees taking the opportunity to consider the reports and deciding whether they want to ask for a Government response.
- 6.3 The Officials Policy Committee (comprising the chief executives of the three central agencies) has also considered the need for a Government response to our reports.
- 6.4 Both of these mechanisms have been informal. Nevertheless, they formed a basis to complete the “accountability loop” between:
- the Auditor-General’s reports;
 - Parliamentary scrutiny of the reports; and
 - Government responses.
- 6.5 This article gives a brief analysis of each of our reports in the past financial year. It follows a similar format to the articles that we have published in regard to follow-up action on our previous reports in each of the past two years¹, with updated comments as appropriate. However, for this article, we have also considered the wider impact of each report.
- 6.6 We have not included our reports on local government issues, or on one-off inquiries, except where there is a remaining parliamentary interest.

¹ *Central Government: Results of the 2001-02 Audits*, parliamentary paper B.29[03a], pages 95-128; and *Central Government and Other Issues 2001-02*, parliamentary paper B.29[02b], pages 99-126





STATUS OF FOLLOW-UP ACTION ON PREVIOUS REPORTS

Title of Report

SIX Māori Land Administration: Client Service Performance of the Māori Land Court Unit and the Māori Trustee

Date Presented

26 March 2004

Brief Description

Māori Land owners are part of a complex land system that owners of General Land are not. The complexity of this system is a product of history – arising from the efforts of past governments to reconcile customary Māori communal ownership of land with an individual title system based on British land laws. About 6% of New Zealand’s total land area is Māori Land.

Māori Land generally has multiple owners, with the ownership of Māori Land titles currently divided into more than 2.3 million interests. As owners die and their descendants inherit their interests – which can only be achieved by applying to the Māori Land Court *Te Kooti Whenua Māori* – the number of owners of Māori Land increases and the fragmentation of Māori Land ownership continues.

We investigated the effectiveness of the client service provided by:

- the Māori Land Court Unit (an administrative unit within the Ministry of Justice *Tahu o te Ture*, that provides support for the Judges of the Māori Land Court, as well as information and advisory services for Māori land owners); and
- the Māori Trustee *Te Kaitiaki Māori* (who works within the Māori Land system to manage Māori Land on behalf of owners who engage the Trustee’s services through the Māori Trust Office, which is part of the Ministry of Māori Development *Te Puni Kōkiri*).

We assessed selected operations of the two organisations, and considered how they interact with each other and with other organisations.





Key Findings and Recommendations

We reported that, overall, the Māori Land Court Unit has provided a good level of service to its clients through strategic planning based on client surveys, the appointment of Advisory Officers, and the introduction of the Māori Land Information System. Areas where improvements could be made include:

SIX

- management and reporting of applications;
- training of case managers; and
- standardisation of practices and processes between registries.

We also found that the Māori Trustee has provided his clients with a good level of client service. However, we noted that the Trustee's client service could be improved in the following areas:

- establishing more qualitative land management performance measures – particularly in relation to rent collection and review;
- developing a set of criteria to determine which owners should receive written Reports to Owners, and which should be delivered in a formal meeting;
- a strategy for reducing the backlog in processing Court orders in and correspondence; and
- implementing a time-recording system that allocates staff time to individual clients.

We identified areas of risk to the Trustee's future client service performance, including the ongoing government review of the Trustee's role and functions. We also noted some opportunities to increase the amount of interaction between the Māori Land Court Unit and the Trustee so that clients receive a more seamless service.





STATUS OF FOLLOW-UP ACTION ON PREVIOUS REPORTS

Select Committee Scrutiny

The Māori Affairs Committee considered our report in May 2004.

SIX

Impact of Our Report

It is too early to gauge the impact of our report. However, we propose to follow up with both the Māori Trustee and the Māori Land Court Unit to see what improvements have been made as a result of our report. We will report on these at a later date.

Issues Outstanding

We will maintain an active interest in the issues raised in our report; in particular the completion of the government review of the Māori Trustee.





Title of Report

The State Services Commission: Capability to Recognise and Address Issues for Māori

SIX

Date Presented

30 January 2004

Brief Description

The Government has clear expectations of the Public Service in relation to the results it wants to achieve for Māori. The Government influences Māori outcomes through its policies and funding, and the way that public sector entities purchase and deliver services.

Part of the role of the State Services Commission (the Commission) is to provide assurance to the Government on the strategy, capability and performance of Government departments – including in relation to departments' Māori capability.

The objective of our audit was to assess the capability of the Commission to recognise and address issues for Māori in the advice it provides to other departments and Ministers.

We examined the Commission's own capability to recognise and address issues for Māori. We focussed on:

- the Commission's interpretation of its roles and obligations in relation to Māori and the Public Service;
- the Commission's corporate capability;
- the role of the Deputy Commissioner Teams in providing assurance;
- the Commission's policy advice process – using the Senior Leadership and Management Development initiative as an example; and
- the Commission's performance of its Equal Employment Opportunities responsibilities.





STATUS OF FOLLOW-UP ACTION ON PREVIOUS REPORTS

Key Findings and Recommendations

SIX

We reported that the Commission has positioned itself well to work alongside departments to build a Public Service that produces more effective outcomes for Māori. We noted some areas where we think the Commission could further enhance its capability, and we made some recommendations in this regard.

While we found that the Commission recognised responsiveness to Māori as a primary focus, we noted there was some potential for confusion between the role of Te Puni Kōkiri and the Commission in relation to providing advice on departmental capability. We recommended that the Commission complete its discussions with Te Puni Kōkiri to clarify their respective roles.

We found that the Commission has in place appropriate internal systems and processes to give effect to its role for Māori. A coherent strategy is supported by policies and practices designed to maintain and enhance corporate Māori capability. We recommended that the Commission consider evaluating the impact of the strategy.

The Commission provides capability assurance through the management and review of departmental and chief executive performance. We recommended that the Commission should take steps to provide more clarity, formality, and certainty in its relationships with chief executives and their departments.

We found that the Commission's Senior Leadership and Management Development strategy was well aligned to the Government's strategic goals for Māori and the public service, and that the Commission has clearly defined its own role in promoting Equal Employment Opportunities in relation to the role of departments.

Select Committee Scrutiny

The Māori Affairs Committee considered our report in February 2004, and the Government Administration Committee considered it in April 2004. The Government Administration Committee was particularly interested in how our findings related to other government organisations, and has encouraged us to undertake similar reviews of the capability of other organisations in the State sector to recognise and address issues for Māori.





STATUS OF FOLLOW-UP ACTION ON PREVIOUS REPORTS

B.29[04a]

Impact of Our Report

The Minister of Māori Affairs has displayed an interest in the extent to which the State Services Commission has addressed the findings of our report.

SIX

Issues Outstanding

We will maintain an active interest in the issues raised in our report. We also propose to conduct a similar performance audit in respect of the Treasury (see page 57 of our *Annual Plan 2004-05*²).

² Parliamentary paper B.28AP(04).





STATUS OF FOLLOW-UP ACTION ON PREVIOUS REPORTS

Title of Report

SIX

Social Security Benefits: Accuracy of Benefit Administration

Date Presented

10 December 2003

Brief Description

In 2002-03, the Ministry of Social Development (The Ministry) paid \$11,743 million to over 800,000 beneficiaries. Given the very large sums involved, it is clearly important to ensure that payments are made accurately.

Inaccurate benefit payments can result in direct costs to the Ministry from the administrative actions associated with identifying and correcting any errors. Opportunity costs also arise from Ministry staff having to spend time and effort on correcting benefits instead of undertaking other work.

Beneficiaries can suffer hardship when payments are made incorrectly. Under-payments deprive them of income to which they are entitled. Over-payments generally must be repaid, placing financial pressure on beneficiaries.

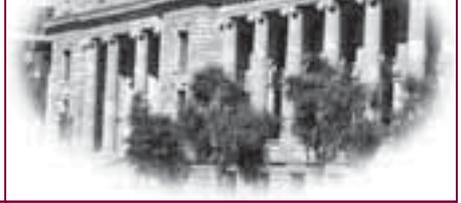
We sought to provide Parliament with assurance that the Ministry has effective systems and methods for ensuring benefit accuracy; and that Parliament can place reliance on the performance data that the Ministry reports.

Key Findings and Recommendations

The Ministry's obligation is to pay benefits correctly on the basis of the information available to it. It measures accuracy in terms of this obligation. It does not currently collect information in other areas that we think are relevant to the general issue of accuracy.

Because of the limitations of the information currently available, we were unable to form a clear view about whether or not the Ministry is performing well.





STATUS OF FOLLOW-UP ACTION ON PREVIOUS REPORTS

B.29[04a]

Our report identified a number of areas in which we believe the information on benefit accuracy currently collected and published by the Ministry could be extended and improved. We made a number of recommendations to highlight areas where improvements could be made. These include that the Ministry:

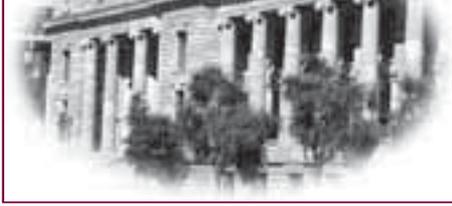
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- explores enhancements to the benefit processing computer system;
- learns more about the extent and causes of under- and over-payments;
- continues to promote internal sharing of information on approaches to staff development and managing caseloads;
- explores the possibility of allocating more case managers to regions with large numbers of clients with complex circumstances;
- investigates the possibility of applying high-level statistical analysis of service centre data;
- requires all regions to assess the performance of staff consistently, with accuracy being accorded an appropriately high priority;
- provides all Regional Commissioners and Regional Operations Managers with training on the appropriate interpretation of the Accuracy Reporting Programme's results;
- regularly performs a risk-sizing exercise to estimate the amount of over-payments;
- continues to explore the collection and analysis of information on errors and their size and causes;
- treats all of its processes for administering benefits as components of an integrated system; and
- periodically undertakes exercises to estimate the number of people who are potentially eligible for social security assistance but who have not applied.

Select Committee Scrutiny

The Social Services Committee considered our report in February 2003, and questioned Ministry staff about various matters identified in the report.





STATUS OF FOLLOW-UP ACTION ON PREVIOUS REPORTS

Impact of Our Report

SIX

Two sets of stakeholders have benefited from our report:

1. Parliament, as it gains an insight into what information is being reported and what is not.
2. Beneficiaries, and people who may become beneficiaries, as they become more informed about what happens at the Ministry as they endeavour to get their full and correct entitlements.

Issues Outstanding

We will maintain an active interest in the issues raised in our report. We propose to ask the Ministry how it has responded to our report.





Title of Report

Ministry of Health: What Further Progress Has Been Made To Implement the Recommendations of the Cervical Screening Enquiry?

SIX

Date Presented

8 December 2003

Brief Description

Organised cervical screening was established in New Zealand in 1990. Such screening can be effective in reducing the incidence of cervical cancer and, since 1990, both the incidence of, and mortality from, invasive cervical cancer have declined in this country.

However, cervical screening is not without its limitations, and even high-quality screening programmes will not be able to prevent all cases of invasive cervical cancer. These limitations can be minimised if screening is properly organised, and appropriately monitored and evaluated.

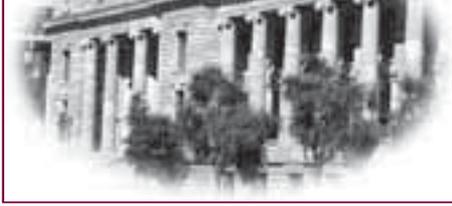
This was our second report in relation to recommendations made to the Minister of Health in April 2001 by a Committee of Inquiry that was set up to look into the under-reporting of cervical smear abnormalities in the Gisborne region.

Our first report³ – published in February 2002 – concluded that good progress was being made to implement the recommendations in a number of areas, but that effective monitoring, evaluation, and audit of the National Cervical Screening Programme (the Programme) still required action.

In this follow-up report we have sought to establish what progress the Ministry of Health (the Ministry) has made since the January 2003 independent review of the implementation of the Committee of Inquiry recommendations.

³ *Ministry of Health: Progress in Implementing the Recommendations of the Cervical Screening Inquiry.*





STATUS OF FOLLOW-UP ACTION ON PREVIOUS REPORTS

Key Findings and Recommendations

SIX

In summary, after two and a half years:

- 31 of the 46 recommendations have been implemented or are expected to be implemented by June 2004;
- work has been planned or has begun on 8 recommendations. However, the recommendations are unlikely to be implemented by June 2004;
- 2 of the recommendations will not be implemented;
- work has begun on a further 4 recommendations (relating to ethics committees) but it is unclear whether they will be implemented; and
- the Ministry is still to decide whether 1 recommendation will be implemented.

The most significant issues for the future will involve ensuring that the appropriate assurance processes are in place around the quality aspects of the Programme – such as completing the Audit of Invasive Cervical Cancer, fully implementing the Operational Policy and Quality Standards and auditing service provider compliance with the standards, and continuing the reviews conducted by the Independent Monitoring Group. The National Screening Unit will need to be more open and collaborative with stakeholders, and ensure that all key staff positions are filled.

We consider that the use of an independent expert to review implementation of the recommendations has added considerable value to the process, and would like to see this type of review continued and expanded to focus on the effectiveness of the whole Programme.

Select Committee Scrutiny

The Health Committee considered our report in December 2003. The Committee indicated that the review was timely, given the Committee's consideration of the Health (Screening Programmes) Amendment Bill.





Impact of Our Report

At the time we did our audit there was public concern over the status of some of the recommendations as well as the time being taken to implement them, e.g. the Audit of Invasive Cervical Cancer. Our report gave assurance on these matters.

SIX

In addition, we were pleased to note that the draft legislation intends that an independent review of the Programme will be undertaken on a regular basis.

Issues Outstanding

We will continue to keep the progress in implementing the Committee of Inquiry's recommendations under review. In this respect, we are meeting with the Ministry quarterly to monitor progress.





STATUS OF FOLLOW-UP ACTION ON PREVIOUS REPORTS

Title of Report

SIX

Managing Threats to Domestic Security

Date Presented

30 October 2003

Brief Description

The events of 11 September 2001 led to an increased focus on domestic security around the world. A mindset change took place whereby responsibility for domestic security no longer lay solely with the traditional security agencies, but began to be shared across a wide range of government agencies. The Bali bombings on 12 October 2002 reinforced the need for an increased focus on domestic security, especially for countries such as New Zealand and Australia.

Threats to domestic security include threats from terrorism, cyber attack on major information or business systems, and attacks against critical physical infrastructure (such as the public water supply). Domestic security can also be affected by events which are likely to threaten the country's economic and social well-being. Such events might include an outbreak of foot and mouth disease, the introduction of pests and diseases that will affect primary industry, or an outbreak of infectious disease – the SARS virus was a recent example.

Our audit set out to provide assurance to Parliament and the public that threats to the country's domestic security were being adequately managed. To do this, we interviewed staff from 18 separate agencies and examined the arrangements in place to identify and respond to domestic security threats. In particular we looked at whether:

- there was an adequate framework to guide domestic security efforts;
- the collection and dissemination of relevant intelligence was well co-ordinated and the intelligence collected was sufficient to address the risks, goals, and objectives identified;





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B.29[04a]

- the preparedness and capability of the various agencies to respond to threats to domestic security was being monitored; and
- there were effective arrangements for monitoring and evaluating the allocation of resources used to achieve domestic security goals.

SIX

Key Findings and Recommendations

We found that New Zealand has taken, and is continuing to take, steps to ensure that it is meeting current “international best practice” in relation to domestic security.

We noted that both formal and informal mechanisms exist to share and co-ordinate domestic security information and intelligence. The capability to collect and analyse information was enhanced after September 2001. A number of agencies carry out or take part in exercises or simulations to test their capabilities and procedures.

Our audit identified a number of issues that need to be addressed. These arose mainly from the number of contributing agencies whose primary responsibilities do not have a domestic security focus. We noted that:

- there is no single document or collection of documents that sets out a whole-of-government Domestic Security Strategy;
- a cross-agency information/intelligence system is in the early stages of development;
- current reporting on the preparedness of domestic security arrangements supports individual agency accountability, but does not provide a whole-of-government picture of preparedness; and
- while the traditional domestic security response elements are well-practised and planned in response aspects, the requirements of the recovery phase have not received as much attention.

Select Committee Scrutiny

The Foreign Affairs, Defence and Trade Committee considered our report on 20 November 2003. The Committee was particularly interested in the aspects of the review covering the sharing of intelligence, and New Zealand’s preparedness for an emergency.





STATUS OF FOLLOW-UP ACTION ON PREVIOUS REPORTS

Impact of Our Report

SIX

The Department of the Prime Minister and Cabinet (DPMC) accepted the findings of our report, and has undertaken to address them within 12 months. DPMC has analysed our report and has identified eight findings. A paper was given to the Officials Committee for Domestic and External Security Co-ordination (ODESC) in December 2003, which outlined the action that is required in respect to the findings. ODESC agreed that work currently under way would address 5 of our recommendations, and the remaining 3 required more work to determine how they would be addressed. The 3 were:

- strengthening the foreign intelligence process by undertaking a gap analysis of what the collector agencies have been asked for compared with what they are able to provide;
- establishing a more formal process for identifying domestic intelligence requirements that includes inter-agency consultation; and
- conducting a comprehensive whole-of-government stocktake of capabilities to respond to domestic security events, to help identify any overlaps or gaps.

The first 2 recommendations are being addressed in a paper to ODESC in June 2004, and a paper addressing the third recommendation was prepared for the ODESC meeting in March 2004.

Issues Outstanding

We have met with the Director of the Domestic and External Security Secretariat and discussed implementation of the recommendations.

We will complete a short audit of the matters identified in our report at the end of 12 months.





Title of Report

Co-ordination and Collaboration in the Criminal Justice Sector

SIX

Date Presented

9 October 2003

Brief Description

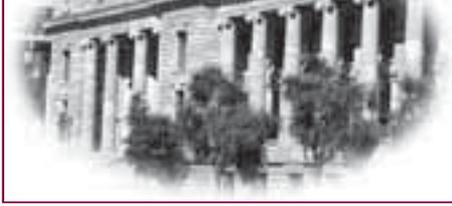
The criminal justice sector is a complex network of discrete but procedurally connected agencies. The four core criminal justice agencies are the Ministry of Justice (the Ministry), the Police, the Department for Courts, and the Department of Corrections.

The core criminal justice sector is a good example of government agencies that must work together in the interests of effectively performing their role. The Government and Parliament have an expectation that Chief Executives and their agencies will identify common outcomes, and actively pursue strategies to achieve these outcomes through collective working.

Our audit examined the way in which the four core agencies were working together to achieve the Government's goals for the criminal justice sector. In particular we sought to examine:

- how the Ministry was discharging its responsibilities for co-ordinating policy advice and other strategic activities across the sector;
- how the Ministry and other agencies managed their relationships; and
- how all agencies were consulting on plans, programme implementation, and the development of shared outcomes.





STATUS OF FOLLOW-UP ACTION ON PREVIOUS REPORTS

Key Findings and Recommendations

SIX

We identified many examples of good practice across the sector, and a strong commitment to sharing information and collaboration. The sector was responding positively to the need to work as a sector to meet Government priorities, and was taking positive steps to clarify roles and responsibilities and strengthen governance structures.

At the same time, the impact of one agency's plans or activities on the other agencies in the criminal justice sector had not always been well understood. The agencies had encountered difficulties in maintaining oversight of one complex project with sector-wide implications, under a tight Ministerial timetable. Important lessons have been learned, and new processes put in place for project oversight and managing risk.

We made the following recommendations:

- In the area of strategic planning, the criminal justice agency Chief Executives should support the Chief Executives Forum by attending all meetings, and that the agencies should consider options for integrating their work in areas such as information systems and sectoral planning and reporting.
- Agencies should improve collaboration in policy development by routinely consulting on their draft policy work programmes. We also suggested that sector Chief Executives should promote active and routine collaboration between research units in each of their agencies in order to avoid duplication, and to consider opportunities for sector wide research.
- A key role for the Ministry should be to oversee the status of information technology systems in the sector, and evaluate sector-wide impacts of any planned changes.
- All justice sector agencies should consider establishing Māori advisory groups. These can serve as a valuable resource for Chief Executives by providing a Māori community perspective on issue for the agency. In addition, an integrated sector strategy should be developed to focus on system-wide outcomes for Māori.
- The criminal justice sector agencies should draw lessons from the events and processes surrounding development of the sentencing and parole legislation for the future management of projects with sector impacts.





Select Committee Scrutiny

The Law and Order Committee considered our report in October 2003.

SIX

Impact of Our Report

Our report was accepted by the entities concerned, and the Treasury and the Department of the Prime Minister and Cabinet have both found it useful. The Ministry of Justice recently completed an analysis of our report, highlighting the recommendations and action taken by sector departments. Justice sector CEOs have now considered this analysis. Indications are that the CEOs have generally found the comments in our report useful to reflect on, although not all of the recommendations have been agreed to.

Issues Outstanding

We will maintain an active interest in the issues raised in our report. We intend to follow-up this report, focussing either on issues in the criminal justice sector, or on co-ordination and collaboration in another sector.





STATUS OF FOLLOW-UP ACTION ON PREVIOUS REPORTS

Title of Report

SIX

Inland Revenue Department: Performance of Taxpayer Audit

Date Presented

6 August 2003

Brief Description

The Inland Revenue Department (the IRD) collects most of the money that the Government requires to carry out its programmes and implement its policies. It is in the interests of New Zealanders collectively that the level of compliance with tax laws is as high as possible.

Each year the IRD audits thousands of taxpayers to detect non-compliance with tax laws, and to deter potential non-compliance in the future. Taxpayer audits are a major part of the IRD's work and involve 881 of its 4800 staff.

This report examined the IRD's taxpayer audit function in the context of the IRD's Taxpayer Compliance Model. We wanted to establish whether taxpayer audit is in a position to deliver the IRD's vision to improve taxpayer compliance.

Key Findings and Recommendations

We found that taxpayer audit was under-developed – much of what was needed for taxpayer audit to play its full part in the Taxpayer Compliance Model and to enable the IRD to meet its strategic direction was not in place. The IRD agreed that the time has come for taxpayer audit to be improved and had already initiated a number of projects.

We recommended that the IRD's strategy for taxpayer audit needed to be further developed. In particular, the IRD should:





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B.29[04a]

- improve the focus and conduct of audits by implementing best practice case management techniques, and by identifying the case management requirements of taxpayer audit.
- strengthen capability through improving formal ongoing training of investigators and reviewing the availability and use of information technology. The IRD should also address the strategies for collection and use of intelligence in taxpayer audit.
- improve the measuring and reporting of performance so that Parliament receives a more transparent view of the value of additional tax assessed. The IRD should also continue to explore ways of assessing the impact of audits on taxpayer compliance.

SIX

We found that there is currently insufficient accountability for ensuring that good practices and new initiatives are taken up. Securing the changes needed for taxpayer audit to support the IRD's strategic direction will require the implementation of sound change management arrangements.

Select Committee Scrutiny

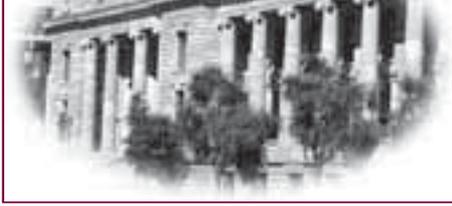
The Finance and Expenditure Committee decided not to inquire into the matters raised in our report.

Impact of Our Report

The IRD has acknowledged that there are a number of changes to be made in the area of taxpayer audits. Many of these changes were well progressed by the time our report was tabled.

The IRD has an extensive process in place to fully implement all of our recommendations. A key feature of this process is the establishment of a Business Initiative Governance Board to oversee changes to taxpayer audit and other new initiatives. The IRD has invited the Office of the Auditor-General to attend meetings of this Board as an observer on a quarterly basis.





STATUS OF FOLLOW-UP ACTION ON PREVIOUS REPORTS

SIX

We have attended two Business Initiative Governance Board meetings, the most recent in March 2004. At that meeting, the IRD reported that:

- our recommendations had been aligned with IRD's Audit Strategy principles; and
- 5 of our 11 recommendations had been completed by the IRD.

Issues Outstanding

We will continue to attend Business Initiative Governance Board meetings to see what further progress is made to implement our recommendations.





Title of Report

Management of Hospital-acquired Infection

SIX

Date Presented

25 June 2003

Brief Description

Hospital-acquired infections are recognised nationally and internationally as a serious problem. Here, and in other developed countries, it is estimated that about 10% of patients admitted to hospital will acquire an infection as a result of their hospital stay. The costs of dealing with hospital-acquired infections in this country's public hospitals are estimated to be more than \$137 million a year.

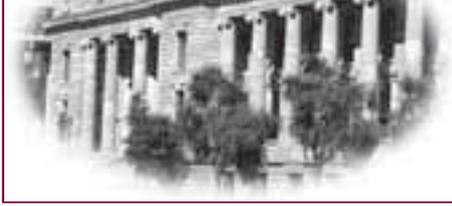
A fair proportion of hospital-acquired infections can be avoided through effective infection control practices. Everyone working in a hospital should take responsibility for infection control. Making sure they do take responsibility – and that reasonable action is taken to manage the risk of infection – is challenging.

Infection control is an essential element of good clinical practice and is vital for patient safety. The purpose of our performance audit was to describe and assess systems for managing hospital-acquired infection in public hospital. The performance audit was reported in two volumes.

Key Findings and Recommendations

We gathered information about infection control arrangements in public hospitals through an extensive survey questionnaire that we sent to all 21 District Health Boards (DHBs). All DHBs were provided with comparative feedback that we hope they will use to improve infection control practices. The results of the survey form the basis of Volume Two of our report.





STATUS OF FOLLOW-UP ACTION ON PREVIOUS REPORTS

SIX

We found that some dimensions of infection control are working particularly well – such as collaboration between infection control and laboratory staff. Others require more attention – for example, auditing of infection control practice, which provides a vital source of assurance about compliance by hospital staff.

We recommended that:

- The Ministry of Health (the Ministry) should review elements of their framework for infection control, and should work towards establishing national surveillance of hospital-acquired infection;
- The Ministry should continue its actions to improve DHBs' monthly risk reporting;
- DHB Boards should increase the scope of their planning, reporting and oversight of infection control. This could include making greater use of their Hospital Advisory Committees, and obtaining community feedback;
- Hospital services should consider increasing the long-term planning associated with infection control. Hospital services should also periodically review whether their infection control resources are adequate;
- Hospital services should ensure that their infection control arrangements are well co-ordinated with the rest of the hospital service;
- Hospital services should review the scope of their infection control arrangements and ensure that staff awareness of infection control policies and practices is maintained at a high level. Auditing compliance with the infection control regime should be treated as a core quality assurance activity; and
- Hospital services should ensure that there are robust procedures in place for identifying, managing and reporting instances of hospital-acquired infection.





Select Committee Scrutiny

We presented our report to the Health Committee in October 2003. Members of the Committee were extremely interested in the report. The Committee subsequently held an inquiry into hospital-acquired infection, and released its findings in May 2004. The inquiry endorsed our report, and recommended that the Ministry implement our key recommendations.

SIX

Impact of Our Report

We also presented our report to the National Infection Control conference in Dunedin, and have been consulted by the Otago DHB about the implications and implementation of our recommendations.

Issues Outstanding

Our report made 36 recommendations, and we are now working with the Ministry to facilitate improvements in infection control practices in hospitals.



Recent Publications by the Auditor-General

Other publications issued by the Auditor-General in the past 12 months have been:

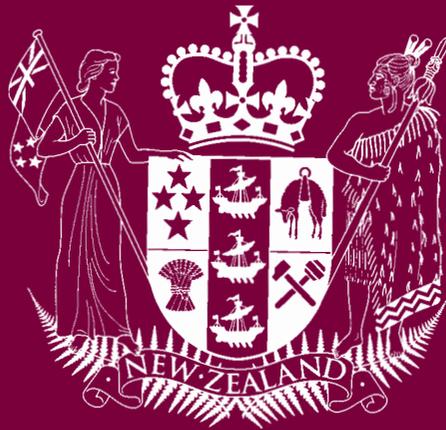
- Local Government: Results of the 2002-03 Audits – B.29[04b]
- Annual Plan 2004-05 – B.28AP(04)
- Accident Compensation Corporation: Case Management of Rehabilitation and Compensation
- Māori Land Administration: Client Service Performance of the Māori Land Court Unit and the Māori Trustee
- The State Services Commission: Capability to Recognise and Address Issues for Māori
- Inquiry into Expenses Incurred by Dr Ross Armstrong as Chairperson of Three Public Entities
- Social Security Benefits: Accuracy of Benefit Administration
- Ministry of Health: What Further Progress Has Been Made to Implement the Recommendations of the Cervical Screening Inquiry?
- Inquiry into Public Funding of Organisations Associated with Donna Awatere Huata MP
- Auckland Region Passenger Rail Service
- Managing Threats to Domestic Security
- Annual Report 2002-03 – B.28
- Key Success Factors for Effective Co-ordination and Collaboration Between Public Sector Agencies
- Co-ordination and Collaboration in the Criminal Justice Sector
- Inland Revenue Department: Performance of Taxpayer Audit
- Auckland Regional Council 2003-04 Rates
- Management of Hospital-acquired Infection

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The Controller and Auditor-General
Tumuaki o te Mana Arotake

**Central Government:
Results of the 2002-03 Audits**

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