Central government: Results of the 2010/11 audits (Volume 1)
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Auditor-General’s overview

In this report, I present the aggregate results of the central government sector audits for 2010/11. I also present in more depth the results and our analysis for government departments and Crown Research Institutes, and discuss the quality of financial and non-financial reporting. The report concludes with some comments and questions that, in my opinion, are important to public accountability reporting in the future.

The 2010/11 year has been challenging for many public entities, with the Government continuing to focus on measures to reduce public sector expenditure while maintaining and improving core performance.

On top of this, the Canterbury earthquakes have been particularly significant for the region and for many public entities. We discuss the main financial reporting implications that we have seen, arising from the earthquakes, for entities and for the financial statements of the Government. We also discuss the Government’s use, for the first time, of section 25 of the Public Finance Act 1989 for the authorisation of emergency expenditure.

We have issued unmodified audit opinions for all government departments and Crown Research Institutes for 2010/11. We have also rated highly both departments and Crown Research Institutes for their management control environment and financial systems and controls for 2010/11. Ninety-five percent of government departments were rated as “Good” or “Very good”. We were very pleased with the excellent result achieved by the Crown Research Institutes, all of which had “Very good” ratings for their management control environment and “Very good” or “Good” for their financial systems and controls. In the latter category, there was a notable improvement from 12% to 50% rated “Very good” in the space of one year.

We continue to support the efforts of public entities and the monitoring departments to improve the planning and reporting of performance information and we are now applying our revised auditing standard in this area. We have seen a marked improvement in the quality of departments’ preparation, use, and reporting of performance information. This is crucial to improving public sector performance. I am particularly pleased that the 28 Crown entities and departments that were audited under our revised auditing standard received unmodified audit opinions for their performance reporting.

Our work during the last few years has provided unique insight into the performance system as a whole. I consider that it is time to stand back and look at the way the public sector measures and reports its performance. The question now is: Where to next with reporting on financial and non-financial performance?
I am pleased that New Zealand is a step closer to the changes to the public sector financial reporting standards and arrangements for accounting and auditing that my Office has been advocating. We support the long-term strategy to separate the reporting requirements of public benefit entities from those of for-profit entities, and the differentiation of reporting according to size. We will continue to press for reporting standards and arrangements – both financial and non-financial – that are most appropriate for the New Zealand public sector.

In particular, I would like to see some focus on these questions:

1. Is “one size fits all” appropriate for the future?
2. Is it is efficient and useful for each and every entity to be measuring higher-level outcomes?
3. Should there be a more collective approach to reporting?
4. Is a simpler, more flexible approach desirable?

I have recently participated in a working group with accounting colleagues from New Zealand and Scotland in a collaborative project for the International Accounting Standards Board to consider whether mandatory disclosure should be reduced to allow more meaningful financial reporting. In July 2011, a report was published: *Losing the excess baggage – reducing the disclosures in financial statements to what’s important*. The working group considers that annual financial statements could be reduced by about a third as a result of what it proposes. I hope this report is given the attention it deserves.

I am concurrently publishing a separate report that discusses the audit results for the education sector. I will also publish a third report of central government audit results early in 2012, which will contain the results and analysis of our 2010/11 audits of State-owned enterprises, district health boards, and other Crown entities.

We are now preparing our work programme for 2012/13, which will focus on the theme of *Our future needs – is the public sector ready?* I want my Office’s work on this theme to make a lasting difference to the public sector and to the public.

Lyn Provost
Controller and Auditor-General
16 December 2011
The changing central government operating environment
Part 1
Developments in the central government sector

1.1 Public entities in the central government sector are facing a challenging environment, with pressure to reduce operating costs while improving service delivery. The trends we are seeing towards greater collaboration and cross-agency working, supported by clear direction from the centre of government, are encouraging.

1.2 In 2012/13, our work will focus on the theme Our future needs – is the public sector ready? We will be paying close attention to how public entities are working to address important social, environmental, and economic issues and to provide better services to New Zealanders.

1.3 We will also be looking closely at the savings achieved by the extensive ongoing change programme, and monitoring how the changes are leading to improved effectiveness and efficiency. We will seek to identify and report good practice in public sector management to promote learning within and between public entities.

Context for all public entities

1.4 Citizens are expecting improved, easier-to-access public services as people become used to 24-hour access to goods and services, self-service options, and the ability to access services through a wide range of different channels and types of technology. At the same time, the ongoing effects of the global financial crisis are still being felt and public entities continue to operate under fiscal constraint. The Government’s financial statements for 2010/11 recorded a deficit for the year of just over $18 billion.1

1.5 The Canterbury earthquakes have had significant financial implications for many public entities (see Parts 2 and 3). The Government deficit recorded in 2010/11 includes $9.1 billion net costs of the Canterbury earthquakes.2 Future costs and liabilities are still uncertain and are likely to be higher than originally expected. These include the Government’s share of local authority costs in response to the earthquakes, such as its share of costs for restoring local authority infrastructure, which could be between $348 million and $610 million.

1.6 Consequent effects of the earthquakes include a rise in insurance costs and in the cost of meeting escalating seismic standards for buildings. These will affect all public entities throughout New Zealand, increasing the existing pressures on their finances.

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1.7 As well as these factors, the Government is seeking more effective and efficient means of administering and delivering public services, which will require innovative ways of working. Central government entities have focused on streamlining processes to achieve greater efficiency. Some of the main changes include:

- a more streamlined and strengthened centre of government;
- mergers and disestablishment of public entities;
- greater use of partnerships with the non-government sector and more outsourcing;
- more integration and "joined-up" delivery of public services; and
- revisions of governance and accountability frameworks.

1.8 There is a trend towards a more streamlined, strengthened centre of government with the aim to lead and better co-ordinate activities, save costs, and improve effectiveness. The Treasury, the State Services Commission, and other government departments are leading this trend.

1.9 For example, the central government sector’s investment in information communications technology is being overseen and co-ordinated by the Office of the Government Chief Information Officer (now based in the Department of Internal Affairs). The Office of the Government Chief Information Officer is also leading a transformation programme, which seeks to improve service delivery to citizens through “joined-up” service delivery and better use of technology. The aim is to deliver more cohesive responses to the needs of citizens, with a single government brand across a range of different delivery channels (such as face-to-face services, the Internet, and telephone) along with self-service and 24-hour access.

1.10 The ways in which public entities buy goods and services are also being reformed, with greater direction and leadership from the centre of government. For example, the Ministry of Economic Development is leading a whole-of-government programme to drive improvements in procurement across all public entities and achieve savings as a result. The all-of-Government contracts for office consumables, print devices, computers, and passenger vehicles are expected to achieve savings of at least $115 million over five years. The Ministry is also working closely with public entities to improve skills and capability in procurement by establishing a procurement academy. The Ministry plans to agree more all-of-government contracts in the current financial year.

See the release Computer panel to deliver further savings, dated 11 October 2010, on the Government’s website (www.beehive.govt.nz).
1.11 The Better Administrative and Support Services programme, which is administered by the Treasury, seeks to lower the cost of central government sector administrative and support services, and reduce the present significant variation in service cost, effectiveness, and efficiency between agencies. It is now working with public entities to improve efficiency through automating and standardising processes, having more common systems, and sharing some back-office services. The Treasury expects that this work could save more than $236 million a year.4

1.12 The Treasury is also addressing concerns that New Zealand’s infrastructure network is fragmented in ownership, funding, and policy. The past two years have seen a trend toward a more national, co-ordinated, and strategic approach to infrastructure. This has included a new Ministerial portfolio and the establishment of a dedicated unit within the Treasury, the National Infrastructure Unit, which has developed a National Infrastructure Plan. The Plan outlines the Government’s intentions for infrastructure development over a 20-year time frame.

Merging and disestablishing public entities

1.13 There have been some important structural changes to the central government sector, particularly through mergers of public entities. Mergers in 2010/11 included bringing the National Library and National Archives into the Department of Internal Affairs, integrating the New Zealand Food Safety Authority and the Ministry of Fisheries with the Ministry of Agriculture, and setting up the Ministry of Science and Innovation, which brought together the Foundation for Research, Science and Technology and the Ministry of Research, Science and Technology. The Government expects these changes to save about $25 million from 2010 to 2013, and about $8 million each year after that.5

1.14 In August 2011, the Government started the process for disestablishing the Alcohol Advisory Council of New Zealand and the Health Sponsorship Council, the transfer of their functions to a new single entity, and for disestablishing the Crown Health Financing Agency, the Mental Health Commission, and the Charities Commission.6

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4 See the Treasury’s media statement Treasury releases benchmarking report, dated 13 April 2011, on the Treasury’s website (www.treasury.govt.nz).

5 See the Cabinet Expenditure Control Committee’s amended minute ECC Min (11) 10/1, State Services Amalgamations Agreed in March 2010: July 2011 Report on Financial Implications. It is available on the State Services Commission’s website (www.ssc.govt.nz).

6 See the Cabinet minute CAB Min (11) 28/5, Public Services to Meet the Needs of 21st Century New Zealand: Due Diligence Report on Proposals for Structural Change. It is available on the State Services Commission’s website (www.ssc.govt.nz).
Greater use of outsourcing and partnerships with the non-government sector

1.15 Services are increasingly being outsourced – delivered by the organisations that are considered to be best placed to work with particular client groups, populations, and projects. For example, Whānau Ora is testing new and innovative types of family and community response models. In the housing sector, the Department of Building and Housing is seeking to work more closely with the community housing sector and iwi in the delivery and management of social housing.

1.16 Greater use of public private partnerships (PPPs) is also being made in national and local infrastructure projects, such as the Waterview Road Project in Auckland and the rollout of high-speed broadband throughout the country.

1.17 In November 2011, we published a discussion paper on PPPs. We noted that, although the use of PPPs is increasing, a sound platform for an ongoing programme of PPPs still needs to be built. There remain:

- limited understanding in wider stakeholder and community groups about partnerships with government;
- fragmented public sector skills, knowledge, and information flows on managing partnerships effectively;
- limited diversity in the capital markets and funding base; and
- a lack of some domestic private sector expertise and capability to enter into partnerships with government.

More integration and “joined-up” delivery of public services

1.18 Public entities are increasingly working with collaborative models to address social and economic issues, and to work towards improved outcomes for New Zealanders. There are a range of initiatives in place, led by chief executives of government departments, to create more “joined-up” administration and delivery of public services.

1.19 For example, the Ministry of Social Development is leading cross-agency approaches to “most at risk” families, and family health centres are bringing the work of multiple agencies into one place. In the justice sector, the Ministry of Justice has leadership and oversight of the Addressing Drivers of Crime initiative. This initiative brings the work of a wide range of agencies together to tackle some of the main causes of crime. The agencies involved include: the Police, Department of Corrections, Ministry of Justice, Ministry of Education, Ministry of Health, Ministry of Social Development, and Te Puni Kōkiri. In the health

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7 Controller and Auditor-General (2011), Managing the implications of public private partnerships, which is available on our website (www.oag.govt.nz).
sector, district health boards are now required to plan services and resource management regionally, not just locally.

**Governance and accountability changes**

1.20 The accountability of the Government to Parliament is one of the cornerstones of New Zealand’s system of government. It is important that our accountability system supports the work that agencies do to improve the lives of New Zealanders, and allows them to do so flexibly and efficiently while maintaining transparency.

1.21 The accountability system continues to evolve. Current aims include introducing greater focus on longer-term planning, allowing greater flexibility for agencies to respond to changing demands, reducing compliance costs, and making sure that reporting requirements meet the needs of Parliament and Ministers.

1.22 A new Budget process for 2012 includes four-year budget plans. The use of these plans is intended to encourage strategic and flexible planning and financial management to enable more effective delivery of long-term outcomes. Departments have also been given the option of producing a Statement of Intent every three years, where appropriate, rather than annually. In 2012, we will be publishing a report on the quality and appropriateness of financial management in government entities.

1.23 Since 2006, we have emphasised the importance of good quality performance information in showing public sector effectiveness and to inform better decision-making. In 2010/11, we introduced a new auditing standard for service performance reporting in central government. Performance Improvement Framework reviews (co-ordinated by the State Services Commission) of a range of public entities have also identified that there needs to be a clearer link between expenditure and the value it brings to New Zealanders.

1.24 Annual audits in 2010/11 have shown that the standard of service performance reporting by public entities is improving markedly (see Parts 6, 7, and 9), but there is still some way to go. In looking at the overall system, we consider that some change would be beneficial (see Part 10).
Part 2

Financial reporting implications of the Canterbury earthquakes

2.1 The Canterbury earthquakes have changed the public sector’s operating environment, whether temporarily or permanently, giving rise to challenging financial reporting implications for some public entities. Some of those implications have been significant and will continue to be so in the foreseeable future as the recovery continues. See Part 3 (paragraphs 3.9–3.22) and Part 5 for more information about effects of the earthquakes.

2.2 In this Part, we comment on the main financial reporting implications that we have seen, along with the associated audit implications. The financial reporting implications relate to:

- damage and repair of physical assets;
- insurance recoveries;
- valuation of physical assets;
- financial statement disclosures; and
- timeliness of external reporting.

Damage and repair of physical assets

2.3 There was significant damage to physical assets, such as land, buildings, infrastructure, plant, and equipment, in and around Christchurch from two major earthquakes in September 2010 and February 2011. Physical assets are often the asset with the greatest value in the statement of financial position. Accurately reporting the damage to those assets required a great deal of time and a lot of judgement.

2.4 For financial reporting purposes, the first issue for public entities to consider after the earthquakes was whether it was possible to assess the extent of the damage to their assets. Where it was possible to make reasonable estimates of the damage, public entities needed to assess the extent to which the damage affected the service potential of those assets. Some damaged assets were still able to be used, but others were not.

2.5 Having assessed the extent of damage to assets, and the effect of the damage on their ability to use the assets, public entities then needed to determine whether the assets were repairable or beyond repair.

2.6 Reporting about the earthquake damage to physical assets in financial reports was generally complicated and challenging because:

- the damage to some assets was hidden;
- some public entities had large numbers of assets that needed a damage assessment;
Part 2  Financial reporting implications of the Canterbury earthquakes

2.7 We had to carefully consider the entities’ judgements, the robustness and reliability of the processes that the entities had applied in accounting for the damage to physical assets, and the reliability of the information provided by public entities (including information from their experts and insurers). We faced challenges in assessing the quality of information when there was a lack of formal documentation supporting damage estimates.

2.8 We have debated with some public entities whether repair costs should be accounted for as an operating expense or capital expenditure. The treatment of repair costs requires public entities to make careful judgements. In our view, the accounting treatment that best complies with financial reporting standards requires:

- minor damage that does not affect the service potential of an asset to be expensed;
- damage that affects the service potential of an asset, but is repairable, to be offset against any available asset revaluation reserve (and, if that is exhausted, the residual amount to be expensed);
- damage that is so extensive it leads to an asset being written off to be expensed; and
- the cost of repairs or reinstatement of an asset, apart from minor repairs, to be capitalised to the cost of the asset.

Insurance recoveries

2.9 The reporting of earthquake-related insurance recoveries often required careful judgement by public entities because of the complexities and uncertainties of the insurance claims process. We had to carefully consider the reasonableness of the judgements that public entities made and the evidence provided to support those judgements.

2.10 Often, the main judgement in reporting insurance recoveries was whether the amount of insurance proceeds could be determined, and whether a receivable and revenue should be recognised in the current year’s financial statements.
Public entities had to consider what stage claims were at, such as claims not yet completed and submitted to insurers, claims accepted by insurers but not yet quantified, and claims submitted and quantified but not yet approved by insurers.

2.11 Public entities needed good evidence to support any decisions to recognise insurance recoveries for claims part way through the insurance claims process. Where insurance recoveries were not recorded in the financial statements, public entities disclosed in the notes to the financial statements the likelihood of insurance proceeds being received in future.

2.12 The complexities and uncertainties of the insurance claims’ process meant that a lot of possible insurance recoveries could not be recognised as a receivable and revenue in the same financial year as the damage to the assets was recognised. This resulted in a lot of volatility in the reported financial performance of public entities affected by the earthquakes.

2.13 For example, the carrying amount of a building might have been written off and recorded as an expense in the current financial year because it had sustained severe earthquake damage and required demolition. However, because of significant uncertainties about the amount of the insurance claim, no insurance receivable and revenue might have been recorded in that year. Therefore, an expense for the damage to the building would be recorded in the current year’s financial statements and the insurance recovery revenue for the repair or reinstatement of the building would be recorded in a future financial year.

2.14 There have been some different views expressed within the New Zealand accounting profession about how insurance recoveries should be presented in financial statements. That is, whether they should be included as part of income (gross presentation) or netted off against the loss they compensate (net presentation). The different views were because of different interpretations of financial reporting standards.

2.15 In our view, presenting insurance recoveries gross in the financial statements is the treatment that best complies with the financial reporting standards. Also, a gross presentation provides transparent information to readers of financial statements about losses and related insurance recoveries arising from the earthquakes.

**Valuation of physical assets**

2.16 Some entities that revalue assets experienced difficulties determining the fair value of those assets because of the damage they sustained, the location of the assets, or the lack of a local property market meaning there was limited or no
Part 2

Financial reporting implications of the Canterbury earthquakes

2.17 Also, where asset values were determined on a depreciated replacement cost basis, valuers had difficulties determining asset replacement costs for use in valuations because of the possibility of increased contractor demand affecting the replacement costs.

Financial statement disclosures

2.18 Public entities were generally good at communicating the financial effects of the earthquakes in their financial statements. Given the significance of the earthquakes, a certain level of disclosure was needed for those public entities to comply with financial reporting standards. The challenge was getting the right balance of information about the earthquakes to comply with standards and to give readers understandable and meaningful information.

2.19 Those public entities most severely affected by the earthquakes usually included a separate note that contained all the information about the financial implications of the earthquakes. That note included information about:

- the damage sustained to assets (or a note that assessments had not been able to be carried out);
- the assumptions and estimates made in accounting for damage; and
- the insurance proceeds received or expected to be received.

2.20 Public entities with a December 2010 year-end that completed financial statements after 22 February 2011 had two separate issues to contend with. They had to reflect the effects of the 4 September 2010 earthquake and include appropriate disclosures about it and also disclose information about the nature and estimated financial effect of the 22 February 2011 earthquake. This was particularly challenging for those entities.

Timeliness of external reporting

2.21 Completing annual financial reports within statutory reporting time frames was not a priority for public entities significantly affected by the earthquakes. Some public entities, such as schools in the Christchurch City, Selwyn District, and Waimakariri District areas, were given extensions to the normal statutory reporting time frames. Where extensions were not granted, statutory time frames were sometimes missed – understandably so.
The Canterbury Earthquake Recovery Authority (CERA) was another public entity that was not required to prepare financial statements in the usual time frames. CERA was established after the 22 February 2011 earthquake (in March 2011) to support the earthquake recovery. It received approval under section 45I of the Public Finance Act 1989 to not prepare an annual report for the 30 June 2011 financial year.

Although not required to prepare financial statements for the period ended 30 June 2011, CERA will be required to report on the period from when CERA was established to 30 June 2012. Therefore, the effect of the exemption under the Public Finance Act has been to delay reporting.

In our view, although the accountability of public sector entities is important, clearly the safety and well-being of people and the re-establishment of operations are paramount.
The 2010/11 central government audits
Part 3

Our audit of the Government’s 2010/11 financial statements

3.1 In this Part, we report the results of our audit of the Financial Statements of the Government of New Zealand for the year ended 30 June 2011 (the Government’s financial statements) and discuss the significant matters arising from the audit.

Our audit report

3.2 The Auditor-General issued the audit report on the Government’s financial statements on 30 September 2011.

3.3 The audit report appears on pages 26 to 28 of the Government’s financial statements. It includes our audit opinion that those statements:

- comply with generally accepted accounting practice in New Zealand; and
- fairly reflect:
  - the Government’s financial position as at 30 June 2011;
  - the results of the Government’s operations and cash flows for the year ended 30 June 2011; and
  - the Government’s borrowings as at 30 June 2011, and unappropriated expenditure, expenses, or capital expenditure incurred in emergencies, and trust money managed by the Government, for the year ended on that date.

3.4 This year, our audit report emphasised the uncertainties in the Government’s financial statements because of the Canterbury earthquakes.

3.5 The most significant effects of the Canterbury earthquakes reflected in the Government’s financial statements related to:

- the Earthquake Commission (EQC);
- the AMI Insurance Limited (AMI) support package;
- the Canterbury residential red zone support package; and
- the Government’s share of local authority costs in immediate response to the earthquakes, and its share of costs for restoring local authority infrastructure damaged by the earthquakes.

3.6 We drew readers’ attention to:

- inherent uncertainties in estimating EQC’s and AMI’s earthquake-related outstanding claims liabilities and reinsurance receivables, using actuarial assumptions;
- inherent uncertainties in estimating the provision resulting from the Government’s offer to purchase properties in the Canterbury residential red zones, using actuarial assumptions; and
3.7 In our view, the disclosures in the Government’s financial statements about the uncertainties related to the Canterbury earthquakes are adequate.

3.8 For more information about the financial reporting and auditing implications arising from the Canterbury earthquakes, see Part 2.

**Significant matters arising from the 2010/11 audit**

**Accounting for the effects of the Canterbury earthquakes**

3.9 The costs associated with the Canterbury earthquakes were significant to the Government this financial year at a net amount of $9.1 billion.

3.10 We were satisfied:

- that the effects of the Canterbury earthquakes had been appropriately recognised and disclosed; and
- that the Government’s financial statements provided a clear overview of the effects of the Canterbury earthquakes.

3.11 The most significant effects of the earthquakes related to:

- EQC’s insurance expenses;
- the AMI support package costs;
- the Canterbury residential red zone support package managed by the Canterbury Earthquake Recovery Authority (CERA); and
- the Government’s share of immediate local authority costs in response to the earthquakes, and its share of costs for restoring infrastructure damaged by the earthquakes. These costs are managed by the Department of Internal Affairs (DIA).

3.12 The Treasury disclosed the uncertainties as a result of the earthquakes in note 30 of the Government’s financial statements, and disclosed details about assumptions and their sensitivities in the notes for the public entities referred to in paragraph 3.11. The Treasury has also completed an analysis to ensure that the main assumptions used by EQC, AMI, and CERA have been consistently applied and that the base data used is comparable.
Note 30 of the Government’s financial statements describes:

- the inherent uncertainties involved in estimating EQC’s and AMI’s earthquake-related outstanding claims liabilities and reinsurance receivables, using actuarial assumptions;
- the inherent uncertainties involved in estimating the provision resulting from the Government’s offer to purchase properties in the Canterbury residential red zones, using actuarial assumptions; and
- the high level of uncertainty associated with the Government’s share of costs for restoring local authority infrastructure damaged by the earthquakes. The uncertainty is such that it is not possible to reliably estimate the costs, so a provision has not been recognised for them. Instead, there is disclosure of a contingent liability for these unquantifiable costs.

We considered it essential to draw readers’ attention to these uncertainties in the audit report that we issued, given the significance of the effects of the Canterbury earthquakes to the Government’s financial statements.

EQC and AMI had actuarial valuations completed for their insurance liabilities. These were appropriately calculated and adjusted as new information became available, including the High Court declaratory judgment on 2 September 2011 about applying the Earthquake Commission Act 1993 in situations where full cover has been reinstated after an earthquake.

Because CERA was established in March 2011, it needed a lot of support from the Treasury to be able to report on its non-departmental activities for consolidation into the Government’s financial statements. The Treasury led the work to ensure that a liability valuation was carried out. As CERA builds its capability, we would expect CERA to be able to carry out this work, with support from the Treasury as needed.

DIA had a challenge trying to obtain adequate information to be able to reliably estimate the Government’s liability for contributing to the restoration of essential infrastructure (wastewater, stormwater, and freshwater systems) and river management systems. When the Government’s financial statements were signed, the underground infrastructure assets had not yet been adequately inspected for damage. The estimate was not considered reliable enough to be formally recorded as a liability. The Government’s financial statements disclosed an estimated contingent liability of between $348 million and $610 million, to provide some indication to readers of the size of the liability – albeit with a high level of uncertainty. We were satisfied that the accounting treatment adopted and the disclosures were appropriate.
3.18 DIA was able to recognise a liability for the Government’s share of response costs, such as Christchurch City Council’s costs associated with caring for displaced people, temporary repairs to essential infrastructure, and other precautionary measures to reduce immediate danger after the earthquakes.

3.19 As well as the earthquake liabilities, the $9.1 billion net cost includes wage subsidies, temporary accommodation, community and trauma support, and other support assistance. It does not include costs yet to be incurred by the Government, such as the Government’s contribution to repairing local roads, which is expected to be recognised when claims are made to the National Land Transport Fund.

Accounting for the support package for AMI Insurance Limited

3.20 We were satisfied that AMI had been appropriately accounted for at 30 June 2011, including the accounting treatment and disclosures relating to the Government’s acquisition of AMI.

3.21 On 7 April 2011, the Government agreed a “support package” in response to AMI’s concerns that its reserves and reinsurance might not be enough to cover all claims resulting from the Canterbury earthquakes.

3.22 We worked closely with the Treasury and our auditor of the Treasury. All parties agreed that the Government controls AMI and should consolidate it. This is based on the Government having the capacity to direct the operating and financing policies of AMI (through its option to make a partial payment and take control of the Board) and that it is directly affected by the risks, or benefits, from AMI’s operations.

Accounting for the scheme for repairing leaky homes

3.23 We were satisfied that the provision of $567 million recognised for the Government’s financial assistance package (FAP) for the owners of leaky homes has been appropriately recognised and disclosed.

3.24 Our auditor of the Department of Building and Housing (DBH) experienced challenges and delays in auditing the provision because the quality of information initially provided for audit to support the measurement of the liability was not satisfactory. We were disappointed with the time taken to resolve the various issues about measuring the provision and the late change to the liability amount. These problems were caused because DBH did not have robust systems and processes in place to calculate the liability.
3.25 In our view, many of the problems we experienced this year in auditing the provision were avoidable. We expect the systems and processes to measure the provision to be significantly improved to enable a timely audit of the liability for the year ended 30 June 2012.

3.26 The FAP became available to homeowners from 29 July 2011. The Government has agreed to contribute 25% of agreed repair costs to owners of leaky homes who qualify for the FAP (affected local authorities also contribute the same amount where private certifiers are not involved). The Government will also provide assistance to homeowners to access bank finance for the remaining agreed repair costs, through loan guarantees under a loss-sharing model with banks.

3.27 We agreed that the Government is required to recognise a provision in the 2011 financial statements for the estimated cost of the Crown’s 25% contribution under the FAP because of the commitments made to owners of leaky homes before 30 June 2011.

3.28 There is considerable uncertainty about the assumptions used in measuring the provision because of the limited claims experience to date. We were satisfied that the nature of the uncertainties and the sensitivities of the assumptions had been satisfactorily disclosed. These uncertainties were drawn to readers’ attention in our audit report on DBH’s financial statements. However, we did not consider it necessary to draw attention to these uncertainties in our audit report on the Government’s financial statements because the provision is not as significant to the Government as it is to DBH.

3.29 The three most critical assumptions used in measuring the provision are the number of eligible homes, the take-up rate for the FAP, and the average cost of repairs. Although we were satisfied with the assumptions used, the assumed FAP take-up rate of 70% is at the higher end of the range. In particular, the rate is higher than that used by local authorities in estimating their leaky home liabilities. These critical assumptions will need to be closely reviewed and updated, taking into account the claims experience, when measuring the provision as at 30 June 2012.

Policies for recognising tax revenue

3.30 We were satisfied that the recognition of taxation revenue under current policies materially complies with generally accepted accounting practice. However, in previous years, we suggested that a thorough review of taxation revenue recognition policies be carried out with a view to fine-tuning the recognition of taxation revenue, where appropriate. The Inland Revenue Department expects to complete its revenue recognition project in 2011/12. This is an important project
Part 3  Our audit of the Government’s 2010/11 financial statements

because of the complexities involved and the potential effect on the way the Government recognises its tax revenue.

3.31 The Department is currently part-way through reviewing its Crown revenue accounting policies and methodologies for each of the main tax types it administers; that is, PAYE, GST, and income tax (for individuals and companies). There have been no changes to the tax revenue accounting policies for 30 June 2011.

3.32 During 2010/11, we commented on the draft discussion document on PAYE. The Department subsequently produced a draft decision document setting out an agreed approach and proposal for changes, which includes a range of specific recommendations for consideration and agreement.

3.33 We recently commented on the draft GST discussion document, and we expect an income tax discussion document to be provided soon. All three discussion documents will need to be considered together to ensure consistency of approach across the different tax types.

3.34 We expect that there will be accounting issues likely to span these three documents. The approach and proposals for change for all three tax types will need to be considered after the release of the income tax document.

3.35 We have recommended that the Treasury closely monitor the progress of the project. It will be important that the project is completed on schedule to enable early consideration of any potential changes to revenue recognition policies, their financial reporting effect, and disclosure requirements (if any) in the Government’s financial statements for 2012.

Accounting for the Emissions Trading Scheme

3.36 We were satisfied with the accounting treatment and disclosures for the Emissions Trading Scheme (ETS), with a provision of $612 million.

3.37 Accounting for the ETS will become more significant to the Government’s financial statements as the ETS is extended into new sectors. There were several refinements and developments required this year, including preparing an accounting policy for revenue and expenditure recognition and agreeing the approach to valuing transactions in New Zealand Units (NZUs).

3.38 The ETS has been operating since 1 January 2008. The forestry sector has been in the scheme since this time, and activity has been increasing during the past few years. Obligations under the ETS began for the following sectors on 1 July 2010:

- liquid fossil fuels (transport);
- stationary energy; and
- industrial processes.
The first emissions returns and surrender obligations for these sectors and for pre-1990 foresters fell within the 2010/11 financial year.

During 2010/11, the Government incurred ETS expenditure for the industrial allocation to emissions-intensive and trade-exposed industry, the compensatory allocations to pre-1990 foresters and fishing quota owners, and for claims for carbon sequestration by post-1989 foresters.

Under the Government’s accounting policy for ETS, the Government recognises a liability and expense for the NZUs issued and recognises a reduction in the liability and revenue for NZUs surrendered.

ETS returns are submitted for a calendar year (in arrears). This year, the Ministry for the Environment has forecast the revenue from emissions produced by participants during the period 1 January 2011 to 30 June 2011. The Ministry has included the forecast revenue for this six-month period, as well as the actual revenue for the six-month period July 2010 to December 2010, in its financial statements.

The carbon price used to calculate the ETS provision is €EUR 11.63 per unit. This is based on the market price of Certified Emission Reduction units (CERs) traded on the European carbon market. We agreed that CER pricing is the best proxy to market values for the NZUs issued under the ETS.

Accounting for the Crown Retail Deposit Guarantee Scheme

The provision at 30 June 2010 for payments under the Crown Retail Deposit Guarantee Scheme (the Scheme) of $748 million was fully utilised during 2010/11 as payments were made to depositors of finance companies that failed while under the Scheme. As at 30 June 2011, there were only four finance companies in the extended scheme. These companies are not expected to fail within the remaining period of the Scheme so the Treasury has not made a provision for further losses.

The Government’s financial statements for 2011 recorded a receivable of $739 million. The receivable is the amount that the Government expects to recover from realising the assets of the failed finance companies that were part of the Scheme.

We were satisfied that the accounting for the Crown Retail Deposit Guarantee Scheme was appropriate and based on reasonable analysis and assumptions, and that the disclosures are adequate for the Government’s financial statements. In particular, we were satisfied that the receivable is based on the most recently available reports from the receivers for the failed finance companies. However, we note that a range of outcomes is possible for the eventual recovery to the Government.
Reporting of commitments

3.47 The reporting of commitments continues to be a challenge, and is now an area of concern. This year, many adjustments to commitments were required as a result of the information we received in our audit returns. Two very significant prior-period errors were identified.

3.48 There was an understatement of $3.996 billion for gas contract commitments and an overstatement of $1.742 billion for inter-entity grants that were not eliminated in the Government’s financial statements. Both prior-period errors have been corrected and a disclosure made about the nature and extent of the errors, as required by financial reporting standards.

3.49 We have recommended that the Treasury provide guidance to public entities about expectations for the disclosure of commitments and emphasised the need for accuracy in the disclosure of commitments. We are pleased that the Treasury intends to do some work on commitments and contingent liabilities in 2012. We expect to see improvements in the quality and the accuracy of the information reported in the Government’s 2011/12 financial statements.

Accounting for the Kyoto Protocol net position

3.50 New Zealand ratified the Kyoto Protocol in December 2002. This international agreement commits New Zealand to reducing its average net emissions of greenhouse gases during 2008-12 (the first commitment period of the Kyoto Protocol, or CP1) to 1990 levels or to take responsibility for the difference.

3.51 The best estimate of New Zealand’s net position at 30 June 2011 is an asset of $291 million. This net asset position is based on a surplus of 21.8 million tonnes of carbon equivalents measured using an exchange rate of EUR €0.57335 = NZ$1 and a carbon price of EUR €7.63 per unit. This compares with a net surplus of 11.2 million tonnes of carbon equivalents last year, which was then measured at a carbon price of EUR €10.75 per unit.

3.52 The major factors behind the forecast decreased emissions were:

- a decrease of 7.5 million tonnes in expected agricultural emissions, as a result of updated scientific data for agricultural emissions; and
- the level of expected deforestation has fallen as a result of further mapping of New Zealand’s land use. This resulted in an increase of 2.9 million tonnes in expected removals of carbon through forests.
3.53 The forecast decreased emissions have been offset by a decrease in the carbon price used to value the net position, mainly because of a change in the carbon pricing methodology. The carbon price is now based on the actual transactions in Kyoto Protocol units in international markets.

3.54 We were satisfied that the estimated asset of $291 million had been recognised in keeping with accounting standards. There is a degree of uncertainty with the asset because fluctuations in the asset value can occur as a result of changes in the underlying assumptions, movements in carbon prices, and the exchange rate of the Euro.

3.55 The movement in the projected balance of Kyoto Protocol units during the first commitment period is set out in a 2011 report, *New Zealand’s net position under the Kyoto Protocol*, which is available on the Ministry for the Environment’s website (www.mfe.govt.nz).

**Using appropriate discount rates for long-term liabilities**

3.56 We were satisfied with the discount rates and assumptions about the Consumer Price Index (CPI) used to value the significant long-term liabilities of the Government.

3.57 We have concluded that the Treasury’s table of risk-free discount rates and CPI assumptions as at 30 June 2011 has been determined in keeping with the Methodology for Risk-free Discount Rates and CPI Assumptions for Accounting Valuation Purposes (the Methodology), and are appropriate for the Government to use.

3.58 We followed up our observations from the previous year’s discount rate review and were satisfied with the outcome. We will continue to monitor these observations next year, because these matters may be subject to future technical developments or different market conditions.

3.59 However, there is one new matter to note this year. In setting the discount rates for long durations, there was no regard given to bank swap rates with 15- and 20-year durations because it was not clear that those rates represented the long-term fixed rate that would be earned in the market. Although we accepted the approach this year, we recommended that further work be done to identify the main factors that indicate that the decision to disregard those bank swap rates for future valuations continues to be reasonable.
Collecting information about related party transactions

3.60 Overall, we were satisfied with the process used to record information about related party transactions and the disclosures made. Returns were received from all Ministers who held office during 2010/11. There were no relevant matters noted by Ministers that required disclosure.

3.61 However, we are aware that the financial reporting standard covering related party transactions is likely to change as part of the general change in financial reporting standards affecting the public sector (see Part 8). We expect that the Treasury will monitor these changes and consider their effect on the Government's financial statements.

Valuing the state highway network

3.62 Last year, we recommended that the New Zealand Transport Agency (NZTA) review the reasonableness and validity of the assumptions used in the methodology to value state highways and that it update the valuation methodology to incorporate “Brownfields” costs.8

3.63 NZTA has made progress with those recommendations by engaging an external specialist to carry out a review of the valuation methodology. This review concluded “that there is nothing to suggest that the depreciated replacement cost (DRC) methodology being used to value the state highway network is inappropriate. The methodology is broadly consistent with the approach used elsewhere”. Therefore, there were no changes to the valuation methodology for 30 June 2011.

3.64 The review supported the remedial work NZTA is doing with data quality and “Brownfields” costs. It also raised for consideration the “discounting” of the valuation of land under the state highway network.

3.65 It has been agreed that these discussions will continue in relation to “Brownfields” costs and the discounting of land values to determine the appropriateness of making any adjustments to future state highway valuations.

Accounting for relativity obligations in Treaty of Waitangi claims

3.66 We are satisfied that the Crown’s obligations as a result of relativity clauses in two previous Treaty of Waitangi settlements have been appropriately accounted for and disclosed. That includes disclosure of an unquantifiable contingent liability for payments that may be required under the relativity clauses.

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8 “Brownfields” costs include: traffic management, environmental compliance, utilities, generic increase in construction costs because of restrictions imposed by the built environment, and costs associated with re-establishing the interface with adjacent properties that have been excluded from the current valuation based on recent urban projects.
3.67 The deeds of settlement negotiated with Waikato-Tainui and Ngai Tahu included relativity clauses. The clauses provide that, where the total redress amount for all historical Treaty settlements exceeds $1 billion in 1994 present-value terms, the Crown is liable to make payments to maintain the real value of Waikato-Tainui and Ngai Tahu’s settlements as a proportion of all Treaty settlements.

3.68 We will continue to work with the Ministry of Justice and the Treasury on this.

Impairment testing of goodwill arising from the acquisition of Air New Zealand Limited

3.69 We were satisfied that the balance of goodwill from the Government’s acquisition of Air New Zealand Limited (Air New Zealand) has not been impaired this year.

3.70 The Crown recognised goodwill of $258 million from the Air New Zealand acquisition, which is tested for impairment annually. An impairment loss must be recognised if the recoverable amount of the Air New Zealand investment (the higher of value-in-use and fair value less costs to sell) is less than its carrying amount, including goodwill.

3.71 The Treasury prepared a model to calculate value-in-use, using inputs (such as revenue growth rates) provided by Air New Zealand. The value-in-use model produced a valuation that showed goodwill was not impaired.

3.72 The difference between the value-in-use valuation and the market capitalisation of Air New Zealand was significant. The Treasury provided an explanation for this difference, and we also obtained comfort that there was no impairment of goodwill by rationalising that there would be a control premium over and above the share price for the Crown’s investment in Air New Zealand.

3.73 We have recommended that the Treasury continue to monitor Air New Zealand’s value-in-use and market capitalisation, and the rationale for differences, for future impairment tests.

Observations about the consolidation process

3.74 It has been a challenging year for preparing and auditing the Government’s financial statements, largely because of the complexity and uncertainties involved in accounting for the effects of the Canterbury earthquakes. Other challenging matters have included accounting for the acquisition of AMI during the year, and measuring the provision recognised for the obligations arising under the Government’s FAP for repairing leaky homes.

3.75 The Treasury had to deal with late adjustments to the financial statements and had to work more closely than usual with some public entities to help them account for the effects of the earthquakes.
Apart from these late adjustments and the leaky homes matter, the Treasury prepared the draft financial statements to a good standard by the statutory deadline. The Treasury’s staff provided support and information to the audit team, including keeping clear and detailed work papers and having an audit file available for our audit team on the first day of our final audit visit.

In recent years, we have raised concerns about the performance of some public entities in preparing timely and accurate financial information for consolidation. This year, we saw an improvement in the receipt and accuracy of the returns received. However, we continue to be disappointed in the number of “except for” audit clearances received (in other words, clearance of most but not all of the information provided for consolidation) and the number of late audit clearances as a result of entity non-performance.

We will continue to work with the Treasury to ensure that public entities that have not performed or met the required deadlines this year work with us actively to meet the deadline next year, with no “except for” audit clearances. In particular, it is expected that both we and the Treasury will work with the public entities that had significant late adjustments to their submissions this year.

We were particularly concerned with the quality and accuracy of the information on commitments submitted for consolidation. There were a number of errors identified through the consolidation and audit process, including two significant prior period errors. We recommended that the Treasury work with public entities to ensure that they accurately report their commitments (discussed in paragraphs 3.47–3.49).
Part 4
Non-standard audit reports issued

4.1 We issued 551 audit reports for public entities in our central government portfolio during the year ended 31 October 2011 (excluding entities in our education portfolio).\(^9\) Of these, 480 audit reports were standard. In this Part, we report on the 71 non-standard audit reports that were issued on the financial and non-financial information of those entities.

Why we report this information

4.2 An audit report is addressed to the readers of an entity’s financial and non-financial information. However, all public entities are ultimately accountable to Parliament for their use of public money and their use of any statutory powers or other authority given to them by Parliament. Therefore, we consider it important to draw Parliament’s attention to the matters that give rise to non-standard audit reports.

4.3 In each instance, the issues underlying a non-standard audit report are drawn to the attention of the entity and discussed with its governing body or chief executive and the responsible Minister, where relevant.

What is a non-standard audit report?

4.4 A non-standard audit report\(^{10}\) is one that contains:
- a modified opinion; and/or
- an “emphasis of matter” or an “other matter” paragraph.

4.5 The auditors we appoint to audit public entities will express a modified opinion because of:
- a misstatement about the treatment or disclosure of a matter in the financial and/or non-financial information; or
- a limitation in scope because the appointed auditor has been unable to obtain sufficient appropriate evidence to support, and accordingly is unable to express, an opinion on the financial and/or non-financial information or a part of the financial and/or non-financial information.

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\(^9\) We decided to report separately on non-standard audit reports that we issued on schools and tertiary education institutions. These are included in our report Education sector: Results of the 2010/11 audits. Also, we report separately on entities in the local government portfolio in our yearly report on the results of those audits.

\(^{10}\) A non-standard audit report is issued in accordance with the requirements of the New Zealand equivalents to the International Standards on Auditing: No. 705: Modifications to the Opinion in the Independent Auditor’s Report and/or No. 706: Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report.
4.6 There are three types of modified opinion:
   • an “adverse” opinion (see paragraphs 4.10–4.11);
   • a “disclaimer of opinion” (see paragraphs 4.14–4.15); and
   • a “qualified opinion” (see paragraphs 4.17–4.19).

4.7 The appointed auditor will include an “emphasis of matter” paragraph (see paragraph 4.22) or “other matter” paragraph (see paragraph 4.34) in the audit report to draw attention to matters such as:
   • fundamental uncertainties;
   • breaches of law; or
   • concerns about probity or financial prudence.

4.8 The appointed auditor has to include an “emphasis of matter” paragraph or an “other matter” paragraph in the audit report in such a way that it cannot be mistaken for a modified opinion.

4.9 Figure 1 outlines the decisions that an appointed auditor has to make when considering the appropriate form of the audit report.

Adverse opinions

4.10 An adverse opinion is the most serious type of non-standard audit report.

4.11 An adverse opinion is expressed when the appointed auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial and/or non-financial information.

4.12 During 2011, we expressed an adverse opinion for two public entities that did not recognise their museum collection assets nor the associated depreciation expense:
   • Royal New Zealand Navy Museum Trust Incorporated; and
   • RNZAF Museum Trust Board.

4.13 The Appendix sets out the details of these adverse opinions.

Disclaimers of opinion

4.14 A disclaimer of opinion is expressed when the appointed auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion (that is, a limitation in scope), and the appointed auditor concludes that the possible effects on the financial and/or non-financial information of undetected misstatements, if any, could be both material and pervasive.
Figure 1
Deciding on the appropriate form of the audit report

Has the auditor identified any issues during the audit that are material or pervasive and will affect the reader's understanding of the financial and/or non-financial information?

NO
Auditor expresses an unmodified opinion

YES
Auditor expresses a modified opinion

Auditor determines the appropriate opinion depending on how material or pervasive the issues identified during the audit are to the reader's understanding of the financial and/or non-financial information.

Limitation in scope
Auditor has not obtained sufficient appropriate audit evidence about an issue.

Limitation is pervasive to understanding the financial and/or non-financial information.

Limitation is material to understanding the financial and/or non-financial information.

Misstatement
Auditor concludes that there is a misstatement in the financial and/or non-financial information.

Limitation is pervasive to understanding the financial and/or non-financial information.

Limitation is material to understanding the financial and/or non-financial information.

Misstatement is material to understanding the financial and/or non-financial information.

Misstatement is pervasive to understanding the financial and/or non-financial information.

Auditor expresses an unmodified opinion

Auditor expresses a modified opinion

Disclaimer of opinion
Qualified opinion
Adverse opinion

NO
Auditor expresses a modified opinion

YES
Auditor expresses an unmodified opinion

Has the auditor identified any other matter that is, in the auditor's judgement, relevant to the reader's understanding of the financial and/or non-financial information but not appropriately presented or disclosed?

NO
No "other matter" paragraph

YES
Auditor includes an "other matter" paragraph

Has the auditor identified any matters that, although appropriately presented or disclosed in the financial and/or non-financial information, are of such importance that they are fundamental to the reader's understanding of the financial and/or non-financial information?

NO
No "emphasis of matter" paragraph

YES
Auditor includes an "emphasis of matter" paragraph

Note: This flowchart is based on the requirements of the New Zealand equivalents to the International Standards on Auditing, No. 700: Forming an Opinion and Reporting on Financial Statements, No. 705: Modifications to the Opinion in the Independent Auditor’s Report, and No. 706: Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report.
4.15 A disclaimer of opinion is also expressed when, in extremely rare circumstances involving multiple uncertainties, the appointed auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements and/or non-financial performance information because of the potential interaction of the uncertainties and their possible cumulative effect on the financial and/or non-financial information.

4.16 We are pleased to report that it was not necessary for us to express a disclaimer of opinion on the financial and/or non-financial information of any entity in the central government portfolio covered by this report.

Qualified opinions

4.17 A qualified opinion is expressed when the appointed auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in aggregate, are material, but not pervasive, to the financial and/or non-financial information.

4.18 A qualified opinion is also expressed when the appointed auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the appointed auditor concludes that the possible effects on the financial and/or non-financial information of undetected misstatements, if any, could be material but not pervasive.

4.19 Also, a qualified opinion is expressed when the appointed auditor concludes that a breach of statutory obligations has occurred and that the breach is material to the reader’s understanding of the financial and/or non-financial information. An example of this is where a Crown entity has breached the requirements of the Crown Entities Act 2004 because it has not included budgeted figures in its financial statements.

4.20 During 2011, we expressed qualified opinions on the financial or non-financial information of the following 11 public entities covered by this report:

- Southern District Health Board (two months ended 30 June 2010);
- Ngati Whakue Education Endowment Trust Board (two years ended 31 December 2009 and 31 December 2010);
- Counties Manukau District Health Board;
- Tauranga Moana Māori Trust Board;
- New Zealand Māori Arts and Craft Institute;
- New Zealand Post Recycle Centre Limited (a subsidiary of New Zealand Post Limited);
Wilson Home Trust (a trust for which Waitemata District Health Board is the sole and permanent trustee);

Auckland DHB Charitable Trust (a trust controlled by Auckland District Health Board, for two years ended 30 June 2010 and 30 June 2011);

Three Harbours Health Foundation (Waitemata District Health Board);

Gisborne Laundry Services (associated with Tairawhiti District Health Board); and

The Māori Trustee and Group.

4.21 The Appendix sets out the details of the qualified opinions. In some instances, the audit opinion was qualified for more than one reason.

“Emphasis of matter” paragraphs

4.22 In certain circumstances, it may be appropriate for the appointed auditor to include additional comments in the audit report to draw readers’ attention to a matter that, in the appointed auditor’s professional judgement, is fundamental to their understanding of the financial and/or non-financial information. The additional comments will be included in the audit report in an “emphasis of matter” paragraph, provided the appointed auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial and/or non-financial information.

4.23 During 2011, we used nine main types of “emphasis of matter” paragraphs for the public entities covered by this report.

4.24 The first type of “emphasis of matter” paragraph related to the uncertainties associated with the Canterbury earthquakes. Audit reports that included such “emphasis of matter” paragraphs were issued for:

- Financial Statements of the Government of New Zealand;
- the Earthquake Commission;
- AMI Insurance Limited and Group;
- Canterbury Earthquake Recovery Authority, and
- Department of Internal Affairs.

4.25 The second type of “emphasis of matter” paragraph related to the existence of a high degree of uncertainty about the value of unlisted investments that could have a material effect on the statement of financial performance and the statement of financial position. The audit reports for Public Trust and Group and the New Zealand Venture Investment Fund Limited and Group, and each of its subsidiaries, included such an “emphasis of matter” paragraph.

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11 Only CERAs statements of appropriations were audited because a full annual report was not required for the period from 29 March 2011, when it was established, to 30 June 2011.
4.26 The third type of “emphasis of matter” paragraph related to the reduction made by a Board to the valuation of buildings carried out by an independent valuer that was not material to the financial statements as a whole. The audit report for MidCentral District Health Board and Group included such an “emphasis of matter” paragraph.

4.27 The fourth type of “emphasis of matter” paragraph related to serious financial difficulties faced by the entity. The audit reports for Whanganui District Health Board and Spring Creek Mining Company (a subsidiary of Solid Energy New Zealand Limited) included such an “emphasis of matter” paragraph.

4.28 The fifth type of “emphasis of matter” paragraph related to the uncertainty about the delivery of office functions in future. The audit report for the Dental Council included such an “emphasis of matter” paragraph.

4.29 The sixth type of “emphasis of matter” paragraph related to the change in the nature of the entity’s operations including the transfer of certain assets to a charitable trust. The audit report for Tuhoe-Waikaremoana Māori Trust Board and Group included such an “emphasis of matter” paragraph.

4.30 The seventh type of “emphasis of matter” paragraph related to the uncertainties associated with the Department of Building and Housing’s provision for the Weathertight Services Financial Assistance Package in its non-departmental schedule of liabilities.

4.31 The eighth type of “emphasis of matter” paragraph related to financial statements being appropriately prepared on the “going concern” assumption because the financial statements contained appropriate disclosures about the use of the going concern assumption. The following public entities’ audit reports included such an “emphasis of matter” paragraph:
- Cardiff Holdings No. 1 Limited (a subsidiary of Genesis Power Limited);
- Cardiff Holdings No. 2 Limited (a subsidiary of Genesis Power Limited);
- Kupe Holdings Limited (a subsidiary of Genesis Power Limited);
- GP No. 1 Limited (a subsidiary of Genesis Power Limited);
- GP No. 2 Limited (a subsidiary of Genesis Power Limited);
- GP No. 4 Limited (a subsidiary of Genesis Power Limited); and
- GP No. 5 Limited (a subsidiary of Genesis Power Limited).
4.32 The ninth type of “emphasis of matter” paragraph related to the “going concern” assumption being appropriately not used because public entities were disestablished or expected to be disestablished in the near future. The following public entities’ audit reports included such an “emphasis of matter” paragraph:

- Archives New Zealand;
- Electricity Commission;
- Foundation for Research, Science and Technology;
- Ministry of Research, Science and Technology;
- Securities Commission;
- National Library of New Zealand;
- Ministry of Fisheries;
- Crown Health Financing Agency;
- Environmental Risk Management Authority;
- Legal Services Agency (two years ended 30 June 2010 and 30 June 2011);
- Health Sponsorship Council;
- Auckland Transition Agency;
- Charities Commission;
- Mental Health Commission;
- Alcohol Advisory Council of New Zealand;
- Meat Biologics Research Consortium (Meat Biologics Consortia Limited, a consortium of Massey University, AgResearch, and IRL BIOSOL Limited);
- Scion Australasia Limited (a subsidiary of New Zealand Forest Research Institute Limited);
- PIBDT Ownership Limited;
- Manukau Pacific Markets Limited (a subsidiary of PIBDT Ownership Limited);
- Southmarkets Limited (a subsidiary of PIBDT Ownership Limited);
- Public Trust Investment Funds Balanced Income Fund;
- Public Trust Investment Funds;
- Ngai Tahu Ancillary Claims Trust (two years ended 30 June 2010 and 30 June 2011);
- Taranaki Provincial Patriotic Council (three years ended 30 September 2008, 30 September 2009, and 30 September 2010); and
- Electoral Commission (three months ended 30 September 2010).

4.33 The Appendix contains more information about the “emphasis of matter” paragraphs that were included in audit reports.
“Other matter” paragraphs

4.34 In certain circumstances, it may be appropriate for the appointed auditor to communicate a matter that is not adequately presented or disclosed in the financial and/or non-financial information because, in the appointed auditor’s professional judgement, the matter is relevant to readers’ understanding of the financial and/or non-financial information. The additional comments will be included in the audit report in an “other matter” or a similarly titled paragraph.

4.35 There were no “other matter” paragraphs in the audit reports of the public entities covered by this report.
Part 5
The Controller function and the appropriation audit

5.1 The Controller function and appropriation audit are important aspects of the Auditor-General’s work. They support the fundamental principle of Parliamentary control over government expenditure.

5.2 In this Part, we discuss the appropriation matters that arose from the Canterbury earthquakes, and the amount of unauthorised expenditure in 2010/11.

The system of appropriation

5.3 The Public Finance Act 1989 (the Act) defines the system of appropriation, which is the primary means by which Parliament authorises the Executive to use public resources. Under this system, expenses and capital expenditure should be incurred only within an appropriation or other statutory authority. The net assets of government departments should not exceed the limits set in the relevant Appropriation Act.

5.4 The Controller function ensures that the Government is operating within the financial authorities that Parliament has approved.

5.5 Audit work carried out on appropriations supports the formal operation of the Controller function. Section 15(2) of the Public Audit Act 2001 now explicitly recognises this audit work as part of the basic functions of the Auditor-General.

5.6 Our appointed auditors must carry out an appropriation audit in conjunction with the annual audit of each government department, to confirm that:

- expenses and capital expenditure have been incurred within the amount, scope, and period of an appropriation or other statutory authority;
- expenses incurred have been for lawful purposes; and
- any unappropriated expenditure is reported in the Government’s financial statements.

5.7 The Treasury provides useful guidance on the system of appropriations on its website (www.treasury.govt.nz). This guidance includes:

- Guide to the Public Finance Act;
- Guide to Appropriations;
- Treasury Circular 2007/05: Multi-year, Revenue Dependent and Department to Department Appropriations;
- Treasury Circular 2006/04: Unappropriated Expenditure – Avoiding Unintended Breaches; and
- Treasury Instructions.
Appropriation issues arising from the Canterbury earthquakes

5.8 One of the defining events of 2010/11 has been the series of earthquakes experienced by the Canterbury region. The two major earthquakes were on 4 September 2010 and 22 February 2011, and have been followed by thousands of aftershocks (including a significant earthquake on 26 December 2010 and two significant earthquakes on 13 June 2011). These earthquakes were devastating. They caused substantial damage to property and infrastructure and 182 people died as a result of the February earthquake.

5.9 At a different level, but nevertheless important, the earthquakes have also raised significant appropriation issues.

5.10 After the declaration of a state of emergency by the Mayor of Christchurch on 22 February 2011, the Minister of Finance invoked the provisions of section 25 of the Public Finance Act to enable expenses to be incurred to meet the emergency, whether or not an appropriation is available. On 23 February 2011, the Minister of Civil Defence declared a state of national emergency, which superseded the state of emergency declared by the Mayor. The Minister of Finance confirmed the section 25 approval that day.

5.11 The section 25 approval power should be used only where the proposed expenditure:

- needs to be incurred immediately to meet the emergency, or will be incurred automatically as a result of the emergency; and
- is outside the scope of any existing appropriation administered by a department or is in excess of the unused amount of an existing appropriation.

5.12 On 23 February 2011, the Secretary to the Treasury wrote to the Auditor-General about the use of section 25 and the approval process put in place to monitor expenditure. The following day the Auditor-General formally acknowledged this letter, and the extraordinary event that had required the Government to invoke this power.

5.13 The Treasury told departments to use existing appropriations where possible and to obtain approval from the Secretary to the Treasury or the Deputy Secretary if they were intending to incur expenditure under section 25. Departments were to separately record spending under section 25 and report this to the Treasury.

5.14 Two approvals were granted, for Vote Emergency Management and Vote Finance. Total spending under this section 25 authority for the year ended 30 June 2011 was just over $28 million. The use of section 25 of the Act ended on 1 May 2011 when the national state of emergency was lifted.
5.15 Where possible, costs associated with re-instating departmental assets and/or operations after the 22 February earthquake were met using existing appropriations. Nine departments received an additional “other expense” appropriation to provide authority for these expenses because existing appropriations were insufficient.

5.16 Under the current Government policy setting, outlined in the National Civil Defence Emergency Management Plan, four Canterbury local authorities will be reimbursed for 60% of permanent repairs to essential infrastructure (such as freshwater, stormwater, and wastewater systems) and river management systems.

5.17 The Government has provided an indemnity under section 65ZG of the Public Finance Act, which enables this expense to be incurred without further appropriation. As at 30 June 2011, it was not possible to reliably estimate the total amount that will be reimbursed. The obligation to reimburse the four local authorities was recorded as an unquantifiable contingent liability.

5.18 The Treasury is monitoring the total earthquake-related expenditure incurred by departments and the estimated future costs for all appropriation types. When the Government’s financial statements were published, the estimated total cost was $13.601 billion. Of this sum, $4.514 billion was expected to be recovered through EQC’s claims on its reinsurers and other earthquake-related revenue.

5.19 We worked closely with the Treasury to address various appropriation matters arising from the earthquakes. We jointly presented a seminar to affected government agencies in June 2011, outlining our views on the significant accounting and appropriation matters arising. We also issued guidance to appointed auditors on the expected accounting treatment for earthquake-related matters. These matters included:

- Whether asset write-offs or impairment of assets resulting from earthquake damage qualify as remeasurements. We concluded that these expenses do not meet the criteria of a remeasurement, and require an appropriation.
- Potential breaches of the scope of appropriations arising from costs associated with re-instating departmental assets and/or operations after the 22 February earthquake.
- The risk that departments would understate their earthquake recovery expenses by incorrectly accounting for their insurance receipts.
5.20 We set up a central process to review the proposed accounting responses to matters arising from the Canterbury earthquakes. We did this to help ensure a consistent approach to the accounting issues that arose. It also gave us the opportunity to share the lessons learnt with the appointed auditors.

5.21 The circumstances arising from the Canterbury earthquakes were unique and we had concerns about how it would affect the appropriation framework. Overall, the appropriation framework proved to be flexible enough to allow the response to the Canterbury earthquakes while retaining appropriate accountability for the funds used.

**Expenditure in 2010/11**

5.22 Turning to the more routine authorisation matters arising during the year, we can report that almost all government expenditure during 2010/11 was authorised by appropriations in the usual way.

5.23 There was one use of section 26B of the Public Finance Act, which enables the Minister of Finance to approve expenses that exceed an appropriation in the last three months of the financial year, if those additional expenses are within the scope of the appropriation and do not exceed the greater of $10,000 or 2% of the total appropriation. The relevant appropriation authorised more than $90 million of expenditure on naval helicopter forces and the Minister of Finance approved additional expenditure of $0.99 million.

5.24 In two instances, the Government used Imprest Supply to approve expenditure and the decisions were too late in the year to be incorporated into Supplementary Estimates. This expenditure needs to be validated in the Appropriation (Financial Review) Act for the financial year.\(^{12}\) The two areas of expenditure were:

- additional expenditure in two appropriations for some electoral administration expenses, which amounted to $0.735 million; and
- new expenditure to acquire Canterbury properties that were zoned as unsuitable to live in (properties in residential red zones), which amounted to $1.039 billion.

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Unauthorised expenditure in 2010/11

5.25 There were 25 instances of expenditure that was not authorised by an appropriation or any other approval process. The total of this expenditure was about $135 million.

5.26 In 17 of these instances, there was an appropriation authorising that type of expenditure, but the Government spent more than was authorised.\textsuperscript{13} For these 17 instances, the total expenditure in excess of authority was more than $58 million. The biggest individual instance was just over $25 million, incurred by the Ministry of Foreign Affairs and Trade. The unappropriated expenditure arose from a review of the application of the Ministry’s accounting policy for New Zealand’s International Agency commitments, which are unconditional obligations under New Zealand International Financial Reporting Standards.

5.27 The other eight instances\textsuperscript{14} involved expenditure that was outside the scope of, or without any, appropriation. The total expenditure in these instances was nearly $77 million. The biggest single instance was $70 million incurred as a result of the refinancing of district health board debts.

5.28 Overall, expenditure in excess of or outside appropriation, and therefore without any parliamentary authority, is a very small proportion of overall government expenditure.

5.29 We continue to encourage departments to pay closer attention to ensuring that they have authority before incurring any expenditure. Departments should seek the necessary authority and approval as soon as they become aware that they have incurred unappropriated expenditure. We also continue to work with the Treasury to provide better guidance and support through the administrative systems that support the Crown’s financial management.

Net asset holdings

5.30 The Act sets a limit on the net assets that departments may hold. Section 22(3) states:

\begin{quote}
The amount of net asset holding in a department must not exceed the most recent projected balance of net assets for that department at the end of the financial year, as set out in an Appropriation Act in accordance with section 23(1)(c).
\end{quote}

5.31 A breach of a department’s net asset limit is treated as a breach of appropriation.

\textsuperscript{13} These are listed on pages 172 and 173 of \textit{Financial Statements of the Government of New Zealand for the year ended 30 June 2011}.

\textsuperscript{14} These are listed on pages 171 and 172 of the \textit{Financial Statements of the Government of New Zealand for the year ended 30 June 2011}. 
5.32 Three departments breached their net asset limits during 2010/11,\textsuperscript{15} one more than in the previous year. These breaches (amounting to $2.031 million) were without the authority of an Imprest Supply Act. Two of the breaches in 2010/11 were the result of administrative errors.

5.33 This aspect of appropriations is complex, from a legal and an accounting perspective. Accordingly, departments need to continue taking care in applying the net asset requirements of the Act. We are working with the Treasury to improve the processes and associated guidance to reduce the probability of further breaches.

\textsuperscript{15} The three departments were the New Zealand Customs Service, New Zealand Police, and State Services Commission (see page 174 of the Financial Statements of the Government of New Zealand for the year ended 30 June 2011).
Part 6

Results of government department audits

6.1 In this Part, we report on the results of our audits of government departments in 2010/11, including our assessments of their management control environments, financial information systems, and service performance information and associated systems and controls.

6.2 Part 7 sets out the results of our audits and our assessments for Crown Research Institutes. We will report the results of our audits of State-owned enterprises, district health boards, and other Crown entities in early 2012.

Central government changes

6.3 The global financial crisis has focused the Government’s attention on lifting the performance of the public sector while reducing the rate of spending increases. The Government is focused on “delivering better, smarter public services for less”, and change and improvement programmes continue to be rolled out throughout central government.

6.4 The Government has introduced many initiatives to secure the right capability and capacity to deliver effective and efficient public services and has made some structural changes (including four departmental mergers).

6.5 There were 37 government departments as at 30 June 2011, two fewer than at 30 June 2010 and 30 June 2009.

6.6 A new entity was established in March 2011 to manage issues arising from the Canterbury earthquakes (the Canterbury Earthquake Recovery Authority, or CERA). We have not included CERA’s results in this Part because its full annual report will be audited, for the first time, for the period 29 March 2011 to 30 June 2012.

Audit reports for 2010/11

6.7 We audited 41 government departments in 2010/11, excluding the Government Security Bureau and the New Zealand Security Intelligence Service. The 41 audits include the final audits for four departments that were disestablished during the year and the 37 existing at 30 June 2011 (which includes one new department – the Ministry of Science and Innovation – and two Offices of Parliament – the Office of the Ombudsmen and the Office of the Parliamentary Commissioner for the Environment were transferred to the Auditor-General to audit in 2010/11).

16 “Government departments” includes the two Offices of Parliament that we audited.
17 Excluding the Canterbury Earthquake Recovery Authority, CERA (see paragraph 6.6).
18 Only CERA’s statements of appropriations were audited because a full annual report was not required for the period from 29 March 2011, when it was established, to 30 June 2011.
19 Excluding CERA.
6.8 We issued unmodified audit opinions for all 41 departments for the year ended 30 June 2011.

6.9 In two audit reports (for the Department of Building and Housing and the Department of Internal Affairs), there was an explanatory paragraph drawing readers’ attention to particular matters: the assumptions underpinning the provision made for the Government’s financial assistance package for owners of leaky homes, in the first instance, and the estimates and assumptions about the figures for the Canterbury earthquakes, in the second.

**Final audits for disestablishing departments**

6.10 We carried out final audits for four departments that were disestablished during 2010/11 and merged into other departments:

- Archives New Zealand, disestablished on 31 January 2011 and amalgamated into the Department of Internal Affairs (DIA);
- the National Library of New Zealand, disestablished on 31 January 2011 and amalgamated into DIA;
- the Ministry of Fisheries, disestablished on 30 June 2011 and amalgamated into the Ministry of Agriculture; and
- the Ministry of Research, Science and Technology, disestablished on 31 January 2011 and amalgamated with the Foundation for Research, Science and Technology to form the Ministry of Science and Innovation.

6.11 For all four departments, our audit report included an explanatory paragraph highlighting that the financial statements were appropriately prepared on a disestablishment basis.

6.12 We did not assess the entity’s environment, systems, and controls when we carried out the final audit. This is because the grades we give reflect our recommendations for improvement, and deficiencies identified during the final audit of a disestablishing entity may or may not be relevant to any new or ongoing entity.

6.13 However, we did report our audit findings and any significant issues to the responsible Minister, and we commented on the operation of the environment, systems, and controls during the disestablishment period. Overall, our appointed auditors found that the four disestablishing entities maintained sound systems and controls up until disestablishment. Two departments faced capability loss with staff leaving but managed to maintain most activities and controls either by contracting staff or through effective deployment of existing staff. However, some systems and controls were not maintained, including no formal risk management processes in one department, no internal audit programme in another, and in two departments legislative compliance systems and procedures were not fully carried out during the period.
Matters of audit interest in the other departments

6.14 We reported on some matters of interest drawn from our audits of the 37 other departments.

6.15 Central among these were the implications of the Canterbury earthquakes. These ranged from uncertainties about valuation/costs arising from the earthquake damage to the effect of the earthquakes on departments’ attempts to achieve efficiencies and on risk and internal assurance mechanisms.

6.16 Other issues we drew attention to, and the number of departments that each applied to, included:
- management risks associated with structural changes, such as restructuring costs, loss of institutional knowledge, or weakening of internal controls (six departments);
- weaknesses in procurement practice (six departments);
- unappropriated expenditure (six departments);
- weaknesses in financial management (four departments);
- weakness in forecasting demand, some of which resulted from the Canterbury earthquakes (three departments);
- effect of weaknesses in the department’s expenditure review process on savings projections (one department);
- uncertainties arising from carbon emissions control policies (one department);
- project management arrangements that needed to improve, including the need for an acquisition strategy and for a clearer focus on value for money, estimates that were not robust enough, and reporting that was not regular enough (one department); and
- debt recovery and the need to effectively collect fines (one department).

Environment, systems, and controls

6.17 As part of the annual audit, we examine, assess, and grade central government entities’ environment, systems, and controls for managing and reporting financial and service performance information.

6.18 This is the fifth year that we have used our current assessment framework to support the continued improvement of public entities. We assess three aspects:
- the management control environment;
- financial information systems and controls; and
- service performance information and associated systems and controls.
6.19 The auditors we appoint to audit public entities identify deficiencies in each of these aspects and make recommendations for improvement. The grades assigned reflect the recommendations for improvement as at the end of the financial year. Figure 2 explains these grades.

**Figure 2**
Grading scale for assessing public entities’ environment, systems, and controls

<table>
<thead>
<tr>
<th>Grade</th>
<th>Explanation of grade</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very good</td>
<td>No improvements are necessary.</td>
</tr>
<tr>
<td>Good</td>
<td>Improvements would be beneficial and we recommend that the entity address these.</td>
</tr>
<tr>
<td>Needs improvement</td>
<td>Improvements are necessary and we recommend that the entity address these at the earliest reasonable opportunity.</td>
</tr>
<tr>
<td>Poor</td>
<td>Major improvements are required and we recommend that the entity urgently address these.</td>
</tr>
</tbody>
</table>

6.20 We report our assessments to the department, the responsible Minister, and the relevant select committees. We also advise the central agencies: the Treasury, the State Services Commission, and the Department of the Prime Minister and Cabinet.

**Grades for 2010/11**

6.21 We assessed and graded 37 government departments in 2010/11, including, for the first time, one new department (the Ministry of Science and Innovation) and the two Offices of Parliament. Figure 3 sets out a summary of the grades for departments for 2010/11 for the three aspects that we assess.

**Figure 3**
Summary of grades for the 37 government departments audited for 2010/11
Overall, the results for 2010/11 show that government departments have generally sound management control environments and financial information systems and controls. We graded 95% of the departments as “Good” (needing beneficial improvements only) or “Very good” (no improvements identified as being needed) in each of these aspects.

However, for the year ended 30 June 2011, only 43% of the departments had a “Good” grade (and none had “Very good”) for service performance information and associated systems and controls. The rest (57%) were graded as needing improvement at the earliest reasonable opportunity. No departments were graded “Poor” in 2010/11.

Trends in environment, systems, and controls

We have in the past reported trends for each of the three aspects. As the group of departments has changed for 2010/11, with only 34 departments in the group for all of the last three years (2008/09, 2009/10, and 2010/11), we are able to give trend data for only those 34 departments. This is set out in Figures 4 to 6.

Figure 4
Management control environment – grades of the 34 departments graded in all of the three years, 2008/09, 2009/10, and 2010/11

The proportions for 2010/11 differ slightly in Figures 4 to 6 from those in Figure 3 because of the difference in the number of departments when looking at trends for the years from 2008/09 to 2010/11 (34 departments) compared with the number of departments (37) in 2010/11.
6.25 For both the management control environment and the financial information and controls aspects, the performance of the 34 government departments has been mainly in the “Good” or “Very good” range during the last three years. Results for service performance reporting have been less pleasing, but are improving.
Improvements in reporting service performance information

6.26 An improvement in reporting service performance information is apparent in 2010/11. We did not grade any departments as “Poor”, we graded almost half of the departments as “Good” (about 80% more than in 2009/10), and the percentage of those needing improvement had dropped by a quarter (to 53%) between 2009/10 and 2010/11.

6.27 In 2010/11, we applied our revised standard to auditing the service performance information of 19 departments. Pleasingly, none of these departments received modified audit opinions on their service performance information. In Part 9, we discuss our work to help public entities improve their service performance information and reporting.
Part 7

Results of Crown Research Institute audits

7.1 In this Part, we provide background information about Crown Research Institutes (CRIs) and recent changes to their accountability arrangements and performance framework. We also report on the results of our annual audits of CRIs for 2010/11 and our assessments of their management control environment and financial systems and controls.

Background

7.2 CRIs were established in 1992 under the Crown Research Institutes Act 1992. They are Crown entity companies with a primary purpose to carry out research for the benefit of New Zealand.

7.3 CRIs also provide a range of scientific and advisory services. They are expected to work with industry, firms, and other organisations to encourage and support the sharing of new technology and knowledge.

7.4 CRIs receive funding from different sources, including contestable and non-contestable government funds, contracts for services with local and central government agencies, and commercial work. They are expected to maintain their financial viability and their scientific capability.

7.5 There are eight CRIs, listed below with a brief description of their focus:

- AgResearch Limited (AgResearch) – pastoral, agri-food, and agri-technology sectors;
- Industrial Research Limited (IRL) – industrial, chemical, and pharmaceutical manufacturing, and engineering and medical technologies;
- Institute of Environmental Science and Research Limited (ESR) – scientific and research services in public health, food safety, and forensics;
- Institute of Geological and Nuclear Sciences Limited (GNS) – natural hazards, geologically based energy and minerals, industrial and environmental applications of nuclear science;
- Landcare Research New Zealand Limited (Landcare Research) – terrestrial biodiversity and land resources, greenhouse gases, biosecurity, and pest management;
- National Institute of Water and Atmospheric Research Limited (NIWA) – climate and atmosphere, oceans, and marine and freshwater fisheries, systems, and associated resources;
- New Zealand Forest Research Institute Limited (Scion) – forestry, wood products and wood-derived materials, and other biomaterials; and
• New Zealand Institute for Plant and Food Research Limited (Plant & Food Research) – value and productivity of the horticultural, crop, seafood, and food and beverage industries.

7.6 Many CRIs have set up subsidiary companies or joint ventures to develop and exploit intellectual property or carry out commercial activities. As at 30 June 2011, there were 35 public entities controlled or owned by CRIs.

7.7 For the year ended 30 June 2011, the eight CRIs reported combined total revenue of $685 million and total assets of just under $739 million. Together, they employed almost 4000 full-time equivalent staff.

7.8 Figure 7 shows the size of each CRI, with total staff, revenue, assets, and equity as at 30 June 2011.

Figure 7
Total staff, revenue, assets, and equity of each Crown Research Institute, as at 30 June 2011

<table>
<thead>
<tr>
<th>CRI</th>
<th>Total staff</th>
<th>Revenue $million</th>
<th>Total assets $million</th>
<th>Total equity $million</th>
</tr>
</thead>
<tbody>
<tr>
<td>AgResearch</td>
<td>780</td>
<td>158.3</td>
<td>257.6</td>
<td>195.1</td>
</tr>
<tr>
<td>ESR</td>
<td>325</td>
<td>51.8</td>
<td>53.7</td>
<td>35.5</td>
</tr>
<tr>
<td>GNS</td>
<td>370</td>
<td>72.2</td>
<td>47.8</td>
<td>23.4</td>
</tr>
<tr>
<td>IRL</td>
<td>330</td>
<td>63.7</td>
<td>52.2</td>
<td>39.2</td>
</tr>
<tr>
<td>Landcare Research</td>
<td>415</td>
<td>63.8</td>
<td>50.9</td>
<td>27.0</td>
</tr>
<tr>
<td>NIWA</td>
<td>643</td>
<td>117.9</td>
<td>139.8</td>
<td>90.2</td>
</tr>
<tr>
<td>Plant &amp; Food Research</td>
<td>810</td>
<td>113.7</td>
<td>99.0</td>
<td>68.2</td>
</tr>
<tr>
<td>Scion</td>
<td>313</td>
<td>43.7</td>
<td>37.7</td>
<td>25.9</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>3986</strong></td>
<td><strong>685.1</strong></td>
<td><strong>738.7</strong></td>
<td><strong>504.5</strong></td>
</tr>
</tbody>
</table>

Note: Total staff shows the number of full-time equivalent staff. Figures are for CRI Groups and are from the 2010/11 annual reports. Revenue figures include Crown and commercial revenue and other income (such as interest income).

Governance and accountability

7.9 The governance structure for all CRIs is the same: the Shareholding Ministers (the Minister of Finance and the Minister of Science and Innovation) appoint the board of directors (the Board), which is accountable to the Shareholding Ministers for the CRI’s performance.
7.10 CRI boards are required to produce an annual statement of corporate intent, an annual report, and a half-yearly report, all of which must be presented to the House of Representatives by the responsible Minister (currently the Minister of Science and Innovation).

7.11 Since 2008/09, CRIs have been required to hold annual general meetings with shareholding Ministers or their representative, where the Board describes and accounts for its activities during the past year.

7.12 Since 1 February 2011, the Ministry of Science and Innovation (MSI) has been the primary monitoring department for all CRIs, with the Treasury’s Crown Ownership Monitoring Unit (COMU) having a secondary role in monitoring CRIs’ financial performance. Previously, COMU was the primary monitoring department for CRIs.

7.13 In our view, effective monitoring of the CRIs by MSI will enable better identification of, and responses to, risks and opportunities.

Recent changes in the sector

7.14 Science and innovation are important to New Zealand’s economic growth. The two high-level (government priority) outcomes for this sector are growing the economy and building a healthier environment and society.\(^{21}\)

7.15 Several initiatives and changes have been introduced in the past two to three years to increase the benefits of science and innovation for New Zealand. They include:

- implementing a reform programme for CRIs as a result of the recommendations of the Crown Research Institute Taskforce (the Taskforce);
- establishing MSI;\(^{22}\)
- initiatives to support business investment in research and development; and
- a review of the high-value manufacturing and services sector, including a review of the role of IRL.\(^{23}\)

Taskforce reforms

7.16 The Government established the Taskforce in October 2009 to assess how to get the best out of CRIs, including delivering on national priorities and responding better to the needs of research users, industry, and business.

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\(^{22}\) MSI began operation on 1 February 2011, after the integration of the functions of the former Ministry of Research, Science and Technology and Foundation for Research, Science and Technology.

\(^{23}\) Powering Innovation: Improving access to and uptake of R&D in the High Value Manufacturing and Services Sector. The 2011 report was commissioned by MSI. The report’s recommendations include transforming Industrial Research Limited into an advanced technology institute.
In February 2010, the Taskforce published its report, *How to enhance the value of New Zealand’s investment in Crown Research Institutes*. In that report, the Taskforce recommended several changes that were endorsed by the Government in March 2010 and are now being implemented. The Taskforce’s recommendations included:

- making the purpose and strategic role of each CRI more explicit;
- direct funding to help CRIs deliver their core purpose; and
- enhancing CRI governance and accountability.

**More explicit purpose and role of CRIs**

In November 2010, the Government released Statements of Core Purpose (SCPs) to provide greater clarity of the purpose and strategic role of each CRI. They set out the operating principles that describe the way a CRI must conduct itself, and the outcomes for each CRI to focus on in contributing to the well-being and prosperity of New Zealand (the SCP outcomes).

SCPs are public documents that describe the unique purpose of each CRI. They set out which areas a CRI will lead to achieve the SCP outcomes, and the areas a CRI will contribute to that are led by another CRI to achieve its SCP outcomes.

SCPs are expected to be enduring and have a 10- to 15-year life span. They will be reflected in each CRI’s annual statement of corporate intent.

**Funding to achieve their core purpose**

In response to the Taskforce’s recommendations, the Government introduced Core Funding in the 2011 Budget, with a total of about $215 million for 2011/12 (for all eight CRIs). This represents about 28% of the $774 million Vote Science and Innovation. This Core Funding was mainly re-allocated from contestable funds previously awarded to CRIs, with some also from existing non-contestable funds (such as Capability Funding).

Figure 8 shows a breakdown of Core Funding for each CRI for 2011/12.
7.23 Core Funding is non-contestable annual funding that CRIs can expect to continue receiving. The funding is intended to support each CRI to fulfil its core purpose and to contribute to the outcomes set out in its SCP.

7.24 Each CRI’s Board is responsible for deciding how to invest its Core Funding and is accountable for the CRI’s success in fulfilling its core purpose, carrying out its strategy, and achieving its SCP outcomes.

7.25 Core Funding is not the only revenue source that a CRI is expected to use in achieving its SCP outcomes. Nor does each CRI have to spend all of its Core Funding internally – a CRI can invest in another research provider, such as another CRI or a university, to help in achieving its SCP outcomes.

7.26 Each CRI’s reporting from 2011/12 will have a new focus of reporting the CRI’s impacts and progress towards its SCP outcomes.

7.27 Monitoring will also change, to cover financial viability as well as a range of science and innovation indicators.

**A new performance framework**

7.28 The statements of corporate intent for 2011-2016 introduced changes in response to the Taskforce’s report, including:

- an outline of the CRI’s five-year strategy and how that strategy will contribute to the CRI’s SCP outcomes; and

- a performance framework for measuring and assessing progress.

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**Figure 8**

Core Funding for each Crown Research Institute for 2011/12

<table>
<thead>
<tr>
<th>Crown Research Institute</th>
<th>Core Funding $million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Plant &amp; Food Research</td>
<td>43.1</td>
</tr>
<tr>
<td>NIWA</td>
<td>42.9</td>
</tr>
<tr>
<td>AgResearch</td>
<td>38.9</td>
</tr>
<tr>
<td>CNS</td>
<td>27.1</td>
</tr>
<tr>
<td>Landcare Research</td>
<td>24.2</td>
</tr>
<tr>
<td>Scion</td>
<td>17.7</td>
</tr>
<tr>
<td>IRL</td>
<td>13.5</td>
</tr>
<tr>
<td>ESR</td>
<td>7.7</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>215.1</strong></td>
</tr>
</tbody>
</table>
The new performance framework sets out what resources a CRI will use, the activities it will carry out (outputs), the difference it will make (impacts), and its contribution to goals for New Zealand (its and other CRIs’ SCP outcomes).27

The new CRI performance framework is similar to that for government departments under the Public Finance Act 1989 (PFA) and for Crown entities under the Crown Entities Act 2004 (CEA), to report on outputs, impacts, and outcomes.

There are statutory requirements under the PFA and the CEA for the Auditor-General to assess whether the statement of service performance in the annual reports of government departments and Crown entities (excluding school boards of trustees) is accurate and fairly represents the entity’s service performance for the year.

CRIs are Crown entities, but are exempt from the provisions of the CEA that require the Auditor-General to assess service performance information. Instead, under the Crown Research Institutes Act, CRIs are required to report their performance against their statement of corporate intent. During the annual audit, our appointed auditors will check that CRIs meet this statutory obligation.

In 2011/12 and thereafter, CRIs will be reporting more performance information and reporting on their progress towards their SCP outcomes.

We will continue to check that a CRI meets its statutory obligations of reporting against the targets in its statement of corporate intent, including, now, its progress towards achieving its SCP outcomes.

MSI will co-ordinate in-depth reviews of each CRI by an independent panel of New Zealand and international experts at least once every five years. The panel will assess and report on the CRI’s contribution towards achieving its outcomes and company performance.28

Audit results for 2010/11

We issued standard unmodified audit opinions for all eight CRIs for 2010/11.

As part of the annual audits, our appointed auditors assess and grade the management control environment of CRIs and their financial information systems and controls. (As noted earlier, we do not assess the service performance of CRIs.) We report our assessments of each CRI to its management and board, MSI, the Minister of Science and Innovation, and the Treasury. The grading scale is show in Figure 2 in Part 6.

Figure 9 shows a summary of the grades for 2010/11. Our appointed auditors’ assessments for 2010/11 continue to show strong performance by CRIs.

28 Response to 2011/12 Estimates Vote Science and Innovation, Post hearing questions, Question No. 130.
Figure 9
Summary of Crown Research Institutes’ grades for 2010/11

<table>
<thead>
<tr>
<th></th>
<th>Management control environment</th>
<th>Financial information systems and controls</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very good</td>
<td>8</td>
<td>4</td>
</tr>
<tr>
<td>Good</td>
<td>0</td>
<td>4</td>
</tr>
<tr>
<td>Needs improvement</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Poor</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

Management control environment

7.39 We graded all eight CRIs’ management control environments as “Very good” in 2010/11, consistent with 2009/10. This means that our appointed auditors did not recommend any improvements. This is particularly commendable because our appointed auditors can identify different matters for improvement during the course of an audit which, along with a range of other factors, can result in grades fluctuating from year to year.

7.40 Figure 10 shows the grades for the management control environment since 2006/07.

Figure 10
Grades for Crown Research Institutes’ management control environment, 2006/07 to 2010/11
7.41 The grades for CRIs’ management control environments since 2006/07 have all been either “Very good” or “Good”, with a steady improvement to 100% “Very good”. We congratulate the sector on this excellent result.

Financial information systems

7.42 In 2010/11, all eight CRIs were graded as having either “Very good” or “Good” financial information systems and controls. A “Very good” grade means that the appointed auditors did not recommend any improvements. A “Good” grade indicates that we do not have any significant concerns but that the appointed auditor recommended improvements that would be beneficial.

7.43 The grades for CRIs’ financial systems and controls since 2006/07 have all been either “Very good” or “Good”. Four of the eight CRIs were graded as “Very good” in 2010/11 for their financial information systems and controls compared with one in 2009/10. The three CRIs that improved their grades from “Good” in 2009/10 to “Very good” in 2010/11 all responded fully to our 2009/10 recommendations for improvement.

7.44 The other four CRIs, assessed as having “Good” financial information systems and controls in 2010/11, were also all assessed as “Good” in 2009/10. These CRIs responded in part to our recommendations for improvement. The grades and responses to our recommendations for improvement show that CRIs have continued to maintain, and if necessary to improve, their systems and controls.

7.45 Figure 11 shows the grades for CRIs’ financial information systems and controls since 2006/07.
We are very pleased at the significant increase in the number of “Very good” grades this year and congratulate the sector on this improvement.

**Focus for 2011/12 audits**

As discussed above, changes are being implemented that will affect the performance and reporting expectations for CRIs. In 2011/12, CRIs will, for the first time, report on their progress towards achieving their SCP outcomes under the performance framework set out in their 2011-2016 statements of corporate intent.

Next year, we intend to report on the implementation of these changes (as well as reporting our audit findings).
Quality of reporting
Part 8
The financial reporting environment

8.1 In this Part, we comment on:
- changes in New Zealand’s financial reporting environment; and
- some financial reporting challenges.

Changes in New Zealand’s financial reporting environment

8.2 We have expressed concerns in the past about the ongoing suitability of New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) for many entities in the public sector. Our concerns were prompted, in part, by expected changes to NZ IFRS (because of proposed changes to the underlying International Financial Reporting Standards, IFRS) that would make their application by many public sector entities increasingly more difficult. Some of those changes are occurring, although at a slower pace than we expected, and more changes are envisaged.

8.3 The concerns resulted in the then Auditor-General withdrawing staff from the standard-setting process at the end of 2008, and publishing a discussion paper entitled The Auditor-General’s views on setting financial reporting standards for the public sector,29 in June 2009. In the two and a half years since that paper was published, we have seen meaningful debate about the changes needed to set financial reporting standards in New Zealand and change is now under way.

8.4 We hope that by raising concerns we have helped to influence legislative changes to the Financial Reporting Act 1993 about the External Reporting Board (XRB), which was previously the Accounting Standards Review Board (ASRB). Those changes have, with effect from 1 July 2011, resulted in the XRB being given responsibility for both preparing and issuing financial reporting standards, among other responsibilities. The XRB has established two sub-boards including the New Zealand Accounting Standards Board (NZASB), which is tasked with preparing and issuing financial reporting standards.

8.5 We see the changes as a positive step. They position the XRB to make changes to the financial reporting standards to be applied by different types of reporting entities, including all entities in the public sector. As a result of these changes, the Auditor-General has once again made staff available to the new standard-setting process and a staff member has been appointed to the recently formed NZASB.

8.6 The legislative changes require the XRB to draft a strategy for establishing different tiers of financial reporting for different classes of entities, and to submit the strategy for Ministerial approval by 31 March 2012. The purpose of this requirement is to ensure that the financial reporting requirements that apply to different classes of entities are appropriate.

29 Available on our website (www.oag.govt.nz).
8.7 The XRB started consulting on proposals for its draft strategy in September 2011, at which time the XRB published three papers:

- *Accounting Standards Framework for General Purpose Financial Reporting by Public Benefit Entities*, a consultation paper; and
- *Accounting Standards Framework for General Purpose Financial Reporting by For-Profit Entities*, a further consultation paper.

8.8 The position paper sets out the XRB’s view that a multi-standards approach to financial reporting should be adopted in New Zealand because such an approach is likely to best meet the information needs of users of financial statements. We fully support an approach that focuses on the information needs of users.

8.9 The paper explains the process the XRB went through, and the matters it took into account, in forming the view that there should be a multi-standards approach. The view is based on feedback from consultation on a discussion document issued by the ASRB in September 2009 about a proposed new accounting and assurance standards framework for general purpose financial reporting in New Zealand.

8.10 The multi-standards approach sets a broad strategic shape to the new accounting standards framework. However, the NZASB needs to establish what that means at a detailed level to different categories of reporting entity, to ensure an appropriate level of reporting by all entities. The XRB’s two consultation papers set out proposals for different tiers of reporting entities and the broad proposals for the financial reporting requirements for those different tiers. We comment below on the proposals as they relate to entities in the public sector.

**Implications for entities in the public sector**

8.11 The consultation paper about accounting by public benefit entities proposes three tiers. Public benefit entities in the public sector would be allocated to tiers depending on the amount of their operating expenditure and also the nature of their accountability. The operating expenditure thresholds would be:

- tier 1, operating expenditure of more than $30 million;
- tier 2, operating expenditure between $2 million and $30 million; and
- tier 3, operating expenditure of less than $2 million.

8.12 Tier 1 would also include some public benefit entities in the public sector based on the nature of their accountability, regardless of the amount of their operating expenditure. Those entities include leviers of coercive revenue (such as the Crown) and issuers (such as Kiwibank Limited).

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30 See “Accounting Standards Framework Documents Released” on the XRB’s website (www.xrb.govt.nz).
8.13 The financial reporting requirements for public benefit entities would depend on the tier to which an entity was allocated:

- Tier 1 entities would be required to apply a suite of New Zealand public benefit entity (NZ PBE) standards based on International Public Sector Accounting Standards (IPSAS) modified for New Zealand circumstances, together with relevant domestic standards where there is no equivalent IPSAS.
- Tier 2 entities would apply the NZ PBE standards but with reduced disclosure requirements.
- Tier 3 entities would have simple format template reporting.

8.14 The expectation is that all three tiers would measure and recognise transactions consistently. However, there may be some measurement and recognition differences for tier 3 entities.

8.15 The proposed approach is likely to be more suitable than standards based on international financial reporting standards (IFRS). However, those requirements will be significantly influenced by IPSAS, which is a reasonably comprehensive set of standards with a level of underlying complexity and significant disclosure requirements. Therefore, although NZ PBE standards will be more appropriate and some modifications can be made to IPSAS in creating those standards, they will not be a “silver bullet” that will immediately resolve all the concerns that we have previously raised.

8.16 The consultation paper about accounting by for-profit entities proposes only two tiers. Large for-profit entities in the public sector would be in tier 1 and all other for-profit entities in the public sector would be in tier 2. To qualify as large, a for-profit entity in the public sector would need to have revenue of more than $30 million or assets of more than $60 million.

8.17 The financial reporting requirements for those tier 1 entities would be NZ IFRS, which basically consists of IFRS supplemented by relevant domestic standards. Tier 2 entities would apply NZ IFRS but with reduced disclosure requirements.

8.18 We support the long-term strategy to separate the reporting requirements of public benefit entities and for-profit entities. Although there is currently a reasonable alignment between IFRS and IPSAS, they are likely to diverge in future. This is because IFRS are focusing more on the needs of a narrow set of users (essentially investors in international capital markets), whereas IPSAS are focusing on the needs of resource providers (such as taxpayers) and recipients of public goods and services (such as students, hospital patients, and those receiving social welfare payments).
Some financial reporting challenges

8.19 Although the changes in the financial reporting environment are a positive step, there are some significant financial reporting challenges facing the XRB and the NZASB.

Reducing complexity

8.20 Since the introduction of NZ IFRS, most public entities’ financial statements have become larger and more complex with increased disclosures. We continue to question whether the volume of information contained in financial statements properly meets the information needs of those who typically read the financial statements. There remains a real risk that readers are being presented with too much information, which makes it increasingly difficult to “see the wood for the trees”.

8.21 The tier structure will go part of the way to addressing the issue about complexity of information, particularly for smaller entities, given that the NZASB can determine the disclosure requirements for tiers 2 and 3. However, tier 1 entities will still have extensive disclosures as required by IFRS and IPSAS.

8.22 In October 2010, the International Accounting Standards Board (IASB) invited the New Zealand Institute of Chartered Accountants and the Institute of Chartered Accountants of Scotland to carry out a project to review the levels of disclosure requirements in existing IFRS and to recommend deletions and changes to the disclosure requirements. Those Institutes issued a report in July 2011 entitled Losing the excess baggage – reducing the disclosures in financial statements to what’s important.31 The report recommended deleting specific requirements and enhancing the use of materiality in financial reporting disclosures.

8.23 If disclosure requirements were reduced in line with the recommendations in the July 2011 report, financial statements prepared in keeping with IFRS could be reduced by up to 30% without losing important information for users. In our view, that would be a positive step. We consider that if changes were made to reduce the level of disclosure requirements in IFRS, it would be difficult for the International Public Sector Accounting Standards Board (IPSASB) not to make a similar level of reduction to the disclosure requirements of IPSAS. Any changes to IFRS and IPSAS would be expected to be reflected in New Zealand standards in due course.

31 Available on the website of the New Zealand Institute of Chartered Accountants (www.nzica.com).
Conceptual frameworks for financial reporting in the public sector

8.24 There are currently conceptual frameworks for both for-profit entities and public benefit entities in New Zealand. However, the New Zealand framework for for-profit entities developed by the IASB is more than 20 years old, and the New Zealand framework for public benefit entities is based on the IASB private sector framework and includes only a few changes that focus on the public sector.

8.25 Conceptual frameworks are important because they provide a high-level “roadmap” to standard setters, and a point of reference to preparers and auditors of financial statements for transactions not addressed by a particular standard.

8.26 The IASB is currently working on changing its conceptual framework to one that is more narrowly focused on the needs of those people accessing international capital markets. This is a long-term project that has been under way for several years already.

8.27 During the last few years, the IPSASB has also been working on its first conceptual framework for public benefit entities in the public sector. The work that the IPSASB is doing does consider the work being done by the IASB but is not constrained by it. That work already looks to be focused on the needs of both resource providers (such as taxpayers) and recipients of public goods and services (such as students, hospital patients, and those receiving social welfare payments).

8.28 In our view, both conceptual framework projects are important to New Zealand. The NZASB has a role in appropriately influencing the work being done internationally. Also, as changes are made to conceptual frameworks, it will be important to the New Zealand public sector that the NZASB considers the interaction between the conceptual frameworks, given the public sector includes both for-profit entities and public benefit entities.

Standards for reporting non-financial performance information

8.29 On many occasions, we have commented about how crucial non-financial performance information is to the accountability of many entities in the public sector. Also, we have noted that such information needs to work in conjunction with financial information to convey a coherent and understandable picture about the performance of entities.

8.30 Currently within NZ IFRS, there are only a few paragraphs that deal with statements of service performance, which is a particular form of reporting on non-financial performance information. Supplementing those paragraphs is a document entitled: Technical Practice Aid No. 9: Service Performance Reporting (TPA-9). TPA-9 contains application guidance based on practice at the time the
Part 8 The financial reporting environment

material was first published in 2002. However, it is arguably too detailed and not sufficiently focused on the main principles of what constitutes good reporting of non-financial performance information.

8.31 In our view, it is important that the NZASB develops an appropriate standard for the preparation of non-financial performance information because of the need for that information to integrate with financial information and present a complete performance picture.

**Determining which entities combine to form a group**

8.32 The issue of which entities combine to form a group is important in the public sector. Group financial statements affect the transparency of reporting and accountability, because they show the combined resources, and use of resources, by a “parent” entity.

8.33 “Control” is the accounting concept used to determine which entities are combined to form a group. Current financial reporting standards provide a lot of guidance about what “control” is in a financial reporting sense. This guidance focuses on the underlying substance of arrangements, not on the meaning of the word “control”.

8.34 Notwithstanding the guidance provided in current financial reporting standards, assessing whether an entity controls another in the public sector can be difficult. This is particularly so for entities with no formal ownership instruments such as trusts. Determining whether entities such as trusts are “controlled” for financial reporting purposes remains a challenging area that would benefit from greater clarity.

8.35 In our view, the NZASB needs to clarify what control means for entities with no formal ownership instruments. We consider it important that the entities combined to form a group continue to focus on the substance of arrangements and present useful information to readers.
Part 9
Improving service performance reporting

9.1 In this Part, we discuss our work to help public entities improve their performance information and reporting. We note how the Auditor-General’s revised auditing standard has contributed to improving performance reporting and review our recent work in this area. Our efforts will continue as more public entities will be subject to the revised auditing standard in 2011/12 and 2012/13.

Why performance information and reporting is important

9.2 Performance reporting is an integral part of our parliamentary accountability system, enabling Parliament to hold Ministers and central government entities to account. Parliament is required to make decisions about the funds to be voted through the annual Budget process and to review the performance of the entities that have used those funds.

9.3 Accountability documents such as the annual report and the Statement of Intent (SOI) help ensure that government departments and Crown entities can be held to account by Parliament and the public. Parliament and the public rely on accountability documents to assess the performance of public entities and how effectively they use public funds.

9.4 Performance reports are an essential part of accountability documents. We consider that improving performance information and reporting is crucial in helping to improve the effectiveness and efficiency of public sector entities and to show accountability for their performance. The Auditor-General is keen to see continued improvement in this area.

9.5 If public entities are clear on why they exist, what changes they are seeking to influence, and how their services contribute to those desired changes, then they can build a sound framework for planning, measuring, managing, and reporting their performance. When public entities have good performance systems for running their organisations and making informed decisions, they should more easily produce external accountability reports that are relevant and reliable and in keeping with legislation and generally accepted accounting practice.

Issues about the quality of performance reporting

9.6 In the past several years, we have reported our view that the quality of performance reporting has needed to improve. Until recently, we have observed that in central government, entities have had major deficiencies in their performance reporting, including failures to:

• clearly explain what they are trying to achieve;
• clearly explain the services they are accountable for providing;
Part 9 Improving service performance reporting

- present a framework that illustrates the cause-and-effect relationships and assumptions underpinning the spending of taxpayer funds on public services to achieve public benefit;
- report targets and results through a well-rounded suite of appropriate performance measures; and
- report externally in a way that is integrated with the information they use to manage their business.

9.7 We have continued to work with entities and with central agencies to help ensure that the above issues are addressed.

9.8 Now, after witnessing minimal improvement in the 20 years since the Public Finance Act 1989 was enacted, we have begun to see, in the last two years, government departments and Crown entities improve the quality of their performance reports.

**Phasing in our revised auditing standard**

9.9 We are phasing in a revised standard for auditing service performance reports. Our revised standard requires our auditors to modify their audit opinion if the performance information in the annual report does not, in their opinion, fairly reflect performance for the year. Under the previous auditing standard, there was very little scope for appointed auditors to modify their audit opinion if the content of the performance report was inadequate.

9.10 Before implementing our revised auditing standard, we have endeavoured to prompt and help public entities raise the standard of their performance reporting through our support initiatives, combined with regular evaluation and feedback to entities from appointed auditors. We provided advance notice about the new auditing standard to allow time and to provide support to entities to upskill and improve their performance information and reporting. During this period, we placed greater emphasis on performance information in the audit, provided clear signals and specific advice to entities about continual improvement in this area, and provided guidance and other support to help them meet the challenge. We have supported public entities by carrying out document reviews, one-on-one conversations, various guidance and advice, seminars, workshops, and other forms of support to help them improve their performance information and reporting.

9.11 To help make the improvement programme manageable and to provide a concentrated effort on our support initiatives, we phased in the application of the standard: 28 larger and more complex departments and Crown entities were audited under the revised standard for 2010/11. We will apply the revised standard in our audits of another group of entities for 2011/12, and the rest of the entities in 2012/13.
Audit reports for 2010/11

9.12 All entities being audited under the revised standard reported sufficiently well in their 2010/11 annual reports that we issued an unmodified audit opinion for each entity. A pleasing result indeed.

9.13 In Figure 12, we list the departments and Crown entities that were audited under the revised auditing standard for 2010/11.

**Figure 12**

Entities audited under the revised auditing standard for 2010/11

<table>
<thead>
<tr>
<th>Government departments</th>
<th>Crown entities</th>
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<tbody>
<tr>
<td>Department of Conservation</td>
<td>Accident Compensation Corporation</td>
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<tr>
<td>Department of Corrections</td>
<td>Housing New Zealand Corporation</td>
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<tr>
<td>Department of Labour</td>
<td>Legal Services Agency</td>
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<tr>
<td>Inland Revenue Department</td>
<td>New Zealand Fire Service Commission</td>
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<td>Land Information New Zealand</td>
<td>New Zealand Lotteries Commission</td>
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<tr>
<td>Ministry of Agriculture and Forestry</td>
<td>New Zealand Trade and Enterprise</td>
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<td>Ministry of Economic Development</td>
<td>New Zealand Transport Agency</td>
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<td>Ministry of Education</td>
<td>Public Trust</td>
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<tr>
<td>Ministry for the Environment</td>
<td>Tertiary Education Commission</td>
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<td>Ministry of Fisheries</td>
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<tr>
<td>Ministry of Foreign Affairs and Trade</td>
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<td>Ministry of Health</td>
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<td>Ministry of Justice</td>
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<td>Ministry of Social Development</td>
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<td>New Zealand Customs Service</td>
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<td>New Zealand Defence Force</td>
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<td>New Zealand Police</td>
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<td>Te Puni Kōkiri</td>
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<tr>
<td>The Treasury</td>
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</table>

9.14 During the last year, our appointed auditors maintained contact with these entities, offered advice on critical deficiencies, monitored progress, and reviewed draft performance frameworks and accountability documents. Entities have responded well and have made significant improvements to their performance frameworks, choice of performance measures, and presentation of those frameworks and measures in their annual reports.
9.15 One year ago, we estimated that 15 of these entities appeared to be at risk of receiving a modified audit opinion if they did not make significant improvements to their performance reporting in 2011. As improvements appeared to be taking effect in several entities, we were able to refocus our attention during the year from the 15 entities initially identified as problematic to only eight “at risk” entities, which we monitored closely in the period leading up to the production of their annual reports. Since then, entities have made considerable effort to improve performance measurement systems and reports.

Assessing the quality of performance reporting
9.16 As well as attesting to an entity’s service performance in their audit reports, our appointed auditors also provide advice to entities on where improvements are needed, together with a grade for service performance information and its associated systems and controls (see Part 6).

9.17 The grade for the service performance aspect can be either “Poor”, “Needs improvement”, “Good”, or “Very good”. (See Figure 2, Part 6, for explanations of these grades.)

9.18 There has been a marked improvement overall in the quality of performance reports of those entities being audited under the revised standard. During the last three years, since we have been issuing grades for service performance reporting, the number of these entities graded as “Good” has nearly trebled, and those graded as “Poor” or “Needs improvement” have halved. In the last year alone, more than one-third of these entities have improved their performance reporting grade. Some entities have also told us that they are finding the performance reporting discipline useful for internal management and decision-making purposes.

9.19 Our grade data indicate a clear improvement in the quality of performance reporting, although there remains much room for further improvement by several entities. While the signs of improvement are heartening, it appears that some entities are working on improving their SOIs and annual reports as external reports without, or before, giving attention to the performance objectives relating to their business strategy and operations. We expect public entities to measure and report performance first and foremost for strategic and operational management decision-making purposes, that is, for internal use. Ideally, external accountability documents should be derived from a robust internal performance management system. However, in some instances, the discipline being applied to the external reports is driving greater scrutiny of the entities’ internal performance management frameworks, rather than the other way around.
9.20 As part of our audits, we continue to probe into whether the performance measures in the SOI and annual report are relevant to the internal management of the entity.

9.21 Figure 13 shows the spread of grades for 26 of the original 28 entities (listed in Figure 12) since 2008/09, when we began issuing grades for service performance information and associated systems and controls. The graph tells a clear story: in the three years leading up to applying our revised auditing standard to these government departments and Crown entities:

- no entity has remained in the “Poor” category;
- the number of entities in the “Needs improvement” category has nearly halved;
- the number of entities whose service performance reports are considered “Good” has nearly trebled (and almost doubled in just the last year, with eight entities moving from “Needs improvement” to “Good” in 2011); and
- no entity has yet reached the level of “Very good”. (When an entity receives a “Very good” grade, it means that our appointed auditors cannot recommend any further cost-beneficial improvement.)

**Figure 13**
*Trends from 2008/09 to 2010/11 in service performance grades for 26 of the 28 entities that were audited under the revised auditing standard in 2010/11*

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32 Two of the entities that we audited under the revised standard were disestablished in 2010/11 and therefore were not issued with grades.

33 One entity moved from “Good” to “Needs improvement”.
9.22 It is encouraging to see the extent of the improvement this year, which is possibly understated by the graph because several of those entities whose grades remained the same as last year have improved the standard of their reporting within the same grade band.

9.23 For an overview of the grades of all government departments, see Part 6.

**Recent work and future intentions**

**Previous years**

9.24 Since 2007, and in the lead-up to applying the revised auditing standard, we have been helping public entities improve the quality of their performance reporting. Our work programme has included:

- forums with entities, in which we outlined issues and our expectations regarding the preparation of performance reports; and
- intensive evaluation of accountability documents to provide feedback and advice to entities on the quality of performance reports.

9.25 In 2008, we issued a discussion paper, *The Auditor-General's observations on the quality of performance reporting*,\(^{34}\) to explain the Auditor-General’s expectations and to report on our assessment of the current state of performance reporting.

9.26 In 2008/09, after several years of providing feedback and guidance to entities, appointed auditors began issuing grades for service performance information and associated systems and controls to provide a high-level indicator to entities and to Parliament of our assessment of the quality of performance reports. In 2009, we issued another discussion paper, *Statements of intent: Examples of reporting practice*,\(^{35}\) to share with entities some examples of better practice that we thought might help to improve performance reporting.

9.27 In 2009/10, in partnership with the Treasury, we ran a series of workshops for government departments and Crown entities to:

- identify issues and problems with performance reporting; and
- identify themes that might help us in solving problems and overcoming barriers.

9.28 Along with the Treasury, we also spent time providing one-on-one support and advice to the 28 entities in the first group to which our revised auditing standard was to apply, to help them with their improvement focus ahead of applying the standard.

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\(^{34}\) Available on our website (www.oag.govt.nz).

\(^{35}\) Available on our website (www.oag.govt.nz).
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Initiatives and observations during 2010/11

9.29 During 2010/11, we continued to provide workshops that reinforced our messages, explored further some of the barriers to good performance reporting, and explored suggestions for how those responsible for performance planning, measuring, and reporting could further improve the quality of their performance frameworks, systems, and reports.

9.30 While appointed auditors gave a concentrated effort to advising the larger entities on what was needed to ensure adequate performance reporting in their 2010/11 annual reports, we dedicated other staff resources to providing one-on-one assistance to a second group of entities to which we will apply our revised auditing standard in 2011/12.

9.31 We issued two general publications in 2010/11: Central government: Case studies in reporting forecast performance information\(^{36}\) (February 2011) and Central government: Cost-effectiveness and improving annual reports\(^{37}\) (June 2011) to stimulate thinking and discussion about preparing and using performance information. We also issued specific guidance to the health sector: District Health Boards: Learning from 2010-2013 Statements of Intent\(^{38}\).

9.32 We have received feedback that suggests positive changes are taking place in central government entities regarding the measuring and reporting of performance. There appears to be a greater acceptance than there was a couple of years ago of the need for, and value of, robust reporting of performance, both internally and externally. It appears that greater improvement has taken place in those entities where commitment has come from the top. We have received several comments from chief executives and senior management on the value of performance reports, including comments that improving the performance framework for external accountability documents has helped improve internal performance planning, management, and communication.

9.33 Although public entities appear to more readily accept the need to measure and report their performance in non-financial terms, many advise us that they still find the task difficult. We hope our continuing work programme of support and advice will go some way toward helping these entities to overcome the difficulties in developing robust performance frameworks.

9.34 We also note that government departments and Crown entities are quite keen to explore the possibilities for sector-wide performance reporting, particularly for reporting progress towards the higher-level outcomes. Several sectors have begun developing sector outcomes frameworks that are aimed at providing a common

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36 Available on our website (www.oag.govt.nz).
37 Available on our website (www.oag.govt.nz).
38 Available on our website (www.oag.govt.nz).
framework for entities within a sector for reporting at the outcome level and reducing duplication of effort. See Part 10 for further discussion of this approach to reporting.

Future intentions

9.35 In 2012, our appointed auditors will concentrate efforts on monitoring the progress of the second group of entities to which we will apply our revised auditing standard as they prepare their 2011/12 annual reports.

9.36 We have begun a series of workshops to support the third group of entities to improve their performance information frameworks, systems, and reports as they prepare their 2012–2015 SOIs, which they will report against in 2012/13. We have also begun a pilot initiative to help this third group of entities establish a community of practice, including a website for sharing documents, providing tools, discussing issues, and providing advice.

9.37 We will follow up these support efforts in 2012/13 as our appointed auditors closely monitor the progress of the third group of entities, ahead of applying the revised auditing standard to their audits in 2013.
Part 10
Where to next with reporting on financial and non-financial performance?

10.1 In this Part, we bring together our overall views on the reporting requirements for financial and non-financial performance information. We acknowledge both the progress that has been made to raise the quality of this information, and the challenges that public entities face. We then look to the future and suggest some ideas about possible direction for the future evolution of these reporting requirements.

The governance and accountability framework

10.2 At the heart of our system of government are some simple propositions:
- Parliament authorises the Crown (the Government) to spend public funds;
- the Ministers who make up the Government are responsible for how those funds are used; and
- the Government has to account back to Parliament, through Ministers, for the funds it has spent and what it has achieved with them.

10.3 These propositions are part of the foundations of the Westminster system of representative and responsible government and ensure parliamentary control of government spending.

10.4 The Auditor-General’s job in this system is to give Parliament independent assurance that the information the Government is reporting back to Parliament gives a fair and reasonably accurate picture of what has been spent and achieved. Parliament and the public are then able to use that information to hold the Government to account for its performance.

10.5 This very simple description of the accountability system for central government shows that, in principle, financial and non-financial performance are intertwined. The legislation setting out the detail of the accountability requirements requires public entities to produce two sets of information: financial statements and separate statements of service performance.

10.6 Both sets of information are needed for meaningful accountability. They are also both needed for effective governance and management of organisations, and for those leading an organisation to drive ongoing improvements in performance. Neither an organisation nor those assessing it can make any meaningful judgement on value for money or cost-effectiveness if they cannot put information on what is being done or achieved together with information on what it costs.
Part 10 Where to next with reporting on financial and non-financial performance?

10.7 The Public Finance Act 1989 ushered in significant improvements in the quality of the financial information being produced and reported across central government. It introduced the disciplines of accrual accounting and financial statements prepared in accordance with generally accepted accounting practice (GAAP) to the central government sector. However, the way in which GAAP has evolved since 1989 has created new challenges for the reporting of financial information.

10.8 Improving the quality of information about non-financial performance has been more difficult. The requirements on the information that central government entities must produce and report were strengthened in 2004, with the passage of the Crown Entities Act 2004 and related amendments to the Public Finance Act. Central government entities must report in reasonable detail on their non-financial performance, the reports must be prepared in accordance with GAAP, and they must be audited. In recent years, this Office has worked hard to help public entities to produce information that meets those requirements and is meaningful.\(^3\) There has been good progress in many parts of central and local government, but we know that it has not been easy for many public entities.

Problems with the current requirements

Reporting on financial performance

10.9 Since 2007, the requirement to prepare financial statements in accordance with GAAP has meant that most public sector entities have had to use standards based on the International Financial Reporting Standards (NZ IFRS).

10.10 Our views on this financial reporting environment are reasonably well known, because in 2009, the then Auditor-General reported to Parliament his concerns about the application of these standards to public sector entities.\(^4\) He was concerned that these standards had been developed for application by large profit-oriented entities accessing capital markets, that they were not being changed enough before being applied in the very different context of relatively small public sector entities, and that the way in which the standards were likely to develop would make them even less suitable. The practical result was that the standards were likely to become increasingly difficult to apply and were leading to long financial statements with information of questionable relevance to users.

\(^3\) See, for example, The Auditor-General's observations on the quality of performance reporting (2008) and Central government: Case studies in reporting forecast performance information (2011), which are available on our website (www.oag.govt.nz).

\(^4\) Controller and Auditor-General (2009), The Auditor-General's views on setting financial reporting standards for the public sector, which is available on our website (www.oag.govt.nz).
10.11 Developments since then mean that the environment is now quite different. Part 8 discusses in more detail the changes now under way in the financial reporting environment. In summary:

- the newly established External Reporting Board (XRB) has been given responsibility for developing and approving the standards;
- the XRB has decided to develop separate standards for entities depending on whether they are for-profit or public benefit entities, to better meet the different needs of the users of their financial statements;
- the new standards for public benefit entities will be based on the work of the International Public Sector Accounting Standards Board (IPSASB); and
- the new framework is likely to define three different tiers of public benefit entities (based on size) and tailor the requirements to fit each tier.

10.12 Separately, we have also recently participated in a working group with accounting colleagues from New Zealand and Scotland in a collaborative project for the International Accounting Standards Board (IASB) to consider whether mandatory disclosure should be reduced to allow more meaningful financial reporting. In July 2011, a report was published: *Losing the excess baggage – reducing the disclosures in financial statements to what’s important*.41

10.13 Broadly, the working group’s recommendations are to have disclosures for only the most important information and to give greater emphasis to materiality. Consequently, the report recommends removing a large number of currently mandatory disclosures. The increased emphasis on materiality will require greater judgement to be exercised by all involved in the financial reporting process. The working group thinks that annual financial statements could be reduced by about a third as a result of what it proposes.

10.14 It is too soon to say if this report will produce any change in the international approach. But it does show that there is scope to make financial reporting simpler and more meaningful.

10.15 We intend to continue to work, domestically and internationally, to encourage thinking on how to reduce the cost and complexity involved in preparing (and auditing) financial statements, at the same time as providing better information for users.

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41 Available on the website of the New Zealand Institute of Chartered Accountants (www.nzica.com).
Reporting on non-financial performance

10.16 On non-financial performance reporting, our concerns have been different. Legislative requirements to report on non-financial performance have existed for many years, but for a long time they were regarded by many in the sector as largely a compliance exercise, with little or no value.

10.17 Yet, any well-run organisation should have a sense of its purpose, what it is achieving, how well it is performing, and what improvements it needs to be aiming for. These matters are basic to an organisation’s management of its own performance, and should also be able to provide the basis for some meaningful accountability to Parliament.

10.18 The state sector management reforms of 2004 (the Crown Entities Act 2004 and the amendments to the Public Finance Act) created a more detailed and comprehensive set of legislative requirements for central government agencies to report non-financial performance information.

10.19 Therefore, we began to focus on what we, as auditors of the information, could reasonably expect to see based on these statutory requirements. So far as possible, we have worked with the Treasury and the State Services Commission to ensure that our expectations were reasonable and to support agencies as they worked to improve the quality of their monitoring and reporting of performance. Through our auditing work, we have worked progressively with public entities to help them develop and use appropriate information on their own performance, rather than regarding this as a mechanical compliance exercise.

10.20 Some entities are now telling us that they are beginning to reap the benefits of the work they have put in (see paragraph 9.18). But there is no question that many agencies have found it difficult to meet these requirements and to report simple and meaningful information.

Possible directions for future thinking

10.21 All of the work described has taken place within the existing legislative framework and government policy settings. But our practical experience with entities across the public sector suggests that there is scope to consider whether changes to the system might enable more valuable information to be provided at a reduced cost. The remainder of this Part presents some ideas that we consider should be explored. Our view is that although central government entities are improving their reporting of both financial and non-financial information, there is room for improvement and it makes sense to seek better effectiveness and efficiency not just at the entity level, but also across the central government sector.
A more collective approach to reporting?

10.22 The Public Finance Act requires each individual entity in central government to report on its non-financial performance in relation to each output, each year. However, in practice, the governance and activity of executive government is a more collective, strategic, and long-term business. Under the direction of the collective Cabinet, government departments work together in a range of different ways to achieve results that vary from the short-term delivery of services to the long-term achievement of broader changes.

10.23 The result is that governance and accountability can become disconnected in an unhelpful way. This disconnect becomes obvious in the challenges that longer-term and whole-of-government initiatives are creating for the system. For example:

- the individual entity focus of the current funding and accountability system does not make it easy for central government to explore more collaborative ways of working or initiatives such as shared services; and
- the current efforts to develop longer-term budget plans and strategies have also been hampered by the current requirements for detailed annual forecasting and reporting.

10.24 It is not easy to combine the existing appropriation and reporting requirements, which are annual and based on individual entities, with the more collective and longer-term governance needs of the sector.

Changing the “one size fits all” requirements?

10.25 The current legislation also has a “one size fits all” approach – generic requirements for comprehensive reporting on financial and non-financial performance for most central government entities. Yet, the entities vary widely in their size and responsibilities. Our experience with entities suggests that there could be benefit in considering a more tailored approach.

10.26 As noted, the XRB is already considering how it might tailor reporting requirements for different tiers of entities, through the reporting standards that it is developing. This approach will affect the standards for financial and non-financial performance reporting. This work should go some way towards getting a better fit between the entity and the reporting requirements.

10.27 In particular, we note that at present the legislation specifies in some detail how all entities should go about reporting on their non-financial performance, irrespective of size. This prescriptive approach risks becoming a barrier to progress. It may be useful to look at the legislative requirements alongside the work on standards, to see what changes might be needed to support sensible progress.
10.28 Once you depart from a standard approach, there are many possible variations. There may be scope to tailor requirements beyond the size-based tiers that the XRB will be working with. For example, it might be possible to distinguish between the major policy and strategic agencies that most logically monitor and report on high-level sectoral outcomes, and agencies with more practical and task-focused responsibilities. The latter might be better to report simply on how well they achieve their part of the picture. For example, the Ministry of Health is arguably better placed to report on overall health outcomes than the Blood Service, or even individual district health boards. At present, all of these entities are required to report on the outputs, objectives, and outcomes they contribute to.

Who should be reporting on what?

10.29 These first two points, about the reporting entity and what must be reported, combine to suggest that it would be useful to think about the levels and nature of accountability information at a whole-of-government level. In our view, a helpful starting point is to ask which parts of the machinery of central government are best placed to tell which parts of “the performance story”, and how. Standing back and thinking about the central government sector as a whole, there may be smarter ways of getting better and more meaningful information reported.

10.30 For example, a regular comprehensive report on the state of the environment or on social indicators may be sufficient as a form of outcomes reporting for a whole sector or area of activity involving different agencies. The reporting on some outcomes may not need to be tied to a particular agency or type of agency.

10.31 In the financial area, there may also be scope for some rationalisation of requirements. For example, sometimes legislation requires separate individual and group reports to be prepared when public entities have subsidiaries, and sometimes it enables the entities to report simply at the group level. From an accountability perspective, it may be possible to simplify and standardise some of these reporting requirements.

Developing simpler and more flexible requirements

10.32 The 2004 amendments to the Public Finance Act introduced a level of prescription and analytical complexity that the original Act had largely avoided. It may be time to reconsider the balance between principle and prescription. The three points just discussed show that there might be benefit in introducing a greater level of flexibility in how to achieve the reporting goals for the Executive as a whole.
Start with the information needed for effective management and governance

10.33 In most organisational contexts, the practical focus is on the information gathering, monitoring, and reporting systems needed to support effective management and governance of the organisation. Those systems provide the information the organisation needs to manage and drive its own performance and efficiency. They will usually involve a combination of financial and performance information that helps give management a picture of what they are delivering and whether they are doing it efficiently. That information will then usually provide the basis for preparing the information needed for external reporting and accountability purposes.

10.34 However, sometimes the reverse happens in the central government context. Systems are established over time to generate financial and non-financial information for external accountability purposes and that information is then also used to manage the organisation. Entities may not adequately consider whether that is the most useful information or is sufficient for the purpose of managing the organisation and its performance.

10.35 Other work we have under way suggests that many public entities are good at generating information and putting financial controls in place but they fall down when trying to manage value.

Conclusion

10.36 We do see examples where public entities are working well with the current requirements. Usually, this is when an entity has a clear sense of its strategic purpose and has developed effective systems for managing and monitoring its own performance in terms of both effectiveness and efficiency. When this is in place, the external accountability information largely falls out of the information the organisation generates for its own purposes, and accountability needs are not hard to meet.

10.37 At present, the difficulty that many public entities experience often arises because they do not have the underlying strategic clarity and governance systems (or capability). In some instances, the right response will be that the entity should develop this clarity and capability, because it is necessary and important for its role. But in other instances, it may be that the current requirements are not a good match with the organisation. This prompts a question about whether the requirements could be made simpler and more fit for purpose.
10.38 We are discussing these issues with the Treasury and the State Services Commission. These departments are working on related aspects of public sector management through the Better Public Services project that the Government began in May 2011.
Appendix
Details of the non-standard audit reports issued in 2011

Adverse opinions

Royal New Zealand Navy Museum Trust Incorporated
Financial statements year ended: 30 June 2010
We disagreed with the Trustees not recognising the museum collection assets of the Trust, nor the associated depreciation expense, in the Trust’s financial statements. These are departures from Financial Reporting Standard No. 3: Accounting for Property, Plant and Equipment, which requires museum collection assets not previously recognised to be recognised at fair value and depreciated where appropriate.

RNZAF Museum Trust Board
Financial statements year ended: 30 June 2011
We disagreed with the Trustees not recognising the museum collection assets of the Trust, nor the associated depreciation expense, in the Trust’s financial statements. These are departures from Financial Reporting Standard No. 3: Accounting for Property, Plant and Equipment, which requires museum collection assets not previously recognised to be recognised at fair value and depreciated where appropriate.

Qualified opinions

Southern District Health Board*
Financial statements and statement of service performance for the two months ended: 30 June 2010
Our audit was limited because the district health board did not prepare a statement of forecast service performance for the two-month period ended 30 June 2010 and, therefore, was unable to prepare performance information that reflected the standards of delivery performance achieved and the actual revenue earned and output expenses incurred.

Ngati Whakue Education Endowment Trust Board
Financial statements years ended: 31 December 2009 and 31 December 2010
Our audit was limited because we were unable to confirm the value of the Trust Board’s land that was classified as investment property. The land had not been revalued but instead was recognised at its rating value. This is a departure from Statement of Standard Accounting Practice No 17: Accounting for Investment Properties and Properties Intended for Sale (SSAP-17), which requires the investment property to be revalued annually to net current value.

Counties Manukau District Health Board
Financial statements and statement of service performance year ended: 30 June 2010
Our audit was limited because the district health board recognised some funding from the Ministry of Health which should have been recognised as revenue in the year ended 30 June 2009. These amounts did not meet the requirements under the New Zealand Framework for the Preparation and Presentation of Financial Statements for recognition as a liability. As a result, revenue and the surplus for the year ended 30 June 2010 were overstated and current liabilities and equity were understated.

* Southern District Health Board was formed on 1 May 2010 after the merger of Otago District Health Board and Southland District Health Board.
<table>
<thead>
<tr>
<th>Trust Board/Institute</th>
<th>Financial Years</th>
<th>Audit Limitations</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Tauranga Moana Māori Trust Board</strong></td>
<td></td>
<td>Our audit was limited because we were unable to obtain sufficient evidence to confirm the financial information for the comparative year that related to the Trust Board’s interest in a joint venture due to the joint venture not being audited in that year.</td>
</tr>
<tr>
<td><strong>New Zealand Māori Arts and Craft Institute</strong></td>
<td></td>
<td>Our audit was limited because we were unable to obtain sufficient assurance over the completeness of revenue due to limited controls over that revenue and because two former employees had been charged with theft of admission receipts.</td>
</tr>
<tr>
<td><strong>New Zealand Post Recycle Centre Limited (New Zealand Post Limited)</strong></td>
<td></td>
<td>Our audit was limited because we were unable to obtain sufficient assurance over the completeness of revenue because of limited controls over that revenue.</td>
</tr>
<tr>
<td><strong>Wilson Home Trust (Waitemata District Health Board)</strong></td>
<td></td>
<td>Our audit was limited because we were unable to obtain sufficient assurance over the completeness of revenue because of limited controls over that revenue.</td>
</tr>
<tr>
<td><strong>Auckland DHB Charitable Trust (Auckland District Health Board)</strong></td>
<td></td>
<td>Our audit was limited because we were unable to obtain sufficient assurance over the completeness of revenue because of limited controls over that revenue.</td>
</tr>
<tr>
<td><strong>Three Harbours Health Foundation (Waitemata District Health Board)</strong></td>
<td></td>
<td>Our audit was limited because we were unable to obtain sufficient enough assurance over the completeness of revenue because of limited controls over that revenue.</td>
</tr>
<tr>
<td><strong>Gisborne Laundry Services (Tairawhiti District Health Board)</strong></td>
<td></td>
<td>Our audit was limited because we were unable to obtain sufficient enough assurance over the completeness of revenue because of limited controls over that revenue.</td>
</tr>
<tr>
<td><strong>The Māori Trustee and Group</strong></td>
<td></td>
<td>Our audit was limited because we were unable to obtain sufficient assurance over the Group financial statements because the financial information of the associate, Miraka Limited, had not been audited.</td>
</tr>
</tbody>
</table>
“Emphasis of matter” paragraphs

**Financial Statements of the Government of New Zealand**

*Financial statements year ended: 30 June 2011*

We drew attention to the disclosures in the financial statements about the effects of the Canterbury earthquakes. In particular, we drew attention to the disclosures about:

- the uncertainties involved in estimating the Earthquake Commission’s and AMI Insurance’s outstanding claims liabilities and reinsurance receivables;
- the uncertainties involved in estimating the provision resulting from the Government’s offer to purchase properties in the Canterbury residential red zone; and
- the uncertainty associated with the Government’s share of costs for restoring local authority infrastructure damaged by the earthquakes.

**The Earthquake Commission**

*Financial statements and statement of service performance year ended: 30 June 2011*

We drew readers’ attention to the disclosures in the financial statements outlining the uncertainties associated with the outstanding claims liability and reinsurance receivables because of the Canterbury earthquakes. We also drew readers’ attention to the disclosures in the financial statements outlining that they were appropriately prepared on a going concern basis because the Crown, under section 16 of the Earthquake Commission Act 1993, is obliged to grant or advance sufficient sums to meet any current or future deficiencies.

**AMI Insurance Limited and Group**

*Financial statements year ended: 30 June 2011*

We drew attention to the disclosures in the financial statements about how the Canterbury earthquakes have affected the outstanding claim liability and related reinsurance receivables. The disclosures describe the inherent uncertainties involved in estimating those amounts using actuarial assumptions.

**Canterbury Earthquake Recovery Authority**

*Statements of appropriations for the period ended: 30 June 2011*

We drew readers’ attention to the disclosures in the statements of appropriations about the provision resulting from the Government’s offer to purchase properties in the Canterbury residential red zone. The disclosures describe the significance of the amounts and inherent uncertainties involved in estimating the provision using actuarial assumptions.

**Department of Internal Affairs**

*Financial statements, statement of service performance, and schedules of non-departmental activities year ended: 30 June 2011*

We drew attention to the disclosures in the non-departmental schedules about emergency expenditure incurred by the Department on behalf of the Government. The emergency expenditure was for costs in response to the Canterbury earthquakes and a small amount of the costs for restoration of local authority infrastructure damaged by the earthquakes. We also drew attention to the disclosure about the unquantifiable remaining restoration costs for infrastructure that could not be reliably estimated because of the high level of uncertainty about those costs.
<table>
<thead>
<tr>
<th>Company</th>
<th>Financial Statements and Performance Information</th>
<th>Year Ended</th>
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</thead>
<tbody>
<tr>
<td><strong>Public Trust and Group</strong></td>
<td>Financial statements and non-financial performance information</td>
<td>30 June 2011</td>
</tr>
<tr>
<td></td>
<td>We drew readers’ attention to the disclosures in the financial statements about the value of unlisted mortgage-backed securities of $24.6 million for which there was not an active liquid market and for which no quoted price was available. Although the fair value of these investments was based on the best available information, in the absence of an active liquid market and quoted market prices, a high degree of uncertainty existed about that value, which could have a material effect on the Statement of Financial Performance and Statement of Financial Position.</td>
<td></td>
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<tr>
<td><strong>New Zealand Venture Investment Fund Limited and Group</strong></td>
<td>Financial statements and statement of service performance</td>
<td>30 June 2011</td>
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<tr>
<td></td>
<td>We drew readers’ attention to the disclosures in the financial statements about the uncertainties in measuring the fair value of the unlisted venture capital investments because of the early stage nature and the absence of quoted market prices. These uncertainties could have a material effect on the statement of comprehensive income and statement of financial position.</td>
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<tr>
<td><strong>NZVIF (BPV) Limited (New Zealand Venture Investment Fund Limited)</strong></td>
<td>Financial statements</td>
<td>30 June 2011</td>
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<td></td>
<td>We drew readers’ attention to the disclosures in the financial statements about the uncertainties in measuring the fair value of the unlisted venture capital investments because of the early stage nature and the absence of quoted market prices. These uncertainties could have a material effect on the statement of comprehensive income and statement of financial position.</td>
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<tr>
<td><strong>NZVIF (EIP) Limited (New Zealand Venture Investment Fund Limited)</strong></td>
<td>Financial statements</td>
<td>30 June 2011</td>
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<td>We drew readers’ attention to the disclosures in the financial statements about the uncertainties in measuring the fair value of the unlisted venture capital investments because of the early stage nature and the absence of quoted market prices. These uncertainties could have a material effect on the statement of comprehensive income and statement of financial position.</td>
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<tr>
<td><strong>NZVIF (INF) Limited (New Zealand Venture Investment Fund Limited)</strong></td>
<td>Financial statements</td>
<td>30 June 2011</td>
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<tr>
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<td>We drew readers’ attention to the disclosures in the financial statements about the uncertainties in measuring the fair value of the unlisted venture capital investments because of the early stage nature and the absence of quoted market prices. These uncertainties could have a material effect on the statement of comprehensive income and statement of financial position.</td>
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<tr>
<td><strong>NZVIF (IGT) Limited (New Zealand Venture Investment Fund Limited)</strong></td>
<td>Financial statements</td>
<td>30 June 2011</td>
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<td></td>
<td>We drew readers’ attention to the disclosures in the financial statements about the uncertainties in measuring the fair value of the unlisted venture capital investments because of the early stage nature and the absence of quoted market prices. These uncertainties could have a material effect on the statement of comprehensive income and statement of financial position.</td>
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</table>
NZVIF (Seed Fund) Limited (New Zealand Venture Investment Fund Limited)

Financial statements year ended: 30 June 2011

We drew readers’ attention to the disclosures in the financial statements about the uncertainties in measuring the fair value of the unlisted venture capital investments because of the early stage nature and the absence of quoted market prices. These uncertainties could have a material effect on the statement of comprehensive income and statement of financial position.

NZVIF (No 8) Limited (New Zealand Venture Investment Fund Limited)

Financial statements year ended: 30 June 2011

We drew readers’ attention to the disclosures in the financial statements about the uncertainties in measuring the fair value of the unlisted venture capital investments because of the early stage nature and the absence of quoted market prices. These uncertainties could have a material effect on the statement of comprehensive income and statement of financial position.

NZVIF (TMT) Limited (New Zealand Venture Investment Fund Limited)

Financial statements year ended: 30 June 2011

We drew readers’ attention to the disclosures in the financial statements about the uncertainties in measuring the fair value of the unlisted venture capital investments because of the early stage nature and the absence of quoted market prices. These uncertainties could have a material effect on the statement of comprehensive income and statement of financial position.

MidCentral District Health Board and Group

Financial statements and statement of service performance year ended: 30 June 2011

We drew readers’ attention to the disclosures in the financial statements that outlined that the Board made a 5% reduction to the valuation of buildings that was carried out by the independent valuer as at 30 June 2009 and which was included in the 30 June 2010 and 30 June 2011 financial statements. The Board’s decision was not supported by the New Zealand Equivalent to International Accounting Standard No.16 Property, Plant and Equipment (NZ IAS 16) which requires valuations to be either carried out by, or reviewed by, an independent valuer. There was no information after 30 June 2009 to support a 5% adjustment.

Whanganui District Health Board

Financial statements and statement of service performance year ended: 30 June 2011

We drew readers’ attention to the disclosures in the financial statements outlining the serious financial difficulties of the Board as well as what the Board was doing to manage the situation, which included that the Crown has indicated that it will provide financial support to maintain viability of the Board.

Spring Creek Mining Company (Solid Energy New Zealand Limited)

Financial statements year ended: 30 June 2011

We drew readers’ attention to the disclosures in the financial statements that outlined the serious financial difficulties and the uncertainties about the company’s ability to continue as a going concern.

Dental Council

Financial statements year ended: 31 March 2011

We drew readers’ attention to the disclosures in the financial statements that referred to uncertainty about the future delivery of office functions.
<table>
<thead>
<tr>
<th>Name of Entity</th>
<th>Financial Statements Period</th>
<th>Details</th>
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<tbody>
<tr>
<td>Tuhoe-Waikaremoana Māori Trust Board and Group</td>
<td>Financial statements year ended: 31 March 2011</td>
<td>We drew readers’ attention to the disclosures in the financial statements that referred to the Board of Trustees’ intentions to significantly change the nature of the Board’s operations including the transfer of certain assets to a separate Charitable Trust, which depends on the Board obtaining the approval of the High Court.</td>
</tr>
<tr>
<td>Department of Building and Housing</td>
<td>Financial statements, statement of service performance, and schedules of non-departmental activities year ended: 30 June 2011</td>
<td>We drew readers’ attention to the disclosures in the financial statements that referred to the uncertainties associated with the provision for Weathertight Services Financial Assistance Package in the non-departmental schedule of liabilities.</td>
</tr>
<tr>
<td>Cardiff Holdings No. 1 Limited (Genesis Power Limited)</td>
<td>Financial statements year ended: 30 June 2010</td>
<td>We drew readers’ attention to the disclosures in the financial statements outlining that they were appropriately prepared on a going concern basis because the parent company has confirmed that it would provide adequate support to ensure that the company will meet its debts as they fall due.</td>
</tr>
<tr>
<td>Cardiff Holdings No. 2 Limited (Genesis Power Limited)</td>
<td>Financial statements year ended: 30 June 2010</td>
<td>We drew readers’ attention to the disclosures in the financial statements outlining that they were appropriately prepared on a going concern basis because the parent company has confirmed that it would provide adequate support to ensure that the company will meet its debts as they fall due.</td>
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<tr>
<td>Kupe Holdings Limited (Genesis Power Limited)</td>
<td>Financial statements year ended: 30 June 2010</td>
<td>We drew readers’ attention to the disclosures in the financial statements outlining that they were appropriately prepared on a going concern basis because the parent company has confirmed that it would provide adequate support to ensure that the company will meet its debts as they fall due.</td>
</tr>
<tr>
<td>GP No. 1 Limited (Genesis Power Limited)</td>
<td>Financial statements year ended: 30 June 2010</td>
<td>We drew readers’ attention to the disclosures in the financial statements outlining that they were appropriately prepared on a going concern basis because the parent company has confirmed that it would provide adequate support to ensure that the company will meet its debts as they fall due.</td>
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<tr>
<td>GP No. 2 Limited (Genesis Power Limited)</td>
<td>Financial statements year ended: 30 June 2010</td>
<td>We drew readers’ attention to the disclosures in the financial statements outlining that they were appropriately prepared on a going concern basis because the parent company has confirmed that it would provide adequate support to ensure that the company will meet its debts as they fall due.</td>
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<td><strong>GP No. 4 Limited (Genesis Power Limited)</strong></td>
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<td><strong>Financial statements year ended: 30 June 2010</strong></td>
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<td>We drew readers’ attention to the disclosures in the financial statements outlining that they were appropriately prepared on a going concern basis because the parent company has confirmed that it would provide adequate support to ensure that the company will meet its debts as they fall due.</td>
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<tr>
<th><strong>GP No. 5 Limited (Genesis Power Limited)</strong></th>
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<td><strong>Financial statements year ended: 30 June 2010</strong></td>
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<tr>
<td>We drew readers’ attention to the disclosures in the financial statements outlining that they were appropriately prepared on a going concern basis because the parent company has confirmed that it would provide adequate support to ensure that the company will meet its debts as they fall due.</td>
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<tr>
<th><strong>Archives New Zealand</strong></th>
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<tbody>
<tr>
<td><strong>Financial statements, statement of service performance, and schedules of non-departmental activities seven months ended: 31 January 2011</strong></td>
</tr>
<tr>
<td>We drew readers’ attention to the disclosures in the financial statements that referred to the disestablishment basis appropriately being used in preparing the financial statements because Archives merged with the Department of Internal Affairs from 1 February 2011 and vested its assets and liabilities in the Department of Internal Affairs.</td>
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<tr>
<th><strong>Electricity Commission</strong></th>
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<tr>
<td><strong>Financial statements and statement of service performance four months ended: 31 October 2010</strong></td>
</tr>
<tr>
<td>We drew readers’ attention to the disclosures in the financial statements that referred to the dissolution basis appropriately being used in preparing the financial statements because the Electricity Industry Act 2010 dissolved the Electricity Commission from 31 October 2010 and vested its assets and liabilities in the Electricity Authority.</td>
</tr>
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<thead>
<tr>
<th><strong>Foundation for Research, Science and Technology</strong></th>
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<tbody>
<tr>
<td><strong>Financial statements seven months ended: 31 January 2011</strong></td>
</tr>
<tr>
<td>We drew readers’ attention to the disclosures in the financial statements that referred to the disestablishment basis appropriately being used in preparing the financial statements because the Foundation for Research, Science and Technology was dissolved from 31 January 2011 and its assets and liabilities were vested in the Ministry of Science and Innovation.</td>
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<tr>
<th><strong>Ministry of Research, Science and Technology</strong></th>
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<tbody>
<tr>
<td><strong>Financial statements, statement of service performance, and schedules of non-departmental activities seven months ended: 31 January 2011</strong></td>
</tr>
<tr>
<td>We drew readers’ attention to the disclosures in the financial statements that referred to the disestablishment basis appropriately being used in preparing the financial statements because the Ministry of Research, Science and Technology was dissolved from 31 January 2011 and its assets and liabilities were vested in the Ministry of Science and Innovation.</td>
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<tr>
<th><strong>Securities Commission</strong></th>
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<tbody>
<tr>
<td><strong>Financial statements and statement of service performance year ended: 30 April 2011</strong></td>
</tr>
<tr>
<td>We drew readers’ attention to the disclosures in the financial statements that referred to the disestablishment basis appropriately being used in preparing the financial statements because the functions of the Commission were transferred to the Financial Markets Authority on 1 May 2011.</td>
</tr>
<tr>
<td>Organisation</td>
</tr>
<tr>
<td>--------------------------------------------------</td>
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<tr>
<td>National Library of New Zealand</td>
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<td>Ministry of Fisheries</td>
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<td>Crown Health Financing Agency</td>
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<td>Environmental Risk Management Authority</td>
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<td>Legal Services Agency</td>
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<td>Health Sponsorship Council</td>
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<td>Organization</td>
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<td>Auckland Transition Agency</td>
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<td>Charities Commission</td>
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<td>Mental Health Commission</td>
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<td>Alcohol Advisory Council of New Zealand</td>
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<td>Meat Biologics Research Consortium (Meat Biologics Consortia Limited – Massey University, AgResearch, and IRL BIOSOL Limited)</td>
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<td>Scion Australasia Limited (New Zealand Forest Research Institute Limited)</td>
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<td>PIBDT Ownership Limited</td>
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<td>Manukau Pacific Markets Limited (PIBDT Ownership Limited)</td>
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<td>Southmarkets Limited (PIBDT Ownership Limited)</td>
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<td>Public Trust Investment Funds Balanced Income Fund</td>
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<td>Ngai Tahu Ancillary Claims Trust</td>
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<td>Taranaki Provincial Patriotic Council</td>
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<td>Electoral Commission</td>
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- Cleanest public sector in the world: Keeping fraud at bay
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- Inland Revenue Department: Making it easy to comply
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- Annual Plan 2011/12
- Progress in delivering publicly funded scheduled services to patients
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