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Annual Report 2013/14

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Annual Report 2013/14

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Auditor-General's overview

2013/14 has been a year of extraordinary challenges and achievements; a year that has reminded me that the strength of an organisation relies on its people. I am privileged to work with a talented group of committed and hard-working people, and I thank my staff and private sector audit service providers for their contributions in the last year.

Highlights

A highlight of the year was the publication of our overview report *Reflections from our audits: Our future needs – is the public sector ready?*, which was a first in New Zealand public sector auditing. Our report gave useful insight into how the public sector is preparing to play its part in helping to build the sustainable and prosperous future that New Zealanders want. The response to that report has shown me the value of applying a theme throughout our annual audits, an approach that is now firmly embedded in the way we prepare and carry out our work programme.

This year, we have seen the benefits of putting our Office strategy into practice. The Auditor-General's strategy 2013-17 relates to my entire Office – the Office of the Auditor-General, Audit New Zealand, our shared corporate services teams, and audit service providers. We introduced a five-year programme of work, with a theme for each year, and saw how this longer-term thinking has helped our planning and that of public entities.

In line with the aim of our strategy to see our work reach more people, we adapted our reporting and made more use of social media and blogs. We expanded the range of our sector reports, which are adding valuable insight. The reports focus on significant matters in sectors such as local government, health, and schools. We know that they are being used to help to work out the “state of play” in these sectors.

Our strategy described our intent to add more value to the public sector by using our ability to anticipate and prepare for change. This was evident in our work preparing and training our auditors to effectively and efficiently put into practice new accounting standards and legislative requirements. My staff are working through the consequences of amendments to laws and have contributed to guidance for public entities about the changes. Much of this work will become more visible in 2014/15, when many of the changes come into effect.

Quality work cannot be produced without quality tools. This year, we took a big step forward in how we share, store, and manage our wealth of information and knowledge by introducing the information management system we call “the Source” to Audit New Zealand. The Source is the beginning of our mission to

extract better value from the information and knowledge we hold, and turn it into insight for the benefit of Parliament, public entities, and the public.

Challenges

Our inquiry into Kaipara District Council's poor management of the Mangawhai community wastewater scheme dominated our work in 2013. This exceptionally large and complex inquiry required a huge collaborative effort throughout my Office. My staff take a lot of pride in their work. I know that they found it difficult to hear questions raised about the quality of some of the work this Office carried out in the past. I am proud of the way that they managed this challenging period, and showed integrity and professionalism at all times. We have been using this experience to create positive and meaningful change within the Office, among the local authorities that we audit, and in the wider public sector.

It is interesting how during challenging times the spirit of an organisation can reveal itself. Despite the challenges of the Kaipara inquiry, our overall staff engagement increased. Audit New Zealand has had the greatest increase in engagement, and that tells me a lot about how staff responded to the demands put on them.

Another challenge we tackled strongly during the year was recalibrating how we audit the way local authorities set rates. We addressed various problems and gave the message that "near enough is not good enough" when it comes to using a taxing power. The positive response from local authorities and the improvements in practice we have observed are reassuring.

Financial performance

My Office recorded a surplus of \$989,000, or about 1% of total income. Usually, this surplus would be returned to the Crown. This year, we received approval to establish a memorandum account related to our audit and assurance services, which are funded by fees charged to public entities. As a result, about half the surplus will be repaid to the Crown, while the other half is retained in the memorandum account. We will manage the balance in the memorandum account.

International focus

The international auditing community often seeks my Office's knowledge, skills, and expertise. This year, we chaired an international working group preparing guidance for national audit institutions worldwide. The guidance outlines how audit institutions can make a difference to the lives of people, and received the strong endorsement of Auditors-General around the world. We particularly

focus our international effort in the Pacific, and it was satisfying to be involved in preparing a strategy to guide auditing in the Pacific to 2024.

Concluding comments

Throughout the year, I have talked about the importance of people. Our public sector is strong because of its ability to serve the needs of people and support the communities of New Zealand. We need to remember that our public sector is strong because of the people who work in it and their commitment to serving New Zealanders. I hope that our system of public accountability, including my Office's significant role, continues to recognise that people are at the centre of our efforts to improve the public sector's performance.

A handwritten signature in black ink, appearing to read 'Lyn Provost', written in a cursive style.

Lyn Provost
Controller and Auditor-General

30 September 2014

1

Our role and outcomes

Everything we do is about improving the performance of, and the public's trust in, the public sector.

Our role

The Auditor-General is an Officer of Parliament who carries out her role independently of executive government and Parliament. She is accountable to Parliament for the public resources she uses to do her job. By law, the Auditor-General audits all public entities in New Zealand that are required to prepare general purpose financial reports – about 3800 public entities, such as government departments, central agencies, Crown entities, schools, and State-owned enterprises. The role includes auditing local authorities, which are accountable to the public for the activities that they fund with rates and other revenue that they raise.

The Auditor-General's audits give independent assurance to Parliament and the public about how public entities are performing. Auditing and reporting is an important way of holding public entities accountable for their use of public resources and powers.

Our organisation

Our work is carried out by about 360 staff in two business units – the Office of the Auditor-General (OAG) and Audit New Zealand supported by a shared team of corporate services staff. We contract auditors from about 50 private sector accounting firms. We call this whole organisation “the Office”.

The OAG sets strategy, policy, and standards, appoints and oversees auditors, carries out performance audits, provides reports and advice to Parliament, and carries out inquiries and other special studies.

Audit New Zealand, the larger of the two business units, has offices in seven cities and carries out annual audits of public entities that the Auditor-General allocates to it. Audit New Zealand provides other assurance services to public entities within the Auditor-General's mandate, in keeping with the Auditor-General's auditing standard on the independence of auditors.

How we are funded

The Office is funded through Vote Audit, which has two appropriations for our output expenses – Audit and assurance services, and the multi-class appropriation Statutory auditor function.¹

The Audit and assurance services appropriation pays for us to carry out audits and related assurance services as required or authorised by law, and is largely funded by audit fees collected directly from public entities.

The multi-class appropriation Statutory auditor function is largely Crown-funded and includes two classes of outputs: Performance audits and inquiries, and Supporting accountability to Parliament.

How we make a difference

In carrying out our statutory role, we are able to play an important part in influencing and promoting improvements in the public sector's performance and in building trust in the public sector.

The main impacts we aim for are that our recommendations are acted on, and that Parliament and public entities are supported and get value from our advice.

Our vision

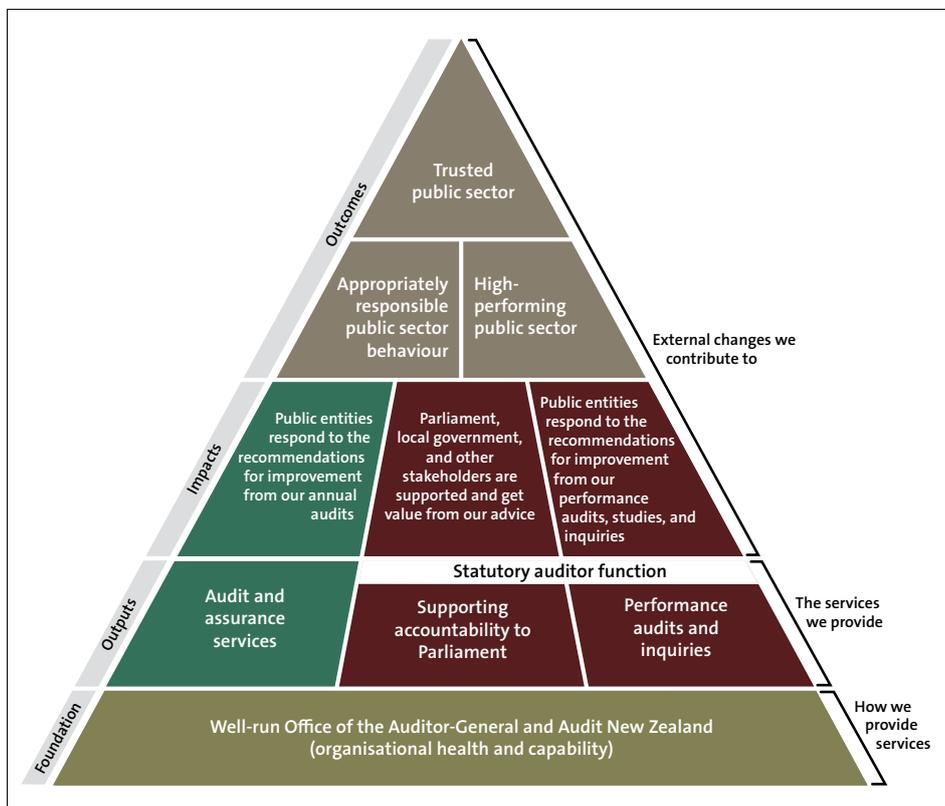
Our vision is that our work improves the performance of, and the public's trust in, the public sector. Everything we do is directed to ensuring that New Zealand has a public sector that is trusted, demonstrates responsible behaviour, and performs well. These outcomes are shown at the top of Figure 1. The rest of this report outlines how effectively we worked towards these outcomes during 2013/14.

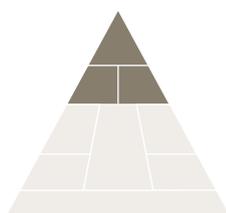
¹ An appropriation is a parliamentary authorisation to incur expenses or capital expenditure. A multi-class output expense appropriation allows expenses to be transferred between the output classes concerned, without the need for separate Parliamentary authority.

The outcomes we aim for

Figure 1 summarises the outcomes we aim for, the effects we aim to have, and the services that we provide.

Figure 1
Our outcomes framework



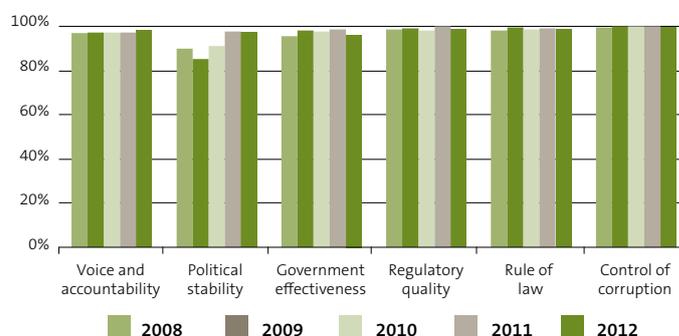


Achieving the outcomes we aim for

We assess that, in 2013/14, we mostly maintained or improved our outcomes.

Trusted public sector		
Measure	Result	Comment
New Zealand is ranked in or above the 90th percentile of the Worldwide Governance Indicators.*	Achieved in 2012	Results for the Worldwide Governance Indicators are usually published every September for the previous calendar year, but are not yet available for 2013.

Figure 2
New Zealand's ranking in the Worldwide Governance Indicators, 2009 to 2012



The State Services Commission's Kiwis Count Survey** shows improved (or at least maintained) rates of public trust with: <ul style="list-style-type: none"> • the public service; and • the public's most recent experience with public services. 	Achieved	For this measure, respondents rate their perceptions of trust in the public service and their trust based on their most recent public service experience. Data collection has been reported quarterly since June 2012. From June 2012 to March 2014, perceptions of trust in the public service improved overall (42% in June 2012 to 44% in March 2014). Trust based on experience also improved overall (74% in June 2012 to 77% in March 2014).
New Zealand's score on the Transparency International Corruption Perceptions Index*** is improved (or at least maintained).	Achieved	New Zealand's 2013 score of 9.1 put it joint-first in the world with Denmark. From 2009 to 2013, New Zealand's score has consistently been between 9.0 and 9.5.

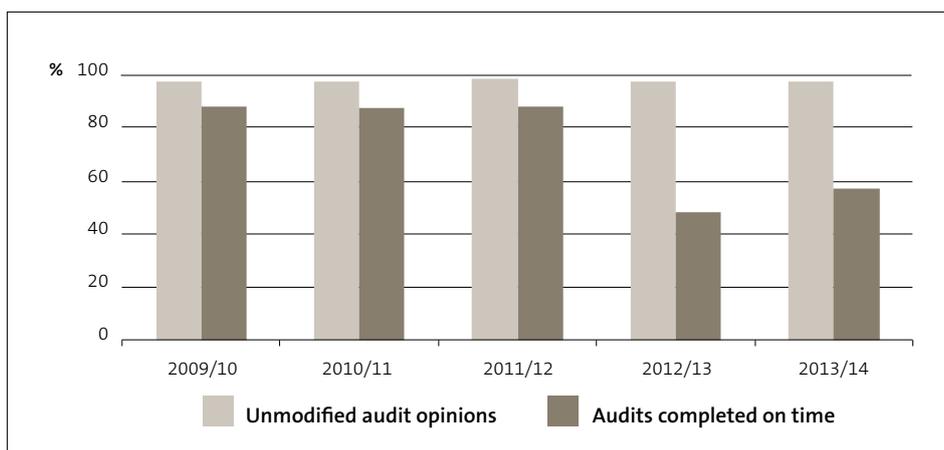
* See the World Bank website, <http://info.worldbank.org>.

** For survey results, contact the State Services Commission, www.ssc.govt.nz.

*** See the Transparency International website, <http://cpi.transparency.org/cpi2012>.

Appropriately responsible public sector behaviour		
Measure	Result	Comment
Public entities' financial reports: <ul style="list-style-type: none"> • fairly reflect their actual performance; and • are publicly available on time. 	Not achieved for audit opinions Not achieved for audit timeliness	An unmodified audit opinion is an indicator that public entities are reporting appropriately and that their financial reports fairly reflect their actual performance. In 2013/14, 97% of audit opinions were unmodified, just short of our 98% target. In 2013/14, only 57% of audits were completed on time, well short of our 90% target. More than 60% of the audits we are required to complete each year are school audits, and in 2013/14 only 45% of those audits were completed on time because of problems with Novopay.

Figure 3
Percentage of unmodified audit opinions and audits completed on time, 2009/10 to 2013/14



High-performing public sector		
Measure	Result	Comment
The State Services Commission's Integrity and Conduct survey shows improved (or at least maintained) rates of State servants who report that State service agencies promote their standards of integrity and conduct.*	Achieved	<p>This survey is held every three years. Changes to the survey mean that the 2013 results are not directly comparable with those from 2007 and 2010. The 2013 survey looked at whether State servants think that their organisation promotes standards of integrity and conduct: 62% of State servants agreed that their agency actively promotes standards of integrity and conduct.</p> <p>The 2007 and 2010 surveys looked at State servants' awareness of their agency's training on integrity and conduct. Results from 2007 (55%) and 2010 (56%) showed that more State servants were aware of integrity training that their organisation provides.</p>
The State Services Commission's Integrity and Conduct survey shows improved (or at least maintained) rates of State servants who reported that, where they observed misconduct breaches in the past year, they reported it.	Survey changes mean results may not be comparable	<p>This survey is held every three years. In 2013, changes were made to the survey. The 2013 survey asked whether State servants reported observed misconduct in all instances, in some instances, or not at all.</p> <ul style="list-style-type: none"> • 23% of State servants who observed misconduct reported all instances. • A further 35% reported some of the breaches they observed. • Together, 58% of State servants reported all or some of the breaches they observed. <p>The 2007 and 2010 surveys asked whether State servants reported observed misconduct or not. In 2010, 63% of State servants reported observed misconduct, while in 2007, 55% reported observed misconduct.</p> <p>To the extent that the results are comparable, the survey appears to show that the rate of State servants reporting observed misconduct has slightly declined from 63% in 2010 to 58% in 2013.</p>
The State Services Commission's Kiwis Count Survey shows improved (or at least maintained) rates of public service quality for all public services.	Achieved	Results for this measure are collected every quarter. Between June 2012 and March 2014, respondents scored the quality of public services at a consistently high level of at least 72.

* See the State Services Commission's website, www.ssc.govt.nz

Strategic risks and risk management

The Auditor-General faces four ongoing strategic risks:

1. loss of independence;
2. audit failure;
3. loss of capability; and
4. loss of reputation.

We manage these risks mainly through processes that support the work we do. Details on how we manage these risks are available on our website. We will continue our focus on managing risks, particularly strategic risks. Our leadership team regularly discusses risk management, including assessing environmental or internal changes that might affect the Office's position. The Office's Audit and Risk Committee meets four times a year and gives further insight and advice to help us to identify and manage risk. The Committee's report for 2013/14, available on our website, outlines the Committee's purpose and summarises its work during 2013/14.

Statement of service performance

In this Part, we report on the services that we are paid to deliver and how well we delivered those services. We discuss:

- achieving our 2013/14 work programme;
- our Audit and assurance services; and
- our Statutory auditor function services.

Achieving our 2013/14 work programme

We set the theme for our 2013/14 work programme, *Service delivery*, in the context of the changing shape of the public sector and changes in the way that services are being delivered. The changes present opportunities and add complexity and risk for the public sector.

We drew on all our audit and assurance work to address the theme and carried out performance audits on the delivery of services that significantly affect people. For example, we carried out audits on education for Māori children, complaints and case management in the Ministry of Social Development and the Accident Compensation Corporation, Auckland Council's building consent process, and the customer operations of Watercare Services Limited.

We looked at ways that closer relationships between government and other partners are changing service delivery. For example, we will soon be reporting on our work on third-party delivery of services such as the Whānau Ora programme. We prepared reports on the results of our audits in important service delivery sectors of health, schools, and social services, which are available on our website. Appendix 1 lists the major reports that we published during 2013/14.

Throughout our Service delivery themed work, we saw how important it is for public services to have a culture oriented to customers and people and in line with the organisation's purpose, and to use the comments of customers and the public to improve those services. We plan to publish an overview of our work on how well the public sector is providing services to the public.

We looked at future themes for our work programme. We decided that the theme for audits and other projects in 2014/15 will be *Governance and accountability* and that the theme for 2015/16 will be *Investment and asset management*.

Output class: Audit and assurance services

We audit all public entities² that are required to prepare general purpose financial reports – from large government departments and district health boards to every state school and local authority. In 2013/14, our annual audits and other assurance services accounted for 88% of our total expenditure.

² In accordance with section 19 of the Public Audit Act 2001, we also audit some organisations that are not public entities. See Appendix 2.

Annual audits

Annual audits provide independent assurance about the reliability of financial statements – and, in many instances, service performance information – that public entities are required to report. The Auditor-General, as the auditor of all public entities, has a statutory duty to audit that information. We produce an audit report for each audit we carry out, which includes our opinion about the fairness of the presentation of the financial statements (and service performance information, where relevant).

We use our annual audits to gather information about public entities to help us to advise Parliament and others, and to provide information for our other work. To be part of a trusted public sector, public entities must fairly report their performance and respond to audit recommendations to improve their systems and controls.

The main processes supporting annual audits

Appointing auditors and monitoring audit fees

The Auditor-General appoints auditors from Audit New Zealand and private sector accounting firms to carry out the annual audits of public entities. When appointing these auditors, the Auditor-General follows principles that are designed to ensure that auditors are independent, audits are of a high quality, and audit fees are reasonable. We continually monitor the allocation of audits among Audit New Zealand and private sector accounting firms to ensure that these principles are adhered to.

Each year an independent review examines the probity and objectivity of the methods and systems we use to allocate and tender audits, and to monitor the reasonableness of audit fees. This year's review confirmed the objectivity of those methods and systems. Appendix 3 contains the review report by John Marshall QC.

We regularly monitor audit fees to ensure that they are fair to public entities, and provide a fair return to auditors for the work required to meet the Auditor-General's auditing standards. In 2013/14, fees changed for a range of reasons, including changes in the scale of operations of some entities, the variable quality of the financial statements and service performance information prepared by some entities, and small changes in auditor charge-out rates (the average hourly cost of carrying out small audits).

Figure 4 summarises the movements in audit fees from 2011/12 to 2013/14, based on the agreed audit fees at the time the analysis was prepared. It shows how changes in the time spent on audits and the average hourly cost of carrying out audits have affected fees. The figures exclude additional audit fees negotiated

with public entities as a result of unforeseen problems arising after audit fees had been agreed. These are usually the exception. However, for the school audits for the year ended 31 December 2012, additional audit fees were agreed with the Ministry of Education for the extra audit work resulting from problems with Novopay. We expect the problems with Novopay will again result in audit fee increases for the school audits for the year ended 31 December 2013. We are working with the Ministry of Education to ensure that the Novopay effect on the next round of school audits is minimised.

Figure 4
Changes in audit fees, 2011/12 to 2013/14

Sector	2011/12 to 2012/13				2012/13 to 2013/14			
	Increase in total fee	Because of changes in time	Because of changes in charge-out rate	Number of entities	Increase in total fee	Because of changes in time	Because of changes in charge-out rate	Number of entities
Central government	2.8%	2.7%	0.1%	385	1.8%	0.3%	1.5%	396
Local government	4.1%	1.9%	2.2%	430	4.2%	3.6%	0.6%	421
Schools	4.2%	3.9%	0.3%	2420	1.9%	-0.9%	2.8%	2426
Total	3.4%	2.6%	0.8%	3235	2.6%	1.2%	1.4%	3243

Maintaining auditors' independence

The Auditor-General's staff (including at Audit New Zealand) and appointed auditors and their staff from private sector accounting firms must meet high standards of independence. We monitor compliance regularly. The Auditor-General works to eliminate or reduce all identified threats to auditors' independence.

Publishing the Auditor-General's Auditing Standards

The Public Audit Act 2001 requires that the Auditor-General publish her Auditing Standards in a report to the House of Representatives at least once every three years, and that each annual report include a description of any significant changes to those standards.

In March 2014, we published the Auditor-General's Auditing Standards, which included updates on various technical matters. However, there were no significant changes to the auditing standards. The updated Auditor-General's Auditing Standards are available on our website.

Carrying out quality assurance reviews

We carry out quality assurance reviews of all appointed auditors to ensure that they have complied with the Auditor-General's Auditing Standards. We aim to review the performance of each of our appointed auditors at least once every three years.

Responding to regulatory and external reporting changes

In 2013, legislative reforms changed the obligations for subsidiaries reporting under the Crown Entities Act 2004 and for those who now report under the Companies Act 1993 (instead of the now repealed Financial Reporting Act 1993). As a result, some subsidiaries will no longer be required to separately report, and their parent entities will only be required to report as a group. The changes allow public entities to report service performance information more flexibly and collaboratively. We are working through the full implications of these reforms.

In 2013/14, we continued our preparation for auditing after the application of the External Reporting Board's new accounting standards for public benefit entities, which came into effect on 1 July 2014.

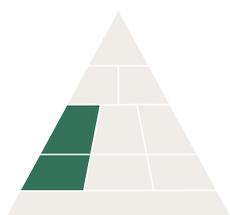
Our performance in 2013/14

The problems with Novopay continue to delay the completion of our school audits. In 2013/14, significantly fewer audited financial reports were issued within statutory time frames than in the three years from 2009/10 to 2011/12, although slightly more were issued than in 2012/13. If the effect of Novopay on the timeliness and completion of school audits is excluded, then our overall performance in annual audits and other assurance services for 2013/14 is comparable to how we performed in 2011/12 – the year before Novopay came into effect.

In 2012/13, the problems with Novopay resulted in audit fees for the 2012 school audits increasing by about 9% (about \$0.9 million). We expect similar increases for the 2013 school audits because of the difficulties in gaining assurance about Novopay. It is disappointing that these problems continue to affect school audits. We will continue to work with the Ministry of Education to ensure that the effect on the 2014 school audits is minimised. In the pages that follow, we set out the measures we use to assess our performance and how we have performed against those measures.

We use one of three ratings to show performance for each measure:

- Achieved – meets or exceeds targets;
- Almost achieved – very close to target when reasonable judgement is applied; and
- Not achieved – below target.



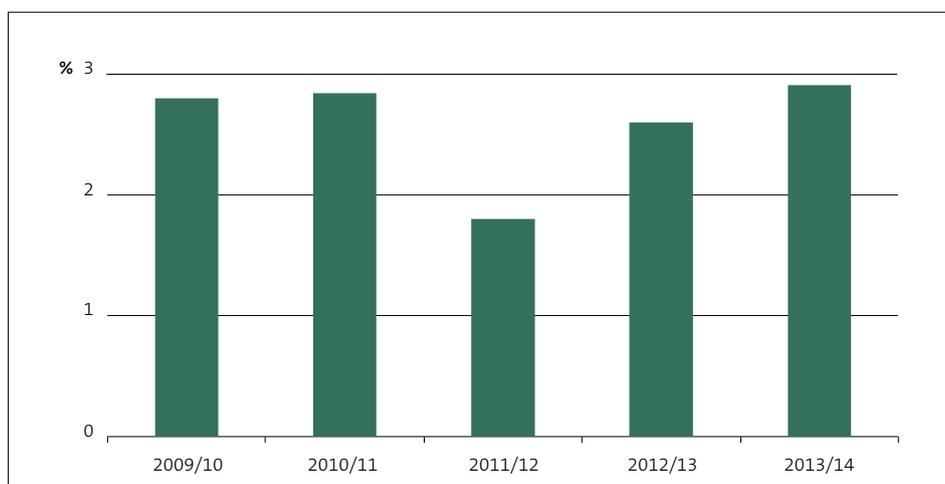
Output class: Audit and Assurance services

2013/14 results and previous performance for Audit and Assurance services

Public entities respond to the recommendations for improvement from our annual audits																																																																		
Measure	Result	Comment																																																																
<p>Central government entities' management control environment (MCE), financial information (FISC), and service performance information systems and controls (SPIASC) are improved (or at least maintained), measured against the previous two years.</p> <p>Movements in MCE, FISC, and SPIASC grades indicate whether entities are accepting and responding to our recommendations, and improving their systems and controls.</p>	Achieved overall	<p>MCE, FISC, and SPIASC results for 2010/11 to 2012/13 show that, overall, these grades improved when measured against the previous two years. MCE and FISC rankings mostly improved, and overall SPIASC rankings improved.</p> <p>The 2013/14 grades will be determined during 2014/15.</p> <table border="1"> <thead> <tr> <th></th> <th>2010/11</th> <th>2011/12</th> <th>2012/13</th> </tr> </thead> <tbody> <tr> <td>MCE</td> <td></td> <td></td> <td></td> </tr> <tr> <td>Very good</td> <td>52%</td> <td>56%</td> <td>62%</td> </tr> <tr> <td>Good</td> <td>41%</td> <td>39%</td> <td>32%</td> </tr> <tr> <td>Needs improvement</td> <td>7%</td> <td>5%</td> <td>6%</td> </tr> <tr> <td>Poor</td> <td>0%</td> <td>0%</td> <td>0%</td> </tr> <tr> <td>FISC</td> <td></td> <td></td> <td></td> </tr> <tr> <td>Very good</td> <td>43%</td> <td>47%</td> <td>52%</td> </tr> <tr> <td>Good</td> <td>51%</td> <td>47%</td> <td>45%</td> </tr> <tr> <td>Needs improvement</td> <td>6%</td> <td>6%</td> <td>3%</td> </tr> <tr> <td>Poor</td> <td>0%</td> <td>0%</td> <td>0%</td> </tr> <tr> <td>SPIASC</td> <td></td> <td></td> <td></td> </tr> <tr> <td>Very good</td> <td>1%</td> <td>4%</td> <td>8%</td> </tr> <tr> <td>Good</td> <td>52%</td> <td>66%</td> <td>74%</td> </tr> <tr> <td>Needs improvement</td> <td>47%</td> <td>30%</td> <td>18%</td> </tr> <tr> <td>Poor</td> <td>0%</td> <td>0%</td> <td>0%</td> </tr> </tbody> </table>		2010/11	2011/12	2012/13	MCE				Very good	52%	56%	62%	Good	41%	39%	32%	Needs improvement	7%	5%	6%	Poor	0%	0%	0%	FISC				Very good	43%	47%	52%	Good	51%	47%	45%	Needs improvement	6%	6%	3%	Poor	0%	0%	0%	SPIASC				Very good	1%	4%	8%	Good	52%	66%	74%	Needs improvement	47%	30%	18%	Poor	0%	0%	0%
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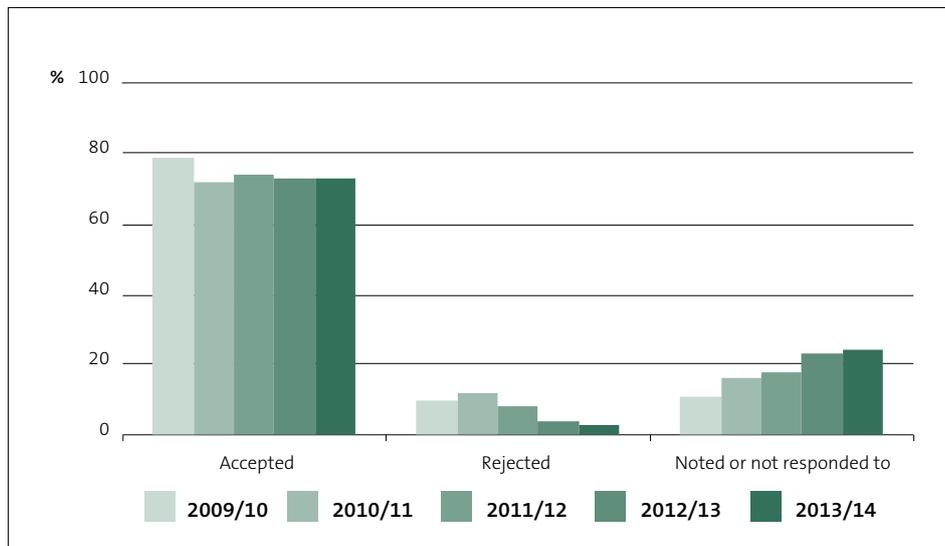
Public entities prepare annual financial statements to a high standard		
The percentage of public entities' audited financial reports containing modified audit opinions is reduced (or at least maintained), measured against the previous two years.	Not achieved	The percentage of public entities' audited financial reports containing modified audit opinions was not reduced when measured against the previous two years. The main reason for not achieving this measure was that, in 2013/14, we issued modified audit opinions for all district health boards. This was because we could not obtain assurance over the information used in some significant performance measures where third-party health providers, such as primary health organisations, provided the performance information to district health boards.

Figure 5
Percentage of audited financial reports that contain modified audit opinions, 2009/10 to 2013/14



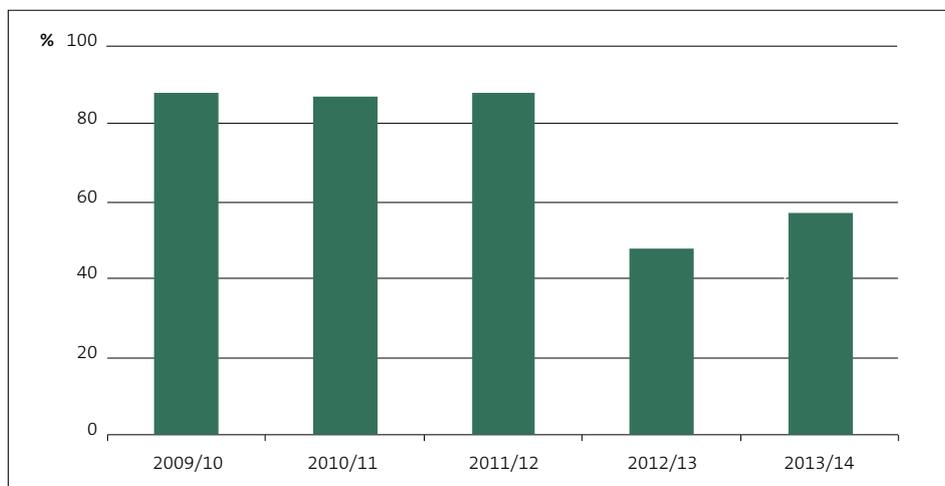
Public entities accept management report recommendations and act on them		
Public entities' acceptance of audit service providers' management report recommendations is improved (or at least maintained), measured against the previous two years.	Almost achieved	Public entities' acceptance of audit service providers' management report recommendations was almost maintained at the same level as the previous two years, and public entities rejected fewer management report recommendations. For the year ended 30 June 2014, a sample of 45 entities was assessed against this performance measure.

Figure 6
Percentage of management report recommendations accepted by public entities, 2009/10 to 2013/14



Audit reports are produced within statutory time frames		
The percentage of public entities' audited financial reports issued within the statutory time frame is improved (or at least maintained), measured against the previous two years.	Not achieved	<p>The percentage of public entities' audited financial reports issued within the statutory time frame improved from 2012/13, but was lower than in 2011/12.</p> <p>The problems with Novopay continue to delay the completion of our school audits. More than 60% of the audits we are required to complete each year are school audits, and in 2013/14 only 45% of them were completed on time because of problems with Novopay. As a result, in 2013/14 only 57% of all our audits were completed on time.</p>

Figure 7
Percentage of audited financial reports issued on time, 2009/10 to 2013/14



Less than 30% of the outstanding audit reports at 30 June are because of inaction on our part.	Achieved	An estimated 22% of the outstanding audit reports at 30 June are because of inaction on our part. This estimate excludes the outstanding audit reports for schools affected by the problems with Novopay. The result reflects our strong focus on reducing the number of audits in arrears during the last three years.
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Management reports are produced within set time frames		
All management reports are issued within six weeks of issuing the audit report.	Not achieved	93% of management reports were issued within six weeks of issuing the audit report, about the same percentage as in previous years.
Audit reports on local authorities' long-term plans are produced within statutory time frames		
No outstanding long-term plan audit opinions at 30 June of the year in which long-term plans are to be adopted by local authorities are because of inaction on our part.	Achieved (in 2011/12)	Long-term plans are audited every three years. Long-term plans were last audited in 2011/12. The next audits will be carried out in 2014/15.
Objective methods are used to allocate audits and set reasonable audit fees		
An annual independent review of our (the OAG's) processes confirms the probity and objectivity of the methods and systems we use to allocate and tender audits, and monitor the reasonableness of audit fees.	Achieved	The 2013/14 review confirmed that we achieved this measure. We have consistently achieved confirmation of the probity and objectivity of the methods and systems that we use to allocate and tender audits, and to monitor the reasonableness of audit fees. The review report by John Marshall QC, is provided in Appendix 3.
Skilled auditors, with a good understanding of public entities, carry out quality audits		
Client satisfaction survey results show that, overall, 85% of respondents are satisfied with the quality of audit work (including the expertise of staff and the quality of the public entity's relationship with its audit service provider).	Achieved	Overall, 85% of respondents were satisfied with the quality of the audit work, which is slightly less than the 87% in 2012/13.
Quality assurance reviews for all appointed auditors are completed during a three-year period. Of the auditors reviewed in any given year, 100% achieve a grade of "satisfactory" or better. This measure reports the results of those auditors who were reviewed in 2013/14.	Almost achieved	92% of auditors reviewed in 2013/14 achieved a grade of satisfactory or better (compared to 89% of auditors reviewed in 2012/13). The 8% of auditors we assessed as not achieving a satisfactory standard are from small audit firms who perform small audits (such as school audits) on behalf of the Auditor-General. We expect that they will make improvements in order to meet our expectations. A follow-up review will be performed of these auditors in 2014/15.

We have sufficient resources to do audits effectively		
The Officers of Parliament Committee accepts any significant proposals for an appropriation increase in audit fees and expenses.	Not applicable in 2013/14	2009/10 to 2013/14: no significant proposals for an increase in appropriation.

Figure 8
Financial performance of output class: Audit and assurance services

	2013/14 Actual \$000	2012/13 Actual \$000	2011/12 Actual \$000	2013/14 Supplementary Estimates \$000	2014/15 Main Estimates \$000
Income					
Crown	150	150	150	150	150
Other	72,139	70,089	71,644	71,042	75,390
Expenditure	(71,755)	(69,448)	(70,729)	(71,192)	(75,540)
Surplus/(Deficit)	534	791	1,065	0	0

* The 2014/15 forecast financial statements are unaudited.

Multi-class output: Statutory auditor function

This multi-class output includes the following:

- **Services to Parliament** – providing advice and reports to help select committees and other stakeholders;
- **Controller function** – providing assurance to Parliament that public money has been spent lawfully and within the authority provided by Parliament; and
- **Reports, studies, and inquiries** – reporting on the results of annual audits, performance audits, and other studies, and inquiring into a public entity's use of its resources.

Services to Parliament

We use information from our annual audits of public entities to advise and inform Parliament, and our other stakeholders, including public entities and the public. Our reporting and advice to Parliament identifies and addresses issues and risks in the public sector.

Our advice and help to Parliament includes:

- reports and advice to select committees to help their financial reviews of public entities and their examination of the Estimates of Appropriations;
- reports to Ministers on the results of the annual audits; and
- reports to Parliament on more general matters arising from our annual audits.

Controller function

The Controller function provides independent assurance to Parliament that what is spent by government departments and Offices of Parliament is spent lawfully, and is within the scope, amount, and period of the appropriation or other authority.

The OAG and appointed auditors carry out standard procedures for the Controller function in keeping with the Auditor-General's auditing standards and a Memorandum of Understanding with the Treasury. We review monthly reports that the Treasury provides. We inform the Treasury of any problems and advise the action to be taken.

Each year, we report to Parliament on any significant matters related to the Controller function.

Reports, studies and inquiries

The Public Audit Act 2001 allows the Auditor-General to carry out performance audits, to inquire into how a public entity uses resources, and to study other matters affecting the public sector.

Each year, we publish reports on the results of our annual audits, performance audits, major inquiries, and other studies. Through this reporting to Parliament and other stakeholders, we consider matters in greater depth than is appropriate within the statutory scope of an annual audit, and examine ways that public entities can perform better.

Performance audits are comprehensive examinations of effectiveness and efficiency that the Auditor-General chooses to carry out. We plan our work programme carefully to provide Parliament with assurance about how well public entities manage a range of matters and programmes, making recommendations where we consider that improvements can be made.

By contrast, our inquiries work reacts to matters of current public concern. We usually receive about 200 requests for inquiries each year, spanning a wide range of concerns about central and local government entities. We deal with most of these through routine correspondence, but, each year, some require significant work. If there is general public interest in an inquiry, we will usually publicly report the results. The Auditor-General administers the Local Authorities (Members' Interests) Act 1968, which regulates pecuniary interest matters in local government. Each year, we usually receive about 50 to 100 enquiries under that Act.

We bring together matters arising from our annual audits in our sector reports, and carry out other studies that result in a range of published reports and information on topical matters affecting public sector accountability and performance.

International contribution

We make a significant contribution to the international auditing community by sharing our knowledge, skills, and expertise. At Parliament's request, we also assist visiting parliamentary delegations by informing them about our work supporting Parliamentary committees.

Hosting international delegations provides opportunities to exchange information and build professional networks. In 2013/14, there was a marked increase in visits by international delegations to our Office, and we were pleased to assist representatives from the Parliaments and/or audit offices of China, Malaysia, Korea, Bangladesh, Indonesia, Vietnam, and Australia. We agreed to an international secondment programme with the Audit Board of the Republic of Indonesia to share our knowledge and experience in auditing accrual-based accounting information.

We work to improve public sector auditing in the Pacific as part of our commitment to the Pacific Association of Supreme Audit Institutions (PASAI). The Auditor-General is Secretary-General of PASAI and represents PASAI on the governing board of the International Organisation of Supreme Audit Institutions (INTOSAI). In 2013/14, we provided substantial support in the drafting of PASAI's 2014-24 strategy, which all PASAI Auditors-General signed in February 2014. Our Office has a special relationship with the Samoa Audit Office. This year we assisted Samoa Audit Office staff with on-site training, performance auditing, and whole-of-government audits.

Our involvement in INTOSAI continued. We chaired two working groups tasked with preparing guidance for supreme audit institutions (SAIs). One of these working groups prepared a new INTOSAI standard on *The Value and Benefits of SAIs making a difference to the lives of citizens*. This standard sets out how SAIs can add value through their work in a way that benefits citizens. We have used this standard as a framework for the *Auditor-General's Strategy 2013-17*.

Our performance in 2013/14

Services to Parliament

Our work plays an important part in supporting accountability to Parliament. Strong demand from select committees for our advice continued. In 2013/14, we provided advice in support of 65 financial reviews and 44 Estimates of Appropriation examinations, and advised or gave evidence to committees on a number of our reports.

Each year, we survey a sample of our stakeholders about how they perceive the quality and usefulness of our work. In 2013/14, we interviewed 11 select committee chairpersons, one deputy chairperson, and 12 senior public servants. The interview results showed that, overall:

- the Office is well regarded;
- the Office carries out its work with integrity and independently of government;
- our staff carry out their work professionally; and
- our reports are clear and easy to understand.

Most of the select committee chairpersons we interviewed were positive about the support and advice we give to select committees. Some identified aspects to improve, including more consistency in the quality of our briefings and being more flexible in how we approach some of our briefings. We will consider these comments, and will act on them.

Our interviewees considered our reports to be generally constructive and of high quality and clear and easy to understand: 19 of the 24 (79%) stakeholders agreed that the advice they receive from us through our reports and services is relevant and useful. This is slightly less than our target of 85%. Interviewees suggested that we seek ways to enhance how we scope and configure our work, and broaden the range of evaluation tools we use. They suggested that working more closely with the organisations we report on would help to improve how the public sector performs. We will consider and act on the helpful suggestions made.

Reports, studies, and inquiries

Our reports

In 2013/14, we completed a range of reports on matters arising from performance audits, major inquiries, sector reports, and other studies. Appendix 1 lists these reports, which are available on our website.

Our reports encourage high performance in the public sector, and often highlight complexities to be managed and factors that support good decision-making.

They make recommendations for improvement, where appropriate. Our work benefits the audited entities and the wider public sector by informing and promoting strong public sector management and performance. For example, our report, *Earthquake Commission: Managing the Canterbury Home Repair Programme*, identified lessons and made recommendations to the Earthquake Commission (EQC) to strengthen their service to the people of Christchurch. Our recommendations should benefit those people whose homes are being repaired under the programme. The EQC accepted the report's recommendations, including the need to improve communication with home-owners. We are following up on whether EQC has carried out the improvements we recommended.

Every year, two of our performance audit reports are reviewed independently. This year, our reports were highly rated, especially for approach, conclusions, and impact. The review panel said that our recommendations were clear, specific, and practical in highlighting ways to improve effectiveness and efficiency. We will continue to seek ways to make our reports as useful and compelling as possible.

Public entities' progress in acting on our recommendations

In 2013/14, we published a series of articles on our website that discussed public entities' progress in acting on recommendations from eight of our performance audit reports published between 2011 and 2012. The public entities concerned have made improvements by acting on our recommendations, but not all recommendations have been fully acted on. In some instances, this was because the recommendations are not "quick fixes". In other instances, the public entities need to do more to progress improvements. We will continue to monitor the progress these entities make on acting on our recommendations.

We published a report on the progress that the Plumbers, Gasfitters, and Drainlayers Board made in addressing the recommendations we made in the 2010 report on our inquiry into that organisation. The Board had worked hard to address our recommendations and now has the arrangements in place to properly govern and manage, including much more transparency about its work. Carrying out its responsibilities at a cost that is acceptable to trades people continues to significantly challenge the Board.

Progress with completion of our 2013/14 work programme

The theme for our 2013/14 work programme was *Service delivery*. The work we started under this theme will be completed by the end of 2014. Figure 9 shows the remaining work under the *Service delivery* theme that will be reported on by the end of 2014.

We plan to publish an overview of our work on the *Service delivery* theme in 2014/15.

Figure 9
Remaining work on the *Service delivery* theme that will be completed by the end of 2014

Reports on client-focused service delivery:

Ministry of Social Development: How it deals with complaints (published 12 August 2014)

Accident Compensation Corporation: How it deals with complaints (published 12 August 2014)

Accident Compensation Corporation: Managing cases

Ministry of Social Development: Managing cases

Education for Māori educational success (third report): Education for Māori: Relationships between schools and whānau

Reports on service delivery through third parties:

Progress in implementing Whānau Ora

Ministry for Primary Industries: Administration, monitoring, and reporting of Primary Growth Partnership programmes

Consultation on our 2014/15 work programme

The theme for our 2014/15 work programme is Governance and Accountability. We consulted the Speaker and select committees, who endorsed our proposed work programme and gave us useful comments for our future work.

The theme is an important focus for our work in 2014/15 given that changes in legislation and financial reporting standards have significantly changed the public sector's accountability requirements. The new arrangements and ways of delivering services can put management and financial control environments at increased risk, and it is important that those in positions of responsibility govern and manage public expenditure well.

Inquiries

Our inquiry into Kaipara District Council's management of the Mangawhai community wastewater scheme dominated our inquiries work in 2013/14 and was a major focus for staff throughout the Office until December, when we published our report *Inquiry into the Mangawhai community wastewater scheme*. The other major inquiry completed during 2013/14 looked at investment decisions by Delta Utility Services Limited, a subsidiary of Dunedin City Council.

In 2013/14, we received 181 new requests for inquiries and 69 requests about Local Authorities (Members' Interests) Act 1968 (Members' Interests Act matters). These numbers are in line with the pattern in recent years.

We met our timeliness goals for general inquiries in central and local government. We did not meet our usual timeliness standard on Members' Interests Act matters

because we prioritised completing our major inquiries, and several matters required relatively long investigation.

Each year, we usually receive a small amount of correspondence under the Protected Disclosures Act 2001. We manage this correspondence as part of our general inquiries work. We have seen no need to report on this correspondence separately. Although the total amount of correspondence remains small, it has increased noticeably in the last year or so. We will continue to monitor this increase and we plan to discuss changes to how we manage protected disclosures with other public entities that commonly receive them.

As we signalled in last year's annual report and in our 2014/15 annual plan, we are reviewing the way we manage our inquiries work to respond to the growing pressure on workload and public expectations of what we can deliver. We will introduce changes in the coming months.

Inquiry into Kaipara District Council's management of the Mangawhai community wastewater scheme

We published our report on this inquiry on 3 December 2013. We presented the report to community meetings in Mangawhai at the same time as we presented it to Parliament.

The 423-page report included a 100-page review of Audit New Zealand's work at Kaipara District Council during the last decade and a review of how our Office and other accountability agencies responded to the complaints. We published a separate summary of the report.

Overall, the inquiry found that Kaipara District Council:

- was out of its depth and effectively lost control of a major infrastructure project;
- failed to attend to its fundamental legal and accountability obligations; and
- had poor governance, management, record-keeping, contracting, and financial management practices.

Although the Mangawhai community needed a wastewater scheme and now has one that works, it has come at a significant cost. As well as the financial cost, the relationship between the Council and the community has been severely damaged.

The independent review of the audit work found problems with the way that some of the audit work had been carried out over the years. Audit quality varied significantly during the decade. The independent reviewer concluded that some aspects of the work on the audits were inadequate between 2006 and 2009 but improved later. We have put in place steps to address the problems that

the review identified. In particular, the Auditor-General decided not to allocate any new audits to Audit New Zealand until she is satisfied that it is consistently achieving appropriate quality in its audit work. Audit New Zealand has an Audit Quality Improvement Programme, overseen by two independent advisors.

We reviewed the way that the Office and other accountability agencies had dealt with concerns that members of the public raised. We found that many of the concerns were well founded. However, we concluded that the public entities' responses were generally reasonable, given the roles, approaches, and information available at the time. As a result of this review, we are reconsidering how we communicate with correspondents and trying to work more closely with the other accountability bodies, to ensure that we collectively "join the dots" better.

Our inquiry identified many lessons that we think will be relevant for other local authorities as well as for many other public entities. We summarised the lessons in Part 6 of our report Summary: *Inquiry into the Mangawhai community wastewater scheme*, which is available on our website.

Other processes that were under way at the same time made completing the inquiry more complex. In particular:

- Parliament was considering a Bill to validate the rates that the Council had set unlawfully for many years. This Bill received its final reading the day after our report was published.
- Judicial review proceedings had been filed with the High Court to challenge the legality of many of the Council's actions, including its rating decisions and its decisions to enter into the construction contracts. The hearing took place in February 2014 and a decision was released in May 2014. Aspects of that decision have now been appealed.

Kaipara District Council has announced that it intends to pursue legal action against the Auditor-General. We will not comment publicly on these matters, beyond the comments made in the report, while the possibility of legal action remains.

Inquiry into property investments by Delta Utility Services Limited at Luggate and Jacks Point

We inquired into property investments by Delta Utility Services Limited (Delta), a council-controlled trading organisation of Dunedin City Council. These property investments were at Luggate, near Wanaka, in mid-2008, and Jacks Point, near Queenstown, in mid-2009.

We agreed to carry out this inquiry because of widespread and persistent questions about what had happened and allegations of impropriety. Our inquiry

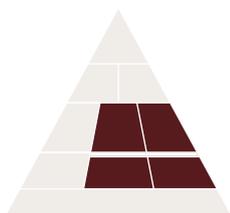
report provided a clear and dispassionate view of the facts. Inquiry into property investments by Delta Utility Services Limited at Luggate and Jacks Point, available on our website, explains in detail what happened.

We identified some positive aspects and some deficiencies on the part of Delta, the Dunedin City Council, and the Council's holding company. We considered that there were lessons to be learned for all involved, and for other local authorities and their council-controlled organisations. The lessons are summarised in Part 7 of the inquiry report.

Solid Energy New Zealand Limited

In December 2013, we decided to carry out additional assurance work on aspects of the governance and management of Solid Energy New Zealand Limited (Solid Energy), so that information about some specific issues could be provided to the Commerce Committee for its financial review of Solid Energy in early 2014. We carried out this work because concerns had been raised with us about the circumstances leading to Solid Energy's deteriorated financial situation.

The Office typically helps select committees with their work by providing a financial review briefing on a public entity in two parts the results of the annual audit, and suggestions for lines of enquiry and questions relevant to the entity. For the briefing on Solid Energy, we provided a third part. We considered that a deeper analysis of the facts leading to Solid Energy's financial situation would help the Commerce Committee to review Solid Energy's finances. Our briefing provided clear, impartial, and relevant information to the Committee. We separately published the third part of our briefing on our website to ensure transparency of the process.



2013/14 results and previous performance for Statutory auditor function

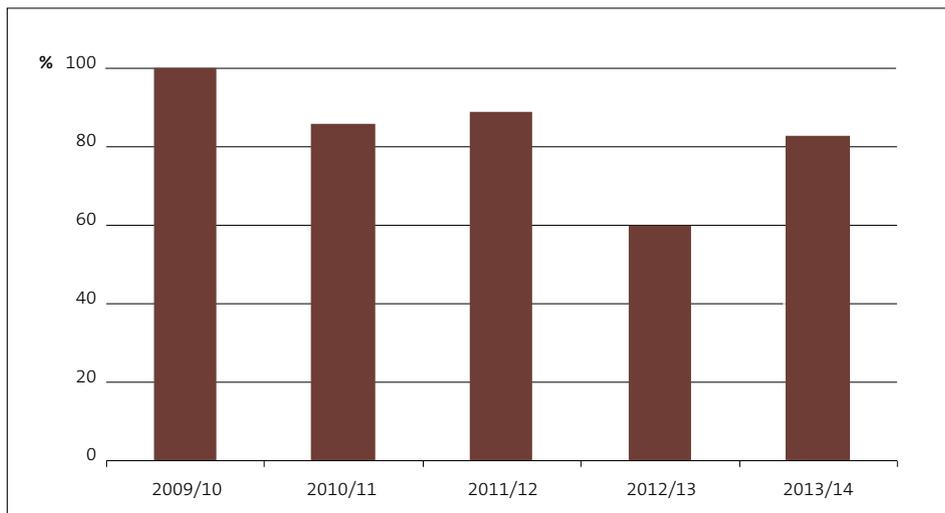
Public entities respond to the recommendations for improvement made from our performance audits, studies, and inquiries

Parliament, local government, and other stakeholders are supported and get value from our advice

Measure	Result	Comment
Entities accept or respond to the recommendations made in our reports, studies, and inquiries.	Achieved for performance audits	<p>Periodically we review how public entities have responded to some of our reports and present the results to Parliament.</p> <p>A series of articles published on our website during 2013/14 showed that although entities had made improvements by acting on our recommendations from eight previous reports, not all recommendations had been fully put into practice.</p> <p>Our report <i>Public entities' progress in implementing the Auditor-General's recommendations 2012</i> showed that entities had made good progress in putting into effect most of the recommendations that we made in six performance audit reports published in 2009 and 2010.</p>
	Achieved for inquiries	<p>In 2013/14 we followed up on a major inquiry report from 2010. The entity had acted to address all points raised.</p> <p>In 2012/13, there were no assessments. In 2011/12, we followed up on three major inquiry reports. In two instances, our recommendations were accepted in principle. In 2010/11, we followed up on three inquiries. In all instances, the entities accepted our comments and acted to address our concerns.</p>

<p>At least 85% of select committee members we survey confirm that our advice assists them in Estimates of Appropriation and financial review examinations.</p>	<p>Almost achieved</p>	<p>Ten of the 12 select committee members (83%) agreed that our advice helped them in Estimates of Appropriation and financial review examinations.</p> <p>The 2014 stakeholder survey sample size was 12, an increase from five in 2013.</p>
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Figure 10
Percentage of select committee members who agreed that our advice helped them in Estimates of Appropriation and financial review examinations, 2009/10 to 2013/14



<p>We deliver an appropriate work programme</p>		
<p>Select committees and other stakeholders are satisfied with the proposed work programme (as indicated by feedback on our draft annual work programme).</p>	<p>Achieved</p>	<p>We received useful comments from two select committees and from other stakeholders, which we considered in finalising our work programme. Consultation on our work programme ensures that our proposed work will be relevant and responsive to our main stakeholders.</p> <p>Comments from 2009/10 to 2012/13 mainly supported our proposals and approach, with useful suggestions for improving the scope of some of our performance audits.</p>

Quality advice is given to Parliamentary select committees, local government, and other stakeholders		
At least 85% of select committee members and other stakeholders we survey rate the advice they receive from us through our Statutory auditor function as 4 or better on a scale of 1 to 5 for relevance and usefulness.	Not achieved	<p>This measure was changed in the 2013/14 annual plan to include all our advisory work across the Statutory auditor function. The 2014 Stakeholder survey sample size was 24.</p> <p>19 of the 24 (79%) stakeholders interviewed agreed that the advice that they receive from us through our Statutory auditor function is relevant and useful.</p> <p>Three of those surveyed were neutral and two disagreed. We will give attention to the comments from these stakeholders about how we can improve our advice to help them in their work.</p>
Independent reviews of two performance audits confirm the quality of our reports.	Achieved	<p>Overall, the reviews confirmed the quality of our reports. They were highly rated for quality, approach, conclusions, and impact. Our recommendations were acknowledged as being clear, specific and practical in highlighting ways to improve effectiveness and efficiency.</p> <p>Every year since 2010, reviews have confirmed the quality of our reports and suggested aspects to improve.</p>

We use relevant standards and quality processes to carry out our Statutory auditor function		
Internal quality assurance is carried out to gain assurance that our policies, procedures, and standards for our Statutory auditor function have been applied appropriately and that they meet relevant standards and procedures. The review is carried out over aspects of our Statutory auditor function at least once every three years. The nature, extent, and frequency of these reviews are based on risk.	Achieved	<p><i>Performance audit reports</i></p> <p>An internal quality assurance review of performance audits carried out in 2013/14 found that the Office's overall approach to performance audit is in line with the fundamental principles set out in relevant professional standards. The review made recommendations for strengthening the design and use of our quality control framework for performance audits. These recommendations are being acted on.</p>

	Achieved	<p><i>Administration of the Local Authorities (Members' Interests) Act 1968 enquiries and responses to requests for inquiries</i></p> <p>The 2013/14 review of the Local Authorities (Members' Interests) Act 1968 enquiries system confirmed that responses to requests were provided in keeping with the relevant policies, procedures, and standards.</p>
	Achieved	<p><i>Financial review and Estimates examination reports</i></p> <p>A 2012/13 review of our financial review and Estimates examination reports found that these were of high quality. Recommendations about the policies and procedures for preparing reports for financial reviews and Estimates examinations were adopted.</p>
	Achieved	<p><i>Controller function</i></p> <p>The 2011/12 review of the Controller function confirmed that appropriate systems were in place and worked effectively. Some process improvements were recommended.</p>
Our performance audit methodology reflects good practice for carrying out audits, as assessed every second year by the Australian National Audit Office.	Achieved	In 2013, the Australian National Audit Office reviewed two of our performance audits and found that the methodology for these audits was largely in keeping with the Office's processes and practices. We are putting into effect the useful improvement opportunities that the review identified.

Our advice and inquiries are completed in a timely way		
Reports and advice are given to select committees and Ministers at least two days before an examination, unless otherwise agreed.	Achieved	From 2009/10 to 2013/14, all reports and advice were given to select committees and Ministers at least two days before an examination, unless otherwise agreed.
At least 80% of our findings on completed inquiries are reported to the relevant parties within three months for routine inquiries, six months for significant inquiries and 12 months for major inquiries.	Achieved for routine inquiries Not achieved for significant and major inquiries	90% of findings for routine inquiries were reported within three months, and 50% of findings for significant inquiries were reported within six months. We completed two major inquiries in 2013/14. Neither were reported on within the 12-month target period.

Figure 11
Percentage of findings on routine inquiries and significant inquiries reported to the relevant parties within the target period, 2009/10 to 2013/14

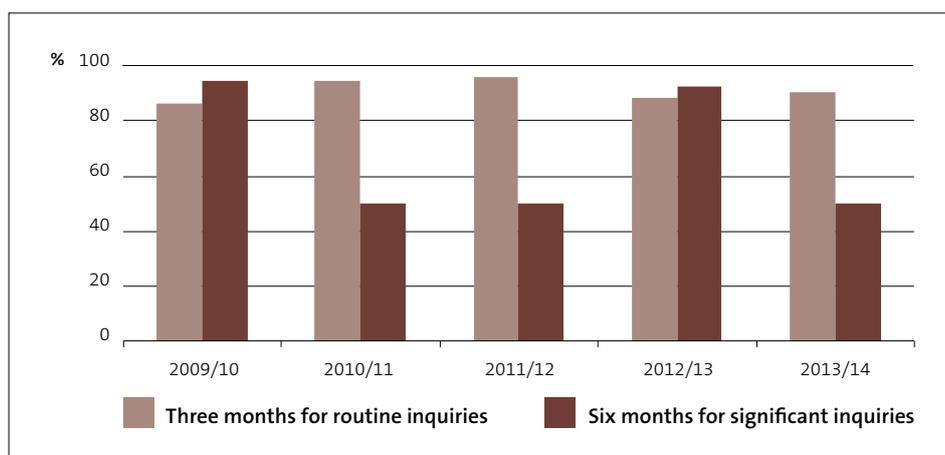
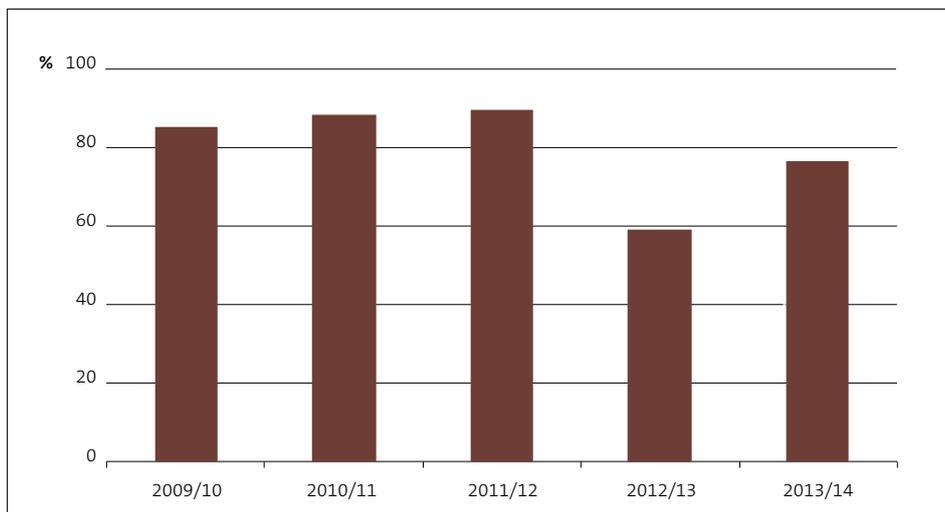


Figure 12
Number of findings on major inquiries reported to the relevant parties within the target period, 2009/10 to 2013/14

Year	Completed major inquiries	Reported within 12 months
2013/14	2	0
2012/13	4	4
2011/12	1	1
2010/11	3	1
2009/10	5	4

We complete at least 80% of enquiries under the Local Authorities (Members' Interests) Act 1968 within 30 working days.	Not achieved	76% of enquiries were completed within 30 working days. We did not meet our timeliness target, because priority was placed on completing major inquiries and several matters that required long investigation.
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Figure 13
Percentage of enquiries under the Local Authorities (Members' Interests) Act 1968 completed within 30 working days, 2009/10 to 2013/14



Controller function is carried out effectively		
Monthly statements provided by the Treasury are reviewed for the period September to June inclusive. Advice of issues arising and action to be taken is provided to the Treasury and appointed auditors within five working days of receipt of the statement.	Achieved	2009/10 to 2013/14: All monthly procedures were followed and agreed time frames achieved.

Figure 14
Financial performance of multi-class output: Statutory auditor function

	2013/14 Actual \$000	2012/13 Actual \$000	2011/12 Actual \$000	2013/14 Supplementary Estimates \$000	2014/15 Main Estimates \$000
Income					
Crown	9,047	9,047	9,047	9,047	9,047
Other	176	156	174	275	260
Expenditure	(8,799)	(9,065)	(8,837)	(9,322)	(9,307)
Surplus/(Deficit)	424	138	384	0	0

* The 2014/15 forecast financial statements are unaudited.

3

Organisational health and capability

We place high importance on having a strong foundation of skilled people working together in a well-run organisation.

Our people

We are committed to an organisational culture where our people are supported and have the capability and opportunity to do their best work. We take joint responsibility with our people for building capability and strengthening their contribution to the Office and to the public sector. The Office seeks to provide our people with a supportive and rewarding place to work.

Equal employment opportunities

Our equal employment opportunities programme is designed to enable us to continue to attract and appoint people, who have the appropriate skills, values, and attributes to meet the Office's needs, and strategic direction. The principles and practice of Equal Employment Opportunities are embedded in our human resources policies. We consider that we have continued to give effect to those principles during the year.

We monitor our recruitment and employment decisions and practices. Our managers are made aware of, and given support to fulfil, our good employer obligations, through specific programmes, courses, and one-on-one coaching. Details about staff numbers and staff diversity between 2011 and 2014 are available on our website.

Building our staff capability

We focus on improving every staff member's skills, as identified in our competency frameworks. We continue our focus on our leadership development programmes, and on improving our staff's engagement (as measured by our annual staff engagement survey). Our average staff engagement scores throughout the organisation increased from 2012/13.

Our audit staff have consistently performed well in the New Zealand Institute of Chartered Accountants (NZICA) final accreditation examinations. In 2013/14, we again achieved a 100% pass rate.

Information systems

Our work involves intensive use of information. We rely on information systems to support this work. Our audit teams in the field use specialist auditing software (TeamMate) and remote access tools.

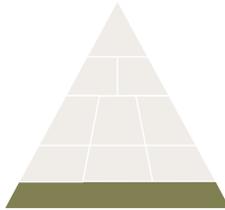
We recognise the significance of the information and insights that the Auditor-General, her Appointed Auditors and their staff gather as they work, and we are committed to using this to help improve the public sector's performance. To improve the collection, analysis, sharing, and reporting of this information, we put the second phase of an enterprise content management system, which we call the Source, into effect in 2013/14. We intend to continue work on this system in 2014/15.

We began putting into effect a Business Intelligence platform, which we plan to use to analyse the various datasets that our auditors collect. Our objective is to use this platform to better understand risks and issues throughout the public sector, and continue our reporting about these.

Facilities

In 2013/14, we completed our long-term property project in Christchurch. After more than two years in makeshift facilities, our Christchurch staff now have a permanent and suitable office.

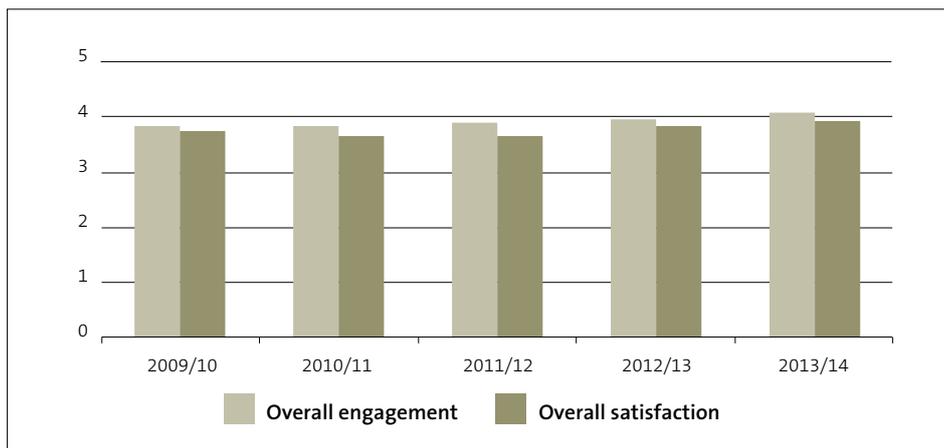
Contact details for our offices are available on the OAG and Audit New Zealand websites.



2013/14 results and previous performance for organisational health and capability

Measure	Result	Comment
Staff are engaged and satisfied		
Improve (or at least maintain) the engagement and satisfaction of our staff measured against the previous two years.	Achieved	<p>The Office's staff engagement survey is based on responses to statements on a 5-point scale, with "1" being the lowest score and "5" being the highest.</p> <p>Our survey results show increases in both overall engagement (4.03) and satisfaction (3.89) when measured against the previous two years. The increase in Audit New Zealand's results for engagement (4.06) and satisfaction (3.93) were particularly encouraging.</p>

Figure 15
Overall staff engagement and satisfaction scores, 2009/10 to 2013/14



Improve (or at least maintain) the average years of experience of our staff measured against the previous two years.	Achieved	Our results improved for Audit New Zealand (6.2 years) and Corporate Services (5.5 years). Results for OAG (6.7 years) improved when measured against the average of the previous two years.
--	----------	--

Figure 16
Average numbers of years staff have been employed by the Office, 2009/10 to 2013/14



Staff turnover	No target set	Overall, we are comfortable with a turnover of up to 20%, but would prefer no more than 15%. This year's turnover was 14.6%, a reduction on the 17.4% in 2012/13.
----------------	---------------	---

Audit staff have high levels of expertise		
Achieve a pass rate of at least 95% for staff undertaking accreditation examinations.	Achieved	This year, we achieved a 100% pass rate for the NZICA final accreditation examinations. We have consistently achieved a pass rate of more than 95% since 2009/10.

<p>Client survey feedback shows that our audit staff's knowledge of entities' business and operating context is improving, and that our auditors are investing in work to understand that context. Our clients give us improved (or at least maintained) ratings (on a scale of 1 to 10) compared with the previous two years for their auditors':</p> <ul style="list-style-type: none"> • understanding of the client's business and the risks the client faces; • general skills and knowledge required to conduct their audit; and • provision of information to help clients identify and promote improvement in their operations. 	<p>Achieved</p>	<p>In 2013/14, a sample of public entities rated Audit New Zealand the same or better in all aspects compared with the previous two years:</p> <p>Ability to understand the business and risks</p> <p>2013/14 – 7.5 2012/13 – 7.5 2011/12 – 7.3</p> <p>General skills and knowledge</p> <p>2013/14 – 7.5 2012/13 – 7.4 2011/12 – 7.2</p> <p>Information to improve</p> <p>2013/14 – 6.8 2012/13 – 6.5 2011/12 – 6.4</p>
<p>Audit staff have high levels of expertise: Auditing performance information</p>		
<p>Our quality assurance reviews of our audit and assurance work confirms that auditors are carrying out the requirements of AG-4 (Revised). AG-4 (Revised) is the Auditor-General's auditing standard on auditing service performance information.</p>	<p>Partially achieved</p>	<p>Quality assurance reviews of our audit and assurance work found auditors are generally meeting the requirements of AG-4 (Revised). The reviews have made recommendations about some areas where compliance can be improved. These are related to the assessment of whether the forecast non-financial performance information provides an adequate basis for reporting service performance information, and the assessment process used for identifying the material performance information for auditing.</p>

Financial statements 2013/14

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Audit report



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INDEPENDENT AUDITOR'S REPORT

TO THE READERS OF THE CONTROLLER AND AUDITOR-GENERAL'S FINANCIAL STATEMENTS AND NON-FINANCIAL PERFORMANCE INFORMATION FOR THE YEAR ENDED 30 JUNE 2014

We have been appointed by the House of Representatives to carry out the audit of the financial statements and non-financial information included in the annual report of the Controller and Auditor-General for the year ended 30 June 2014.

We have audited:

- the financial statements of the Controller and Auditor-General on pages 48 to 75, that comprise the statement of financial position, statement of commitments, statement of contingent liabilities and contingent assets as at 30 June 2014, the statement of comprehensive income, statement of changes in taxpayers' funds (equity), statement of cash flows, statement of output expenses, other expenses and capital expenditure against appropriations, and statement of unappropriated expenditure for the year end on that date, and the notes to the financial statements that include accounting policies and other explanatory information; and
- the non-financial performance information of the Controller and Auditor-General that comprises the statement of service performance on pages 13 to 37.

Opinion

In our opinion:

- the financial statements of the Controller and Auditor-General on pages 48 to 75:
 - comply with generally accepted accounting practice in New Zealand;
 - fairly reflect the Controller and Auditor-General's:
 - financial position as at 30 June 2014;
 - financial performance and cash flows for the year ended on that date;
 - output expenses, other expenses and capital expenditure against each appropriation administered by the Controller and Auditor-General and each class of outputs included in each output expense appropriation for the year ended 30 June 2014; and
 - unappropriated expenditure for the year ended 30 June 2014
- the non-financial performance information of the Controller and Auditor-General on pages 13 to 37:
 - complies with generally accepted accounting practice in New Zealand; and
 - fairly reflects the Controller and Auditor-General's service performance and outcomes for the year ended 30 June 2014, including for each class of outputs:
 - the service performance compared with the forecasts in the forecast statement of service performance at the start of the financial year; and
 - the revenue earned and output expenses incurred as compared with the forecasts in the forecast statement of service performance at the start of the financial year.

The audit was completed on 30 September 2014. This is the date at which our opinion is expressed.

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The basis of our opinion is explained below. In addition, we outline the responsibilities of the Controller and Auditor-General and our responsibilities, and explain our independence.

Basis of Opinion

We carried out the audit in accordance with International Standards on Auditing (New Zealand), and we applied the Auditor-General's Auditing Standard 4 (Revised) – *The Audit of Service Performance Reports* that is also applied to the audit of non-financial performance information in many other public sector entities in New Zealand. Those standards require that we comply with ethical requirements and plan and carry out our audit to obtain reasonable assurance about whether the financial statements and the non-financial performance information are free from material misstatement.

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

An audit involves carrying out procedures to obtain audit evidence about the amounts and disclosures in the financial statements and the non-financial performance information. The procedures selected depend on our judgement, including our assessment of risks of material misstatement of the financial statements and the non-financial performance information, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Controller and Auditor-General's preparation of the financial statements and the non-financial performance information that fairly reflect the matters to which they relate. We consider internal control in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the Controller and Auditor-General's internal control.

An audit also involves evaluating:

- the appropriateness of accounting policies used and whether they have been consistently applied;
- the reasonableness of the significant accounting estimates and judgements made by the Controller and Auditor-General;
- the appropriateness of the reported non-financial performance information within the Controller and Auditor-General's framework for reporting performance;
- the adequacy of all disclosures in the financial statements and the non-financial performance information; and
- the overall presentation of the financial statements and the non-financial performance information.

We did not examine every transaction, nor do we guarantee complete accuracy of the financial statements and the non-financial performance information. We have obtained all the information and explanations we have required and we believe we have obtained sufficient and appropriate audit evidence to provide a basis for our audit opinion.



Responsibilities of the Controller and Auditor-General

The Controller and Auditor-General is responsible for preparing financial statements and non-financial performance information that:

- comply with generally accepted accounting practice in New Zealand;
- fairly reflect the Controller and Auditor-General's financial position, financial performance, cash flows, output expenses, other expenses and capital expenditure against each appropriation and unappropriated expenditure; and
- fairly reflect the Controller and Auditor-General's service performance and outcomes.

The Controller and Auditor-General is also responsible for such internal control as is determined necessary to enable the preparation of financial statements and non-financial performance information that are free from material misstatement, whether due to fraud or error.

The Controller and Auditor-General's responsibility arises from sections 45A, 45B, and 45F of the Public Finance Act 1989.

Responsibilities of the Auditor

We are responsible for expressing an independent opinion on the financial statements and the non-financial performance information and reporting that opinion to you based on our audit. Our responsibility arises from section 38 of the Public Audit Act 2001 and sections 45D and 45F of the Public Finance Act 1989.

Independence

When carrying out the audit, we followed the independence requirements of the External Reporting Board.

We carry out some audits of public entities on behalf of the Controller and Auditor-General. The amount of work we carry out on behalf of the Controller and Auditor-General is no more than the amount of work we did prior to our appointment as auditor of the Controller and Auditor-General. Other than the audit of the Controller and Auditor-General and the audits we carry out on behalf of the Controller and Auditor-General, we have no relationship with or interests in the Controller and Auditor-General.

CST Nexia Audit
CST Nexia Audit
Chartered Accountants
Manukau City, New Zealand

Statement of responsibility

In terms of the Public Finance Act 1989 and the Public Audit Act 2001, the Controller and Auditor-General is responsible for the accuracy and judgements used in the preparation of the financial statements, and for establishing and maintaining systems of internal control designed to provide ongoing assurance of the integrity and reliability of financial reporting.

Appropriate systems of internal control have been employed to ensure that:

- all transactions are executed in accordance with authority;
- all transactions are correctly processed and accounted for in the financial records; and
- the assets of the Office are properly safeguarded.

In my opinion, the information set out in the statement of service performance, the financial statements, and attached notes to those statements (on pages 13-37 and 48-75) fairly reflects our service performance, financial activities, and cash flows for the year ended 30 June 2014, and our financial position as at that date.

Signed:



Lyn Provost
Controller and Auditor-General

30 September 2014

Countersigned:



Maria Viviers
Chief Financial Officer

30 September 2014

Statement of comprehensive income for the year ended 30 June 2014

This statement reports the income and expenditure relating to all outputs (goods and services) produced by the Office. Supporting statements showing the income and expenditure of each output class are on pages 22 and 37.

Explanations of significant variances against the Main Estimates are detailed in Note 21.

	Notes	Actual 2013/14 \$000	Actual 2012/13 \$000	Main Estimates 2013/14 \$000*	Supplementary Estimates 2013/14 \$000*	Main Estimates 2014/15 \$000*
Income						
Crown funding	2	10,120	10,080	10,080	10,120	10,120
Audit fee revenue	3	72,116	70,041	68,114	71,042	75,390
Other income		199	163	275	275	260
Gain on sale of plant and equipment		31	41	-	-	-
Total income		82,466	80,325	78,469	81,437	85,770
Expenditure						
Personnel costs	4	37,664	38,075	37,629	37,543	39,392
Other operating costs	5	42,079	39,920	39,018	42,080	44,735
Depreciation and amortisation expense	9, 10	1,236	1,035	1,324	1,316	1,145
Capital charge	6	498	366	498	498	498
Total expenditure		81,477	79,396	78,469	81,437	85,770
Other comprehensive income		-	-	-	-	-
Total comprehensive income for the year		989	929	-	-	-

* All Estimates information is unaudited.

The accompanying notes form part of these financial statements.

Statement of changes in equity for the year ended 30 June 2014

	Notes	Actual 2013/14 \$000	Actual 2012/13 \$000	Main Estimates 2013/14 \$000*	Supplementary Estimates 2013/14 \$000*	Main Estimates 2014/15 \$000*
Balance at 1 July		6,221	4,021	6,221	6,221	6,221
Surplus for the year		989	929	-	-	-
Surplus repayment due to the Crown	12	(455)	(929)	-	-	-
Capital contribution		-	2,200	-	-	-
Balance at 30 June	14	6,755	6,221	6,221	6,221	6,221

* All Estimates information is unaudited.

The accompanying notes form part of these financial statements.

Statement of financial position as at 30 June 2014

This statement reports total assets and liabilities. The difference between the total assets and total liabilities is called equity. Explanations of significant variances against the Main Estimates are detailed in Note 21.

	Notes	Actual 2013/14 \$000	Actual 2012/13 \$000	Main Estimates 2013/14 \$000*	Supplementary Estimates 2013/14 \$000*	Main Estimates 2014/15 \$000*
Current assets						
Cash and cash equivalents		3,348	3,731	4,515	3,195	4,363
Prepayments		449	334	400	334	334
Work in progress		1,687	2,112	1,200	2,000	1,200
Debtors and other receivables	8	6,470	5,667	5,650	5,000	6,000
<i>Total current assets</i>		11,954	11,844	11,765	10,529	11,897
Non-current assets						
Plant and equipment	9	4,057	4,209	4,411	4,196	3,888
Intangible assets	10	565	692	907	668	652
<i>Total non-current assets</i>		4,622	4,901	5,318	4,864	4,540
Total assets		16,576	16,745	17,083	15,393	16,437
Current liabilities						
Creditors and other payables	11	4,688	4,789	5,339	4,410	5,360
Repayment of surplus due to Crown	12	455	929	-	-	-
Employee entitlements	13	4,095	4,245	4,914	4,190	4,273
<i>Total current liabilities</i>		9,238	9,963	10,253	8,600	9,633
Non-current liabilities						
Employee entitlements	13	549	561	609	572	583
Income in advance		34	-	-	-	-
<i>Total non-current liabilities</i>		583	561	609	572	583
Total liabilities		9,821	10,524	10,862	9,172	10,216
Net assets		6,755	6,221	6,221	6,221	6,221
Equity						
Taxpayers' funds	14	6,221	6,221	6,221	6,221	6,221
Memorandum account	20	534	-	-	-	-
Total equity		6,755	6,221	6,221	6,221	6,221

* All Estimates information is unaudited.

The accompanying notes form part of these financial statements.

Statement of cash flows for the year ended 30 June 2014

This statement summarises the cash movements in and out of the Office during the year. It takes no account of money owed to the Office or owing by the Office, and therefore differs from the statement of comprehensive income.

	Notes	Actual 2013/14 \$000	Actual 2012/13 \$000	Main Estimates 2013/14 \$000*	Supplementary Estimates 2013/14 \$000*	Main Estimates 2014/15 \$000*
Cash flows from operating activities						
Receipts from the Crown		10,120	10,080	10,080	10,120	10,080
Receipts from public entities ¹		40,136	41,980	39,345	40,477	46,031
Payments to suppliers ¹		(10,468)	(12,089)	(10,315)	(12,182)	(15,653)
Payments to employees		(37,691)	(38,571)	(37,398)	(36,246)	(37,971)
Net GST paid ²		(128)	113	-	-	-
Capital charge paid		(498)	(366)	(498)	(498)	(498)
Net cash flow from (used in) operating activities	15	1,471	1,147	1,214	1,671	1,989
Cash flows from investing activities						
Receipts from sale of plant and equipment		103	152	65	39	86
Purchase of plant and equipment		(755)	(3,426)	(617)	(927)	(707)
Purchase of intangible assets		(273)	(372)	(200)	(392)	(200)
Net cash flow from (used in) investing activities		(925)	(3,646)	(752)	(1,280)	(821)
Cash flows from financing activities						
Surplus repayment to the Crown		(929)	(1,449)	(480)	(929)	-
Capital contribution		-	2,200	-	-	-
Net cash flow from (used in) financing activities		(929)	751	(480)	(929)	-
Total net increase (decrease) in cash held		(383)	(1,748)	(18)	(538)	1,168
Cash at the beginning of the year		3,731	5,479	4,533	3,733	3,195
Cash at the end of the year		3,348	3,731	4,515	3,195	4,363

1 The statement of cash flows does not include the contracted audit service provider audit fee revenue or expenditure, as these do not involve any cash transactions with the Office.

2 The GST component of operating activities reflects the net GST paid to and received from the Inland Revenue Department. GST has been presented on a net basis, as the gross amounts do not provide meaningful information for financial statement purposes.

* All Estimates information is unaudited.

The accompanying notes form part of these financial statements.

Statement of commitments as at 30 June 2014

This statement records expenditure to which the Office is contractually committed at 30 June 2014.

Non-cancellable operating lease commitments

The Office leases property, plant, and equipment in the normal course of its business. The majority of these leases are for premises, which have a non-cancellable leasing period ranging from three to nine years.

The Office's non-cancellable operating leases have varying terms, escalation clauses, and renewal rights. There are no restrictions placed on the Office by any of its leasing arrangements.

	Actual 2013/14 \$000	Actual 2012/13 \$000
Non-cancellable operating lease commitments		
Not later than one year	2,458	2,485
Later than one year and not later than five years	8,994	9,111
Later than five years	3,242	6,756
Total non-cancellable operating lease commitments	14,694	18,352
Total commitments	14,694	18,352

Statement of contingent liabilities and contingent assets as at 30 June 2014

This statement discloses situations that existed at 30 June 2014, the ultimate outcome of which is uncertain and will be confirmed only on the occurrence of one or more future events after the date of approval of the financial statements.

Contingent liabilities

The Office did not have any contingent liabilities as at 30 June 2014 (nil as at 30 June 2013).

Contingent assets

The Office did not have any contingent assets as at 30 June 2014 (nil as at 30 June 2013).

The accompanying notes form part of these financial statements.

Statement of output expenses, other expenses, and capital expenditure against appropriations for the year ended 30 June 2014

This statement reports actual expenses incurred against each appropriation administered by the Office.

	Actual 2013/14	Actual 2012/13	Main Estimates 2013/14	Supplementary Estimates 2013/14	Main Estimates 2014/15
Vote Audit	\$000	\$000	\$000*	\$000*	\$000*
Appropriations for output expenses					
Statutory auditor function (multi-class appropriation)					
Supporting accountability to Parliament	3,032	2,515	2,735	3,235	2,720
Performance audits and inquiries	5,767	6,550	6,587	6,087	6,587
<i>Total Statutory auditor function</i>	8,799	9,065	9,322	9,322	9,307
Audit and assurance services	150	150	150	150	150
Provision of audit and assurance services (revenue-dependent appropriation) ¹	71,605	69,298	68,114	71,042	75,390
Total appropriations for output expenses	80,554	78,513	77,586	80,514	84,847
Other expenses to be incurred by the Office					
Remuneration of the Auditor-General and Deputy Auditor-General ²	923	883	883	923	923
Total operating expenses	81,477	79,396	78,469	81,437	85,770
Capital expenditure	1,028	3,823	817	1,319	907
Total annual and permanent appropriations	82,505	83,219	79,286	82,756	86,677

1 Revenue-dependent appropriation – Provision of audit and assurance services. In 2013/14, the Office earned \$72.116 million from audit and assurance services – refer Note 3. The Office is permitted to incur expenditure up to the amount of revenue earned for this appropriation.

2 Costs incurred pursuant to clause 5 of Schedule 3 of the Public Audit Act 2001.

* All Estimates information is unaudited.

Statement of unappropriated expenditure for the year ended 30 June 2014

The Office incurred no unappropriated expenditure during the year ended 30 June 2014 (nil for the year ended 30 June 2013).

Notes to the financial statements for the year ended 30 June 2014

Note 1: Statement of accounting policies

Reporting entity

The Controller and Auditor-General is a corporation sole established by section 10(1) of the Public Audit Act 2001, is an Office of Parliament for the purposes of the Public Finance Act 1989, and is domiciled in New Zealand.

The Controller and Auditor-General's activities include work carried out by the Office of the Auditor-General (OAG) and Audit New Zealand (referred to collectively as "the Office"), and contracted audit service providers. The Office has designated itself as a public benefit entity for the purposes of New Zealand equivalents to International Financial Reporting Standards (NZ IFRS).

The financial statements of the Office are for the year ended 30 June 2014. The financial statements were authorised for issue by the Controller and Auditor-General on 30 September 2014.

Basis of preparation

The financial statements of the Controller and Auditor-General have been prepared in accordance with sections 45A, 45B, and 45F of the Public Finance Act 1989, which include the requirement to comply with New Zealand generally accepted accounting practice (NZ GAAP), and Treasury Instructions.

These financial statements have been prepared in accordance with NZ GAAP. They comply with NZ IFRS and other applicable Financial Reporting Standards, as appropriate for a public benefit entity.

The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

The financial statements have been prepared on a historical cost basis. The financial statements are presented in New Zealand dollars, and all values are rounded to the nearest thousand dollars (\$000). The functional currency of the Office is New Zealand dollars.

There have been no changes in accounting policies during the financial year.

The new multi-tier accounting standards framework, developed by the External Reporting Board (XRB), is now in place. The Office will apply the new PBE accounting standards for the year ending 30 June 2015, complying with Tier 1. The effect of the new accounting standards on the financial statements of the Controller and Auditor-General have been assessed, with no significant changes expected on transition.

2013/14 Main Estimates and Supplementary Estimates

The Main Estimates and Supplementary Estimates figures have been prepared in accordance with NZ GAAP, using accounting policies that are consistent with those adopted in preparing the 2013/14 financial statements.

The 2013/14 Main Estimates figures are those included in the Office's annual plan for the year ended 30 June 2014. In addition, the financial statements also present updated figures from the Supplementary Estimates. The budget figures are unaudited.

2014/15 forecast financial statements

Forecast financial statements for the 2014/15 financial year are now included in this annual report, a requirement of the Public Finance Amendment Act 2013.

The 2014/15 forecast financial statements comply with PBE FRS No. 42: *Prospective Financial Statements*, and have been prepared in accordance with NZ GAAP. They are the Office's first set of prospective financial statements presented under PBE Accounting Standards.

The 2014/15 forecast financial statements are based on the Main Estimates published in Budget 2014, and are unaudited. There is no material impact on this information since the publication of the Main Estimates.

Statement of significant underlying assumptions

The forecast financial statements were compiled on the basis of existing government policies and after the Controller and Auditor-General consulted with the Speaker and the Officers of Parliament Committee. The main assumptions are that:

- The Controller and Auditor-General's portfolio of entities will remain substantially the same as for the previous year.
- The Controller and Auditor-General will continue to deliver the range of products currently provided and will also be in a position to deliver new products, or existing products in new ways, to cope with changing demands.
- The scale of annual audits will remain substantially the same, and audits of most local authorities' long-term plans are carried out in 2014/15.
- The balance of activity associated with inquiries and with advice to Parliament and others will continue to vary because of increases in demand and the effects of the Public Audit Act 2001.
- The Controller and Auditor-General will continue to use audit expertise from Audit New Zealand and private sector accounting firms.

These assumptions were adopted as at 26 March 2014.

Accounting policies

Income

Income is measured at the fair value of the consideration received or receivable. Income is derived mainly from the Crown for outputs provided to Parliament, from fees for the audit of public entities' financial statements, and from fees for other assurance work carried out by the Office, largely at the request of public entities.

Crown funding

Crown funding is recognised during the period to which it relates.

Fee revenue generated by the Office for audits and other assurance work

Fee revenue is recognised when earned, by reference to the stage of completion of audit and other assurance work, if the outcome can be estimated reliably. Revenue accrues as the audit activity progresses by reference to the value of work performed, and as direct expenses that can be recovered are incurred. If the outcome of an audit cannot be estimated reliably, revenue is recognised only to the extent of the direct costs incurred in respect of the work performed. If there are significant uncertainties regarding recovery, or if recovery is contingent on events outside our control, no revenue is recognised.

Fee revenue generated by contracted audit service providers for audits

Fee revenue generated by contracted audit service providers (other than Audit New Zealand) for audits of public entities is also recognised as the work progresses, based on advice from the contracted audit service providers. Contracted audit service providers invoice and collect audit fees directly from public entities.

Expenditure

Expenses of audit service providers

Fees for audits of public entities carried out by contracted audit service providers are recognised as the work progresses, based on advice from the contracted audit service providers. Contracted audit service providers invoice and collect audit fees directly from public entities.

Leases

An operating lease is a lease that does not transfer substantially all the risks and rewards incidental to ownership of an asset. Lease payments under an operating lease are recognised as an expense on a straight-line basis over the lease term. All leases entered into by the Office are operating leases.

Foreign currency transactions

Foreign currency transactions (including those for which forward foreign exchange contracts are held) are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the surplus or deficit.

Capital Charge

The capital charge is recognised as an expense in the period to which the charge relates.

Financial instruments

Financial assets and financial liabilities are initially measured at fair value plus transaction costs, unless they are carried at fair value through profit or loss, in which case the transaction costs are recognised in the surplus or deficit.

Cash and cash equivalents

Cash includes cash on hand and funds on deposit with banks and is measured at its face value.

Work in progress

Work in progress is stated at estimated realisable value, after providing for non-recoverable amounts. Work in progress represents unbilled revenue.

Debtors and other receivables

Debtors and other receivables are initially measured at fair value and, where appropriate, subsequently measured at amortised cost using the effective interest rate, less impairment losses.

Impairment of a receivable is established when there is objective evidence that the Office will not be able to collect amounts due according to the original terms of the receivable. Significant financial difficulties of the debtor, probability that the debtor will enter into bankruptcy or liquidation, and default in payments are considered indicators that the debt is impaired. The amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted using the original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognised in the surplus or deficit.

Property, plant, and equipment

Property, plant, and equipment include furniture and fittings, leasehold improvements, office equipment, information technology hardware, and motor vehicles. The property, plant, and equipment total is shown at cost, less accumulated depreciation and impairment losses.

Additions

Individual assets, or group of assets, are capitalised if their cost is greater than \$1,000.

The cost of an item of property, plant, and equipment is recognised as an asset if, and only if, it is probable that future economic benefits or service potential associated with the item will flow to the Office and the cost of the item can be measured reliably.

In most instances, an item of property, plant, and equipment is recognised at its cost. Where an asset is acquired at no cost, or for a nominal cost, it is recognised at fair value as at the date of acquisition.

Disposals

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount of the asset. Gains and losses on disposals are included in the surplus or deficit.

Subsequent costs

Costs incurred subsequent to initial acquisition are capitalised only when it is probable that future economic benefits or service potential associated with the item will flow to the Office and the cost of the item can be measured reliably.

The costs of day to day servicing of property, plant, and equipment are recognised in the surplus or deficit as they are incurred.

Depreciation

Depreciation is provided on a straight-line basis on all property, plant, and equipment, at rates that will write off the cost less estimated residual values of the property, plant, and equipment over their useful lives. The useful lives and associated depreciation rates of major classes of assets have been estimated as follows:

- Furniture and fittings 4 years (25%)
- Office equipment 2.5 - 5 years (20% - 40%)
- IT hardware 2.5 - 5 years (20% - 40%)
- Motor vehicles 3-4 years (25% - 33%)

Leasehold improvements are depreciated over the unexpired period of the lease or the estimated remaining useful lives of the improvements, whichever is the shorter.

The residual value and useful life of an asset is reviewed, and adjusted if applicable, at each balance date.

Intangible assets

Software acquisition and development

Acquired computer software licenses are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. Costs associated with maintaining computer software are recognised as an expense when incurred.

Costs that are directly associated with the development of software for internal use by the Office are recognised as an intangible asset. Direct costs include the software development and employee costs.

Staff training costs are recognised as an expense when incurred.

Amortisation

The carrying value of an intangible asset with a finite life is amortised on a straight-line basis over its useful life. Amortisation begins when the asset is available for use and ceases at the date that the asset is derecognised. The amortisation charge for each period is recognised in the surplus or deficit.

The useful life and associated amortisation rate of computer software is estimated at between 2.5 and 5 years (20% - 40%).

Impairment of non-financial assets

Property, plant, and equipment and intangible assets that have a finite useful life are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable through either continued use or disposal. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use.

Value in use is depreciated replacement cost for an asset where the future economic benefits or service potential of the asset are not primarily dependent on the asset's ability to generate net cash inflows and where the Office would, if deprived of the asset, replace its remaining future economic benefits or service potential.

If an asset's carrying amount exceeds its recoverable amount, the asset is impaired and the carrying amount is written down to the recoverable amount. The impairment loss is recognised in the surplus or deficit. Any reversal of an impairment loss is also recognised in the surplus or deficit.

Creditors and other payables

Creditors and other payables are initially measured at fair value and, where appropriate, subsequently measured at amortised cost using the effective interest method.

Income in advance

Income in advance is recognised where amounts billed are in excess of the amounts recognised as revenue.

Employee entitlements

Short-term employee entitlements

Employee entitlements that the Office expects to be settled within 12 months of balance date are measured at nominal values based on accrued entitlements at current rates of pay.

These include salaries and wages accrued up to balance date, annual leave, and time off in lieu earned but not yet taken at balance date, retiring and long service leave entitlements expected to be settled within 12 months, and sick leave.

The Office recognises a liability for sick leave to the extent that future absences are expected to be greater than the sick leave entitlements earned in the future. The amount is calculated based on the unused sick leave entitlements that can be carried forward at balance date, to the extent that the Office anticipates those unused entitlements will be used by staff to cover those future absences.

The Office recognises a liability and an expense for bonuses where it is contractually obliged to pay them, or where there is a past practice that has created a constructive obligation.

Long-term employee entitlements

Entitlements that are payable beyond 12 months, such as long service leave and retiring leave, have been calculated on an actuarial basis. The calculations are based on:

- likely future entitlements based on years of service, years to entitlement, the likelihood that staff will reach the point of entitlement, and contractual entitlements information; and
- the present value of the estimated future cash flows.

Presentation of employee entitlements

Sick leave, annual leave, time off in lieu of overtime worked, and vested long service leave are classified as a current liability. Non-vested long service leave and retiring/resigning leave expected to be settled within 12 months of balance date are classified as a current liability. All other employee entitlements are classified as a non-current liability.

Superannuation schemes

Obligations for contributions to the Auditor-General's Retirement Savings Plan, KiwiSaver, and the Government Superannuation Fund are accounted for as defined contribution plans, and are recognised as an expense in the surplus or deficit as incurred.

Provisions

A provision is recognised for future expenditure of uncertain amount or timing when there is a present obligation (either legal or constructive) as a result of a past event, it is probable that an outflow of future economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. Provisions are not recognised for future operating losses.

Equity

Equity is the Crown's investment in the Office and is measured as the difference between total assets and total liabilities. Equity is disaggregated and classified as taxpayers' funds and a memorandum account.

Memorandum account

The Office's memorandum account reflects the cumulative surpluses/(deficits) on audit and assurance services provided that are intended to be fully cost recovered from third parties through fees. The balance of the memorandum account is expected to trend toward zero over time.

Commitments

Expenses yet to be incurred on non-cancellable contracts that have been entered into on or before balance date are disclosed as commitments to the extent that there are equally unperformed obligations.

Cancellable commitments that have penalty or exit costs explicit in the agreement on exercising that option to cancel are included in the statement of commitments at the value of that penalty or exit cost.

Goods and Services Tax

All items in the financial statements, including appropriation statements, are stated exclusive of Goods and Services Tax (GST), except for receivables and payables in the statement of financial position, which are stated on a GST-inclusive basis.

Where GST is not recoverable as input tax, it is recognised as part of the related asset or expense. The net amount of GST recoverable from, or payable to, the Inland Revenue Department (IRD) is included as part of receivables or payables in the statement of financial position. The net GST paid to or received from the IRD, including the GST relating to investing and financing activities, is classified as an operating cash flow in the statement of cash flows.

Commitments and contingencies are disclosed exclusive of GST.

Income tax

The Office is exempt from paying income tax in terms of section 43 of the Public Audit Act 2001. Accordingly, no charge for income tax has been provided for.

Output cost allocation

The Office has determined the cost of outputs using allocations as outlined below.

Direct costs are those costs directly attributable to a single output.

Direct costs that can readily be identified with a single output are assigned directly to the relevant output class. For example, the cost of audits carried out by contracted audit service providers is charged directly to output class: Provision of audit and assurance services.

Indirect costs are those costs that cannot be identified in an economically feasible manner with a specific output. These costs include: corporate services costs, variable costs such as travel, and operating overheads such as property costs, depreciation, and capital charges.

Indirect costs are allocated according to the time charged to a particular activity.

There have been no changes in cost allocation policies since the date of the last audited financial statements.

Judgements and estimations

The preparation of these financial statements requires judgements, estimations, and assumptions that affect the application of policies and reported amounts of assets, liabilities, income, and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are

believed to be reasonable under the circumstances. Actual results may differ from these estimates.

Audit fee revenue and work in progress

Assessing the value of audit fee revenue and associated work in progress or income in advance for engagements open at balance date is the most significant area where such judgements, estimations, and assumptions are made. This involves estimating the stage of completion of each engagement based on the value of work completed at balance date and the expected work to complete the engagement. A different assessment of the outcome on an engagement may result in a different value being determined for revenue and also a different carrying value being determined for work in progress.

Depreciation and amortisation

Determining the depreciation rates for physical assets and amortisation rates for intangible assets requires judgement as to the likely period of use of the assets. Different assessments of useful lives would result in different values being determined for depreciation or amortisation costs, accumulated depreciation or amortisation, and net book values.

Retirement and long service leave

An analysis of the exposure in relation to estimates and uncertainties surrounding retirement and long service leave liabilities is disclosed in Note 13.

Note 2: Crown funding

The Crown provides revenue to meet the costs of the Office in assisting Parliament in its role of ensuring accountability for public resources. The services provided to Parliament include reports to Parliament and other constituencies, reports and advice to select committees, responding to taxpayer and ratepayer enquiries, advice to government bodies, professional bodies, and other agencies, and administering the provisions of the Local Authorities (Members' Interests) Act 1968.

Note 3: Audit fee revenue

	Actual 2013/14 \$000	Actual 2012/13 \$000
Fee revenue generated by the Office for audit and assurance services	40,289	41,267
Fee revenue generated by other contracted audit service providers for audits of public entities*	31,827	28,774
Total audit fee revenue and other income	72,116	70,041

* Revenue generated by contracted audit service providers (other than Audit New Zealand) does not involve any cash transactions with the Office.

Note 4: Personnel costs

Employer contributions to defined contribution plans include contributions to the Auditor-General's Retirement Savings Plan, KiwiSaver, and the Government Superannuation Fund.

	Actual 2013/14 \$000	Actual 2012/13 \$000
Salaries and wages	36,554	37,209
Other employee-related costs	142	277
Employer contributions to defined contribution plans	1,130	1,193
Increase/(decrease) in employee entitlements	(162)	(604)
Total personnel costs	37,664	38,075

Note 5: Other operating costs

	Actual 2013/14 \$000	Actual 2012/13 \$000
(Decrease)/Increase in provision for impairment of receivables	(85)	5
Fees to CST Nexia for the audit of the Office's financial statements	94	93
Fees to CST Nexia for other assurance services provided to the Office	6	10
Operating lease payments	2,357	2,030
Fees for audits of public entities carried out by CST Nexia*	127	119
Fees for audits of public entities carried out by other contracted audit service providers*	31,700	28,655
Net loss on disposal	1	3
Other expenses	7,879	9,005
Total other operating costs	42,079	39,920

* Expenditure relating to audits carried out by contracted audit service providers does not involve any cash transactions with the Office.

Note 6: Capital charge

The Office pays a capital charge to the Crown on its taxpayers' funds as at 31 May and 30 November each year. The capital charge rate is determined by the Treasury, and for the year ended 30 June 2014 was 8% (2013 – 8%).

Note 7: Overdraft facility

The Office has the use of an overdraft facility to manage its seasonal cash flows during the second half of the financial year. The overdraft limit is \$500,000, and interest is charged on the daily balance at Westpac Banking Corporation's Prime Lending Rate.

During this financial year, no funds were drawn down under the facility (and none were drawn down in 2012/13).

Note 8: Debtors and other receivables

	Actual 2013/14 \$000	Actual 2012/13 \$000
Debtors	6,464	5,742
Less provision for impairment of receivables	-	(85)
Net debtors	6,464	5,657
Other receivables	6	10
Total receivables	6,470	5,667

The carrying value of debtors and other receivables approximates their fair value.

As at 30 June 2013 and 2014, all overdue receivables have been assessed for impairment and appropriate provisions applied, as detailed below:

	Actual 2013/14			Actual 2012/13		
	Gross \$000	Impairment \$000	Net \$000	Gross \$000	Impairment \$000	Net \$000
Not past due	5,115	-	5,115	4,702	-	4,702
Past due 1-30 days	938	-	938	534	-	534
Past due 31-60 days	349	-	349	225	-	225
Past due 61-90 days	3	-	3	97	-	97
Past due over 90 days	59	-	59	184	(85)	99
Carrying amount	6,464	-	6,464	5,742	(85)	5,657

The impairment provision has been calculated based on expected losses for the Office's pool of debtors. Expected losses have been determined based on an analysis of the Office's losses in previous periods and review of specific debtors.

Movements in the provision for impairment of receivables are as follows:

	Actual 2013/14 \$000	Actual 2012/13 \$000
Balance at 1 July	85	178
Additional provisions made/(written back) during the year	(85)	5
Receivables written off during the period	-	(98)
Balance at 30 June	-	85

Note 9: Plant and equipment

	Furniture and fittings \$000	Office equipment \$000	Leasehold improvements \$000	IT hardware \$000	Motor vehicles \$000	Total \$000
Cost						
Balance at 1 July 2012	2,104	742	282	1,701	1,261	6,090
Additions	74	173	2,330	485	365	3,427
Disposals	(110)	(415)	-	(91)	(334)	(950)
Balance at 30 June 2013	2,068	500	2,612	2,095	1,292	8,567
Additions	20	16	406	207	106	755
Disposals	(375)	(120)	-	(116)	(185)	(796)
Balance at 30 June 2014	1,713	396	3,018	2,186	1,213	8,526
Accumulated depreciation and impairment losses						
Balance at 1 July 2012	2,089	710	-	1,244	454	4,497
Depreciation expense	21	56	79	295	242	693
Elimination on disposal	(110)	(413)	-	(91)	(218)	(832)
Balance at 30 June 2013	2,000	353	79	1,448	478	4,358
Depreciation expense	25	63	200	314	234	836
Elimination on disposal	(375)	(120)	-	(116)	(114)	(725)
Balance at 30 June 2014	1,650	296	279	1,646	598	4,469
Carrying amounts						
Balance at 1 July 2012	15	32	282	457	807	1,593
Balance at 30 June 2013	68	147	2,533	647	814	4,209
Balance at 30 June 2014	63	100	2,739	540	615	4,057

Note 10: Intangible assets

	Acquired software \$000	Internally generated software \$000	Total \$000
Cost			
Balance at 1 July 2012	3,171	120	3,291
Additions	396	-	396
Disposals	(22)	-	(22)
Balance at 30 June 2013	3,545	120	3,665
Additions	273	-	273
Disposals	-	-	-
Balance at 30 June 2014	3,818	120	3,938
Accumulated amortisation and impairment losses			
Balance at 1 July 2012	2,544	88	2,632
Amortisation expense	318	24	342
Disposals	(1)	-	(1)
Balance at 30 June 2013	2,861	112	2,973
Amortisation expense	392	8	400
Disposals	-	-	-
Balance at 30 June 2014	3,253	120	3,373
Carrying amounts			
At 1 July 2012	627	32	659
At 30 June 2013	684	8	692
At 30 June 2014	565	-	565

There are no restrictions over the title of the Office's intangible assets. No intangible assets are pledged as security for liabilities.

Note 11: Creditors and other payables

	Actual 2013/14 \$000	Actual 2012/13 \$000
Creditors	1,442	1,416
Income in advance	2,073	2,016
Accrued expenses	525	837
GST payable	648	520
Total creditors and other payables	4,688	4,789

Creditors and other payables are non-interest-bearing, and are normally settled on 30-day terms. The carrying value of creditors and other payables therefore approximates their fair value.

Note 12: Surplus repayment due to the Crown

The repayment of surplus to the Crown is due to be paid by 31 October each year.

	Note	Actual 2013/14 \$000	Actual 2012/13 \$000
Total comprehensive income for the year		989	929
Less Surplus transferred to memorandum account	20	(534)	-
Total provision for surplus repayment to the Crown		455	929

Note 13: Employee entitlements

	Actual 2013/14 \$000	Actual 2012/13 \$000
Current employee entitlements comprise:		
Salary and other accruals	1,494	1,428
Annual leave	2,217	2,427
Long service leave	66	104
Time off in lieu of overtime worked	86	103
Retiring leave	134	81
Sick leave	98	102
Total current portion	4,095	4,245
Non-current employee entitlements comprise:		
Long service leave	-	-
Retiring leave	549	561
Total non-current portion	549	561
Total employee entitlements	4,644	4,806

The measurement of the retirement and long service leave obligations depend on a number of factors that are determined on an actuarial basis using a number of assumptions. Two key assumptions used in calculating this liability include the discount rate and the salary inflation factor. Any changes in these assumptions will affect the carrying amount of the liability.

The discount rate is based on NZ Government bond data at 30 June 2014. The salary inflation factor has been determined after considering historical salary inflation patterns and after obtaining advice from an independent actuary.

If the discount rate were to differ by 1% from the Office's estimates, with all other factors held constant, the carrying amount of the liability would be an estimated \$33,826 higher/lower.

If the salary inflation factor were to differ by 1% from the Office's estimates, with all other factors held constant, the carrying amount of the liability would be an estimated \$49,275 higher/lower.

Note 14: Equity

	Note	Actual 2013/14 \$000	Actual 2012/13 \$000
Taxpayers' funds			
Balance at 1 July		6,221	4,021
Surplus/(deficit)		989	929
Transfer of memorandum account net (surplus)/deficit for the year		(534)	-
Capital injection		-	2,200
Repayment of surplus to the Crown		(455)	(929)
Balance at 30 June		6,221	6,221
Memorandum account	20		
Balance at 1 July		-	-
Memorandum account net surplus/(deficit) for the year		534	-
Balance at 30 June		534	-
Total equity		6,755	6,221

Note 15: Reconciliation of surplus to net cash flow from operating activities

This reconciliation discloses the non-cash adjustments applied to the surplus reported in the statement of comprehensive income on page 48, to arrive at the net cash flow from operating activities disclosed in the statement of cash flows on page 51.

	Actual 2013/14 \$000	Actual 2012/13 \$000
Surplus	989	929
Non-cash items		
Depreciation and amortisation	1,236	1,035
Total non-cash items	1,236	1,035
Working capital movements		
(Increase)/decrease in prepayments	(115)	507
(Increase)/decrease in receivables	(803)	1,085
(Increase)/decrease in work in progress	424	(905)
(Decrease)/increase in payables	(67)	(653)
(Decrease)/increase in provisions	-	(209)
(Decrease)/increase in employee entitlements	(150)	(597)
Total net working capital movements	(711)	(772)
Investing activity items		
Loss/(profit) on sale of plant and equipment	(31)	(38)
Loss/(profit) on sale of intangible assets	-	-
Total net investing activity items	(31)	(38)
Other items		
(Decrease)/increase in non-current employee entitlements	(12)	(7)
Total other items	(12)	(7)
Net cash flow from operating activities	1,471	1,147

Note 16: Related party transactions

All related party transactions have been entered into on an arm's-length basis.

The Office is a wholly owned entity of the Crown. The Government is a major source of revenue for the Office.

Significant transactions with government-related entities

The Office has received funding from the Crown of \$10.120 million (2013 \$10.080 million) to provide performance audits, inquiries, advice to Parliament, and audits of small entities for the year ended 30 June 2014.

Collectively, but not individually significant transactions with government-related entities

In conducting its activities, the Office is required to pay various taxes and levies (such as GST, FBT, PAYE, and ACC levies) to the Crown and entities related to the Crown. The payment of these taxes and levies, other than income tax, is based on the standard terms and conditions that apply to all tax and levy payers. The Office is exempt from paying income tax.

The Office also purchases goods and services from entities controlled, significantly influenced, or jointly controlled by the Crown. Purchases from these government-related entities for the year ended 30 June 2014 totalled \$1.498 million (2013 \$1.506 million). These purchases included air travel from Air New Zealand, capital charge from The Treasury, and postal services from New Zealand Post. The balances outstanding at balance date amount to \$47,800. Normally, 30-day credit terms apply to these amounts.

During the year, there were transactions between the Office and close family members of key management personnel, as follows:

- Some close family members of key management personnel were employed by the Office. The terms and conditions of their appointment were no more favourable than the Office would have adopted if there were no relationship to key management personnel.
- Close family members of a member of key management personnel were directors in a company that provided services to the Office under a contract that was entered into before the appointment of the member. The cost of the services purchased was \$13,800 (2013 – \$16,100) and there was nil outstanding at balance date (2013 – nil).

Key management personnel compensation

	Actual 2013/14 \$000	Actual 2012/13 \$000
Salaries and other short-term employee benefits	3,471	3,381
Post-employment benefits	-	-
Other long-term benefits	-	-
Termination benefits	-	-
	3,471	3,381

Key management personnel include the Auditor-General, the Deputy Auditor-General, and the ten members of the OAG and Audit New Zealand Leadership Teams.

Note 17: Financial instrument risks

The Office's financial instruments are limited to cash and cash equivalents, debtors and other receivables, and creditors and other payables. These activities expose the Office to low levels of financial instrument risks, including market risk, credit risk, and liquidity risk.

Market risk

Currency risk

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

The Office incurs a small portion of operating expenditure in foreign currency, and risk is minimised through prompt settlement. Recognised liabilities that are payable in a foreign currency were nil at balance date (2013 – nil).

Interest rate risk

Interest rate risk is the risk that the fair value of a financial instrument will fluctuate, or the cash flows from a financial instrument will fluctuate, due to changes in market interest rates.

The Office has no interest-bearing financial instruments and, accordingly, has no exposure to interest rate risk.

Credit risk

Credit risk is the risk that a third party will default on its obligation to the Office, causing the Office to incur a loss.

In the normal course of the Office's business, credit risk arises from debtors and other receivables and deposits with banks.

The Office is permitted to deposit funds only with Westpac, a registered bank with high credit ratings. For its other financial instruments, the Office does not have significant concentrations of credit risk.

The Office's maximum credit exposure for each class of financial instrument is represented by the total carrying amount of cash and cash equivalents, and net debtors and other receivables (see Note 8).

There is no collateral held as security against these financial instruments, including those instruments that are overdue or impaired.

Liquidity risk

Liquidity risk is the risk that the Office will encounter difficulty raising liquid funds to meet commitments as they fall due.

In meeting its liquidity requirements, the Office closely monitors its forecast cash requirements with expected debtor receipts and cash drawdowns from the New Zealand Debt Management Office. The Office maintains a target level of available cash to meet liquidity requirements.

The Office's financial liabilities are outlined in Note 11: Creditors and other payables. These are all due to be settled on 30-day terms.

Note 18: Categories of financial instruments

The carrying amounts of financial instruments are as follows:

	Note	Actual 2013/14 \$000	Actual 2012/13 \$000
Loans and receivables			
Cash and cash equivalents		3,348	3,731
Debtors and other receivables	8	6,470	5,667
<i>Total loans and receivables</i>		9,818	9,398
Financial liabilities measured at amortised cost			
Creditors and other payables	11	4,688	4,789
<i>Total financial liabilities measured at amortised cost</i>		4,688	4,789

Note 19: Capital management

The Office's capital is its equity, which comprise taxpayers' funds and a memorandum account. Equity is represented by net assets.

The Office manages its revenues, expenses, assets, liabilities, and general financial dealings prudently to achieve the goals and objectives for which it has been established. The Office's equity is largely managed as a by-product of managing income, expenses, assets, liabilities, and compliance with the Government Budget processes, Treasury Instructions, and the Public Finance Act 1989.

Note 20: Memorandum account

	Actual 2013/14 \$000	Actual 2012/13 \$000
Audit and assurance services		
Balance at 1 July	-	-
Revenue	72,139	-
Expenses	(71,605)	-
Surplus/(deficit) for the year	534	-
Balance at 30 June	534	-

The Office has established a memorandum account, commencing from the 2013/14 financial year. The memorandum account summarises the accumulated surpluses and deficits incurred in the provision of audit and assurance services by the Office on a full cost recovery basis. These transactions are included as part of the Office's operating income and expenses in the surplus/deficit, however are excluded from the calculation of the Office's repayment of surplus (refer Note 12). The cumulative balance of the surplus/(deficit) of the memorandum account is recognised as a component of equity (refer Note 14).

The balance of the memorandum account is expected to trend toward zero over a reasonable period of time. The memorandum account balance will be taken into account when setting fees in future years.

Note 21: Explanation of significant variances against the Main Estimates

Explanations for major variances from the Office's Main Estimates figures in our *Annual Plan 2013/14* are as follows:

Statement of comprehensive income

Actual audit fee revenue was higher than the Main Estimates by \$3.9 million, with the increase mainly due to changes in the split of fee revenue across financial years, and additional work completed by contracted audit service providers.

Operating costs were higher than the Main Estimates by \$3 million, also a reflection of higher contracted audit service provider revenue.

Statement of financial position

Non-current assets were lower than the Main Estimates by \$0.696 million, as the actual costs of the Office's Wellington fitout were lower than originally forecast.

Current liabilities were lower than the Main Estimates by \$0.993 million, mainly due to lower employee entitlements, a result of reduced leave balances.

Net assets are \$0.452 million higher than forecast, due to the establishment of the memorandum account as outlined in Note 20.

Note 22: Office accommodation statistics

The following statistics are provided in keeping with Government directives about the management of departmental accommodation given to chief executives in 1991.

	Actual 2013/14	Actual 2012/13
Area	6859m ²	6412m ²
Number of staff (FTE)	369	372
Space allocation per person	19m ²	17m ²
Total costs of leased office accommodation	\$2,349,120	\$2,005,377
Rent costs per person	\$6,366	\$5,388
Utility costs per person	\$296	\$281
Vacant accommodation	0	0

Appendix 1

Major reports published in 2013/14

Reports funded from multi-class output: Statutory auditor function
Performance audits
<i>Earthquake Commission: Managing the Canterbury Home Repair Programme</i> (published 5/11/13)
<i>Effectiveness and efficiency of arrangements to repair pipes and roads in Christchurch</i> (published 14/11/13)
<i>Regional services planning in the health sector</i> (published 20/11/13)
<i>Immigration New Zealand: Supporting new migrants to settle and work</i> (published 5/12/13)
<i>Department of Corrections: Managing offenders to reduce reoffending</i> (published 10/12/13)
<i>Watercare Services Limited: Review of service performance*</i> (published 29/5/14)
<i>Setting up Central Agencies Shared Services*</i> (published 26/6/14)
Inquiries
<i>Inquiry into the Mangawhai community wastewater scheme</i> (published 3/12/13)
<i>Summary: Inquiry into the Mangawhai community wastewater scheme</i> (published 3/12/13)
<i>Inquiry into property investments by Delta Utility Services Limited at Luggate and Jacks Point</i> (published 20/3/14)
<i>Inquiry into the Plumbers, Gasfitters, and Drainlayers Board: Follow-up report</i> (published 28/5/14)
Other reports and studies
<i>Commentary on Affording Our Future: Statement on New Zealand's Long-term Fiscal Position</i> (published 8/8/13)
<i>Using development contributions and financial contributions to fund local authorities' growth-related assets</i> (published 9/8/13)
<i>Using the United Nations' Madrid indicators to better understand our ageing population</i> (published 16/10/13)
<i>Maintaining a future focus in governing Crown-owned companies</i> (published 13/2/14)
<i>Reflections from our audits: Our future needs – is the public sector ready?</i> (published 27/5/14)
Reports funded from output class: Audit and assurance services
<i>Central government: Results of the 2012/13 audits (Volume 1)</i> (published 10/12/13)
<i>Public entities in the social sector: Our audit work</i> (published 10/12/13)
<i>Continuing to improve how you report on your TEI's service performance</i> (published 12/12/13)
<i>The Auditor-General's Auditing Standards 2014</i> (published 18/3/14)
<i>Additional work on Solid Energy New Zealand Limited</i> (to Commerce Committee for financial review 6/3/14, published on our website 20/3/14)
<i>Central government: Results of the 2012/13 audits (Volume 2)</i> (published 17/4/14)
<i>Schools: Results of the 2012 audits</i> (published 21/5/14)
<i>Health sector: Results of the 2012/13 audits</i> (published 22/5/14)
<i>Local government: Results of the 2012/13 audits</i> (published 29/5/14)

* Reports relating to our 2013/14 *Service delivery* theme.

Appendix 2

Entities audited under section 19 of the Public Audit Act 2001

Section 37(2)(c) of the Public Audit Act 2001 (the Act) requires us to include in the annual report a list of entities audited by the Auditor-General under an arrangement in accordance with section 19 of the Act.

At 30 June 2014, arrangements had been entered into for audits of the following entities:

- Māori Education Trust
- Literacy Aotearoa
- Tokelau International Trust Fund
- NZ Sports Foundation Charitable Trust
- Greytown District Trust Lands Trust
- The AUT/Millennium Ownership Trust
- ANDRILL Joint Venture.

Appendix 3

Report from John Marshall QC

JOHN MARSHALL QC

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16 July 2014

Mrs Lyn Provost
Controller and Auditor-General
PO Box 3928
Wellington

Dear Mrs Provost

ANNUAL REPORT OF THE INDEPENDENT REVIEWER OF AUDIT ALLOCATION PROCESSES

Introduction

1. Thank you for appointing me as independent reviewer of the basis upon which auditors are appointed to act on your behalf, and the basis upon which appropriate levels of audit fees are determined.
2. This is my report on those processes for the financial year ended 30 June 2014, and I confirm that I am independent of the Office of the Auditor-General (OAG), Audit New Zealand and all the private sector audit firms.
3. I am required to evaluate the processes involved, and to report upon the probity and objectivity with which they are implemented. I have total freedom in the way I carry out my task, and I am able to inspect any relevant files, and obtain copies of any documents and correspondence if I wish to consider those in more detail.
4. There are four types of appointment of auditors:
 - (i) An appointment made by the Auditor-General of an auditor for an entity, usually for a term of 3 years, in accordance with the "audit allocation model";
 - (ii) An appointment of an auditor for an entity, following a contestable tender if you consider that is an appropriate process in the circumstances;

- (iii) A re-appointment of an auditor for a further term, usually a further 3 years, to audit the entity;
- (iv) Where the audits involve 150 or more budgeted hours, the individual auditor, and senior personnel involved in the audits, cannot undertake the audit work for more than six consecutive years, so a new auditor is required to be appointed, but that may be another person in the same firm.

New allocations

5. In the past financial year, the Auditor-General appointed auditors for 40 new entities. That number includes 3 schools or school-related entities. Apart from schools, these new entities include, for example, newly established Crown entities, new subsidiaries of existing entities, and new entities resulting from mergers. There has been no evident dissatisfaction expressed by those entities, either with the method or with the terms of any of the appointments made during the year. The "audit allocation model", under which those appointments were made, has been the principal method of allocation since 2003. There is an established, and now well-publicised, set of criteria for those appointments.

Contestable tenders

6. No appointments were made by means of contestable tenders during the past year. The process still remains available to the Auditor-General if it suits the particular circumstances, but the increasing reliability and practicality of the audit allocation model, and its cost effectiveness, mean that the use of contestable tenders is not likely to occur very often.
7. However, two major entities, which wanted a change of auditor, asked for a contestable tender. The Auditor-General did not agree to that, but after consideration of one case, did appoint a new auditor for that entity during the last year. However, in the second case, the Auditor-General, not only did not agree to a contestable tender, but also did not agree to appoint a new auditor.

Re-appointments and new appointments

8. Other than the cases of auditors for schools, which I deal with in the following paragraph, existing auditors were re-appointed during the financial year to audit 472 public entities, and their subsidiaries, for a further term. In addition, in 10 cases a new auditor was appointed as a result of rotation of the previous auditor to preserve auditor independence, or for better alignment with the underlying principles of the audit allocation model. In one case the Auditor-General agreed to a change for other reasons, which I referred to in paragraph 7. Reappointment of the same auditor can

be made where the auditor has completed less than 6 years (or 5 for an entity listed on the NZX) in that role, or where the audit is expected to take less than 150 hours.

Re-appointments - schools

9. The 3 year contracts covering appointment of auditors for schools will come to an end following the 31 December 2014 audit round, so the Auditor-General will have the task of reappointing existing auditors, or changing auditors in respect of some schools. There are a total of approximately 2400 schools, so this is a big job for the Auditor-General. However, most schools involve audits of less than 150 budgeted hours, so auditors may carry on their work for more than 6 years. The only appointments made in the last year were appointments for 2 new school related entities, and 1 private school which has become integrated. Appointments are in progress for a number of other new schools which are due to open in the future.
10. In the report next year I will be looking at any issues which may have arisen with the appointment of auditors for schools. Obviously auditors must continue to meet the Auditor-General's independence requirements, and there may be cases where the auditor, or the school, request changes for specific reasons. In addition, the Auditor-General may, in some cases, wish to make changes to improve alignment with the underlying principles of the audit allocation model, such as audit quality, or critical mass.

Issues about fees and performance

11. During the last year, a comparatively small number of entities raised questions, or made complaints, about the level of their audit fees, or about the performance of their auditors. Some of these questions or complaints have been informal, and have been resolved. However, others were more formal, and have involved more extensive correspondence and discussions. The parties, with the assistance of the OAG, reached agreement on fees in each case, or are still negotiating. The Auditor-General prefers that the fee be agreed between the entity and the appointed auditor by negotiation, with assistance and information from the OAG where required. The Auditor-General will only set the fee as a last resort, and there were no circumstances last year where that was required.
12. I have perused files of cases where entities have questioned their fees, or asked that a new auditor be appointed. I am satisfied that the process which the OAG has followed in these cases has been appropriate and reasonable. Indeed, in one case the OAG looked at a fee charged by an auditor, even when the entity had not questioned it, when the OAG felt that the fee may have been too high. The Auditor-General has had correspondence with the auditor about this, and would like to carry out a review of the audit fees after the 2013 audit has been completed. The entity has not yet been advised of this concern.

13. The OAG's database enables it to analyse audit fees for all public entities. The audit hours, average hourly charge-out rates, and the experience of the audit team, are contributing components of the fees of auditors, and that data can be obtained. This means that the OAG can check the fees for all types and sizes of entities, year by year, individually and sector by sector. In particular, the movement in hourly rates, and the time involved in an audit, or a range of audits, can be accurately identified.
14. The OAG uses this material, constructively, to help respond to enquiries or complaints received. The response is usually given by the OAG direct to the entity, though sometimes the auditor responds, using information supplied by the OAG. In either case, the comparative data which is relevant to a particular entity is recorded in an explanatory letter, along with a description of the various factors lying behind the audit costs. While the analysis performed by the OAG often indicates that the audit fee is well substantiated and within an appropriate range, it also indicates where audit fees are outside that range – either higher than expected, or lower. In either case, the auditor and the entity are informed of those findings and expected to negotiate further in order to reach agreement.
15. In a number of cases it is apparent that the entity has failed to provide necessary information to the auditor, and failed to adequately prepare or check material that requires audit, or otherwise to co-operate properly with the auditor. This usually means that the auditor has to spend more time on the audit than has been budgeted, and sometimes that an increase in fees is justified. The Auditor-General's prior approval must be sought if the appointed auditor wants to then negotiate additional audit fees.
16. In most cases where the issue of fees has been raised, the detailed explanation given to entities by the OAG (or, in some cases, by an auditor using data supplied by the OAG) has led to a resolution, or to a withdrawal of the complaint, or to no further action being taken by the entity. In the year under review I inspected the records in respect of 12 entities which had expressed concern about the level of fees, or, more rarely, auditor performance. In most of these cases a resolution has been achieved. I refer to paragraph 7 above where reference was made to two major entities which wanted a change of auditor, and also raised questions relating to the audit fees. The Auditor-General agreed, as already noted, to a change in auditor in one of those cases. In the other case, no change of appointed auditor has been made. In each case, the Auditor-General took the view that the fees which were questioned were reasonable.
17. The Auditor-General is preparing a report to be tabled in Parliament about a number of matters that are of concern to the Auditor-General in the Licensing Trust sector. Recently, there have been issues relating to audit fees with some Licensing Trusts. In most of the cases, the Trusts did not provide all the necessary information to the auditor, or it was late or of poor quality, and the auditor had to carry out more work than was anticipated. However, some of the Licensing Trusts believed that their audit fees were too high. In one case, the fee was reduced but with a clear expectation of

what was required of the entity so that the auditor could focus on the audit rather than with matters that should be the concern of the entity. In other cases, discussions are continuing.

Christchurch earthquakes

18. The reports in the last two years have appropriately made reference to issues relating to the auditing of public entities in Christchurch. Clearly, in relation to at least some entities, the problems which have arisen as a result of the earthquakes, have resulted in additional auditing work. Damage which has been caused by the earthquakes to buildings, assets, and property, and also service production which has been affected, have made audits more difficult. Sometimes increases in audit fees have been necessary. There is one issue concerning fees of an entity which the OAG is working on. The Auditor-General was also asked to look into some claim handling practices of a Crown Entity, and reported on that in October 2013.

Novopay – and resulting issues concerning school audits

19. In the 2013 report it was noted that the Auditor-General had kept under review the problems affecting the payment of teachers and administrative school staff, arising from the Ministry of Education's new payroll system known as "Novopay". From an audit point of view, the difficulty has been the additional time and effort required by schools, the Ministry, auditors and the OAG, to obtain certainty about payroll reports, and to complete, and audit, accurate annual financial statements in a timely way.
20. The financial year for schools is the calendar year, and in the 2012 financial year there were major issues for auditors which meant that by 31 May 2013, which is the statutory date for completing school audits, only about one-third of the approximately 2400 schools audits had been able to be completed. As a result of the problems in the 2012 financial year, the auditors were excused for not completing the audits in time, and the Auditor-General and the Ministry of Education approved approximately \$940,000 in additional fees for auditors. That sum was paid by the Ministry, not by the schools.
21. The 2013 financial year also involved further problems, but it is pleasing to know that many of the problems now appear to have been largely resolved. However, delays in obtaining audit comfort from the Ministry of Education and the payroll provider over some parts of the payroll have again meant that many school audits have been unable to be completed by 31 May 2014. An increase in auditors' fees, due to the problems with Novopay, will again be met by the Ministry for the 2013 audits.

Other issues and developments

22. A number of other issues and developments have emerged during the last year, or are being developed in the next year.

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- (i) During the year, shares in three electricity entities; Mighty River Power Limited, Meridian Energy Limited and Genesis Energy Limited, were listed on the New Zealand Stock Exchange. However as the majority shareholding is still owned by the Crown, those companies are still required to be audited by the Auditor-General.
- (ii) Maori Trust Boards, as from 2013, are no longer classified as public entities under the Public Audit Act 2001, and are no longer subject to auditing by the Auditor-General. Auditing of them is now covered by the Maori Trust Boards Amendment Act 2011. However, there are still several previous audits of some Maori Trust Boards which the Auditor General will complete as the information is provided by those Trust Boards.
- (iii) Reference was made to the Crown Entities Amendment Act 2013 in last year's report. Other recent statutes which are relevant are the Public Finance Amendment Act 2013, the State Sector Amendment Act 2013, and the Financial Reporting Amendment Act 2014. Under the Crown Entities Amendment Act 2013, a significant number of Crown Entity subsidiaries will not be required to be separately audited in the future. The implications of the other statutes are under consideration, and will be discussed in next year's report.
- (iv) The Auditor-General's inquiry into the Mangawhai community wastewater scheme in November 2013 found that the audits of Kaipara District Council carried out by Audit New Zealand between 2006 and 2009 were substandard in some respects. In the interest of audit quality, the Auditor-General decided not to allocate any new audit arrangements to Audit New Zealand until Audit New Zealand can assure the Auditor-General that it has reached the objective of consistent audit quality throughout its portfolio.
- (v) The Charter schools which have been introduced in the last year are not schools which are run by the Ministry of Education, and are therefore not public entities under the Public Audit Act 2001 which the Auditor-General is required to audit.
- (vi) With effect from 1 July 2014 the External Reporting Board has put in place some new accounting standards which affect public benefit entities in the public sector. At least 80% of entities which are the responsibility of the Auditor-General are public benefit entities, for example local authorities and schools, which do not have any obligation to make a profit. The new accounting standards involve some changes in financial reporting, but the Auditor-General's view is that increases in audit fees are generally not justified. The Ministry of Education is considering whether or not to require all schools to report as Tier 2 entities rather than allow approximately 50% of them to report as Tier 3 entities as a result of their smaller size.

- (vii) A District Council raised the question of whether there could be a discount in audit fees if audit work for eight or nine Councils in the region could be carried out by a common auditor. The OAG considered this question but came to the view that the circumstances of the various Councils were different. Every Local Authority is a separate entity, and every Local Authority audit is carried out separately, to its own level of materiality, and in accordance with its own particular issues and circumstances. The exception to that is where there is some form of shared services, or other arrangements between two or more Councils, such as shared accounting systems or rating systems. In such cases a common auditor would be appointed to audit those activities on behalf of the Auditor-General.

Conclusion

- 23. In conclusion, having regard to everything I have considered, and have spoken about with representatives of the OAG, I advise my position is as follows:
 - (i) I consider that the processes adopted by the Auditor-General and by the OAG in relation to the allocation and appointment of auditors for audits falling within the Auditor-General's mandate, during the financial year to 30 June 2014; have been appropriate for their purpose; and have been applied in a way which is fair and responsible, having regard to the respective interests of the parties concerned.
 - (ii) That observation applies both to the way in which auditors have been appointed or re-appointed, and to the way in which questions as to the appropriateness of an audit fee have been dealt with.
 - (iii) In cases where issues have been raised by entities as to fee levels, or as to auditor performance, those issues have been, or are being, dealt with fairly and professionally.
 - (iv) Other issues which I have examined, which touch upon the Auditor-General's mandate and the operations of the OAG, have, in my view, been dealt with reasonably and responsibly.
- 24. Taking everything into account, my conclusion is that the processes by which audits in the public sector have been allocated, and fees have been set, in the financial year to 30 June 2014, have been carried out with due probity and objectivity.

Yours sincerely



John Marshall

Publications by the Auditor-General

Other publications issued by the Auditor-General recently have been:

- From auditor to soldier – stories of the men who served
- Accident Compensation Corporation: How it deals with complaints
- Ministry of Social Development: How it deals with complaints
- State-owned enterprises: Results of the 2012/13 audits
- Public entities' progress in implementing the Auditor-General's recommendations 2014
- The Auditor-General's strategic intentions 2014/15 to 2017/18
- Annual Plan 2014/15
- Setting up Central Agencies Shared Services
- Watercare Services Limited: Review of service performance
- Local government: Results of the 2012/13 audits
- Inquiry into the Plumbers, Gasfitters, and Drainlayers Board: Follow-up report
- Reflections from our audits: *Our future needs – is the public sector ready?*
- Health sector: Results of the 2012/13 audits
- Schools: Results of the 2012 audits
- Central government: Results of the 2012/13 audits (Volume 2)
- Additional work on Solid Energy New Zealand Limited

Website

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