A New Age for Public Auditing

Robert Buchanan and Kevin Simpkins introduce the Public Audit Act 2001.

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THE Public Audit Act at last became a reality on 6 April this year. It has been a long wait — over a decade — since first proposed.

The Act came into force on 1 July 2001 and applies to audits of balance dates that occur from that date. The broader public auditing mandate, however, applies from day one. That considered, it is important that all public auditors, including those who act under existing appointments by the Auditor-General, are aware of the importance of the Act and the changes it brings about.

This article describes some of the key features of the Act and explains how the system of public auditing will work.

The purposes of the Act

Section 3 identifies two purposes:

- to make the Auditor-General[1] an Officer of Parliament; and
- to reform and restate the law relating to the auditing of public sector organisations.

Officer of Parliament: the constitutional aspects

The Act has constitutional significance because it establishes the Auditor-General and the Deputy Auditor-General as fully-fledged "Officers of Parliament". They join a select group — the only others being the Ombudsmen and the Parliamentary Commissioner for the Environment — who are appointed on the recommendation of the House of Representatives and are accountable directly to the House.

Currently, the Auditor-General and the Deputy Auditor-General are appointed by the Crown. This makes them officers of the Crown — despite their statutory independence from the Executive.

The change in their status stems from a 1989 report by the Finance and Expenditure Select Committee on Officers of Parliament.[2]

The report quoted from a submission of the Clerk of the House on the constitutional status of the Auditor-General.

It has always seemed strange to me that the Controller and Auditor-General was not a statutory Officer of Parliament on the same basis as the Ombudsmen.

The office of Controller and Auditor-General is a very old one with a very close relationship with Parliament. Indeed, the Controller and Auditor-General has a closer relationship with the House than any of the Officers of Parliament on the strength of his involvement with … [the Finance and Expenditure] Committee.[3]

All of the submissions to the Committee supported the Auditor-General being put on the same constitutional basis as the other Officers of Parliament.

The Committee said it was "indisputable" that the Auditor-General, as an independent "watchdog", should be placed on an independent statutory basis.

The Public Audit Act reflects the key characteristics of an Officer of Parliament by:

- continuing the Auditor-General's traditional role of helping Parliament to hold Ministers, officials and public entities responsible and accountable for their use of public money;

PUBLIC AUDIT ACT 2001 – KEY POINTS

What is it?

A single, comprehensive Act dealing with the auditing of public entities.

When does it come into force?

For balance dates falling on or after 1 July 2001.

What are the key changes?

The Auditor-General and Deputy Auditor-General become Officers of Parliament.

A new definition of "public entity" determines the Auditor-General's portfolio.

The full public auditing mandate will apply to all public entities (except banks).

All audits will be done under the Public Audit Act – even for public entities which are companies registered under the Companies Act 1993.

The Auditor-General's auditing standards will be published.

What will not change?

The Auditor-General's power to appoint auditors.

The qualifications required of financial report auditors.

- ensuring that the Auditor-General and the Deputy Auditor-General are appointed on the recommendation of the House of Representatives;
- making the Auditor-General an "Officer of Parliament" for funding and accountability purposes under the Public Finance Act 1989; and
- making it a duty of the Auditor-General to act independently at all times.

The Act sits alongside other public accountability legislation such as the Ombudsmen Act 1975, the Official Information Act 1982 and the Public Finance Act 1989.

Local Government

The Act confirms the Auditor-General's role as the auditor of local government. It introduces (in section 22) an important new power to report publicly to a local authority. This will sit alongside the existing power to report to Parliament on local government matters.

Section 22 acknowledges the interests of a local authority's electors — as opposed to taxpayers generally — in receiving information about the authority's affairs.

The public auditing system: key characteristics

The rest of this article discusses the key characteristics of the public auditing system. They are:

- the Auditor-General's portfolio — which turns on the definition of "public entity" in section 5;
- the Auditor-General's public auditing mandate, as set out in Part 3 of the Act;
- the requirement for the Auditor-General to publish auditing standards under section 23;
- the arrangements for the appointment of auditors under Part 5; and
- the reporting and disclosure powers of the Auditor-General and appointed auditors.

The portfolio: "public entity"

One of the big achievements of the Act is that it comprehensively defines, in a single statute, the range of entities which are subject to public audit. This is a big advance in making the law more accessible. The Act uses the term "public entity" to describe the Auditor-General's auditing portfolio. The term is defined in section 5(1) and (2) — refer to *Table 1*.

Table 1

(1) In this Act, **public entity** means each of the following entities:

(a) the Crown:

(b) each office of Parliament, except where another auditor has been appointed for that office under section 40(b) of the Public Finance Act 1989:

(c) an entity of a class described in Schedule 1:

(d) an entity listed in Schedule 2:

(e) an entity in respect of which the Auditor-General is the auditor under any other enactment … :

(f) an entity which is controlled by one or more entities of the kinds referred to in paragraphs (a) to (e).

(2) For the purposes of subsection (1)(f), an entity is controlled by one or more other entities if —

(a) the entity is a subsidiary of any of those other entities; or

(b) the other entity or entities together control the entity within the meaning of any relevant approved financial reporting standard; or

(c) the other entity or entities can together control directly or indirectly the composition of the board of the entity within the meaning of sections 7 and 8 of the Companies Act 1993 (which, for the purposes of this paragraph, are to be read with all necessary modifications).

Schedules 1 and 2 largely confirm the current portfolio. Examples of classes of public entity (Schedule 1) are Crown entities, local authority trading enterprises (LATEs), and state-owned enterprises (SOEs).

Examples of specific entities in Schedule 2 are the Auckland Aotea Centre Board of Management and the Historic Places Trust. The Reserve Bank is a new addition to the portfolio through inclusion in Schedule 2.

The test of "control" in section 5(2), however, will broaden and clarify the Auditor-General's portfolio.

Currently, for example, the Auditor-General has no mandate in respect of trusts or other ventures established by local authorities (unless they fall within the definition of a LATE). Section 5(2) will pick up all of these entities so long as one or more local authorities (or other public entities) can exercise control, as defined.

The term "control" includes the meaning of that term in any relevant approved financial reporting standard.

At this point there is no such financial reporting standard. However, a standard based on ED-84: *Consolidating Investments in Subsidiaries* is expected to be approved by the Accounting Standards Review Board in the near future.

This approach has the advantage that any future changes to determining the "group reporting entity" in financial reporting standards will automatically flow through to the Auditor-General's portfolio.

If an entity is part of the group reporting entity of a public entity, the Auditor-General will be the auditor.

"Controlled" statutory bodies

Section 5(2)(c) captures a wide range of entities whose members are appointed by the Crown under statute.

Many of these bodies, for example the Medical Council, are not "public sector" entities or subject to government control in any other sense. The Crown's only involvement is through a Ministerial power to appoint most or all of their members.

Section 5(3) of the Act addresses the position of these entities by providing that, where the entity is specifically referred to in legislation and the entity is expressly required or permitted by legislation to have its financial statements audited by someone other than the Auditor-General, the Public Audit Act will not apply.

The public auditing mandate

Besides bringing the whole of the Auditor-General's auditing portfolio into a single statute, another important achievement of the Act is to apply the public auditing mandate consistently across the portfolio. This contrasts with the previous position, where:

- the Auditor-General's full auditing mandate (including "effectiveness and efficiency" audits) applied to some entities — primarily, government departments, local authorities, and LATEs — but not others; and
- the nature of the financial report auditing mandate appeared to differ between those entities which were companies (in which case, the audit was conducted under the Companies Act 1993) and those which were not.

Part 3 of the Act sets out the Auditor-General's mandate in clear terms. There are four key functions.

That of "auditor"

Section 14 says that the Auditor-General is "the auditor" of every public entity. Deliberately, it does not define what this means. Nor do any of the specific auditing functions in Part 3 limit the generality of this provision.

The generality of section 14 will enable the Auditor-General's role to develop in line with the evolving professional role of an auditor.

The financial report audit

Section 15 says that:

> *The Auditor-General must from time to time audit the financial statements, accounts, and other information a public entity is required to have audited.*

Again, the section stays clear of definitions. Nor does it try to be specific about what must be audited, or when.

The section recognises that each public entity may have its own accountability requirements, and that the nature of those requirements may vary according to its particular circumstances.[4]

What the section does ensure, however, is that to the extent that an entity's accountability documents must be audited, the Auditor-General has a duty to perform the audit.

Section 15 will, therefore, be able to keep pace with developments both in public accountability and in financial reporting generally. The introduction of new reporting requirements such as triple bottom line reporting for government departments, for example, would not necessitate any amendment to section 15.

Section 17 enables the Auditor-General to provide other auditing services for a public entity at its request.

Performance audit

Section 16 introduces for the first time the term "performance audit" to the Auditor-General's mandate. In contrast to the mandatory financial report audit under section 15, performance audit is a discretionary activity which can be performed at any time, either in respect of a single entity or across a sector.

The performance audit is a composite of two strands of existing public audit activity:

- the "effectiveness and efficiency audit" — which as noted earlier has until now been applied only to some parts of the public sector;[5] and
- examination of issues of compliance, waste and probity — which the Audit Office has addressed in the course of its annual auditing activity for a number of years.

In practice, it is expected that the annual audit of entities within the portfolio will continue to comprise the financial report audit and aspects of the performance auditing function referred to above.

Inquiries

Section 18 of the Act contains a broad function of inquiry into:

> *… any matter concerning a public entity's use of its resources.*

An inquiry may take place on request or on the Auditor-General's own initiative. Its only constraint is where the relevant public entity is required to adhere to government or local authority policy. In these circumstances, the inquiry is limited to the extent to which the public entity is using its resources in a manner consistent with that policy.

An inquiry may be carried out in respect of any public entity except the Reserve Bank of New Zealand or a registered bank.

Although the inquiry function is a new one, it recognises the long-standing expectation among the public, politicians and local authorities that the Auditor-General will:

- look into matters of concern raised by members of the public about financial, accountability and governance issues in public entities; and
- undertake formal inquiries into, and report to Parliament on, matters of high public interest.

Until now, this work has been undertaken in the context of the Auditor-General's general function as auditor of public entities. It represents a significant part of the work of the Office of the Auditor-General, as shown by these figures from the 2000 Annual Report of the Office:

Enquiries received from:

- *Taxpayers* 45
- *Ratepayers* 172
- *Members of Parliament* 66

The inquiry function will not amount to a formal system of complaint investigation for citizens affected by administrative decisions. That remains the province of the Ombudsmen, under the Ombudsmen Act 1975.

The Auditor-General's focus, in contrast, tends to be on systemic issues. In addition, an inquiry is clearly performed at the

discretion of the Auditor-General rather than as of right.

Publication of auditing standards

The Act requires the Auditor-General to publish — in a report to the House — the auditing standards to be used in the conduct of audits and inquiries. This report is to be prepared every three years. Any changes to the standards during a particular year must be referred to in the annual report of the Auditor-General. This mechanism will ensure transparency in the standards used.

The Auditor-General's current auditing standards comprise all of the standards of the Institute, together with:

- public sector elaboration on some of those standards; and
- a small number of additional standards where the Institute has not developed standards to date.

Appointment of auditors

The Act continues the Auditor-General's power to appoint auditors to exercise functions on his or her behalf. As a prelude to describing the power, it is important to note that the Act does not require the Auditor-General to appoint an auditor for a public entity. Nor does it prescribe any process for making appointments.

The current Auditor-General's intention, however, is to retain the policy of contestable audit provision which was introduced in 1992. The operational split between the Office of the Auditor-General and Audit New Zealand (which facilitates contestability) is also unaffected.

The Auditor-General may appoint an auditor to carry out one or more audits of a public entity.

One of the big achievements of the Act is that it comprehensively defines, in a single statute, the range of entities which are subject to public audit.

The necessary qualifications of an auditor depend on the type of audit. For a financial report audit, or other auditing services under section 17, the appointee must be:

- an employee of the Auditor-General (typically this will be an Audit New Zealand director); or
- a person or partnership qualified to audit a company under the Companies Act 1993.

An auditor for a performance audit or an inquiry may be any person who is suitably qualified for the purpose, as determined by the Auditor-General.

Reporting and disclosure

The Auditor-General's powers to report are central both to the public auditing system and to the Auditor-General's role as an Officer of Parliament. The Act has three main reporting provisions:

- section 20 retains the Auditor-General's power to report to the House of Representatives;
- section 21 confers a comprehensive power to report to a Minister, a select committee, a public entity, or anyone else, on anything the Auditor-General considers it desirable to report on; and
- section 22 contains the procedure for public reporting to local authorities, mentioned earlier.

The Auditor-General cannot delegate the powers under sections 20 and 22. However, appointed auditors can, subject to the oversight of the Auditor-General, exercise the power to report under section 21.

Conclusion

The Public Audit Act 2001 has been a long time coming.

While its success will be judged from the benefit of experience, it establishes a "straight-forward", transparent and enduring basis for public auditing in New Zealand as we move into the 21st century.

Footnotes

1 Although the Act preserves the full title "Controller and Auditor-General", it uses the abbreviated term "Auditor-General". We follow that approach in this article.

2 Finance and Expenditure Committee, *Report on the Inquiry into Officers of Parliament*, 1989, I. 4B.

3 This role has developed substantially since 1989. The Office of the Auditor-General now supplies permanent advisers to most select committees.

4 For example, some public entities' audited financial statements must include a statement of service performance.

5 The Auditor-General will now be able to carry out effectiveness and efficiency audits in respect of any public entity except the Reserve Bank of New Zealand or a registered bank: section 16(3).