# Introduction

This report constitutes our "annual report" on the audits for 1999-2000 of the Crown and its sub-entities – mainly as reflected in the *Financial Statements of the Government of New Zealand for the Year Ended 30 June 2000*.

The first article deals with matters relating to the Government's *Financial Statements* as audited and presented to the House (pages 9-15). Specific topics addressed include:

- who should account for urban state highways;
- accounting for property, plant, and equipment, and other valuation issues;
- provisions, contingent liabilities, and contingent assets;
- student loan debt; and
- full consolidation.

The second article deals with the results of our audits of government departments for the year ended 30 June 2000 (pages 17-25). Specific topics addressed are:

- the audit opinions issued on departments' annual financial statements; and
- departments' financial management and service performance management.

The third article comprises discussion of a number of other matters that arose during the course of 1999-2000 – either as a result of our audits or otherwise from the discharge of our functions and powers in connection with public money (pages 27-68). These matters are as listed in the *Contents* on page 5.

1.001 The Audit Office issued its audit report on the *Financial Statements of the Government of New Zealand for the Year Ended 30 June 2000*[1] (the *Financial Statements)* on 8 September 2000. This is the same date on which the Treasurer and Minister of Finance, and the Secretary to the Treasury, signed their Statement of Responsibility for the *Financial Statements*.

## Unqualified Opinion Issued

1.002 The audit report appears on pages 18-19 of the *Financial Statements*. The report includes our unqualified opinion that those statements:

- *comply with generally accepted accounting practice; and*
- *fairly reflect –*
    - *the results of operations and cash flows for the year ended 30 June 2000; and*
    - *the financial position as at 30 June 2000.*

1.003 As in previous years, the Treasury has provided a comprehensive commentary on the financial performance and position, which is presented on pages 6-16 of the *Financial Statements*.

1.004 In addition to that commentary, we draw attention to the following significant items reflected in the reported results.

## Urban State Highways – Who Should Account for Them?

1.005 Last year we reported the need for urban state highways to be accounted for in the *Financial Statements*, and that we would work with the Treasury and Transit New Zealand (TNZ) with a view to resolving the issue by 30 June 2000.[2]

1 Parliamentary paper B.11.

2 *Fifth Report for 1999*, parliamentary paper B.29[99e], pages 13-14.

1.006 TNZ has legal opinions that indicate that the Crown owns rural state highways and motorways and local authorities own urban state highways. The latter have a value based on depreciated replacement cost of approximately $1,300 million.

1.007 However, many local authorities do not account for urban state highways within their financial statements because TNZ fully funds the state highway network and, in their view, TNZ effectively has control of the asset. At present, many of these roads are not accounted for in either the Crown's or local authorities' financial statements.

1.008 With the expected issue in late-2000 or early-2001 of a Financial Reporting Standard on Accounting for Property, Plant, and Equipment (see also paragraph 1.010 below), changes may be required to valuation methodologies presently applied to roading. Again, we will work with TNZ and the Treasury to resolve any issues arising.

1.009 As a result of discussions between the three parties, and a further review of the information needed to reliably record an opening balance for the value of urban state highways in the *Financial Statements*, it has been agreed to defer first recognition of these assets until 30 June 2001.

## Accounting for Property, Plant, and Equipment, and Other Valuation Issues

1.010 We believe that progress needs to be made on a number of matters as a result of the expected issue of a Financial Reporting Standard on Accounting for Property, Plant, and Equipment, and the pending move to full consolidation of SOEs and Crown entities in the *Financial Statements*. These matters include:

- Consistently applying throughout the Crown reporting entity the "fair value" approach to valuing assets that we anticipate the Financial Reporting Standard will advocate.

- Reviewing the various valuation methodologies that are in use to ensure consistency among the components that make up the Crown reporting entity. The unfunded liability balances of the Accident Compensation Corporation and the Government Superannuation Fund are two examples that have already been addressed.



## Provisions, Contingent Liabilities, and Contingent Assets

1.011 The recent approval of a Financial Reporting Standard on Provisions, Contingent Liabilities, and Contingent Assets[3] has significant implications for the accounting treatment of such items. Every organisation making up the Crown reporting entity will need to ensure that their accounting policies and treatments comply with the standard for the year ending 30 June 2002.

1.012 We raised this issue last year in the context of environmental liabilities[4] (such as the cost of cleaning up contaminated sites). We asked our auditors to discuss it with Crown reporting entities and local authorities, the results of which indicate that local authorities have a greater awareness of (that is, identifying, quantifying, and recording) potential environmental liabilities than Crown reporting entities.

1.013 Our concerns for Crown reporting entities are that:

- individual entities may not have identified all of the environmental provisions and contingencies for which they are responsible that will collectively flow through to the *Financial Statements*; and
- the Crown may have residual environmental obligations that have not yet been identified.

1.014 We understand that the Treasury will be issuing guidance to Crown reporting entities on the impact of the proposed Financial Reporting Standard. For our part, we will continue to have our auditors work closely with individual entities in order to assist future compliance with the standard.

3 FRS-15: *Provisions, Contingent Liabilities and Contingent Assets*, November 2000.

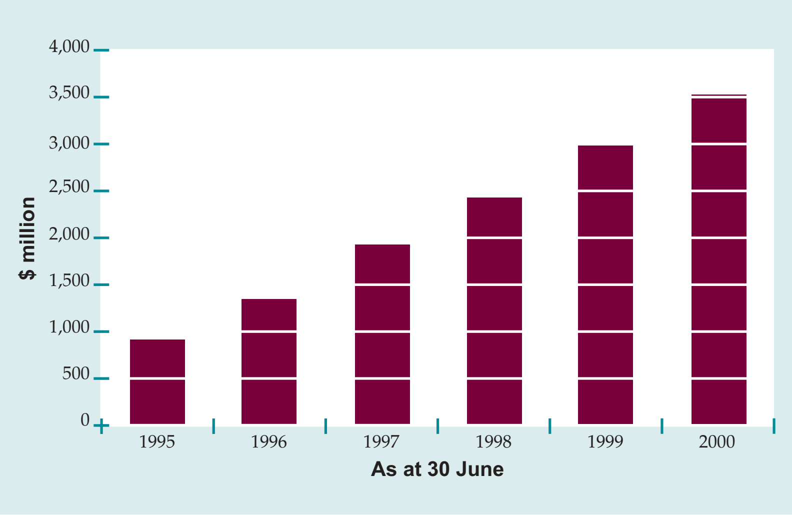
4 *Fifth Report for 1999*, page14.

## Student Loan Debt

1.015 Current and former tertiary students owed the Crown $3,523 million (after providing for doubtful debts) as at 30 June 2000. This asset is shown under Advances in the Crown's Statement of Financial Position and is analysed in Note 7 to the *Financial Statements*.[5]

1.016 Outstanding student loan debt is a significant asset for the Crown that has grown rapidly, as illustrated in Figure 1.1.

*Figure 1.1*
*Student Loan Debt 1995-2000*




1.017 Total student loan debt is projected to grow at a similar rate in future years. Last year we raised questions as to the level and extent of information – such as profiles of the age, individual amounts outstanding, and expected maturities – that it is appropriate to disclose. We discuss our answers to those questions on pages 59-62.

5 *Financial Statements*, parliamentary paper B.11, 2000, pages 23 and 63 respectively.

## Full Consolidation

1.018 As discussed in previous years, we anticipate that the Crown's exemption from having to prepare fully consolidated financial statements will be removed when the new Financial Reporting Standard on Consolidation of Investments in Subsidiaries is promulgated early in 2001.

1.019 The Treasury and the Audit Office are giving continuing consideration to the implications of full consolidation from the financial reporting and auditing perspectives.

## Introduction

2.001 This article reports on the results of the 1999-2000 audits of 43 government departments. Its purpose is to inform Parliament of the assurance given by the audits in relation to:

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

## Audit Opinions Issued

2.002 The Public Finance Act 1989 (the Act) specifies departments' responsibilities in fulfilling the requirements for general purpose financial reporting. Sections 34A(3) and 35(3) of the Act require departments to prepare their financial statements in accordance with generally accepted accounting practice.[1]

2.003 The Act also sets out the responsibility of the Audit Office to issue an audit opinion on the financial statements of each department (section 38).

2.004 To form an opinion on the financial statements of departments, our audits are conducted in accordance with generally accepted auditing standards together with our own additional standards appropriate to public sector audits. The audits are planned and performed so as to obtain all the information and explanations considered necessary in order to provide sufficient assurance that the financial statements are free from material mis-statements, whether caused by fraud or error. In forming our opinion, we also evaluate the overall adequacy of the presentation of information in the financial statements.

2.005 All of the 43 government departments audited received audit reports containing an unqualified audit opinion (see Figure 2.1 on the next page).

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

*Figure 2.1*
*Analysis of Audit Opinions 1996-2000*

| Year Ended 30 June | 2000 | 1999 | 1998 | 1997 | 1996 |
|---|---|---|---|---|---|
| Unqualified opinions | 43 | 42 | 44 | 42 | 45 |
| Qualifications regarding statements of service performance | - | - | - | 1 | 1 |
| Qualifications regarding other issues | - | - | - | 3 | - |
| **Total audit opinions issued** | **43** | **42** | **44** | **46** | **46** |

2.006 This is the third successive year of unqualified opinions for all departments – a pleasing situation for all concerned.

## Financial Management and Service Performance Management

2.007 In 1994, we began reporting our assessments of certain aspects of management to the chief executive and to stakeholders in each department (such as the responsible minister and the select committee which conducts the financial review of the department).

2.008 While conducting the annual audit, our auditors examine aspects of financial management and service performance management. The purpose of this exercise is to identify specific areas of management where there are weaknesses, and to make recommendations to eliminate those weaknesses.

## *Financial Management*

2.009 We assess the following aspects of financial management:

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

## *Service Performance Management*

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

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

## *The Rating System*

2.011 The rating system we use is as follows:

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

## *The Results*

2.012 We assessed management in each of the 43 departments. A summary of the assessments (215 in total – 5 for each department) is given in Figure 2.2 on the next page.

*Figure 2.2*
*Summary of Assessments of Aspects of Financial Management and Service Performance Management in Departments for 1999-2000*

| Aspects Assessed | | Excellent | | Good | | Satisfactory | | Just Adequate | | Not Adequate | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | No. | % | No. | % | No. | % | No. | % | No. | No. |
| FCS | | 16 | *37* | 22 | *51* | 5 | *12* | 0 | *0* | 0 | 43 |
| FMIS | | 15 | *35* | 25 | *58* | 3 | *7* | 0 | *0* | 0 | 43 |
| FMCE | | 16 | *37* | 22 | *51* | 5 | *12* | 0 | *0* | 0 | 43 |
| SPIS | | 10 | *23* | 20 | *47* | 13 | *30* | 0 | *0* | 0 | 43 |
| SPMCE | | 17 | *39* | 18 | *42* | 8 | *19* | 0 | *0* | 0 | 43 |
| **Totals** | **2000** | **74** | ***34*** | **107** | ***50*** | **34** | ***16*** | **0** | ***0*** | **0** | **215** |
| | *1999* | *52* | *25* | *115* | *55* | *42* | *20* | *1* | *0* | *0* | *210* |
| | *1998* | *46* | *21* | *101* | *46* | *70* | *32* | *3* | *1* | *0* | *220* |

**Key**
FCS – Financial Control Systems
FMIS – Financial Management Information Systems
FMCE – Financial Management Control Environment
SPIS – Service Performance Information and Information Systems
SPMCE – Service Performance Management Control Environment

TWO

2.013 The highlights of the results are as follows:

- There were 74 assessments of "Excellent" (34%) and 107 assessments of "Good" (50%). The total of 181 assessments (84%) that were either "Excellent" or "Good" indicates continued improvement compared with 79% in 1999 and 67% in 1998.
- "Satisfactory" assessments issued – 34 (16% of all assessments) – were down on the 20% of 1999 and 32% of 1998, but only because of the continually increasing proportion of "Good" and "Excellent" assessments.
- No assessments of "Not Adequate" or "Just Adequate" were issued. There have been no "Not Adequate" assessments in all of the seven years we have now been issuing these assessments, while "Just Adequate" assessments have steadily reduced from a peak of 11 in 1995 and 1996 to none in 2000.



2.014 We compared our assessments for 1999 and 2000 for each of the 42 departments where the comparison is possible. The overall results for those 42 departments are summarised in Figure 2.3 below.

*Figure 2.3*
*Management Assessments for 2000 Compared to 1999*

| Aspects Assessed[1] | Higher | Same | Lower | Total |
|---|---|---|---|---|
| FCS | 11 | 31 | 0 | 42 |
| FMIS | 7 | 34 | 1 | 42 |
| FMCE | 9 | 32 | 1 | 42 |
| SPIS | 4 | 37 | 1 | 42 |
| SPMCE | 5 | 37 | 0 | 42 |
| **Totals** | **36** | **171** | **3** | **210** |
| *%* | *17* | *82* | *1* | *100* |

1 See Figure 2.2 for key to abbreviations.

2.015 The noteworthy features of these results are:

- 82% of the assessments did not change between 1999 and 2000.
- 17% of the assessments were higher in 2000 than in 1999.
- Only 3 of the assessments (1%) were lower than in 1999.

2.016 The extent of the shift to higher assessments – while being a little less, proportionately, than the previous year (17% in 2000 compared with 19% in 1999) – is highly commendable, given that previous improvements restrict the scope for further improvements of the same magnitude.

2.017 Departments have taken a keen interest in how their performance can be improved to achieve improved assessments. Our auditors continue to offer advice on improvements through management letters.

2.018 We have now reported our assessments of management performance to Parliament and its select committees for each of the past seven years. Our assessments have often been of considerable interest to select committees when conducting their financial reviews of departments.

2.019 Departments vary greatly in terms of size and organisational structure. When we first reported results of the assessments to select committees, we took care to alert committees to those differences and urged them not to make comparisons between departments without being mindful of considerations, such as size and structure, which could explain reported differences in performance. Caution should continue to be exercised in using these assessments.

# 3.1
# Compliance with Cabinet Expenditure Delegations

***The limits determined by the Cabinet on who has authority to spend money are part of the regime of controls over public expenditure. As the administrators of that expenditure, departments must ensure compliance with the limits of the Cabinet's delegated authority. Mostly, departments are meeting that obligation, but there is some room for improvement.***

## Background

3.101 Under the current Cabinet delegation of financial authority to departmental chief executives and responsible ministers,[1] *chief executives have full authority within the constraints of the Public Finance Act 1989 to expend departmental cash, or incur departmental expenses or liabilities, except in the following four areas:*

- *publicity expenses;*
- *compensation or damages in settlement of claims;*
- *ex gratia expenses; and*
- *the purchase, development or lease of fixed assets.*

3.102 The limits on financial delegations set by the Cabinet were revised with effect from 1 July 1999, and are as shown in Figure 3.1 on the next page.

3.103 All proposed expenses or financial commitments that exceed a financial delegation limit require specific Ministerial or Cabinet authorisation. This requirement extends to subsequent variations of authority, with an exception for operational simplicity.[2]

1 Promulgated in Cabinet Office Circular CO (99) 7, 30 June 1999.

2 Variations to the purchase, development or lease of fixed assets that do not exceed 10% of the value of the initial authorisation (and the new cost does not exceed the delegation limit of the issuer of the initial authorisation) are excluded.

*Figure 3.1 – Limits on Delegated Financial Authorities*[1]

| | **Departmental Chief Executives: Authority not exceeding (GST inclusive if applicable)** | **Responsible Ministers: Authority not exceeding (GST inclusive if applicable)** |
|---|---|---|
| DEPARTMENTAL OPERATING EXPENSES | | |
| Publicity expenses[2] | $100,000 | No limit |
| Expenses for compensation or damages in settlement of claims[3] | $100,000 | $500,000 |
| Ex gratia expenses[4] | $20,000 | $50,000 |
| PURCHASE DEVELOPMENT OR LEASE[5] OF FIXED ASSETS[6] | | |
| Initial Approval | $7 million | $15 million |
| Subsequent Variations to Approval Given under Own Authority | Difference between total value of all prior approvals and $7 million | Difference between total value of all prior approvals and $15 million |
| Subsequent Variations to Approval Given under the Authority of the Responsible Minister | Difference between total value of all prior variations and 10% of initial approval given by the Responsible Minister, provided that the total project cost does not exceed $15 million | N/A |
| Subsequent Variations to Approval Given under the Authority of Cabinet | None | Difference between total value of all prior variations and 10% of initial approval given by Cabinet, provided that the total variations do not exceed $7 million |

1 Reproduced from the Schedule to Cabinet Office Circular CO (99) 7.
2 Advertising expenses must comply with the provisions set out in Appendix 2 of the Cabinet Office Manual.
3 Expenses for compensation or damages for settlement of claims should be endorsed either by the Crown Law Office or a court judgement. Claims under $50,000 need not be referred to the Crown Law Office if a departmental solicitor certifies that such claims are in order.
4 Ex gratia expenses are those made in respect of claims that are not actionable at law, but for which there exists a moral obligation and payment should be made.
5 Leases covered by the delegation limits are operating leases of more than one year's duration. Note that departments cannot enter into finance leases in their own right (see Treasury Circular 1994/7).
6 See the Appendix to CO (99) 7 for more guidance on interpreting the delegation limits for fixed assets, and for seeking authorisation above those limits, particularly in relation to operating leases.

## Our Review

3.104 We wanted to establish whether chief executives were complying with the delegations in force since 1 July 1999. To do this our auditors undertook a survey of 43 government departments to find out whether:

- the departments had correctly updated their documentation on financial delegations to reflect the revised limits set by the Cabinet; and, if so
- the updated documentation had been satisfactorily communicated to relevant staff; and
- the departments were complying with the revised delegations.

3.105 The survey also sought to establish whether the term "ex gratia" was understood in departments.

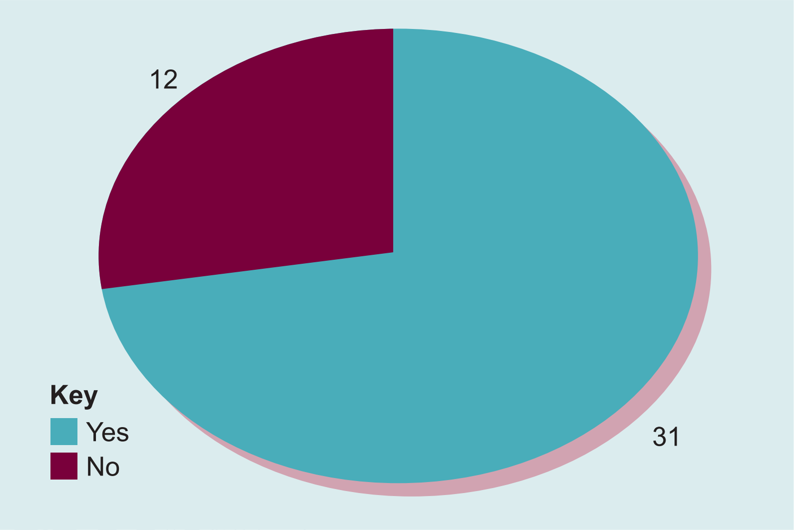
## The Results of Our Review

### *Financial Delegations Documentation Correctly Updated*

3.106 Of the 43 departments, 31 had updated their documentation on financial delegations to reflect the revised limits set by the Cabinet. For the remaining 12:

- 7 had an update in progress;
- 1 had told relevant staff of the changes by memo;
- 2 had annual budgets well within the revised delegation limits and the departments therefore thought it unnecessary to update their documentation; and
- 2 had yet to update their documentation.

*Figure 3.2*
*Financial Delegations Documentation Correctly Updated*

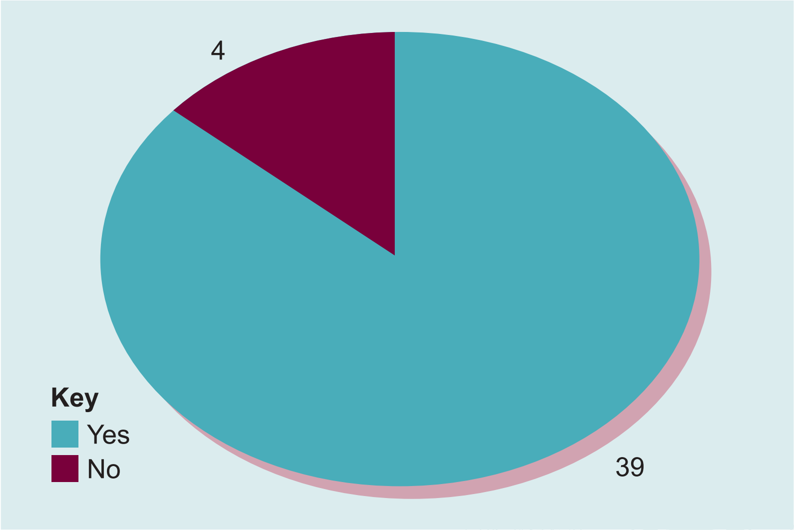


### *Relevant Staff Satisfactorily Informed*

3.107 Of the 43 departments, 39 had satisfactorily communicated the revised limits on financial delegations to relevant staff. For the remaining 4:

- 1 had not done so because it had not updated its documentation;
- 1 was in the process of sending to relevant staff a copy of the Cabinet Office Circular setting out the revised delegations;
- 1 planned to distribute the updated documentation to staff once it had completed the update; and
- 1 was made aware of the need to inform staff by the auditor at the conclusion of the audit.

*Figure 3.3*
*Relevant Staff Satisfactorily Informed*

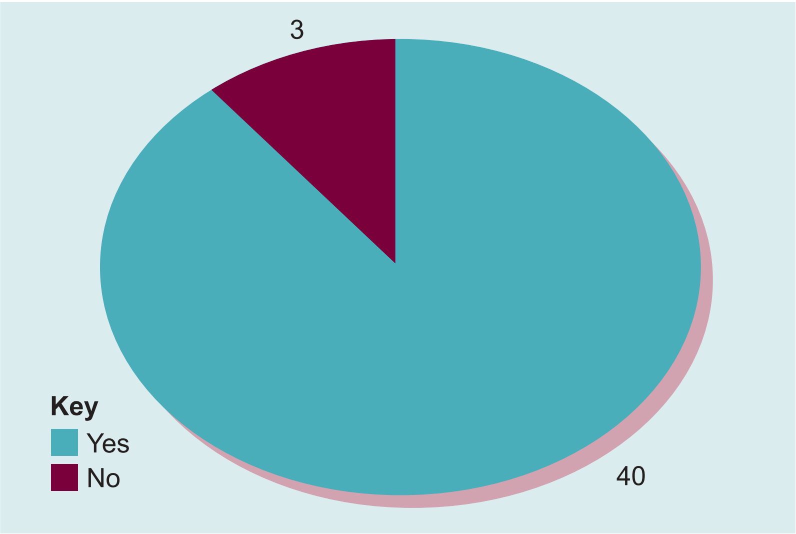


## *Departmental Compliance*

3.108 Of the 43 departments, 40 were reported to be complying with the revised delegations. For the remaining 3:

- each had instances of payments being authorised by persons not holding the authority to do so (including one department that on two occasions obtained retrospective approval from its minister); and
- each had nevertheless updated its financial delegations documentation and communicated it to staff.

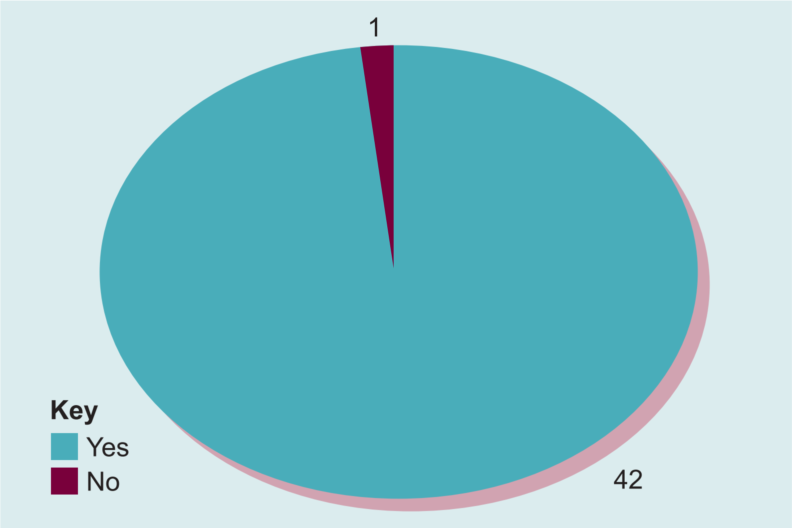
*Figure 3.4*
*Departmental Compliance*



### *Understanding the Term "Ex Gratia"*

3.109 The term "ex gratia" (as defined in Note 4 in Figure 3.1 on page 30) was clearly understood in 42 departments. The one department in which the term was not clearly understood was reported as taking a conservative approach, to the extent that any payment likely to be within that category was referred to the chief executive.

*Figure 3.5*
*Understanding the Term "Ex Gratia"*




## Conclusions

3.110 We found that the majority of departments had correctly updated their financial delegations documentation to reflect the revised limits and had satisfactorily communicated the updated documentation to relevant staff. Where the documentation had not been updated, or staff had not been informed, action was being taken to rectify the failure.

3.111 Keeping the documentation up to date and informing relevant staff of the new position are essential measures in preventing non-compliance with the authority of the Cabinet. Nevertheless, the three departments that had not always complied (see paragraph 3.108) had updated their documentation and informed the staff. In those departments, at least, those measures were clearly not sufficient in themselves – suggesting that regular monitoring for compliance should also be undertaken.

3.112 Not all departments have an annual budget that is large enough to permit expenditure on fixed assets in excess of the delegated limits of a chief executive or responsible minister. Some departments may also be unlikely to spend money on the other types of restricted expenditure. Nevertheless, we recommend in those cases that, in the interests of good management practice, the departments should make sure that:

- their own documentation records what authorities the Cabinet has delegated; and
- relevant staff are made aware of the limits of those authorities.

# 3.2 Departmental Reporting on "Closing the Gaps"

*Departments were required to include specific information in their 1999-2000 annual reports on their contribution to improving outcomes for Maori and Pacific Island peoples. Within the relatively limited time given to them, departments made a creditable effort to meet the reporting requirements.*

*Future reporting could be improved with more preparation and by refinements to the specifications of what departments are required to report. Improved departmental reporting would assist in the preparation of an aggregate annual report on the subject.*

## Introduction

3.201 As part of its "Closing the Gaps" strategy (the Gaps strategy), in June 2000 the Government required all departments to provide specific information in their annual reports on their contribution to improving outcomes for Maori and Pacific Island peoples. Departments made their first attempt at such disclosures in their annual reports for 1999-2000.[1]

3.202 The information contained in the annual reports was additional to the standard information required and, therefore, it was not subject to our annual audit. Nevertheless, we reviewed a selection of key departments' approaches to their Gaps strategy reporting.

3.203 This article discusses our observations on that reporting and highlights some ways in which the reporting could be improved.

1 The detailed reporting requirements were conveyed to departments by the Treasury in a circular dated 19 June 2000.

## Information Required of Departments

3.204 Every department that incurred either departmental or non-departmental expenditure on improving outcomes for Maori was told that it should disclose in its annual report a breakdown of the expenditure, split into the following categories:

***Category 1:*** Expenditure targeted solely at improving outcomes for Maori;

***Category 2:*** Expenditure intended to improve outcomes for at-risk groups, but not targeted specifically at Maori; and

***Category 3:*** Other expenditure on Maori not covered by Categories 1 and 2.

3.205 Departments were also required to include, as a minimum, the following additional information on the nature of expenditure on activities aimed at improving outcomes for both Maori and Pacific Island peoples (unless agreed with their responsible minister):

- Actual compared with budgeted expenses (departmental and non-departmental) on Maori within Categories 1, 2 and 3, and on Pacific Island peoples.
- The "intervention logic" for this expenditure – that is, the linkage between the expense and the intended outcome (how the expense is expected to influence the outcome), as well as plans to manage any risks associated with the intervention.
- Where available, evidence of effectiveness in achieving the desired outcomes from this expenditure. This information may include the results of any evaluation or pilot study undertaken, or other valid means of determining effectiveness.
- If information on effectiveness was not currently available, information on planned steps to obtain such information in the future, including when it would be available.

3.206 Departments were required to present the information in a section of their annual report addressing "Effectiveness in Closing the Gaps".

3.207 We understand that an aim of having the information provided in the annual reports was to enable an aggregate annual report on such expenditure to be compiled. This aggregate report was to be used to assist the Government in its oversight of the Gaps strategy.

## The Annual Reports We Reviewed

3.208 We reviewed the "Effectiveness in Closing the Gaps" section in the annual reports of the following departments:

**Core "Gaps" Departments –**

- Department of the Prime Minister and Cabinet (DPMC)
- Ministry of Pacific Island Affairs
- State Services Commission
- The Treasury
- Te Puni Kokiri

**Sector and Service Departments with Key "Gaps" Strategy Roles –**

- Department of Child, Youth and Family Services
- Department of Labour
- Department of Work and Income
- Ministry of Economic Development
- Ministry of Education
- Ministry of Health
- Ministry of Social Policy

## Approaches to Reporting

3.209 Our review revealed a number of issues arising from the approaches to Gaps strategy reporting. These issues broadly relate to:

- the level of adherence to the reporting framework; and
- the nature of the information provided in the annual reports.

## Differences in How Departments Reported

3.210 Where differing sets of information are to be combined, it helps if the information is in a similar format. However, there were differences in how departments reported their Gaps strategy expenditure. Most departments provided the information in specific sections of the report that were consistent with the reporting requirements, but others did not. Figure 3.6 opposite outlines these differences in approach.

3.211 The Department of Labour was able to provide a breakdown of expenditure by category on improving outcomes for both Maori and Pacific Island peoples. The DPMC also indicated which category included Pacific Island peoples expenditure.

3.212 Both the Ministry of Pacific Island Affairs and Te Puni Kokiri noted that all their expenditure was targeted at Pacific Island peoples and Maori respectively, and did not provide a category breakdown.

3.213 The Treasury and the Ministry of Social Policy did not present their information in a manner consistent with the reporting requirements, but both provided information on policy, research, or other activities that they carry out that relate to Maori outcome improvement. Similarly, the State Services Commission discussed a number of activities that fell under Category 3, but did not specifically address the reporting requirements further.

3.214 Few reasons for non-compliance with the reporting framework were provided, and no non-complying department indicated whether its responsible minister had agreed to the departure from the reporting requirements.

*Figure 3.6*
*Differences in Reporting Approach*

| Department | Expenditure by Category | Actual/Budget | Intervention Logic | Evidence of Effectiveness | Plans to Obtain Effectiveness Information |
|---|---|---|---|---|---|
| DPMC | ✓ | ✓ | ✓ | ✓ | ✓ |
| Child, Youth and Family Services | ✓ | ✓ | ✓ | ✓ | ✓ |
| Labour | ✓ | ✓ | ✓ | ✓ | ✓ |
| Health | ✓ | ✓ | ✓ | ✓ | ✓ |
| Te Puni Kokiri | ✢ | ✓ | ✓ | ✓ | ✓ |
| Pacific Island Affairs | ✢ | ✓ | ✓ | ✓ | ✖ |
| Economic Development | ✓ | ✓ | ✖ | ✓ | ✓ |
| Work and Income | ✓ | ✓ | ✖ | ✓ | ✖ |
| Education | ✓ | ✓ | ✖ | ✓ | ✖ |
| State Services Commission | ✓ | ✖ | ✖ | ✖ | ✖ |
| Treasury | ✖ | ✖ | ✖ | ✖ | ✖ |
| Social Policy | ✖ | ✖ | ✖ | ✖ | ✖ |

**Key:**
✓ The annual report included this information in a specific section.
✖ The annual report did not include this information in a specific section.
✢ Not applicable – all expenditure was targeted at improving Maori or Pacific Island peoples outcomes.

THREE

## Nature of the Information Reported

3.215 The nature of information reported on under each component of the framework varied substantially.

### *Actual Compared with Budgeted Expenditure on Maori and Pacific Island Peoples*

3.216 Reporting on planned and actual expenditure in Category 1 (expenditure targeted solely at Maori) appears to have been relatively straightforward. However, the treatment of reporting on Categories 2 and 3 expenditure was variable. In most cases, departments assessed budgeted and actual expenditure on Maori as 15% of total budgeted and actual expenditure (based on Maori making up 15% of the general population).

3.217 Assigning a simple proportion in that way may provide an indication of both the funding a department could expect to apply to Maori outcome improvement and the likely costs a department could expect to incur. But such assessments may not be of practical benefit, given that the levels of Maori use of services may be disproportionate to the Maori percentage of the general population (either nationally or locally).

3.218 Most policy departments attempted to provide a category breakdown for policy advice functions. Exceptions were the Treasury, DPMC, and the Ministry of Social Policy.

3.219 It was expected that the expenditure information would be provided at the programme or activity level. Again, we observed some variability. For example:

- The Department of Labour provided vote, output class and activity information, as did the Ministry of Economic Development.
- The Ministry of Health reported on specific policy projects targeting Maori and Pacific Island peoples, and provided associated expenditure information. However, the majority of expenditure in the health sector on Maori outcomes is incurred through Non-departmental Output Classes, which was reported at an output class level and not at a programme level.

3.220 Departments explain in the statement of accounting policies the manner in which GST is reflected in the financial statements included in the annual report. But for some departments it is unclear how the reported expenditure on Maori and Pacific Island peoples reflects GST. For example:

- DPMC, the Department of Labour, and the Ministry of Economic Development specify whether GST is included or excluded in the expenditure reported; but
- the Ministry of Pacific Island Affairs and Te Puni Kokiri do not make clear whether GST is included or excluded.

### *Intervention Logic*

3.221 Intervention logic was another area where adherence to the reporting requirements was variable. Of the six departments that did not have specific sections addressing intervention logic, the Ministry of Economic Development provided explanations of the expenditure in each category, and the Ministry of Education provided an explanation of how the "expense influences the desired outcome".

3.222 The Ministry of Health, while commenting on the intervention logic of policy projects, did not provide information on the intervention logic for Non-departmental Output Class expenditure.

### *Evidence of Effectiveness, and Plans to Obtain Effectiveness Information*

3.223 The quality of reporting on the effectiveness of programmes and activities, and on plans to obtain programme/activity effectiveness information, was mixed.

3.224 Departments were required to report evidence of the effectiveness of programmes in achieving outcomes. Nevertheless:

- some departments (e.g. the Ministry of Education, the Department of Work and Income, and the Ministry of Economic Development) reported on the effectiveness of achievement of outputs and participation of Maori and Pacific Island peoples in programmes, rather than providing evidence of effectiveness in "closing the gaps"; and
- the Ministry of Health, while discussing monitoring the effectiveness of specific policy projects, did not provide information about the effectiveness of Non-departmental Output Class expenditure.

3.225 Generally, policy departments did not provide information on either the effectiveness of policy advice provided or the planned steps to obtain such information.

## Our Observations

3.226 In general, we believe that departments made a creditable effort to report the information required on the Gaps strategy. Obviously, as this was the first time such an exercise had been carried out, teething problems were to be expected.

3.227 As mentioned in paragraph 3.207 on page 39, we understand that the aim of having the information provided in the annual reports was to enable an aggregate annual report on Gaps strategy expenditure to be compiled. The variability of adherence to the reporting requirements by the departments we looked at would appear to make achievement of that aim very difficult. In addition, the variability in the nature, extent and format of the information provided by departments would make it very difficult to draw accurate conclusions from such a report.

3.228 In our view, future reporting could be improved by:

- a consistent approach among departments;
- clarification of the extent to which policy departments should attempt to comply with the reporting requirements;
- departments being more specific at the start of the year about their planned expenditure – particularly in Categories 2 and 3 – against which actual expenditure could be better assessed;
- a clear statement of the nature of the effectiveness reporting sought;
- appropriate and consistent treatment of GST; and
- stating whether the minister’s agreement had been obtained to departing from the reporting requirements (when that happens).

3.229 Overall, the reporting requirement is a positive step in increasing the transparency of the Gaps strategy and departmental contributions to it. We understand that the Government will be seeking to improve the quality of future Gaps strategy expenditure reporting. We support such improvement and suggest that the Government consider making any future aggregate annual report publicly available.

# 3.3
# Managing Employee Fraud

***Employee fraud in government departments is relatively rare. However, it does happen and we were surprised that fewer than half of the departments we surveyed had formal policies and procedures specifically for minimising the likelihood of employee fraud or dealing with it when it happened.***

## Why We Looked At the Subject

3.301 Information that had come to our attention led us to the view that the quality of departmental policies and procedures for managing employee fraud was mixed. Therefore, we decided to survey departments for current practice.

## What We Looked At

3.302 Our auditors examined each department to:

- establish whether it had formal written policies and procedures for minimising the likelihood of employee fraud and identifying the action to be taken once the department had determined that it had occurred; and
- assess how the department had managed any employee fraud that had occurred.

3.303 In those departments in which employee fraud had occurred in the past three years, the auditor examined whether the department had:

- documented policies and procedures;
- regularly reviewed transactions, activities or locations that may be susceptible to fraud;

- treated employees suspected of fraud consistently, regardless of seniority or position; and
- reviewed and (if necessary) amended internal control procedures and related practices following determination that fraud had occurred.

## Incidence of Employee Fraud

3.304 Over the past three years (that is, 1997-98 to 1999-2000), there were 136 identified instances of employee fraud in 22 departments. The total established loss from the frauds was $1,568,034.[1] Not all of the 136 instances involved loss of money; nor was it always possible to establish the exact amount of money lost.

3.305 Of the $1,568,034 lost, $320,243 had been recovered and $417,239 was still the subject of investigation. The balance was regarded as not recoverable for a number of reasons, including:

- the perpetrator was not known or the perpetrator's identity could not be proved;
- it was not possible to quantify the amount lost; and
- the amount involved was considered too small to justify the additional expense of recovery action.

## Policies and Procedures

3.306 Of the 43 departments we surveyed, only 16 had formal policies and procedures for managing employee fraud. One department said a policy was being developed; 18 departments relied instead on the provisions of an employee code of conduct; and six departments said that employee fraud was either identified as not being a risk or considered not to be a priority.

1 That represents 0.0009% of the total government expenditure of approximately $106,000 million over the three-year period.

## How Employee Fraud Was Dealt With

3.307 Of the 22 departments in which employee fraud had occurred in the past three years, 10 had formal policies and procedures for managing it. And of the 136 instances of employee fraud, 106 occurred in those 10 departments.[2]

3.308 Also, of those 22 departments:

- 18 undertook regular reviews of transactions, activities or locations susceptible to fraud;
- 18 treated employees suspected of fraud consistently, regardless of seniority or position; and
- 19 reviewed and amended internal control procedures and related practices following the occurrence of fraud.

3.309 Analysis of the 136 instances of employee fraud shows that individuals perpetrated 129, staff acting in collusion perpetrated 3, and a person or persons unknown perpetrated 4. As for the consequences:

74 cases resulted in staff being dismissed

18 cases resulted in staff resigning

44 cases were still under investigation

in 44 of the 92 cases finalised staff were prosecuted.[3]

2 However, 60 of the 106 occurred in two large departments.

3 The decision to prosecute rests with the police, who may decide that there is insufficient evidence on which to proceed.

## The Quality of Employee Fraud Management

3.310 For each of the 22 departments in which employee fraud had occurred, we assessed the quality of the department's management of the fraud. The criteria that we used were broadly similar to those we use to assess departments' financial management (see paragraph 2.011 on page 22). The results of our assessment are:

| Standard | Number of Departments |
|---|---|
| Not adequate | – |
| Just adequate | 8 |
| Satisfactory | 7 |
| Good | 6 |
| Excellent | 1 |

## Conclusions

3.311 We are disappointed at the small proportion of departments that had formal policies and procedures for managing employee fraud. We acknowledge that the risk of employee fraud will vary according to the size of the department, the complexity of its operations, and other factors. But we do not believe that there is never any risk. Indeed, smaller departments – in which internal controls could be harder to apply – could be at greater risk than larger departments.

3.312 In our view, every department should formally address the matter of employee fraud, and formulate an appropriate policy on how to minimise it and (in the event that it occurs) how it will be dealt with.

3.313 A code of conduct – or, perhaps, an individual employment contract – may identify employee fraud as constituting serious misconduct and specify the action that follows if serious misconduct is considered to have occurred. However, neither of those documents is likely to include a detailed and comprehensive statement of the department's policies and procedures for managing all aspects of employee fraud. For example, the absence of standardised procedures and documentation could lead to inconsistencies in how individual cases are dealt with.

3.314 In our view, the benefits of detailed and comprehensive policies and procedures are that:

- the response to employee fraud is both considered and appropriate;
- the same course of action is taken in every case; and
- the particulars of a fraud and the action taken is better documented, increasing the ability to refer the case to the police for prosecution.

3.315 **We recommend that an employee fraud policy should include, as a minimum, these key elements:**

- **a system for undertaking regular reviews of transactions, activities or locations that may be susceptible to employee fraud;**
- **specifications for fully documenting what happened in an employee fraud and how it is to be managed;**
- **the means for ensuring that every employee suspected of committing fraud is dealt with in the same manner, regardless of the employee's seniority or position;**
- **the principle that every effort is to be made to gather sufficient reliable evidence to support a prosecution, and that every case of fraud will be referred to the police with a view to prosecution; and**
- **the principle that recovery of the lost money or other property will be pursued wherever possible and practicable.**

3.316 The chief executive and management of every department need to be clear on their attitude towards employee fraud, and employees need to be aware of that attitude and the consequences of transgressing. The only satisfactory way of achieving those objectives is in a formal statement of policies and procedures about which everyone in the organisation is fully informed.

3.317 We will maintain our interest in the subject by keeping under review how departments are formalising their attitude to employee fraud and how they deal with any cases that occur.

# 3.4 Funding Arrangements with Non-government Organisations

*The arrangements under which non-government organisations are paid public money to provide goods or services to third parties need to be drawn up so as to ensure:*

- *adequate accountability for the money paid; and*
- *that compliance costs are kept to the minimum for both the paying agency and the provider organisation.*

*The Treasury is leading a group of officials with the objective of formulating best practice guidelines by early-2001.*



## Background

3.401 In early-2000 the Hon Richard Prebble MP asked us to consider a range of issues in relation to the Health Funding Authority's contracting arrangements with Te Whanau o Waipareira Trust (the Waipareira Trust). The particular concerns raised were more appropriately addressed – and were subsequently reported on – by the Serious Fraud Office.

3.402 However, a range of more general issues arose out of the preliminary work that we did in order to respond to Mr Prebble's request. In particular, we noted the need for the Government to develop consistent practice among departments in dealing with private entities such as the Waipareira Trust – especially the need to monitor performance when purchasing is by way of contractual arrangements.

3.403 A number of enquiries we made identified specific aspects of contracting arrangements with non-government organisations (NGOs) that need further consideration. These aspects include:

- processes for selecting appropriate recipients of Government funding;
- purchasing and contracting arrangements between funders and NGOs;
- monitoring by funders of contracted service delivery by NGOs; and
- evaluation of the outcomes of Government-funded activities.

3.404 We pursued these issues through further discussions with officials, with a view to best practice guidelines being developed.

## Government Response

3.405 As a result of our recommendation to develop best practice guidelines, the Treasury is leading an officials group with the objective of formulating the guidelines by early-2001. Given the policy considerations that will probably have to be addressed, this is a task that is best undertaken by executive government. Nevertheless, we are contributing to the process by way of advice based on the extent of our knowledge and experience.

3.406 The officials group has a challenging task on its hands. The group has to determine how to balance the need to:

- maintain and demonstrate adequate accountability in the arrangements that funders enter into with NGOs;
- minimise compliance costs for funders and NGOs alike;
- achieve and measure the funder's desired outcomes;
- ideally, produce guidelines that will mean that NGOs are treated similarly by, and consistently between, funders;
- provide best value for both the ultimate recipients or beneficiaries of the funding and the taxpayer.

3.407 The contractual model that has typically been relied on to date has, on the face of it, offered the simplest and most transparent form of accountability relationship. However, taking all factors into account may well result in a conclusion that contracting is only one of a range of possible arrangements.

## Impact Evaluation

3.408 In paragraph 3.403 we refer to evaluating the outcomes of Government-funded activities – which means that funders need to be able to demonstrate and measure the desired outcomes from the funding provided. We addressed at length the subject of *Impact Evaluation – Its Purpose and Use* in a report earlier this year.[1]

3.409 We are encouraged by the Government's response to that report and the work of another officials group – in this instance led by the State Services Commission – in addressing the issues we raised.

## Our Powers of Inquiry

3.410 NGOs such as the Waipareira Trust are (as already stated) private entities and, consequently, we have no mandate to audit them. Our powers are limited to asking such entities to supply information to us about how they have spent any public money paid to them by a government department or Crown entity that we are auditing.

3.411 The question of whether our mandate should be extended to include the power to audit NGOs in receipt of public money was raised during the first reading debate on the Public Audit Bill. As a result:

- the Finance and Expenditure Committee asked us to comment on our existing powers to obtain information from NGOs when auditing public entities that had paid them money; and

1 *First Report for 2000*, parliamentary paper B.29[00a], pages 99-140.

- the Minister in charge of the Audit Department asked us to provide draft legislation to the Committee concerning our ability to "monitor and report on" public money provided to an NGO as a private provider.

3.412 We responded (in a joint report with the Treasury) to the Committee in the following terms:

- we already have power to "follow" taxpayer funds into an NGO – by seeking information from the NGO about whether it has, in fact, performed a contract or provided services;
- there is currently no need to extend our functions and powers concerning NGOs; and
- additional provisions, to avoid doubt, specifying in more detail our existing functions and powers concerning NGOs were unnecessary.

3.413 We also expressed the view that the better approach lay in ensuring *that each public entity which contracts service provision to NGOs, or makes grants of taxpayer funds for public services, has sound practice in respect of its:*

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

3.414 The Committee accepted that the functions and powers that we are to be given by the Public Audit Bill were adequate concerning NGOs and did not recommend any change.

# 3.5
# Disclosing Fiscal Risks on Defence Capital Projects

***Future spending on defence capital equipment is expected to be significant as new projects are approved. This spending will have budgetary implications in terms of commitments entered into with suppliers and the need for appropriations from Parliament. To consider those implications properly, Parliament needs information about:***

- ***the capability of the New Zealand Defence Force – especially in relation to its capital equipment needs;***
- ***the fiscal risks attaching to capital equipment purchases; and***
- ***the funding requirements (in the form of appropriations) to pay for the purchases.***

3.501 The Ministry of Defence is responsible for managing the purchase or refurbishment, on behalf of the Crown, of various items of equipment identified as contributing to a change in the capability of the New Zealand Defence Force (NZDF).[1]

3.502 For the 2000-01 financial year, the Government has asked Parliament to appropriate $145 million for the purchase of defence equipment for the NZDF.[2] This appropriation is only to meet payments due on purchases for currently approved projects that were in progress at the time of formulating the estimates of Vote Defence for the year.

1 *Estimates of Appropriations*, parliamentary paper B.5 Vol. 1, 2000, page 333.

2 Ibid., page 335.

3.503 However, a number of other purchase or refurbishment projects for defence equipment are now known about. Shortly after presentation of the Budget in June this year the Government announced that it was proceeding with acquisition for the Army of light armoured vehicles (estimated to cost $611 million, including GST) and tactical communications equipment (estimated to cost $124 million, including GST).

3.504 In order to allow progress on those newly announced acquisitions, a sum in the region of $180 million was included in the amount of liabilities to be incurred in 2000-01 of $1,250 million, for which Parliament's authority was sought and obtained in section 8 of the Imprest Supply (Second for 2000/01) Act 2000.

3.505 The *Budget Economic & Fiscal Update* for 2000 includes disclosure of unquantified fiscal risks. Under the heading "Defence – capital injections (changed risk)" the *Update* states that:[3]

> *The Government intends to assess its defence policy priorities during 2000/01 – capital injections may be required to implement these priorities once this is completed and the NZDF's capability needs are determined.*

3.506 The effect of what we describe in paragraphs 3.503-3.505 is that the Government will be relying on funds available to it under imprest supply to meet any initial liabilities for the additional defence equipment purchases, without having had to persuade Parliament to provide an appropriation for the purpose.

3.507 In our *Third Report for 1999: The Accountability of Executive Government to Parliament*[4] we said that Parliament needs better information in order to effectively hold Executive Government to account. Among the points we made in that report – which are particularly relevant in the context of major defence equipment purchases – is the need for:

- Better information on ***capability*** – in NZDF's case especially in relation to its equipment needs.

3 Parliamentary paper B.3, page 77.

4 Parliamentary paper B.29[99c].

- Better information on ***risks***. We believe that there is plenty of room to improve the disclosure of unquantified fiscal risks in the *Budget Economic & Fiscal Update*.

- A more disciplined approach to the use of ***imprest supply***. Because no appropriation is being sought in 2000-01 for the newly approved NZDF equipment purchases, the Government effectively has a free hand (within the overall limits of imprest supply) to apply public money to purposes that have not been put to, or approved by, Parliament.

# 3.6 Student Loan Debt

***Student loan debt is increasing rapidly,[1] but not enough information is being collected about the operations of the Student Loan Scheme. One of the consequences of this lack of information is uncertainty about how much debt the Crown is likely to recover. Other consequences include the unknown impacts of the Scheme in terms of intended and unintended socio-economic outcomes.***

3.601 In June this year we issued a report on *Student Loan Scheme – Publicly Available Accountability Information*.[2] In that report we expressed concern at the lack of information being collected and analysed about the operations of the Scheme.

3.602 Total student loans outstanding (including interest) at 30 June 2000 were $4,004 million, against which a provision for doubtful debts of $481 million was made.[3] In our view, the asset for the outstanding debt would better be valued on a "fair value" basis – which is likely to be by way of actuarial valuation.

3.603 The methodology used to calculate the provision for doubtful debts contains separate components for *capital* and *interest*:

- a flat 10% on the *capital* portion of the outstanding debt; and
- an amount representing write-offs of *interest* accrued in accordance with Government policy.[4]

1 See paragraphs 1.015-1.017 on page 14.
2 ISBN 0 477 02868 3.
3 *Financial Statements*, parliamentary paper B.11, 2000, page 63.
4 Ibid.

3.604 Our ability to form a view on the reasonableness of the amount brought to charge in 1999-2000 for the increase in the provision for doubtful debts ($133 million) is affected by the limited availability of information that might help to corroborate the aggregate provision of $481 million at 30 June 2000.

3.605 We made a number of key findings and recommendations in our June report, and we understand that officials are considering a Government response to them. We repeat those findings and recommendations here for further consideration and scrutiny by Parliament.

## Key Findings

3.606 In our view, key stakeholders receive adequate information on the current financial position of the Scheme at an aggregate level. However, we think that there are the following shortcomings in public accountability information:

- limited information on the fiscal risks attached to the Scheme; and
- lack of information on the impact of the Scheme on intended and unintended socio-economic outcomes.

3.607 The adequacy of valuation of the student loan debt also needs to be reviewed, especially in light of the expected move to a net present value ("fair value") model for valuation.

3.608 In our opinion, the following related capability and accountability issues need to be addressed to provide better public accountability information:

- fragmented responsibility for the Scheme as a whole;
- lack of focus of strategic policy advice and research;
- shortcomings in data collection, analysis and exchange;
- shortcomings in forecasting;
- lack of the system's responsiveness to change; and
- gaps in service to borrowers.

## Recommendations

3.609 We recommend that the financial reporting requirements for the Scheme be improved by:

- reporting more regularly – for example, reporting at the quarterly intervals stated in the original Government decision on reporting on the Scheme;
- having annual financial reports audited and presented to the House within the same time as departmental annual reports (sections 35-39 of the Public Finance Act 1989);
- developing an interim response (until fair value methodology is adopted) to the issue of lack of appropriation for debt write-offs;
- including in reports to Ministers and Parliament – especially the Ministry of Education's *Student Loan Scheme Annual Report* – more information on financial projections, financial performance, fiscal risks, and more detailed analysis of past uptake and repayment patterns;
- including in financial forecasts for the Scheme assumptions and risk assessments;
- developing and reporting against a set of indicators for the financial performance of the Scheme; and
- developing and reporting against a set of coherent and assessable outcome indicators for the Scheme – including both intended outcomes and risks of unintended outcomes.

3.610 In order to clarify responsibilities and improve information availability, we also recommend that the related capability and accountability issues be addressed by:

- reviewing the current fragmentation of responsibilities for the Scheme;
- considering (as part of that review) the suggestion of establishing a separate agency (with the appropriate specialist skills) with overall responsibility for strategic risk management of the Scheme and for financial reporting on the Scheme;

- the agency responsible for managing the fiscal risks of the Scheme regularly reviewing the Crown's credit risk from the Scheme;
- clarifying the responsibility of the Ministry of Education for strategic policy advice on the Scheme – including the purpose and role of research (and its adequate resourcing) and what reporting obligations are included;
- clarifying other agencies' accountability for collecting and exchanging data for monitoring against socio-economic indicators – to ensure that those agencies supply the appropriate information in a timely manner;
- Statistics New Zealand undertaking a trial integration of selected datasets relating to the Scheme with a view to providing statistics to inform strategic policy, financial risk management, financial reporting, and forecasting;
- directing officials of the relevant agencies to resolve the data exchange issues hindering analysis of the impact of the Scheme;
- the Ministry of Education commissioning research on the areas of socio-economic impact where there is no information; and
- revising the information for students to ensure that they receive adequate information on repayment choices and the potential impact of having a student loan.

# 3.7 Supplementary Estimates for 1999-2000

***The Minister of Finance did not present the* Supplementary Estimates *for 1999-2000 to the House until 15 June 2000. Effectively, that gave the House two weeks to consider them before the end of the financial year. We believe that two weeks was too short a time for adequate parliamentary scrutiny – particularly because of the scale of new expenditure initiatives that the* Supplementary Estimates *included. This timing issue brought the system – and its constitutional values – under pressure.***

3.701 *A long-standing principle under the Westminster style of government is that no expenditure of public money can take place without the prior approval of Parliament. In New Zealand, both the Constitution Act 1986 and the Public Finance Act 1989 continue this historical requirement. Appropriation ensures that Parliament, on behalf of the taxpayer, has adequate scrutiny of how public resources are to be used . . . .*[1]

3.702 General elections in New Zealand are traditionally held near to the end of a calendar year. If there is a change of government, the new administration takes up office almost at the middle of the financial year (which runs from 1 July to 30 June). The new administration also inherits the budgetary settings determined by the previous government, together with their actual fiscal consequences.

3.703 The government that took office in late-1999 inherited a larger than forecast fiscal surplus. It decided to spend a significant amount of that surplus on new initiatives, and to bring the expenses to charge in the 1999-2000 financial year. That decision had implications for the accounting treatment of the new expenditure initiatives.

1 *Putting It Together*, the Treasury, page 29 (ISBN 0-478-10609-2).

3.704 The transactions and arrangements for some of the initiatives were designed carefully (in terms of established legal and accounting frameworks) to enable the expenses to come to charge in the 1999-2000 year. The effect was to establish liabilities that were properly recognised in terms of generally accepted accounting practice, without benefits remaining in the control of the Crown at 30 June 2000. This allowed the new expenditure initiatives to be recognised as expenses in the 1999-2000 financial year even though the benefits and outcomes of the expenditure related to future periods.

3.705 The Government also had to obtain appropriation from Parliament for the new expenditure initiatives before 30 June 2000. But there was a timing difficulty because the main *Estimates of Appropriations* for the year – in which major new expenditure initiatives are usually introduced – had been passed some months earlier, before the general election. The only means of obtaining appropriations for the new expenditure was through the *Supplementary Estimates*.

3.706 The Government did not present the *Supplementary Estimates of Appropriations* for the year ended 30 June 2000[2] to the House until 15 June 2000 – the same day on which it presented the main *Estimates of Appropriations* for the year ending 30 June 2001.[3] Under Standing Orders, Supplementary Estimates stand referred to the Finance and Expenditure Committee (FEC), which may examine a Vote itself or refer it to any subject select committee for examination.[4]

3.707 Consequently, the FEC had to examine and report on the *Supplementary Estimates*, and the House had to pass the Appropriation (Supplementary Estimates) Bill, within two weeks. Otherwise, the expenditure incurred in anticipation of Parliament agreeing to the appropriations covered by the *Supplementary Estimates* would have been unlawful. Therefore, the FEC had a limited opportunity to conduct and report on its examination.

2 Parliamentary paper B.7, 2000.

3 Parliamentary paper B.5, 2000.

4 S.O. 327.

3.708 Ordinarily, examination of Supplementary Estimates is not a particularly onerous exercise because:

- the FEC or subject select committee has more time to look at the individual Votes;
- most of the supplementary appropriations being sought are technical in nature – that is, accounting adjustments with a fiscally neutral impact; and
- when appropriation is sought for a new expenditure initiative the overall fiscal impact is not significant in relation to total expenditure for the year.

3.709 Examination of the *Supplementary Estimates* for 1999-2000 was different, not only because of the shortage of time but also because there were appropriations for new expenditure initiatives with a significant fiscal impact. We illustrate the range of supplementary appropriations sought at the end of this article. (Even after accounting for the new expenditure initiatives, the Government had an operating balance for 1999-2000 of a net surplus of $1,449 million – which compared to a deficit of $36 million forecast in the 1999-2000 Budget.)

3.710 In our view the course adopted meant that some of the transparency contemplated by the Fiscal Responsibility Act 1994 was lost. An important principle of this Act is that new expenditure initiatives with a significant fiscal impact will be included in the Budget Policy Statement and, accordingly, that there will be adequate parliamentary time to consider and debate them.

3.711 The Government's actions ensured that the expenditure on its new initiatives was properly accounted for and was lawful. But the limitation of time for parliamentary scrutiny to two weeks brought the system – and its constitutional values – under pressure. It would have been preferable, from a constitutional standpoint, for the Government to have introduced the *Supplementary Estimates* into the House earlier, so as to have allowed time for adequate parliamentary scrutiny. Alternatively, the Government could have sought appropriations for the new expenditure initiatives through the *Estimates of Appropriations* for 2000-01.

## Range of Supplementary Appropriations 1999-2000

### *Vote Finance $123 million*

This was for:

a once-only cash payment of $120 million to the West Coast Region (for the "West Coast Package") to an entity to be established; and

funding to enable a once-only capital injection of $3 million into New Zealand Symphony Orchestra Limited (as part of the arts package).

### *Vote Culture and Heritage $108 million*

This was for a package of new measures in the arts and culture sector, branded collectively as *building cultural identity*. The package included:

$20 million for Creative New Zealand

$6.5 million for the Christchurch Art Gallery

$0.3 million for the Edwin Fox Society

$2 million for a newly established Music Commission

$1 million for the New Zealand Film Archive

$22 million for another new entity – New Zealand Film Production Fund Trust

$3 million for the New Zealand Historic Places Trust

$0.76 million for the Royal New Zealand Ballet

$28 million for New Zealand On Air.

## *Vote Police $95 million*

This amount included:

$6 million for new sworn staff

$15 million to compensate for over-optimistic savings forecasts

$7 million for loss on sale of assets relating to the Ngai Tahu settlement

$66 million for writing down the value of the INCIS computer system.

## *Vote Defence $73 million*

This was predominantly for new defence equipment purchases (see also the comments on this subject in paragraphs 3.501-3.507 on pages 56-58).

## *Vote Sport, Fitness and Leisure $17 million*

This was to provide new funding for the Sydney 2000 Olympics team ($1 million) and to support high-performance sports people competing in key international sporting events ($16 million).

## *Vote Maori Affairs $15 million*

This was for once-only funding for Maori development through language and culture. The money was to be paid to a trust to be established.

## *Vote Tourism $10 million*

The principal components were an expense transfer from the previous financial year of $4.5 million for marketing New Zealand as a visitor destination, and a once-only grant of $5.6 million for trade and tourism opportunities arising from the defence of the America's Cup in 2003.

## *Vote Business Development $3 million*

This was for the establishment costs and interim policy advice costs associated with the new Vote Economic Development and Vote Industry and Regional Development portfolios.