Controller and Auditor-General
Tumuaki o te Mana Arotake

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Parliamentary paper

Central government: Results of the 2008/09 audits

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Central government: Results of the 2008/09 audits

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

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Hon Dr Lockwood Smith MP
Speaker
House of Representatives
WELLINGTON

Mr Speaker

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

Yours faithfully

Lyn Provost
Controller and Auditor-General

Wellington

18 February 2010

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Introduction

This report is in four sections.

Section 1 provides an overview of the results of our audits in the central government sector for 2008/09.

The audit of the financial statements of the Government is the most significant audit we carry out. The Treasury managed the consolidation and preparation of the statements to a good standard, and we issued an unqualified audit opinion. Several of the issues from previous audits had been addressed.

An important new issue in the latest audit related to long-term insurance and retirement plan liabilities. There was a significant difference in the long-term discount rates that different entities used to value those liabilities. This led to the Treasury, as a short-term solution, directing the Government Actuary to use a particular discount rate to recalculate the retirement plan liability at 30 June 2009 for the Government's financial statements. We concluded, after much effort, that the discount rates used were acceptable. However, closer monitoring (as we had recommended in our 2007/08 audit) would have identified the issues with the rates earlier, and might have enabled a long-term solution to be found.

In our annual audits, we typically assess each entity's management control environment and financial information systems and controls. Generally, we were pleased with the results for 2008/09. More than 90% of entities were graded either "very good" (they did not need to improve their management control environment) or "good" (they could make beneficial improvements). The results for entities' financial information systems and controls were similar. District health boards (DHBs), however, continue to be over-represented in the lower grades.

The results for service performance reports and associated systems and controls – graded for the first time in the 2008/09 audits – were more mixed. We observed that the quality of such systems and controls varied widely between entities. The audit results suggest that most entities need to make improvements. As we discuss in Section 2, we are working closely with entities to progress improvements in service performance reporting.

Auditing entities' compliance with authority for expenditure is also important for us. Although there are several mechanisms the Executive can use to authorise expenditure, we continue to see government departments incur expenditure without authority. Government departments need to have effective procedures in place to ensure that their spending is within the appropriate bounds, and to seek relevant authority or approval promptly.

For completeness, we have included an explanation of the non-standard audit reports we issued last year. These are audit reports that contain a qualified opinion and/or an explanatory paragraph.

Section 2 briefly sets out our intentions for improving service performance information and reporting. We consider that improving information and reporting is crucial in helping public entities demonstrate their performance. We recognise the challenges in this area, and are working closely with the Treasury and public entities to achieve improvement.

Section 3 considers audit-related issues affecting DHBs. In 2008/09, our audits focused on procurement policies and practices, and non-financial performance reporting. We found negligible improvement in procurement policies in the sector since our 2007/08 audits. Although the risk management policy component has improved, there is room for every aspect of procurement policies to improve further. We continue to be concerned about the number of deficiencies in all aspects of DHB procurement practices.

We also looked at DHBs' service performance information and associated systems and controls. The DHBs' 2009–2012 Statements of Intent are not as well developed as similar documents elsewhere in the public sector, so we graded all DHBs as "poor/needs improvement". The sector is doing a lot of work on its accountability documents and the accountability framework. However, we are concerned that the poor quality of the external performance reports might reflect more serious, underlying problems with the health sector accountability framework and, possibly, the planning and management arrangements for DHBs' services. Accordingly, we have set out some recommendations for the Ministry of Health and the wider health sector.

Section 4 considers audit-related issues affecting the education sector. For the 2008 tertiary education institution (TEI) audits, audit arrears increased when compared to the previous two years, mainly due to the timeliness of subsidiary audits. We are working closely with TEIs during the 2009 audits to help bring any subsidiary audit arrears up to date. This will help the timely completion of all TEI sector audits.

As in 2007, we focused in 2008 on procurement policies and capital asset management. Although some TEIs had procurement policies in place that reflected our previous recommendations and were in line with good public sector practice, overall the sector's progress was disappointing. Most TEIs have made some progress in improving the quality of their capital asset management planning, but they still have much work to do to raise standards to a level comparable with wider good public sector practice.

In 2008/09, we saw some improvement in integrated schools' accountability for public funding. We have previously reported to Parliament that the financial boundaries between Boards and proprietors in integrated schools had become blurred. Some Boards had used their general public funding for capital expenditure, which is the financial responsibility of the proprietors. Recent work by the Ministry of Education has reduced the possibility that public funds intended for the Board's general operating expenses can be misspent on costs associated with land or buildings owned by proprietors.

We have noticed common governance, financial management, and operating issues arising in recent audits of Māori immersion schools. The Ministry of Education has work under way that could address many of the issues we have identified. We consider there is scope for these schools to improve their practices. We will be considering what further work we might do after we complete the 2009 audits of all schools.

Section 1

Overall audit results for 2008/09

Section 1 has four Parts that cover the overall audit results for 2008/09.

Part 1

In Part 1, we discuss the significant matters arising from the 2008/09 audit of the Government's financial statements.

Part 2

In Part 2, we report on our 2008/09 assessments of central government entities' environment, systems, and controls.

Service performance reporting is also discussed in Parts 5 and 7.

Part 3

In Part 3, we briefly outline the public finance principles underpinning our Controller function and appropriation audit work, discuss the unappropriated expenditure for 2008/09, and report on some of the issues we have considered during the year.

Part 4

In Part 4, we report on the non-standard audit reports issued during the 2009 calendar year on the financial statements of public entities within our central government portfolio of audits. These non-standard audit reports contain qualified opinions and/or explanatory paragraphs.

Part 1
Matters arising from auditing the 2008/09 financial statements of the Government

1.1 In this Part, we report the results of our audit of the *Financial Statements of the Government of New Zealand for the year ended 30 June 2009* (the Government's financial statements) and discuss the significant matters arising from the audit.

Audit opinion

1.2 The Deputy Auditor-General issued the audit report on the Government's financial statements on 30 September 2009.

1.3 The audit report appears on pages 22 and 23 of the statements. The audit report includes our unqualified audit opinion that those statements:

- comply with generally accepted accounting practice in New Zealand; and
- fairly reflect:
  - the Government's financial position as at 30 June 2009; and
  - the results of the Government's operations and cashflows for the year ended 30 June 2009.

Summary of significant matters arising from the 2008/09 audit

1.4 The following is a summary of the significant matters arising from the audit. We discuss them in more detail in the rest of this Part:

- The Treasury managed the process for preparing the Government's financial statements well. We were pleased with an improvement in public entities' reporting accurately and on time, given concerns we have raised previously. Nevertheless, further improvements can be made. We have recommended that the Treasury continue to closely monitor public entities' reporting performance. (See paragraphs 1.5–1.8.)
- Information reported to the Treasury in August 2009 on the long-term insurance and retirement plan liabilities for the Government's financial statements at 30 June 2009 showed a significant difference between the long-term discount rates used to value those liabilities. The difference raised concerns that there may be a material misstatement in the liabilities. The Treasury investigated the difference and, as a short-term solution, directed the Government Actuary to use a particular discount rate to value the retirement plan liabilities at 30 June 2009. After carrying out a lot of extra audit work, we concluded that the discount rates used were acceptable. However, we believe that the issue should have been identified earlier. We had recommended after our 2007/08 audit that the Treasury closely monitor discount rates, given the sensitivity of the liability valuations to changes in rates. Closer monitoring

would have identified the significant difference in long-term discount rates earlier and may have enabled a long-term solution to the issue to be found. Inefficiencies in audit time and costs may also have been avoided. We have recommended that the Treasury work with the actuaries involved in valuing the liabilities during 2009/10 to agree a consistent approach to discount rate assumptions in future. (See paragraphs 1.9–1.27.)

- A provision has been recognised at 30 June 2009 for future payments under the Retail Deposit Guarantee Scheme introduced in October 2008. We are satisfied that the provision is based on reasonable assumptions. However, we note that there are a wide range of outcomes possible under the scheme. The approach to the provisioning to date has been high level and should be tested with a fuller analysis for each institution. We have recommended that the Treasury carry out a fuller analysis of non-bank financial institutions that are part of the Retail Deposit Guarantee Scheme and allocate responsibility for the integrity of the financial information and financial controls over provisioning calculations. (See paragraphs 1.28–1.36.)
- Taxation revenue of $1.423 billion arising from banks' structured finance transactions was recognised in 2008/09 following the outcome of the first High Court case against the Bank of New Zealand, which found in favour of the Commissioner of Inland Revenue, and based on subsequent legal advice. On 23 December 2009, the Commissioner and the respective banks reached settlement agreements under which the banks will pay 80% of the tax in dispute ($1.2 billion). Interest will also be due, but the final figure can only be determined after new assessments are made, statements of account issued, and transfers made from tax pools. We understand that, under the settlement agreements, the Commissioner will not impose any shortfall penalties. (See paragraphs 1.37–1.42.)
- We are pleased that issues we raised in previous years' audits about recognising taxation revenue have been acted on. However, there are areas of revenue recognition where further consideration is needed, including income tax refunds. We have recommended that the Treasury support Inland Revenue in its review of policies for recognising taxation revenue, which is to start in 2009/10. (See paragraphs 1.43–1.47.)
- Recommendations we made last year to improve the valuation of state highways have been implemented, with one exception. The valuer had expressed concerns that the average unit costs may not be appropriate for high-value urban projects and could result in an undervaluation of the network. We have recommended that the Treasury work with the New Zealand Transport Agency to review the approach to valuing the state highway network,

particularly for the costs associated with congested/high-value urban projects. (See paragraphs 1.48–1.53.)

- A recommendation we made last year to independently review the methodology and assumptions for the Kyoto Protocol projected net position during 2008/09 has not yet been implemented. Regular independent reviews are important, given that the projection, by its nature, is subject to a lot of uncertainty. We have recommended that the Treasury work with the Ministry for the Environment to ensure that an independent review is carried out during 2009/10. We understand that an external review has recently been carried out. (See paragraphs 1.54–1.63.)

Significant matters arising from the 2008/09 audit

The Treasury and public entity performance

1.5 The Treasury proactively managed the consolidation reporting by significant public entities in 2008/09 and prepared the Government's draft financial statements to a good standard by the statutory deadline. Treasury staff provided significant support and information to the audit team, including keeping clear and detailed work papers and having an audit file available for our audit team on the first day of our final audit visit.

1.6 In recent years, we have raised significant concerns about the performance of some public entities in preparing timely and accurate financial information for consolidation. We were pleased to see an improvement in public entities' performance this year. However, further improvements can still be made. We have encouraged the Treasury to continue closely monitoring the reporting performance of entities and, where necessary, to involve the relevant chief executives.

1.7 This year, we received all of the expected consolidation clearances on entity-level consolidation information within the set timeframes. However, we were disappointed in the number of "except for" clearances we received (in other words, clearance of most but not all of the information provided for consolidation) and the number of unadjusted errors.

1.8 Some common themes in the "except for" clearances and unadjusted errors reported to us were:

- There were eight "except for" clearances relating to revaluations of property, plant, and equipment. Generally, further work had to be done by the entities to resolve audit queries, or valuers' representation letters needed to be obtained.
- Auditors reported unadjusted errors relating to commitments for seven entities. These errors highlighted that there is a need to improve entities'

understanding of what should be reported as a commitment in the consolidation reporting template.

- Although the information on financial instruments reported by entities generally improved, the auditors of five entities identified significant errors in accounting for, classifying, or disclosing financial instruments.

Discount rates for long-term liabilities

1.9 The operating balance and net worth reported in the Government's financial statements are significantly affected by changes in discount rates and other assumptions applied to key liabilities. These liabilities include:

- Accident Compensation Corporation (ACC) outstanding claims liability of $23,786 million (2008: $18,006 million), and
- the Government Superannuation Fund (GSF) retirement plan liability (net of plan assets) of $8,988 million (2008: $8,257 million).[1]

1.10 These two liabilities are valued each year using actuarial valuation models, which forecast expected future payments and then discount these payments back to a present value using risk-free discount rates that match the period of the liability. ACC uses an external actuary to value the ACC claims liability, while the Government Actuary values the GSF liability with external actuarial assistance.

1.11 The valuations are sensitive to changes in key actuarial assumptions, such as risk-free discount rates and inflation rates (price and wage). The Government's financial statements include extensive disclosures about the two liabilities in Notes 25 and 26, which include sensitivity analysis about those key assumptions.

1.12 Last year, we highlighted the sensitivity of these liabilities to changes in discount rates and noted that there was a small variance in the discount rates applied by the GSF and ACC. In particular, we recommended that the Treasury "closely monitor the discount rates proposed for liability valuations by ACC and GSF" and "confirm that the rates are appropriate and that differences between the two rates are supportable."

1.13 When the Treasury reviewed the 2008/09 year-end consolidation reporting by the GSF and ACC, it identified that there were significant differences in the long-term discount rates used to value the ACC and GSF liabilities. At the long term, the ACC liability was valued using a discount rate of 6.0% per annum, whereas the Government Actuary valued the GSF liability for the Government's financial statements using a discount rate of 8.6% per annum. The Treasury was concerned about the reasonableness of the long-term discount rate applied in

1 The valuation of the GSF liability for the Government's financial statements is completed under NZ IAS 19 *Employee Benefits*, while the valuation for the GSF financial statements is completed under NZ IAS 26 *Accounting and Reporting by Retirement Benefit Plans*. These valuations are different.

the GSF valuation. Because of the size and long-term nature of the liabilities, there was concern that the discount rates used may have resulted in a material misstatement of the liabilities included in the Government's draft financial statements provided for audit.

1.14 The Treasury investigated the reasons for the difference in discount rates and the methodologies used to determine discount rates over the life of the liabilities. This resulted in the Treasury directing the Government Actuary to recalculate the GSF retirement plan liability at 30 June 2009 based on the Treasury-determined discount rates. The recalculated GSF liability using the Treasury-determined rates was $807 million higher than the initial valuation, with a corresponding increase in the Government's deficit for the year. The Treasury did not direct ACC to change the discount rates used to value the ACC liability.

1.15 We had to carry out considerable extra audit work to satisfy ourselves about the appropriateness of the valuation of the ACC and GSF liabilities, given the initial significant differences in long-term discount rates. We had discussions with the Treasury, the Government Actuary, and ACC and its actuaries to understand the approaches adopted to derive the discount rates.

1.16 Although we are satisfied with the outcome of the discount rates issue, we are disappointed that this issue was identified only in August 2009. Given our previous recommendation to the Treasury, we consider that this issue should have been addressed much earlier. In our view, the Treasury should have been closely monitoring the discount rates proposed to be used in the ACC and GSF valuations. This would have enabled the Treasury to identify the initial significant difference in the discount rates sooner and consider whether a long-term solution to this issue could be found.

1.17 Although the Treasury acted quickly and appropriately to resolve this issue once it was identified, the deadline for the statutory audit sign-off of the Government's financial statements led to the Treasury finding a short-term solution. There were considerable inefficiencies, particularly in audit time and cost. We also understand that the Government Actuary had had discussions with the Treasury in the previous 18 months with a view to working together to review the discount rate methodology, but had not been able to progress this with the Treasury.

1.18 We have recommended that the Treasury work with the Government Actuary and ACC during 2009/10 to agree a consistent approach to the derivation of risk-free discount rate and inflation assumptions to be used in the Government's financial statements.

1.19 We discuss in more detail below the reasons for the differences in the discount rates and how we were able to reach the conclusion that the discount rates used in measuring the GSF and ACC liabilities in the Government's financial statements are acceptable.

How and why we concluded that the discount rates are acceptable

1.20 The approaches used to derive the discount rates are based on market yields for Government bonds. The longest-term Government bonds mature in 2021 (that is, in 12 years' time). The main difference in valuing the ACC and GSF liabilities arises in extrapolating discount rates for the duration of the liabilities, which exceed 50 years. The original GSF approach, which had been used for some years, was based on implied forward rates from market yields of all bonds, including the 2021 bond, and used this market-based data to extrapolate the longer-term discount rates. The ACC and Treasury approaches are based on the same market rates at the short end, but move to a long-term nominal discount rate of 6.0%. That rate is based on recent historical averages of 10-year Government bond yields.

1.21 While the revised GSF (as directed by the Treasury) and ACC discount rates are the same beyond 15 years, the rates diverge between years 7 and 15. The divergence in the discount rates is largely due to ACC applying less weight than the Treasury to the nominal yield data for bonds with a term exceeding seven years.

1.22 Deriving discount rates is complex, so we asked an external actuary for advice on the approaches used by the Treasury, ACC, and the Government Actuary. This let us assess the acceptability of the long-term discount rates and the divergence in discount rates between years 7 and 15. Our actuary told us that:

- There is considerable judgement involved in extrapolating long-term discount rates beyond available market data and determining the weighting to apply to lightly traded Government bonds. There is no single correct method.
- The absolute level of discount rates is less important than the gap between discount rates and assumed future inflation levels (the "real discount rate"), and that achieving consistency in this gap should be a key area of focus.
- The initial GSF discount rates produced the highest long-term real discount rates.
- Both the Treasury and ACC methodologies derive long-term nominal discount rates specifically by referring to long-term real discount rate assumptions. However, because of different inflation assumptions, the Treasury methodology used for the revised GSF valuation produces higher long-term real discount rates than the ACC methodology.
- The ACC extrapolation applies less weight to yield data for bonds with a term exceeding seven years than does the Treasury extrapolation. There is limited

evidence to suggest that longer-term New Zealand bonds are considerably less liquid than short-term bonds. Our actuary's preferred approach would be to apply similar weight to short-term and long-term bonds when determining nominal yields, then overlay this with consideration of the relationship to the longer-term inflation assumption adopted.

- The rates calculated under both the Treasury and ACC methodologies are within a reasonable range for long-term real discount rates.

1.23 We concluded that the discount rates (and associated inflation rates) applied in measuring the GSF and ACC liabilities in the Government's financial statements was acceptable at 30 June 2009. This is after considering:

- the advice from our expert actuary;
- the work of our Appointed Auditors for ACC and the GSF;
- the views of ACC's external actuaries;
- the Government Actuary's advice that he was comfortable, as an interim solution, that the amended approach complied with NZ IAS 19 *Employee Benefits*;
- the written representations we received from the Board of ACC about the valuation of the ACC liability and the appropriateness of the discount rates used in the valuation; and
- the written representations we received from the Secretary to the Treasury about the appropriateness of the discount and inflation rates applied in measuring the GSF and ACC liabilities.

1.24 We also considered the effect on the ACC liability if it were to be recalculated based on the Treasury discount rates. ACC calculated that the liability would reduce by $672 million if the calculation was based on the Treasury discount rates (with appropriate amendment of inflation assumptions). This would cause a reduction of the same amount in the Government's deficit for the year.

1.25 Because the measurement of these liabilities and the operating balance are particularly sensitive to changes in the discount rate and inflation assumptions, we asked the Treasury to increase the disclosures in this area in the Government's financial statements. The Treasury agreed to do this. The improved disclosures include:

- specific comment in the Commentary to the Government's financial statements about sensitivity of the large long-term liabilities to underlying assumptions, such as discount rates and inflation rates;
- additional narrative on sensitivities in the ACC and GSF notes and also in the "Judgements and Estimations" section of the accounting policies; and
- additional analysis of key assumptions in the ACC and GSF notes.

1.26 In addition, the Treasury proposed a new disclosure of undiscounted future cash flows, by period, for both ACC and the GSF.

1.27 We consider that these enhanced disclosures, together with the existing detailed note disclosures, provide appropriate information about the exposures of the Crown to these schemes. They appropriately highlight to the readers of the Government's financial statements the significant sensitivity of the value of the ACC and GSF liabilities to their underlying assumptions.

Retail Deposit Guarantee Scheme

1.28 In October 2008, the Government introduced the Retail Deposit Guarantee Scheme (the scheme). By 30 June 2009, 73 financial institutions had joined the scheme and the amount of funds subject to the guarantee totalled $124 billion. Detailed information about the scheme is disclosed in Note 30 to the Government's financial statements.

1.29 As at 30 June 2009, the Treasury has recorded a provision of $816 million for future payments under the scheme. The provision has been determined based on the likelihood of default actions triggering the guarantee and the expected loss given default (amounts payable to depositors less assets realised). The provision encompasses an amount for:

- non-bank financial institution guarantees that are considered likely to be called on; and
- estimated interest that would be payable to qualifying depositors for those institutions where a defaulting event is considered probable.

1.30 The Treasury's assessment of which non-bank financial institutions are likely to call on the guarantee has been determined using financial information from the Reserve Bank of New Zealand and external inspectors engaged to carry out detailed reviews of the financial institutions' loan books, funding arrangements, and operational structures.

1.31 Key assessments and assumptions used in determining the provision include the probable risk of default for each institution, probability of default for each institution's loan book, and the loss given default for each asset class.

1.32 The provision has been determined based on the scheme not extending beyond 12 October 2010. While this was the position at 30 June 2009, the Government decided in August 2009 to extend the scheme on amended terms. This has been treated as a non-adjusting post balance date event, which means that it has been disclosed in the Government's financial statements but the amount of the provision has not been adjusted. We agree with this approach.

1.33 The estimated interest that would be payable to qualifying depositors is a significant component of the provision. The Treasury has refined the calculation of the interest component of the provision following the High Court ruling on Mascot Finance Limited. The High Court ruling clarified that, based on the particular form of trust deed, interest is payable until full repayment of the principal is made. While we consider the assumptions to be reasonable in the circumstances, there is considerable uncertainty about the behaviour of investors after an event of default. Accordingly, there may be a significant deviation from this estimate.

1.34 Overall, we are satisfied that the provision of $816 million is based on reasonable assumptions and is appropriate in the circumstances. Nevertheless, we believe a wide range of outcomes are still possible under the scheme.

1.35 We have recommended that the high-level approach taken to date to determining the Crown's exposure and establishing the provisions for these institutions needs to be tested by completing a fuller analysis of each institution. The focus needs to be on testing the Reserve Bank's loss given default assumptions, and modelling the cash flow gap between paying out claims and receiving the proceeds from recovery of the institution's assets.

1.36 A finance manager was appointed to support the Treasury's deposit guarantee team in June 2009. We have recommended that this role should include specific responsibility for the integrity of the financial information used for determining the Crown's exposure. The responsibilities should include obtaining as accurate financial information as possible for individual institutions, and establishing financial controls over the provisioning calculations.

Tax assessments for structured finance transactions

1.37 Terminal taxation revenue is normally recognised in the Government's financial statements when assessments are made. However, in past financial years, the Government's financial statements did not recognise taxation revenue assessed for "structured finance" transactions (predominantly in the banking industry). This was because the tax revenue relating to the transactions was in dispute and could not be reliably measured. We accepted this treatment because of the complexity of the issues being disputed with the financial institutions concerned, and because there was no legal precedent for such transactions.

1.38 The judgement on the first court case against the Bank of New Zealand (BNZ), released during 2008/09, found in favour of the Commissioner of Inland Revenue. As a result, Inland Revenue and the Treasury reviewed the previous accounting treatment for these assessments. They considered that, as at 30 June 2009, the uncertainty of recovery had been sufficiently reduced to justify recognising the assessments as taxation revenue. Accordingly, taxation revenue of $1,423 million (for all of the cases) was recognised in the Government's 2008/09 financial statements. This position is based on the outcome of the BNZ case together with opinions from Inland Revenue's legal team and Crown Law about the similarity of the other structured finance cases to the BNZ case and the likelihood that the Crown's cases will succeed.

1.39 However, given the complexity of the cases and the sums of money involved at 30 June 2009, it was considered likely that the judgements would be appealed and that it may be some years before the final amount of tax owing will be known. Therefore, the Government's financial statements have also disclosed a contingent liability to reflect this. A contingent asset of $1,191 million was also disclosed (in Note 32) for use of money interest on the structured finance transaction assessments. This contingent asset is for the maximum interest the financial institutions would be required to pay.

1.40 The Government's financial statements have not recognised any revenue or receivable relating to penalties associated with the structured finance transactions. This was because any penalties that may be imposed are at the discretion of the Commissioner. (The revenue recognition point for penalties is at the point that Inland Revenue determines, calculates, and communicates penalties to the taxpayer.) Disclosure about penalties is included in the comment on Contingent Assets in Note 32. The disclosure is unquantified because of the uncertainties at 30 June 2009 about the level of penalties that may be imposed.

1.41 We agreed with the Treasury's treatment of the structured finance assessments as at 30 June 2009. However, we noted during our audit that this position would need to be reconsidered as future cases or appeals were decided by the Courts.

1.42 After we completed our audit, the High Court judgement on the Westpac case has also found in favour of the Commissioner. This was followed on 23 December 2009 by the Commissioner and the respective banks reaching settlement agreements under which the banks will pay 80% of the tax in dispute ($1.2 billion). Interest will also be due, but the final figure can only be determined after new assessments are made, statements of account issued, and transfers made from tax pools. We understand that, under the settlement agreements, the Commissioner will not impose any shortfall penalties.

Tax revenue recognition policies

1.43 In recent years, we have raised a number of issues about revenue recognition policies for income tax, particularly about the revenue recognition point for provisional tax and the treatment of payments into provisional tax pooling accounts.

1.44 We are pleased with the responses to the issues that we raised. However, there remain areas where further consideration of revenue recognition policies is required. Given the large amounts involved, any change in revenue recognition policies can have a significant effect on the Government's financial statements.

1.45 During the past couple of years, a number of companies have been helping the public with seeking tax refunds from Inland Revenue. These companies review taxpayer records and identify any refunds due to the taxpayer. Where a refund is due, they help the taxpayer to request a personal tax summary, as a step towards applying for a refund. There are an increasingly significant number of taxpayers applying for refunds in this manner.

1.46 Inland Revenue and the Government currently do not accrue for (or disclose as a contingent liability) any refunds relating to personal tax summaries requested after balance date that relate to earlier periods. We have accepted the non-recognition of these liabilities based on materiality and consistency with prior liability recognition points.

1.47 We understand that Inland Revenue plans a review of its policies for recognising taxation revenue during 2009/10. We have recommended that the Treasury support Inland Revenue in this review and ensure that the issue of income tax refunds is included.

State highways valuation

1.48 The independent valuation of the state highway network as at 30 June 2009 is $24 billion (2008: $21 billion). By value, it is the largest physical asset on the Government's balance sheet. Note 20 to the Government's financial statements contains detailed information about the state highways valuation.

1.49 Last year, we reported that the external valuer for the New Zealand Transport Agency (NZTA) had expressed concerns that the average unit costs used in the valuation may not be appropriate for some high-value urban projects. The valuer was unable to accurately quantify the effect of this issue, but indicated it could result in an undervaluation of the network.

1.50 We recommended that NZTA investigate the matter further during 2008/09. Work has progressed on revising the methodology, but has not yet been fully completed. NZTA proposes to arrange an independent peer review of the revised methodology, because of the potential effect on the state highway network valuation and the potential variability depending on land use intensity and traffic volumes. NZTA will begin implementing the revised methodology after it is endorsed by an independent reviewer.

1.51 We again have recommended that Treasury work with NZTA to review the approach to valuing the state highway network during the coming year, with particular consideration of the costs of construction in congested/high-value locations. It is important for this work to be concluded in a timely manner, given the potentially significant effect on the Government's financial statements.

1.52 The potential undervaluation noted by NZTA's external valuer was based on a review of three large state highway construction projects where the actual costs of construction were in excess of the average unit costs used in the valuation. The additional costs arose from traffic management, environmental compliance, utilities, increased construction costs as a result of the restrictions imposed by the built environment, and the significant costs associated with re-establishing the interface with adjacent properties. This implied a potential undervaluation of urban state highways and the network as a whole.

1.53 Other issues we reported last year have been satisfactorily resolved. We highlighted issues in the methodology and quality assurance processes for the state highways valuation. We are satisfied that the valuation process and quality assurance has improved significantly from 2008. We also highlighted an issue with the indexing of land valuations that may be causing inaccuracies in the valuation. To resolve this, NZTA successfully completed a full revaluation of all land holdings for the Government's 2008/09 financial statements.

The Kyoto Protocol net position

1.54 The best estimate of the Kyoto Protocol net position at 30 June 2009 is a $207 million asset (2008: $562 million liability). This position is based on a surplus of 9.6 million Kyoto Protocol emission units (2008: 21.7 million deficit) measured using an exchange rate of €EUR 0.4628 = $NZ1 and a carbon price of €EUR 10.00 for each unit (2008: €EUR 12.50 for each unit).

1.55 In 2006/07, an independent UK-based firm, AEA Technology, carried out a review of the robustness of the assumptions and methodology underlying the projections for the net position under the Kyoto protocol. In 2007/08, we recommended that a further independent review of the assumptions and methodology underlying the projections be completed during 2008/09.

1.56 Because of the late timing of the request for tender, the availability of suitably qualified experts, and the timetable for completing the Government's financial statements, a suitable expert could not be found to complete an independent review in 2008/09. We are disappointed that this matter was not addressed earlier.

1.57 We have recommended that an updated review of the assumptions and methodology underlying the Kyoto projections be carried out during the 2009/10 financial year. We understand that an external review has recently been carried out.

1.58 During our 2008/09 audit, we considered whether it was appropriate to recognise the forecast net surplus as an asset. We agreed that an asset could be recognised because there was evidence of an existing market for Kyoto Assigned Amount Units (AAUs). During the year, the Government allocated some of its AAUs to the forestry sector, and some of these have since been sold on international markets.

1.59 The movement in the projected balance of Kyoto Protocol emission units is set out in the *Net Position Report 2009. New Zealand's projected balance of Kyoto Protocol units during the first commitment period*, which is published by the Ministry for the Environment. The movement in the projected emission units and the movement to a surplus rather than a deficit is mainly because of the following factors:

- Increased net removal of carbon from planted forests, due to new information on post-1989 planted forests that indicates these forests are removing more carbon dioxide per hectare than previously assumed.
- Based on an intentions survey, emissions from deforestation are projected to be lower in 2009 than in 2008 due to falling profits from transferring the land to dairy use and implementation of the emissions trading scheme.
- Agriculture emissions are projected to be lower due to the effects of drought in 2008 and a continuing decline in animal numbers.

1.60 The size of the surplus has been compiled from agricultural, forest sink, and deforestation projections provided by the Ministry of Agriculture and Forestry, energy (including transport) and industrial processes projections from the Ministry of Economic Development, and waste projections from the Ministry for the Environment. The estimate includes consideration of the effects of the emissions trading scheme as proposed at that time.

1.61 The Kyoto Protocol asset is the Ministry for the Environment and the Treasury's best estimate of the likely position under the Protocol. However, it should be noted that the Kyoto net position asset is, by its nature, more uncertain than most other items in the statement of financial position. It is likely that successive estimates will change as more updated information becomes available, better systems are implemented, and some uncertainties are reduced. Some of the main aspects of the Kyoto provision that are subject to fluctuation over time include:

- the price for each tonne of carbon;
- the exchange rate with the Euro; and
- the various assumptions underlying the calculation of the emissions and sinks (for example, forecasts of GDP, oil prices, population growth, and the effect of the emissions trading scheme).

1.62 Consistent with previous years, no liability for periods beyond 2012 has been recognised because New Zealand currently has no specific obligations beyond the First Commitment Period. Any obligations in future periods have yet to be negotiated.

1.63 A contingent liability of $1,995 million has been disclosed for the first time this year for the Kyoto Protocol. It relates to the future agreements for commitment periods after the Kyoto Protocol's 2012 end point. In the first Kyoto commitment period, New Zealand has claimed credits for 92.3 million tonnes of carbon removals from forests. The disclosure of this contingency highlights that, on harvest of the forests in future commitment periods, the carbon will be released and there will be an associated liability.

Purchase of Toll (New Zealand) Limited

1.64 The Crown purchased Toll (New Zealand) Limited on 1 July 2008. The initial fair value assessment of the acquired assets and liabilities showed that the purchase consideration exceeded the fair value of the assets and liabilities acquired by $255 million. This has been appropriately expensed during 2008/09.

1.65 Detailed information on the acquisition has been disclosed in Note 34 to the Government's financial statements. We reviewed that note and agree that it meets the requirements of NZ IFRS 3 *Business Combinations*.

Related parties

1.66 NZ IAS 24 *Related Party Disclosures* requires disclosure of transactions between the Government reporting entity and key management personnel, their close family members, or entities they control, jointly control, or significantly influence. Although we are not aware of any significant transactions that require disclosure as a result of this requirement, currently there are no mechanisms in place to collect all the information about such transactions.

1.67 Information on Ministers' interests is recorded in the register of pecuniary interests, but this does not include information on family members and their interests. Further, there are no mechanisms to collect information about any transactions between these interests and entities within the Government reporting entity.

1.68 During our 2008/09 audit, financial reporting standard-setters were considering amendments to NZ IAS 24. The Treasury decided to await the outcome of this work before taking the issue further. We agreed with the Treasury's approach.

1.69 The related party transaction disclosures in Note 7 to the Government's 2008/09 financial statements are consistent with those in the 2007/08 financial statements. As well as the specific disclosures required about remuneration of key management personnel (Ministers of the Crown who are members of Cabinet), there is specific disclosure about other potential related party relationships and transactions that might exist. This states:

> *The Cabinet Manual sets out guidance in respect of Ministers' conduct, public duty, and personal interests. Ministers are responsible for ensuring no conflict exists or appears to exist between their personal interests and their public duty. Therefore, there is a clear expectation that Ministers will not influence or affect any transactions and outstanding balances between the Government and themselves or their family, whanau, and close associates*.

1.70 The above disclosure was agreed as appropriate, given the Treasury's decision to await the outcome of the standard-setters' revision of NZ IAS 24.

1.71 The Accounting Standards Review Board approved an amendment to NZ IAS 24 in November 2009. The Treasury is currently considering the effect of this amendment on the Government's financial statements.

Audit Committee for the Government's financial statements

1.72 We are pleased that the Treasury extended the mandate of its Risk and Audit Committee to include consideration of the Government's financial statements. We had previously recommended that the Treasury investigate establishing an audit committee for those statements.

1.73 We met with the Risk and Audit Committee three times during the year to discuss our audit of the Government's financial statements.

Part 2
Assessing entities' environment, systems, and controls

2.1 In this Part, we report on our 2008/09 assessments of the environment, systems, and controls of government departments, Crown entities (excluding school boards of trustees and tertiary education institutions), and State-owned enterprises (SOEs).

2.2 We set out our findings on the management control environment and financial information systems and controls for the past three years. We also separately set out our findings for the first year of grading service performance information and associated systems and controls.

Background

2.3 As part of the annual financial audit, our auditors examine, assess, and grade central government entities' environment, systems, and controls for managing and reporting financial and service performance information.

2.4 This examination is part of the auditor's work in forming an opinion on the financial and service performance statements. Deficiencies identified by auditors are highlighted as areas for improvement. The grades assigned directly reflect the recommendations for improvement as at the end of the financial year. The framework and commentary is intended to support continual improvement by public entities.

2.5 We report our assessments to the entity, the responsible Ministers, and the relevant select committees. In the 2006/07 financial year, we introduced a new assessment framework to improve the transparency, usefulness, and understandability of our reporting.

The areas we examine

2.6 We assess and report on three areas:

- management control environment;
- financial information systems and controls; and
- service performance information and associated systems and controls, where applicable.

2.7 **The management control environment** is the foundation of the control environment, and the areas that our audit may consider include:

- strategic planning, policies and practices;
- ethics;
- governance;

- organisational structure and assignment of authority and responsibility;
- human resources;
- risk management;
- overall legislative compliance arrangements;
- key entity-level control policies, procedures, information systems, and communication;
- management style; and
- emphasis on effectiveness and efficiency.

2.8 **Financial information systems and controls** are the systems and controls (including application-level computer controls) over financial performance and financial reporting.

2.9 **Service performance information and associated systems and controls** refers to the quality of the service performance measures selected for reporting against, and the systems and controls (including application-level computer controls) over service performance reporting.

2.10 This, 2008/09, is the third year that we have graded the management control environment and financial information systems and controls. It is the first year that we have graded service performance information and associated systems and controls.

2.11 We allowed for a transitional period before we graded service performance information and associated systems and controls by not grading them in 2006/07 or 2007/08. However, our auditors did assess them in both these years and provided comments to entities about improvements they could make.

2.12 The Auditor-General has a statutory requirement to attest to the statement of service performance included in the annual reports of government departments and Crown entities (excluding school boards of trustees and tertiary education institutions). Grading in 2008/09 was part of our phasing in of improvements to the way we audit service performance information to meet this requirement. Part 5 sets out more information about our intentions for auditing service performance information.

Our grading system

2.13 Auditors base the grades that they assign in their assessment on deficiencies observed through the audit, and on the associated recommendations for improvement. Auditors' conclusions on deficiencies (that is, the gap between "actual practice" and "how practice should be"), and the associated recommendations for improvement, are based on their assessment of how far the entity's practice falls short of good practice. Good practice is based on auditors' professional expertise and judgement, taking into account what is deemed appropriate for each entity, given its size, nature, and complexity. Auditors' professional judgement is informed by many factors, including national and international standards, knowledge of good practice, and standards and expectations for the public sector. The auditor makes recommendations for improvements only when, in their judgement, the benefits of the improvement would justify the costs.

2.14 Our grading scale is shown in Figure 1.

Figure 1
Grading scale for assessment of environment, systems, and controls

Grade	Explanation of grade
Very good	No improvements are necessary.
Good	Improvements would be beneficial and the entity should address these.
Needs improvement	Improvements are necessary and we recommend that the entity should address these at the earliest reasonable opportunity.
Poor	Major improvements are required and we recommend that the entity should urgently address these.

Interpretation of results

2.15 Our auditors' approach and the standards they apply reflect the unique circumstances of each entity in each financial year. Entities vary greatly in size and organisational structure, and sometimes undergo restructuring or other organisational changes. Grades for a particular entity may fluctuate from year to year. Some of the factors that may cause fluctuations include changes in the operating environment, standards, good practice expectations, and auditor emphasis. For these reasons, we advise caution when comparing grades between years and between different entities.

2.16 How an entity responds to the auditor's recommendations for improvement, as they arise, is more important than the grade change from year to year. A downward shift in grade, for example, may not indicate deterioration – it may be that the entity has not kept pace with good practice expectations for similar entities between one year and the next. Consequently, the long-term trend in grade movement is a more useful indication of progress than year-to-year grade changes.

Results for the management control environment and financial information systems and controls

2.17 Results for 2008/09 are pleasing, with 137 of the 150 entities[1] (91%) receiving either a very good (no improvements needed) or good (only beneficial improvements needed) grade for the management control environment. Likewise, 138 entities received either a very good or good grade for the financial information systems and controls.

2.18 Figure 2 shows a summary of the 2008/09 grades, by type of entity, for the management control environment and for financial information systems and controls. There were no poor grades for either aspect in 2008/09.

Figure 2
Summary of grades for 2008/09

		Grades received for MCE			Grades received for FISC		
Type of entity*	**Number of entities**	**VG**	**G**	**NI**	**VG**	**G**	**NI**
Government departments	39	15	21	3	12	24	3
District health boards	21	1	15	5	0	15	6
Crown research institutes	8	6	2	0	1	7	0
Other Crown entities	65	39	22	4	34	29	2
State-owned enterprises	17	12	4	1	6	10	1
Total	**150**	**73**	**64**	**13**	**53**	**85**	**12**

MCE – Management control environment.
FISC – Financial information systems and controls.
Ratings used are: VG – Very good, G – Good, NI – Needs improvement.
Government departments exclude Offices of Parliament, the Government Communications Security Bureau, and the Security Intelligence Service. School boards of trustees and tertiary education institutions are not included in the above analysis for other Crown entities. Crown research institutes reduced from nine entities in 2007/08 to eight entities in 2008/09. Air New Zealand Limited has been included as if it were a State-owned enterprise.

2.19 Improvements would be beneficial to the management control environment of 43% of all central government entities and to the financial information systems and controls of 57% of all entities.

1 Grades for three entities had not been finalised at the time of publication. Results for previous years may also differ to previously published results for those years if the grades were finalised after publication. Figures have been rounded down in some cases to ensure that totals add correctly.

2.20 Thirteen entities received needs improvement grades for the management control environment, and 12 received needs improvement grades for financial information systems and controls. District health boards (DHBs) were over-represented in each aspect, with five and six DHBs respectively.

2.21 It is disappointing that five entities (one government department, one SOE, and three DHBs) received needs improvements grades for both their management control environment and their financial information systems and controls.

2.22 We examined the detailed recommendations for improvement in the 9% of all entities that received needs improvement grades in 2008/09 for both the management control environment and financial information systems and controls. We did not find any particular recurring themes or issues. However, we will continue to carry out such analysis to see if there are any particular common themes or issues on which we can provide further guidance to both entities and auditors.

2.23 We will also examine the recommendations for improvement in entities receiving good grades to see whether there is any further assistance or support we can provide auditors or entities, as appropriate.

2.24 We have published entity names and grades in this report only for the DHB sector (see Part 6). Although this information is available to the public through other means, we consider that there would be benefit in making this information more accessible to the public. We intend to look into this further.

Trends from 2006/07 to 2008/09

2.25 Figures 3 and 4 below show the trends in grades for all 150 entities for the management control environment and financial information systems and controls during the past three years.

2.26 The overall trend is pleasing for both the management control environment and financial information systems and controls, because it shows that entities have generally improved their grades. This reflects that entities have satisfactorily made the changes that we recommended to them.

Figure 3

Management control environment – grades for 2006/07 to 2008/09, as percentages

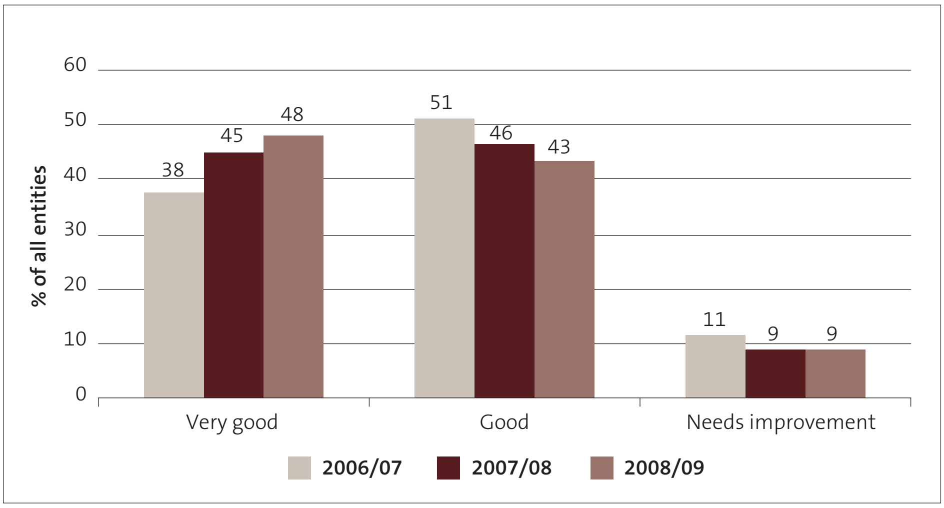
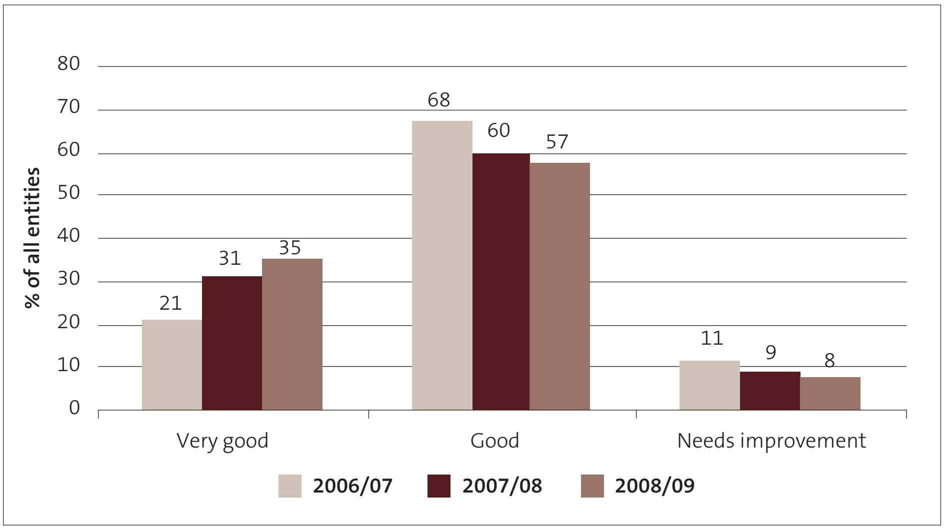


Figure 4

Financial information systems and controls – grades for 2006/07 to 2008/09, as percentages



2.27 The results show an increase in very good grades for the management control environment, from 38% of all entities in 2006/07 to 48% in 2008/09. Good grades have decreased from 51% in 2006/07 to 43% in 2008/09, showing that entities have generally improved from good to very good.

2.28 Results for the financial information systems and controls of all entities show an increase in very good grades, from 21% of all entities in 2006/07 to 35% of all entities in 2008/09. Good grades decreased from 68% in 2006/07 to 57% in 2008/09, also showing that entities have generally improved from good to very good for this aspect.

2.29 It is pleasing that no entities have received a poor grading for either aspect since the introduction of this framework in 2006/07. However, there has been only a slight decrease in the proportion of needs improvement grades, from 11% in 2006/07 to 9% in 2008/09 for the management control environment, and to 8% in 2008/09 for financial information systems and controls.

2.30 As noted above (paragraph 2.15), grades may fluctuate from year to year depending on a range of factors. We are interested in how entities respond to auditors' recommendations for improvement as well as the trends in grade movements.

2.31 Most entities responded either in full or in part to recommendations from the 2007/08 audit for both beneficial and necessary improvements.

2.32 Deficiencies in the management control environment were not resolved at all for six entities (three government departments, two DHBs, and one other Crown entity). Deficiencies in financial information systems and controls were also not resolved at all for three entities (two DHBs and one other Crown entity).

2.33 It is always concerning when entities do not take appropriate action to address the matters raised by our auditors and do not achieve the improvements recommended. Our auditors continue to work with the entities concerned to ensure that the recommendations are implemented.

Figure 5

Management control environment – grades for 2008/09, by type of entity, as percentages

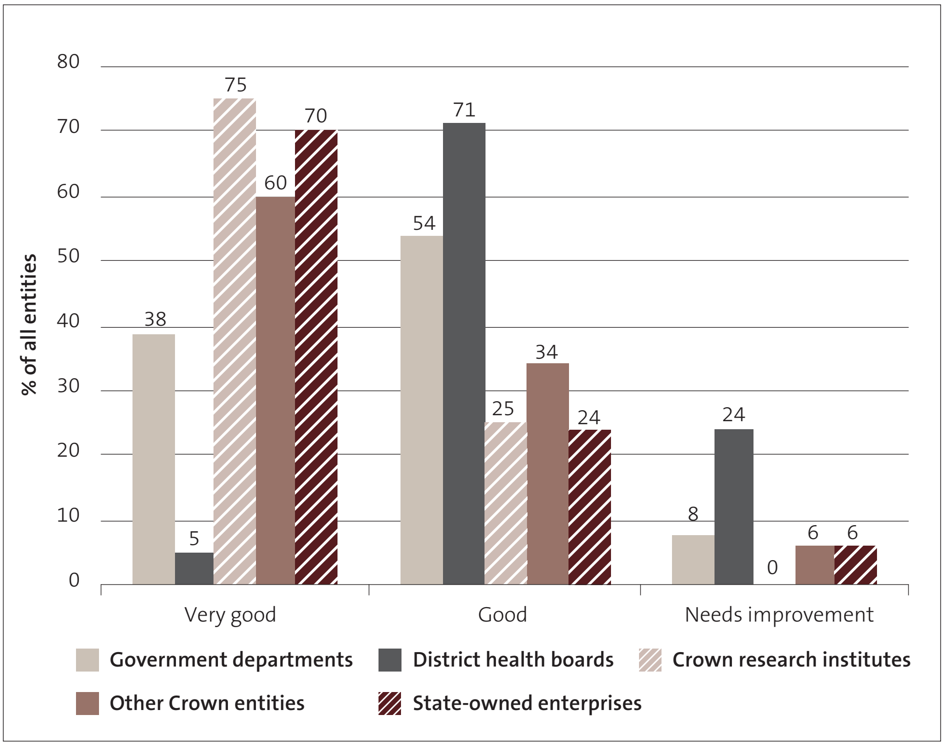
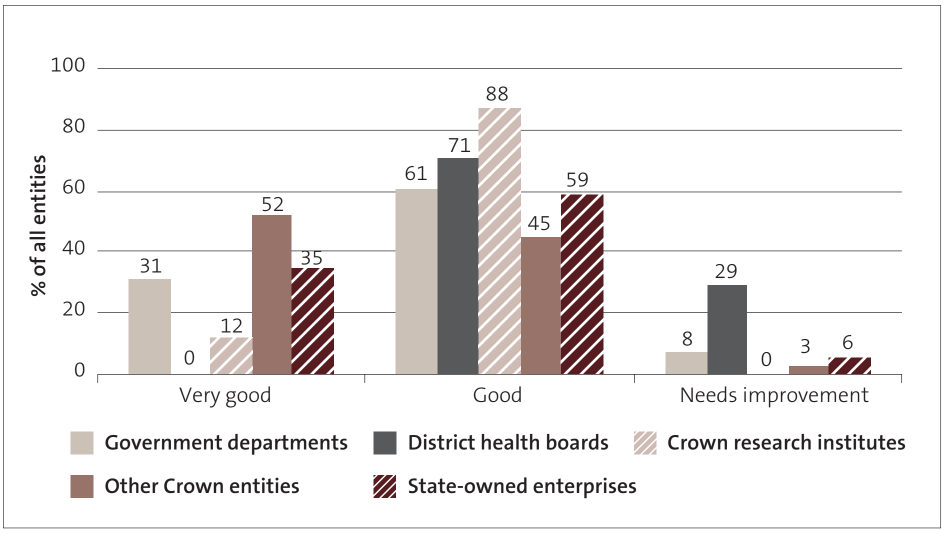


Figure 6

Financial information systems and controls – grades for 2008/09, by type of entity, as percentages



Sector analysis

2.34 Figures 5 and 6 show the proportion of grades within each of the central government sectors for 2008/09. Results for each sector are discussed below.

Government departments

2.35 Figures 7 and 8 show steady improvement overall in both the management control environment and financial information systems and control grades for government departments since 2006/07.

2.36 During the last three years, the proportion of government departments receiving either a very good (no improvements) or good grade (only beneficial improvements) increased from 79% to 92% for the management control environment and from 84% to 92% for financial information systems and controls.

Figure 7

Management control environment – grades for government departments from 2006/07 to 2008/09, as percentages

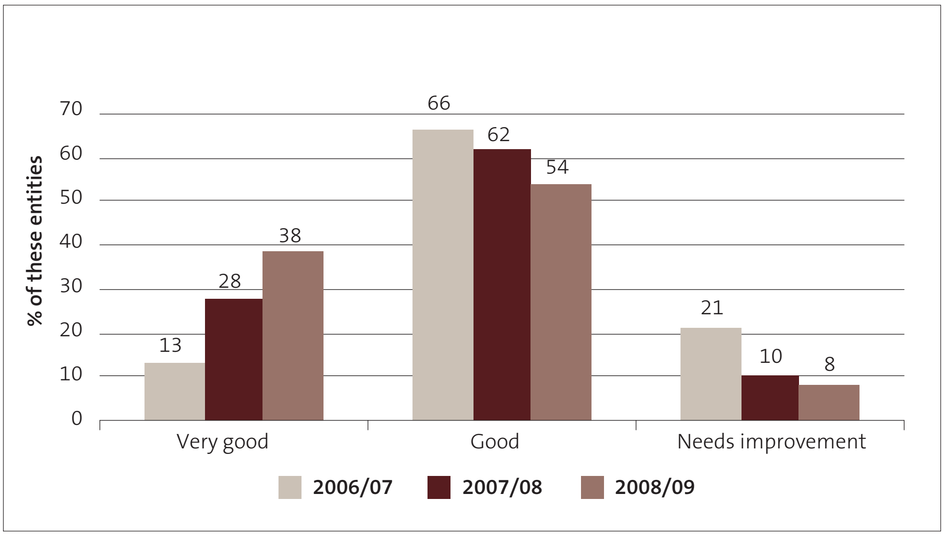
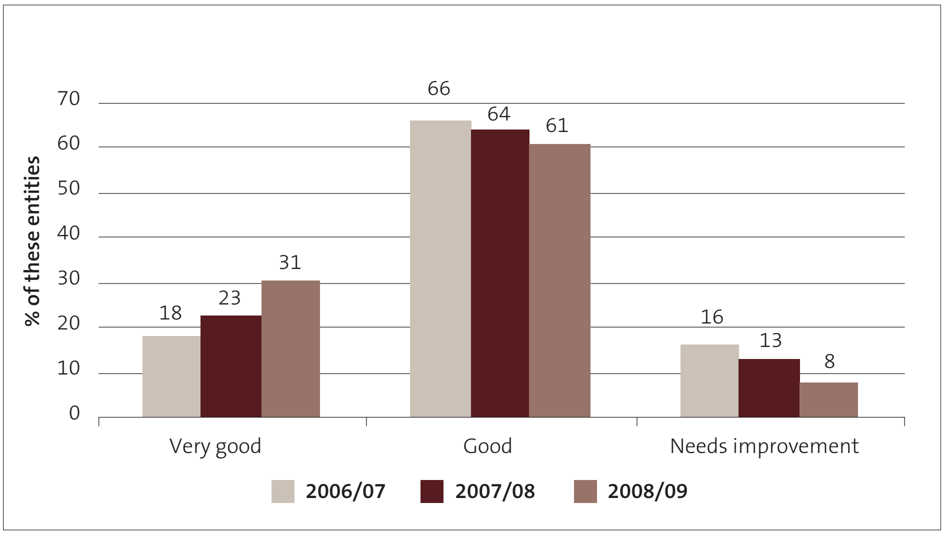


Figure 8

Financial information systems and controls – grades for government departments from 2006/07 to 2008/09, as percentages



2.37 For both aspects, the proportion of government departments receiving very good grades has increased year after year, while the proportion has decreased for needs improvement grades.

2.38 In 2008/09, three government departments (8%) were graded as needs improvement for the management control environment, and three were graded as needs improvement for financial information systems and controls.

2.39 Six government departments fully resolved deficiencies that we had identified and improved their management control environment after the 2007/08 audit, helping them to achieve very good grades in 2008/09.

2.40 However, three government departments that were graded as needs improvement for their management control environment in 2008/09 were unchanged from 2007/08. Four of the five government departments graded as needs improvement in 2007/08 for financial information systems and controls have resolved deficiencies, resulting in good grades in 2008/09.

2.41 One government department has been graded as needs improvement for both the management control environment and financial information systems and controls in all three years of grading, which is a serious concern.

2.42 We expect entities to take appropriate action to address the matters raised by our auditors and to make the improvements that we recommend. In the case referred to above, some deficiencies identified in previous audits have been resolved, but improvements are still needed in both aspects. We continue to report our findings to the relevant Minister and select committee.

Other Crown entities

2.43 The other Crown entities group is the largest of the central government sectors, with 65 entities. It includes Crown agents (excluding DHBs), autonomous Crown entities, and independent Crown entities.

2.44 In the three years of grading, at least 94% of other Crown entities received a grade of either very good (no improvements necessary) or good (only beneficial improvements needed) for their management control environment or financial information systems and controls.

2.45 Figures 9 and 10 show the trend since 2006/07 for an increase in very good grades for both the management control environment (from 53% to 60%) and for financial information systems and associated controls (from 32% to 52%). Good grades have decreased during this period, showing that entities have addressed our recommendations for improvement.

Figure 9

Management control environment – grades for other Crown entities from 2006/07 to 2008/09, as percentages

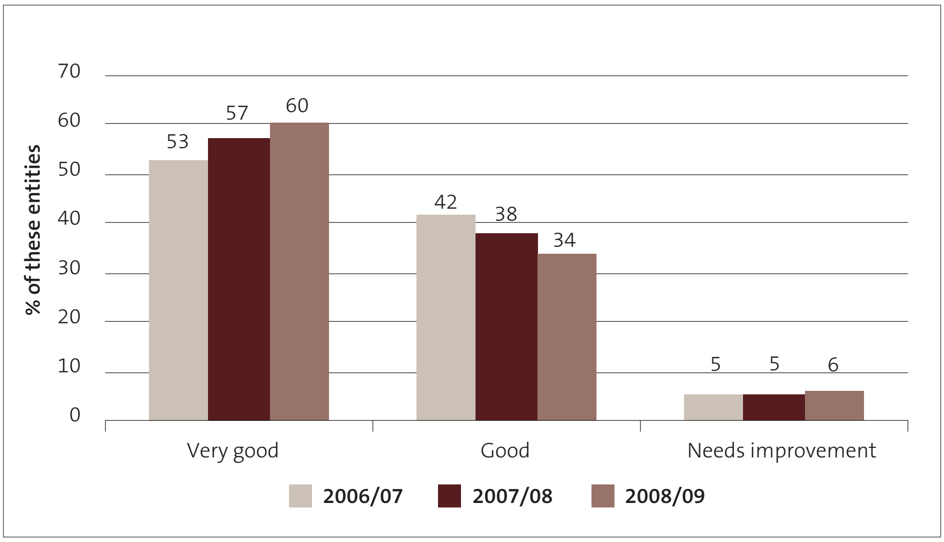
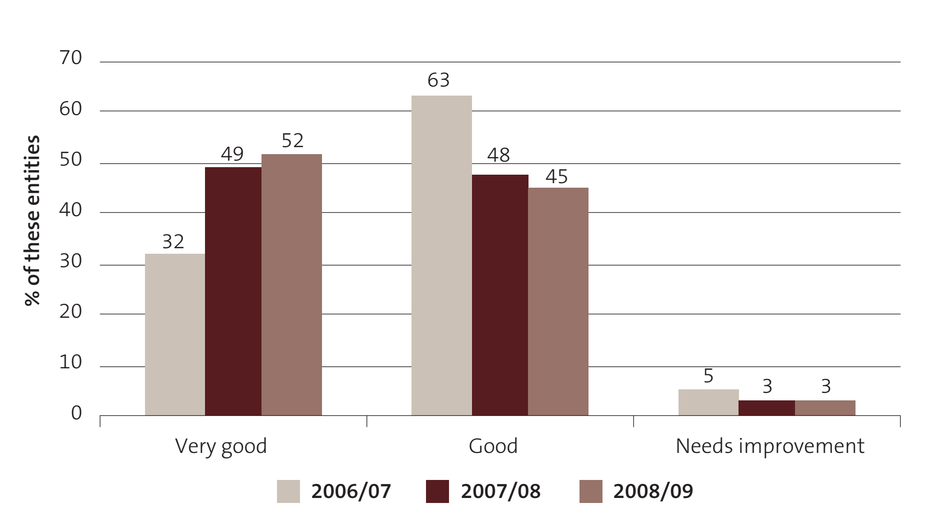


Figure 10

Financial information systems and controls – grades for other Crown entities from 2006/07 to 2008/09, as percentages



2.46 The results show a small increase in the number of entities needing to improve their management control environment, from three entities in 2007/08 to four in 2008/09. Two of these entities only partially resolved the deficiencies identified in the 2007/08 audit, and again received needs improvement grades in 2008/09.

2.47 Two entities received needs improvement grades for their financial information systems and controls in both 2008/09 and in 2007/08. Deficiencies identified in the 2007/08 audit were only partially resolved in one case and not at all in the other.

2.48 Five entities addressed our recommendations, after the 2007/08 audit, for making beneficial improvements to their management control environment, helping them to achieve very good grades. Similarly, seven entities improved to very good grades for their financial information systems and controls.

2.49 As noted above (paragraph 2.15), grades can be lower from one year to another because of a range of factors, such as organisational change or auditor emphasis. Six entities received lower grades in 2008/09 than in 2007/08 for their management control environment, and four entities received lower grades for their financial information systems and controls.

Crown research institutes

2.50 Figures 11 and 12 show that, in 2008/09, all Crown research institutes (CRIs) continued to be assessed as either very good or good for both the management control environment and financial information systems and controls. This is consistent with results from the previous two years, and shows that CRIs have generally sound environments, systems, and controls. We are pleased to see this continued strong performance.

Figure 11

Management control environment – grades for Crown research institutes from 2006/07 to 2008/09, as percentages

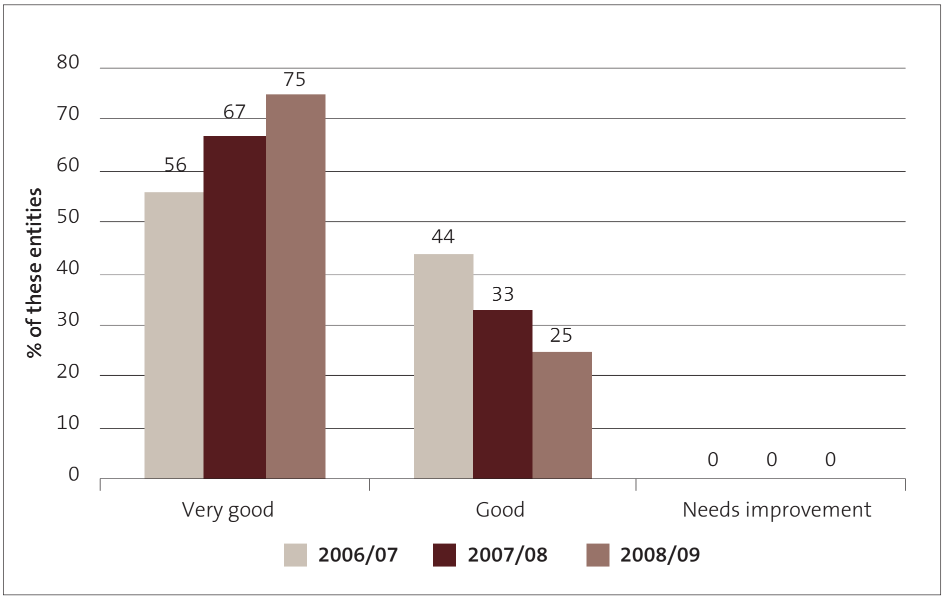
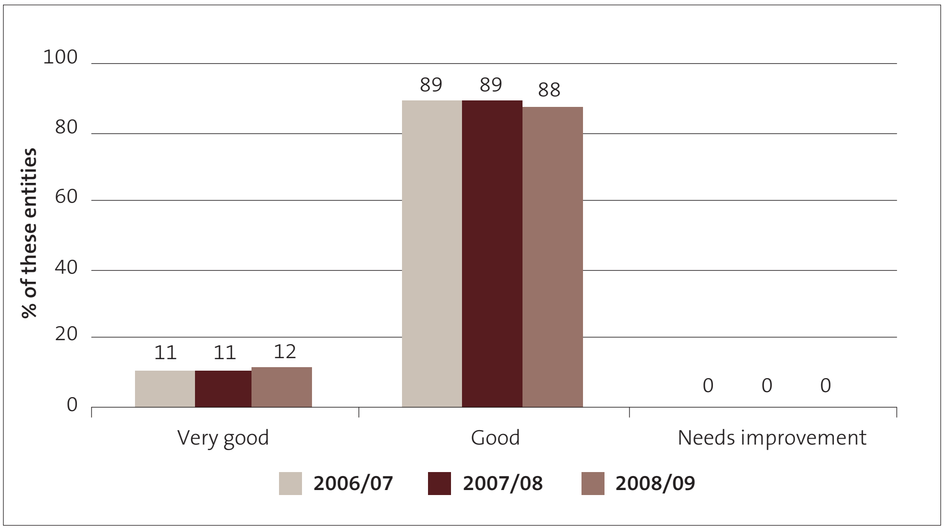


Figure 12

Financial information systems and controls – grades for Crown research institutes from 2006/07 to 2008/09, as percentages



2.51 Six of the eight CRIs had their management control environments assessed as very good in 2008/09. One CRI's financial information systems and controls were assessed as very good.

2.52 Looking at how CRIs have responded to the auditor's 2007/08 recommendations for beneficial improvements to financial information systems and controls, one CRI fully resolved the deficiencies identified by auditors and improved its grading from good in 2007/08 to very good in 2008/09. Five CRIs partially resolved their deficiencies and received unchanged good grades for financial information systems and controls in 2008/09.

2.53 As Figure 12 shows, seven CRIs (88% of the sector) could move to a very good grade by implementing the auditor's recommendations identified in 2008/09 for their financial information systems and controls.

District health boards

2.54 Figures 13 and 14 show that DHBs continue to be over-represented in the lower grades, with necessary improvements identified for both the management control environment (24% of DHBs in 2008/09, compared to 19% in 2007/08[2]) and financial information systems and controls (29% of DHBs in 2008/09, compared to 33% in 2007/08).

2 Results for district health boards were incorrectly reported last year as 24% needing improvement in 2007/08.

Figure 13
Management control environment – grades for district health boards from 2006/07 to 2008/09, as percentages

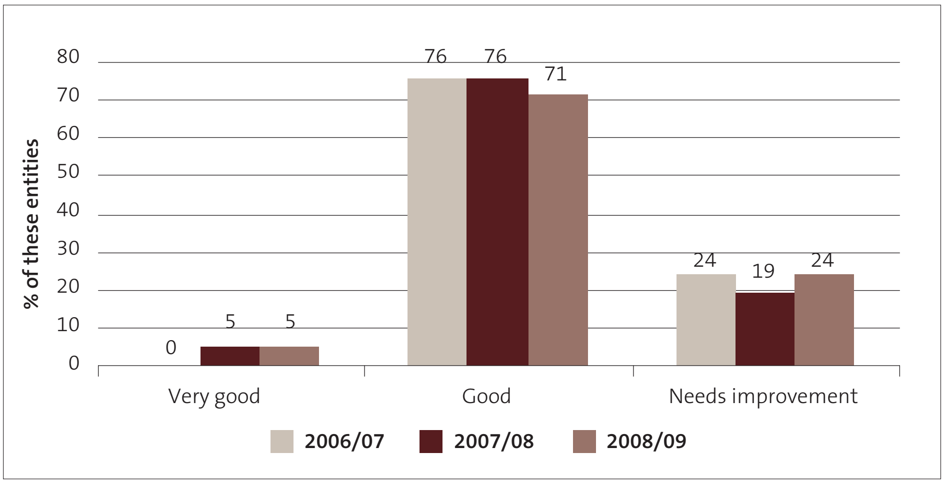
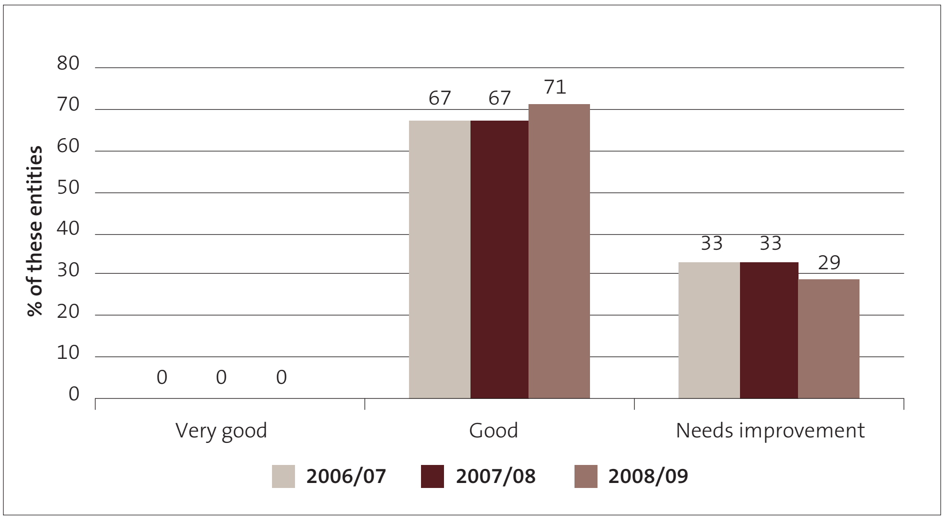


Figure 14
Financial information systems and controls – grades for district health boards from 2006/07 to 2008/09, as percentages



2.55 We discuss the results of DHB audits for 2008/09 in more detail in Part 6.

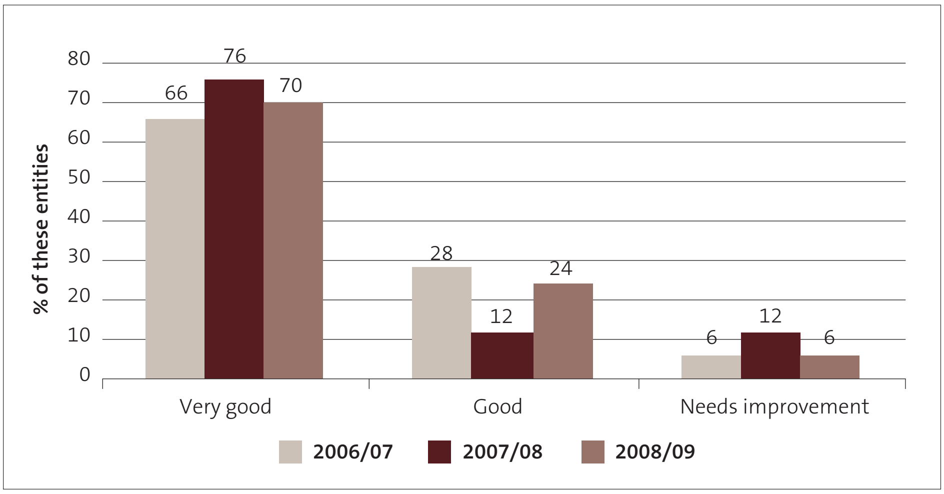
State-owned enterprises

2.56 Overall, the results in 2008/09 show that the SOEs have generally sound management control environments and financial information systems and controls, with 94% receiving either a very good or a good grade for these aspects. Twelve of the seventeen SOEs received very good grades for their management control environments, and six received very good grades for their financial information systems and controls.

2.57 Figures 15 shows that SOEs have generally sound management control environments, with between 66% and 76% of SOEs having received very good grades in each of the years since 2006/07.

Figure 15

Management control environment – grades for State-owned enterprises from 2006/07 to 2008/09, as percentages



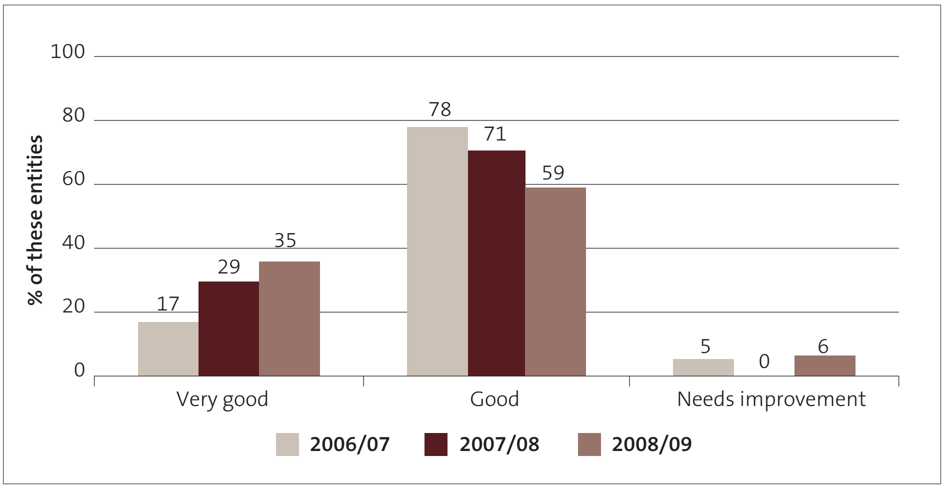
2.58 Figure 16 shows an increase in very good grades for financial information systems and associated controls, from 17% in 2006/07 to 35% in 2008/09. Good grades have decreased during this period, showing that entities have followed the auditor's recommendations.

2.59 As Figure 16 shows, 10 entities (59% of the sector) could move to a very good grade by implementing the auditor's recommendations in 2008/09 for their financial information systems and controls.

2.60 In 2007/08, 12 SOEs received good grades for their financial information systems and controls. Four of these entities fully resolved, and eight entities partially resolved, deficiencies identified by auditors in 2007/08. This resulted in two of the entities receiving very good grades in 2008/09 for this aspect.

Figure 16

Financial information systems and controls – grades for State-owned enterprises from 2006/07 to 2008/09, as percentages



2.61 One entity received a needs improvement grade for both the management control environment and financial information systems and controls in 2008/09. This entity also received a needs improvement grade for its management control environment in 2007/08 and needs improvement grades for both aspects in 2006/07.

Results for service performance information and associated systems and controls

2.62 As we noted in paragraph 2.12, the Auditor-General has a statutory requirement to attest to the statement of service performance included in the annual reports of government departments and Crown entities (excluding school boards of trustees and tertiary education institutions). We graded service performance information and associated systems and controls for 125 entities (detailed below). There is no statutory requirement relating to CRIs and SOEs. We discuss this further in Part 5.

2.63 The auditor's expectations for the quality of the service performance information are derived from:

- legislation (Public Finance Act 1989 and Crown Entities Act 2004);
- accounting standards and guidance;
- Technical Practice Aid 9: *Service Performance Reporting*; and
- guidance and instructions from the Treasury and State Services Commission.

2.64 These expectations are reflected in the Auditor-General's Auditing Standard 4 (Revised) – *The Audit of Service Performance Reports*.

2.65 Our primary objective in examining this aspect was to assess the quality of the forecast performance reports and supporting systems and controls. Auditors reviewed the Statement of Service Performance included in the 2008/09 annual report, the 2009-2012 Statement of Intent, 2009/10 Forecast Statement of Service Performance, and the associated information contained in the *Information Supporting the Estimates*.

2.66 In reviewing and grading forecast reports, our auditors considered the relevance, reliability, understandability, and comparability of information in presenting a clear and cohesive description of performance. Performance elements (outcomes, impacts, and outputs) and their associated measures should be presented in a clear and informative context.

2.67 We recognise that the absence of reporting standards for non-financial performance reports requires more judgement, both for those preparing reports and for auditors in issuing opinions on reports.[3] As well as our normal quality assurance processes, we supported consistency in grading among our appointed auditors by carrying out team-based peer reviews of proposed grades. This resulted in team-based peer reviews of more than 60% of the service performance grades.

2.68 Auditors reviewed and commented on (but did not grade) performance reports in the 2006/07 and 2007/08 audits. Results of these reviews showed that the overall quality of performance reporting by central government agencies was poor.

2.69 Results of the first year of grading service performance information and associated systems and controls are still disappointing and show that there continues to be room for improvement. In our view, improving the quality of performance reporting is critical, not only for demonstrating accountability but also for improving public sector effectiveness.

2.70 In recent years, our Office has placed much emphasis on improving auditing standards, methodology, and reporting by appointed auditors. We are also working with the Treasury on a wider framework for service performance management and accountability in the public sector.

2.71 In 2008/09, auditors assessed and graded 39 government departments, 21 DHBs, and 65 other Crown entities for service performance information and associated systems and controls. Figure 17 shows a summary of grades for departments and

3 See, for example, our publications *The Auditor-General's observations on the quality of performance reporting* (June 2008) and *Central government: Results of the 2007/08 audits* (June 2009).

other Crown entities. DHBs were all graded as poor/needs improvement, but are excluded from our analysis in this section and discussed separately in Part 6.

Figure 17
Summary of grades for 2008/09

		Grades received for service performance information and associated systems and controls		
	Number of entities	G	NI	P
Government departments	39	9	26	4
Other Crown entities	65	22	38	5
Total	**104**	**31**	**64**	**9**

Ratings used are: VG – Very good, G – Good, NI – Needs improvement.

2.72 No entities were rated as very good, but 31 entities were graded as good (where we recommended beneficial improvements).

2.73 We assessed 64 entities as needing to improve their service performance reports and associated systems and controls. Nine entities were assessed as poor, requiring major improvements because of significant deficiencies.

2.74 Of the 64 entities needing to improve, the quality of their service performance information and associated systems and controls varied widely. Some entities' service performance information would have required improvements in only a few aspects to achieve a good grade. Other entities' service performance information needed to improve in a range of aspects or had more significant deficiencies, which meant they were closer to a poor grade.

2.75 Our assessments were not significantly affected by the type or size of entity.[4] We did find that, among government departments, policy departments with significant non-departmental activities were more likely to have been assessed as poor compared with departments having other types of functions.[5] We have been discussing this issue with the Treasury, which is currently leading work in developing service performance reporting guidance for policy advice.

4 Entity size was assessed primarily based on audit effort (hours) as a proxy for a range of factors such as size, complexity, and risk.

5 Government department functions are stated in the Treasury report: *Public Sector Financial Management Capability*, August 2008.

Recurring themes and conclusions

2.76 Our overall conclusions on the service performance information are similar to our findings from the assessments of service performance reporting from the 2007/08 audits.[6] We found that:

- Many entities were not clear about what the entity was trying to achieve and what its services were.
- There was often confusion about how an entity would know that it was achieving what it hoped to through delivering quality services.
- Important information about the quality of services and their impact was often omitted. There appeared to be an over-reliance on measures that assessed service quantity and very few measures that assessed service quality.
- There was a lack of contextual information to help the reader understand the targets set and the relative level of performance that an entity was seeking to achieve.
- There were also instances where the information in the Statement of Intent was inconsistent with that in the *Information Supporting the Estimates*.

2.77 Improvements were recommended to the 31% of entities who received good grades. Commonly, the information was easy to comprehend, and provided a clear picture of what an entity was trying to achieve and how it could be achieved. Overall, the information provided a basis for assessing performance. Although the service performance information was not necessarily complete:

- The information did set out all of the performance framework components (outcomes, impacts, operating intentions, outputs, and performance measures and targets).
- There was a logical flow that linked the outcomes and impacts to outputs. Often the linkages were strengthened through use of tables, pictures, or diagrams.
- There was an adequate range of relevant output performance measures and targets that reflected a range of performance dimensions (such as quantity, quality, and timeliness).

2.78 We expect entities to take appropriate action to address the matters raised by our auditors and to achieve the recommended improvement to service performance reporting and associated systems and controls. We recognise that this is a challenging area, but believe that it is integral to improving the effectiveness and efficiency of the public sector – both in actual performance and demonstrating it through better accountability. Part 5 sets out our intentions and work programme for improving service performance information and reporting.

6 Controller and Auditor-General (May 2009), *Central government: Results of the 2007/08 audits*.

Part 3
The Controller function and the appropriation audit

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

3.2 In this Part, we briefly outline the public finance principles underpinning this work and the work's main features. We then discuss unappropriated expenditure in 2008/09 and for the early parts of 2009/10, and report on some other matters we have had to consider recently.

Summary

3.3 Throughout the year, there are several approval mechanisms in place to provide some flexibility for the Executive in responding to changes to expenditure:

- The primary authority for any expenditure comes from an Appropriation Act. The first Appropriation Bill, setting out the detailed Estimates of Appropriation, is introduced with the Budget in May and is usually passed into law in August each year. A second Appropriation Bill, containing supplementary Estimates of Appropriation that update the original estimates, is introduced with the following year's Budget, and is passed by the end of the financial year.
- Section 26A of the Public Finance Act 1989 (the Act) enables the Governor-General to approve the transfer of small amounts between output expense appropriations within the same Vote during the year.
- Section 26B of the Act enables the Minister of Finance to approve expenses or capital expenditure that exceed an existing appropriation in the last three months of the year. To be approved under section 26B, the expenses or capital expenditure need to be within the scope of the appropriation and below the greater of $10,000 or 2% of the total appropriation.
- Imprest Supply Acts give conditional authority to the Crown to incur expenses or capital expenditure before an appropriation, up to a global maximum and subject to later incorporation in an Appropriation Act. In practice, the Crown controls the use of this authority by requiring Cabinet to approve any particular use of it.

3.4 We continue to see instances where departments incur expenditure without the authority of any of these mechanisms. Any expenses or capital expenditure incurred without authority is unauthorised expenditure, and is therefore unlawful. Any unappropriated and unlawful expenditure has to be separately reported and validated in the Appropriation (Financial Review) Act that is passed after each financial year, under section 26C of the Act.

3.5 In 2008/09, there were 39 instances of unauthorised expenditure, amounting to more than $927 million. This represents an increase in both number and value of such instances from the previous year (2007/08: 32 instances amounting to $567 million), but represents a small part of total government expenditure during the year.

3.6 At the time of writing this Part, the emerging trend of instances of confirmed and potential unappropriated expenditure for the first six months of 2009/10 appears consistent with that for 2008/09.

3.7 Departments need to understand the importance of appropriation and lawfulness, and the processes within the Act that support them.

3.8 We continue to emphasise the need for departments, with support from the Treasury, to have effective procedures to ensure that all public expenditure is within the appropriate bounds, and to seek relevant expenditure authority or approval promptly.

Public expenditure principles

3.9 Two important principles govern public expenditure:

- appropriation; and
- lawfulness of purpose.

3.10 The Act defines the system of appropriation, which is the primary means by which Parliament authorises the Executive to use public resources. Under this system, expenses and capital expenditure should be incurred only within an appropriation or other statutory authority. Departments' net assets should not exceed the limits for which they have authority from Parliament.

3.11 Lawfulness of purpose includes, but is wider than, the principle of appropriation. To be lawful, expenses or capital expenditure must be incurred not only within an appropriation but also within the legal authority or capacity that enables the department to carry out the activity concerned.

3.12 Departments must pay particular attention to ensuring that all expenses and capital expenditure are lawful on both counts. They must have effective systems and processes in place to support this aim.

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

- *A Guide to the Public Finance Act*;
- *Guide to Appropriations*;

- *Treasury Circular 2007/05: Multi-Year, Revenue Dependent and Department to Department Appropriations*;
- *Treasury Circular 2006/04: Unappropriated Expenditure – Avoiding Unintended Breaches*; and
- *Treasury Instructions*.

3.14 At the start of the 2009/10 financial year, the Treasury issued *Treasury Instructions 2009*. These reflect new requirements for calculating the financial surplus that departments must repay to the Crown, in keeping with section 22 of the Act. These new requirements are also covered by Treasury Circular 2009/10, issued in September 2009, which effectively amended the Treasury Instructions and made the new requirements retrospectively applicable to the 2008/09 financial year.

Operating the Controller function

3.15 Sections 65Y to 65ZA of the Act set out the legislative provisions for the Controller function. Its main features are:

- Departments provide information to the Treasury about the expenses and capital expenditure incurred against the authorities available. The Treasury collates and monitors this information throughout the year.
- The Treasury supplies monthly reports[1] to enable the Controller to fulfil the role (section 65Y).
- Throughout the financial year (usually each month), the Office of the Auditor-General and departments' appointed auditors perform the Controller function using standard procedures. They carry out these procedures in keeping with the Auditor-General's Auditing Standard 2: *The Appropriation Audit and the Controller Function* (AG-2) and a Memorandum of Understanding[2] between the Treasury and the Office of the Auditor-General.
- The Controller can direct a Minister to report to the House of Representatives if the Controller has reason to believe that expenditure has been incurred that is unlawful or not within the scope, amount, or period of any appropriation or other authority (section 65Z).
- The Controller can stop payments from a Crown or departmental bank account, to prevent money being paid out if the Controller believes the payments may be applied for a purpose that is not lawful or is not within the scope, amount, or period of any appropriation or other authority (section 65ZA).

1 Monthly reporting is not required for July and August.

2 The joint understanding and expectations about the role and procedures associated with the Controller function are set out in the *Memorandum of Understanding between the Treasury and the Office of the Auditor-General.*

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

3.17 The Auditor-General's appointed auditors must carry out an appropriation audit in conjunction with the annual audit of each department, to confirm that:

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

Unappropriated expenditure in 2008/09

3.18 Most of the government expenditure during 2008/09 was authorised by appropriations in the usual way. There were a few transfers under section 26A of the Act, and a few approvals under section 26B.

3.19 There were 39 instances of expenditure (adding up to more than $927 million) that were not authorised through any of the approval processes provided by the Act. Some of these related to expenditure in the previous year.

3.20 In 24 of the 39 instances, expenditure was within the scope of an appropriation but more than the amount authorised by Parliament.[3] Total expenditure in excess of authority was more than $914 million. Some of these instances related to expenditure that is demand-driven.

3.21 The other 15 instances[4] involved expenditure that was outside the scope of any appropriation. The total expenditure in these cases was more than $13 million.

3.22 This is a relatively small amount of overall unauthorised expenditure and number of instances when compared to total government expenditure. However, it is still a concern when government agencies incur expenditure without the necessary authority from Parliament.

3.23 We continue to encourage departments to pay closer attention to ensuring that they have authority before incurring any expenditure. We also continue to work with the Treasury to provide better guidance and support through the administrative systems that support the Crown's financial management.

3 These are listed on pages 157 and 158 of the *Financial Statements of the Government of New Zealand for the Year Ended 30 June 2009*.

4 These are listed on page 159 of the *Financial Statements of the Government of New Zealand for the Year Ended 30 June 2009*.

Unappropriated expenditure in 2009/10

3.24 In the first six months of the 2009/10 financial year, and at the time of writing this Part:

- there were two confirmed instances of unappropriated expenditure, involving expenditure of $7 million;
- there was one instance of unappropriated expenditure (of $0.25 million) discovered, relating to the previous year; and
- several other potential instances of unappropriated expenditure were being investigated.

3.25 Taken together, the reported and potential instances of unappropriated expenditure for the first six months of 2009/10 appear to be consistent with the trend for 2008/09.

Net asset holdings

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

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

3.27 A breach of a department's net asset limit is treated as a breach of appropriation.

3.28 This aspect of appropriations is complex, from both a legal and an accounting perspective. Only two departments breached their net asset limits during 2008/09,[5] significantly lower than the nine instances in the previous year.

3.29 Departments need to continue taking care in applying the net asset requirements of the Act.

3.30 From 2008/09, departments have also had to follow the new requirements set out in *Treasury Instructions 2009* for calculating the repayment of any surplus to the Crown. Departments also need to take these new requirements into account in considering how they approach the forecasting and monitoring of their net asset levels under the system of appropriations.

Remeasurements

3.31 The Act provides for remeasurements. These are financial transactions that are defined to be excluded from the meaning of expenses used in the Act. Therefore, unlike other expenses, they do not require an appropriation.

5 These are listed on page 160 of the *Financial Statements of the Government of New Zealand for the Year Ended 30 June 2009*.

3.32 The Act also provides authority for a department's net asset level to increase beyond its authorised limit, after the remeasurement of an asset or liability. In these cases, the excess will not be treated as a breach of appropriation. An example of a remeasurement is the revaluation of land and buildings.

3.33 Section 2 of the Act defines remeasurements as "revisions of prices or estimates that result from revised expectations of future economic benefits or obligations that change the carrying amount of assets or liabilities". Section 2 also sets out what remeasurements do not include. For example, they do not include revisions that result from transactions or events directly attributable to the Crown's actions or decisions. Thus, revaluing student loan receivables after a policy decision to change the applicable interest rate is not a remeasurement, and is therefore subject to appropriation limits in the usual way.

3.34 In July 2006, the Treasury issued *Measuring Remeasurements* to provide guidance in this area.

3.35 In our Controller function and appropriation audit work, we frequently have to consider whether transactions or events result in a remeasurement. This requires careful judgement, and the legal and accounting issues are not straightforward.

3.36 Departments therefore need to take care when assessing transactions as remeasurements, and refer to the guidance available from the Treasury in doing so. We also encourage early discussion between departments and appointed auditors, where appropriate.

Part 4
Non-standard audit reports issued in 2009

4.1 In this Part, we report on the non-standard audit reports issued during the 2009 calendar year on the financial statements of public entities within our central government portfolio of audits.[1]

4.2 The financial statements of school boards of trustees are part of our central government portfolio of audits.[2] In the following text, we discuss schools separately from the other public entities.

Why are we reporting this information?

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

4.4 In each case, the issues underlying a non-standard audit report are drawn to the attention of the entity and discussed with its governing body, or chief executive in the case of a government department.

What is a non-standard audit report?

4.5 A non-standard audit report[3] is one that contains:

- a qualified opinion; and/or
- an explanatory paragraph.

4.6 An auditor expresses a **qualified opinion** because of:

- a disagreement between the auditor and the entity about the treatment or disclosure of a matter in the financial statements; or
- a limitation in scope because the auditor has been unable to obtain enough evidence to support, and accordingly is unable to express, an opinion on the financial statements or a part of the financial statements.

1 We report separately on entities within the local government portfolio, in our yearly report on the results of audits for that sector.

2 There are about 2450 state schools governed by boards of trustees, which are made up of members of the local community (usually parents of children attending the school). The board of each school is a Crown entity and, as such, is obliged to prepare annual financial statements in accordance with generally accepted accounting practice.

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

4.7 There are three types of qualified opinion:

- an "adverse" opinion (see paragraphs 4.11-4.12);
- a "disclaimer of opinion" (see paragraph 4.16); and
- an "except-for" opinion (see paragraph 4.19).

4.8 The auditor will include an **explanatory paragraph** (see paragraph 4.24) in the audit report to emphasise a matter such as:

- a breach of law;
- a fundamental uncertainty; or
- a significant judgement affecting the financial statements.

4.9 Auditors have to include an explanatory paragraph in the audit report in such a way that it cannot be mistaken for a qualified opinion.

4.10 Figure 18 outlines the decisions that an auditor has to make when considering the appropriate form of the audit report.

Adverse opinions

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

4.12 An adverse opinion is expressed when the auditor and the entity disagree about the treatment or disclosure of a matter in the financial statements and, in the auditor's judgement, the treatment or disclosure is so material or pervasive that the financial statements are seriously misleading.

4.13 During 2009, the auditor expressed an adverse opinion for two public entities:

- Royal New Zealand Navy Museum Trust Incorporated; and
- RNZAF Museum Trust Board.

4.14 The Appendix sets out the details of the adverse opinions.

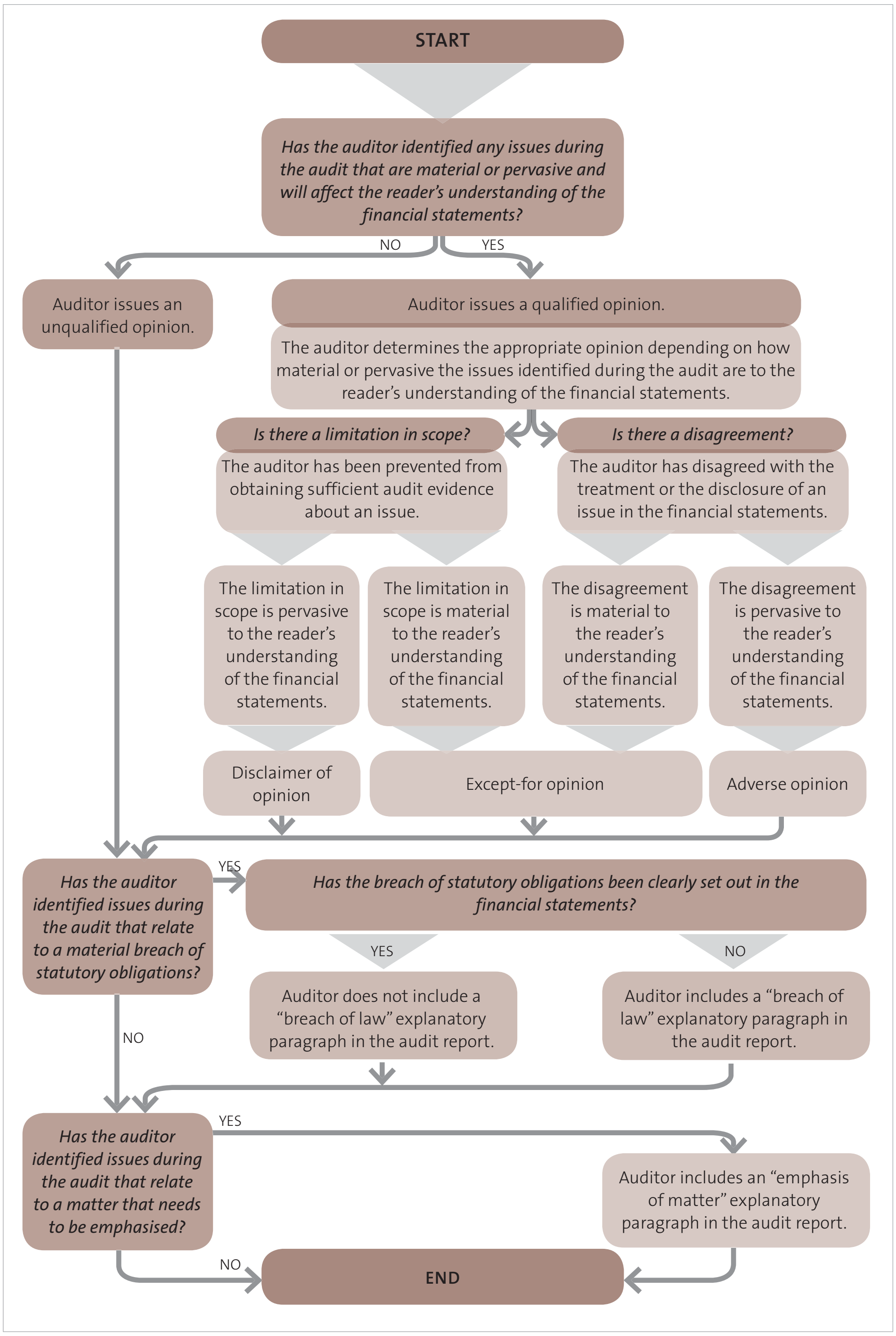
4.15 We are pleased to report that it was not necessary for auditors to express an adverse opinion on any school boards' financial statements in the 2009 calendar year.

Disclaimers of opinion

4.16 A disclaimer of opinion is expressed when the scope of an auditor's examination is limited, and the possible effect of that limitation is so material or pervasive that the auditor has not been able to obtain enough evidence to support an opinion on the financial statements. The auditor is accordingly unable to express an opinion on the financial statements as a whole or on part of them.

Figure 18

Deciding on the appropriate form of the audit report



4.17 During 2009, a disclaimer of opinion was expressed for one school – Te Kura Kaupapa Māori o Ruamata. The Appendix sets out the details of the disclaimer of opinion.

4.18 We are pleased to report that it was not necessary for auditors to express a disclaimer of opinion on any non-school public entity's financial statements in the central government portfolio in 2009.

Except-for opinions

4.19 An except-for opinion is expressed when the auditor reaches one or both of the following conclusions:

- The possible effect of a limitation in the scope of the auditor's examination is (or may be) material but is not significant enough to require a disclaimer of opinion. The opinion is qualified by using the words "except for the effects of any adjustments that might have been found necessary" had the limitation not affected the evidence available to the auditor.
- The effect of the treatment or disclosure of a matter with which the auditor disagrees is (or may be) material, but is not, in the auditor's judgement, significant enough to require an adverse opinion. The opinion is qualified by using the words "except for the effects of" the matter giving rise to the disagreement.

4.20 An except-for opinion can be expressed when the auditor concludes that a breach of statutory obligations has occurred and that the breach is material to the reader's understanding of the financial statements. An example of this is where a Crown entity has breached the requirements of the Crown Entities Act 2004 because it has not included budgeted figures in its financial statements.

4.21 During 2009, auditors expressed except-for opinions for 14 non-school public entities (2008: 12 non-school public entities):

- Auckland DHB Charitable Trust (a trust controlled by Auckland District Health Board);
- Christchurch Polytechnic Institute of Technology and Group;
- Counties Manukau District Health Board and Group;
- Ivey Hall and Memorial Hall 125th Anniversary Appeal Gifting Trust (a trust controlled by Lincoln University);
- Ivey Hall and Memorial Hall 125th Anniversary Appeal Taxable Activity Trust (a trust controlled by Lincoln University);
- Massey University and Group;

- Massey Ventures Limited and Group (a subsidiary of Massey University);
- New Zealand Historic Places Trust;
- Ngati Whakaue Educational Endowment Trust Board;
- Orcon Internet Limited (a subsidiary of Kordia Limited);
- Tauranga Moana Maori Trust Board;
- Tūwharetoa Māori Trust Board;
- UCOL International Limited (a subsidiary of Universal College of Learning, or UCOL); and
- Wellington Institute of Technology.

4.22 Auditors expressed except-for opinions for the financial statements of 30 schools (2008: 29 schools):

- Allenvale Special School & Res. Centre;
- Excellere College;[4]
- Hillcrest School (Pahiatua);
- Kiwitahi School;
- Mayfield Primary School;
- New Plymouth Girls' High School;
- Paeroa Central School;
- Piopio Primary School;
- Rawhitiroa School;
- Ross Intermediate (2 years);
- Saint Peter's College (Palmerston North);
- Saint Joseph's School (Hastings);
- Sunset Primary School;
- Taumarunui High School Community Trust;
- Te Whanau-a-Apanui Area School;
- Te Kura Kaupapa Māori o Manurewa;
- Te Kura Kaupapa Māori o Ngati Kahungunu ki Heretaunga;
- Te Kura Kaupapa Māori o Tamarongo;
- Te Kura Kaupapa Māori o Waiuku;
- Te Kura-a-iwi o Whakatupuranga Rua Mano;
- Te Wharekura o Rakaumangamanga;
- Titahi Bay Intermediate;

4 Two except-for opinions were expressed for the College covering different periods. The first covered the period before the College ceased to be a state school, and the second covered the period after the College became a state school again.

- Tokoroa East School;
- Upper Hutt School;
- Wanganui City College;
- Wellington East Girls' College;
- Wellington Girls' College;
- Whanganui Awa School; and
- Whareorino School.

4.23 The Appendix sets out the details of the except-for opinions. In some cases, the audit opinion was qualified for more than one reason.

Explanatory paragraphs

4.24 In certain circumstances, it may be appropriate for the auditor to include additional comments in the audit report. Through an explanatory paragraph, the auditor emphasises a matter that they consider relevant to a reader's proper understanding of an entity's financial statements.

4.25 For example, an explanatory paragraph could draw attention to an entity having breached its statutory obligations for matters that may affect or influence a reader's understanding of the entity's financial statements. In this situation, the audit report would normally draw attention to the breach only if the entity had not clearly disclosed the breach in its financial statements.

4.26 During 2009, there were 10 main types of matters emphasised by auditors of non-school public entities in explanatory paragraphs.

4.27 The first type of matter is funding for a capital appropriation that was not recognised as an equity transaction. The audit opinion for the University of Auckland included such an explanatory paragraph.

4.28 The second type of matter is the existence of high degree of uncertainty about the value of unlisted mortgage-backed securities that could have a material effect on the statement of financial performance and the statement of financial position. The audit opinion for the Public Trust included such an explanatory paragraph.

4.29 The third type of matter is the reduction made by a Board to the valuation of buildings carried out by an independent valuer that was not material to the financial statements as a whole. The audit opinion for MidCentral District Health Board included such an explanatory paragraph.

4.30 The fourth type of matter is fundamental uncertainty about the validity of the "going concern" assumption. Entities whose audit reports included such an explanatory paragraph were:

- New Zealand Institute for Plant and Food Research Limited and Group; and
- GraceLinc Limited (a subsidiary of New Zealand Institute for Plant and Food Research Limited).

4.31 The fifth type of matter is serious financial difficulties faced by the entity. The audit opinion for Whanganui District Health Board included such an explanatory paragraph.

4.32 The sixth type of matter is the current financial statements being issued to replace previously issued financial statements for clarification on funding issues. The audit opinion for Manukau Institute of Technology included such an explanatory paragraph.

4.33 The seventh type of matter is financial statements appropriately prepared on the "going concern" assumption because the financial statements contained appropriate disclosures about the use of the going concern assumption. Entities whose audit reports included such an explanatory paragraph were:

- AgResearch (PPGR Consortia) Limited (a subsidiary of AgResearch Limited);
- AgResearch (Pastoral Genomics Consortia) Limited (a subsidiary of AgResearch Limited);
- Air New Zealand Consulting Limited (a subsidiary of Air New Zealand Limited);
- Air New Zealand Associated Companies (Australia) Limited (a subsidiary of Air New Zealand Limited);
- Cardiff Holdings No.1 Limited (a subsidiary of Genesis Power Limited);
- Cardiff Holdings No.2 Limited (a subsidiary of Genesis Power Limited);
- CelcomOne Limited (a subsidiary of AgResearch Limited);
- Celcom Three Limited (a subsidiary of AgResearch Limited);
- ContainerScan Limited (a subsidiary of AgResearch Limited);
- Eagle Air Maintenance Limited (a subsidiary of Air New Zealand Limited);
- GP No.1 Limited (a subsidiary of Genesis Power Limited);
- GP No.2 Limited (a subsidiary of Genesis Power Limited);
- GP No.4 Limited (a subsidiary of Genesis Power Limited);
- GP No.5 Limited (a subsidiary of Genesis Power Limited); and
- Kupe Holdings Limited (a subsidiary of Genesis Power Limited).

4.34 The eighth type of matter is where the "going concern" assumption was appropriately not used because organisations were disestablished. Entities whose audit reports included such an explanatory paragraph were:

- E-Learnz Incorporated (a subsidiary of Eastern Institute of Technology Limited);
- iPredict Limited (a subsidiary of Victoria University of Wellington);
- Land Transport New Zealand;
- Marlborough Provincial Patriotic Council;
- Ngāi Tahu Ancillary Claims Trust;
- New Zealand Fast Forward Limited (a subsidiary of New Zealand Fast Forward Fund Limited);
- Predictions Clearing Limited (a subsidiary of Victoria University of Wellington); and
- Southland Provincial Patriotic Council.

4.35 The ninth type of matter is where the budget figures were from an updated budget that was approved by the Board but did not comply with the Crown Entities Act 2004. Entities whose audit reports included such an explanatory paragraph were:

- Southland District Health Board; and
- Otago District Health Board.

4.36 The tenth type of matter is where breaches of statutory obligations were disclosed in the audit reports. Entities whose audit reports included such breaches were:

- AgResearch (Meat Biologics Consortia) Limited (a subsidiary of AgResearch Limited);
- AgResearch Plant Bio Holding Limited (a subsidiary of AgResearch Limited);
- AgResearch Shelf Four Limited (a subsidiary of AgResearch Limited);
- AgResearch Strategic Investments Limited (a subsidiary of AgResearch Limited);
- AgResearch (USA) Limited (a subsidiary of AgResearch Limited);
- Celentis Limited (a subsidiary of AgResearch Limited);
- Grasslanz Technology Limited (a subsidiary of AgResearch Limited);
- Ministry of Pacific Island Affairs;
- Paraco Technology Limited (a subsidiary of AgResearch Limited); and
- Phytagro New Zealand Limited (a subsidiary of AgResearch Limited).

Schools

4.37 Because of the number of non-standard audit reports in each category, we are not listing each school for which the auditor included an explanatory paragraph in the audit report. We are instead reporting the types of explanatory paragraphs that were issued and the number of schools that received each type.

4.38 There were two main types of matters emphasised by auditors in explanatory paragraphs:

- school closures (five schools, 18 transport networks, and two subsidiaries); and
- serious financial difficulties (17 schools and one subsidiary).

4.39 There were six major types of explanatory paragraphs included by auditors for breaches of law:

- not reporting by 31 May 2009 (63 schools);
- borrowing above the permitted limit without approval (14 schools);
- not submitting financial statements for audit by 31 March 2009 (11 schools);
- investing in non-approved institutions (nine schools);
- not including the required variation statements (six schools); and
- not having a 10-year property plan (five schools).

4.40 Most schools disclose breaches of law in their financial statements. Therefore, the above figures should not be taken as a picture of compliance generally.

4.41 In addition, auditors emphasised matters for other reasons for 21 schools and one subsidiary.

4.42 The Appendix contains more information about the explanatory paragraphs that were included in audit reports.

Section 2

Our intentions

Section 2 has one Part.

Part 5

In Part 5, we discuss our intentions for improving service performance information and reporting.

Service performance reporting is also discussed in Part 2 and Part 7.

Part 5
Our intentions for improving service performance information and reporting

5.1 In this Part, we:

- discuss our views on service performance information and reporting;[1]
- describe our recent work to improve the quality of performance information and reporting; and
- describe our joint work programme with the Treasury to further improve the quality of performance reporting.

Our views on performance information and reporting

5.2 Our views on the importance and the quality of performance information and reporting are set out in our June 2008 discussion paper, *The Auditor-General's observations on the quality of performance reporting*.[2] We summarise some key points below.

Why performance information and reporting is important

5.3 Performance reports are an essential part of accountability documents. Accountability documents ensure that government departments and other state sector entities can be held accountable to Parliament and the public. Parliament and the public rely on accountability documents to assess the performance of public entities and the effectiveness of public entities' use of taxes.

5.4 We consider that improving service performance information and reporting is crucial in helping to improve the effectiveness and efficiency of public sector entities and in demonstrating accountability for their performance.

Our views on the quality of performance reporting

5.5 We have, during the past few years, increased our emphasis on performance reporting and carried out in-depth reviews of selected entities' accountability documents.

5.6 We have found that the quality of performance reporting continues to be disappointing, despite public sector entities having more than 20 years of experience in preparing and using performance reports. Performance reports are:

- not prepared as robustly as they should be to serve external readers' needs;
- not used as well as they might be by external readers as part of the accountability process; and

1 Service performance information provides primarily non-financial information that records the output delivery performance of a public entity against specified objectives. The information is usually shown in statements of service performance (or equivalent reports) and is compared with information contained in forecast non-financial performance reports. For ease of reading, we use the terms "performance information" and "performance reporting".

2 *The Auditor-General's observations on the quality of performance reporting*, June 2008, available on our website: www.oag.govt.nz.

- not used as well as they might be by internal readers – managers and governors of public entities – to improve public service effectiveness.

5.7 We also found that many entities' performance reports:

- do not set out coherent performance frameworks showing logical links from the medium-term outcomes information and organisational strategies to the annual output information; and
- do not have well-specified, relevant, understandable, reliable, and comparable performance measures and targets.

5.8 Although there is much guidance available to help public sector entities with their performance reporting, there are no reporting standards in New Zealand for performance reporting. As a result, each entity has needed to create its own framework for performance reporting and judge which elements (outcomes and outputs) within that framework will reflect its nature. In addition, initiatives that central agencies, other sector agencies with leadership roles in the public sector, and we have taken to help improve performance reporting have often lacked co-ordination, sustained effort, and focus.

5.9 The recently appointed Auditor-General[3] has been disappointed to find that performance reporting by public sector entities has improved very little in the last 15 to 20 years, despite a lot of talk and considerable effort by many. She has endorsed the Office's recent work to improve the quality of external service performance reports.

Our recent work to improve the quality of performance reporting

5.10 During the last couple of years, we have focused on improving performance information and reporting by:

- publishing examples of better practice to help public sector entities;
- carrying out work to improve the standards, methodology, and reporting our appointed auditors use in their audit work; and
- developing a shared work programme with the Treasury to help improve the way the wider public sector system for performance management and accountability works.

Better practice examples

5.11 In June 2009, we published *Statements of intent: Examples of reporting practice*.[4] This discussion paper gives examples of reporting practice drawn from the 2008/11 statements of intent of government departments and Crown entities.

3 The Auditor-General, Lyn Provost, took office in October 2009.

4 Available on our website, www.oag.govt.nz.

Although the examples reflect better practice at that time, there is still room for further improvement in service performance reports.

Revised auditing standard

5.12 During 2008/09, we reviewed and began updating our approach to auditing performance information and reporting. We consulted on, and finalised, a revision of the Auditor-General's standard on auditing performance information, AG-4. We refer to the new standard as AG-4 (Revised).[5]

5.13 The previous auditing standard required auditors to attest to whether the statement of service performance fairly reflected the standards of service delivery compared with forecast standards in the statement of service performance. The most significant change in the revised standard is that auditors will be required to attest to whether the statement of service performance fairly reflects actual service performance for the year. This is a subtle but important change, which – in essence – requires the auditor to form an opinion on whether service performance is fairly reflected (instead of an opinion on whether the SSP reports faithfully against the forecast SSP).

5.14 AG-4 (Revised) reflects the increased interest in the public sector in improving the quality of external service performance reports to reflect the entity's management of performance and actual achievements.

Our joint work programme with the Treasury

5.15 We have recently developed a joint work programme with the Treasury to help ensure that our efforts to improve the quality of performance management and information are complementary and provide public entities with clear and consistent information about how they can improve.

5.16 Our joint work programme envisages improvements in the next three years in the following areas:

- continuing to work with departments and agencies through existing and new work streams;
- clarifying requirements, tackling some of the challenges with the current system (for example, reporting on policy advice), and looking for ways to reduce compliance costs (for small agencies in particular); and
- enhanced audit reporting through the implementation of AG-4 (Revised).

5 Available on our website, www.oag.govt.nz. AG-4 (Revised) applies to local authorities and government departments, and to Crown entities that are required to prepare a statement of intent and statement of service performance under sections 139 and 150 of the Crown Entities Act 2004. This excludes the audit of service performance reports of other Crown entities (such as tertiary education institutions and those Crown entities required to prepare and report against a statement of corporate intent), where their service performance reporting requirements are governed by other legislation.

5.17 We will be phasing in AG-4 (Revised) in the three financial years ending 30 June 2011 to 30 June 2013. We have categorised entities as A, B, or C, depending on their size (the largest entities are generally category A).[6]

5.18 We and the Treasury intend to work directly with all category A entities to enable auditors to apply AG-4 (Revised) to the audit of the performance information for the year ending 30 June 2011. We will carry out similar work with category B entities to apply AG-4 (Revised) for the year ending 30 June 2012, and for category C entities and district health boards for the year ending 30 June 2013.

5.19 Through this work programme with the entities within each category, we expect to give a comprehensive external perspective on the current state of their performance information. We expect to better understand their concerns with their information and its preparation. We also expect to help identify areas for improvement (by drawing on our observations of better practice), and to provide support for, and feedback on, improvements that might be made immediately and in the longer term.

5.20 It is important to note that public sector entities are ultimately responsible, as the preparers, for their accountability plans and reports. Our work is intended to help with ensuring that plans and reports are a good reflection of internal management and achievements, while meeting the principles of good accountability that underlie the Public Finance Act 1989 and the Crown Entities Act 2004.

5.21 Throughout this joint work programme, we will continue to:

- have our appointed auditors take an objective view of the quality of entities' performance reports;
- report to Ministers and select committees on our assessments and grading of entities' management control environment, financial information systems, and service performance information and associated systems and controls; and
- prepare reports identifying examples of better practice and increasingly, we expect, good practice.

Implications of AG-4 (Revised) for audit fees

5.22 We have always anticipated that improving our audit work on service performance information would have implications for audit fees. As we introduce AG-4 (Revised), we will need to ensure that we are carrying out professional and robust audit work that maintains the assurance value of the audit opinions that we issue.

6 Entity size was assessed primarily on audit effort (hours) as a proxy for a range of factors, such as size, complexity, and risk.

5.23 We have assessed the probable effect of AG-4 (Revised) and expect that our audit work will primarily need to increase in:

- understanding the entity and management control environment;
- reviewing and testing the statement of service performance (SSP) systems; and
- liaising and communicating with public entities.

5.24 We expect to increase the overall number of hours spent on auditing service performance information. The effect on audit fees of this increased audit work will vary from entity to entity. Currently, our auditors spend about 7% of their time auditing service performance information. We estimate that this may need to double for Category A and B entities. We are still analysing the implications for entities in Category C, which includes district health boards. We will continue to advise entities about what they can do to help us reduce the additional audit work that may be needed as we implement AG-4 (Revised).

5.25 We are well aware that cost changes can be very difficult for the public sector to accommodate in this economic environment. We have attempted to minimise the cost for the public sector by funding audit and focused engagement transition costs (see paragraph 5.18), and by taking a three-year implementation approach to help spread the overall impact on the public sector.

Concluding comments

5.26 The generally poor quality of current performance information and reporting means that the public sector is not able to demonstrate its achievements and to demonstrate improvements in effectiveness. There are financial and public trust implications in this inability.

5.27 Improving the quality of performance reporting will need co-operation and effort from government departments, central agencies, Crown entities and their monitoring departments, and auditors.

5.28 We recognise there are challenges that we will need to work through to get improvement, and that our Office has a key role to play. We are convinced that we can – and must – work together to meet the reasonable expectations for useful information to underpin the public sector system of accountability.

Section 3

District health boards and our audit work

Section 3 has two Parts that discuss the 2008/09 audit results for district health boards.

Part 6

In Part 6, we describe the place of district health boards within the health sector, how district health boards are funded, and their governance and accountability arrangements. We then discuss their financial performance during 2008/09, and the details of our audit results.

Part 7

In Part 7, we focus on audit work we carried out to review the service performance information of district health boards and their associated systems and controls.

We discuss the district health boards' planning and accountability framework and consider whether the complexities of the framework, and other underlying issues, may be contributing to the low quality of service performance information.

There are three recommendations at the end of Part 7.

Part 6
Results of district health board audits for 2008/09

6.1 Just over $12.240 billion was appropriated for government expenditure in 2008/09 for the health sector.[1] About three quarters (73.8%) was to fund health services provided by the district health boards (DHBs). The actual expenditure by the DHBs for 2008/09 was just over $11.931 billion.

6.2 The Auditor-General is the auditor of the DHBs and their subsidiary organisations. In this Part, we briefly describe the DHBs and their operating environment, and report the results of our annual audits of DHBs for the 2008/09 financial year.

What is the health sector?

6.3 There are 21 DHBs throughout New Zealand. They were set up under the New Zealand Public Health and Disability Act 2000, which sets out the roles and functions of the DHBs. Their main responsibility is to provide, or fund the provision of, health and disability services in their district, with the purpose of:

- improving, promoting, and protecting the health of communities;
- promoting the integration of health services, especially primary and secondary care services; and
- promoting effective care or support of those in need of personal health services or disability support.

6.4 The health sector includes subsidiary companies that DHBs may have set up individually or jointly.

6.5 Since the Ministry of Health introduced the Primary Health Care Strategy, DHBs have been responsible for setting up not-for-profit Primary Health Organisations (PHOs). PHOs provide primary health care services to their enrolled populations and are funded by the DHBs. They are not public entities. There are currently 81 PHOs throughout New Zealand.

How are district health boards funded and for what?

6.6 The overall funding that DHBs are allocated is based on the government's spending priorities during the budgeting process.

6.7 The amount that the individual DHBs receive is determined by the size of the district's population, with additional socio-economic and other risk factors taken into account.

6.8 The funding covers the health and disability services that the DHB provides directly to its population, or indirectly through another provider (such as another DHB, a PHO, or a private for-profit or not-for-profit provider such as a non-government organisation).

1 The *Estimates of Appropriations 2008/09*, B.5, page 152.

Size of the district health boards

6.9 DHBs vary considerably in the amount of funding that they receive, the size of the population that they serve, and the area that they cover (see Figure 19 and Figure 20).

Figure 19
District health board areas

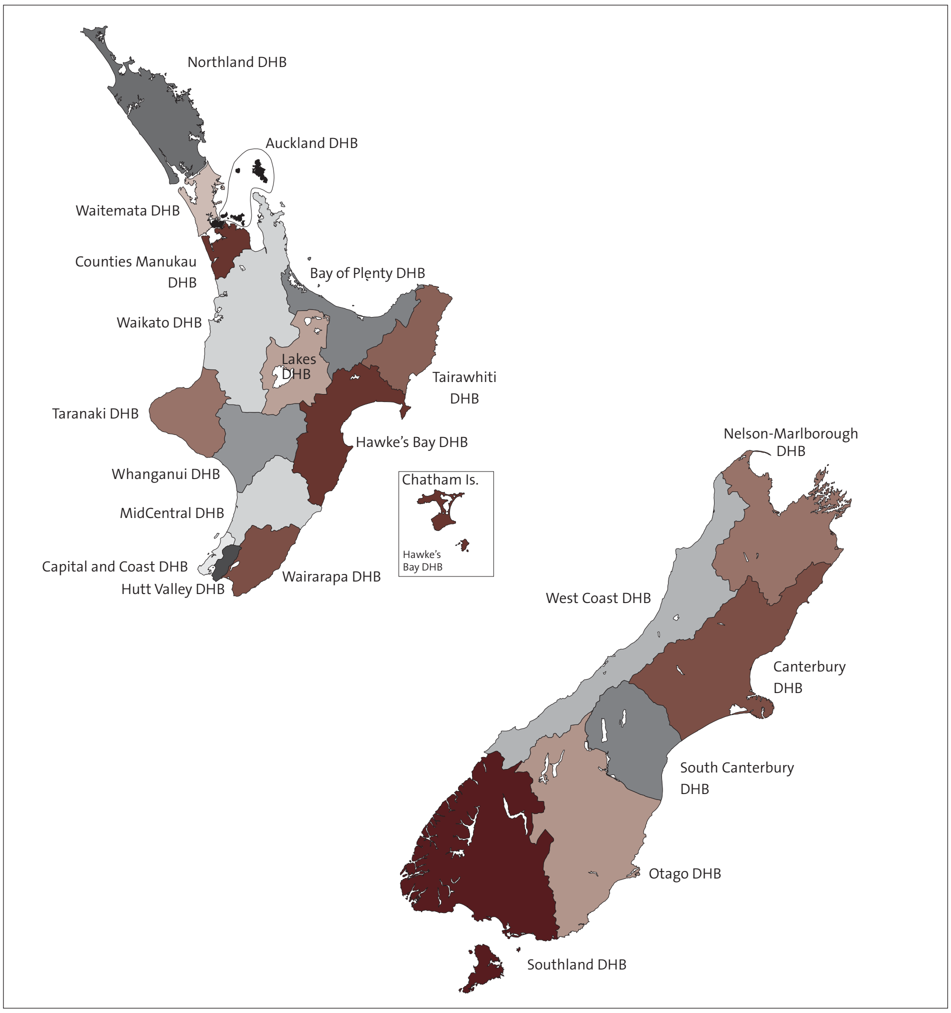


Figure 20

Population and funding of district health boards in 2008/09

District health board	Population[a]	Funding[b] $000
North Island		
Auckland	446,785	881,337
Bay of Plenty	207,935	491,430
Capital and Coast	285,380	536,775
Counties Manukau	477,915	932,041
Hawke's Bay	153,885	358,708
Hutt Valley	142,220	287,506
Lakes	102,650	234,294
MidCentral	166,350	373,103
Northland	155,785	389,731
Tairawhiti	45,910	115,426
Taranaki	107,578	257,887
Waikato	358,570	781,745
Wairarapa	39,713	99,926
Waitemata	525,260	1,013,278
Whanganui	63,328	172,777
South Island		
Canterbury	496,845	1,027,024
Nelson-Marlborough	136,130	309,705
Otago	186,020	418,864
South Canterbury	55,318	137,842
Southland	110,585	234,756
West Coast	32,108	101,740

a: Population figures used to calculate 2008/09 population-based funding (Ministry of Health, 11 December 2009).
b: 2008/09 budgeted figures, from *Estimates of Appropriations 2009/10*, B.5, pages 167-169.

Governance and accountability arrangements

6.10 DHBs are responsible for identifying and providing for the health needs of their district. They are required to prepare district strategic and annual plans that are consistent with New Zealand's health and disability strategies.[2] Each year, DHBs also publish a Statement of Intent (SOI), which is a high-level, less detailed statement about how the DHB intends to address the health needs of its district. DHBs are also increasingly expected to prepare inter-district plans for health services and resourcing. We comment in Part 7 on the health sector's accountability framework.

6.11 Each DHB is governed by a board of up to eleven members, four of whom are appointed by the Minister of Health (the Minister). DHBs are directly accountable to the Minister. DHBs are Crown Agents under the Crown Entities Act 2004, and therefore required to give effect to government policy when directed by the Minister.

6.12 The monitoring department for DHBs is the Ministry of Health (the Ministry), which both monitors and supports DHBs.

6.13 There have been several recent and major changes within the health sector. The Ministerial Review Group reported at the end of July 2009.[3] Its report included recommendations that affect the support structures for DHBs. The Government has responded to these by signalling the establishment of the National Health Board as an "expert advisory board" with an independent chairperson,[4] and the National Health Board business unit within the Ministry, under a National Director.[5] The business unit has just recently introduced additional levels to the existing monitoring regime, which take effect in the current financial year.

6.14 The monitoring regime for 2008/09 has three different levels of intervention – standard monitoring, performance watch, and intensive monitoring.[6]

2 See section 38, New Zealand Public Health and Disability Act 2000.

3 See www.beehive.govt.nz/release/ministerial+review+group+report+released.

4 The expert advisory board provides the Minister of Health and the Director-General with independent expert advice, and is supported by National Health Board Business Unit staff.

5 The National Health Board Business Unit is a "branded business unit" within the Ministry of Health, with its own organisational structure, and a clearly defined separate identity (like MEDSAFE, Biosecurity New Zealand (in the Ministry of Agriculture and Forestry), and Work and Income (in the Ministry of Social Development)).

6 Briefly stated, standard monitoring is used when a DHB is in a sound financial position, has accountability arrangements in place, and is complying with requirements in a timely manner. DHBs are under a performance watch regime when there is some non-compliance or deterioration against the performance watch requirements. There is intensive monitoring if there is continuing non-compliance and/or deterioration, or a single event creates a material risk. There are two further intervention stages in addition to intensive monitoring – intermediate governance action, and direct governance action if the Minister is seriously dissatisfied with the Board's performance.

6.15 Under this regime the Minister can, in addition to intensive Ministry monitoring, change how the DHB is governed, to help improve its performance. The Minister can do this by appointing one or more Crown monitors to observe the decision-making processes of the board, to help the board understand the policies and wishes of the Government, and to advise the Minister on any matters about the DHB, the board, or its performance.[7] If seriously dissatisfied, the Minister can dismiss the board and appoint a commissioner.

6.16 As at December 2009, Capital and Coast DHB, Southland DHB, West Coast DHB, and Whanganui DHB were on the intensive monitoring list. Hawke's Bay DHB, Hutt Valley DHB, Otago DHB, and Waitemata DHB were all on the performance watch list. During 2008/09, four Crown monitors were in place, in Whanganui DHB (two monitors) and Capital and Coast DHB and Southland DHB (one monitor in each). As at December 2009, there were only two Crown monitors in place: in Capital and Coast DHB and Southland DHB. A commissioner is in place in Hawke's Bay DHB, and will remain until the next DHB board elections.

Annual audit

6.17 Under section 15 of the Public Audit Act 2001, the Auditor-General audits the financial statements, accounts, and other information that each of the 21 DHBs and their subsidiaries are required to have audited each year. She does not audit the PHOs, because they are not public entities. However, under section 16 of the Public Audit Act 2001, she can look at whether DHBs are fulfilling their responsibilities for primary health care.

6.18 The purpose of the annual audit is to give assurance that a public entity's reports fairly reflect its financial and non-financial performance, and do not mislead the reader.

Financial performance of district health boards

6.19 Figure 21 sets out the financial performance of the 21 DHBs for the year ended 30 June 2009.

7 See section 30 of the New Zealand Public Health and Disability Act 2000.

Figure 21
Summary of district health boards' 2008/09 financial performance

District health board	Revenue[a] $m	Expenditure[a] $m	Surplus (Deficit)[a] $m	Deficit as % of revenue	Planned Surplus (Deficit)[b] $m	Variance to plan $m
Auckland	1,638.2	1,637.9	0.3[c]		0.0	0.3
Bay of Plenty	557.9	558.0	(0.1)[c]	0.0	(1.9)	1.8
Canterbury	1,278.9	1,291.2	(12.4)	1.0	0.0	(12.4)
Capital and Coast	770.9	837.0	(66.0)[c]	7.8	(52.7)	(13.3)
Counties Manukau	1,138.5	1141.5	(3.0)	0.2	(3.1)	0.1
Hawke's Bay	416.5	422.6	(6.1)	1.5	(6.5)	0.4
Hutt Valley	397.7	406.7	(9.0)	2.3	0.0	(9.0)
Lakes	279.4	273.8	5.6		(0.7)	6.3
MidCentral	478.4	488.3	(9.9)	2.1	(4.7)	(5.2)
Nelson-Marlborough	373.9	378.7	(4.8)	1.3	(5.5)	0.7
Northland	447.0	446.7	0.3		0.0	0.3
Otago	513.5	522.5	(8.9)[c]	1.7	(9.3)	0.4
South Canterbury	160.5	157.7	2.8		(0.4)	3.2
Southland	259.1	271.5	(12.4)[c]	4.8	(8.1)	(4.3)
Tairawhiti	136.9	140.0	(2.8)[c]	2.3	(1.7)	(1.1)
Taranaki	289.2	289.8	(0.7)[c]	0.2	(2.0)	1.3
Waikato	994.3	995.9	(1.6)[c]	0.2	15.8	(17.4)
Wairarapa	119.3	123.3	(4.0)	3.4	0.0	(4.0)
Waitemata	1,211.0	1,215.7	(4.8)	0.4	(12.6)	7.8
West Coast	118.8	126.5	(7.7)	6.5	(8.0)	0.3
Whanganui	196.4	206.3	(9.9)	5.0	(9.8)	(0.1)
Totals	**11,776.3**	**11,931.6**	**(155.1)**	**1.3**	**(111.2)**	**(43.9)**

a: Audited results.

b: From the annual plans of DHBs. Figures provided by the Ministry of Health, January 2010.

c: In eight cases (Auckland, Bay of Plenty, Capital and Coast, Otago, Southland, Tairawhiti, Taranaki, and Waikato DHBs), the surplus (deficit) is affected by including profits from joint ventures or associates that are additional to the revenue shown. For these eight DHBs, the surplus (deficit) shown is, therefore, not the same as revenue less expenditure.

Overall financial stability

6.20 The board usually prepares the DHB's financial statements based on the "going concern" assumption (that is, that the DHB will continue to operate for the foreseeable future).

6.21 Sometimes, there are doubts about the appropriateness of the going concern assumption. Doubts can arise for many reasons, including:

- future funding not being agreed;
- potential for defaulting on loans or breaching borrowing covenants;
- significant liquidity or cash flow problems; or
- dependence on the continuing support of the Crown.

6.22 Where there are doubts, the board must be able to justify using the going concern assumption.

6.23 In some circumstances, to justify using the assumption, the board seeks assurances of financial support from the Crown (through the Minister). Such assurance is usually given in the form of a "letter of comfort". In 2008/09, as in 2007/08, the Ministers of Health and Finance issued five letters of comfort. These were for the same five DHBs as in 2007/08:

- Capital and Coast DHB;
- Otago DHB;
- Southland DHB;
- West Coast DHB; and
- Whanganui DHB.

6.24 We note with concern that the overall level of deficit in the DHB sector has increased from $43.4 million in 2007/08 to $155.1 million in 2008/09. The numbers of DHBs in deficit has also increased. There were 13 DHBs in deficit in 2007/08, compared with 17 in 2008/09.

Audit opinions issued for the year ended 30 June 2009

6.25 Five DHBs received a non-standard audit opinion for 2008/09 (see also Part 4 of this report):

- Counties Manukau DHB received a qualified audit opinion for failing to recognise as revenue $14.374 million received from the Ministry in that year;
- the audit opinions we issued for Otago DHB and for Southland DHB were unqualified, but each contained an explanatory paragraph. The explanatory paragraph draws attention to the DHB's use of budget figures in the financial

statements from the budget approved by its Board in December 2008, rather than the forecast financial statements in place at the start of the financial year as required under section 154(3)(c) of the Crown Entities Act 2004;

- the audit opinion we issued for MidCentral DHB contained an unqualified opinion with an explanatory paragraph about the valuation of buildings; and
- the audit opinion we issued for Whanganui DHB contained an unqualified opinion with an explantory paragraph about serious financial difficulties.

6.26 The 2008/09 audit opinions for all other DHBs contained standard unqualified audit opinions with no explanatory paragraphs.

Environment, systems, and controls

6.27 As part of our annual audits, the Auditor-General also comments on the management control environment, the financial information systems and controls, and the service performance information and associated systems and controls of DHBs, to highlight areas for improvement. Grades are assigned that directly represent the recommendations for improvement. Figure 22 sets out our grades for the management control environment, financial information systems and controls, and service performance information and associated systems and controls for the DHBs, for the year ended 30 June 2009. See Part 2 for a discussion of the environment systems and controls framework, and the grades we use.

6.28 We have provided a grade for the service performance information and associated systems and controls for the first time in 2008/09. We did not grade this aspect in our 2006/07 and 2007/08 audits, because we have been updating the standards and methodology our auditors apply in auditing this area in response to the Crown Entities Act 2004 and changes in 2004 to the Public Finance Act 1989. We have also been carrying out reviews of public entities' current performance information frameworks and reporting. We wanted to give public entities time to respond to the recommendations for improvement we have made resulting from our reviews and updated expectations of auditors.

6.29 All DHBs were graded as poor/needs improvement for the service performance information and associated systems and controls. We have commented further on this in Part 7 of this report.

Figure 22

Summary of district health boards' 2008/09 ratings for environment, systems, and controls

District health board	Management control environment	Financial information systems and controls	Service performance information and associated systems and controls
Auckland	Very good	Good	Poor/needs improvement
Bay of Plenty	Good	Good	Poor/needs improvement
Canterbury	Good	Needs improvement	Poor/needs improvement
Capital and Coast	Needs improvement	Needs improvement	Poor/needs improvement
Counties Manukau	Good	Good	Poor/needs improvement
Hawke's Bay	Good	Good	Poor/needs improvement
Hutt Valley	Needs improvement	Needs improvement	Poor/needs improvement
Lakes	Needs improvement	Good	Poor/needs improvement
MidCentral	Good	Needs improvement	Poor/needs improvement
Nelson-Marlborough	Good	Good	Poor/needs improvement
Northland	Good	Good	Poor/needs improvement
Otago	Good	Good	Poor/needs improvement
South Canterbury	Good	Good	Poor/needs improvement
Southland	Good	Good	Poor/needs improvement
Tairawhiti	Needs improvement	Needs improvement	Poor/needs improvement
Taranaki	Good	Good	Poor/needs improvement
Waikato	Needs improvement	Good	Poor/needs improvement
Wairarapa	Good	Good	Poor/needs improvement
Waitemata	Good	Good	Poor/needs improvement
West Coast	Good	Good	Poor/needs improvement
Whanganui	Good	Needs improvement	Poor/needs improvement

6.30 Comparisons with the year ended 30 June 2008 are available only for the management control environment and the financial information systems and controls. These are set out in Figures 23 and 24. Results for 2008/09 showed:

- a 5% drop (to 71%) in "good" ratings for the management control environment compared with 2007/08 (and an increase by 5% to 24% in "needs improvement" ratings); and
- a 4% increase (to 71%) in "good" ratings and a 4% drop in "needs improvement" (to 29%) for financial information systems and controls compared with 2007/08.

Figure 23
Management control environment

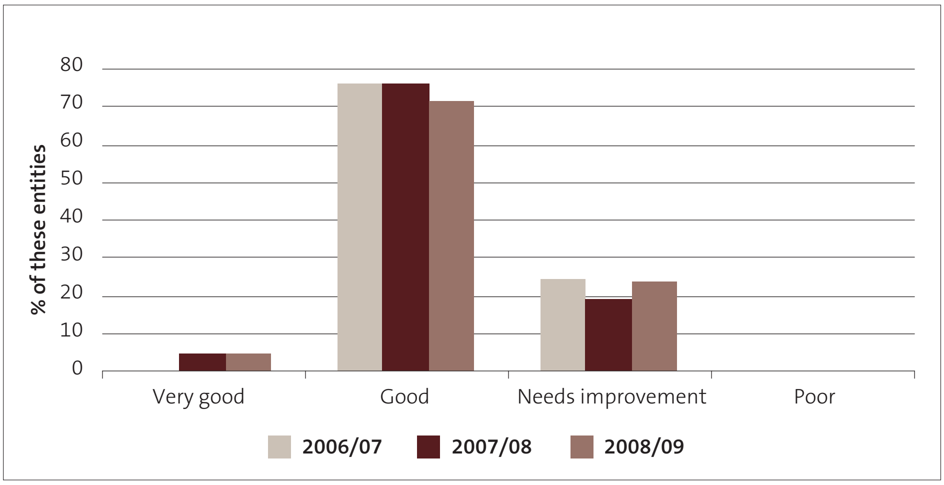
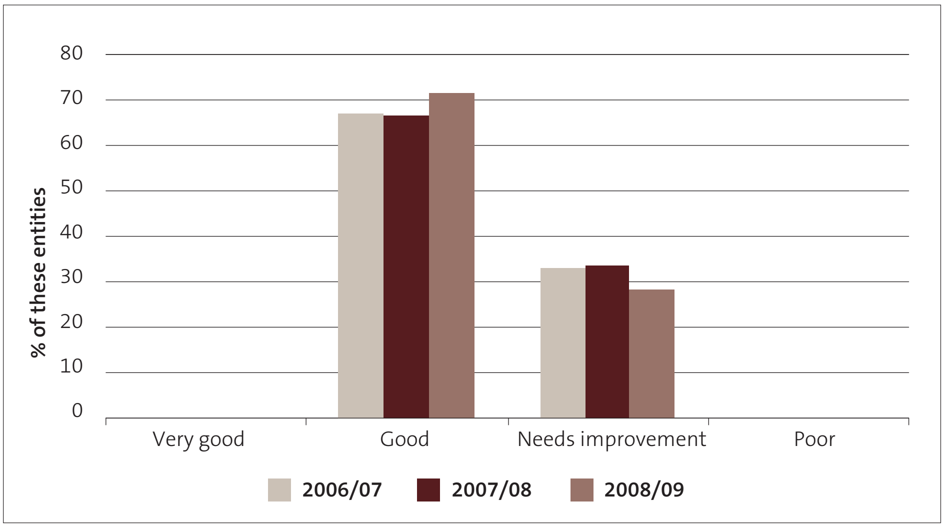


Figure 24
Financial information systems and controls



Key areas of audit focus in the 2008/09 annual audits

6.31 Two key areas of focus for the audits of DHBs in 2008/09 were:

- procurement policies and practice; and
- non-financial performance reporting.

Procurement policies and practice

6.32 Procurement is an activity that is critical to the effectiveness and efficiency of public entities. It covers all the business processes associated with purchasing and contract management, from policies through to practice. As part of the annual audit for 2008/09, we asked our auditors to:

- follow up on the extent to which any deficiencies and recommendations from the 2007/08 annual audit of procurement policies and practice had been addressed, including a review of a sample of significant procurement decisions of the DHB; and
- check for any other issues that the DHB needed to address to comply with good public sector practice.

6.33 During 2008/09, we also completed an in-depth performance audit of three DHBs' procurement policies and practices. This in-depth review, and other inquiry work, complemented the results of our annual audit work on procurement, and will be reported separately to Parliament.

6.34 In summary, our annual audit work found:

- negligible improvement since last year in the quality of DHBs' procurement policies. Many DHBs are still working on the recommendations arising from our audits for the year ended 30 June 2008, and there are still six DHBs that are deficient in all of the nine aspects of procurement policy that we examined; and
- an increase in deficiencies in procurement practices within DHBs since last year, though this may be largely because we assessed procurement practices based on our own audit, rather than based on a review of DHB self-assessments as we did in 2007/08. Eight DHBs had deficiencies in all six key procurement practice aspects. This is a significant increase from the one DHB in 2007/08 that had deficiencies in all aspects.

6.35 Our 2008/09 audit results are set out in more detail below.

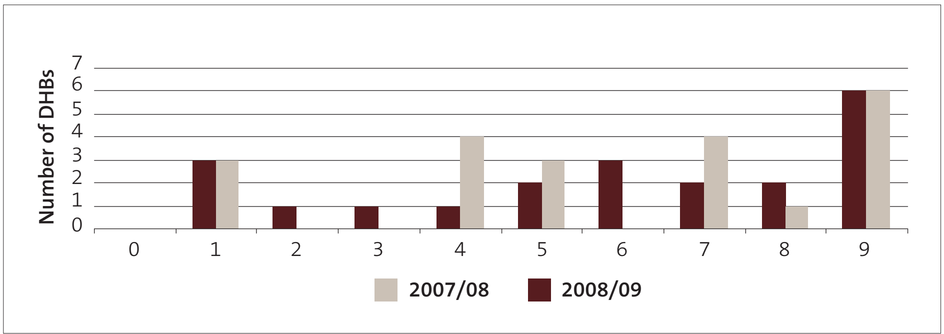
Improving procurement policies

6.36 In the 2008/09 audit, we examined whether DHBs had addressed earlier deficiencies in nine key aspects of procurement policy.[8]

6.37 While there has been a slight improvement in some DHBs, in many DHBs issues remain from the 2007/08 audit recommendations. In 2008/09, six of the DHBs were deficient in all nine aspects, with 11 DHBs deficient in seven or more of the nine (see Figure 25). Figure 26 sets out which of the nine key aspects DHBs were deficient in.

Figure 25

Number of deficient aspects of procurement policy

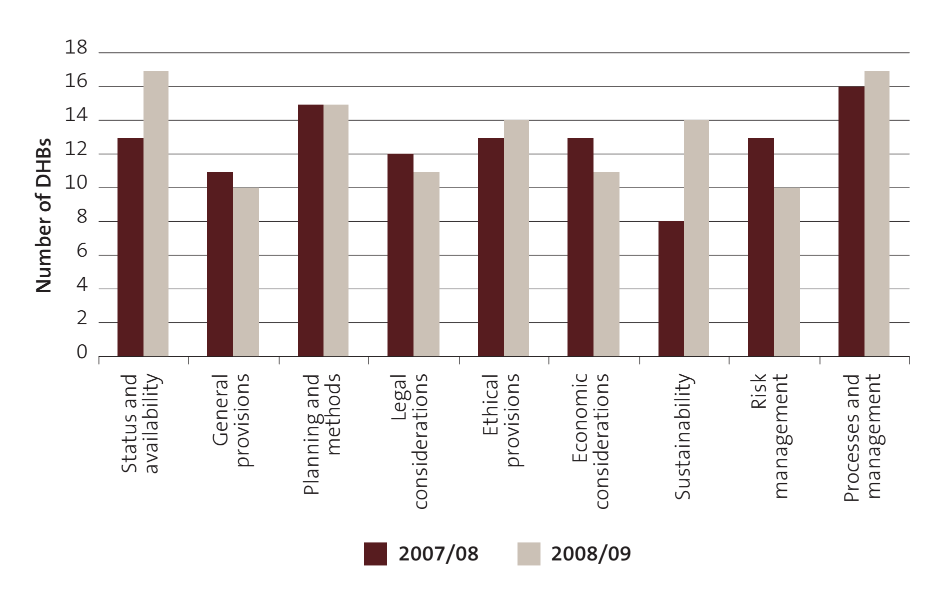


8 The nine aspects of procurement policy that we examined were:

- whether the policies cover all the DHBs' procurement activities, who approved the policies, and whether they are available to the relevant staff (that is, status and availability);
- general provisions (for example, whether they reflect the essential principles set out in our guidance);
- planning and methods (for example, whether they include an appropriate range of procurement approaches);
- legal considerations (for example, whether they reflect public law obligations and caution about process-related contract obligations);
- ethical provisions (for example, whether they deal with conflicts of interest);
- economic considerations (for example, requirements to ensure value for money);
- whether they take sustainability into account;
- risk management (for example, whether they include provisions for identifying, recording, assessing, and managing risks); and
- processes and management (for example, whether open tendering is required for conventional procurement).

Figure 26

Number of district health boards with procurement policy deficiencies, by aspect



6.38 Deficiencies in procurement policies occurred in all nine aspects, as in 2007/08, with most in processes and management, status and availability, planning and methods, sustainability, and ethical provisions. There were notably fewer DHBs with deficiencies in risk management than there were in 2007/08. But there was a notable increase in the number of DHBs with deficiencies in status and availability, and in sustainability.

6.39 In particular, better guidance is needed in the DHBs' policies about:

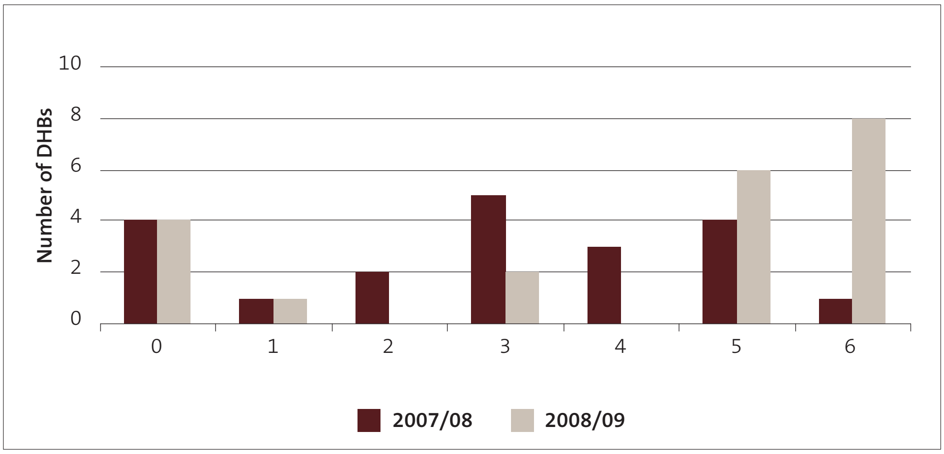
- when to tender and timing of tenders;
- dealing with late tenders;
- risk management processes;
- managing fraud and corruption risks;
- dealing with gifts and hospitality when they are associated with procurement;
- managing the risk of potentially unfair advantage when former employees seek to be contractors;
- management of intellectual property considerations;
- obtaining value for money;
- ensuring that the management of contracts is appropriate; and
- sufficiency of documentation.

Improving procurement practice

6.40 In 2007/08, we reported on the deficiencies in DHBs' procurement practice, based on a survey that the DHBs completed (that is, by reviewing the DHBs' self-assessments). In the 2008/09 audit, we examined whether DHBs had addressed their earlier deficiencies in the six aspects of procurement practice by auditing a sample of their contracts.[9]

6.41 Fourteen of the 21 DHBs are deficient in five or more of the six aspects of procurement practice in 2008/09, compared with five DHBs in 2007/08. Figure 27 shows the number of deficient aspects of procurement practice, by the number of DHBs.

Figure 27
Number of deficient aspects of procurement practice



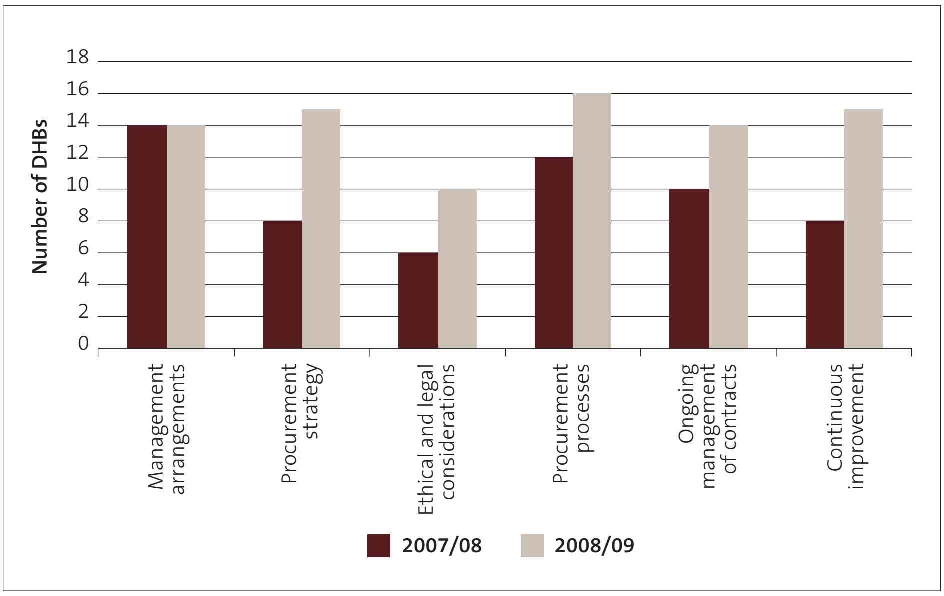
9 The six aspects of procurement practice that we surveyed were:
- management arrangements (for example, structure of procurement management, staff capacity for procurement, management of contract information);
- procurement strategy (for example, strategic planning, selecting a procurement approach to suit the particular circumstances);
- ethical and legal considerations (for example, managing conflicts of interest);
- procurement processes (for example, whether open tendering is used where practical and appropriate, how value for money is achieved);
- ongoing management of contracts (for example, approach to monitoring contracts); and
- continuous improvement (for example, recent improvements, having established some priorities for future improvement).

6.42 Probably because we audited procurement practices this year (last year we reviewed the self-assessment returns by the DHBs), we have found a greater number of deficiencies than in 2007/08.[10] However, the issues were similar to those reported last year.

6.43 Figure 28 sets out which of the six aspects of procurement practice the 21 DHBs were deficient in. All of the six aspects of procurement practice needed to improve, with no fewer than ten DHBs deficient in any particular aspect, and 16 DHBs deficient in procurement processes. DHBs had more deficiencies in all aspects except management arrangements, compared with 2007/08.

Figure 28

Number of district health boards with deficiencies in procurement practice, by aspect



Procurement policies and practices, in summary

6.44 Overall, we note a negligible improvement in procurement policies in the DHB sector since our 2007/08 audit. The risk management policy component has improved. There is room for further improvement in every aspect.

6.45 We continue to be concerned about the number of deficiencies in all aspects of DHB procurement practices. Auditors have raised specific concerns with each DHB's management and Board, and we have reported the concerns to the Minister and the Health Committee in the context of reporting the results of the 2008/09 audit.

10 We will consider the implications of the difference for our future audit work.

6.46 We are aware that there are likely to be changes in procurement frameworks in the health sector, with the creation of a national shared service agency. In our view, whatever the procurement framework, there are issues to be addressed.

6.47 We are, therefore, publishing a report on our audit findings on the purchasing practices of DHBs, and are discussing our findings with the Ministry, District Health Boards of New Zealand (DHBNZ), and other sector groups. We will also be writing, in consultation with the sector, a report on contract management practices, based on our audit findings, and on shared experience of good contract management practices within the sector. We will continue to monitor the DHBs' progress.

Non-financial performance reporting

6.48 In the 2008/09 audit of DHBs, we reviewed the 2009–2012 Statements of Intent. For the first time, we also graded the service performance reports, based on our review of the 2009–2012 Statements of Intent and supporting systems and controls, and the audit of the 2008/09 Statements of Service Performance.

6.49 We reached the view that the 2009–2012 Statements of Intent of DHBs are not yet as well developed as similar accountability documents in other parts of the public sector. As a consequence, we have ranked all DHB Statements of Intent at the lower end of the assessment scale, with a grade of "poor/needs improvement".

6.50 We acknowledge the extensive work that the sector is doing on accountability documents and the accountability framework. We have reported in detail on DHB non-financial reporting in Part 7 of this report.

Part 7
Service performance information of district health boards – the accountability framework

7.1 In this Part, we report our conclusions from our review of the service performance information and associated systems and controls for the 21 district health boards (DHBs). We carried out our review as part of our 2008/09 annual audits. In drawing our conclusions, we acknowledge the extensive work that the sector is doing on accountability documents and the accountability framework, and recognise that the DHB sector has work in place to address weaknesses in its service performance reporting.

7.2 We also summarise the DHB sector's planning and accountability framework and consider whether the complexities of the framework, and other underlying issues, may be contributing to the low quality of the DHBs' service performance information, and the statements of intent (SOIs) in particular.

7.3 We make three recommendations for helping to improve the accountability framework that DHBs must operate under, which we would expect to result in improved accountability reporting within the general purpose accountability documents (that is, the SOI and the annual report).

Audit work during 2008/09

7.4 In the 2008/09 audit of each DHB, we reviewed the SOI for 2009-12. The SOI includes the statement of forecast service performance (forecast SSP), which sets out the performance measures and targets to be reported in the year-end Statement of Service Performance (the SSP), which is subject to our audit opinion.

7.5 This year, and for the first time, we issued a grade for entities' service performance information and associated systems and controls. The grade is based on our review of the reporting of prospective information in the 2009-12 SOI and supporting systems and controls, and of service performance information reported in the 2008/09 SSP. We explain our reporting and associated grading system in Part 2 of this report. To help ensure consistency in the grading of SOIs, we also reviewed our auditors' findings, conclusions, and proposed grade. We reported our conclusions about the individual DHBs' service performance information to the DHB's Board and management, the Minister of Health (the Minister), and to Parliament.

7.6 The results reported below apply to the documents reviewed at the time of the 2008/09 audit. Since that time, we are aware of further work by both the Ministry and the DHBs to improve DHB accountability documents. This includes revised guidance from the Ministry for the DHB SOIs and District Annual Plans (DAPs), a review of the DHB performance measurement framework to reduce the reporting burden, more focus on Government priorities, and the advent of new requirements for Performance Improvement Action, for all Crown entities.

7.7 It remains to be seen how successful these will be in addressing the following issues. We note, however, that revised guidance and reduced amount of reporting will be effective only to the extent that the resulting reports give a meaningful and complete picture of DHB service performance.

Poor grades for district health boards

7.8 We graded all DHBs' service performance information and associated systems and controls as "poor/needs improvement", at the lower end of our assessment scale. While the presentational quality varied considerably, a consistent feature of the SOIs was that they did not identify clearly or comprehensively the DHBs' services, and the quality of the reported performance measures was poor. In our view, DHBs' 2009-12 SOIs are not yet as well developed as similar accountability documents in other parts of the public sector.

7.9 We took into account the following factors, evident throughout the health sector, in giving a grade of "poor/needs improvement":

- a failure to distinguish between the various elements of performance;
- poor specification of outcomes;
- a lack of main measures for outcomes;
- poor specification of outputs;
- a lack of coverage of the range of DHB services beyond those focused on in the national health priorities; and
- a lack of direct measures of service delivery, especially the (almost total) lack of service quality measures.

What good performance reporting is supposed to achieve

7.10 To meet the expectations set out in the Crown Entities Act 2004, generally accepted accounting practice, and guidance from the Treasury and the State Services Commission, SOIs and annual reports (including their forecast and historical SSPs) should present a clear, logical, integrated, and cohesive performance story. The reports should exhibit the qualities of relevance, reliability, comparability, and understandability.

7.11 The elements of performance and their associated measures should be presented in an informative context. The links between outputs, impacts, and outcomes (the "intervention logic") should be clear and understandable, and their relevance to the DHB's strategic priorities should also be apparent. Performance reports produced to a satisfactory standard should provide a basis for assessing the DHB's efficiency (of service delivery) and effectiveness (in achieving intended outcomes). The link between financial information and good quality non-financial performance information should provide a basis for assessing cost-effectiveness.

7.12 However, we have concluded that the quality of SOIs for the DHB sector in these respects is poor and has shown insufficient improvement in recent years, despite quite extensive work throughout the sector to improve the quality of SOIs. It is as yet too soon to see if the more recent initiatives in the sector and by the National Health Board business unit in the Ministry of Health will make a difference to the quality of non-financial performance information.

7.13 Reported performance objectives are often vague and disconnected. We do not see a unified performance story within the accountability documents that:

- plans the DHB's outputs and makes it clear what impacts and ultimately outcomes they are expected to achieve;
- reconciles long-term strategic priorities, the Minister's priorities, national health priorities, and local communities' specific health profiles, needs assessments, and initiatives; and
- identifies clearly and unambiguously the services the DHB is accountable for, including services delivered on its behalf by other providers.

The risks in reporting performance information poorly

7.14 There are risks associated with poor reporting of performance information. DHBs need to consider the wider implications for business planning and management of having effective and efficient service performance reporting. The risks to the sector are not confined to getting poor grades, receiving an adverse audit opinion, or providing misleading information about its activities.

7.15 In our view, good accountability processes should be an integral part of how an entity manages its day-to-day business. The low quality of SOIs may reflect underlying problems with the sector's accountability framework. It may also reflect poor integration of the DHB's business planning and management processes with accountability reporting, an important risk to effective and efficient management and to good accountability.

7.16 Considering these risks, we have revised our Standard for issuing audit opinions on SSPs.[1] We intend to apply the revised Standard to audits of DHBs during 2012/13.

7.17 We recognise the work that DHBs are doing both individually and collegially, assisted by the monitoring department (the Ministry of Health) and the central agencies (the Treasury and the State Services Commission) to improve the quality of SOIs. DHBs have sought advice from their auditors and from this Office, too. However, in our view, the quality of SOIs is also affected by the complexity of the DHB accountability framework. DHBs are required to produce more accountability documents than other Crown entities – notably a district strategic plan (DSP),

1 AG-4 (Revised): *The Audit of Service Performance Reports*, 2009.

district annual plan (DAP), and an SOI. An intention of the Crown Entities Act 2004 was that Crown entities would produce good quality general purpose information for Parliament and the public. In our view, in their current form none of these DHB accountability documents (individually or collectively) fulfil this intention.

DHBs' planning and accountability framework

7.18 DHBs are required to prepare a larger number of planning and prospective performance reports, as part of their accountability framework, than do other Crown entities:

- Each DHB is responsible for identifying and providing for its district's health needs and is required to prepare district strategic and annual plans (signed off by the Minister and the Ministry of Health) that are consistent with New Zealand's health and disability strategies. Both documents are quite detailed.
- Each year, the DHB also publishes an SOI, a higher-level, less detailed statement about how the DHB intends to address the health needs of its district.
- Actual performance achieved against the performance measures and forecast targets in the SOI are reported in the annual report, which includes the SSP upon which the auditor must issue an audit opinion.

District Strategic Plan

7.19 The DSP is required by section 38 of the New Zealand Public Health and Disability Act 2000 (the Act) and must be made available to the public. It is a medium-term plan (covering five to ten years) that outlines how the DHB plans to fulfil its objectives and functions. It must be reviewed at least every three years.

7.20 As well as expressing the DHB's strategy for meeting the local health needs of its district, the DSP must also reflect the overall direction of health and disability strategies. Section 38(3)(a) of the Act requires that, in developing or amending the DSP, DHBs must:

- assess the health status of their respective populations;
- identify any factors that may adversely affect this status;
- assess the population's needs for health services; and
- determine the contributions those services are intended to make towards the health outcomes sought.

7.21 The approach required for preparing a DSP reflects the usual reporting framework in the public sector and is compatible with the performance reporting framework required by the Crown Entities Act 2004.

District Annual Plan

7.22 The district annual plan (DAP) is also a public accountability document. It must not be inconsistent with the DSP. It must include the intended outputs of the DHB for the forthcoming year (together with the amount of any capital expenditure required) and how they relate to the DSP, as required by section 39 of the Act. It is the basis for the DHB's funding agreement with the Crown. The DHB's SOI and Crown Funding Agreement for the year must be attached to the DAP. The DAP does not have to duplicate any output information that is in the SOI.[2]

Statement of Intent

7.23 Section 42 of the Act requires DHBs to prepare performance reports in accordance with Part 4 of the Crown Entities Act 2004. Sections 141 and 142 of the Crown Entities Act prescribe the content of the SOI, and Sections 151 and 153 prescribe the contents of the annual report, including the SSP.

7.24 Crown entities, including DHBs, are required to prepare an SOI to cover the medium term, namely the forthcoming financial year and at least the two following years. The SOI's purpose is to promote public accountability and, as such, it must include the following performance information:

- background information about the DHB, its operating environment, and the nature and scope of its functions and intended operations;
- the specific impacts, outcomes, or objectives that it seeks to achieve or contribute to, including how they might relate to government policy directions;
- how the DHB intends to perform its functions and conduct its operations;
- how the DHB proposes to manage its organisational health and capability; and
- the main financial and non-financial measures by which the future performance of the DHB may be judged.

7.25 Extra information required for the first financial year of the SOI includes a forecast SSP. The forecast SSP must:

- describe the classes of outputs the DHB proposes to supply;
- provide measures and forecast targets for output delivery;
- identify the expected revenue and expenses for each class of outputs; and
- comply with generally accepted accounting practice.

7.26 The measures and forecast targets provided in the forecast SSP are to be reported against in the end-of-year SSP, and audited.

2 Section 39(2)(b) of the Act exempts from inclusion in the DAP any output information (and proposed funding) included in the SOI for that year.

Annual report

7.27 The annual report must include an SSP. In essence, the SSP must:

- be prepared in accordance with generally accepted accounting practice;
- describe each class of outputs supplied during the year;
- include, for each class of outputs, the standard of service delivery achieved compared with the forecast targets set out in the forecast SSP; and
- include, for each class of outputs, the revenue earned and output expenses incurred compared with the forecast expected levels set out in the forecast SSP.

7.28 Section 156 of the Crown Entities Act 2004 requires the Auditor-General to audit the SSPs of Crown entities.

The Ministry of Health's review of accountability documents

7.29 The Ministry of Health reviewed DHB accountability arrangements in 2007. The review sought to reduce compliance activity and to sharpen focus on performance improvement. In addition, the review sought to:

- assign appropriate responsibility for planning and decision-making to a mature DHB sector by minimising prescriptive compliance requirements;
- simplify accountability processes and documents, clarifying the linkages between documents and ensuring that only meaningful and relevant information is collected; and
- sharpen the focus of the DHB accountability arrangements on improving performance and on the reporting of performance in a vital few areas.[3]

7.30 In October 2007, the Ministry produced its report, *Accountability: A better way of working together (Report of the DHB Accountability Arrangements Review)*. The report signals the need for change, observing that, "The DHB sector has now matured and it is time to shift the focus from capacity building to improving performance". It comments that the accountability arrangements need updating to reflect this shift and that the changes envisaged "aim to give stakeholders a clear picture of DHB and system performance overall".

7.31 In the report's summary of major changes, it lists several changes to annual accountability and planning arrangements. The changes focus on the DAP, not the SOI, although a subsidiary comment on the DAP mentions further consideration to be given to moving to a single, annual accountability document (instead of producing both a DAP and an SOI).

7.32 Although the report makes passing reference to the SOI, its focus is the DSP and the DAP. References to the SOI are to the high-level outcomes and objectives, with

3 Ministry of Health (December 2008), *2009/10 DAP Guidelines: Questions and answers*.

no reference to the output-oriented forecast SSP, which is a critical component of the SOI. Indeed, the report appears not to acknowledge the role of the SOI in output reporting, seeing this as the exclusive domain of the DAP.

7.33 Neither is reference made in the report to the role of the SSP within the annual report, which constitutes the independently verified, historical, and public account of a DHB's performance.

7.34 It appears to us that, at the time of writing the report, the Ministry of Health did not focus on the SOI or the annual report as primary accountability documents to Parliament. Its primary focus was the DAP. This is not surprising. The DAP is the funding and contractual management mechanism between the Ministry of Health and DHBs and, in the Ministry's view, DHB boards focus on the DAP as a key means for effective and efficient governance. The Ministry's 2007 report gives little consideration to the extent to which DHB accountability requirements are complementary and how they interact to minimise effort while providing an appropriate basis for funding, performance, and accountability needs.

7.35 Two years on, there have been several recent and major changes within the health sector. In response to the recommendations of the Ministerial Review Group at the end of July 2009, the Government has established the National Health Board within the Ministry (see Part 6, paragraphs 6.12-6.13). We have been told that, during the next 12 months, the National Health Board will review the DHB planning, reporting, and monitoring framework and activities.

7.36 The purpose of this review is to move towards a more integrated process that links planning, accountability, and performance management in the DHB sector. We have also been told that:

- changes have already been made, and the Ministry has signalled legislative changes to support effective performance accountability of DHBs within changing national, regional, and local responsibilities; and
- the Ministry acknowledges that the SOI and the DAP should be seen as complementary documents, both of which matter under the current accountability arrangements.

7.37 We outline below the issues that any such changes will, in our view, need to address.

Issues with the accountability framework for district health boards

7.38 We are concerned at indications that the poor quality of the external performance reports may reflect more serious, underlying problems with the health sector accountability framework and, possibly, the planning and management arrangements for DHBs' services.

7.39 In our view, there are two major factors in the poor quality of reporting in SOIs:

- the large number of accountability documents (which we have discussed in detail above); and
- the diminished status of the SOI in comparison with the DAP.

Primacy of the District Annual Plan for funding purposes

7.40 Several DHBs have described the SOI to us as an "add-on" to the suite of accountability documents, relegated in importance, and produced as a compliance exercise instead of as a document at the centre of the DHBs' strategic and operational performance management system. This appears to be reflected in the lack of emphasis given to the SOI (and in particular the lack of mention of the forecast SSP) in the Ministry of Health's *Accountability* report.

7.41 The Crown Funding Agreement is the funding mechanism for DHBs. It is based on the DAP and, to that extent, the DAP is of greater importance to DHBs than the SOI. Because it contains the information by which Crown funding is determined, it tends to be a fairly detailed document. The DAP generally contains a greater volume of information, more extensive level of detail, and greater use of technical terms and specifications than we would expect to see in an SOI. A DAP will typically contain volume and case-weight information for various clinical procedures as well as an extensive list of objectives relating to inputs, capability and relationship building, processes, reporting, and other administrative tasks. It also sets out output and outcome information. It is intended to be primarily an "internal" document, used as a management tool for DHBs and to provide accountability to the Minister.

7.42 By contrast, the SOI is an external general-purpose accountability report. In practice, it is prepared primarily for Parliament and usually derived from the DAP, with little acknowledgement that it is the primary prospective performance report for external users, including both Parliament and the public. While the sector appears to acknowledge its parliamentary audience, it is less obvious that SOIs also need to be prepared with the public in mind.

7.43 Consequently, there is little incentive to ensure that the SOI has the quantity and quality of performance information required to achieve its legislative purpose.

7.44 Yet the DAP is unable to fulfil the important accountability role intended for the SOI. There is no expectation that the DAP will be reported against – there is no statutory requirement to report historical (that is, actual) performance against the DAP. By contrast, the SOI contains the forecast SSP – the blueprint for the SSP, which is intended to be the historical and public account of a DHB's performance, verified by the audit opinion. For this reason, the SOI performs the primary function of laying out the performance expectations of DHBs, against which actual performance is formally reported and verified.

7.45 We consider that the information currently included by DHBs in the SOI (or the DAP), taken either individually or when read together, would fail to meet the requirements of the Crown Entities Act 2004 and generally accepted accounting practice to provide information necessary to assess the DHBs' service performance. This is because that information does not, generally speaking, cover all the services that the DHB is responsible for, and because the quality of reporting of outputs and associated performance measures is poor. Consequently, the SSP based on the SOI would also fail to meet the expected standard of reporting.

7.46 In our view, attention needs to be given to the health sector accountability framework as a whole, and in particular to:

- the integration of business planning, management, and reporting systems;
- meeting a variety of information needs in the most effective way; and
- accountability beyond the individual DHB, on a regional and national basis.

Accountability information as part of integrated management of health services

7.47 The lack of integration of the planning and accountability documents leads to further questions about the extent, or lack of, integration in the business planning process itself:

- How well are the planning and management arrangements integrated throughout each DHB?
- How well are the planning and accountability documents integrated with what is actually being planned and managed within DHBs? Do the documents reflect how DHBs manage their business?

7.48 To be effective, and to avoid compliance burden, service performance information needs to be systematically integrated with the DHB's business management processes.

7.49 It has been suggested to us from within the DHB sector that integrating service performance planning and management with financial planning is a challenge. This challenge, together with the vague, incomplete, and disjointed performance stories in the SOIs, suggests that planning and accountability documents may not be fully reflecting the breadth of service delivery or a sufficient range of the key performance indicators that are integral to successfully managing service delivery.

7.50 Misalignment and lack of integration of planning documents is likely to result in waste. If the systems for producing non-financial performance information are not integrated and streamlined, then there is likely to be unnecessary duplication of effort. In our view, consideration needs to be given to:

- reviewing the range of planning and accountability documents and, where necessary, to streamlining the reporting requirements; and
- integrating the systems that capture, collate, and report non-financial performance information.

7.51 Ideally, an integrated system would capture all of the financial and non-financial information necessary for management's day-to-day running of DHBs, and customised internal and external performance reports (including DAPs, SOIs, and annual reports) would be produced from that common system.

Responding to the need for a variety of accountability information

7.52 The recent publishing in daily newspapers of the performance of the 21 DHBs against the six national Health Targets, and of data on sentinel events, is evidence there is public interest in, and demand for, certain performance information, not necessarily in the form of annual reports.

7.53 DHBs use means other than the required accountability documents, including community newspapers and their websites, to tell their public of progress in certain health areas that are of particular public interest.

7.54 The Ministry of Health and DHBs need to identify the most effective and appropriate way to report to their various audiences, including and beyond the current public accountability documents, such as the SOI and annual report. Different reports will be needed for different purposes:

- special-purpose, internal reports for DHB management monitoring and decision making;
- general or special-purpose reports from DHBs to the Ministry;
- general-purpose, annual external accountability reports to Parliament and the public; and
- special-purpose reports to the public, when timely.

Accountability beyond the single DHB

7.55 Public sector accountability arrangements, to a large extent, assume individual entity accountability. This raises some issues in the health sector, where 21 DHBs have been set up to cover the whole country, with funding based on population numbers, but with some services provided across DHB boundaries, by region, and nationally. Variability in demand, and scarcity and uneven distribution of health personnel, add to the complexity of service delivery and increase cross-boundary accountabilities. Various funding and management mechanisms are applied to overcome service delivery issues. However, the accountability requirements continue to assume individual DHB responsibility.

7.56 Responses to the recent report of the Ministerial Review Group will put greater pressure on cross-boundary accountability issues, by requiring more regionalisation of (and in some cases, national) planning and service delivery. The Ministerial Review Group acknowledged that this would require changes to governance and support arrangements.[4] In our view, it also requires changes to accountability arrangements.

7.57 There is also scope for cross-DHB measures and standards to allow for a wider view to be taken, of the health system as a whole as well as DHB by DHB. The commonality of services among DHBs provides scope for significant common performance measures to be used, to enable such system-wide scrutiny. We are aware that the Ministry has done much work in this area. Agreement on commonality of measures is yet to be reached in many areas, something that should, in our view, be progressed as soon as reasonably possible.

Our recommendations

Recommendation 1

7.58 We recommend that the Ministry of Health review, in consultation with the district health boards, the range of planning and accountability documents in the health sector to:

- identify options for statutory reporting requirements that are more effective and efficient;
- incorporate within the accountability framework provision for:
  - better accountability for services that are planned and delivered across district health board boundaries; and
  - clarifying the target audience for various forms of reports and then more appropriately meeting the needs of the users of those reports.

4 *Meeting the Challenge: enhancing sustainability and the patient and consumer experience within the current legislative framework for health and disability services in New Zealand*, Report of the Ministerial Review Group, 31 July 2009 ("the Ministerial Review Group report"), page 5.

Recommendation 2

7.59 We recommend that district health boards, working with the Ministry of Health:

- investigate and assess the extent to which non-financial performance systems (for planning, managing, and reporting service performance and its impacts) are integrated, and the extent of duplication or other inefficient use of resources; and
- improve the effectiveness and efficiency of individual district health boards' performance planning, management, and reporting systems if these are not well-integrated or are inefficient, having regard to any requirements by the Ministry to streamline reporting requirements (as described in Recommendation 1).

Recommendation 3

7.60 We recommend that the district health board sector and the Ministry of Health continue their efforts to improve external performance reporting in the sector, including:

- adopting performance measures and standards throughout the sector that better enable an assessment of the performance of the health system; and
- better identifying, distinguishing, and linking the health services delivered (outputs) and the impact of those services on health status.

Section 4

Education sector and our audit work

Section 4 has four Parts that discuss the education sector and our 2008/09 audit results.

Part 8

In Part 8, we describe the tertiary education sector and the roles and responsibilities of the agencies in that sector. We explain how tertiary education institutions are funded, and discuss their financial performance for 2008/09. We then discuss the results of our 2008/09 audits of tertiary education institutions.

Part 9

In Part 9, we explain what integrated schools are and how they are funded. We then discuss some risks associated with their funding, and the actions the Ministry of Education is taking to address those risks.

Part 10

In Part 10, we explain our decision to postpone until 2011/12 a performance audit of monitoring by the Tertiary Education Commission of the tertiary education sector.

Part 11

In Part 11, we describe the settings in which Māori immersion schools operate. We then discuss some of the common issues that have arisen in recent years during our annual audits of these schools.

Part 8
Results of tertiary education institution audits for 2008

8.1 This Part provides some background information about tertiary education institutions (TEIs) and their operating environment. It sets out the results of our annual audits of TEIs for 2008, including a summary of our audit findings about the quality of TEIs' procurement policies and capital asset management.

8.2 Unlike most other public entities, the financial year for TEIs (and schools) ends on 31 December each year. This aligns with their academic teaching year.

What is the tertiary education institution sector?

8.3 The New Zealand tertiary education system includes all post-school education and training, from university research and diploma and degree study courses to industry training. In 2009/10, government expenditure on tertiary education will total about $2.9 billion (excluding GST).[1] The tertiary education sector includes both public TEIs and private sector providers.

8.4 There are 31 public TEIs providing training, education, and research services in New Zealand.[2] The TEI sector has three distinct sub-sectors – universities (of which there are eight), institutes of technology and polytechnics (20), and wānanga (three). Each TEI sub-sector tends to describe itself as distinct from the other two TEI sub-sectors. The TEI sub-sectors have established "umbrella" bodies to represent the interests of their member organisations, foster collaboration, and facilitate a point of contact with external stakeholders. TEIs also maintain relationships in their own right with stakeholders.

8.5 In addition, many TEIs have established subsidiary organisations to carry out activities consistent with the functions and duties of a TEI, having decided that these activities can be more sensibly managed in a separate legal structure. For example, a number of the TEIs have established research companies, scholarship trusts, childcare centres, and student hostel accommodation centres.

Governance and accountability arrangements

8.6 TEIs are Crown entities[3] independently governed by councils whose functions are set out in the Education Act 1989 (the Act). The precise constitution of each TEI council differs. For the 2008 financial year, each TEI council consisted of not fewer than 12 members nor more than 20 members. Most councillors are elected or appointed by stakeholder groups, although four are appointed by the Minister

1 We have excluded student support initiatives (for example, student allowance and student loan amounts), which are estimated at about $1.1 billion – see www.minedu.govt.nz/theMinistry/PolicyAndStrategy/TertiaryEducationStrategy/AppendixContextAndTrends.aspx, accessed on 11 January 2010.

2 The 31 TEIs are listed in Figure 31, where their 2008 financial performance is summarised.

3 To preserve the academic integrity of TEIs, only certain provisions of the Crown Entities Act 2004 apply to them. The applicable provisions are set out in Schedule 4 of that Act.

for Tertiary Education (the Minister). We note that the Education (Polytechnics) Amendment Act 2009 will change the constitution of councils for institutes of technology and polytechnics, with effect from 1 May 2010. The constitution of these Councils will reduce from 12-20 members to eight. Four members will be appointed by the Minister, and the other four members will be appointed by the institutes of technology and polytechnics, in keeping with their statutes.[4]

8.7 Unlike some other classes of Crown entities, TEIs are not directly accountable to a Minister of the Crown. However, the Crown monitors the performance and viability of the TEI sector through the activities of the Ministry of Education (the Ministry), the Tertiary Education Commission (the TEC), and the New Zealand Qualifications Authority (NZQA). We discuss the broad role of each of these agencies in paragraphs 8.11-8.16.

8.8 In certain circumstances, the Crown may actively support TEI councils to govern their institutions. Sections 195A to 195D and 222A to 222E of the Act set out a graduated set of formal intervention powers that allow for different levels of support, according to the TEIs' individual situations. The powers range from requiring a TEI to provide specified information about the operation, management, or financial position of the TEI at a given time, to dissolving the TEI council and appointing a Commissioner to govern the TEI.

Roles and responsibilities of tertiary education institutions

8.9 Section 159ABA of the Act sets out the planning, funding, and monitoring framework of the tertiary education sector. This framework requires TEIs to prepare plans (currently called Investment Plans) that set out TEIs' responses to the Government's tertiary education priorities and to stakeholder needs. The Investment Plans establish the levels of Crown funding for the TEIs. TEIs are also required to prepare an annual report that includes, among other information, a set of audited financial statements and statement of service performance.[5]

8.10 Sections 180 and 181 of the Act set out the functions and duties of each TEI council. These functions include appointing a Chief Executive, and ensuring that TEIs are managed in keeping with their Investment Plans. In discharging their functions, TEI councils must ensure that TEIs strive to attain the highest standards of excellence in education, training, and research, and operate in a financially responsible manner that ensures the efficient use of resources and the long-term viability of the TEI.

4 See section 222AA of the Education Act 1989.

5 Section 154 of the Crown Entities Act 2004, section 220 of the Education Act 1989.

Other agencies with a role in the tertiary education institution sector

8.11 Three central government education agencies have a significant influence on the operation of the TEI sector.

Ministry of Education

8.12 The Ministry prepares strategic policy for the tertiary education sector, carries out relevant research and analysis, and monitors the performance and capacity of the TEC and NZQA. The Ministry has few direct relationship with TEIs.

Tertiary Education Commission

8.13 The TEC interacts more directly with TEIs than the Ministry. The TEC is responsible for leading the Government's relationship with the tertiary education sector. The TEC implements the Government's Tertiary Education Strategy (the strategy – see paragraph 8.18). The TEC works with TEIs (and also the private providers of tertiary education) to agree Investment Plans that outline how they respond to the strategy.

8.14 The TEC's chief executive has statutory responsibilities for monitoring and assessing the operations and ongoing viability of TEIs. To do this, the TEC:

- monitors TEIs' finances, governance, and management;
- advises the Minister on appointments to TEI councils;
- supports the development of TEIs' governance and management capability; and
- provides statutory intervention advice to the Minister and implements any decisions made by the Minister.

8.15 The TEC meets regularly with TEIs to discuss their strategies, financial management issues, and risks.

New Zealand Qualifications Authority

8.16 NZQA's primary function is to co-ordinate the administration and quality assurance of national qualifications. NZQA has an overarching quality assurance role in tertiary education and is responsible for conducting quality assurance in all tertiary education organisations except universities.[6] The Government has recently revised its quality assurance arrangements for the tertiary education sector, which NZQA is now implementing.[7]

6 Quality assurance in the universities is carried out by the New Zealand Vice Chancellors' Committee under sections 241 and 260 of the Education Act 1989.

7 For more information on the quality assurance arrangements, see www.nzqa.govt.nz.

Recent changes to the operating environment

8.17 In recent years, significant policy changes have been implemented in the tertiary education sector and further work is under way to give effect to the policies of the current Government. Changes already made affect the role of TEIs, the ways TEIs are funded, and the way quality assurance is carried out. Further changes will be implemented in the next five years, with an immediate focus on the institutes of technology and polytechnics sub-sector in 2010. The focus of the ongoing reform process is to make tertiary education more relevant and more efficient, so that it meets the needs of students, the labour market, and the economy.[8]

8.18 In December 2009, the Government released its 2010–2015 Tertiary Education Strategy for the tertiary education system.[9] The strategy outlines the Government's priorities for the next five years and how it will achieve them. The Government expects the tertiary education system to:

- provide New Zealanders of all backgrounds with opportunities to gain world-class skills and knowledge;
- raise the skills and knowledge of the current and future workforce to meet labour market demands and social needs;
- produce high-quality research to build on New Zealand's knowledge base, respond to the needs of the economy, and address environmental and social challenges; and
- enable Māori to enjoy educational success as Māori.[10]

8.19 As a result of these reforms, TEIs are responsible for responding to government direction and to regional and national stakeholders, by preparing and agreeing an Investment Plan with the TEC. Investment Plans cover the provision of education, training, and research, and the development of new or enhanced capability by each TEI. Given the current economic conditions, the TEC is expecting that TEIs will make trade-offs within the total funding allocated to best meet the needs of students, business, iwi, and communities.

8.20 Government expenditure levels on tertiary education are based on a three-year funding path under the Investment Plan model. The funding path is based on a range of factors, including expected demographic changes, student demand, and competing priorities for funding within and outside the education sector. Funding supports what is agreed in Investment Plans, and future funding is influenced by how well TEIs perform against their Investment Plans.

8 See www.minedu.govt.nz/theMinistry/PolicyAndStrategy/TertiaryEducationStrategy/MinistersForeword.aspx, accessed on 11 January 2010.

9 See www.beehive.govt.nz/release/minister+releases+tertiary+education+strategy, accessed on 19 January 2010.

10 See www.minedu.govt.nz/theMinistry/PolicyAndStrategy/TertiaryEducationStrategy/PartOneStrategicDirection.aspx, accessed on 19 January 2010.

8.21 Investment Plans were in place for all TEIs in 2008.

How tertiary education institutions are funded

Tertiary education funding system

8.22 The Government determines both the total level of funding and the amount available for each tertiary education sub-sector. During 2008/09, the Government provided funding of about $2.3 billion to TEIs, most of which is administered by the TEC. This funding is distributed through a number of different funding mechanisms. Most funding is distributed through a bulk funding arrangement, involving a small number of separate but closely related funds discussed in Figure 29. These funds are all linked to Investment Plans and have a three-year baseline that is updated at each Budget.

Figure 29
Description of the broad funding system for the tertiary education sector

The Student Achievement Component ($1,604 million in 2009/10) is the most significant part of the tertiary funding system. It is the single largest source of revenue for universities, wānanga, and institutes of technology and polytechnics.* It provides subsidies for teaching and learning in mainstream tertiary qualifications (with most learners also paying tuition fees). Allocations are based on total student enrolments agreed in Investment Plans, and are calculated using a sophisticated formula with funding rates that vary significantly by the type of qualification and for each part of the sector.

The Tertiary Education Organisation Component ($662 million) provides funding (mainly for universities, wānanga, and institutes of technology and polytechnics) to support a range of core roles, capability needs, and innovation not directly related to student enrolments. There are six elements within this component, of which the largest two are:

- The Performance-Based Research Fund ($242 million), which is used to allocate the bulk of the Government's research funding to TEIs. This fund allocates funding based on assessments of research quality. It aims to raise the quality of research done in the sector and to help ensure that teaching at degree level and above is underpinned by research.
- The Capability Fund ($420 million), which is used to fund the cost of tertiary education organisations maintaining and enhancing their capability to deliver quality and relevance, and to develop their specific and distinctive roles in the network of tertiary education provision.

As well as the main bulk funding arrangements, the Government operates a number of other funds (some of which are allocated through Investment Plans).

*It is also allocated to many private training establishments and other tertiary education providers.

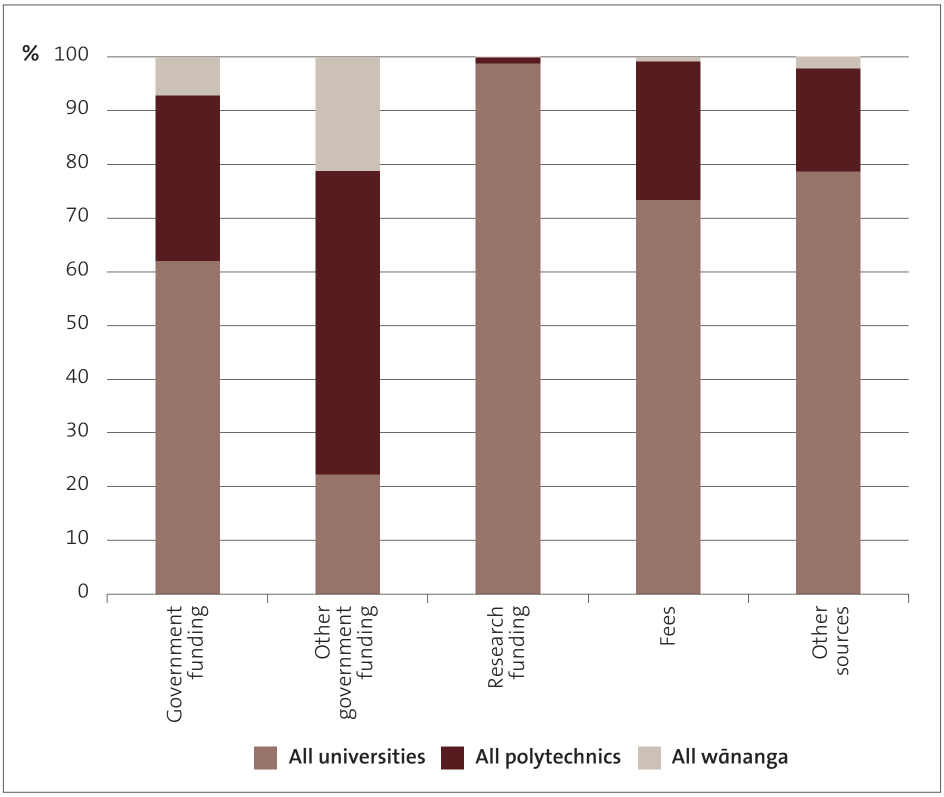
Source: Vote Education – see www.treasury.govt.nz/budget/2009/estimates/est09educ.pdf, pages 5-7.

TEI revenue sources

8.23 TEIs receive revenue from government funding, research funding, fees, and other sources. Figure 30 shows that universities consume a significant proportion of government grant and research funding. By comparison, institutes of technology and polytechnics consume the largest proportion of "Other Government Funding".[11] Student fees are also a considerable source of revenue for universities and polytechnics, but make up only a small proportion of revenue for wānanga.

Figure 30

Funding for tertiary education institutions by revenue source for 2008



11 This includes a range of funds, mostly administered by TEC, such as the Quality Reinvestment Programme Fund.

Summary of tertiary education institutions' 2008 financial performance

8.24 TEIs are required to keep proper accounting records and prepare annual financial statements. Figure 31 summarises the financial performance of the 31 TEIs for the year ended 31 December 2008.

Figure 31
Summary of tertiary education institutions' financial performance for 2008

Tertiary education institution	Revenue $000	Surplus/(Deficit) $000
University of Auckland	788,915	24,921
University of Otago	519,795	18,518
University of Canterbury	272,474	14,977
Victoria University of Wellington	300,993	9,900
Massey University	398,621	5,283
Auckland University of Technology	237,244	5,108
Lincoln University	88,753	(1,316)
University of Waikato	188,481	(1,671)
Christchurch Polytechnic Institute of Technology	82,486	7,926
Southern Institute of Technology	41,142	5,491
Manukau Institute of Technology	89,709	2,891
Aoraki Polytechnic	23,579	2,511
Telford Rural Polytechnic	12,542	2,044
Bay of Plenty Polytechnic	33,529	1,877
Nelson Marlborough Institute of Technology	49,329	1,553
Eastern Institute of Technology	36,015	1,289
Waiariki Institute of Technology	35,621	852
Wellington Institute of Technology	49,286	621
Waikato Institute of Technology	71,236	608
The Open Polytechnic of New Zealand	52,215	600
Unitec New Zealand	118,533	(82)
Otago Polytechnic	50,513	(337)
Whitireia Community Polytechnic	46,422	(498)
Universal College of Learning	51,897	(966)
Northland Polytechnic	33,800	(1,132)
Tai Poutini Polytechnic	24,374	(1,512)
Tairawhiti Polytechnic	16,270	(1,985)
Western Institute of Technology at Taranaki	23,663	(2,748)

Tertiary education institution	Revenue $000	Surplus/(Deficit) $000
Te Wānanga o Aotearoa	128,355	5,937
Te Wānanga o Raukawa	21,164	2,728
Te Wānanga o Awanuiārangi	22,940	2,078
Total	**3,909,896**	**105,466**

Source: Education Counts website – www.educationcounts.govt.nz/__data/assets/excel_doc/0011/16310/Financial-performance-of-public-providers-TEIs.xls#FNP.1!A1.
Note: The surplus/(deficit) figures also take account of abnormal items. Some totals may not add due to rounding.

Tertiary education institutions' audit results for 2008

8.25 The Auditor-General is the auditor of all TEIs and each of their public entity subsidiaries.[12] She carries out the annual audit of TEIs' financial statements and other information that each of the 31 TEIs and their subsidiaries are required to have audited. The Auditor-General's practice is to appoint auditors to conduct annual audits on her behalf.

8.26 In an annual audit, the auditor:

- examines an entity's financial statements, performance information, and other information that must be audited (statement of service performance);
- assesses the results of that examination against a recognised framework (usually generally accepted accounting practice); and
- forms and expresses an audit opinion.

8.27 The audit involves gathering all the information and explanations needed to obtain reasonable assurance that the financial statements and other information do not have material misstatements caused by fraud or error. The auditor also evaluates the overall adequacy of the presentation of information.

8.28 We issue audit opinions for each TEI (usually referred to as "the parent accounts"), for each TEI subsidiary that is also a public entity, and for the combined entities that represent the TEI group (usually referred to as "the group accounts").

Audit opinions for the year ended 31 December 2008

8.29 We issued unqualified audit opinions for 28 of the 31 TEI group accounts in 2008. This means that the financial statements that we audited complied with generally accepted accounting practice, and fairly reflected each TEI group's financial position and the results of its operations and cash flows for the year ended 31 December 2008. These audit opinions also mean that readers of the TEIs' accounts can be confident that the performance information reported by the

12 Schedule 1 of the Public Audit Act 2001.

TEIs fairly reflects their service performance achievements, as measured against the performance targets adopted for the year ended 31 December 2008.

8.30 We issued qualified audit opinions for three of the TEI group accounts in 2008. The qualifications were specific to the circumstances of each TEI.

8.31 Two TEIs' unqualified audit opinions contained explanatory paragraphs. We provide more detail about each of these "non-standard" audit opinions in Part 4 of this report.

8.32 We also issued a number of non-standard audit opinions in the broader TEI sector – on the financial statements of subsidiary public entities. Part 4 also discusses the detail of these opinions.

Areas of focus in the 2008 annual audit

8.33 Each year, we identify particular areas of focus for each annual audit. For the 2008 annual audit of TEIs, the particular areas of focus were procurement policies and capital asset management. This was the second year that we had asked our auditors to focus on these issues.

Procurement policies

8.34 Procurement covers all the business processes associated with purchasing, spanning the whole cycle from identifying needs through to the end of a service contract or the end of the useful life and subsequent disposal of an asset. We expect TEIs to follow good public sector practice when procuring goods or services.

8.35 The Government expects public entities to conduct their procurement having regard to:

- the policy principles set out in the Ministry of Economic Development's *Government Procurement in New Zealand, a Policy Guide for Purchasers*;
- the Auditor-General's June 2008 good practice guide, *Procurement guidance for public entities*;
- the Auditor-General's June 2008 good practice guide, *Public sector purchases, grants, and gifts: Managing funding arrangements with external parties*; and
- the Auditor-General's June 2006 good practice guide, *Principles to underpin management by public entities of funding to non-government organisations*.

8.36 We asked our auditors to check whether TEIs had addressed the findings and recommendations from our 2007 audit work on TEI procurement policies.

8.37 Overall, we were disappointed with the sector's progress in improving the quality of their procurement policies. A few TEIs still had no procurement policy. Some of our 2007 audit recommendations had been addressed, but a large number of TEIs needed to make further improvements to have their policies align with good public sector practice.

8.38 We were pleased to note that some TEIs had updated procurement policies in place that reflected our 2007 recommendations and were in line with good public sector practice. We reported the findings of this work to TEI councils in the management letters that accompanied our 2008 audit opinion.

8.39 As part of the 2009 audits, we have asked our auditors to ensure that TEIs have addressed the 2008 audit findings and recommendations about procurement, and to examine the extent to which those policies align with recent good practice documents about procurement. The results of this audit work will be reported to TEI councils, TEI management, and the Minister.

Capital asset management

8.40 Capital asset management is the process of achieving optimal whole-of-life effectiveness of assets at minimum cost. Where asset management is, or should be, a significant part of an entity's activities, the asset management process should be an important part of the entity's decision-making and management control environment. The asset information, including depreciation, reported in the financial statements should be aligned with the underlying information in the asset management plan.

8.41 Since 2006, the Treasury has been leading a work programme about capital asset management in the central government sector. The TEC is leading a set of initiatives in the TEI sector that is aligned to the Treasury's capital asset management work programme. These initiatives include the TEC working collaboratively with the TEI sector in 2009 to encourage stronger capital asset management planning practices, and to seek better information on the TEI capital asset management stock.

8.42 Given the value of the collective asset base of the TEI sector ($7.4 billion),[13] the Auditor-General expects TEIs to have comprehensive capital asset management plans in place. As part of the 2008 annual audit, we asked our auditors to determine the extent to which TEIs had an up-to-date capital asset management plan in place, and whether the information aligned with the asset information in the 2008 financial statements.

8.43 We are pleased to report that most TEIs have made some progress in improving the quality of their capital asset management planning since our 2007 audit. However, there is still much work to be done for the TEI sector's capital asset management practices to meet standards of good public sector practice. Therefore, as part of the 2009 audit, we have asked our auditors to follow

13 *Financial Statements of the Government of New Zealand for the Year Ended 30 June 2009*, page 89.

up on the extent to which TEIs have addressed our 2008 audit findings and recommendations about capital asset management.

Matters arising during the 2008 audits of tertiary education institutions

Funding sourced from capital appropriations

8.44 During the 2008 audit, we identified a financial reporting issue with some TEC funding disbursed to institutes of technology and polytechnics and wānanga, sourced from a capital appropriation. Crown funding provided under the authority of a capital appropriation is most often for capability building and is, therefore, an investment in the Crown's equity in the recipient entity. Some of the funding agreements between the TEC and some institutes of technology and polytechnics and wānanga were not as clear as they could have been about the purpose and intent of some capital funding.

8.45 Where funding has been provided under the authority of a capital appropriation, it will seldom be appropriate for the entity to account for that funding as revenue. Due to the lack of clarity in some of the funding agreements, some TEIs had accounted for this TEC funding, sourced from a capital appropriation, as revenue in their draft financial statements. After discussions with the TEIs concerned and the TEC, most of the matters were resolved before the audits were due to be completed in April 2009.

8.46 We are pleased that the TEC has taken a number of steps to ensure that its future funding agreements will be clearer about the intent and purpose of funding, particularly where funding is sourced from a capital appropriation.

Audit timeliness

8.47 An important aspect of the performance of public entities is the issuing of audited financial statements within statutory time frames. We want those interested in the accountability of public entities to receive our audit assurance as soon as possible after the end of the financial year.

8.48 For the 2008 TEI audits, the statutory deadline was 30 April 2009.[14] We have become more concerned about the audit timeliness of the TEI sector. Figure 32 shows an increase in audit arrears in the TEI sector in 2008/09 when compared with the two previous years.[15]

14 Section 220 of the Education Act 1989.

15 These audit arrears figures include TEI audits in arrears for 2008 and earlier years at 30 June 2009. The Auditor-General's financial period ends on 30 June each year.

Figure 32

Tertiary education institution sector – audits outstanding at 30 June 2009

Total audits due in 2008/09	Arrears at 30 June 2009	Arrears at 30 June 2008	Arrears at 30 June 2007
134	42 (31%)*	23 (19%)	33 (27%)

* Each arrears figure includes all outstanding audits, including any audits from prior years. The arrears percentages have been calculated using the total number of TEI audits due at 30 June for each year reported.

Source: Controller and Auditor-General, *Annual Report 2008/09*, page 30.

8.49 In the main, it is the timeliness of TEI subsidiary audits that affects the TEI sector's audit arrears figures. We have asked our Appointed Auditors to work closely with TEIs during the 2009 audits to bring any public entity subsidiary audit arrears up to date, and to ensure the timely completion of all TEI sector 2009 audits.

Part 9
Accountability for public funding of integrated schools

9.1 In our *Annual Plan 2008/09*, we signalled our intention to carry out a performance audit of how the Ministry of Education (the Ministry) manages the Crown's financial interest in integrated schools. In this Part, we discuss what the Ministry is doing to manage the risks associated with public funding of integrated schools and explain our decision to defer our audit.

9.2 We describe integrated schools, outline their funding sources, and discuss our concerns about how they account for their funding. We also comment on recent actions taken by the Ministry that prompted our decision to defer our performance audit.

Integrated schools and their funding

What are integrated schools?

9.3 Integrated schools are privately owned schools that are part of the state education system. They provide education within the framework of a particular or general religious or philosophical belief. The "special character" of an integrated school refers to its religious or philosophical character.

9.4 There are 327 integrated schools in New Zealand, comprising 13% of all state schools. They are governed by elected Boards of Trustees (Boards), which are Crown entities, in the same way that state schools are governed. However, integrated schools differ from other state schools because integrated schools have proprietors, which are private entities. The proprietors own, provide, and maintain the school buildings and land. They also have responsibility for maintaining the special character of their schools. The Boards are responsible for the teaching in, and operating of, their schools.

How are integrated schools funded?

9.5 Boards and proprietors both receive funding from the Government and both may also raise funding directly from private sources.[1] The Private Schools Conditional Integration Act 1975 (the Act) sets out which matters Boards and proprietors are each responsible for and gives proprietors some capacity to set compulsory charges for attendance at the school (known as "attendance dues"). There are also limits on what attendance dues can be used for. The Ministry is responsible for most of the public funding for integrated schools and administers the Act.

9.6 When a proprietor raises funds from parents or others, that is a transaction between two private sector parties even though the school office often provides administrative support. However, this fundraising has been the subject of

1 For example, proprietors may seek voluntary financial contributions (from parents/caregivers) and fundraise for general, unspecified purposes.

public interest in the last year, usually because of concerns about the size of the donations being sought, confusion about whether the contribution is voluntary or compulsory, or a lack of clarity about whether the donation is for the (public sector) Board or the (private sector) proprietor.

9.7 The Government funds Boards for the teaching and operating costs of integrated schools and for minor maintenance, in the same way that it funds all other state schools.

9.8 The Government also provides public funding directly to proprietors for two purposes:

- "Policy One" funding, which is calculated on a per-pupil basis, is used for major maintenance of school buildings to keep them at the same standard as state schools; and
- "Policy Two" funding, which is used to help integrated schools finance their expansion to meet school roll growth that would otherwise have to be met by expanding local state schools.

9.9 In 2008/09, the Government spent $72.6 million to help proprietors of integrated schools modernise their existing property and expand their schools. The Ministry's accountability documents show funding allocations for integrated schools grouped with those for state schools, so a breakdown of public funding to Boards of integrated schools is not readily available.

Risks associated with public funding of integrated schools

9.10 We reported to Parliament in 2005 and 2006 that the financial boundaries between Boards and proprietors had become blurred, with some instances of public funds intended for the Boards' general operating expenses being spent on other purposes and for the benefit of the proprietors. In particular, some Boards had used their general public funding for capital expenditure, which is the responsibility of the proprietors.

9.11 In 2008, our concerns about how some integrated schools were using public funding led us to propose a performance audit of the Ministry's management of the Crown's financial interest in integrated schools. Our proposal was signalled in our *Annual Plan 2008/09*, which was published in May 2008.

9.12 We also note that, in April 2009, the Treasury raised concerns about the accountability of proprietors.

Actions taken by the Ministry to address funding issues

9.13 We carried out scoping work in 2009/10 for our performance audit. This scoping work included meeting with Ministry officials, and reviewing the Ministry's work since 2007 on managing the funding of integrated schools.

9.14 In our view, recent Ministry work has reduced the possibility that the Boards and proprietors of integrated schools can misspend public funds (intended for the Board's general operating expenses) on costs associated with land or buildings owned by proprietors. However, we consider that there still remains the possibility of inappropriate use of public funds by integrated schools. We discuss the Ministry's actions in the following paragraphs.

Improved guidance and fixing of past problems

9.15 The Ministry has improved its guidance to integrated schools to help prevent inappropriate spending of public funds on land or buildings owned by proprietors. An agreement was also signed between the Ministry and the Association of Proprietors of Integrated Schools (which represents proprietors) in December 2007 to "regularise" historic property expenditure issues. These issues related to Boards inappropriately using public funds for capital expenditure, which was the responsibility of school proprietors.

Probity audit into allocation of public funds in integrated schools

9.16 In late 2007, the Ministry released the findings of a probity audit it had commissioned that investigated how proprietors used Policy One and Policy Two funding. The audit found that most proprietors did not account separately for spending of Policy One funding, Policy Two funding, and their private funding. As a result, a view could not be formed about whether the Policy One and Policy Two funding was being spent only as intended, or whether there had been any under-spending or over-spending of these public funding allocations. The audit recommended that the Ministry require proprietors to maintain separate bank accounts and separate ledger balances for their different funding streams.

Moves towards strengthened financial reporting requirements for integrated schools

9.17 In 2008, the Ministry carried out a detailed review of integrated schools. It concluded that existing accounting arrangements for property costs at integrated schools were inadequate to provide the Crown with confidence that public funds were properly spent. The Ministry also noted that there was little incentive for proprietors to comply with Crown requirements.

9.18 The review recommended imposing specific accounting and planning requirements on proprietors. These included separating money received and spent, and establishing independent audits to ensure compliance with Crown requirements.

9.19 Ministry briefings in 2009 proposed strengthening the accountability requirements for integrated schools. The proposed changes aim to ensure that the accounts demonstrate that:

- proprietors have spent Policy One funding correctly;
- attendance dues have been set at levels justified by proprietors' property-related costs; and
- proprietors have spent public funding in a timely fashion.

9.20 In our view, these proposed changes demonstrate that the Ministry is aware of, and is attempting to address, the ongoing risks associated with the existing public funding arrangements for proprietors of integrated schools.

Changes to financial statements agreed to by the Ministry

9.21 In June 2009, the Ministry agreed that all integrated schools should disclose their proprietors as related parties and disclose all transactions between Boards and proprietors in the Boards' 2009 financial statements. In our view, these changes should improve the transparency of financial transactions between Boards and proprietors and how public funding is spent in integrated schools.

Concluding comments

9.22 The Ministry's actions and proposed changes should reduce risk and address the issues that prompted our consideration of a performance audit in May 2008. We intend to closely monitor the Ministry's progress on managing the risks and issues through our annual audits and ongoing relationship with the Ministry.

9.23 If we find that the risks associated with public funding of integrated schools are not being adequately and promptly addressed, we might decide to carry out a performance audit of the Ministry, as originally indicated. Alternatively, we might decide to carry out a performance audit of the financial relationship between Boards and proprietors, with a focus on aspects that our annual audits of integrated schools do not cover in detail.

Part 10
Tertiary Education Commission's monitoring of the tertiary education institution sector

10.1 In this Part, we explain our decision to postpone until 2011/12 a performance audit of monitoring by the Tertiary Education Commission (the TEC) of the tertiary education institution (TEI) sector.

10.2 The tertiary education system is a significant national asset and is very important to New Zealand's economy and society. Given the importance of tertiary education and the significant sums of money involved, we planned to carry out a performance audit of the TEC's monitoring of TEIs.[1] Our intention was to provide assurance to Parliament that the TEC's monitoring function was being effectively carried out. We planned to carry out this work in 2009.

10.3 In early 2009, the TEC underwent significant restructuring. The restructuring included a new approach to how the TEC monitors the operation and long-term viability of TEIs. Given these significant changes, we decided to defer until 2011/12 our audit of the TEC's monitoring of TEIs.

Tertiary Education Commission

10.4 The TEC is a Crown entity responsible for a range of functions, including monitoring the financial and operational viability of TEIs and overseeing the Crown's financial interests in the TEI sector. It has a staff of 240[2] and manages the $2.9 billion[3] allocated each year to the TEI sector. Expenditure in the sector is guided by the Tertiary Education Strategy 2010-2015.

Funding changes in the tertiary education institution sector

10.5 Funding arrangements in the TEI sector have changed significantly in the last five years. Historically, TEIs were almost solely funded based on student numbers. However, funding TEIs based on student numbers represented a high level of risk for TEIs because they were vulnerable to changing numbers of annual enrolments.

10.6 Investment Plans have replaced this previous funding system. The change to Investment Plans has required the TEC to work with each TEI to prepare a flexible plan that takes into account the TEI's current capability, asset base, and financial situation, and its place within the overall network for the provision of tertiary education, as well as student numbers.

1 See Part 8 for background information on the TEI sector and the results of the 2008 audits.

2 Full-time equivalent staff as at 30 June 2009.

3 We have excluded student support initiatives (for example, student allowance and student loan amounts), which are estimated at about $1.1 billion – see www.minedu.govt.nz/theMinistry/PolicyAndStrategy/TertiaryEducationStrategy/AppendixContextAndTrends.aspx.

Monitoring financial and operational viability

10.7 Until early 2009, the TEC's role of monitoring TEIs was carried out by a unit called the Tertiary Advisory Monitoring Unit (TAMU). TAMU had a staff of 16 and its functions included:

- monitoring TEIs' finances, governance, and management;
- providing advice on Ministerial appointments to TEIs' councils;
- governance and management capability building, which involved meeting regularly with TEIs to discuss their strategies and financial management issues;
- lead responsibility for risk assessment and advice on statutory interventions in TEIs, which involved identifying risks to the financial and operational viability of a TEI, supporting TEIs when risks arose, and advising the Crown if further action was required (for example, installing a Crown Observer); and
- implementing the Minister for Tertiary Education's decisions on interventions.

10.8 In early 2009, the TEC restructured and disestablished TAMU. The restructuring reflected the Government's objective to simplify the tertiary education funding system, reduce central bureaucracy, strengthen quality, and ensure greater accountability.

10.9 A new unit, TEI Financial Monitoring (TEIFM) was established. TEIFM will concentrate on one of the core functions of TAMU[4] – monitoring and assessing TEIs' financial affairs against budgets and financial guidelines and reporting on risks to the viability of TEIs.

10.10 Functions that require direct engagement with TEIs are carried out by Investment Managers who have regular discussions with TEIs and monitor reports to the TEC on financial and non-financial performance.

TEC's monitoring and reporting processes for TEIs

10.11 In line with the Government's wish to strengthen quality and ensure greater accountability in the TEI sector, the TEC is implementing new monitoring and reporting processes for TEIs.

10.12 The TEC has five new processes:

- *Financial monitoring framework*: Separate from the TEI's statutory intervention role, this process will allow TEIs to be rated as of low, moderate, or high financial risk. TEC will then monitor the TEIs, according to the level of financial risk. The first set of assessments using this new monitoring regime will be completed by September 2010.

4 The remaining functions that were carried out by TAMU are now carried out by other TEC units, not TEIFM.

- *Reporting to Government*: TEC now plans to report to the Government in April and October each year on the performance of TEIs. The first such report has been submitted. The report comments on the financial and educational performance of TEIs and includes the TEC judgements on the actions taken by TEIs to address the financial and educational challenges they face. The TEC expects the depth of information reported to increase over time.
- *Capital asset management reporting*: The TEC is requesting information on TEIs' capital asset values and the condition and suitability of TEI assets. The TEC will use this information to provide annual reports to the Treasury on TEIs' capital asset management. The depth of information sought through this reporting process will increase over time[5] and as capital asset management capability in the TEI sector matures. This new monitoring process is currently being implemented.
- *Statutory interventions*: The Education Act 1989 enables the Government to intervene in the operation of a TEI if its long-term viability is considered to be at risk. These intervention powers, and the criteria used to trigger an intervention, are being reviewed. New educational performance criteria will be included in the gazetted criteria for interventions in TEIs. The range of interventions available to the Crown has also been extended.[6]
- *TEI governance*: Legislative changes to the structure and composition of some TEI councils have been passed and will be in effect by 1 May 2010. The TEC is preparing an assessment tool that will enable it to form evidence-based judgements about TEI governance capability.

Tools TEC can use to address under-performance

10.13 If a TEI is not delivering agreed outputs, the TEC can:

- require the TEI to "make up" under-delivery or over-delivery in the following year;
- reduce funding in future years, or not provide any increase for growth;
- recover funding where the expected delivery has not occurred;
- suspend funding; or
- revoke the Investment Plan.

5 The TEC requires this capital asset management reporting from all TEIs that are granted any special right – such as the Secretary for Education's consent to borrow or to dispose of assets (under section 192 of the Education Act).

6 These changes are introduced through the Education (Polytechnics) Amendment Act 2009 and relate to an enhanced range of Crown interventions available only for polytechnics. The Ministry of Education and the TEC have been consulting on the use of statutory interventions for universities and wānanga.

Reasons for postponing our performance audit

10.14 The changes outlined above are being implemented now. By 2011/12, they will have been in place long enough for us to assess the TEC's implementation of its new approach. At present, we would be able only to describe the new system and identify any gaps, although our analysis so far indicates that the system is sound.

10.15 We have, therefore, decided to postpone our performance audit until we can reasonably assess the TEC's implementation of the new system. This will result in more useful assurance about whether the TEC's system for monitoring the TEI sector is working effectively and enable us to identify improvements at an early stage (if they are required).

Part 11
Our audit role in Māori immersion schools

11.1 In this Part, we describe the settings in which Māori immersion schools operate in the New Zealand school sector. We discuss some of the common issues that have arisen in recent years during our annual audits of these schools.

What are Māori immersion schools?

11.2 Māori education programmes involve students being taught either all or some curriculum subjects in the Māori language, either in immersion (Māori language only) or bilingual (Māori and English) programmes. The current policy framework sets out four levels of immersion, which are used for planning, resourcing, and monitoring purposes.

11.3 The focus of this Part is on Māori immersion schools, in which the principal language of instruction is te reo Māori (the Māori language). These schools operate at level 1 of the immersion framework described above – 81-100% of class time is in Māori. Māori immersion schools fall into two broad categories: kura kaupapa Māori and kura-ā-iwi.[1]

11.4 Kura kaupapa Māori are state schools established under section 155 of the Education Act 1989. Schools designated as kura kaupapa Māori adhere to a particular philosophy known as Te Aho Matua, which sets out an approach to teaching and learning. The philosophy of Te Aho Matua is underpinned by Māori values, beliefs, and customs.[2] Within the kura kaupapa Māori group of schools, there is often a distinction applied – the term kura refers to primary schools teaching students in years 1 to 8, and wharekura are schools that teach students in years above year 8.[3]

11.5 Māori immersion schools can also be established under section 156 of the Education Act 1989, which allows for the establishment of a school with a special designated character.[4]

11.6 The first Māori immersion school opened in 1985. It operated as a private school until 1989, when the Education Act was amended to permit the establishment of kura kaupapa Māori state schools. As at 1 July 2009, there were 84 Māori immersion schools.[5]

1 Iwi and hapū have established kura-ā-iwi, which cater to local iwi and hapū education needs and usually teach the local Māori dialect and tikanga.

2 Section 155, Education Act 1989.

3 Wharekura can apply to schools teaching years 1-10, years 1-13, years 7-13, and years 9-13.

4 See www.educationcounts.govt.nz/publications/series/5851/35307/5, accessed on 10 February 2010.

5 See www.educationcounts.govt.nz/__data/assets/file/0009/57546/Mori-Medium-Education-2009.xls. This figure includes kura teina. Kura teina are fledgling schools not yet fully established and recognised as kura kaupapa Māori schools under the Education Act 1989. The establishment process for kura kaupapa Māori was revised in 2009. More detail can be found at www.minedu.govt.nz.

11.7 Māori immersion schools tend to be small, with an average roll of 75 students. Some Māori immersion schools have smaller rolls, sometimes because of their geographic isolation.

11.8 In 2007, 164,020 domestic school learners were recorded as of Māori ethnicity – almost 22% of the total New Zealand school population.[6] A relatively small proportion of Māori school students receive their education through Māori immersion schools. As at 1 July 2009, 6,195 students received their education through Māori immersion schools.[7]

11.9 The 2007/08 report on Māori education by the Ministry of Education (the Ministry) states that the Māori education sector has made a major contribution to the education system as a whole by giving learners a new means through which to achieve education success, and has enhanced the ability of the system to deliver for and with Māori.[8]

11.10 The latest achievement results for students learning in Māori immersion schools are favourable. For example, the 2007/08 report notes that year 11 candidates at schools teaching in Māori were more likely to meet both the NCEA literacy and numeracy requirements than other Māori candidates.[9]

11.11 *Te Marautanga*, released in 2008, is the Government's curriculum for Māori immersion schools.[10] The curriculum is based on Māori values, philosophies, principles, and practices. The Ministry reports that it is intended that kura kaupapa Māori use *Te Marautanga* to develop their learning programmes, in partnership with boards, teachers, whānau, and local communities.[11]

Accountability and funding arrangements

11.12 The Education Act 1989 prescribes the process for establishing Māori immersion schools.[12] Māori immersion schools are governed by Boards of Trustees (Boards) and managed by principals, in the same way as other state schools. In addition, each Māori immersion school has its own governance mechanisms and board constitutions that are intended to ensure that the community is fully involved in the governance and operation of the kura kaupapa Māori. This inclusive approach

6 See www.educationcounts.govt.nz/publications/series/5851/35307/4#graph4, accessed on 10 February 2010.

7 Defined as being all students involved in Level 1 Māori medium education for 20 1/4 to 25 hours per week. See www.educationcounts.govt.nz/__data/assets/file/0009/57546/Mori-Medium-Education-2009.xls, accessed on 18 January 2010.

8 See www.educationcounts.govt.nz/publications/series/5851/35307/5, accessed on 10 February 2010.

9 See www.educationcounts.govt.nz/publications/series/5851/35307/5, accessed on 10 February 2010.

10 For more detail on the curriculum, see http://www.tki.org.nz/r/marautanga/pdfs/te-marautanga-o-aotearoa.pdf, accessed on 15 January 2010.

11 See www.educationcounts.govt.nz/publications/series/5851/35307/5, accessed on 10 February 2010.

12 For more background, refer to sections 155 and 156 of the Education Act.

to governance has led to some of the common audit issues we list in paragraph 11.25.

11.13 Māori immersion schools are subject to the same accountability requirements that govern all other state schools. For example, they are required to prepare a school charter and also to prepare and have audited a set of annual financial statements. The Auditor-General is the auditor of all Māori immersion schools.

11.14 Māori immersion schools are funded in the same way as all other state schools, according to a range of Government policies, such as roll numbers and the school's decile rating. Māori immersion schools also receive additional funding to take account of the higher costs for teaching in Māori caused by a general lack of expertise in te reo Māori to provide what are considered to be the necessary capabilities and capacity to run an effective system of schools (for example, professional development, teaching resources, and teacher relief) and to develop and maintain their te reo Māori immersion environment.

Other entities with an interest in Māori immersion schools

Ministry of Education

11.15 As the Government's lead education policy advisor, the Ministry provides advice to the Government on the Māori education sector and other education policy issues that affect Māori immersion schools.

11.16 The Ministry is also responsible for monitoring and supporting all state school boards in their governance role. We have previously reported on the Ministry's performance in monitoring and supporting all school boards of trustees, including Māori immersion schools.[13] This role covers general training and support for school boards, as well as support for school boards at risk of poor performance (including statutory intervention[14] under the Education Act 1989).

Education Review Office

11.17 The Education Review Office (ERO) reviews and reports on the performance of all schools, including Māori immersion schools. ERO has a dedicated group of staff who evaluate the quality of Māori immersion school services.[15]

13 *Ministry of Education: Monitoring and supporting school boards of trustees* (June 2008), available on our website (www.oag.govt.nz).

14 The six types of statutory intervention in schools are specified in Part 7A of the Education Act 1989. They can range from requiring a school board to provide specified information to the Secretary for Education to dissolution of the school board and appointment of a commissioner to govern the school.

15 For more information on ERO's role, see www.ero.govt.nz.

Te Rūnanga-nui o Ngā Kura Kaupapa Māori o Aotearoa

11.18 Te Rūnanga-nui o Ngā Kura Kaupapa Māori o Aotearoa was established in 1993. Although not a public entity, it is the national collective body of all kura kaupapa Māori operating under the Te Aho Matua philosophy. Te Rūnanga-nui o Ngā Kura Kaupapa Māori o Aotearoa is designated in the Education Act 1989 as the kaitiaki (guardian) of the Te Aho Matua approach to teaching and learning.

11.19 Te Rūnanga-nui o Ngā Kura Kaupapa Māori o Aotearoa works with the Ministry to discharge its responsibilities in the Māori immersion school sector.

Common challenges for Māori immersion schools

11.20 Some of the challenges that affect the operation and performance of Māori immersion schools are the same challenges that affect other schools that share some similar characteristics, such as small rolls, geographic isolation, and low decile status. Māori immersion schools also face some challenges unique to them because te reo Māori is the principal language of instruction.[16]

11.21 For example, while the pool of resources available to support the implementation of the curriculum in te reo Māori is growing, it is sparse by comparison with the number of resources available to support the implementation of the curriculum in schools that teach in English. Māori immersion schools also have a much smaller skilled workforce to draw their teaching staff from than other schools. Many of these issues have been previously considered and reported on by both the Ministry and ERO.

11.22 In June 2002, ERO reported on the performance of kura kaupapa Māori and concluded that many kura kaupapa Māori need support to improve their practice in several areas, including their teaching practices.[17] Similarly, the Ministry reported to the Māori Affairs Committee in March 2008 on some of the governance issues in kura kaupapa Māori that were causing the unusually high number of statutory interventions in kura kaupapa Māori. There are currently statutory interventions in 15 Māori immersion schools.[18]

11.23 Although the range of reasons for these statutory interventions varies, as they do for other state schools subject to statutory intervention, the main issues leading to these statutory interventions are Board organisation and management and Board systems and processes.

16 English instruction can be provided as well.

17 See www.ero.govt.nz/ero/publishing.nsf/Content/The%20Performance%20of%C2%A0Kura%20Kaupapa%20Maori, accessed on 10 February 2010.

18 Data provided by the Ministry of Education in February 2010.

Common issues identified in our audits of Māori immersion schools

11.24 As for all state schools, we audit the annual financial statements of every Māori immersion school. In recent years, we have identified some common issues in our audits of this group of schools. If these issues were addressed, we consider that this would enhance the accountability for the use of public funds by Māori immersion schools.

11.25 The common issues we have identified include the need for:

- development of greater financial management expertise at both governance and management levels;
- timely preparation of annual financial statements for audit;
- maintenance of adequate accounting records;
- adequate disclosure of related party transactions in financial statements;
- effective identification and management of conflicts of interest;
- development and implementation of sound governance and operating policies that ensure the probity of decision-making and public expenditure; and
- approval of any additional remuneration for principals and teaching staff.

Improving the accountability of Māori immersion schools

11.26 We have met with Ministry officials during 2008/09 to discuss some of the themes that have emerged in our audit work in Māori immersion schools. The Ministry acknowledges that some of the audit issues we have identified diminish the level and timeliness of these schools' accountability for their use of public funds.

11.27 The Ministry has various streams of work in place to address many of the issues that have previously been reported about the performance and accountability of Māori immersion schools. For example, the Ministry is now delivering tailored training and support to Boards of Māori immersion schools. It is also establishing a pool of appropriately skilled people to perform the statutory intervention roles in Māori immersion schools. The Ministry told us that it is developing options for a more flexible resourcing model for Māori immersion schools that reflects their unique circumstances.

11.28 In our discussions, we have encouraged the Ministry to ensure that its work programme is well co-ordinated and helps to address the common audit issues in Māori immersion schools.

11.29 We are currently completing our 2009 annual audits of all schools, including Māori immersion schools. As this audit work draws to a close, we will be considering what further work we might carry out to address the common themes discussed in this Part.

Appendix
Details of the non-standard audit reports issued in 2009

Adverse opinions

Royal New Zealand Navy Museum Trust Incorporated

Financial statements year ended: 30 June 2008

We disagreed with the Board not recognising the museum collection assets of the Trust, nor the associated depreciation expense, in the Trust's financial statements. These are departures from Financial Reporting Standard No. 3: *Accounting for Property, Plant and Equipment*, which requires museum collection assets not previously recognised to be recognised at fair value and depreciated where appropriate. In addition, we were unable to verify some material revenues because of limited controls over those revenues.

RNZAF Museum Trust Board

Financial statements year ended: 30 June 2009

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

Disclaimers of opinion

Te Kura Kaupapa Māori o Ruamata

Financial statements year ended: 31 December 2005

We were unable to form an opinion on the financial statements because of the following limitations in scope:

- we were unable to obtain appropriate and sufficient audit evidence to support expenditure of $394,210 and fixed asset additions of $40,331;
- we were unable to confirm that all related party transactions have been properly recorded and disclosed in the financial statements;
- we were unable to confirm fundraising and other activities revenue had been properly recorded; and
- the Board of Trustees did not provide budgeted figures for the financial year in the financial performance and position statements.

Except-for opinions for public entities other than schools

Christchurch Polytechnic Institute of Technology and Group

Financial statements year ended: 31 December 2008

We disagreed with the Council not preparing consolidated financial statements for the Group for the year ended 31 December 2008 in accordance with New Zealand Equivalent to International Accounting Standard No. 27 (NZ IAS 27): *Consolidated and Separate Financial Statements*. Because the Council did not prepare group financial statements in accordance with NZ IAS 27 for the year ended 31 December 2007, there is no comparative information for the Group in the 2008 financial statements. We also reported that, if it were not for the departure from NZ IAS 27, the financial statements would have fairly reflected the Institute and Group's financial position, results of operations, cash flows, and achievements measured against performance targets for the year.

Massey University and Group

Financial statements year ended: 31 December 2008

Our audit was limited because the University did not carry out a revaluation of land and buildings in its 31 December 2007 financial statements – so we were unable to determine whether the carrying value of land and buildings was materially misstated. This was a departure from New Zealand Equivalent to International Accounting Standard No. 16: *Property, Plant and Equipment*, which requires that entities recognise land and buildings at fair value and carry out revaluations regularly enough to ensure that the revalued land and buildings are not included at a value that is materially different to fair value.

Wellington Institute of Technology

Financial statements year ended: 31 December 2008

We disagreed with the accounting treatment to account for quality reinvestment programme funding as revenue and as a net receivable in the financial statements. In our opinion, the quality reinvestment programme funding should have been treated as a contribution from the Crown in the 2008 financial statements.

UCOL International Limited (Universal College of Learning)

Financial statements year ended: 31 December 2008

Our audit was limited because the Company was unable to establish the amount of tax-related liabilities to be recognised in its financial statements, as required by New Zealand Equivalent to International Accounting Standard No. 12: *Income Taxes*. The Company was also unable to file returns to the Income Tax Department of India for activities carried out in India from 2004 to 2008.

Counties Manukau District Health Board and Group

Financial statements year ended: 30 June 2009

We disagreed with the District Health Board recognising some funding from the Ministry of Health as income in advance and not revenue in the year ended 30 June 2009. This amount did not meet the requirements under the New Zealand *Framework for the Preparation and Presentation of Financial Statements* for recognition as a liability.

New Zealand Historic Places Trust

Financial statements year ended: 30 June 2009

Our audit was limited because the Trust did not adjust the value of its land and buildings even though the Trust undertook a revaluation of its land and buildings as at 30 June 2009. The Trust decided that the revalued amounts did not reflect fair value, given the specialist nature of the historic assets involved. This was a departure from the New Zealand Equivalent to International Accounting Standard No.16 *Property, Plant and Equipment*, which requires entities to recognise land and buildings at fair value and to carry out revaluations regularly enough to ensure that revalued land and buildings are not included at a value that is materiality different to fair value. We noted that the audit report was not issued within the time frame set out in section 156(2) of the Crown Entities Act 2004 because of the complexity of some of the issues with the valuation of land and buildings.

Ngati Whakaue Educational Endowment Trust Board

Financial statements year ended: 31 December 2008

Our audit was limited because we were unable to confirm the value of the Trust Board's land that was classified as investment property. The land had not been revalued but instead was recognised at its rating value. This is a departure from Statement of Standard Accounting Practice No. 17: *Accounting for Investment Properties and Properties Intended for Sale*, which requires the investment property to be revalued annually to net current value.

Orcon Internet Limited (Kordia Limited)

Financial statements year ended: 30 June 2008

Our audit was limited because the financial statements of the Company had not previously been audited. Therefore, we could not form an opinion about the comparative information. The lack of assurance about the comparative information meant that adjustments may have been necessary for the Statement of Financial Performance to be fairly stated.

Tūwharetoa Māori Trust Board

Financial statements years ended: 30 June 2003 and 30 June 2004

Our audit was limited because the comparative information was limited – the Trust Board's subsidiary's employee entitlements payroll records were not available to audit.

Massey Ventures Limited and Group (Massey University)

Financial statements year ended: 30 June 2008

Our audit was limited because we were unable to verify that the unaudited financial information of the Company's associate was properly recorded and disclosed in the financial statements. The associate, which was not a public entity, was not within the Auditor-General's mandate and its shareholders elected not to have an audit carried out.

Tauranga Moana Māori Trust Board

Financial statements years ended: 30 June 2007 and 30 June 2008

Our audit was limited because the financial statements of the Trust Board for the year ended 30 June 2007 and 30 June 2008 included unaudited figures relating to its interest in a joint venture. There were no satisfactory audit procedures to confirm those figures because the joint venture is not a public entity and as such, the Auditor-General is not its auditor.

Ivey Hall and Memorial Hall 125th Anniversary Appeal Gifting Trust (Lincoln University)

Financial statements year ended: 31 December 2008

Our audit was limited because we were unable to verify certain revenue due to limited controls over that revenue.

Ivey Hall and Memorial Hall 125th Anniversary Appeal Taxable Activity Trust (Lincoln University)

Financial statements year ended: 31 December 2008

Our audit was limited because we were unable to verify certain revenue due to limited controls over that revenue.

Auckland DHB Charitable Trust (Auckland District Health Board)

Financial statements year ended: 30 June 2008

Our audit was limited because we were unable to verify certain revenue due to limited controls over that revenue.

Except-for opinions for schools

Wellington Girls' College

Financial statements year ended: 31 December 2008

We disagreed with the Board of Trustees not preparing group financial statements to consolidate the financial statements of its controlled entity, the Wellington Girls' College Charitable Foundation. This is a departure from New Zealand Equivalent to International Accounting Standard No. 27: *Consolidated and Separate Financial Statements*, which requires the Board of Trustees to present consolidated financial statements.

New Plymouth Girls' High School

Financial statements year ended: 31 December 2008

We disagreed with the Board of Trustees not preparing group financial statements to consolidate the financial statements of its controlled entity, the New Plymouth Girls' High School Centenary Trust Board. This is a departure from New Zealand Equivalent to International Accounting Standard No. 27: *Consolidated and Separate Financial Statements*, which requires the Board of Trustees to present consolidated financial statements.

Te Wharekura o Rakaumangamanga

Financial statements year ended: 31 December 2008

We disagreed with the Board of Trustees not preparing group financial statements to consolidate the financial statements of its controlled entity, Te Wharekura o Rakaumangamanga Foundation Charitable Trust. This is a departure from New Zealand Equivalent to International Accounting Standard No. 27: *Consolidated and Separate Financial Statements*, which requires the Board of Trustees to present consolidated financial statements.

Wanganui City College

Financial statements year ended: 31 December 2008

We disagreed with the Board of Trustees not preparing group financial statements to consolidate the financial statements of its controlled entity, the College House Hostel Trust. This is a departure from New Zealand Equivalent to International Accounting Standard 27: *Consolidated and Separate Financial Statements*, which requires the Board of Trustees to present consolidated financial statements.

Wellington East Girls' College

Financial statements year ended: 31 December 2008

We disagreed with the Board of Trustees' decision to increase the amount owing to trusts for bequests received to help restore the capital value of the bequests. This is a departure from New Zealand Equivalent to International Accounting Standard 37: *Provisions, Contingent Liabilities and Contingent Assets*, which requires provisions to be valued at their present obligation.

Allenvale Special School & Res. Centre

Financial statements years ended: 31 December 2006, 31 December 2007, and 31 December 2008

Our audits were limited because the results of an investigation into the financial management of the school were not known at the completion of the audits.

Mayfield Primary School

Financial statements year ended: 31 December 2008

Our work was limited because of an unresolved investigation into certain transactions between the school and a related party. There were no practical audit procedures to determine the effect of the investigation until a conclusion has been reached.

Excellere College

Financial statements for periods: 1 January 2005 to 5 April 2005 and 8 September 2008 to 31 December 2008

Our audit was limited because we were unable to verify some revenue due to limited controls over that revenue for the period 1 January 2005 to 5 April 2005. The College ceased to be a state school on 5 April 2005. Our audit was also limited because the financial statements of the College for the period 6 April 2005 to 7 September 2008 had not previously been audited. Because the College was not a state school for this period, we were unable to form an opinion about whether the opening balances as at 8 September 2008 relating to fixed assets, inventories, accounts payable, and accounts receivable in the financial statements were fairly stated.

Paeroa Central School

Financial statements year ended: 31 December 2008

Our audit was limited because we were unable to verify some revenue due to limited controls over that revenue.

Titahi Bay Intermediate

Financial statements year ended: 31 December 2008

Our audit was limited because we were unable to verify some revenue due to limited controls over that revenue.

Whareorino School

Financial statements year ended: 31 December 2008

Our audit was limited because we were unable to verify some revenue due to limited controls over that revenue.

Piopio Primary School

Financial statements year ended: 31 December 2008

Our audit was limited because we were unable to verify some revenue due to limited controls over that revenue.

Rawhitiroa School

Financial statements year ended: 31 December 2008

Our audit was limited because we were unable to verify some revenue due to limited controls over that revenue.

Kiwitahi School

Financial statements year ended: 31 December 2008

Our audit was limited because we were unable to verify some revenue due to limited controls over that revenue.

Taumarunui High School Community Trust

Financial statements year ended: 31 December 2008

Our audit was limited because we were unable to verify some revenue due to limited controls over that revenue.

Te Kura Kaupapa Māori o Tamarongo

Financial statements year ended: 31 December 2008

Our audit was limited because we were unable to verify some revenue due to limited controls over that revenue.

Upper Hutt School

Financial statements year ended: 31 December 2008

Our audit was limited because we were unable to verify some revenue due to limited controls over that revenue.

Hillcrest School (Pahiatua)

Financial statements year ended: 31 December 2008

Our audit was limited because we were unable to verify some revenue due to limited controls over that revenue.

Tokoroa East School

Financial statements year ended: 31 December 2008

Our audit was limited because we were unable to verify some revenue due to limited controls over that revenue, and we were unable to verify the number of staff employed because some staff information was not available for audit.

Ross Intermediate

Financial statements years ended: 31 December 2007 and 31 December 2008

Our audits were limited because we were unable to verify certain revenue and expenditure due to limited controls over that revenue and expenditure.

Te Kura Kaupapa Māori o Waiuku

Financial statements year ended: 31 December 2007

Our audit was limited because we were unable to verify some revenue – there were limited controls over that revenue and certain source accounting records and invoices were missing.

Sunset Primary School

Financial statements year ended: 31 December 2008

Our audit was limited because we were unable to verify certain revenue – there were limited controls over the receipt of that revenue and we were unable to verify some transactions made by cheques because there was no supporting documentation for those transactions.

Te Kura Kaupapa Māori o Manurewa

Financial statements year ended: 31 December 2008

Our audit was limited because we were unable to obtain sufficient evidence concerning the lack of controls at Board level over approval processes and other internal procedures during the period March to September 2008.

Te Whanau-a-Apanui Area School

Financial statements year ended: 31 December 2008

Our audit was limited because we were unable to verify some local fund revenue and expenditure due to lack of records for that revenue and expenditure.

Te Kura Kaupapa Māori o Ngati Kahungunu ki Heretaunga

Financial statements year ended: 31 December 2006

Our audit was limited because we were unable to verify certain expenditure due to limited supporting documentation for those transactions.

Whanganui Awa School

Financial statements year ended: 31 December 2008

The Board of Trustees has not included a provision for cyclical maintenance in the annual report. This is a departure from its reporting requirements.

Saint Peter's College (Palmerston North)

Financial statements year ended: 31 December 2008

We disagreed with the Board of Trustees in recognising expenditure, incurred in 2008 for capital works on land owned by the School proprietor, as an asset. The use of funding for this purpose is not permitted by law unless the Board of Trustees' financial interest in the capital works has been agreed by the proprietor and approved by the Ministry of Education. The Board of Trustees' financial interest is not the subject of an agreement with the proprietor and the Ministry of Education had not granted the approval. Therefore, the expenditure was unlawful and does not meet the criteria for the Board of Trustees to recognise a fixed asset. As a result, the fixed assets, equity, and surplus of the College were overstated.

Saint Joseph's School (Hastings)

Financial statements year ended: 31 December 2008

We disagreed with the Board of Trustees making an unlawful transfer of funds to its proprietor.

Te Kura-a-iwi o Whakatupuranga Rua Mano

Financial statements year ended: 31 December 2007

Our audit was limited because we were unable to verify the transfer of funds from the Board of Trustees to the Whakatupuranga Rua Mano Charitable Trust.

Explanatory paragraphs for public entities other than schools

University of Auckland

Financial statements year ended: 31 December 2008

We drew readers' attention to the disclosures in the financial statements about the Partnerships for Excellence funding in 2007, which was provided by the Crown as a capital appropriation for increasing the University's capability. This should have been recognised as equity in nature and not recognised as income in advance. In addition, the relevant research contract funding should have been recognised as a capital contribution from the Crown in 2008 rather than partly as revenue and partly as a liability.

Public Trust

Financial statements year ended: 30 June 2009

We drew readers' attention to the disclosures in the financial statements about the value of unlisted mortgage-backed securities of $38 million, for which there was not an active market and for which no quoted price was available. Although the fair value of these investments was based on the best available information, in the absence of an active market and quoted market prices, a high degree of uncertainty existed about that value, which could have a material effect on the Statement of Financial Performance and Statement of Financial Position.

MidCentral District Health Board and Group

Financial statements year ended: 30 June 2009

We drew readers' attention to the disclosures in the financial statements about the 5% reduction the Board made to the valuation of buildings carried out by the independent valuer. This is not supported by the New Zealand Equivalent to International Accounting Standard No.16: Property, Plant and Equipment, which requires valuations to be either carried out by or reviewed by an independent valuer. However, the reduction is not material to the financial statements as a whole.

New Zealand Institute for Plant and Food Research Limited and Group

Financial statements year ended: 30 June 2009

We drew readers' attention to the uncertainty over the ability of the subsidiary, GraceLinc Limited, to generate positive cash flows from operations. Its viability depended on the continued financial support from New Zealand Institute for Plant and Food Research, and thereafter on the commercial success of its products.

GraceLinc Limited (New Zealand Institute for Plant and Food Research Limited)

Financial statements year ended: 30 June 2009

We drew readers' attention to the uncertainty over the outcome of the Company's plans to generate positive cash flows from its operations in the near future. The viability of the Company depends on the continued financial support of the parent company and the commercial success of its products.

Whanganui District Health Board

Financial statements year ended: 30 June 2009

We drew readers' attention to the serious financial difficulties of the Health Board. The Health Board was managing the situation and, subject to deficit support, there would be sufficient cash flows generated from operating activities to meet the investing and financing cash flow requirements as set out in the Health Board's Statement of Intent. The Crown has indicated that it would provide such support where necessary to maintain viability.

Manukau Institute of Technology

Financial statements year ended: 31 December 2008

We noted that the current financial statements were reissued to replace previously issued financial statements, to account for funding based on further clarification received from the Tertiary Education Commission.

GP No.1 Limited (Genesis Power Limited)

Financial statements year ended: 30 June 2009

We noted that the financial statements were appropriately prepared on the going concern basis because the parent company had confirmed that it would provide adequate support to ensure that it will meet its debts as they fall due.

GP No.2 Limited (Genesis Power Limited)

Financial statements year ended: 30 June 2009

We noted that the financial statements were appropriately prepared on the going concern basis because the parent company had confirmed that it would provide adequate support to ensure that it will meet its debts as they fall due.

GP No.4 Limited (Genesis Power Limited)

Financial statements year ended: 30 June 2009

We noted that the financial statements were appropriately prepared on the going concern basis because the parent company had confirmed that it would provide adequate support to ensure that it will meet its debts as they fall due.

GP No.5 Limited (Genesis Power Limited)

Financial statements year ended: 30 June 2009

We noted that the financial statements were appropriately prepared on the going concern basis because the parent company had confirmed that it would provide adequate support to ensure that it will meet its debts as they fall due.

Kupe Holdings Limited (Genesis Power Limited)

Financial statements year ended: 30 June 2009

We noted that the financial statements were appropriately prepared on the going concern basis because the parent company had confirmed that it would provide adequate support to ensure that it will meet its debts as they fall due.

Cardiff Holdings No.1 Limited (Genesis Power Limited)

Financial statements year ended: 30 June 2009

We noted that the financial statements were appropriately prepared on the going concern basis because the parent company had confirmed that it would provide adequate support to ensure that it will meet its debts as they fall due.

Cardiff Holdings No.2 Limited (Genesis Power Limited)

Financial statements year ended: 30 June 2009

We noted that the financial statements were appropriately prepared on the going concern basis because the parent company had confirmed that it would provide adequate support to ensure that it will meet its debts as they fall due.

Air New Zealand Associated Companies (Australia) Limited (Air New Zealand Limited)

Financial statements year ended: 30 June 2008

We noted that the financial statements were appropriately prepared on the going concern basis because the parent company had confirmed that it would provide adequate support to ensure that the company would meet its debts as they fall due.

Eagle Air Maintenance Limited (Air New Zealand Limited)

Financial statements year ended: 30 June 2008

We noted that the financial statements were appropriately prepared on the going concern basis because the parent company had confirmed that it would provide adequate support to ensure that the company would meet its debts as they fall due.

Air New Zealand Consulting Limited (Air New Zealand Limited)

Financial statements year ended: 30 June 2008

We noted that the financial statements were appropriately prepared on the going concern basis because the parent company had confirmed that it would provide adequate support to ensure that the company would meet its debts as they fall due.

AgResearch (PPGR Consortia) Limited (AgResearch Limited)

Financial statements year ended: 30 June 2008

We noted that the financial statements were appropriately prepared on the going concern basis because the parent company had confirmed that it would provide adequate support to ensure that the company would meet its debts as they fall due. We noted a breach of the Financial Reporting Act 1993 because the Board of Directors failed to meet their statutory reporting deadline.

AgResearch (Pastoral Genomics Consortia) Limited (AgResearch Limited)

Financial statements year ended: 30 June 2008

We noted that the financial statements were appropriately prepared on the going concern basis because the parent company had confirmed that it would provide adequate support to ensure that the company would meet its debts as they fall due. We noted a breach of the Financial Reporting Act 1993 because the Board of Directors failed to meet their statutory reporting deadline.

CelcomOne Limited (AgResearch Limited)

Financial statements year ended: 30 June 2008

We noted that the financial statements were appropriately prepared on the going concern basis because the parent company had confirmed that it would provide adequate support to ensure that the company would meet its debts as they fall due. We noted a breach of the Financial Reporting Act 1993 because the Board of Directors failed to meet their statutory reporting deadline.

Celcom Three Limited (AgResearch Limited)

Financial statements year ended: 30 June 2008

We noted that the financial statements were appropriately prepared on the going concern basis because the parent company had confirmed that it would provide adequate support to ensure that the company would meet its debts as they fall due. We noted a breach of the Financial Reporting Act 1993 because the Board of Directors failed to meet their statutory reporting deadline.

ContainerScan Limited (AgResearch Limited)

Financial statements years ended: 30 June 2007 and 30 June 2008

We noted that the financial statements were appropriately prepared on the going concern basis because the parent company had confirmed that it would provide adequate support to ensure that the company would meet its debts as they fall due. We noted a breach of the Financial Reporting Act 1993 because the Board of Directors failed to meet their statutory reporting deadline.

E-Learnz Incorporated (Eastern Institute of Technology Limited)

Financial statements year ended: 31 December 2008

We noted the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements, because the Board decided to wind up the Society in 2009.

iPredict Limited (Victoria University of Wellington)

Financial statements year ended: 31 December 2008

We noted the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements, because the company has negative equity at the time of the financial statements being approved and no letter of support has been received from shareholders.

Predictions Clearing Limited (Victoria University of Wellington)

Financial statements year ended: 31 December 2008

We noted the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements. The company had no equity at the time of the financial statements being approved, its immediate parent entity had negative equity, and no letter of support has been received from shareholders.

Land Transport New Zealand

Financial statements year ended: 30 June 2008

We noted the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements, because the entity was disestablished and merged with Transit New Zealand to form a new entity effective from 1 August 2008.

Ngai Tahu Ancillary Claims Trust

Financial statements year ended: 30 June 2009

We noted the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements, because the Trust will cease to operate following the transfer of the remaining claim property.

New Zealand Fast Forward Limited (New Zealand Fast Forward Fund Limited)

Financial statements year ended: 31May 2009

We noted the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements, because the Board decided to wind up its operations as of 31 May 2009.

Marlborough Provincial Patriotic Council

Financial statements year ended: 31May 2008

We noted the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements, because the Council was disestablished on 31 May 2008 and the residual funds will be gifted to the Marlborough RSA Welfare Account. This audit report was for a 20-month period.

Southland Provincial Patriotic Council

Financial statements year ended: 30 September 2008

We noted the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements because the Council was disestablished by resolution on 15 December 2005. Assets and liabilities are still held by the Council until a final decision is made about where these assets and liabilities will vest.

Southland District Health Board

Financial statements year ended: 30 June 2009

We drew readers' attention to the disclosures that the budget figures in the financial statements were from an updated budget approved by the Board later in the financial year but did not comply with the Crown Entities Act 2004, which requires the Health Board's financial statements to include the forecast financial statements prepared at the start of the financial year.

Otago District Health Board

Financial statements year ended: 30 June 2009

We drew readers' attention to the disclosures that the budget figures in the financial statements were from an updated budget approved by the Board later in the financial year but did not comply with the Crown Entities Act 2004, which requires the Health Board's financial statements to include the forecast financial statements prepared at the start of the financial year.

Ministry of Pacific Island Affairs

Financial statements year ended: 30 June 2009

We noted a breach of the Public Finance Act 1989 because the Ministry did not include performance measures and standards in its statement of forecast performance. Performance measures and standards are required by law.

Celentis Limited (AgResearch Limited)

Financial statements year ended: 30 June 2008

We noted a breach of the Financial Reporting Act 1993 because the Board of Directors failed to meet their statutory reporting deadline.

AgResearch Plant Bio Holding Limited (AgResearch Limited)

Financial statements year ended: 30 June 2008

We noted a breach of the Financial Reporting Act 1993 because the Board of Directors failed to meet their statutory reporting deadline.

AgResearch (USA) Limited (AgResearch Limited)

Financial statements year ended: 30 June 2008

We noted a breach of the Financial Reporting Act 1993 because the Board of Directors failed to meet their statutory reporting deadline.

AgResearch (Meat Biologics Consortia) Limited (AgResearch Limited)

Financial statements year ended: 30 June 2008

We noted a breach of the Financial Reporting Act 1993 because the Board of Directors failed to meet their statutory reporting deadline.

Phytagro New Zealand Limited (AgResearch Limited) *Financial statements year ended: 30 June 2008* We noted a breach of the Financial Reporting Act 1993 because the Board of Directors failed to meet their statutory reporting deadline.
AgResearch Strategic Investments Limited (AgResearch Limited) *Financial statements year ended: 30 June 2008* We noted a breach of the Financial Reporting Act 1993 because the Board of Directors failed to meet their statutory reporting deadline.
Grasslanz Technology Limited (AgResearch Limited) *Financial statements year ended: 30 June 2008* We noted a breach of the Financial Reporting Act 1993 because the Board of Directors failed to meet their statutory reporting deadline.
AgResearch Shelf Four Limited (AgResearch Limited) *Financial statements year ended: 30 June 2008* We noted a breach of the Financial Reporting Act 1993 because the Board of Directors failed to meet their statutory reporting deadline.
Paraco Technology Limited (AgResearch Limited) *Financial statements year ended: 30 June 2008* We noted a breach of the Financial Reporting Act 1993 because the Board of Directors failed to meet their statutory reporting deadline.

Explanatory paragraphs for schools

Emphasis of matter, by type and number (including those explanatory paragraphs outlined in the qualified audit reports above)

Closures (five schools, 18 transport networks, and two subsidiaries) Accounting standards require schools that have been or are being closed to prepare their financial statements on the basis that they are not a "going concern". We noted that five closed schools, 18 closed transport networks, and two closed school subsidiaries had prepared their financial statements correctly.
Serious financial difficulties (17 schools and one subsidiary) Some schools are in serious financial difficulty, mainly because of large working capital deficits. We noted that 17 schools and one school subsidiary had included disclosures in their financial statements that outlined their financial difficulties and the actions they were taking to address the factors that had resulted in those difficulties.

Breaches of law, by type and number (including those breaches of law outlined in the qualified audit reports above)

Not reporting by 31 May 2009 (63 schools)

Board of Trustees have a statutory obligation to issue their audited financial statements by 31 May.

We noted that 63 schools had breached the law by failing to meet this statutory reporting deadline, and had not chosen to disclose the breach in their financial statements.

Borrowing above the permitted limit without approval (14 schools)

Board of Trustees are not permitted to borrow above a permitted limit without the approval of the Ministers of Education and Finance.

Fourteen schools had breached the law by not seeking authority from the joint Ministers for borrowing above the permitted limit.

Not submitting financial statements for audit by 31 March 2009 (11 schools)

Board of Trustees have a statutory obligation to submit their financial statements for audit by 31 March.

Eleven schools had breached the law by failing to submit their financial statements for audit by 31 March 2009, and had not chosen to disclose the breach in their financial statements.

Investing in non-approved institutions (nine schools)

In order to safeguard public money, schools may invest their surplus funds only in approved banking and other institutions.

Nine schools had breached the law by investing in non-approved banking institutions without the authority of the Ministers of Education and Finance.

Variation statements (six schools)

Schools are obliged by the Education Act 1989 to include, in their annual reports, statements comparing their performance against their objectives.

Six schools had breached the law by not including such statements in their annual reports.

10-Year property plan (five schools)

Board of Trustees have a statutory obligation to prepare and review annually, and have professionally reviewed every three years, a property plan that includes all the maintenance requirements of the school for a prospective ten-year period.

Five schools had breached the law by failing to update the 10-year property plan annually.

Other reasons (21 schools and one school subsidiary)

Our audit reports included explanatory paragraphs for other reasons:

- Four schools failed to keep proper accounting records.
- Three schools acquired an interest in land without the approval of the Minister of Education.
- Two schools had made payments to staff outside the Ministry of Education payroll service.
- Two schools had trustees who were interested in contracts with the Boards of Trustees, under which the total payments made or to be made by or on behalf of the Boards of Trustees exceeded $25,000 in a financial year without the approval of the Minister of Education.
- Two schools used their funds to pay for improvements to buildings on land owned by the schools' proprietors, without the approval of the Ministry of Education.
- One school wrote off the value of some buildings because it had not obtained sufficient approval to recognise an interest in their value.
- One school granted a license to occupy certain school buildings and part of the school field to third parties.
- One school had two permanently appointed staff serving on the Board of Trustees during the year.
- One school did not exclude a member of the Board of Trustees with a declared conflict of interest from board meetings to consider and discuss matters in the area where which the conflict existed.
- One school paid its staff in advance without the approval of the Ministry of Education.
- One school had a falsely made an advance payment (the Ministry of Education was considering whether this matter needed to be reported to the Police).
- One school spent a large amount of money on an overseas trip for some students and adults, which was considered wasteful and showed a lack of probity.
- One school relied on the continuing financial support of its bank.
- One subsidiary relied on the financial support of its shareholding schools to continue as a going concern.

Publications by the Auditor-General

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

- Auckland City Council: Management of footpaths contracts
- Investigation into conflicts of interest of four councillors at Environment Canterbury
- Effectiveness of arrangements to check the standard of services provided by rest homes
- Ministry of Justice: Supporting the management of court workloads
- How the Thames-Coromandel District Council managed leasing arrangements for Council land in Whitianga
- Auditor-General's decision on parliamentary and ministerial accommodation entitlements
- Ministry of Education: Managing support for students with high special educational needs
- Ministry of Social Development: Changes to the case management of sickness and invalids' beneficiaries
- Annual Report 2008/09
- How the Ministry of Education managed the 2008 bus tender process
- New Zealand Defence Force: Progress with the Defence Sustainability Initiative
- Response of the New Zealand Police to the Commission of Inquiry into Police Conduct: First monitoring report
- Statements of intent: Examples of reporting practice
- The Auditor-General's views on setting financial reporting standards for the public sector
- Inland Revenue Department: Managing tax debt
- Electricity Commission: Review of the first five years
- Local government: Results of the 2007/08 audits
- How government departments monitor Crown entities

Website

All these reports are available in HTML and PDF format on our website – www.oag.govt.nz. Most of them can also be obtained in hard copy on request – reports@oag.govt.nz.

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