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Auditor-General's mid-term review



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Auditor-General's mid-term review

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October 2022

Our Office waiata – Te Mana Arotake

Lyrics by Angela and Susan Wallace, music by Rosie Salas

Ruia taitea kia tū	Cast away the sapwood
ko taikaka anake	but let the heart remain
Anei rā mātou	Here we are
o Te Mana Arotake	the Office of the Auditor-General
E whakatau tika te huarahi	Seeking accountability
mō te Paremata e	on behalf of Parliament
Anei rā mātou	Here we are
o Te Mana Arotake	the Office of the Auditor-General
E whakatau tika te huarahi	Seeking accountability
mō te tāngata e	on behalf of the people
Ko te mahi tūturu	Our main purpose
kia ū te kawanatanga	is that the government maintains
Ki te tika, te pono	its integrity and honesty
mō te iwi whānui e	for all people

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Auditor-General's overview

E ngā mana, e ngā reo, e ngā karangarangatanga maha o te motu, tēnā koutou.

The Controller and Auditor-General (the Auditor-General) is an Officer of Parliament appointed under the Public Audit Act 2001.

The public audit function has been a critical part of New Zealand's public accountability system since the first Auditor-General was appointed in 1846. The Auditor-General's work helps Parliament and the public to hold public organisations to account for their performance. The aim of this work is to improve the performance of, and the public's trust in, the public sector.

Under the Public Audit Act, the Auditor-General is the auditor of all public organisations. Their duties include auditing financial statements and performance information, auditing spending against appropriations, carrying out performance audits and inquiries, and providing advice to Parliamentary select committees. In carrying out these functions, the Auditor-General must act independently.

The independent mandate and reputation of the Office are jealously guarded. The Office has built a strong reputation over many years for the work we do – both nationally and internationally.

This year, I reached the mid-point of my seven-year term as Auditor-General. I commissioned this review to reflect on where we are as an Office and the challenges the Office faces. I also wanted to confirm the key priorities for the remainder of my term.

When I began my term in mid-2018, the Office had recently published a strategy that sought to increase its impact with Parliament, the public, and public organisations. The strategy set out how the Office planned to do this through the relevance of the work we do, and how we work with each of those groups.

After a decade of minimal investment in the Office, Parliament provided, from 2019, increased funding to develop the capacity and capability needed to implement the Office's strategic plan. I consider that we have delivered on this investment and made solid progress against the strategy.

We have:

- improved our reporting to Parliament and the public;
- increased our focus on topics that matter to New Zealanders and delivered more of our work at a time when it can have the most impact;
- updated and expanded our good practice resources for public organisations; and
- increased our engagement activities with Parliament and those who lead and govern public organisations.

These improvements have given us a solid foundation on which to build. The work we do is generally well-received and impactful. We continue to receive strong, positive feedback from Parliament on our core role of helping it to hold public organisations to account for their performance.

Despite this progress, we still face significant challenges in building our capacity and capability. For example, we have some way to go in modernising our technology environment. However, we have clear strategies, good planning to support these strategies, and generally good momentum on them. Getting the Office to this point has involved a lot of hard work. I am pleased with the progress we have made, but there remains much to do and this will require ongoing investment.

The most significant challenge we currently face is delivering the Office's mandatory audit work. Many issues are affecting the future sustainability of the audit profession, which have cast doubt on the future of public sector audits.

These issues include the ability to attract and retain talent, the increased regulatory scrutiny on audits, increased requirements in auditing standards, more complex audit issues, increasing scope in the nature of information subject to audit, increasing expectations for auditors to provide more value beyond their mandatory audit work, and the transition of audit practices and methodologies to a modern digital world.

The effects of the Covid-19 pandemic have exacerbated these issues – and created new ones. Many risks that could previously be managed have become issues that must be addressed.

The most obvious consequence has been a deferral of audits as a result of delays by both public organisations and auditors. These delays have created a backlog of public sector audits to complete. As a result, my immediate priority is to address this backlog so that this key element of the public accountability system is not diminished.

Importantly, the measures that must be employed to address backlogs in the short term will not by themselves be enough to ensure the sustainability of public audit for the longer term. More needs to be done to sustainably deliver the portfolio of nearly 3400 annual audits across the public sector in the future.

There is no single solution to this. I must consider the audit portfolio as a whole and, given the environment we are in, allocate audit work to those audit service providers best placed to complete it over the medium to longer term. To ensure that we have enough capacity to do our core audit work, we need to also directly address the sustainability of audit fees (where they are not currently sustainable).

The Office must also play its part in enhancing the overall reputation of the audit profession so that it remains an attractive career option for graduates and others looking for a dynamic, challenging, and rewarding career.

Parliament has recently extended the mandate of the Auditor-General to areas such as auditing climate reporting and the New Zealand health plan. Independent assurance over this information will be of value to the public and Parliament, but my auditors will need to develop new capabilities in these areas. Such extensions to the nature of the information subject to audit, while critical to maintaining public trust, will also put pressure on both audit capability and capacity.

Within this broader context, particular attention needs to be given to Audit New Zealand, the Office's in-house audit service provider. As with the Office more broadly, new investment in Audit New Zealand has been severely limited during the last decade or longer. This has created a range of issues, and Audit New Zealand has increasingly been unable to match the other major audit firms in areas such as audit methodologies and tools.

Audit New Zealand is a key business unit for the Auditor-General. It is a benchmark public sector audit service provider, adds capability to the broader Office, and means that the Auditor-General will always have access to an auditor for all public organisations. I need to safeguard and strengthen Audit New Zealand's reputation to ensure that it is well positioned to continue playing its important role in the Office.

For Audit New Zealand to remain effective and efficient in its role, it must invest in new audit tools and technologies. I will also have to ensure that Audit New Zealand's audit portfolio best matches its capacity and capability and that it can continue to match other major audit firms in the quality of its work, its engagement with public organisations, and the way it manages its business.

We need to ensure that the Office maintains the trust and confidence of Parliament, the public, and the people who lead public organisations. This includes continuing to enhance the trust that Māori have in our role of helping Parliament and the public to hold public organisations to account.

The Office must work to deliver on our te ao Māori strategy. We have a strong interest in increasing our capability internally and growing our relationships with Māori. We have recently recruited a Kaiwhakahaere to lead the work on our te ao Māori strategy.

Finally, the Office must continue to build on its reputation as a trusted source of analysis, opinion, and advice.

How well the public sector delivers for, and engages with, New Zealanders in an environment where society is increasingly connected and misinformation can be easily disseminated will be key to the public sector maintaining the public's trust and confidence. The integrity of public organisations will also continue to be critical to maintaining that trust.

Therefore, it is important to maintain and enhance the Office's profile and reputation for independent assurance and evidence-based reporting, and for being current and relevant with our work.

Our people continue to be critical to our success. To meet our aspirations for the Office, we must continue to recruit and retain people who believe in the importance of our role and are prepared to work to the high standards that Parliament and the public expect from us. We stand or fall on the values we bring to our work and, in particular, our independence and courage to speak truth to power, supported by the quality of our work.

I thank Parliament for the strong support it has shown the Office. Holding the role of Auditor-General is a privilege. I look forward to playing my part in continuing to build the Office's reputation and impact during the remaining years of my term and positioning the Office well for the next Auditor-General.

Nāku noa, nā

A handwritten signature in black ink, appearing to read 'JM Ryan', with a stylized flourish at the end.

John Ryan
Controller and Auditor-General | Tumuaki o te Mana Arotake

20 October 2022

1

Introduction

- 1.1 This Part discusses the scope of the mid-term review and how it was carried out.
- 1.2 This year, I reached the mid-point of my seven-year term as the Controller and Auditor-General (the Auditor-General). I commissioned this review to reflect on where we are as an Office,¹ the challenges we face, and our priorities as I complete my term and prepare the Office for the next Auditor-General in 2025.

Scope of the mid-term review

- 1.3 During this review, I considered:
- the progress that the Office has made against our current strategy;
 - the environment that I expect the Office to work in for the remainder of my term; and
 - what I need to focus on so that the Office continues to deliver on its mandate in that environment.
- 1.4 I have not considered:
- whether any change to the functions, duties, and powers of the Auditor-General under the Public Audit Act 2001 (the Act) is needed;
 - making any changes to the Office's approach to appointing auditors, including having Audit New Zealand as a separate business unit within the Office; or
 - the merits of individual audits, reports, or decisions and advice the Office has given or published.
- 1.5 These matters are either primarily for Parliament's consideration or subject to other independent review processes that are separately reported on, including in the Office's annual report.

1 In this report, references to the "Office" include the Office of the Auditor-General, Audit New Zealand, the Corporate Services Group, and other contracted audit service providers, all of which carry out work on the Auditor-General's behalf.

How the review was carried out

- 1.6 To carry out the review, we completed several different pieces of work. These included:
- an assessment of the Office using the Supreme Audit Institutions Performance Measurement Framework (SAI PMF);²
 - interviews with a range of people who have an interest in our work;³
 - a survey sent to all Office staff; and
 - analysis of key information, including surveys of members of Parliament, public organisations, the results of quality assurance, and findings from other reviews.

External reference group work

- 1.7 An external reference group tested the findings of the review. These experts challenged my thinking and assisted with the review process. They also provided me with advice and support to help meet the objectives of the review.
- 1.8 The group members were Sir John Clarke, Sir Maarten Wevers, Margaret Devlin, and Grant Hehir. Appendix 1 includes background information on each member of the reference group.

Acknowledgements

- 1.9 This review would not have been possible without those people who provided valuable time and input to inform the findings. These included the external reference group members and the wide range of people we interviewed in Parliament, academia, the media, the public sector, and beyond.
- 1.10 I thank all of those who took time to provide their input. It has all been of value to me.

² The SAI PMF is an International Organisation of Supreme Audit Institutions (INTOSAI) tool that provides SAIs with a framework for voluntary assessments or peer reviews of their performance against the Framework for INTOSAI Professional Pronouncements and other established international good practices for external public auditing. We used the SAI PMF as a base and adjusted for matters where the international framework is not relevant to the Office. As allowed in the SAI PMF, we also relied on the Office's systems of quality assurance as evidence to inform the indicators on audit processes and quality.

³ Appendix 2 lists those we interviewed.

2

The progress that the Office has made against our current strategy

- 2.1 This Part discusses:
- the Auditor-General’s work;
 - the Office’s strategy; and
 - what the Office has achieved since adopting the strategy.

The Auditor-General’s work

- 2.2 The Auditor-General is an Officer of Parliament. The role is an important part of New Zealand’s constitutional framework and a recognised pillar of the national integrity system.⁴ The Office aims to increase trust and confidence in the public sector and in central and local government.
- 2.3 When public organisations spend public money,⁵ New Zealanders expect that spending to be appropriately authorised, effective, and efficient. Parliament and the public are also interested in whether public organisations carry out their activities with integrity.
- 2.4 As the public sector auditor, the Auditor-General provides independent assurance on these matters through two main functions. These are:
- the annual programme of mandatory audits of the financial statements and statements of service performance that public organisations publicly report; and
 - a programme of discretionary work, including performance audits, other assurance activities, inquiry work, and advice to Parliamentary select committees.
- 2.5 These activities underpin the information that the Office provides Parliament and the public to be able to hold public organisations to account for their performance. These, with our research activities, also inform the good practice guidance, seminars, and other material we produce to support public organisations to improve their performance.
- 2.6 A public sector audit includes additional matters that are not usually covered in a private sector audit. A public sector audit, for example, does not just provide an independent opinion on whether a public organisation has fairly reflected the results of its activities in its financial statements and, as required, its statement of service performance. A public sector audit also considers aspects of whether a public organisation is complying with its statutory obligations and whether it is

4 According to Transparency International, the pillars of a national integrity system typically include the legislative branch of the government, the executive branch of the government, the judiciary, the public sector, law enforcement, the electoral management body, the Ombudsman, an audit institution, anti-corruption agencies, political parties, the media, civil society, and business.

5 Public organisations include government departments, Crown entities, State-owned enterprises, tertiary education institutions, Crown research institutes, electricity distribution businesses, local authorities, council-controlled organisations, and schools.

operating with integrity. This could include highlighting where waste or a lack of probity has occurred.

- 2.7 To carry out this work, the Auditor-General employs staff in two business units – the Office of the Auditor-General and Audit New Zealand – and contracts with private sector accounting firms (other audit service providers). A shared Corporate Services Group supports the two business units. Together, these four parts of the Office work together to deliver all work carried out on the Auditor-General’s behalf.
- 2.8 The Office of the Auditor-General carries out strategic audit planning, sets policy and standards, appoints auditors and oversees their performance, carries out performance audits, provides reporting and advice to Parliament, carries out inquiries and other special studies, and develops and shares good practice guidance.
- 2.9 The Office of the Auditor-General also carries out the Controller function. This function provides independent assurance to Parliament and the public on the extent to which the expenses and capital expenditure of government departments and officers of Parliament are lawful and within the scope, amount, and period of the appropriation or other statutory authority given by Parliament.
- 2.10 The Auditor-General appoints auditors from Audit New Zealand and other audit service providers to carry out the annual programme of nearly 3400 mandatory audits of public organisations on the Auditor-General’s behalf.⁶
- 2.11 Appendix 4 contains background information about the nature of a public sector audit, the Office’s systems and processes for ensuring the independence and quality of our work, and how the Office is held to account.

The Office’s strategy

- 2.12 The Office’s current strategy was developed in 2017/18 and is organised around four strategic shifts. These are:
- Focus more on examining how well the public sector achieves positive change for New Zealanders.
 - Help New Zealanders become better informed about public sector performance and accountability.
 - Be more active in sharing insights about what “good” looks like.
 - Help improve the public sector accountability system.
- 2.13 The Office’s strategy, including the four strategic shifts, was designed to contribute to the ultimate outcome for the Office – that Parliament and the public have trust and confidence in the public sector.

⁶ Office of the Auditor-General (2011), *Appointing public sector auditors and setting audit fees*. Note that the number of mandatory audits can change over time.

What the Office has achieved since adopting the strategy

At the start of my term

- 2.14 At the start of my term, the Office had been through a period of significant challenge and change. There had not been an Auditor-General for more than a year.
- 2.15 Because the Deputy Controller and Auditor-General has the same powers, duties, and functions as the Auditor-General,⁷ the Office had been able to continue its work during this time. However, uncertainty about the Auditor-General role and the need to focus on maintaining the Office's core work meant that there was limited opportunity to make progress with implementing the strategic shifts.
- 2.16 In addition, as I noted in a business case supporting a budget bid as part of Budget 2019:
- demand for the Office's work was increasing;
 - public expectations of accountability were shifting;
 - the public sector was under significant pressure; and
 - Parliament, and public organisations wanted us to do more.
- 2.17 There had been minimal new Crown funding to support the activities of the Office during the previous decade. This limited the discretionary work that the Office could complete and the ability of the Office to invest in new technology.
- 2.18 The minimal new funding also meant that there was an increasing risk that the Office's capability and the relevance of our work and reputation would decline, that we would not achieve our strategy, and that our technology would remain vulnerable and dated. Staff were also being paid below comparable market rates.
- 2.19 In Budgets 2019 to 2021, Parliament progressively invested in the Office to expand the scope, relevance, and timeliness of our discretionary (Crown-funded) work and to modernise the Office's technology and remuneration systems. We have used the funding to progress the Office's strategy and to address our capability and capacity risks in areas that are directly funded by the Crown.

What the Office has achieved with increased funding

We have broadened the focus and approach of our performance audits, inquiries, and other work with a view to increasing our impact

- 2.20 With the increased Crown funding approved by Parliament, we broadened our work programme to focus more on outcomes and areas of high impact and to complete more self-initiated inquiries. We also enhanced the way we follow up on how public organisations have responded to the recommendations in our

performance audits. This allows us to complete more, and more timely, follow ups of our performance audits.

- 2.21 Those we interviewed as part of this review recognised that the Office has been increasingly focusing on topics and issues that matter to New Zealanders. They also recognised that the timeliness of the work we publish has improved, citing our work on the wage subsidy scheme and the roll-out of the Covid-19 vaccine as examples. There has also been positive feedback on the increasing relevance and impact of our inquiries work.
- 2.22 I recognise that increasing the volume of our work can create challenges and additional pressure on the public organisations we audit.
- 2.23 During the last two years, in particular, much of our work has focused on public organisations involved in the response to the Covid-19 pandemic. These public organisations were delivering critical services in a time of crisis, often with other reviews under way.
- 2.24 In my view, these are the very matters that the Auditor-General should be involved in, and provide insights about, for Parliament and the public. These are matters that affect the everyday lives of New Zealanders.
- 2.25 Nevertheless, we will need to ensure that we continue to strike an appropriate balance between providing assurance over historical performance and taking the opportunity to influence critical work of the public sector when it is in progress.

We have refreshed and expanded our good practice material

- 2.26 We have invested in dedicated resources to focus on developing new good practice guidance and refreshed several of our existing good practice guides. These include our guides on severance payments, sensitive expenditure, managing conflicts of interest, and setting fees and charges.
- 2.27 We have also extended the scope of our good practice materials where the Office has particular expertise. Since 2019, we have published updated or new guidance to support the public sector (Appendix 3 sets out our suite of good practice guidance published since 2019). In 2022, we published an integrity framework for public organisations and held a series of seminars to promote it.
- 2.28 We have received extensive feedback that public organisations value our good practice materials and the seminars and events we run to promote them. We aim for our good practice material to contribute to positive improvements in public organisations, which in turn should lead to increased trust and confidence in the public sector.

We are using more data and analytics

- 2.29 We have invested in increased data and analytics capability. We have also developed a data and analytics strategy to better use data to generate insights from our work.
- 2.30 Although we already collected the selected financial information of many public organisations, we now have a non-financial performance data set for about 400 public organisations. This currently includes more than 110,000 data points for at least five years. We intend to use this data to track organisational performance over time. For example, for the former district health boards we have information for 11 years, which provides a base for comparing future performance in the health sector.
- 2.31 We are increasingly using this information and our other data assets and analytical capabilities in our work, such as performance audits, sector reports, and select committee briefings. However, we can get more benefit and insight from this and other data. We also need to consider how to more effectively use data and analytics in our mandatory audit work. This remains an important focus and will require ongoing investment.

Increased reporting from the Controller function

- 2.32 In recent years, we have invested in a dedicated role and resources to lead our Controller function work. This has resulted in an increase in public reporting on Controller matters. We now regularly report on whether government expenditure has been appropriately authorised, including spending on the Government's response to the Covid-19 pandemic. We have also reported on several high-profile matters where questions had been raised about the lawfulness of government expenditure, for example:
- the purchase of land at Te Puke Tāpapatanga a Hape (commonly referred to as Ihumātao); and
 - the Cost of Living payments.

We are better targeting our engagement with Parliament and public organisations

- 2.33 In my role as Auditor-General, I generally have the power to only report findings and make recommendations. Apart from some specific circumstances, I do not have the power to change what a public organisation is doing.⁸ For example, I cannot intervene in decisions that public organisations make, nor can I direct a public organisation to act on my findings or recommendations.

⁸ Exceptions to this include sections 65Z and 65ZA of the Public Finance Act 1989 and the Auditor-General's role under the Local Authorities (Members' Interests) Act 1968.

- 2.34 This means that it is important to maintain the reputation and authority of the Auditor-General's role so that the Office can continue to influence the public sector to improve its effectiveness, efficiency, and integrity.
- 2.35 To encourage public organisations to act on our recommendations, we build and maintain strong relationships with those who can influence change, particularly those who govern and lead public organisations. These include chief executives, chairpersons, Mayors in local government, and Audit and Risk Committee chairpersons.
- 2.36 We also invest in, and manage relationships with, central government agencies and regulators because they often identify similar risks and seek similar improvements throughout the public sector. In many cases, they can also more directly influence change.
- 2.37 We have increasingly targeted our engagement activities at the highest-priority organisations and issues. We hold virtual Audit and Risk Committee Chairs' forums on a range of topical matters, share what "good" looks like in seminars for public servants, and present our work to newly elected councillors of local authorities, with a particular focus on conflicts of interest.
- 2.38 Key to the success of the Auditor-General's role is assisting Parliament in its scrutiny of public organisations' performance. We mainly provide this through:
- advice to select committees to assist their annual reviews of selected public organisations and assisting their examination of the Estimates of Appropriations (for example, we provided 181 briefings to select committees in 2021/22); and
 - reports to responsible Ministers on the results of our annual audits (for example, we provided 169 letters to Ministers in 2021/22).
- 2.39 Our most recent survey of select committee chairpersons showed that they consider our briefings to be high quality and provide valuable lines of questioning for committees to use if they wish. Select committee chairpersons consider the Office to be a patient and approachable advisor, independent of the political system. This is very positive feedback for the work we do in supporting Parliament.
- 2.40 However, we know that select committee chairpersons, public servants, and others with an interest in our work often cannot read all of our briefings and reports because of time constraints. Although the Office's reports are an important record of our work, including our findings and recommendations, we continue to look for more accessible ways to share our messages with particular audiences.
- 2.41 In our work, we have highlighted important messages that public organisations have not always addressed in a timely manner. For example, we raised, over many years, the issue that councils were not investing enough in maintaining and

renewing their infrastructure assets (for example, pipes). Although many councils are now starting to address this (as we saw in the most recent long-term plans), there is a history of underinvestment.

- 2.42 We continue to consider new ways of encouraging public organisations to take appropriate action in response to our findings and recommendations. This is also a challenge for audit offices in other countries. There could be opportunities to learn from them about their experiences influencing positive change.

Increased focus on performance reporting

- 2.43 I, along with many former Auditors-General, recognise that robust and comprehensive performance reporting is a crucial part of accountability and have encouraged improvements in public organisations' performance reporting.⁹ I have appointed a dedicated role for performance reporting and produced further good practice materials.

- 2.44 Parliament has also recognised the need to modernise performance reporting. During an annual review debate in the House in April 2022, the Minister of Finance noted that:

More broadly, when the Auditor-General refers to the question of performance reporting, we are happily taking that report away and working out how we can develop a better longer-term approach.

- 2.45 With this acknowledgement, we are in a position to provide support to Parliament as it seeks improvements in this important area of public accountability.

Influencing improvements in public accountability

- 2.46 A robust public accountability system is vital to maintaining trust in the public sector. We have invested in understanding the effectiveness of the current public accountability system and produced reports on where the public accountability system can be improved. These reports have included Māori perspectives on public accountability.

- 2.47 This work has underpinned the Office's position as we look to influence improvements to public accountability – in particular, in sectors undergoing significant reform.

- 2.48 I was pleased that our submission on the health reforms resulted in several changes to enhance public accountability, including changes requiring our Office to provide assurance on the New Zealand health plan and the public reporting of performance against it.

9 See, for example, Office of the Auditor-General (2009), *The Auditor-General's views on setting financial reporting standards for the public sector*, page 8.

2.49 I was also pleased with the interest in our submission on the Water Services Entities Bill as part of the three waters reform, given our focus on improving public accountability of the proposed new water services entities.

Staff capacity and capability has increased

2.50 My focus has been on establishing transparent and modern systems and processes for people management and development.

2.51 In the last two years, we have built a new competency framework, provided active career management support for staff, and implemented a transparent and competitive remuneration framework. Our overall staff engagement remains strong and higher than the public sector benchmark.

2.52 We have added more resources and attempted to address remuneration and other pressures. However, the Office still has high turnover, particularly audit staff from our in-house audit service provider, Audit New Zealand. This is largely driven by high workloads and a competitive market for trained accountants that is likely to continue for some years.

2.53 Our remuneration system ensures that, for like-for-like roles, gender pay gaps are minimal and often show negative gaps (that is, women paid more than men). The particular challenge for our organisation is in addressing vertical segregation (where there are more men than women in senior positions) and occupational drivers (where traditionally higher-paid roles are held by men). This is not an issue in all parts of the organisation but is particularly an issue in Audit New Zealand.

2.54 Bringing more women into senior levels in Audit New Zealand is clearly a matter to address and there is work under way to do this.

2.55 The Office's current people strategy is due to be refreshed. We have an opportunity to consider recruitment and retention in the current environment when developing our new strategy.

We are improving our systems capability

2.56 When I started as Auditor-General, many of the Office's information systems had been developed in-house and staff had enhanced them over time when resources allowed. This meant that:

- many of our core systems were close to the end of their useful life and had security, maintenance, and resilience risks;
- we were not making the best use of the expertise and technology available from the marketplace;
- critical functions had limited technology support; and
- information and data held in the Office was not easily accessible, making it more difficult to draw out insights.

- 2.57 The Office was also struggling with increased complexity in the delivery of public services, growing service demand, and meeting the level of service offerings that were increasingly expected by public organisations and our staff.
- 2.58 We now have an Information Systems Strategic Plan to inform our investment in new technology and to enable us to work more effectively and efficiently, including using data and analytics better.
- 2.59 We are two years through a five-year programme to modernise our information systems technology. The work we have completed so far has largely involved strengthening the Office's critical business tools and security, identifying and procuring a new audit tool for Audit New Zealand, and preparing to move important systems to a cloud-computing environment. Overall, we remain on track to transform key technologies by the end of my term, and we will continue to invest in our information systems.

Cultural capability is an area of focus

- 2.60 Over many years, the Office has completed work that has particular relevance to Māori.¹⁰
- 2.61 We have recently developed a te ao Māori strategy to help build the Office's cultural capability. The strategy includes developing a position statement describing the Office's role in relation to Te Tiriti o Waitangi/The Treaty of Waitangi (the Treaty), an examination of the Office's history, independent research on Māori perspectives on public accountability, and appointing a Kaiwhakahaere to lead this work in the future.
- 2.62 As well as this more strategic work, we have rolled out training to staff to develop their confidence and competence when engaging with organisations that operate on the basis of tikanga Māori, including training in te reo Māori and tikanga. Our annual discretionary work programme also includes a series of topics examining how well the public sector is delivering outcomes for Māori and how well public organisations are meeting their Treaty obligations.

Progress against the Office's strategy

- 2.63 In summary, the Office has made good progress in delivering our strategy. The strategic shifts we have made have, in general, been recognised both internally and externally.
- 2.64 However, we have faced long-standing challenges in delivering our mandatory audit work, which have become more apparent and urgent as a result of the Covid-19 pandemic. New challenges have also arisen. We discuss these further in Part 3.

The environment I expect the Office to work in for the remainder of my term

3

- 3.1 This Part discusses:
- the operating environment for the public sector and its implications for trust and confidence;
 - building capability for the future; and
 - the challenges that the Office faces in delivering our mandatory audit work.

The operating environment and implications for trust and confidence

- 3.2 Since my term began in mid-2018, the operating environment for the Office has been dominated by several significant matters, which I expect will affect the remainder of my term. These matters are:
- the Covid-19 pandemic;
 - public sector reforms;
 - bringing Māori perspectives more into decision-making;
 - addressing climate change; and
 - the rise of misinformation.

The Covid-19 pandemic

- 3.3 The Covid-19 pandemic has had multiple effects on the Office, the public sector, and New Zealand as a whole.
- 3.4 The speed and scale of public spending (such as the wage subsidy scheme) and the criticality of the programmes of work led by the public sector (such as the Covid-19 vaccination roll-out) mean that the pandemic has also dominated the Office's discretionary work programme.
- 3.5 We know that the public sector will likely have to deal with the long-term effects of the pandemic. These include:
- clearing backlogs in delivering key services;
 - addressing issues that have been exacerbated by the pandemic (such as school attendance); and
 - dealing with more general issues, such as staff shortages, supply-chain constraints, and cost pressures.
- 3.6 There has also been a significant increase in government debt and an increased focus on the value for money of public spending.

3.7 All of these issues are likely to continue, to some degree, for the remainder of my term. They will also put more pressure on an already pressured public sector, and are likely to continue to feature in our work.

Public sector reforms

3.8 Public sector reforms have involved significant changes to key public sector agencies and services. These changes include:

- establishing Te Whatu Ora – Health New Zealand and Te Aka Whai Ora – Māori Health Authority;
- merging institutes of technology and polytechnics into Te Pūkenga;
- reforming three waters services; and
- reforming the resource management system.

3.9 The Government is also concurrently considering the future for local government.

3.10 The reforms have, at least during the transition phase, increased risks to the affected sectors' delivery of core services. These risks are likely to continue for some time.

3.11 The reforms will affect our work. For example, the health sector reforms significantly extended the mandate of the Auditor-General to audit both the New Zealand Health Plan and the reporting against it.

3.12 The Public Service Act 2020 has changed the way that public organisations are expected to work together through formal structures such as cross-government initiatives and Interdepartmental Executive Boards.¹¹ It also set new expectations for the public service – in particular, for its stewardship responsibilities and its support for the Māori–Crown relationship.

3.13 There have also been changes to the public finance system through the introduction of clusters of agencies.¹² These are intended to support inter-agency collaboration, help Ministers to collectively direct spending and make trade-offs between related areas, support medium-term planning, and put a greater focus on value for money.

3.14 It is likely that the costs and benefits of all these reforms will face increased attention from Parliament and the public as they are implemented. How successful the reforms are will likely affect public confidence in the public sector and the Government. The Office will continue to pay close attention to the reforms.

¹¹ This is a new model of public service agency designed to draw together chief executives to deal with complex issues that have impacts and policy levers for a wide range of portfolio areas.

¹² The Government is piloting the establishment of two clusters of agencies in the justice and natural resources sectors.

Bringing Māori perspectives more into decision-making

- 3.15 The third area is the public sector's focus on bringing Māori perspectives more into decision-making. This has affected how the public sector operates and delivers its services.¹³
- 3.16 Te ao Māori is an integral part of our national identity. Knowledge of te reo Māori provides an opportunity to better understand and appreciate the cultural landscape of New Zealand. There has been an upsurge in the celebration of te ao Māori, and a revitalisation of te reo Māori across New Zealand, in recent years. Te reo Māori is now embraced as a taonga and a living language of New Zealand. This trend signals positive implications for race relations and the progress and achievement of Māori in New Zealand society.
- 3.17 The Treaty is New Zealand's founding document and part of our constitutional framework. The principle of partnership that underpins the relationship between Māori and the Crown has been evolving over a long period of time, along with the principles of participation and protection. Some areas of the public sector have applied these principles for many years.
- 3.18 New Zealand is now entering a post-settlement phase – about 90 Treaty settlements have been signed in the last three decades. At the same time, the Māori economy has continued to grow and is now a significant factor in the economy of New Zealand. The Treaty settlements, along with a strengthened Māori economy, provide a strong basis for the Māori–Crown relationship to mature – particularly in terms of partnerships between Māori and Crown agencies. Māori are also increasingly represented both in local and central government.¹⁴
- 3.19 Public organisations are increasingly mindful of their responsibilities, as well as the opportunities, to work more closely with Māori. Under the Public Service Act 2020, public service chief executives have responsibility for developing and maintaining the capability of the public service to engage with Māori and to understand Māori perspectives.
- 3.20 Public organisations are at different stages of developing the capability needed to effectively work with Māori. The Office will continue to enhance its relationships with Māori to better understand and plan its work about how the public sector works with Māori and the outcomes it achieves.
- 3.21 Many of the reports of the Waitangi Tribunal are now moving to address contemporary issues. This means that almost every aspect of government could

¹³ See, for example, section 14 of the Public Service Act 2020.

¹⁴ As of 30 June 2021, 16.2% of public service leaders reported being Māori (Te Kawa Mataaho Public Service Commission, www.publicservice.govt.nz).

come under the Tribunal's scrutiny. Those inquiries will likely centre on outcomes for Māori and Māori–Crown relations.

Addressing climate change

- 3.22 Although climate change is a pervasive issue, both central and local government have a key leadership role in addressing it. This includes policy and legislative settings, regulatory interventions, planning, funding, and investing activities, and leadership in reducing the public sector's own carbon emissions and environmental impact.
- 3.23 New Zealand has made significant commitments to reducing carbon emissions, including the Government's updated Paris Agreement commitment to reduce net greenhouse emissions to 50% below gross 2005 levels by 2030.
- 3.24 The Government has introduced various programmes and initiatives to meet these commitments. The public is concerned about progress to address climate change. Any failure to deliver on these commitments will likely be of strong public interest.
- 3.25 The Office also has new responsibilities. These include auditing disclosures about greenhouse gas emissions in climate statements prepared by public organisations, which are covered by mandatory climate reporting requirements. We have an important role in maintaining trust in the reliability of the disclosures.

The rise of misinformation

- 3.26 As we have seen during the pandemic and elsewhere, misinformation can undermine the trust that people have in the public sector and potentially in New Zealand's system of government as a whole.
- 3.27 New Zealanders have more access to information and are more connected on a real-time basis than ever before. People increasingly rely on digital tools, including social media, for news and information.
- 3.28 These tools can improve communications and access to knowledge. However, at the same time, they and the artificial intelligence systems they use have made it easier to disseminate false or misleading information.
- 3.29 How well the public sector connects with the public will be critical to preventing misinformation and a distrust of officials and experts becoming a dominant narrative in future debates. Misinformation in relation to public sector performance can best be countered by transparent, regular, accurate, and reliable performance reporting.

- 3.30 The Office's assurance function supports Parliament and the public to understand how the public sector is performing and whether it is operating with integrity. The factors described above mean that our role as a source of trustworthy information is now more important than ever.
- 3.31 To maintain and enhance trust in the work of the Auditor-General and the work of the Office, we need to protect the Office's independence, exercise the Office's duties and powers responsibly and effectively, carry out our work in a timely manner, and ensure that our work has relevance and impact.
- 3.32 The Office does not generally need to be a high-profile organisation, but we do need those who influence the system to understand our role and for New Zealanders to trust in the work of the Auditor-General.

Building capability for the future

- 3.33 Although many other changes could affect the Office's operating environment during the remainder of my term – for example, natural disasters or escalating international conflicts – the five significant contextual changes discussed above form a frame to build the capability that I consider will be helpful regardless of the context.
- 3.34 When my term began, it would have been difficult to predict the operating environment that I have faced as Auditor-General. We need to be ready for continuing change over the next few years. It will be important to continue to build a broad-based capability to respond to any future environment we might encounter. As we look to the future, the Office will need to attract staff with a wide range of relevant skills and experience to support its role in sustaining and strengthening democratic processes and key institutions in New Zealand's system of government.

The challenges facing the delivery of our mandatory audit work

Challenges in the auditing profession

- 3.35 When I started my term, mandatory audit work was largely completed on time to high quality. However, the audit profession faced clear challenges that needed to be addressed.
- 3.36 Several factors were changing the way an auditor completed their work and, increasingly, the nature of the information that needed to be audited. These factors included:
- the volume and complexity of transactions carried out by organisations subject to audit;

- increased use of difficult-to-audit technologies such as artificial intelligence; and
 - an increase in the complexity and number of laws, regulations, and standards governing how organisations report and the information to be audited.
- 3.37 There were also underlying vulnerabilities affecting the audit profession. These included:
- relying on international recruitment and surge resources to have enough capacity to complete the necessary audit work;
 - a decline in the number of people majoring in accounting in New Zealand’s universities;
 - long-term issues with under-recovery of the costs of some audits;
 - questions in the minds of investors and others about the value of an audit; and
 - questions about whether auditors were truly independent.
- 3.38 The effects of the Covid-19 pandemic crystallised many of the challenges that the audit profession already faced. It turned risks into issues that needed to be addressed urgently.
- 3.39 In particular, the border closures restricted the international flow of auditors (whom the New Zealand audit profession had relied on to help resource audits) and reduced staff availability to carry out audits.
- 3.40 The Covid-19 pandemic also meant that audits were more complex (in areas such as auditing valuations and the capitalisation of costs) and more inefficient (some organisations were unable to prepare information necessary for audits in time). This made it more challenging to complete audits in a timely manner. The pandemic also created significant challenges for preparers of financial statements and performance information in providing auditors with good-quality and timely information to audit.
- 3.41 The most significant challenge facing the profession is a severe and enduring global shortage of auditors at a time when audit work is increasing in volume and complexity.
- 3.42 To illustrate this, in April 2021, a survey of audit service providers by Chartered Accountants Australia and New Zealand revealed that the 13 major audit service providers in New Zealand had 206 senior auditor vacancies. By October 2021, this had increased to more than 260 vacancies.¹⁵

15 Chartered Accountants Australia and New Zealand (December 2021), “Moves to address auditor shortage will maintain trust in New Zealand Inc” at [charteredaccountantsanz.com](https://www.charteredaccountantsanz.com).

Audit delivery challenges for the Auditor-General

Capacity

- 3.43 The Auditor-General is the auditor of all public organisations. This means that the Auditor-General has no discretion to change the number of public audits required each year. This contrasts with private sector audit firms. Private sector audit firms can, and have, relinquished audits from their audit portfolio when they do not have capacity.
- 3.44 In addition, the largest organisations in the public sector have a 30 June balance date. This means that most audit work is completed between July and November to meet statutory reporting deadlines.
- 3.45 During these peak periods, auditors routinely work long hours to meet deadlines. Historically, a significant amount of surge resourcing has been brought into the country to complete the work. In 2019, for example, Audit New Zealand added 252 weeks of additional resourcing between July and December. Other major firms report similar requirements.
- 3.46 These issues have resulted in some audit firms looking at alternative ways to resource audits. For example, most large audit service providers (particularly the “Big 4”) have started to move audit work to so-called low-cost countries (for example, India, Philippines, China, and Vietnam).
- 3.47 Generally speaking, these firms send the audit tasks that need little auditor judgement offshore. However, as their approach matures, they are increasingly sending tasks that involve greater auditor judgement offshore as well.
- 3.48 Although this might create some audit efficiencies, it raises new questions about the protection of information and audit quality. Audits of many public organisations need to access sensitive or classified information. As a result, successive Auditors-General have limited the audit work that can be completed outside of New Zealand.
- 3.49 Sending work offshore can also remove training opportunities for junior auditors in New Zealand, who would be usually allocated this type of audit work.

Sustainable audit fees

- 3.50 The Public Audit Act 2001 (the Act) requires audit fees to be reasonable. In practice, this means that fees need to be reasonable for the public organisation being audited and provide a fair level of return to the auditor.¹⁶
- 3.51 However, audit fees have not always kept pace with the rising costs of providing audit services. This means that audit service providers have not consistently

¹⁶ See section 42 of the Act.

recovered what could be considered sustainable audit fees from public organisations.

- 3.52 The costs of completing an audit have increased for several reasons, including those mentioned in paragraph 3.36. However, the Auditor-General's guidance on setting fees within the model of audits being allocated to audit service providers, rather than being subject to contestable tendering, has historically been restrictive in relation to audit fee increases. This reflects a desire to keep downward pressure on fee increases in the absence of a market setting the price, as is the case for private sector audits.
- 3.53 Sustainable audit fees need to meet rising costs, allow appropriate new investment, enable audit service providers to retain and develop talent, and incentivise auditors to complete audits of appropriate quality.

Specific challenges within the Auditor-General's audit portfolio

- 3.54 Because of the nature of public sector auditing, and because the Auditor-General is required to audit a wide range of public organisations, there are several specific challenges in appointing auditors to complete all of the Auditor-General's audits. These include challenges in finding auditors who will meet the Auditor-General's quality standards and independence requirements.
- 3.55 Some small audit service providers have difficulty in retaining suitably qualified staff and investing in appropriate systems to carry out high-quality public sector audits.
- 3.56 The Auditor-General's Auditing Standards have strict independence requirements that auditors must comply with. This often limits the range of audit firms that can be appointed to complete an audit. For example, a firm providing tax advice to a public organisation would be prohibited from being that organisation's auditor.
- 3.57 Some public organisations expect their auditor to provide a particular skill that not all audit service providers have. For example, auditors of wānanga in the tertiary education sector should have an understanding of tikanga.
- 3.58 Each sector within the public sector also has its own unique challenges. This is particularly the case for the Auditor-General's school audit portfolio. Each of the more than 2400 schools in New Zealand is a Crown entity, and they are all required to be audited by the Auditor-General. Schools make up more than 70% of the total number of entities in the Auditor-General's audit portfolio.
- 3.59 There have historically been challenges in finding enough auditors to complete school audits. This has been because of auditors retiring from the profession or because auditors want to relinquish their audits, often because they do not consider the audit fees to be economic. In other cases, auditors have not been able to keep up with the continued increase in quality requirements.

- 3.60 It might be timely to consider the public accountability arrangements for schools, including the nature of independent assurance over that reporting. We are continuing to work with the Ministry of Education on streamlining the financial reporting and audit process for schools.

The effects of the Covid-19 pandemic

- 3.61 The Covid-19 pandemic has created several challenges for audit firms, including more complex audits and staff shortages (as a result of New Zealand's borders being closed).
- 3.62 Different audit firms have addressed these challenges in different ways. For example, many audit firms reduced their private sector audit portfolios to match their available audit staff. Anecdotally, the larger firms have reduced the size of their overall audit portfolios by about 10% during the last two years.
- 3.63 Given the anticipated delays in completing audits, Parliament passed legislation extending the statutory reporting deadlines for many public organisations (including Crown entities, local authorities, and council-controlled organisations) to enable public organisations to meet their annual reporting obligations for 2019/20, 2020/21, and 2021/22.
- 3.64 Despite this, some audits still could not be completed within the extended statutory time frames. This was particularly the case for audits carried out by the Office's in-house audit service provider, Audit New Zealand.
- 3.65 In 2020/21, 71% of public sector audits were completed by the extended statutory reporting deadlines. We still have a backlog of public sector audits for the 2021/22 year. Although the delays can largely be attributed to the disruption created by the Covid-19 pandemic, addressing what could become a more enduring level of delayed audits needs my attention.
- 3.66 There has been good progress in clearing the outstanding 2020/21 audits. However, the delay in completing public sector audits has had a flow-on effect for the next tranche of audits that need to be completed in 2022. This is at a time when disruptions to, and the complexities in, carrying out audits are expected to continue and public organisations are generally under pressure with fatigued workforces.
- 3.67 To decrease the pressure on Audit New Zealand while it clears its backlog of audits, I have reallocated about 50,000 hours of audit work from Audit New Zealand to other audit service providers with capacity to complete this work on time. Further reallocations might be required.

- 3.68 It is worth noting that the disruption caused by the Covid-19 pandemic has created some positive changes for auditors – in particular, the amount of travel audit teams carry out. I intend that, where possible, the Office’s working environment will continue to benefit from these changes as remote working becomes more normalised.
- 3.69 Like most other organisations, we are continuing to contend with the implications of a hybrid working model, including the implications for our organisational culture.
- 3.70 There are also implications for the Office’s future working environment. The Office leases its office premises and we re-evaluate our size and location needs when we renew those leases. Changing work patterns present an opportunity to think about the Office’s future accommodation needs.

Positioning Audit New Zealand for the future

- 3.71 Successive Auditors-General have chosen to have an in-house audit service provider for several very good reasons.
- 3.72 Having an audit service provider that is solely focused on public sector audits means that the Auditor-General has an ongoing connection with, and direct source of intelligence about, public organisations. Audit New Zealand’s non-profit-seeking objective also gives the Auditor-General a benchmark for the fees that private sector auditors charge.¹⁷
- 3.73 Audit New Zealand is also expected to be the Auditor-General’s auditor of last resort for many sectors. It is also expected to audit in areas where independence requirements mean that other firms are not able to carry out the audit.
- 3.74 As the Auditor-General’s in-house audit service provider, Audit New Zealand is expected to recover its costs over the long term (including for capital expenditure). However, it does not have the same commercial imperative to generate profits as the other audit service providers.
- 3.75 To achieve this, the Office operates a memorandum account for audit and assurance services funded by audit fees.¹⁸ However, given historical constraints on audit fee increases, Audit New Zealand has struggled to build any buffer in the memorandum account to allow for new investment, such as new audit methodologies and tools.

17 To support the requirement for audit fees to be reasonable to the organisation being audited and provide a fair level of return to auditors, the Auditor-General can use Audit New Zealand’s audit fees as a comparison for maintaining reasonable fees for all the audit service providers that carry out work on the Auditor-General’s behalf.

18 The purpose of a memorandum account is to keep the revenue and expenses for activities that are wholly funded by third parties separate from those that are funded by the Crown.

- 3.76 Audit New Zealand has some advantages over private sector audit firms. Because it carries out only public sector audits, it has a deeper understanding of the Auditor-General's expectations of public sector audits.
- 3.77 The Office appoints an independent provider to carry out an annual survey of public organisations about their satisfaction with the audit service they receive. The 2022 survey reinforced that Audit New Zealand's satisfaction scores are consistently lower than those for other audit service providers. The level of satisfaction public organisations have with Audit New Zealand's audit service needs to improve.
- 3.78 About 88% of public organisations audited by audit service providers other than Audit New Zealand were satisfied with their audit, compared with 60% of those audited by Audit New Zealand. Feedback suggests that timeliness of audit completion and communication are important factors in this gap in satisfaction.
- 3.79 As well as clearing the backlog of audits, there is a need to better position Audit New Zealand for the future. This includes further considering its audit portfolio so that the portfolio reflects its strengths and capabilities. There is also a need to build Audit New Zealand's staff capacity, continue investing in technology, review its practice management, and continue to find ways to increase the efficiency of the way it carries out audits.
- 3.80 This work is under way. Repositioning Audit New Zealand for the future will be a priority for the remainder of my term.

4

What I need to focus on

- 4.1 I am satisfied that the Office has made good progress against the Office's strategy and in delivering on the investment Parliament has made since 2019. We now have broader capabilities, which we have used to:
- broaden the focus and approach of our performance audits, inquiries, and other work;
 - refresh and expand our good practice material;
 - increase our use of data and analytics;
 - increase reporting from the Controller function;
 - better target our engagement with Parliament, public organisations, and other groups with an interest in our work;
 - increase our focus on performance reporting;
 - influence improvements in public accountability;
 - increase our staff capability; and
 - improve our information systems.
- 4.2 We have also given greater focus to our cultural capability.
- 4.3 However, some challenges still need to be addressed. These will be a focus for the remainder of my term as Auditor-General. I will need to focus on:
- strengthening our core assurance role and clearing the backlog in audit work created by the Covid-19 pandemic;
 - continuing to increase the impact of our work;
 - enhancing our relationships with Māori;
 - building our influence; and
 - continuing to build our capability.

Strengthening our core assurance role, including clearing the current audit backlog

- 4.4 Auditing as a discipline and career choice is not as popular to students and those entering the workforce as it once was. There are currently fewer students studying accounting at New Zealand universities, and a tight labour market is giving graduates a wide range of opportunities. Historically, international recruitment and short-term supplementation during peak work periods could make up for the reduced number of people entering the audit profession.
- 4.5 Some smaller chartered accounting practices are also choosing to no longer offer audit services.

- 4.6 Offsetting these trends is that private sector audit service providers often prefer public sector audit work to some private sector audits. This means that these firms, even those with limited capacity, are often willing to take on more public sector audit work.
- 4.7 Nevertheless, a key issue for the sustainability of public sector auditing will be securing enough auditors of the right quality to carry out public sector audits in the future.
- 4.8 To some extent, whether or not chartered accounting practices choose to offer audit services will depend on whether auditing continues to be a profitable activity. Therefore, audit fees need to be reasonable for public organisations and allow auditors to cover the cost of completing a high-quality audit, invest for the future, and get a reasonable return for their work.
- 4.9 Although the Office has periodically made changes to audit portfolios for particular audit service providers, we have not reconsidered the appropriateness of the allocation of work to auditors across the Auditor-General's entire portfolio for some time. During the last decade or more (until the recent reallocations related to the Covid-19 pandemic), most changes were related to a single entity and in response to specific circumstances that had arisen.
- 4.10 Audit New Zealand has a deep understanding of the requirements of public sector auditing, including in key areas such as audits of spending against appropriations, audits of performance information, audits of councils' long-term plans, and awareness for issues of waste and probity.
- 4.11 Audit New Zealand also needs exposure to auditing both public benefit entities (such as government departments) and for-profit entities (such as many council-controlled trading organisations and other public organisations with a commercial focus) given the prevalence of groups that include both public benefit entities and for-profit entities, including the financial statements of the Government.
- 4.12 In part, this is because it is important for Audit New Zealand to have a balanced portfolio of audits to sustain relevant capability and to provide the Auditor-General with a direct view of the costs of, and challenges with, auditing all types of public organisations.
- 4.13 We have made progress with some immediate areas of concern. For example, we have developed secondment programmes with international audit offices and allowed staff from outside the country to work on audits in a way that manages information security risks. However, we know that there is much more to be done to reposition Audit New Zealand for the future.

- 4.14 Within the broader sustainability challenges in the Auditor-General's audit portfolio, the school sector has particular risks. Although we might be able to continue to contract school auditors for most schools, this is becoming more challenging for the reasons described in paragraphs 3.58 and 3.59.

Priorities for our core assurance role

- 4.15 My immediate priority is to support Audit New Zealand in clearing its backlog of deferred audits as a result of the Covid-19 pandemic. The current backlog is affecting Audit New Zealand's reputation and increasing the stress on staff, who have been under sustained pressure since the pandemic began. The backlog is also diverting attention away from repositioning Audit New Zealand.
- 4.16 To ensure a sustainable audit portfolio, it is timely to review the allocation of public sector audits. I have begun work to determine the appropriate portfolio for each of my audit service providers. During the next three years, I will use this review to move audits to the audit service provider I consider best suited to carry out the work in the medium to long-term.
- 4.17 Reviewing the audit portfolio will provide an opportunity to test whether the Office is providing each audit service provider (including Audit New Zealand) with a portfolio of public organisations that reflects their particular skills, knowledge, and capacity.
- 4.18 A key consideration will be reconfirming what Audit New Zealand's best role is in delivering public sector audits. To this end, I have started a review of Audit New Zealand. This review is looking at what a sustainable business model for this part of the Office is, capturing the benefits of our investment in new technology for audit delivery and practice management, and considering the right level of integration for Audit New Zealand within the Office's broader work (for example, how Audit New Zealand staff might be deployed on other work of the Office when capacity allows).
- 4.19 As noted in paragraph 3.60, there is an opportunity to consider the appropriateness of the public accountability arrangements for schools and to work with the Ministry of Education during the remainder of my term on streamlining financial reporting for schools and audit processes.

Continuing to increase the impact of our work

- 4.20 To remain relevant to Parliament and the public, we need to continue to focus on matters of public interest, concern, and risk. To do this, we will need strong intelligence gathering, analysis, and insight to inform our discretionary work programme, areas of audit emphasis, and matters that lend themselves to guidance and/or research.
- 4.21 We will continue to build on the forums we have developed (such as the Audit and Risk Committee Chairs' forums) and, as we did this year, consider surveying the public directly on the areas of interest they may have to inform our work.
- 4.22 We will continue to have regular discussions with select committee chairpersons as a group (to supplement regular individual meetings) and continue to invite members of Parliament to briefings on our reports.
- 4.23 We need to enhance our data and analytics capability and apply this to our mandatory audit work more effectively. We also need to extract more insight from the information we collect.
- 4.24 During the Covid-19 pandemic, we saw that the public sector was understandably more focused on the immediate than the longer term. Although this was understandable, climate change, carbon emissions reduction, and many of the Government's social and environmental programmes need a long-term perspective. The Office is in a unique position to help Parliament and the public by shining a light on how well placed the public sector is to address these and other long-term challenges.
- 4.25 Higher government debt levels in recent years – as a result of responding to the Covid-19 pandemic – have been a matter of increased public interest. Similarly, we expect the Office's role in considering value for money to also be of increasing public interest.
- 4.26 Understanding the performance of the public sector will rely on how well it reports on its own performance. This has been an area of concern to the Office. We will need to continue to focus on it for the remainder of my term.
- 4.27 We will continue to maintain our focus on, and promote improvement in, matters related to trust and integrity. This will include broad-based integrity audits of public organisations.

Continuing to enhance our relationships with Māori

- 4.28 To remain relevant, the Office must continue to be seen as trustworthy. We need to make sure that public organisations are held to account in a way that Parliament, iwi, hapū, and whānau Māori, as well as the wider public, can have confidence in.
- 4.29 The Office has recently developed a te ao Māori strategy and appointed our first director-level position designed to lead our capability development internally and help us build deeper and richer relationships with Māori.
- 4.30 The Office will need to carry out a significant programme of work to build our capability and our relationships in this area. Making progress with this work and establishing a basis for long-term relationships externally will be a key focus for me.

Building our influence

- 4.31 Although the Office has continued to produce work of significance and impact, the public generally does not have a good understanding of our role and what we stand for.
- 4.32 Declining public trust in governments around the world and an increase in widespread misinformation highlights the need for the Office's independent, authoritative, and trusted voice.
- 4.33 This does not mean that we need a high public profile. However, we must continue to be seen as a source of truth in a setting where there is an overload of information and increasing amounts of misinformation.
- 4.34 To do this, we need to be clear about whom we wish to influence and how best to do this. The roles of the Auditor-General and Deputy Auditor-General in informing public debate need to be more specifically defined.
- 4.35 We also need to provide the information and reports we produce in a way that is relevant and easily accessible. Communicating clearly to the right people in the right ways will be a key area of focus for the Office.

Continuing to build our capability

- 4.36 To achieve these changes, we will need to continue to invest in our people, processes, tools, and technologies.
- 4.37 Given the nature of the Office's work, we need staff who can operate in multiple environments and often in complex and high-stress situations. They need sound judgement, analytical capabilities, and advanced interpersonal and communications skills. These staff are not easy to recruit.
- 4.38 As a consequence of the Covid-19 pandemic (which has increased workload) and the auditor shortage (which is driving increased salaries across the profession), staff turnover in Audit New Zealand has been unusually high in recent years. With borders re-opening, auditors are also taking the opportunity to travel and work overseas. We need to build strong staff capability by addressing, where we can, the reasons people might leave. We also need to continue to invest in people's training, development, and careers to retain staff for longer.
- 4.39 Doing all we can to build our workforce, retain the highly talented staff we have, and address our gender pay gap will continue to be a priority for me (see paragraphs 2.53 and 2.54). These will be key components of our new people strategy.
- 4.40 We also have well-developed plans to invest in technology and data and analytics to enhance the efficiency of how Audit New Zealand delivers audits. Key to many of the changes I have discussed in this Part will be implementing Audit New Zealand's new audit tool in 2023, replacing our audit contract management system (also in 2023), and developing more robust data and analytics capabilities.
- 4.41 All of these matters require a strong financial base for the Office. In the short term, although we have adequate Crown funding for our discretionary work, we are forecasting deficits in our memorandum account for our mandatory audit work. During the next five years, we will need to address these forecast deficits by improving the efficiency of how we carry out mandatory audits, increasing audit fees, and, where appropriate, seeking further direct investment from the Crown.

Appendix 1

Reference group biographies

Sir John Clarke (Ngāti Porou and Ngā Puhī)

Sir John has worked in a wide range of environments in the public sector, including education, justice, health, human rights, Crown law, social welfare, environment, and heritage.

Sir John has played a major part in Māori-Crown relations and been the principal cultural adviser to all Ministers of Treaty Settlements for more than 25 years. He has held numerous senior management positions in the public sector, including Chief Executive of the then Ministry of Māori Affairs and Group Manager Department of Justice. He has also served as Race Relations Conciliator and Human Rights Commissioner.

Sir John is the former principal of Ngata Memorial College and Wellington High and Community Institute. He was involved in implementing te reo Māori in secondary schools from 1971 to 1977.

Sir John has conducted eight major inquiries as a member of the Waitangi Tribunal. He is currently chairperson of the Māori Heritage Council and principal adviser to the Asthma and Respiratory Foundation and Pharmacy Council. He is a Trustee of Te Rimu Ahuwhenua Trust and Tokarangi Forest Trust. Sir John is a former recipient of the Sir Woolf Fisher Fellowship and was made Knight Companion of the New Zealand Order of Merit in 2018.

Sir Maarten Wevers

Sir Maarten is a former New Zealand diplomat and public servant who served as New Zealand's High Commissioner to Papua New Guinea and Ambassador to Japan. He was the Chief Executive of the Department of the Prime Minister and Cabinet from 2004 to 2012.

Sir Maarten has held several governance roles. Between 2013 and 2018, he was the Chairman of the Board of the Earthquake Commission, and he is currently the Deputy Chair of the Fred Hollows Foundation of New Zealand. He has also served as Registrar of Pecuniary and Other Specified Interests of Members of Parliament since 2013.

Sir Maarten was made a Knight Companion of the New Zealand Order of Merit in 2012.

Margaret Devlin

Margaret is a professional director operating primarily within the infrastructure sector, with a particular focus on audit, risk, diversity, and inclusion.

Margaret is Chair of Watercare Services Limited, Lyttelton Port Company Limited, Infrastructure NZ, and Hospice Waikato. She is a Director of Waikato Regional Airport Limited, London Green Limited, Dairy NZ Limited, and Waimea Water Limited. Until 30 June 2022, she was also a Director of Aurora Energy Limited.

Margaret has extensive experience in governance and executive management in New Zealand and the United Kingdom, primarily in the water and infrastructure sectors.

Margaret is a Chartered Fellow of the New Zealand Institute of Directors.

Grant Hehir

Grant Hehir is the Auditor-General for Australia. Grant started his term as Auditor-General on 11 June 2015.

Before his appointment as Auditor-General for Australia, Grant served as the Auditor-General for New South Wales between November 2013 and June 2015. He worked for the State Government of Victoria between 1998 and 2013 in several senior roles, including as Secretary of the Department of Treasury and Finance, and the Department of Education and Training.

He is a fellow of CPA Australia and the Institute of Public Administration Australia.

Appendix 2

List of external interviewees

Names	Position held at date of interview
Duncan Webb	Chairperson, Finance and Expenditure Committee
Caralee McLiesh	Chief Executive and Secretary to the Treasury
Struan Little	Deputy Chief Executive and Deputy Secretary, Budget and Public Investment, The Treasury
Peter Hughes	Public Service Commissioner and Head of Service, Te Kawa Mataaho
Helene Quilter	Deputy Public Service Commissioner, Te Kawa Mataaho
Tony Lynch	Acting Chief Executive, Department of the Prime Minister and Cabinet
Paul James	Chief Executive, Department of Internal Affairs
Steven Sutton	Deputy Secretary, Critical Projects and Governance, Te Puni Kōkiri
Bruce Robertson	Chairperson and member of several local authority audit and risk committees
Warren Allen	Chairperson of the Office's audit and risk committee
Karen Thomas	Chief Executive, Taituarā – Local Government Professionals Aotearoa
Susan Freeman-Greene	Chief Executive, Local Government New Zealand
Jim Palmer	Chairperson, Review into the Future for Local Government
Richard Harman	Journalist
Nikitin Sallee	Journalist
Ian Ball	Professor of Practice – Public Financial Management, Te Herenga Waka Victoria University of Wellington
Norman Gemmell	Chair in Public Finance, Te Herenga Waka Victoria University of Wellington
April Mackenzie	Chief Executive, External Reporting Board
Peter Vial	Group Executive New Zealand and the Pacific, Chartered Accountants Australia New Zealand
Gordon Hansen	Partner, PKF Goldsmith Fox (the Auditor-General's external auditor)
Julie Haggie	Chief Executive Officer, Transparency International New Zealand
Anne Tolley	Chairperson, Transparency International New Zealand and Commission Chair, Tauranga City Council
James Jong	Chief Internal Auditor, Ministry of Education and Head of Profession, Internal Audit and Risk Assurance
Matthew Tukaki	Chairperson, National Māori Authority
Haami Piripiri	Chairperson, Te Rūnanga o Te Rarawa
Arihia Bennett	Chief Executive Officer, Te Rūnanga o Ngāi Tahu

The Office contracts an external provider to survey select committee chairpersons every two years. They included questions relevant to the mid-term review in the 2022 survey. The survey incorporated interviews with eight select committee chairpersons, and this review has taken those results into consideration.

Appendix 3

Good practice guidance since 2019

Title	Date	Description
<i>Putting integrity at the core of how public organisations operate: An integrity framework for the public sector</i>	July 2022	Advice to support leaders throughout the wider public sector in taking a whole-of-organisation approach to building a culture of integrity in their organisations. We designed a simple interactive tool that explains the integrity framework. For ease of reference, we also produced an A3 version of the framework that can be downloaded and printed.
<i>Managing conflicts of interest in procurement</i>	March 2022	This includes six common scenarios where conflicts of interest can arise during procurement. The resource sets out why the scenario represents a conflict of interest, how it might affect trust and confidence, and why some proposed mitigations may not fully address the risk. The scenarios also provide some ways to help avoid, mitigate, or manage the conflicts.
<i>Setting and administering fees and levies for cost recovery: Good practice guide</i>	August 2021	This is an update of the guide we published in 2008 and has been expanded to cover some levies as well as fees. It also updates the principles that public organisations should consider when making any decisions on setting and administering fees and levies.
<i>Getting it right: Managing conflicts of interest involving council employees</i>	August 2021	In this article, we share our findings on how conflicts of interest of council employees, including the chief executive and staff, are managed across four councils.
<i>Controlling sensitive expenditure: Guide for public organisations</i>	October 2020	This guide provides practical guidance on specific types of sensitive expenditure and outlines the principles for making decisions about sensitive expenditure.
<i>Local Authorities (Members' Interests) Act 1968: A guide for members of local authorities on managing financial conflicts of interest</i>	June 2020	We want members who are covered by the Local Authorities (Member's Interests) Act 1968 – and those advising them – to be aware of the Act's rules and the steps they need to take to ensure that they do not inadvertently breach them. This guide also explains our statutory functions under the Act.

Appendix 3
Good practice guidance since 2019

<i>Managing conflicts of interest: A guide for the public sector (and resources)</i>	June 2020	In this guide, we describe conflicts of interest in the public sector and how to identify, disclose, and manage them. It represents our view of what constitutes good practice in the public sector. We also published resources to support the updated good practice guide.
<i>Severance payments: A guide for the public sector</i>	June 2019	This guide is intended to help public sector employers when considering making a severance payment to a departing employee. It replaces our 2012 publication and has been updated to reflect more recent case law and changes in accounting standards.

Appendix 4

Background information on public sector auditing and the Office's systems and processes

What is covered in a public sector audit?

A public sector audit will consider whether:

- a public organisation fairly reflects the delivery of its services and the results of its activities in its financial statements and, as required, statement of service performance;
- a public organisation is complying with aspects of its statutory obligations;
- a public organisation is carrying out its activities effectively and efficiently;
- waste is occurring or likely to occur as a result of any act or failure to act by a public organisation;
- there is any sign or appearance of a lack of probity as a result of any act or omission by a public organisation or by one or more of its members, office holders, or employees; or
- there is any sign or appearance of a lack of financial prudence as a result of any act or omission by a public organisation or by one or more of its members, office holders, or employees.

The Public Audit Act 2001 (the Act) sets out the last five of these requirements.¹⁹ As a result, a public sector audit is broader than a private sector audit, which will usually only consider whether the organisation fairly reflects the results of its activities in its financial statements.

The simple existence of an audit has value because the public sector knows that its work will be independently reviewed and reported on. Knowing that it will be audited can also moderate a public organisation's activities so that it is more consistent with the expectations set out in its legislative and regulatory framework.

Audits come at a cost that management and those charged with governance sometimes see as a compliance cost that should be minimised. This can be because the public organisation is paying for a service that it is a secondary audience for. The primary audience is Parliament and the public.

This is particularly the case in more commercially based public organisations, such as council-controlled trading organisations, port companies, and Crown research institutes. These organisations have a Board that may have expectations about what an audit will or will not cover. Although these Boards may not be the audit's primary audience, they should receive a professional audit service.

¹⁹ See section 16(1) of the Act.

Independence

The Act provides a robust and broad mandate to ensure that the Auditor-General is independent of both central and local government. This level of independence is comparatively rare worldwide, but it is essential to the performance of the role.

To be able to discharge their role effectively, the Auditor-General needs to be able to challenge the effectiveness, efficiency, and integrity of public sector processes and those responsible for implementing and governing those processes, including Ministers.

The duty to act independently is part of the affirmation of Office that all Auditors-General must make as part of their appointment process. This is a legislative requirement that the Act sets out.²⁰ Other than the Act's requirements, the Auditor-General cannot be directed to carry out a piece of work.²¹

The Act is more than 20 years old. Surveys of Australian and New Zealand legislation commissioned by the Australasian Council of Auditors-General have considered the independence of those Auditors-General. New Zealand has consistently been rated with the highest or second-highest score.

The survey considers key factors that contribute to the independence principles of the International Organisation of Supreme Audit Institutions (INTOSAI). The results show that the Act contains the appropriate safeguards for the role of the Auditor-General to remain independent and that the Auditor-General has the appropriate powers to carry out their mandate.

INTOSAI's performance measurement framework recommends that the role of the Auditor-General be written into the state's legal framework at the highest level, ideally within its constitution. Because New Zealand does not have a written constitution, it is theoretically possible that a simple majority vote of Parliament could alter or repeal the Auditor-General's independence and mandate.

As a result, it is essential that politicians and the public understand and respect the independent role that the Auditor-General plays in New Zealand's public accountability system and that the way the Auditor-General and their Office operates is maintained.

To be effective and credible, the Auditor-General and their staff must be independent of the public organisations being audited. To ensure independence, the Act provides that the Auditor-General:

- is an officer of Parliament and can report directly to Parliament;

²⁰ See section 9 of the Act.

²¹ For example, the Auditor-General cannot be directed to complete a performance audit or inquiry by whichever political party holds power.

- is appointed by the Governor-General on the recommendation of the House of Representatives for a single term of no more than seven years;
- is paid under a permanent legislative authority from Parliament, with the amount determined independently by the Remuneration Authority; and
- makes any requests for funding directly to Parliament through the Officers of Parliament Committee (rather than through the Executive).

Auditors whom the Auditor-General appoints to carry out audits on the Auditor-General's behalf must also be independent. When the Auditor-General appoints an auditor, they are required to sign an engagement form to confirm that they will comply with the requirements of objectivity and independence and carefully manage conflicts of interest. There are also strict limits on the number of years that senior team members can audit the same public organisation.

Auditing firms are sometimes asked to carry out reviews or provide consultancy advice to the public organisations that they audit. The Auditor-General has a standard that covers whether auditors can accept those other engagements. Only engagements of an assurance nature can be carried out as well as the audit.

Audit service providers are required to get approval from the Office of the Auditor-General before they can accept those other engagements. This will be provided only after a rigorous assessment to ensure that independence is preserved.

The work allowed in the Auditor-General's Auditing Standards is more prohibitive than the standards applying to private sector audits. Independence standards applying to private sector audits allow auditors to carry out non-assurance work, including tax planning, that the Auditor-General does not permit. This position has been taken because there have been high profile international failures where conflicts of interest have been at least part of the issue.

In recent years, I have increased my expectation of audit service providers' independence to ensure that commercial interests do not undermine this fundamental tenet of auditing.

All the Office's staff are required to complete an annual employee independence declaration. This outlines their financial interests and relevant personal, employment, and business relationships.

Six months later, every employee must complete a statement of compliance. This confirms that their personal independence disclosures are up to date and that they have complied with specified key independence policies of the Office.

The Office actively uses this information to ensure that staff resourced on audits and inquiries are independent in both fact and appearance.

The Auditor-General does not comment on government or local authority policy decisions, because these are appropriately determined by democratically elected representatives. However, the Auditor-General can report on whether public organisations are carrying out their activities effectively and efficiently in a manner consistent with those policy decisions and, ultimately, whether those activities are achieving their stated aim.

Despite the Office's relatively settled constitutional position, legislation has been proposed in recent years that would extend the power of the Executive in a way that would affect the independent role of the Auditor-General and other Officers of Parliament.

Although we do not consider that these proposals were deliberately planned to have this effect, we need to be constantly vigilant about this.

Quality

New Zealanders benefit from a mature public accountability regime and a strong public financial management system.

New Zealand legislation sets out most reporting requirements for public sector organisations, particularly the content of, and time frames for, reports. Financial reporting standards developed by an independent standard setter, the External Reporting Board (XRB), support this legislation.

Most public organisations in New Zealand understand the importance of transparency and accountability, and of completing annual financial and non-financial reporting to a high standard in a timely way.

They are also largely receptive to the recommendations that auditors make to further improve their reporting and operational effectiveness and efficiency. For example, in 2021/22, large public organisations implemented 676 recommendations to improve systems and processes that auditors had made during the annual audits.

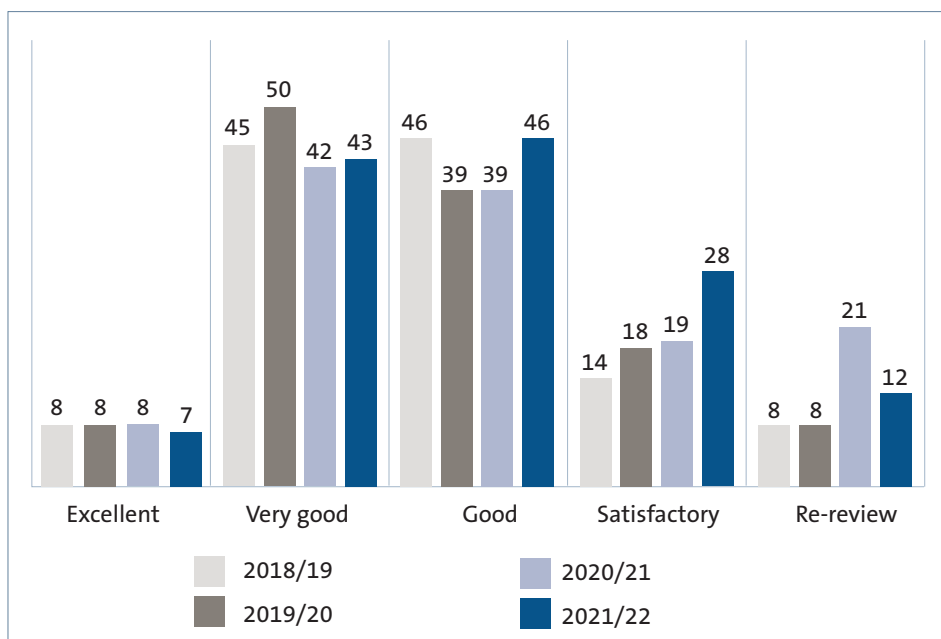
Audits carried out on the Auditor-General's behalf must reflect the unique nature of the organisations in the New Zealand public sector and the standards that should be expected from those who manage public resources.

For this reason, the Auditor-General can determine how audits are done by setting their own auditing standards. These are known as the Auditor-General's Auditing Standards. So that these standards are transparent to Parliament and the public, the Auditor-General is required to publish the auditing standards they apply or intend to apply in a report to the House of Representatives at least once every three years.²²

The Auditor-General's Auditing Standards consist of the Professional and Ethical Standards (including standards for quality) and the Auditing Standards of the New Zealand Auditing and Assurance Standards Board. These are supplemented by Auditor-General's Statements. The Auditor-General's specific standards cover situations where there is generally no equivalent standard issued by the XRB.

Each year, staff from the Office of the Auditor-General's quality assurance team review the quality of mandatory audits against the Auditor-General's standards. The quality assurance programme covers all appointed auditors during a three-year cycle and assesses the quality of audits. Figure 1 shows the quality grades for appointed auditors for the last four years.

Figure 1
Audit quality grades for all appointed auditors, 2018/19 to 2021/22



All audit service providers, including Audit New Zealand, also have their own quality assurance programmes and are subject to external reviews by professional accounting bodies and regulators. The external reviews of Audit New Zealand are on the invitation of the Auditor-General.

External reviews provide additional scrutiny of the Office's quality control systems and processes, and help benchmark their effectiveness. While we were completing this mid-term review:

- the Financial Markets Authority was carrying out a review of Audit New Zealand's system of quality control and a sample of issuer audits; and
- the New Zealand Institute of Chartered Accountants was carrying out a practice review of Audit New Zealand.

Quality assurance reviews are also carried out on other Office products. A quality assurance review of selected inquiries was recently completed. It found that the inquiries were within the Auditor-General's mandate and that there was clear evidence to support the judgements and findings in the reports.

In 2019, a quality assurance review of three performance audits concluded that they were supported by enough appropriate audit evidence. The most recent quality review of a sample of performance audits was carried out in September 2022.

Every two years, the Australian National Audit Office reviews two performance audits and provides feedback and suggestions for improvement. This is a part of a mutual peer review relationship, and staff from the Office also review the Australian National Audit Office's performance audits.

A new standard for quality needs to be adopted by the end of 2022. This is Professional and Ethical Standard 3 – *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements* (PES 3).

PES 3 requires the Auditor-General to sign off an annual monitoring report by 15 December 2023 that formally concludes that the objectives of the standard have been met. This will need a step-change in reporting and monitoring of quality by those that have ownership of, and responsibility for, Office products.

The adoption of PES 3 provides an opportunity for the Office to consider and integrate the multiple reviews that help to provide assurance over the quality of the Office's work.

In adopting PES 3, the quality assurance team will also have additional responsibilities for managing the system of quality and monitoring. The audit quality team has not been at full capacity for some time. There are staff vacancies and audit quality staff have been deployed to support other parts of the organisation.

As a result, there have been delays in completing the Office's programme of quality assurance reviews. A governance group from the Office has been monitoring this regularly.

Given the importance of the Office producing high-quality work, monitoring and governance over the quality assurance programme must continue. It is particularly important to gain assurance that delays to quality assurance reviews are not compromising the Office's strong quality assurance systems and the move to new quality assurance standards.

Being held to account

The Crown funds the Auditor-General through Vote Audit for performance audits and inquiries and supporting accountability to Parliament. Annual audits and other assurance work carried out by Audit New Zealand are funded from audit fees paid by public organisations.

As an Officer of Parliament, the Auditor-General does not have a responsible Minister. The Officers of Parliament Committee, which is chaired by the Speaker, is responsible for considering funding requests by the Auditor-General. The Finance and Expenditure Committee reviews Vote Audit.

The Officers of Parliament Committee appoints a private sector auditing firm to carry out an annual audit of the Auditor-General's financial and non-financial performance. Policies ensure that the auditor appointed by the Officers of Parliament Committee is independent of the Office and performs only minimal or no audit work for the Auditor-General as a contracted audit service provider.

The Auditor-General also has an Audit and Risk Committee. Three of its four members are independent of the Office (including the chairperson). This committee reports publicly on its activities in the Office's annual report.

The Office's audit allocation model and fee-setting processes are independently reviewed annually. The findings of this review are also set out in the Office's annual report.

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