Controller and Auditor-General
Tumuaki o te Mana Arotake

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Observations from our central government work in 2022/23

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Chris Tse, Office of the Auditor-General

Observations from our central government work in 2022/23

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December 2023

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Auditor-General's overview

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

For the public sector to have the social licence it needs to do its work well, it must be trusted by the public.

We know that, in many countries around the world, trust in governments is declining. In New Zealand, although we continue to have reasonably high levels of trust in the government and its institutions, parts of our society have lower levels of trust. We also know, as we have seen in recent Parliament protests, that for many, trust is vulnerable and can rapidly erode.

When we consider what drives trust in the public sector, we often talk about competence – providing core public services effectively and efficiently; reliability – providing those services in normal times and times of crisis and stewarding the system for the long-term; and whether people believe the public sector acts honestly, openly, and fairly. The perception of honesty can be far more significant than competence and reliability in determining whether the public sector is viewed as trustworthy.

As Auditor-General, I am deeply interested in the trust that the public and Parliament have in the public sector. This means considering how well the public sector is demonstrating its competence, reliability, and honesty.

Central government audits

My annual audits, including the audit of the financial statements of the Government, provide assurance that the financial reporting of the Government complies with generally accepted accounting practice. This work forms the basis for much of my reporting to Parliament and assists the annual review process where select committees, on behalf of Parliament, scrutinise the performance of public organisations.

The financial statements of the Government remain world-leading in many respects. They are prepared on a timely basis, to appropriate accounting standards, and present the information in a manner that I consider to be fair and materially correct. This is no small achievement and one we should continue to celebrate, especially in a year when major reforms and severe weather events made their preparation more complex.

The public sector also continues to ensure that it works within the authority provided to it by Parliament. Although breaches of that authority do still occur, attention to this issue over recent years has meant that these breaches have reduced.

However, good financial reporting and robust independent assurance of financial information is not sufficient to demonstrate the competence, reliability, and honesty of the public sector. If good financial reporting was all that was required, we would have few concerns about public trust.

We know that most annual reports are unlikely to be widely read or understood. They can be complex, dense, and limited in what they report on and how they are communicated. They meet statutory reporting requirements, but often do not report on what matters most to the public.

The public and Parliament can be more interested in the outcomes public organisations are seeking to achieve, the initiatives that will deliver those outcomes, the public money spent on them, what has been achieved, value for money, and the work done to sustain and protect the resources that organisations are the stewards of. But these questions are rarely answered in the public reporting provided by public organisations.

Although there is good practice in how some public organisations report on aspects of their performance, we continue to see reporting that points out how busy public organisations have been rather than what they have achieved and what impact they have had on the outcomes the public is interested in. Reporting often gives little useful information for either the public or Parliament to effectively scrutinise the performance of these public organisations. There are few other areas of our lives where we would accept paying for services with no comprehensive understanding of what we received for the money we spent.

When we consider the reforms in education and health, for example, it is important for the public to understand the challenges in these reforms, the progress being made, and the time frames over which substantive progress to achieving the intended reform outcomes will occur. This would enable an informed discussion on whether these reforms are working and are value for money.

This type of reporting is not easy and there is no legal requirement to do it. The recent Standing Orders Committee recommendation that Parliament open an inquiry into performance reporting and parliamentary accountability could inform legislative changes that I believe are needed to ensure that public organisations regularly report on what matters most to the public and Parliament.

Recurring concerns

There are other matters that affect public trust – some of which we have raised many times in recent years.

The public expect the public sector to operate fairly and transparently. We continue to see issues with the way that procurement is managed by public organisations. The appropriate management of conflicts of interest in particular, at all levels of government, has proven to be a recurring theme.

Māori continue to have lower trust in the public sector than many other New Zealanders. Our work has highlighted good practices that some public organisations have been following to build trust, with real success. But we have also seen a lack of substantive progress and leadership in embracing whānau-centred approaches across the public sector in areas where they are known to be successful.

The New Zealand Defence Force asked me to look at how it was progressing with efforts to eliminate harmful behaviours and sexual violence in its organisation. No one should feel unsafe from their colleagues in the workplace. Harmful behaviours and sexual violence are not only intolerable and damaging at a personal level, they can seriously undermine public trust in an organisation and in the public sector more generally.

Another integrity issue we have highlighted over several years is the unpaid liability for incorrectly calculated holiday pay. For the health sector, this was more than $2 billion at 30 June 2023. Although some payments to staff have recently begun to be made, this has taken many years. More attention and urgency should have been given to correctly paying staff their legal entitlements, especially when many New Zealanders are experiencing a cost-of-living crisis.

Serving New Zealanders during crises

The significant weather events in the early part of 2023 and work we have done elsewhere reinforce that the public is less interested in who provides services and more interested in how local and central government work together to provide services when and where they are needed. Although there is considerable effort put into this relationship, both central and local government report ongoing challenges in working together.

Given recent events, the public and Parliament may well want to know whether the public sector is adequately prepared to manage future emergencies. Our work on Covid-19 reiterated a message from the World Health Organisation that government responses to crises are often characterised by "panic then forget".

Whether the Government has adequately considered the likely risks to New Zealand in repeated crises (such as droughts, floods, and earthquakes) were matters we considered when looking at the Treasury's *He Tirohanga Mokopuna* (its 2021 long-term fiscal statement and insights briefing). There are many lessons from Covid-19 that the public sector needs to learn from and embed in how it operates. The public rightfully expects the public sector to be prepared for the next crisis.

Acknowledgements

As Auditor-General, I am often asked to look at matters that have not gone to plan. However, in our experience, the public sector generally performs its responsibilities diligently, with integrity, and with a genuine concern for the welfare of all New Zealanders. The work is hard and often thankless. There are multiple pressures on the public sector and a low tolerance for failure. Although no public sector is perfect, and there will always be matters that can be improved, I add my thanks for the work of the public sector in supporting New Zealand and New Zealanders.

I also thank my staff and audit service providers who, over recent years, have worked in difficult circumstances to assure the public and Parliament on the integrity of our public financial management system and the performance of the public sector. The need for robust independent assurance remains critical to building and maintaining trust in our public management system.

Finally, I thank Parliament for its ongoing support of my Office and the work we do.

Nāku noa, nā

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

11 December 2023

The operating environment for central government

1

1.1 In this Part, we describe the environment in which central government agencies are operating, including:

- the continuing challenges of the Covid-19 environment;
- the North Island weather events and their implications for public organisations;
- climate change and its effects on the way we plan and invest in infrastructure;
- how the public sector is responding to challenges with new governance structures and ways of working;
- our audit delivery progress amid these challenges; and
- changes to the way Parliament scrutinises public organisations, and how we plan to support this.

Recovery from a pandemic alongside inflationary and efficiency pressures

1.2 Covid-19 restrictions were relaxed in early 2022, allowing for increased mobility in and out of New Zealand during 2022/23. The immediate response to Covid-19 became a less prominent part of the public sector's work from the second half of 2022. However, the effects of Covid-19 were still evident through deferred work and backlogs in some sectors, and effects on staffing, costs, and supply chains.

1.3 Inflationary pressures on salaries and other costs have continued to affect the public sector. In August 2023, the Minister of Finance directed many public organisations to cut baseline costs and reduce spending on contractors and consultants. In the lead-up to the 2023 election, the size of the public sector and the value for money it is delivering were much discussed. The challenge in the current operating context will be maintaining service delivery levels and quality while reducing the cost of providing those services.

1.4 There continues to be an insufficient amount of cost and efficiency measures in Government agency reporting. Having a good understanding of value for money and other cost and efficiency measures allows a more focused discussion on cost-reduction options and any trade-offs they might entail. We discuss performance reporting and its importance for public accountability in more detail in Part 2 of this report.

1.5 Parts of the public sector are experiencing significant change. In particular, the reforms to the health and tertiary sectors and proposed changes to water services require careful management to achieve their intentions. For example, the Pae Ora (Healthy Futures) Act 2022 changed the health sector by consolidating a variety of health organisations, including the 20 district health boards. Achieving the goals of the reforms, as well as implementing any decisions made by the incoming Government, will continue to be a key challenge for the public sector.

North Island weather events

1.6 In early 2023, weather events (including Auckland flooding and Cyclone Gabrielle) caused significant damage and disruption across six regions of the North Island. The rebuild and recovery effort will be significant, not least because the events affected a wide geographical area and placed stresses on many communities that were already experiencing economic and other pressures.

1.7 After the weather events, central and local government agencies responded by setting up new work programmes under new governance structures and distributing funding to businesses and communities. Immediate funding decisions included money for urgent infrastructure repairs, assisting with temporary accommodation, and providing business and community support.

1.8 Such responses rely on the public sector's capability to rapidly shift resources to adapt and respond to unexpected events. They are pressured times for public servants in both central and local government, who work extremely hard responding to these events under difficult circumstances.

1.9 High levels of co-operation and co-ordination are required between central and local government to support regions' recovery from the weather events. For councils, the weather events have added further uncertainty to an operating environment influenced by several concurrent policy reform programmes (resource management reform, water management, and the Future for Local Government review). There will be challenges ahead in working out how cyclone damage will be repaired and paid for, as well as determining what level of resilience can be achieved in the future. Resourcing will be a particular barrier for smaller councils.

1.10 The Treasury has forecast about $9 billion of cyclone-related rebuild and recovery investment activity between 2023 and 2026 (with a further $1 billion after this) in both the public and private sectors. About $5 billion of this relates to local and central government infrastructure.

1.11 The Treasury is monitoring and tracking central government cyclone-related spending. This is an encouraging initiative that supports accountability for this significant amount of government spending.

1.12 In recent years, we have emphasised the importance of transparency and integrity in public spending decisions, particularly in response to crises.[1] Recent events have seen significant expenditure using approaches such as high-trust funding arrangements, policies prepared at speed, and urgent procurement processes. These have been necessary steps, but they have come with risks to probity and can raise questions about integrity and value for money.

Climate change and its effects on planning and investing in infrastructure

1.13 The state of infrastructure in New Zealand is affected by a range of factors, including population pressures and increasing construction costs. Some sectors are experiencing an infrastructure deficit. The effects of the recent weather events have yet again highlighted the need to factor climate resilience into infrastructure planning and management.

1.14 The public sector shapes the systems and policies needed to help communities adapt to climate change in the short term, and to mitigate its effects in the longer term. Many public organisations are already responsible for meeting commitments under the Government's National Adaptation Plan and the Emissions Reduction Plan. The changes required by these plans will be wide-reaching, including adapting legislative and decision-making frameworks, co-ordination within and across levels of government, and funding mechanisms to enable adaptation to climate risks.

Responding to challenges through new governance arrangements and ways of working

1.15 Many of the challenges that New Zealand faces require public organisations to innovate and work together. In December 2022, the first State of the Public Service report noted that further change is needed in the way the public service operates to be able to work in more people-centred and collaborative ways. We agree with this.

1.16 In 2020, the Public Service Act introduced new structures and ways of working to help the public service adapt and work more effectively, such as inter-departmental ventures and joint operational arrangements. The Act also allows for interdepartmental executive boards "that support joined-up planning and budgeting and/or policy alignment on complex cross-cutting issues".[2]

1 Our article *Getting it right: Supporting integrity in emergency procurement* suggests improvements public organisations can make to maintain high standards of integrity when carrying out emergency procurements. *Managing public funding in an emergency response or recovery* is a short article to help public sector staff ensure robust and transparent decision-making even when fast action is required. See oag.parliament.nz/reports.

2 See the fact sheet *Organisations of the Public Service* on the website of Te Kawa Mataaho at publicservice.govt.nz.

1.17 As these systems evolve, we will keep a focus on transparent and meaningful reporting of the resources allocated to this work, whether substantive changes are evident in the way the public service is operating, and, ultimately, what has been achieved.

1.18 During 2022/23, we reported that adopting these new ways of working can be difficult, even where there is consensus that change is needed. There is a tension between the need to act with urgency and the need to take time to build trust and relationships.

1.19 We reviewed Te Puna Aonui, the interdepartmental executive board established to simplify government agency collaboration to eliminate family violence and sexual violence. We found that realising the potential of Te Puna Aonui by establishing new ways for agencies to work together effectively with tangata whenua and community partners was critical to success, but difficult to execute.

1.20 Some interdepartmental executive boards have reported on their progress in 2023, whether separately (such as Te Puna Aonui) or appended to a single public organisation's annual report (such as the Border Executive Board). We look forward to seeing what effect these boards have. When organisational structures change, the accountability system and reporting requirements also need to adapt to ensure that there is appropriate accountability for spending and for progress in improving outcomes.

1.21 Many central government entities are responsible for system leadership, often without having control over the system they lead. For example, the Ministry of Housing and Urban Development leads the housing and urban development system but does not control, and cannot direct, others in the system, such as councils and property developers.

1.22 A lead agency needs to build and maintain effective relationships to support the system's strategic direction. In our view, it should also understand the current and likely future performance of the system to inform its policy choices. Other components of effective system leadership include a shared strategy and action plan, sound governance arrangements, and regular reporting on performance to identify corrective actions and to support accountability and transparency.

1.23 As well as the governance and leadership methods outlined above, public organisations use a range of methods to manage cross-government programmes and report on spending. One way of doing this is through tracking spending by initiative (such as cyclone recovery funding, climate emergency response funding, and Covid-19 response and recovery funding initiatives). Tracking and publishing funding for cross-government initiatives allows for increased transparency and a better understanding of how funding is used.

1.24 Communicating progress towards complex, cross-government goals can be difficult, but it is essential for Parliament and the public to understand what has been allocated and spent and what is being achieved.

Our completion of annual audits

1.25 The public audit system is critical for supporting the scrutiny of government spending and performance. Annual audits help ensure that public organisations report reliable and relevant information to Parliament and the public about how they have used public money and how well they have performed.

1.26 In 2022/23, the Covid-19 pandemic continued to affect the nature and timing of our annual audits. The first half of 2022/23 was particularly difficult, with audits affected by the global auditor shortage and other Covid-19 effects, including staff illness and shortages both for audit service providers and public organisations.

1.27 Given these challenges, we prioritised the audits most important to New Zealand's public accountability system – such as the financial statements of the Government, government departments, and Financial Markets Conduct reporting entities, such as Auckland Council.

1.28 We have now substantively addressed deferred audits and have largely returned audit completion rates to pre-pandemic levels.

Changes to the way Parliament scrutinises public organisations

1.29 A key part of Parliament's role is scrutinising the performance of the Executive. As part of this scrutiny, select committees conduct annual reviews of public sector performance, examine the Estimates of Appropriations, and conduct inquiries into issues or concerns.

1.30 The way select committees scrutinise the performance of the public sector is set to change during 2023/24. The Standing Orders Committee has recommended changes to parliamentary processes that will strengthen the ability of Parliament to undertake effective scrutiny of the Government.

1.31 We welcome these changes and look forward to supporting select committees with insights and observations from our audits and other work.

2 Improving how the government reports on its performance

2.1 In this Part, we set out our observations about performance reporting across central government.

2.2 Performance reporting is about showing what has been achieved with public money. It is about how a government explains the difference it has made for New Zealanders, when using their taxes.

2.3 Members of Parliament play a critical role in holding a government to account and scrutinising information about what is being achieved with public money.

2.4 As we have noted in previous reports, the way governments currently report on their performance is not good enough to enable Parliament and the public to hold a government to account. It is often too hard to tell what value New Zealanders are receiving from about $160 billion of central government spending each year.

2.5 Our concerns have been reinforced by recent reports from the Parliamentary Commissioner for the Environment and the Productivity Commission.

2.6 With the introduction of the new accounting standard PBE FRS 48, which sets out requirements and principles for public organisations to report on their performance, we have seen some improvements and examples of good practice in how the government reports on its performance as part of our audit work.

2.7 However, we continue to find reporting that does not adequately explain what value New Zealanders are receiving from government spending, including in areas that are vitally important to New Zealanders and New Zealand's future.

2.8 We welcome the report of the Standing Orders Committee recommending the establishment of a special select committee to conduct an inquiry into performance reporting. In our view, fundamental changes are needed to how the government is required to report on its performance to ensure that public sector reporting meets the accountability requirements for New Zealand in the 21st century. This is an important and urgent matter.

2.9 Over 2022/23, our work has examined how the government reports on its performance at the multiple levels at which it operates, from all-of-government through to cross-agency arrangements and individual agencies.

Reporting at an all-of-government level

2.10 The objectives of a government are often at an all-of-government level (for example, reducing child poverty, addressing climate change, and reducing inequities for disadvantaged groups).

2.11 At any level, it is vital that a government is clear about what it is seeking to achieve, how it will measure progress, what its plans are, and what progress is being made.

2.12 In 2020, the Government of the day amended the Public Finance Act 1989 to introduce a new requirement for the Government to set out the well-being objectives that will guide its Budget decisions. This amendment provides an important opportunity for the Government to clearly set out its objectives at an all-of-government level and explain how they will be assessed.

2.13 Since 2020, however, these well-being objectives have tended to be broad (such as equipping New Zealanders with and enabling New Zealand businesses to benefit from new technologies and lift productivity and wages through innovation), without any specification of how progress against these objectives will be measured and reported on.

2.14 Furthermore, as we have previously noted, governments are not required to, and do not, report on what is being achieved at an all-of-government level.

2.15 In our view, fundamental changes are needed to the public accountability system to ensure that the Government, at an all-of-government level, clearly sets out what it intends to achieve and how progress will be assessed and provides information on what has been achieved.

2.16 The 2020 amendments to the Public Finance Act also introduced a new requirement for the Treasury to periodically report on the state and future of well-being in New Zealand, as part of its stewardship responsibilities.

2.17 This new requirement provides an important opportunity for the Treasury to inform the wider public sector, the Government, and the public on the state of current and longer-term issues that matter to New Zealanders.

2.18 In late 2022, the Treasury published its first report on the state of New Zealand's well-being, *Te Tai Waiora: Wellbeing in Aotearoa New Zealand* (Te Tai Waiora).

2.19 In our view, future well-being reports provide an important opportunity to support a richer and wider understanding of the issues that matter to New Zealanders and to inform government decision-making, including how successive governments set out their all-of-government objectives.

2.20 In previous reports, we have also highlighted the need for the Government to improve its reporting on significant policy and funding initiatives across all of government (such as the Provincial Growth Fund).

2.21 We previously found that, for initiatives such as the Provincial Growth Fund, the reporting is fragmented between multiple public organisations and it is difficult for the public and Parliament to track spending and assess progress across the fund.

2.22 The Treasury has put in place new ways to track major policy programmes. These apply to initiatives funded through the Covid-19 Response and Recovery Fund and the Climate Emergency Response Fund, as well initiatives that respond to the recent severe weather events in the North Island.

2.23 These new mechanisms are a useful innovation, but they are not without limitations. The Treasury simply consolidates information supplied by public organisations. We will be looking at whether the reporting will present meaningful information on the value being achieved by the spending.

2.24 As part of our 2022/23 audit work, we have continued to find significant issues in reporting on major policy programmes and policy issues that span multiple public organisations and one or more sectors.

2.25 We have recently audited the performance of the New Zealand Upgrade Programme. Although there is some useful publicly reported information on the progress of funded transport projects, it is not clear to us how the previous Government intended to determine whether the overall objectives of the programme have been met, or how effective investments have been in improving the overall state of our infrastructure.

2.26 Successive governments have invested in initiatives to improve socio-economic outcomes for Māori. In the most recent budget (Budget 2023), $825 million was allocated for this purpose. It remains difficult to track such spending from its announcement in the Budget, through the public organisations developing and delivering the funded initiatives, through to the actual impact it has for Māori communities. Māori – and other members of the public – need to be provided with a clearer view of what has been achieved, so that they can discuss results, understand when and why things have not gone to plan, and ultimately hold the Government to account for its performance.

Reporting across major cross-agency arrangements

2.27 As noted in Part 1, there are some major cross-agency arrangements that are broadly designed to enable public organisations to work together towards outcomes and issues that matter to New Zealanders (such as whether New Zealanders are better educated and healthier).

2.28 The changes to the Public Service Act in 2020 enable governments to establish, among other mechanisms, interdepartmental executive boards to address specific cross-agency issues (such as eliminating family violence and sexual violence).

2.29 In our view, the reporting of these interdepartmental executive boards provides an opportunity to bring together key performance information across different areas and different public organisations.

2.30 There are currently five interdepartmental executive boards, which are at different levels of maturity in their reporting.

2.31 For the recently established interdepartmental executive boards, it is understandable that their reporting is less developed when it comes to providing meaningful information on how they are making a difference for New Zealanders. For boards that have been operating for many years, we expected, but are not yet seeing, meaningful information on how they are having a positive impact:

- **Border Executive Board** (established in January 2021): Performance measures/indicators of success were being prepared in 2023/24. Information on the Board's strategic intentions has previously been provided by the New Zealand Customs Service. The Border Executive Board will begin work on its first standalone strategic intentions document during 2023/24.
- **Spatial Planning Board** (originally established in April 2021, as Strategic Planning Reform Board): Reporting focuses on how well it is supporting reform of the environmental management system through repeal and replacement of the Resource Management Act 1991.
- **Executive Board for the Elimination of Family Violence and Sexual Violence** (established in March 2022 replacing the previous joint venture which had been operating since September 2018): Current reporting focuses on the appropriation it directly administers. An Outcomes and Measurement Framework was recently published, which includes plans to prepare measures over two phases and significant timeframes. Reporting against the framework will be every second year.
- **Climate Change Chief Executives Board** (established in July 2022): Six-monthly progress reporting from the Board to the Prime Minister and relevant Ministers on the Government's progress in implementing actions and meeting the objectives contained in the Emissions Reduction Plan and the National Adaptation Plan. Two reports have been produced to date (February 2023 and August 2023), with reporting evolving over time. These reports (with some redactions as necessary in accordance with the Official Information Act) have also been published on the Board's website (alongside a summary slide deck of the second report). In our view, the scope of the reporting by the

Climate Change Chief Executives Board is a useful innovation and represents a model worth exploring in other areas.

- **Digital Executive Board** (established in September 2022): Reporting is at an early stage and focuses on setting up and establishing processes to fulfil its strategic intentions.

2.32 We will continue to monitor and engage with the relevant select committees on the performance and reporting of each interdepartmental executive board on how they are collectively making a difference for New Zealanders.

Reporting at a sector level

2.33 In 2022/23, we published a case study examining performance reporting at a sector-level focusing on the transport sector.[3] The case study focused on examining how well public reporting by the transport sector enables an integrated view of how well the public organisations in the transport sector are collectively making a difference for New Zealanders.

2.34 We found examples of good practice reporting on performance, which other sectors can learn from. For example, the transport sector has a clearly defined set of outcomes that are meaningful to the public as well as a comprehensive set of indicators for measuring progress.

2.35 We also found that the reporting on Road to Zero and the Rail Network Investment Programme illustrates how a sector can provide rich, integrated, and consolidated reporting on outcomes and major cross-agency initiatives.

2.36 We are encouraging other parts of the public sector to look at and learn from the case study and this reporting.

Reporting at an agency level

2.37 Most performance reporting by the public sector is at the agency level. In previous reports, we have noted the need to see considerable improvements in how public organisations are reporting on major initiatives, using meaningful performance measures, and presenting performance information that explains how well they are serving and making a difference for New Zealanders.

2.38 Over the past year, the Treasury has issued expectations and requirements for public organisations to improve their reporting on major initiatives, particularly those that have been introduced through recent Budgets.

2.39 It is too early to see whether these expectations and requirements will translate into more meaningful reporting.

3 See *Transport sector: A case study of sector-level performance* at oag.parliament.nz.

2.40 Accounting Standard PBE FRS 48 focuses on enabling public organisations to provide meaningful and appropriate information for users on their service performance. Given the introduction of PBE FRS 48, our work this year included a closer examination of the performance information in the Estimates in this year's Budget.[4]

2.41 We focused on spending by public organisations in six Votes (totalling over $101 billion in annual spending), given their scale and their importance in delivering critical services and outcomes for New Zealanders:

- Vote Health;
- Vote Business, Science and Innovation;
- Vote Social Development;
- Vote Education;
- Vote Transport; and
- Vote Agriculture, Biosecurity, Fisheries and Food Safety.

2.42 In our examination of the performance information across these Votes,[5] we found some improvements to the performance information, with some examples of good practice. However, we also found three weaknesses that urgently need addressing:

- Measures, either quantitative or qualitative, that are not meaningful or comprehensive (for example, the percentage of contracts monitored against their milestones).
- Gaps in measuring what difference is being made (for example, how funding and activities are resulting in improvements in regional productivity, quality of education, or resilience of the roading network).
- Poor measures for assessing the stewardship, oversight, and monitoring functions of departments.

The need for reform of the public accountability system

2.43 There are examples of good reporting and there have been some improvements to how the public sector reports on its performance. But many of the improvements and the examples of good practice that we have found rely on public organisations doing more than what they are legislatively required to report on. For example, the annual reporting on Road to Zero is outside of what the transport sector is required to report on.

4 See "Do your measures measure up?" at oag.parliament.nz.

5 Our examination of the performance information across these Votes focused on the performance information in the Estimates, but also took into account relevant performance information that public organisations may set out elsewhere (such as in strategic intentions documents).

2.44 New Zealand faces a number of significant complex and long-term challenges (such as climate change, child poverty, and inequity) that will require a greater focus on the long-term and public organisations working together to achieve better outcomes.

2.45 In our view, legislative and system reform is needed to put in place a system of public accountability and reporting that is fit for purpose and can respond to the challenges facing New Zealand.

2.46 This system must have a focus on what matters to New Zealanders instead of what is important to public organisations. The reporting needs to shift away from a focus on inputs, activities, and outputs to a focus on reporting on how the government is serving and making a difference for New Zealanders.

2.47 From all-of-government through to individual public organisations, the accountability requirements should support meaningful and accessible reporting that clearly sets out:

- what the Government is seeking to achieve and how progress will be assessed;
- how the Government is intending to achieve its objectives through its initiatives, services, activities, and spending; and
- what progress is being made.

2.48 The recent changes to Standing Orders represent an opportunity to improve scrutiny and for select committees to demand more meaningful information from the government on the issues that matter to New Zealanders.

2.49 Changes to parliamentary practice will not be enough. As the Standing Orders Committee recognises, it is equally important to tackle issues in how the government reports on its performance, as well as issues in how the reporting is scrutinised.

2.50 The Committee's recommendation that there be an inquiry into performance reporting presents a unique opportunity to examine and recommend changes to legislation.

2.51 Legislative reform would be an important step to help ensure the public sector meets the expectations of the public and Parliament in how it reports on its performance. This would not be a small task, but given the importance of public trust in government it is both a critical and urgent one.

Our audit of the Government's financial statements

3

3.1 In this Part, we summarise our audit report on the Government's financial statements.

3.2 Our audit report on the Government's financial statements each year provides independent assurance that the financial statements present fairly the Government's financial performance and position. Our work allows Parliament, the public, and the international community to be confident in the appropriateness and reliability of the financial information presented.

3.3 For 2022/23, our audit report included an unmodified opinion and a description of the key audit matters arising during the audit. Each year we review whether the previous year's key audit matters remain relevant and consider any new matters that should be included in the audit report.

3.4 The key audit matters included in our audit report on the Government's financial statements for the year ended 30 June 2023 were:

- calculating the value of other persons and companies tax revenue;
- valuing property, plant, and equipment:
  - land;
  - state highways; and
  - electricity generation assets;
- valuing financial assets where market data is not available:
  - student loans;
- valuing the Accident Compensation Corporation's outstanding claims liability; and
- entitlements under the Holidays Act 2003.

3.5 We discuss each of these matters below.

Calculating the value of tax revenue from other persons and companies

3.6 The Government recognised tax revenue of $9.9 billion from other persons and tax revenue of $18.3 billion from companies.

3.7 Tax revenue for the year from other persons and companies was estimated because the final income tax owed for a year is known only when a tax return is filed. Filing could happen more than a year after the tax year.

3.8 The estimate is based on forecasting other persons and companies' taxable profits, which relies on assumptions and projecting how the economy will perform in the future.

3.9 Estimating tax revenue is inherently uncertain and judgement is used to estimate:

- the performance of the New Zealand and global economy and how it relates to tax revenue;
- the amount of tax to be collected from provisional taxpayers who have not yet filed their final tax return; and
- the amount of tax revenue where payments have been received but no provisional or final tax return has been filed.

3.10 We considered tax revenue from other persons and companies to be a key audit matter because the calculation is complex and subject to a high degree of judgement and estimation.

3.11 We reviewed the systems, processes, and controls for receiving and reviewing provisional and final tax returns, tax assessments, and tax revenue. This included understanding Inland Revenue's information technology system used to manage tax.

3.12 We tested the underlying data used in the forecast tax revenue estimation models to confirm that it was relevant and used appropriately. We reviewed the main judgements and assumptions applied in the models and considered the sensitivity of the models to changes in assumptions.

3.13 We used independent economic experts to assess the main assumptions about the future, such as economic growth, which could cause a material adjustment to tax revenue from other persons and companies.

3.14 We were satisfied with the continuing appropriateness of net operating surplus as a macro-economic indicator used to estimate tax revenue from other persons and companies.

3.15 We reviewed any changes in tax policy in terms of the likely impact on tax revenue recognition.

3.16 We also:

- carried out a review of Inland Revenue's retrospective review of the 2022 tax estimation to tax return information received from taxpayers to assess the robustness of the methodology used to estimate tax revenue;
- reviewed the accounting adjustments to tax revenue processed by Inland Revenue;
- reviewed the year-end procedures and testing carried out by Inland Revenue for significant taxpayers, and any adjustments arising from this review by Inland Revenue; and
- reviewed the relevant disclosures.

3.17 As a result of the audit work, we were satisfied that tax revenue from other persons and companies for the year ended 30 June 2023 was reasonable and that the disclosures were appropriate.

Valuing property, plant, and equipment

3.18 The Government owns property, plant, and equipment with a carrying value of $267.4 billion at 30 June 2023.

3.19 Revaluations are carried out regularly or when there is a material difference between fair value and carrying value. Considerable judgement is needed in determining the valuation approaches and assumptions for some of these assets.

3.20 Valuers have considered the impact of prevailing economic conditions on the significant estimates and judgements applied in the valuation process, such as the effect of interest rates and inflation.

3.21 For assets valued using the optimised depreciated replacement cost approach, supply chain disruptions and labour supply constraints have caused increases in construction costs, which affected valuations. Valuers have needed to assess the extent to which these cost changes are short-term or ongoing and need to be taken into account for cost-based valuations.

3.22 We considered the valuation of the classes of property, plant, and equipment outlined below a key audit matter because of the significance of the amounts involved, the level of complexity, and the judgements applied.

Land

3.23 Land was valued at $79.7 billion at 30 June 2023.

3.24 The value of land is based on different valuation approaches. The approach selected will be informed by how that land is used.

3.25 The most significant approaches used include market-based sales evidence, rateable values per square metre of adjacent land, and sales indices.

3.26 There are significant judgements involved in these valuations.

For land that was not subject to a revaluation this financial year

3.27 We assessed the reasonableness of the method used to confirm the valuation was not materially different from the land's fair value and reperformed the calculations.

3.28 Where indices or market data was used, we compared the information to external sources of information.

For land that was subject to a revaluation this financial year

3.29 We assessed the appropriateness of the valuation approach applied by independent valuers or entities.

3.30 We confirmed the competence, capabilities, and objectivity of the independent valuers, considered the valuers' main assumptions, and tested that information provided to the independent valuers was consistent with the information held by entities.

3.31 We discussed with valuers, and considered the appropriateness of, how economic factors and market conditions have affected the valuations.

3.32 Where entities used an index as a basis for recording a valuation movement, we assessed the appropriateness of the index used to other external data sources and compared the retrospective accuracy of indices applied in previous periods.

3.33 As a result of the audit work, we were satisfied that the value of land at 30 June 2023 was reasonable and that the disclosures were appropriate.

State highways

3.34 The state highways (excluding land) were valued at $59.5 billion at 30 June 2023 by an independent valuer.

3.35 The value of the state highways cannot be measured precisely due to the unique nature of the state highway network. Significant estimates and assumptions are made, including assumptions about quantities and unit rates used to construct the state highways and the remaining useful life of the assets. Severe weather events in early 2023 further complicated the valuation of parts of the state highway due to the need to determine the impairment or write-off of assets.

3.36 Changes to the underlying estimates and assumptions can cause a material movement in the valuation of the state highways.

3.37 We examined how the state highways are valued, the significant estimates and assumptions used, and their reasonableness. We confirmed the competence, capabilities, and objectivity of the valuer, considered the valuer's main assumptions, and assessed the valuation procedures. We considered whether there were any limitations placed on the valuer and whether centrally calculated rates applied to the valuation were appropriate.

3.38 We confirmed that key controls were operating over the systems and processes used to record costs and other asset information about the state highways.

3.39 We considered how the valuer took the current economic environment into account, including the judgements applied in assessing whether recent cost increases are temporary or reflect sustainable market conditions that need to be taken into account in assessing replacement cost rates.

3.40 We also assessed the reasonableness of the impairments and write-off of assets.

3.41 As a result of the audit work, we were satisfied that the value of the state highways at 30 June 2023 was reasonable and that the disclosures were appropriate.

Electricity generation assets

3.42 The electricity generation assets were valued at $20.1 billion at 30 June 2023.

3.43 Valuing electricity generation assets is complicated and relies on significant assumptions about the future prices of electricity, generation costs, generation capacity, and demand. Each of these assumptions affects the others.

3.44 These assumptions are sensitive to small changes that can have a significant effect on the value of the electricity generation assets.

3.45 We examined how electricity generation assets are valued. We confirmed the competence, capabilities, and objectivity of the valuers, tested their procedures for carrying out the valuations (including the information they used), and considered their main assumptions and judgements.

3.46 We considered the reasonableness of valuation approaches and assumptions. We tested the sensitivity of the main assumptions to confirm that they were reasonable.

3.47 We compared the forecast prices of electricity to the expected longer-term wholesale prices and market data, where it was available.

3.48 We considered how the valuers took the current economic environment into account in the valuations and the effect of any estimation uncertainties on the final valuations of electricity generation assets.

3.49 We also considered whether the valuers took into account the future of the New Zealand Aluminium Smelter at Tiwai Point in determining their valuation assumptions.

3.50 As a result of the audit work, we were satisfied that the value of electricity generation assets at 30 June 2023 was reasonable and that the disclosures were appropriate.

Valuing financial assets where market data is not available

3.51 The Government's financial statements included financial assets that were valued using significant non-observable inputs (that is, where market data is not available) of $24.4 billion at 30 June 2023.

3.52 These financial assets include loans (including student loans, discussed below), investments, and deposits.

3.53 When there is no quoted market price for a financial asset, the value of the asset is estimated using an appropriate technique, such as a valuation model. These models are usually complex, using inputs from market data when available. Otherwise, inputs are derived from non-market data, which requires greater judgement.

3.54 We considered the valuation of financial assets where market data is not available, including student loans, a key audit matter as their calculation is complex and subject to a high degree of judgement and estimation.

3.55 Based on a sample of investments, we reviewed the valuation techniques and tested the controls and inputs used to determine the value of financial assets where market data is not available.

3.56 Taking into account the nature of the selected financial assets, the valuation techniques adopted, and the uncertainties in determining values, we:

- tested the relevant internal controls over data entered into financial systems for these assets;
- assessed valuation approaches applied where a fund manager carries out the valuation;
- compared the fair value of financial assets to independent information and investigated any significant differences; and
- assessed the appropriateness of the inputs used in the valuation where market data is not available.

3.57 As a result of the audit work, we were satisfied that the value of financial assets where market data is not available at 30 June 2023 was reasonable and that the disclosures were appropriate.

Student loans

3.58 The Government held student loans with a value of $9.4 billion at 30 June 2023.

3.59 Student loans are measured using actuarial and predictive models, which reflect current student loan policy and macro-economic assumptions.

3.60 The value is sensitive to changes in several assumptions, including future income levels, repayment behaviour, inflation, and discount rates.

3.61 For student loans, we:

- tested a sample of student loan applications during the year to ensure that loans were correctly paid out;
- tested the internal controls over student loans entered into financial systems and actuarial models used by the valuer;
- checked that the underlying information used in the valuation was correctly extracted from the system;
- used an independent expert to review the main assumptions in the student loans model, including a review of the cash flow forecasts, the risk-free discount rate and risk premium used to determine the fair value of loans, and adjustments for employment and overseas non-compliance;
- assessed the controls and valuation approaches applied by the valuer and tested the operational effectiveness of controls over the valuation model; and
- carried out a retrospective review of the actual repayments of student loans in previous years against prior year cash flow forecasts to consider whether there was any estimation bias.

3.62 As a result of the audit work, we were satisfied that the value of student loans at 30 June 2023 was reasonable and that the disclosures were appropriate.

Valuing the Accident Compensation Corporation's outstanding claims liability

3.63 The outstanding claims liability of the Accident Compensation Corporation (ACC) has been valued at $51.5 billion at 30 June 2023 by an independent actuary.

3.64 Estimating the value of the outstanding claims liability is complicated because it consists of many sub-components that are aggregated to arrive at the overall estimate.

3.65 Assumptions used to determine the value of the outstanding claims liability include:

- the risk-free discount rates and consumer price index assumptions published by the Treasury and used in calculating a present value of expected claims payments;

- the risk margin for the inherent uncertainty in the estimate of the present value of expected claims payments;
- the effects of inflation and innovation on future medical costs; and
- how long it will take people to recover from injuries.

3.66 Assumptions are closely linked and cannot be viewed in isolation. Changes in assumptions can have a large effect on the value of the outstanding claims liability (and the gain or loss that is recognised).

3.67 We considered the valuation of the outstanding claims liability a key audit matter because the calculation is complex and subject to a high degree of judgement and estimation.

3.68 We examined how ACC's outstanding claims liability is valued. We confirmed the competence, capabilities, and objectivity of the actuary who carried out the valuation, and tested their procedures.

3.69 We assessed the reasonableness of the methodology applied. We also reviewed ACC's main assumptions about each significant type of claim to see whether these were appropriate.

3.70 We engaged an independent expert to consider the appropriateness of the risk-free discount rates and consumer price index assumptions published by the Treasury.

3.71 We tested the systems and controls and, in particular, tested the process for recording claims. We tested the reconciliations of the underlying claims data with ACC's systems.

3.72 We tested the main assumptions by considering past claims.

3.73 We assessed the reasonableness of forecasts that differed from past experience by looking at the evidence supporting the forecasts.

3.74 We engaged an actuary to review the scope, approach, and reasonableness of the estimated liability.

3.75 We examined the sensitivity analysis for movements in the main assumptions, and reviewed the related financial statement disclosures.

3.76 As a result of the audit work, we were satisfied that ACC's outstanding claims liability at 30 June 2023 was reasonable and that the disclosures were appropriate.

Entitlements under the Holidays Act 2003

3.77 The provision for employee entitlements includes $2.5 billion for amounts owing to employees who have been paid less than their legal entitlements under the Holidays Act 2003.

3.78 Of the total, $2.1 billion of the provision relates to employees of Te Whatu Ora Health New Zealand and $0.4 billion to some school employees paid through the Ministry of Education.

3.79 These public organisations have not yet finished determining the final amounts they owe to their staff. They have made a sufficiently reliable estimate based on a sample of former and current employees, applying assumptions, and projecting the result over the affected employees.

3.80 Applying the Holidays Act 2003 to complex employment arrangements requires a good understanding of both the legislation and employees' contractual terms. To determine the entitlements also often requires judgement and negotiation and agreement with employee representatives.

3.81 Where an obligation is uncertain or cannot be reasonably measured at 30 June 2023, there is an unquantified contingent liability. This is the case for known cases of non-compliance for some school employees paid through the Ministry of Education because analysis has not yet progressed to the point where a calculated estimate of payments is possible.

3.82 We have reported this as a key audit matter since 2018 because of its nature and effect on many public employees.

3.83 For Te Whatu Ora and the Ministry of Education (on behalf of school employees), we considered the progress made during the year in resolving the holiday pay calculation issues.

3.84 We reviewed the changes in the provision since the previous year and considered the support for any significant movements.

3.85 For the calculations for Te Whatu Ora, we:

- obtained an understanding of the changes made to methodology, assumptions, and sample sizes compared to the previous estimate and the updated employee information; and
- considered the expertise of those engaged to do the calculations.

3.86 For the Ministry of Education (on behalf of school employees), we obtained an update on the Holidays Act compliance programme and reviewed management's assessment of their best estimate in line with PBE IPSAS 19: *Provisions, Contingent Liabilities and Contingent Assets* and requirements of the Holidays Act 2003.

3.87 We reviewed the disclosures for compliance with relevant financial reporting standards.

3.88 As a result of the audit work, we were satisfied that the provision for entitlements under the Holidays Act 2003 at 30 June 2023 was reasonable and that, where a liability is uncertain or cannot be reliably measured, the contingent liability disclosures were appropriate.

Other audit matters

3.89 The following matters, while not key audit matters, were also considered particularly significant during the audit.

State of emergency – extreme weather events

3.90 During the financial year, the North Island experienced severe weather events that affected public organisations, including some that form part of the Government's financial statements.

3.91 Significant events such as these have the potential to materially affect financial reporting.

3.92 The Government's financial statements includes disclosure of these impacts in note 3, North Island Weather Events (NIWE).

3.93 We planned our work with the appointed auditors of affected public organisations to consider and assess the impact of the NIWE, such as the effect on:

- appropriations, including potential scope issues;
- revenue recognition, such as insurance proceeds;
- liability recognition where there are obligations created; and
- impairment of property, plant, and equipment, including state highways.

3.94 Through the appointed auditors of the affected public organisations, we:

- gained an understanding of the various financial impacts and considered the accuracy and the appropriateness of the accounting treatment;
- considered the Treasury's assessment of the potential effect on the Government's financial statements; and
- considered the appropriateness of disclosure of these matters in the Government's financial statements.

3.95 On 1 June 2023, the Government announced that it would enter into a funding arrangement with councils in cyclone-affected and flood-affected regions to support them. We considered the potential accounting treatment implications of this announcement and the appropriateness of the disclosure included in the Government's financial statements.

3.96 We concluded that the accounting treatment and the disclosure of the NIWE in the Government's financial statements were appropriate.

Health sector reforms

3.97 During 2020/21, the Government announced the disestablishment of all district health boards (DHBs) with effect from 30 June 2022 and the establishment of Health New Zealand (Te Whatu Ora) and the Māori Health Authority (Te Aka Whai Ora). The Te Whatu Ora annual report for the year ended 30 June 2023 was the first time the financial information for most of the health sector was prepared, and audited, within a single public organisation.

3.98 There were inherent additional risks associated with a change of this significance. Te Whatu Ora faced challenges in collating financial and non-financial information from numerous sources and in assessing the accounting treatment of certain items (such as the valuation of all the hospitals or the provision for holiday pay), as well as transactions between other health agencies (such as the transfer of inventory from the Ministry of Health).

3.99 We have:

- considered any potential additional risks associated with this reform change, and any potential effect on the Government's financial statements throughout the audit cycle;
- considered the potential effect on specific account balances, including the valuation of property, plant, and equipment, the holiday pay provision, disclosures, and overall financial reporting; and
- reviewed any disclosures relating to the financial effect on the Government's financial statements.

3.100 Creating the first annual report for Te Whatu Ora was a significant achievement. The Board and management of Te Whatu Ora were able to do this despite concurrent restructure and consolidation of financial and other systems.

3.101 Although there were some understandable delays in receiving the required information, the Treasury, Te Whatu Ora, and auditors were able to complete the work required and there was no effect on the signing of the Government's financial statements.

Education sector amalgamation

3.102 In February 2019, the Government announced that the country's 16 Institutes of Technology and Polytechnics (ITPs) would merge to form Te Pūkenga.

3.103 The head office for Te Pūkenga did not provide sufficient instructions to business units for the collation of financial information at 30 June 2023 and there was a lack of review of information provided to ensure that accounting policies were consistently applied. There was also limited consideration given to inter-business unit or inter-group eliminations for consolidation into the Government's financial statements.

3.104 This resulted in unsubstantiated financial information which, although not material for the Government's financial statements, is significant for the integrity of the broader public financial management system.

4 The Controller function

4.1 The Controller function is an important part of the Auditor-General's work. It supports the fundamental principle of Parliamentary control over government expenditure.

4.2 Under New Zealand's constitutional and legal system, the Government needs Parliament's approval to:

- make laws;
- impose taxes on people to raise public funds;
- borrow money; and
- spend public money.[6]

4.3 Parliament's approval to incur expenditure is mainly provided through appropriations, which are authorised in advance through the annual Budget process and annual Acts of Parliament.[7] When the Government wants to incur expenditure not yet authorised in an Appropriation Act, it can draw on the Parliamentary authority provided in an Imprest Supply Act. Expenditure can be authorised in advance through permanent legislation. Some expenditure can also be approved retrospectively.

4.4 The incidence of unappropriated expenditure reached an historical low in 2020/21, with 11 instances. The number of instances has risen slightly since then (to 16 in 2022/23), but it remains low. The amount of unappropriated expenditure as a percentage of the Government's budget was 0.19% of the budgeted expenditure (2021/22: 0.1%).

4.5 In this Part, we discuss:

- why the Controller work is important;
- how much public expenditure was unappropriated in 2022/23 and why;
- how 2022/23 compares with previous years;
- the reasons for unappropriated expenditure over the last eight years; and
- a summary of work we carried out in 2022/23 to discharge the Controller function.

6 Section 22 of the Constitution Act 1986.

7 Appropriations are authorities from Parliament that specify what the Crown may incur expenditure on (specific areas of expenditure). Most appropriations specify limits in terms of the type of expenditure (the nature of the spending), scope (what the money can be used for), dollar amount (the maximum that can be spent), and period (the time frame for which the authority is given).

Why the Controller work is important

4.6 Appropriations ensure that Parliament, on behalf of the public, has adequate control over how the Government plans to spend public money. Appropriations also ensure that the Government can be subsequently held to account for how it has used that money.

4.7 Most of the Crown's funding is obtained through taxes. Parliament and the public are entitled to assurance that the Government is spending public money as authorised by Parliament.[8]

4.8 As the Controller, the Auditor-General helps maintain the transparency and legitimacy of the public finance system. The Auditor-General provides an important check on the system on behalf of Parliament and the public by providing independent assurance that the expenditure is within authority. The Auditor-General also provides assurance that any government expenditure without authority has been identified and dealt with appropriately. As an Officer of Parliament, the Auditor-General is independent of the Government.

4.9 In the Appendix, we explain how public expenditure is authorised, who is responsible for managing it, and the Controller's role in checking it.

How much public expenditure incurred in 2022/23 was unappropriated

4.10 The Government's financial statements for the year ended 30 June 2023 report 16 instances of unappropriated expenditure (2021/22: 14 instances (revised)). Expenditure incurred above or beyond appropriation for the 2022/23 year was $346.7 million (2021/22: $169.1 million). Figure 1 shows a breakdown of unappropriated expenditure categories.[9]

4.11 The unappropriated expenditure categories shown in Figure 1 fall into three broader categories:

- approved by the Minister of Finance (Category A);
- with Cabinet approval (Categories B and C); and
- without prior Cabinet approval (Categories D, E, and F).

8 That is, it is within the type, scope, dollar amount, and period limits authorised by Parliament.

9 New Zealand Government (2023), *Financial Statements of the Government of New Zealand for the year ended 30 June 2023*, pages 156-162, at treasury.govt.nz.

Figure 1
Unappropriated expenditure incurred for the year ended 30 June 2023

Category	Unappropriated expenditure by category	2022/23 Number	2022/23 $million	2022/23 Votes
A	Approved by the Minister of Finance under section 26B of the Public Finance Act 1989	1	1	Customs
B	With Cabinet authority to use imprest supply but in excess of appropriation before the end of the financial year	2	1	Conservation
C	With Cabinet authority to use imprest supply but without appropriation before the end of the financial year	-	-	
D	In excess of appropriation and without prior Cabinet authority to use imprest supply	7	333	Conservation, Health, Revenue
E	Outside scope of an appropriation and without prior Cabinet authority to use imprest supply	4	2	Social Development, Education
F	Without appropriation and without prior Cabinet authority to use imprest supply	2	11	Corrections; Business, Science and Innovation
	Total	**16**	**347***	

* The total does not tally because amounts are rounded to the nearest million.

Approved by the Minister of Finance (Category A)

4.12 Small overruns of expenditure in the last three months of the financial year (that is, within $10,000 or 2% of the appropriation) may be approved by the Minister of Finance under section 26B of the Public Finance Act. Although unappropriated, expenditure approved under section 26B is lawful.

4.13 There was one instance of unappropriated expenditure authorised under this section for 2022/23 (2021/22: One instance).

With Cabinet approval (Categories B and C):

4.14 When it is anticipated that expenditure will be above or beyond the appropriation limits, departments should seek prior Cabinet approval to use imprest supply for the expenditure not covered by appropriations.

4.15 However, the use of imprest supply is an interim authority (the second annual Imprest Supply Act expires on 30 June each year), so all expenditure using this authority must also be appropriated through an Act of Parliament by 30 June (see the Appendix for how appropriations work).

4.16 Sometimes Cabinet's approval to use imprest supply is obtained, but the extra expenditure is not included in an Appropriation Act before the end of the financial year, so the expenditure remains unappropriated.[10]

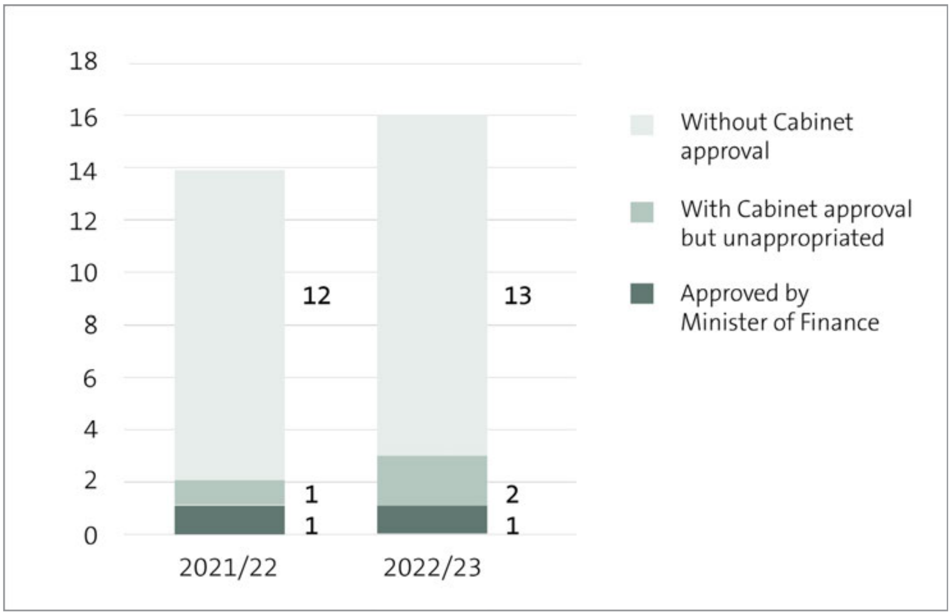
4.17 There were two instances of unappropriated expenditure in this category in 2022/23 (2021/22: One instance).

Without prior Cabinet approval (Categories D, E, and F)

4.18 For 2022/23, the Government's financial statements report 13 instances of expenditure incurred above or beyond the appropriation limits without any authority at the time it was incurred. The expenditure was without Parliamentary appropriation and without Cabinet's prior approval to use imprest supply (2021/22: 12 instances).

4.19 Figure 2 shows a slight increase in the incidence of unappropriated expenditure in 2022/23, with two more instances than for 2021/22 (see Figure 5 for an eight-year time series).

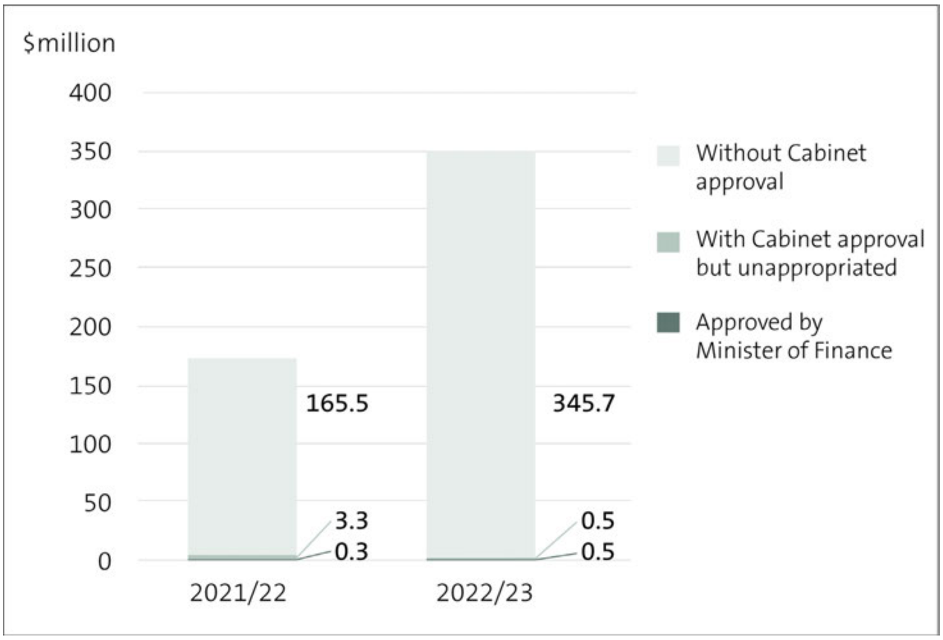
Figure 2
Number of instances of unappropriated expenditure for 2021/22 and 2022/23



10 Normally through the annual Appropriation (Supplementary Estimates) Act.

4.20 Figure 3 compares the dollar amounts of unappropriated expenditure for 2021/22 and 2022/23. The amount of unappropriated expenditure in 2022/23 ($346.7 million) was more than double that for 2021/22 ($169.1 million).[11]

Figure 3
Amount of unappropriated expenditure for 2021/22 and 2022/23



4.21 Expenditure outside the bounds of the appropriations tends to be relatively low. The dollar value of unappropriated expenditure doubled in 2022/23 and, accordingly, it has doubled as a percentage of the Government's budget. The $346.7 million for 2022/23 was 0.19% of the Government's final budgeted amount for that year, compared with 0.1% for 2021/22.

4.22 The higher dollar amount is attributed to one instance, in Vote Revenue. The expense associated with writing down the book value of debtors (that is, the debt impairment and debt write-off expense) exceeded the amount appropriated for this purpose by $282.6 million. This constitutes 81.5% of the $346.7 million of unappropriated expenditure for 2022/23.

4.23 Without this single Vote Revenue item, the value of unappropriated expenditure would have been the lowest in the last seven years.

11 New Zealand Government (2023), *Financial Statements of the Government of New Zealand for the year ended 30 June 2023*, page 156, at treasury.govt.nz.

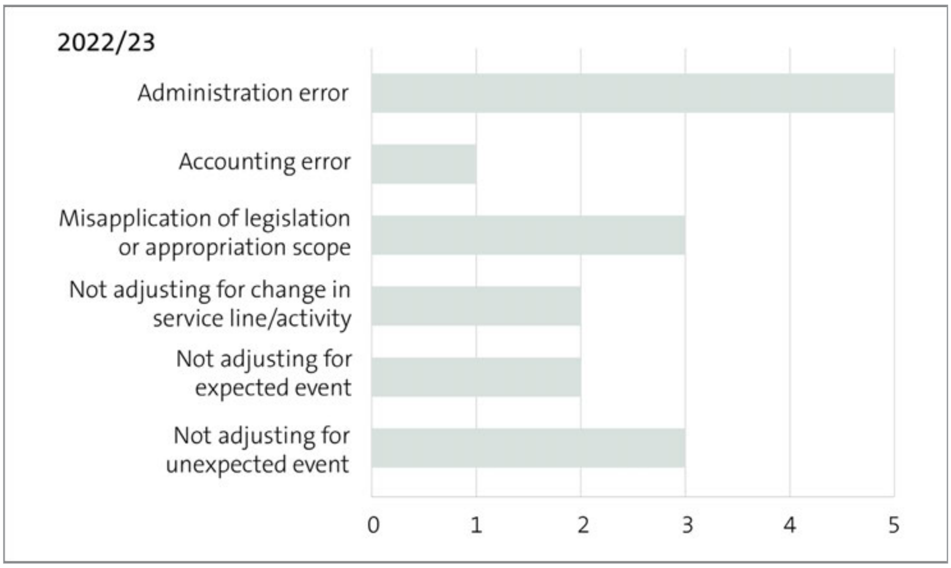
Why the expenditure was unappropriated

4.24 Figure 4 assigns the instances of unappropriated expenditure into the six categories that describe why the unappropriated expenditure came about in 2022/23.

4.25 Once again, and disappointingly, administrative errors continue to feature: five of the sixteen instances resulted from administrative oversights, but they account for 5% of the value of unappropriated expenditure.

4.26 Unexpected events gave rise to three instances, amounting to 81.7% of the value of unappropriated expenditure.

Figure 4
Reasons for unappropriated expenditure in 2022/23, by number of instances



Administration error

4.27 Five instances of unappropriated expenditure resulted from administrative errors in Vote Conservation, Vote Corrections, and Vote Business, Science and Innovation.

4.28 For the second year running, the Department of Conservation has failed to properly manage expenditure authorised under the *Community Conservation Funds* appropriation. The *Community Conservation Funds* appropriation authorises the payment of grants for community groups and private landowners to work on public and private land, to assist with pest and weed control, fencing, and other biodiversity management actions, and to support community biodiversity restoration initiatives.

4.29 An expense transfer from 2022/23 to 2023/24 was calculated incorrectly, and this reduced the expenditure limit of the appropriation by more than intended. The Department of Conservation sought and obtained Cabinet authority to use imprest supply. Up to that point, $998,000 had been incurred without Cabinet authority, with a further $103,000 incurred with Cabinet authority but nonetheless unappropriated.[12]

4.30 The Department of Conservation made a similar mistake in the *Management of Recreational Opportunities* appropriation. An expense transfer between appropriations within Vote Conservation was calculated incorrectly, and this reduced the expenditure limit of the *Management of Recreational Opportunities* appropriation by more than intended. As a result, the Department incurred $5.128 million in excess of the appropriation limit.

4.31 If activities authorised for a particular financial year are delayed or otherwise deferred, it is common for government departments[13] to request an in-principle expense transfer (IPET), to transfer funding to the following financial year. If the transfer is granted in principle, the department must seek confirmation of the transfer during that (following) financial year. If confirmed, the department will need to seek approval under imprest supply to incur the expenditure, unless the expenditure is already covered by the Appropriation Act for that year.

4.32 Between-year expense transfers are usually confirmed and authorised under the Imprest Supply Act in October of each year, after the departments' financial statements have been audited and published. However, if the expenditure needs to take place before then, then departments need to secure the correct financial authority in time.

4.33 One such instance arose in 2022/23 under the Vote Corrections appropriation *Waikeria Corrections and Treatment Facility*, which authorises expenditure on improvements to infrastructure. Due to an administrative error, the Department of Corrections did not ensure that the expense transfer had been authorised before incurring expenditure of $649.

4.34 The New Zealand Institute for Plant and Food Research Limited is a Crown Research Institute, which focuses on breeding, pest and disease control, sustainable production, food innovation, and seafood technology. During 2022/23, authority was obtained under Vote Business, Science, and Innovation for the Crown to provide an $11 million operating grant to Plant and Food Research Limited. The grant was to provide financial support to the company in the wake of losses it suffered from the North Island weather events.

12 Because the unappropriated expenditure is split between two categories in the Financial Statements of the Government, it has been counted as two instances.

13 For the purpose of this Part, references to government departments also refer to Officers of Parliament.

4.35 Although the appropriation covered the payment of an operating grant, the Ministry of Business, Innovation and Employment made the payment in the form of a Shareholder Subscription Agreement, which is a capital contribution from the Crown. There was no appropriation in the Vote to cover such a capital contribution, so the payment was unappropriated.

Accounting error

4.36 During 2022/23, the Department of Conservation received an appropriation to incur expenses up to $16.5 million to improve the Molesworth Recreation Reserve land. The Department made payments to compensate for the re-grassing and fertilising of pastures. It treated these payments as expenses, under the *Molesworth Recreation Reserve improvements* appropriation.

4.37 However, under accounting rules, the expenditure constitutes capital improvements; it is of a capital nature, not an expense. Although Vote Conservation did have a capital expenditure appropriation for the Molesworth Recreation Reserve, that appropriation authorised expenditure of only $476,000 and therefore did not cover all the capital improvement expenditure. Consequently, the Department exceeded the appropriation by $11.7 million.

Misapplication of legislation or appropriation scope

4.38 Since 1993, the Ministry of Social Development had been applying different payment criteria from that set out in legislation to a group of Accommodation Supplement recipients.[14] These payments were unlawful under the Social Security Act 2018 and outside the scope of Vote Social Development's *Accommodation Assistance* appropriation.[15]

4.39 This matter was brought to our attention in mid-2022. We wrote to the Ministry of Social Development in October 2022 to outline our concerns and request that urgent action be taken to rectify the problem.

4.40 In November 2022, legislative change was enacted to align the Act with current practice. The legislative change was given Royal Assent on 25 November 2022, by which time $554,000 of Accommodation Supplement payments had been made outside the scope of appropriation during 2022/23.

4.41 As part of its broader response, the Ministry carried out a review of its processes for (a) minimising the risk of its practices not aligning with legislation (including

14 In these cases, the Ministry of Social Development was treating the community-based partner of those in residential care as though they were single, for the purposes of calculating their Accommodation Supplement entitlement.

15 The Ministry reported this in its 2021/22 annual report and it was reported in the financial statements of the Government for the year ended 30 June 2022. We also explained the matter in our 2021/22 report to Parliament, *Observations from our central government audits: 2021/22*, paragraphs 3.16 to 3.22.

the appropriation scope) and (b) resolving alignment issues when they are identified. The Ministry also began work to identify whether there were any other areas with similar characteristics to the Accommodation Supplement issue.

4.42 So far, the Ministry has identified two other areas where benefit payments were not fully aligned with the relevant authority. Out of School Care and Recreation subsidy payments are subject to a cap of 20 hours each week. Where teacher-only days happened during term time, the Ministry found payments made above the cap. This resulted in unappropriated expenditure of $89,000 against the *Childcare Assistance* appropriation in Vote Social Development. The Ministry also identified payments under the *Training Incentive Allowance* (TIA) appropriation that were not in keeping with the Training Incentive Allowance Welfare Programme. That Programme defines working age as people aged 18 to 64, and those aged over 65 who are not eligible for New Zealand Superannuation. Payments were made to 16- and 17-year-olds ($155,000 in 2021/22 and $160,000 in 2022/23), who are ineligible for the allowance.

4.43 The Ministry states on page 203 of its 2022/23 annual report that the age criteria did not align to the policy intent of TIA nor to the agreed operational policy design settings for this type of assistance, which was to also support eligible clients aged 16 to 17 years old. This alignment issue was identified in May 2023, and a temporary suspension of new and existing TIA payments to young people aged 16 to 17 under this welfare programme was put in place until the legislation could be changed.

4.44 We support the Ministry's efforts to identify and correct cases where current practice has diverged from the legislative or regulatory requirements.

Change in activity

4.45 Two instances of unappropriated expenditure in 2022/23 resulted from government departments changing their activity without ensuring they had parliamentary authority to cover the expenditure.

4.46 In protecting the New Zealand border, the New Zealand Customs Service (Customs) carries out clearance and enforcement activities relating to travellers and goods. Parliament authorises expenditure on these activities mainly through separate appropriations for travellers and goods respectively.

4.47 The increase in international travel following the Covid-19 pandemic created airport congestion. Customs staff were reassigned to traveller clearance activities to deal with the increase in traveller numbers. This resulted in expenditure exceeding the *Travellers Clearance and Enforcement* appropriation by $532,000.

The Minister of Finance authorised the excess expenditure under section 26B of the Public Finance Act 1989. This means that the excess expenditure was lawful, albeit unappropriated. The expenditure will be "confirmed" in the next Appropriation (Confirmation and Validation) Act.

4.48 The School Lunch Programme appropriation category in Vote Education is limited to "providing school lunches to students in schools and kura with high concentrations of disadvantage". During 2022/23, the Ministry of Education made $1.1 million in payments to cover fixed costs incurred by school lunch programme providers that were unable to deliver school lunches because of the North Island weather events and various teachers' strikes. Subsidising providers' fixed costs is outside the scope of the appropriation and, as such, the Ministry did not have the authority to make those payments.

4.49 Compensating school lunch providers in this way follows on from the Ministry's practice during the 2021 Covid-19 lockdowns. At that time, Ministry also paid providers to deliver community food parcels to families. Although meeting a need, it was also outside the scope of the appropriation. The 2022/23 financial statements of the Government reports $7.4 million of unappropriated expenditure for both types of payment during 2021/22.

Not adjusting for expected event

4.50 Whenever the value of a Crown asset reduces, it is an expense to the Crown. Most expenses require appropriation, including those resulting from asset devaluations. One such instance relates to impairments to the value of public conservation land.

4.51 In 2022/23, Vote Conservation had an appropriation for impairments to the value of public conservation land to be transferred to iwi as part of the Treaty of Waitangi Settlements. The appropriation authorised impairment expenses up to $5.97 million. During the year, the Department of Conservation reviewed the accounting treatment of previous Treaty settlements. It identified instances where the carrying value of the land, going back several years, needed to be written down. The expense from the write-downs of these historical value impairments exceeded the appropriation by $32.13 million.

4.52 In Vote Health, the *International Health Organisations* appropriation authorises the Government's contribution to the World Health Organization. An increase in membership fees, coupled with a foreign exchange rate rise, resulted in expenditure exceeding the appropriation by $47,000.

Unexpected event

4.53 As explained above, asset write-downs result in expenses, and the Crown must receive an appropriation (or other authority) from Parliament to incur expenses. Two of the three unexpected events that led to unappropriated expenditure in 2022/23 were from writing down the carrying value of debtors by amounts that exceeded the appropriation.

4.54 When Ruapehu Alpine Lifts Limited entered liquidation, the Department of Conservation needed to write off the debt owing to the Crown. The *Provision for Bad Debts and Doubtful Debts* appropriation was insufficient to cover the debt write-off, resulting in $425,000 exceeding the appropriated amount.

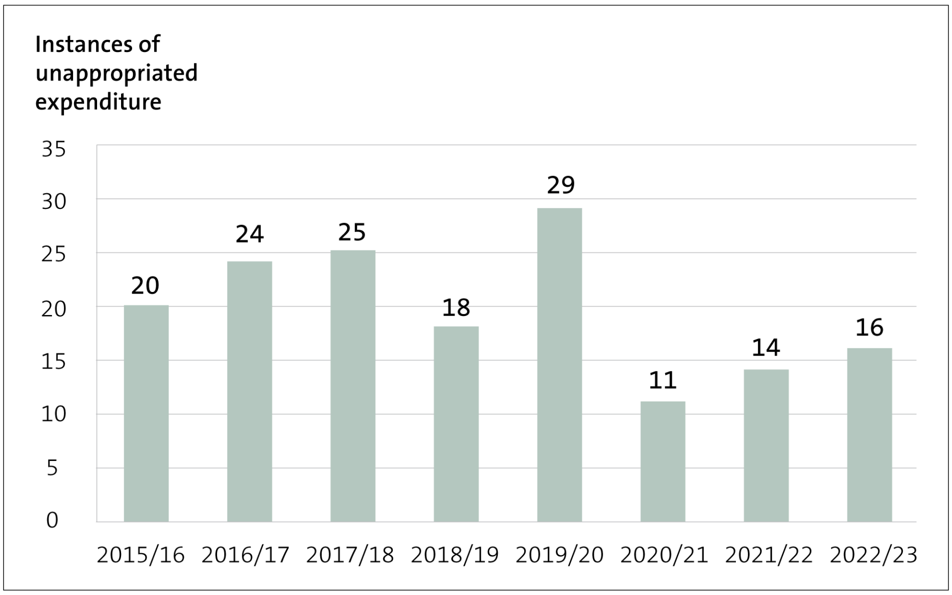
4.55 Economic conditions, including the effects of the North Island weather events, led to a significant increase in the level of Crown debt across all tax types, Kiwisaver, and Working for Families in the final quarter of 2022/23. This increased the level of debt impairment and debt write-off expense beyond the amount anticipated for 2022/23, to $1,467.6 million, which was $282.6 million higher than the appropriation limit (see also paragraph 4.22).

4.56 The costs of defending and settling health and disability-related legal claims against the Crown exceeded the appropriation in 2022/23. Costs totalling $1.95 million included litigation expenses relating to Covid-19, which was more difficult to predict than most other types of expenditure. As a result, the Vote Health *Legal Expenses* appropriation was exceeded by $145,000.

How 2022/23 compares with previous years

4.57 There has been a steady increase in the number of instances of unappropriated expenditure since the historical low of 11 instances in 2020/21, rising to 16 in 2022/23 (see Figure 5). Nevertheless, the number of instances reported in the Government's financial statements for the three years 2020/21 to 2022/23 are the three lowest so far this century.

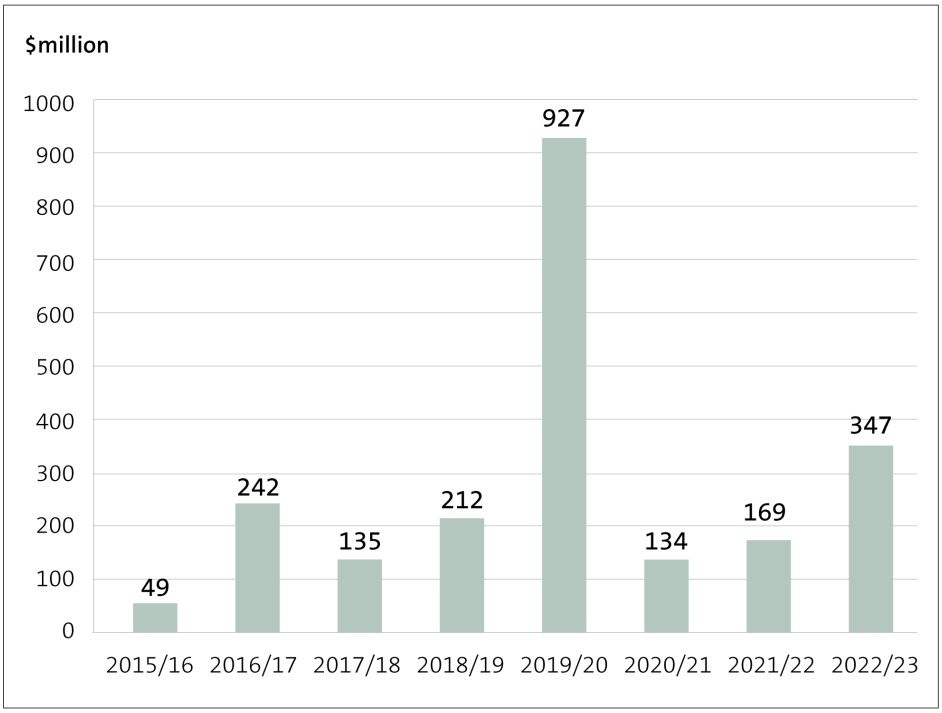
Figure 5
Number of instances of unappropriated expenditure, from 2015/16 to 2022/23



4.58 Figure 6 shows the dollar amount of unappropriated expenditure incurred during the last eight years. The dollar amount of unappropriated expenditure tends not to correlate with the number of instances. Apart from an outlier year (2019/20), which is mostly attributable to one instance ($676.8 million), the value of unappropriated expenditure follows the usual fluctuations over time.

4.59 As explained in paragraph 4.22, 81.5% of unappropriated expenditure for 2022/23 was attributable to just one item – debt write-offs and write-downs under Vote Revenue, resulting from economic conditions, including the effects of the North Island weather events in early 2023.

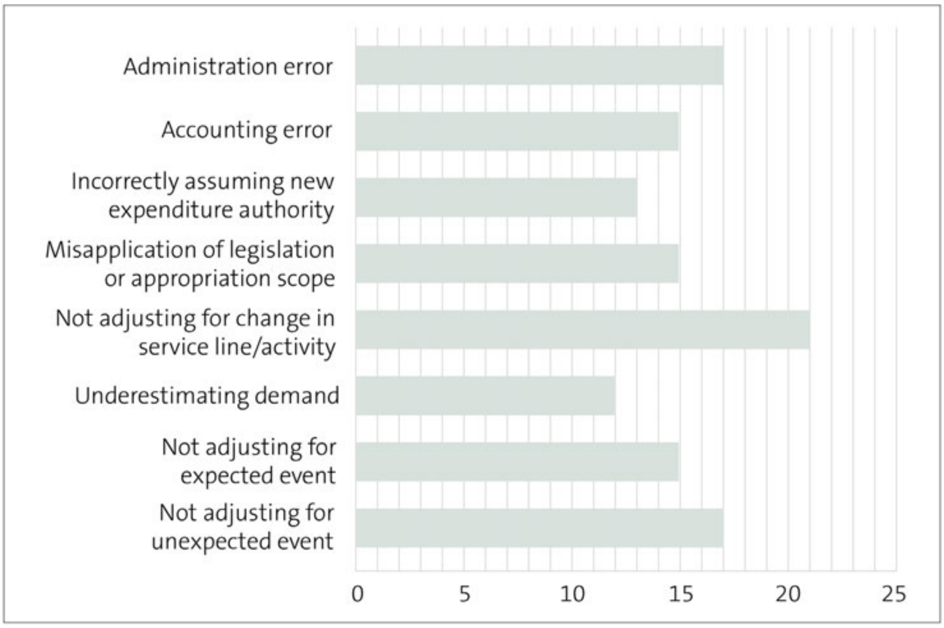
Figure 6
Amount of unappropriated expenditure, from 2015/16 to 2022/23



Reasons for unappropriated expenditure over time

4.60 Figure 7 shows the causes of unappropriated expenditure over an eight-year period and the frequency of occurrences.

Figure 7
Reasons for unappropriated expenditure, from 2015/16 to 2022/23



4.61 In recent years, the most common reason for unappropriated expenditure has been departments' failures to secure authority to cover changes in the scope of their functions, service lines, activities, or in the expenditure type (21 cases, which is 17% of all cases).

4.62 Government departments need to consider the implications those changes might have for the authority needed for the expenditure. If the new activity or item of expenditure is not covered by existing appropriations, then departments will need to seek authority under imprest supply before incurring the expenditure.

4.63 It is disappointing that 26% of cases resulted from administration or accounting errors (17 and 15 cases respectively) or from other failures in appropriation management (13 cases). These should be avoidable.

4.64 Administration errors include mistakes made when seeking additional authority for expenditure between Budgets.[16] Other errors are made when funding is transferred from one appropriation to another, reducing the expenditure limit

16 That is, when seeking Cabinet authority to use imprest supply or seeking additional appropriation through the annual Supplementary Estimates Bill.

of the original appropriation. In some cases, the transferred amount has been calculated incorrectly; in others, it appears that the transfer has been made without sufficient awareness of the likely future expenditure.

4.65 Government departments need to diligently manage and monitor the way that funding is moved and expenditure authorities are changed during the financial year (that is, between Budgets).

4.66 Accounting errors relate mainly to the misapplication of accounting rules, commonly referred to as "generally accepted accounting practice" (GAAP). For the most part, GAAP is specified in financial reporting standards, which determine how expenditure is recognised, classified, measured, and reported in government departments' financial statements.

4.67 The accounting treatment of an item has implications for the type of expenditure authority required. The most common problem involves determining whether expenditure is of a capital or an operating nature. Operating expenditure requires an operating expense appropriation, and capital expenditure requires a capital expenditure appropriation. If departments account for expenditure incorrectly, the subsequent correction of the error might result in expenditure not being covered by the correct appropriation type.

4.68 Government departments must ensure that the GAAP accounting implications for all expenditure are properly thought through and, in turn, that the accounting implications for appropriations are also identified and properly managed.

4.69 Over the last eight years, a failure to manage the timing of expenditure and the required authority for that expenditure resulted in 13 cases of unappropriated expenditure. The most common cause involves departments receiving Cabinet's "in principle" agreement to have funding and expenditure authority transferred from one financial year to the next (IPETs).

4.70 IPETS are not included in the annual Budget and do not authorise expenditure. All IPETs need to be formally confirmed (or otherwise) in the new financial year, usually in October. If confirmed, then the department must receive explicit approval to use imprest supply to cover that expenditure. Unappropriated expenditure arises when the department incurs the expenditure before the required authority is given.

4.71 We have been urging government departments to better manage the transfer of expenditure authority between years.

4.72 Another common cause, which is of considerable concern to us, is when government departments fail to keep expenditure within the scope of what the law allows (15 cases). Given that the Government must not incur expenditure on any activity outside the scope of those authorised by Parliament, we expect government departments to comply with the law.

4.73 Departments need to understand what their appropriations may and may not cover and regularly review their practices to ensure that they align with the relevant authorities. They also need to ensure that, when the appropriation scope is tied to legislation or regulation and the legislation or regulation has changed, practice is immediately realigned to the revised authority.

4.74 There have been 12 cases of unappropriated expenditure in the last eight years because of demand-driven expenditure exceeding the forecast expenditure. Unexpected demand can arise from situations that could not reasonably have been foreseen but can also arise from situations that should have been anticipated and provided for in advance.

4.75 Government departments need to ensure that there is sufficient authority available to cover heavily demand-driven activity.

4.76 Unappropriated expenditure due to specific events that should have been anticipated are included in the Figure 7 category, “Not adjusting for expected event” (15 cases). However, unappropriated expenditure can also arise as a direct result of unexpected events – that is, those where we would consider it unreasonable for departments to have known in advance that they would need to seek additional authority. Such events resulted in 17 cases of unappropriated expenditure over the last eight years. They can include expenses relating to sudden asset impairments, unexpected legal expenses, and obligations placed on the Crown at short notice.

Work carried out to discharge the Controller function

Monitoring public expenditure

4.77 Throughout 2022/23, we monitored public expenditure to determine whether it was in line with the authority provided by Parliament.[17]

4.78 We checked that the amount of new "between-Budget" expenditure agreed by Cabinet[18] (that is, the use of imprest supply) remained within the $28.5 billion authorised through the second annual Imprest Supply Act. For changes made during the year to individual appropriations, we checked a sample to ensure that they had been properly authorised.

Audits of government departments

4.79 We carry out the core of the Controller work through annual audits of government departments and associated interactions with those departments.[19] As part of our audits, we examined the financial systems and financial records of government departments to determine whether public expenditure has been properly authorised and accounted for.

4.80 Where the Government had incurred expenditure above or beyond what Parliament had authorised, we checked that the nature and amount of unappropriated expenditure was accurately reported to Parliament and the public.[20]

Resolving issues arising and providing advice

4.81 Much of the Controller responsibilities include considering matters arising where the question of whether public expenditure is unauthorised is not straightforward or, at least, requires some consideration before a conclusion is drawn.

4.82 From time to time, government departments seek the Controller's view on a matter, to gain assurance about the lawfulness of its expenditure or, alternatively, to help alert it to the need to seek additional expenditure authority. At other times, our auditors, the Treasury, members of Parliament, or the news media will identify matters that prompt deeper scrutiny and consideration by our Office. Not all of our deliberations conclude that expenditure is unlawful.

4.83 One such matter concerned the Cost of Living Payment, administered by Inland Revenue. This matter came to our attention when the first payment was made in August 2022.

17 Under section 65Y of the Public Finance Act 1989.

18 Or through Cabinet delegation to joint Ministers.

19 Under section 15 of the Public Audit Act 2001.

20 That is, through our audits of the financial statements of the Government, and the financial statements of all government departments, for the year ending 30 June 2023.

4.84 After gathering the necessary information and establishing the facts surrounding the payments, we concluded that the Cost of Living Payments made to overseas residents were within the scope of the appropriation. However, we raised concerns with Inland Revenue about how the eligibility criteria were applied for the Cost of Living Payment, uncertainty about how many ineligible people received the payment, and the approach to recovering payments from ineligible recipients.

4.85 Inland Revenue took action to address these problems. This included estimating the amount of ineligible payments, carrying out extra checks on people's residential status to prevent payments to customers with unconfirmed residential status, and contacting people about eligibility and repayment requirements.

Helping to improve capability and promote good appropriation management

4.86 In 2022/23, we continued to support the Treasury's Finance Development Programme by delivering seminars to government department finance professionals. In those seminars, we highlighted the importance of Parliamentary control of Crown expenditure, how the Controller function supports New Zealand's constitutional arrangements, why it is important to avoid incurring public expenditure without the proper authority, and some of the common problems that can lead to unappropriated expenditure.

Appendix
How appropriations work

Who approves the spending of public money and how?

Each year, the Government puts forward its expenditure proposals for the coming financial year in the Budget (usually in May). It formally presents its proposed Budget to Parliament in the Appropriation (Estimates) Bill, along with various explanatory documents. This is the first appropriation Bill for the financial year.

The Bill sets out estimates of what will be spent under each ministerial portfolio. In general, every ministerial portfolio associated with a department has a corresponding "Vote" in the Budget (for example, Vote Health sets out all the expenditure in the health portfolio). Each Vote is made up of several specific appropriations. Each appropriation sets out:

- the maximum amount of expenditure being approved;
- the scope (that is, what the money can be used for); and
- the date on which the appropriation lapses (most appropriations last for one year).

Once Parliament has considered and passed the Bill, it becomes law as an Act. In general, any expenditure outside what has been approved in this Act of Parliament will be unlawful.

The Budget generally does not become law until several weeks into the financial year.

If the Appropriation (Estimates) Bill is not passed before the financial year begins, how can the Government spend money lawfully in the meantime?

The Appropriation (Estimates) Bill needs to be passed within four months of Budget Day. From 1 July until the Bill becomes law, the Government must continue to operate and spend public money. To cover this period, interim authority is provided through an Imprest Supply Act, which is enacted before the financial year begins. The first annual Imprest Supply Act therefore allows the Government to incur expenditure before the Budget for that year is enacted in legislation. The expenditure authority under this Imprest Supply Act is repealed when the Appropriation (Estimates) Act comes into force.

There are usually at least two Imprest Supply Acts in each financial year.

What happens if things change during the year?

The changing nature of government activities and unexpected demands means that it is rarely possible to foresee all future expenses and capital expenditure. The system recognises the need for some flexibility to respond to changing events.

A second Imprest Supply Act for the year is enacted, usually at the same time as the Appropriation (Estimates) Act. This provides authority for expenditure that might not have been envisaged when the Budget estimates were finalised. It remains in force until the end of the financial year to provide authority for unexpected expenditure.

Cabinet requires that any use of imprest supply must be authorised by a specific Cabinet decision (or, in some instances, by approval of joint ministers under delegation from Cabinet). But Imprest Supply Acts provide only "interim" authority. To remain lawful, all expenditure incurred under an Imprest Supply Act must be approved by Parliament under an Appropriation Act passed before the end of the financial year.

Expenditure under the second Imprest Supply Act is typically appropriated through a second appropriation Act, the Appropriation (Supplementary Estimates) Act, which is usually enacted in June. This allows the Government to update the initial estimates in the Budget and get legislative approval for those changes (which include expenditure already incurred under imprest supply).

If expenditure under the authority of an Imprest Supply Act is incurred too late in the financial year to be authorised through the Appropriation (Supplementary Estimates) Act, then as at 30 June it becomes "unappropriated expenditure". It must be validated by Parliament through a third appropriation Act, the Appropriation (Confirmation and Validation) Act, in the next financial year.[21]

The Public Finance Act includes several other mechanisms for approving minor changes to the expenditure authorities approved by Parliament. For example, there is limited scope for the Governor-General to approve, by Order in Council, transfers between appropriations in a Vote.[22]

To provide further flexibility during the final three months of the year, the Public Finance Act authorises the Minister of Finance to approve a limited amount of extra expenditure within the scope of an existing appropriation.[23] Flexibility under these mechanisms is subject to confirmation by Parliament through the Appropriation (Confirmation and Validation) Bill.

21 Section 26C of the Public Finance Act 1989. The Appropriation (Confirmation and Validation) Bill, which is introduced after the end of the financial year, allows Parliament to retrospectively confirm or validate all unappropriated expenditure incurred during the year.

22 Section 26A of the Public Finance Act 1989.

23 Section 26B of the Public Finance Act 1989.

Sections 25 and 25A of the Public Finance Act also authorise the Government to spend public money outside appropriations in emergency situations, subject to confirmation by Parliament through the Appropriation (Confirmation and Validation) Bill.

Does that mean any expenditure outside the revised Budget (Supplementary Estimates) is unlawful?

Such expenditure can be unlawful, but not always. It could still be lawful if it is covered by some other authority, for example, a relevant section in the Public Finance Act or by another Act of Parliament. However, expenditure incurred under Cabinet authority to use imprest supply, but not included in an Appropriation Act at the end of the financial year, becomes unappropriated and remains unlawful until it is validated by Parliament.

Does the Auditor-General have a role in the Budget process?

No. The Government prepares the Budget. The Minister of Finance and the Treasury co-ordinate the work of the various government departments and individual Ministers to put together a set of expenditure proposals for the Government as a whole. The Auditor-General is not part of the Government nor are they answerable to Ministers, and so they have no role in this process.[24] The Auditor-General does not audit the Budget.

Once the Government has presented its proposed Budget to Parliament, individual select committees consider the proposals in the various Votes. The Auditor-General's staff provide advice to the select committees to assist their scrutiny of the expenditure proposals in the Budget estimates.

Parliament then votes on whether to pass the Appropriation (Estimates) Bill. Votes on Budget and expenditure matters are automatically regarded as confidence matters. That means that, if a Government cannot persuade a majority of Parliament to support its expenditure plans, then it does not have enough support to continue as the Government.

Who spends the money and how?

All public money must be held in a Crown or departmental bank account. The Treasury is responsible for managing Crown bank accounts unless it delegates responsibility to a department to operate as an agent of the Crown. Government departments are responsible for managing departmental bank accounts.

24 There is a special process for working out the budget for Officers of Parliament (such as the Auditor-General) to ensure that the funding decisions are made by Parliament and not the Government. The Auditor-General is involved in this process in their capacity as the chief executive of their own Office.

Each department forecasts its cash requirements based on its budget and agrees cash payment schedules with the Treasury. The Treasury is responsible for disbursing cash to government departments during the year in keeping with those schedules. Responsibility for how that cash is applied rests with the government departments' chief executives.

The government departments are responsible for paying non-departmental providers (for example, Crown entities funded from their Votes) and for their own departmental expenditure.

The public financial management system operates on an "accrual" rather than a cash basis of accounting. This means that expenditure is accounted for when it is incurred (that is, when there is an obligation to pay), as opposed to when the payment is made. To keep within Budget limits, government departments need to manage expenditure on an "accrual" basis.

Who is responsible for ensuring that public money is spent correctly?

Departmental chief executives are responsible under the Public Finance Act for the financial management and performance of their department. This includes ensuring that they have both the funding authority and the necessary legal mandate before incurring expenses or capital expenditure.[25]

Government departments are required to report regularly to the Treasury on the expenses and capital expenditure incurred by the department against the appropriation or other statutory authority provided. The first report for the financial year is provided in October (covering the previous July to September period) and then monthly after that. This and other financial information is used to compile the monthly financial statements of the Government.

The Treasury is also required to report to the Controller all expenditure incurred compared with the appropriation (or other authority) and all expenditure incurred without authority or in excess of the authority given. This is carried out monthly, beginning in October each year, in co-ordination with the requirements in the paragraph above.

25 Section 34(1)(a) of the Public Finance Act 1989.

Who checks whether government departments are spending money lawfully within authority?

This is where the role of the Controller comes in. To check and verify the expenditure, the Auditor-General's Controller team:

- reviews the Treasury's monthly reports;
- carries out tests on the financial information (provided by the Treasury from the Crown Financial Information System);
- checks that Cabinet's authority for changes to budgets are correctly applied;
- reports back to the Treasury highlighting any issues (including unappropriated expenditure), comments on actions needed to confirm or validate any unappropriated expenditure, and advises on any further action that the Treasury or the department needs to take to resolve outstanding issues; and
- confers with the relevant auditors about issues affecting the government departments they audit.

As well as auditing government departments' financial statements, the Auditor-General is responsible for auditing the appropriations administered by each department (the appropriation audit).

Through the appropriation audit of each department, our auditors look at systems and some transactions to check that public money was spent as Parliament intended. If an appointed auditor detects expenditure outside authority through the appropriation audit work, then the auditor will discuss the matter with the government department, advise the department about reporting the matter and taking corrective action, and inform the Controller. The appointed auditor will also check whether the department properly reports the matter in its financial statements.

Expenditure above or beyond the appropriation limits

The public finance system provides some flexibility to how public expenditure is authorised. This is necessary to:

- allow the Government to incur expenditure not covered at the time by Appropriation Acts, including to allow for unanticipated expenditure during the year as circumstances change (through imprest supply);
- allow for immediate expenditure in declared emergencies (sections 25 and 25A of the Public Finance Act); and
- provide for the approval of relatively small amounts of expenditure in excess of appropriation without needing approval from Parliament (sections 26A and 26B of the Public Finance Act).

However, in general, when government departments do not get approval for expenditure before it is incurred, it is unlawful. Expenditure approved by Cabinet under imprest supply will also be unlawful if Parliament has not appropriated it before the end of the financial year.

We have urged government departments to seek early approval as soon as they have identified the need for previously unanticipated expenditure, so that any expenditure over and above that authorised in the Appropriation (Estimates) Act can be authorised by Cabinet before the event and subsequently authorised by Parliament in the Appropriation (Supplementary Estimates) Act.

Ministers need to report unappropriated expenditure to Parliament and, for that expenditure to be lawful, must seek Parliament's retrospective approval of unappropriated expenditure through an Appropriation (Confirmation and Validation) Bill.

How does the Controller deal with expenditure incurred outside appropriation limits?

When government departments become aware of potentially unappropriated expenditure, they are expected to immediately tell their appointed auditor, the Treasury, and their Minister (who will need to seek additional authority for the expenditure). The department should provide the Treasury with an explanation of the issue as well as an explanation of actions taken to resolve it, for example, to gain additional authority in advance to avoid unappropriated expenditure or to seek validation of any already unappropriated expenditure through an Appropriation (Confirmation and Validation) Act.

Auditors might detect potentially unappropriated expenditure through their audit process, as might the Treasury through its financial management and budgeting work. After collating information from government departments each month, the Treasury provides its monthly report to the Controller highlighting actual, expected, and potentially unappropriated expenditure. The Controller then carries out the work we described in Part 4.

The Controller monitors all matters that come to their attention until they are resolved and will often, through their auditors, advise government departments on any corrective action required. For expenditure that is confirmed as being unappropriated, corrective action includes disclosing the facts in the affected departments' annual financial statements (and the Government's financial statements). After the end of the financial year, the Auditor-General audits the departments' and the Government's financial statements to ensure that all unappropriated expenditure is correctly disclosed.

If a government department does not take the action required to prevent continuing unauthorised expenditure, then the Controller can write to the department's chief executive or the relevant Minister directing that no further expenditure can be incurred under the affected appropriation until approval has been obtained.

If the government department still fails to obtain the correct approval, then the Controller can direct the Minister, the Treasury, and the department to stop payments from the relevant bank account and direct the Minister to report to the House of Representatives. This would be an unusual sanction and used only in exceptional circumstances.[26]

26 Sections 65Z and 65ZA of the Public Finance Act 1989.

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