Public
Sector
Committee

October 1994

Occasional Paper 2

Auditing Whole of Government Financial Statements: The New Zealand Experience

ISSUED BY THE
INTERNATIONAL FEDERATION OF ACCOUNTANTS

ACKNOWLEDGMENT: The Public Sector Committee (PSC) of the International Federation of Accountants (IFAC) is indebted to June Pallot and Lyn Provost for allowing it to publish this case study as an Occasional Paper of the PSC. The views expressed in the Occasional Paper are those of the authors and are not necessarily shared by the PSC or the IFAC.

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ISBN 1-887464-23-9

PREFACE

The Public Sector Committee (PSC) is a standing committee of the Council of IFAC formed to address, on a coordinated worldwide basis, the needs of those involved in public sector financial reporting, accounting and auditing. In this regard, the term "public sector" refers to national governments, regional (e.g., state, provincial, territorial) governments, local (e.g., city, town) governments and related governmental entities (e.g., agencies, boards, commissions and enterprises).

PSC has been given the authority, on behalf of the Council, to issue standards, guidelines, studies and occasional papers on financial reporting, accounting and auditing in the public sector.

Occasional papers are intended to provide information that contributes to some segment of the body of public sector financial reporting, accounting and auditing knowledge. They are aimed at providing new information or fresh insights into public sector issues and generally result from research activities such as: literature searches, questionnaire surveys, interviews, experiments, case studies and analysis.

PSC believes that the issue of such occasional papers pronouncements will contribute to the development of public sector financial management and accountability throughout the world.

This second occasional paper examines the audit issues associated with the development of accrual based financial reporting for central Government. It addresses, in particular, the problems experienced in gaining adequate audit evidence in a situation where previously there had been inadequate recording of assets and liabilities, giving rise to significant valuation issues.

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TABLE OF CONTENTS

CHAPTER 1

INTRODUCTION

.001 In 1989, New Zealand passed legislation (the *Public Finance Act, 1989*) which transformed the financial reports produced by its central government. Full accrual accounting by all individual government departments was followed in 1992 by the preparation of accruals-based financial statements for the government as a whole (referred to in New Zealand as the Crown). The government reporting entity was extended in 1993 to include State-owned enterprises, which are commercial companies owned by the government, and Crown entities which are other public bodies over which the government exercises control. Details of the process of preparing whole of government financial statements (referred to in New Zealand as the Crown financial statements) are provided in the companion paper, Occasional Paper 1 "Implementing Accrual Accounting in Government: The New Zealand Experience".

.002 Important features to note are that accrual-based financial statements were viewed as an integral part of overall management and public sector reform, rather than as a technical accounting issue in isolation and that politicians, departmental managers, the Treasury and the Audit Office shared a common vision of more efficient and more accountable government of which the Crown financial statements were a concrete and visible product. The main steps in the development of the Crown financial statements are summarized in Appendix 1 to this paper.

.003 The Public Finance Act requires that the Crown financial statements be audited by the Auditor-General (Audit Office). Part III of the Act requires that the Crown financial statements be prepared within two months of the end of the financial year (30 June) and the audit be complete within a month after that. Given that New Zealand was the first country to produce whole of government financial statements on a full accruals basis, this meant that a large and complex new task had to be accomplished in a very short period of time. Furthermore, New Zealand is a small country with a limited pool of expertise. As well as attesting to financial statements, therefore, the Audit Office was positioned in terms of knowledge and expertise to assist in such functions as:

- Providing advisers to Parliament's Finance and Expenditure Committee during its consideration of the *Public Finance Bill* in 1989, its inquiry into reporting by the Crown and its sub-entities, and its inquiry into the format of the Crown financial statements;
- Commenting on the Crown accounting policies as they were developed;
- Providing comment on the format of the Crown financial statements;
- Carrying out a special audit of the opening balances at 1 July 1991 for the half-year financial statements to 31 December 1991;
- Close liaison with the Treasury throughout the financial statements' preparation period;
- Participation in some of the more technical valuation issues; for example, libraries, roads, and archives; in particular, advising on the evidential standards to be met.

.004 This paper describes the role played by the Audit Office in the development of the Crown financial statements. Following an explanation of the role of the Audit Office in New Zealand, the role played by the Audit Office is analyzed in terms of fundamental audit characteristics such as independence, criteria (in particular, accounting practices to provide a true and fair view in the absence of relevant accounting standards) and evidence. The audit and management processes involved in auditing the Crown financial statements - including planning, setting of materiality levels, project control, training and reporting - are then described. The paper concludes with lessons for other countries.

CHAPTER 2

THE AUDIT OFFICE IN NEW ZEALAND

.005 The Audit Office in New Zealand (i.e., the Controller and Auditor-General, a Deputy Controller and Auditor- General and any other person appointed by the Auditor-General to act on the Auditor-General's behalf) is created by Act of Parliament. Its role is to provide assurance that governmental organizations are operating, and accounting for their performance, in accordance with Parliament's intentions. The principal outcomes sought from discharging this role are, firstly, public confidence in the integrity of public sector accounting and reporting systems and the information produced from them; and, secondly, better use of public resources. In pursuit of these outcomes, the Audit Office produces a range of reports to Parliament, appointed representatives, ministers, management and, ultimately, the public at large.

.006 In common with private sector auditors, the Auditor-General makes a report on an audited entity's public accountability statements, i.e., the 'short-form audit report' or the 'audit opinion' which is attached to and forms part of the audited statements. With the introduction of statements of service performance in many parts of the public sector, the audit report commonly has to address both financial and non-financial performance. The Auditor-General is appointed by Parliament to be the auditor of all public sector entities with the exception (for reasons of historical accident) of the Reserve Bank of New Zealand.[1] The public sector entities number over 3,500 including central government departments, local authorities, state trading enterprises, schools and a host of different commercial and non-commercial Crown entities. Thus, the Audit Office has traditionally had experience in auditing commercial enterprises and consolidations. All staff who carry out audits of financial statements are qualified accountants. As members of the Institute of Chartered Accountants of New Zealand (the Institute) (formerly the New Zealand Society of Accountants), they must follow its accounting and auditing standards and are subject to its code of practice and ethical conduct. The Institute is a single professional body with a single body of knowledge encompassing both the public and private sectors. This means that all accountants, irrespective of where they work, receive education and training in commercial accounting practices and techniques. The single professional body and single education and admission requirements not only facilitate communication and cross-fertilization of ideas between the public and private sectors, but also enable relatively easy movement of personnel between them.

.007 In addition to assurance as to the validity of financial statements, it is expected that the Auditor-General will provide independent assurance that accountability arrangements applied to public sector entities are adequate and that entities are conducting their affairs effectively and efficiently as well as lawfully and with probity. This assurance may be conveyed in reports by the Auditor-General to the House of Representatives pursuant to the reporting powers under the Public Finance Act 1977. The Act does not, however, restrict the Auditor-General to reporting to the House but confers the power effectively to report to whomever and whenever the Auditor-General chooses on any matter relating to the Auditor-General's auditing responsibilities. In practice, the power is constantly used to report to select committees, ministers, governing bodies, chief executives and other interested parties. The content of any report is at the Auditor-General's discretion relating to:

(i) Any accounts or transactions that are required to be audited by the Audit Office under any Act; or
(ii) The performance or exercise by the Audit Office of any of its functions, duties, or powers under any Act.

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1 This anomaly arises from the fact that the Reserve Bank originated in the private sector and was subsequently nationalised in 1936. The change from private sector auditors has never been made.

.008 As well as reports arising out of findings of the regular annual audits, there are some reports based on special studies, often into single specific subjects. Such studies have included the results of what are known internationally as ‘efficiency and effectiveness’ or ‘value for money’ (VFM) audits.

.009 There are a number of other activities which the Audit Office currently undertakes to assist Parliament, and in particular select committees, in holding the Executive to account. While there is no specific legislative mandate for these activities, they draw on the independent knowledge gained during the audit process and are consistent with both the Auditor-General’s broader reporting responsibilities and with making a constructive contribution to the public accountability process. It is commonplace for the Audit Office to be asked to appear before each select committee conducting a review to provide further details of the results of the audit of the entity, the report on the accountability statements, and any other matter on which the committee may want independent assurance or advice.

.010 In addition to the regular reviews of estimates and financial performance, a select committee may conduct an inquiry into any matter within its terms of reference. Again, the Auditor-General may be requested to appear before the committee or be requested to make staff of the Audit Office available to assist the committee. Finally, the Auditor-General may assist select committees in their consideration of proposed legislation, particularly if issues of public sector accountability or management are involved. Advice to the Finance and Expenditure Committee during its consideration of the *Public Finance Bill* in 1989, its inquiry into reporting by the Crown and its sub-entities, and its inquiry into the format of the Crown financial statements are notable examples.

.011 By the early 1990s, when work on the Crown financial statements commenced, the Audit Office had established a culture committed to the enhancement of financial management and accountability throughout the public sector. The former was the legacy of A.C. Shailes, Auditor-General from 1975 to 1982, whose 1978 report on financial management in central government departments advocated a shift towards accrual accounting in the interests of better asset management and cost responsibility. His successor, B.H.C. Tyler, championed the principle of accountability to Parliament and the public at large and advocated better reporting as a means of achieving this. In promoting better accountability and financial management, Auditors-General have sought to balance their role as “watchdog” with their role of “improver”. Although the two roles are complementary, they can be in tension since the former role is one of pointing out deficiencies in performance, spending, accountability or probity whereas the latter is one of positive encouragement. While Auditors-General in some countries adopt a strong “watchdog” stance - and are frequently under pressure from elected representatives to do so - the Audit Office in New Zealand places considerable emphasis on its “improver” role. In this, it may act as something of a mentor or coach and its reports therefore focus on achievements to date, areas for further improvement and suggestions for how this might be achieved. Reports also tend to be on general themes affecting all departments or other class of entities (e.g., cost allocation, asset management, performance measurement) rather than singling out individual entities for attention. These themes may be followed up several years in succession until the required standard is achieved across the board.

.012 The above discussion should have served to highlight some of the differences between the Audit Office in New Zealand and other legislative auditors and to explain the stance adopted by the Audit Office in the audit of the Crown financial statements. The latter is now discussed at two levels: a broader level concerned with the nature of the audit itself; and a more specific level documenting the specific practices and techniques adopted in carrying out the task.

CHAPTER 3

THE ROLE OF THE AUDIT OFFICE IN DEVELOPING THE CROWN FINANCIAL STATEMENTS

.013 Fundamental characteristics of an audit are independence, the existence of criteria or standards against which to form a judgment; and the collection of evidence to support that judgment. Specific issues which arose in relation to these during the audit of the Crown financial statements are discussed below.

Independence

.014 The Audit Office in New Zealand is independent of the Executive arm of government. All those who carry out audits on the Auditor-General's behalf must, as a professional requirement, exhibit independence in thought and action as is required in the private sector. Additionally, independence is secured under Act of Parliament. Like members of the judiciary, the Auditor-General and deputy currently have a tenure of office that is independent of the government of the day. Only the Governor-General, upon address from the House of Representatives, can remove the Auditor-General from office and this must be on grounds of disability, bankruptcy, neglect of duty or misconduct. The Public Finance Act provides permanent appropriation for the salary of the Auditor-General and deputy in a manner consistent with other Officers of Parliament and members of the judiciary while the resources needed to carry out the necessary work and publicly report are allocated by the Parliament upon the recommendation of the Officers of Parliament select committee.

.015 In light of the above arrangements, there has not been any great concern about the independence of the Audit Office in any of its activities, including audit of the Crown financial statements. Observers from other regimes, however, might raise questions about independence when the Audit Office advises on legislation against which it later audits. How independence was maintained given the close cooperation between the Treasury and the Audit Office in the production of the Crown financial statements may also be a matter of interest. The Audit Office itself has also been conscious of being viewed as both "judge and jury" following its experience with the first audited non-financial performance measures (statements of service performance or SSPs) in 1989. In an effort to assist public sector entities to produce better reports, and because there were no existing standards or guidelines internationally, the Audit Office had published the criteria they had used in forming an opinion on SSPs. Most entities failed to achieve an unqualified opinion on the SSPs in the first round and disgruntled managers tended to blame the Audit Office for this.

.016 By the time the Audit Office came to be involved in the Crown financial statements, therefore, it was extremely conscious of avoiding being seen to set reporting standards. Its participation in the Finance and Expenditure Committee's consideration of legislation as well as its investigation into Crown entities and the method of consolidation and its participation in the development of accounting policies was vital given its accounting expertise (particularly as applied in government) and its knowledge of the entire public sector. A by-product of the Audit Office's involvement was that because of its broad client base, it could see the relevance of proposed policies for other entities. For example, it was able to point out that library valuations were relevant not just to the National Library but also to local authorities, schools and universities and bring these other parties into the discussions.

.017 At the same time, the Audit Office insisted that any policies were set by other parties - the Treasury or, in specific areas, relevant professional groups (for example, by librarians in the case of library valuation standards). Making constructive contributions while steering clear of involvement in final decisions on policy required careful management. This included educating all parties concerned as to the role of audit as well as self-discipline on the part of the Audit Office personnel. The Audit Office was prepared to participate in general discussions of principles and concepts, to comment on draft proposals (particularly the implications for the collection of evidence) but insisted on standing back from actual decisions on policies. It was prepared to assist in identifying the advantages and disadvantages of adopting a policy but not prepared to state whether the policy should be adopted.

.018 As well as making it clear that it would stand back from final decisions on policy questions, the Audit Office also made it clear that, while it would do its utmost to ensure an unqualified audit opinion could be issued in the interests of public confidence in the financial statements, it would qualify if the necessary requirements could not be met. The Audit Office never wavered from its commitment to professional excellence. In New Zealand this means adherence to the fundamental principles identified in the Code of Ethics of the Institute of Chartered Accountants of New Zealand: Integrity; Objectivity; Professional Competence, Due Care and Timeliness; Compliance with Technical Standards; Professional Behavior (i.e., personal conduct consistent with the good reputation of the profession); Confidentiality; and Independence.

Standards

.019 In most areas (e.g., internal control, accounting policies of individual entities), the criteria employed in audit were very little different from those regularly employed in the private sector or which had been previously employed in the public sector. Where significant innovative thinking was required, however, was in matters distinctive to the Crown as a whole. The Public Finance Act 1989 specified that Crown reporting be in accordance with generally accepted accounting practice (GAAP). However, since this was the first time internationally that accrual-based financial statements had been prepared for a national government as a whole, GAAP had not been codified anywhere for issues such as definition of the reporting entity, the method of consolidation, infrastructure and heritage assets, defense assets, taxation revenues, and welfare obligations.

.020 In the absence of GAAP dealing specifically with accounting by national governments, the task of resolving accounting issues and determining accounting policies to be adopted in the preparation of Crown financial statements was undertaken by the policy group within the financial management branch of the Treasury. Where equivalent circumstances in the private sector could not be found, accepted accounting principles were followed. Agreement on these principles therefore formed a major part of early discussions between the Treasury, the Audit Office and relevant experts. At roughly the same time the Institute was developing its *Statement of Concepts* to guide standards setting. Not dissimilar from private sector conceptual framework projects elsewhere, the *Statement of Concepts* covered such matters as objectives of financial reporting, definition and recognition of elements, underlying assumptions and desirable qualitative characteristics of accounting information. Those working on the Crown accounting policies were able to both draw on the emerging S*tatement of Concepts* and test its usefulness, providing suggestions for improvement where appropriate. Particular use was made of the definitions of elements; for example, in distinguishing between liabilities from contingent liabilities or commitments in the case of pensions, accident compensation payments and welfare benefits.

.021 In some instances a trade-off had to be made between the conceptual and the practical. For example, revenue from the Goods and Services Tax should, in theory, be recognized when the liability to the Crown is incurred. In the first two years, however, the information systems of the Inland Revenue Department were not developed to the point where this figure could be reliably estimated and the payment due date was adopted instead. This was one occasion where the auditor was able to play a useful role as arbitrator between the Treasury and the entity involved when the two had differing views. The differences tended to be along conceptual versus practical lines. If, for example, a department declared that its current technology meant that it could not produce information to the degree of reliability required by a proposed accounting policy, the Audit Office was able to provide assurance to the Treasury as to what the department was stating. Conversely, the Audit Office was able to provide assurance to the department that what Treasury was proposing was in line with generally accepted accounting practice.

.022 Practical possibilities also had to be considered in assessing the costs and benefits of independent valuations of military equipment and Crown land. While independent valuation of assets is preferred in principle, in the case of defense assets, there was little relevant expertise outside the department while issues of national security (not to mention cost) constrained the ability to obtain a valuation from elsewhere. In the case of Crown land, independent valuation was considered prohibitively expensive and unlikely to contribute much additional benefit over the valuation already prepared by the Government Valuer. In instances where theoretical ideals had to be moderated by practical considerations, full disclosure of the situation to readers of the financial statements was made.

Evidence

.023 Evidential criteria did not, for the most part, differ from those normally applied in the private sector. There were, however, at least two issues which created difficulties in obtaining evidence. The first was the quality of the accounting and internal control systems in the various entities given the recency of the shift to accrual accounting, significant restructuring of departments and changes in personnel. Fortunately, the departments had been operating accrual accounting systems and reporting on a full accruals basis for two years by the time the Crown financial statements were produced so that most problems had been ironed out, consistency had been secured and it was possible to concentrate on issues specific to the Crown as a whole (e.g., infrastructure and heritage assets, taxation revenues) or issues arising from the consolidation itself (e.g., consolidation method, eliminations). Another problem with new systems was that there was little prior history or trends to assist in analyzing the reasonableness of figures such as provisions for bad debts. Analytical review techniques were therefore severely limited. The auditors had to rely on examining the processes and assumptions used in estimating the provision as well as their knowledge of other businesses; in retrospect the figures turned out to be sufficiently close.

.024 The second problem was that assets such as roads, archives, the National Library collection, much defense equipment, and the conservation estate had either not been valued before or the recording and control systems for them were unsophisticated and unreliable. While managers were used to keeping evidence such as invoices, it had not occurred to them to keep evidence on, for example, the valuation procedures and methods they had followed. The auditors dealt with these problems by asking the departments to keep the evidence, working alongside them as much as possible and encouraging them to put in appropriate systems over time. Fortunately, the inquiry by the Finance and Expenditure Committee in 1991 and Treasury's development of draft accounting policies provided forums for early identification of the major accounting and valuation issues. Had specification of the auditor's evidential requirements been left until the interim examination prior to the first Crown financial statements, it is doubtful that adequate evidence could have been available.

.025 A very important valuation was that of the Crown's pension liability with respect to its employees. There were two major problems here. First, the Government Superannuation Fund (GSF) did not have an adequate data base; records were held in many different departments and they had not been reviewed for accuracy and consistency. Time was therefore needed to get the records right. The second problem was that the GSF had not had an actuarial valuation for 26 years; furthermore, at that stage auditing of actuarial valuations was in its infancy such that there was no readily available auditing standard on the topic. The Audit Office firstly reviewed the adequacy of the base data. Once satisfied with this, it employed its own actuary to give an independent report on the valuation provided by the Government Actuary and spent considerable time with the actuary gaining an understanding of the valuation. In the second year that Crown financial statements were produced, the Audit Office asked the independent actuary to give an opinion on the underlying assumptions. The Government Actuary was very cautious in statements about the valuation and pointed out that half a percent change in an assumption would change the valuation by half a billion dollars - well outside materiality limits. The approach the Audit Office decided to adopt had two elements. First, the disclosure about the valuation in the first set of financial statements was to be significant and refer to the actuary's full report. Second, the Auditor-General's report to Parliament set out the limitations of an actuarial valuation and explained the process and the significant difference that small variations in assumptions could make. The principles of full disclosure and full reporting to Parliament were also adopted in other areas where there were difficulties.

CHAPTER 4

SPECIFIC ISSUES IN AUDIT MANAGEMENT

.026 The following describes the practices adopted by the Audit Office in dealing with specific aspects of the audit process.

Project Management

.027 One of the most obvious features of the production of audited Crown financial statements is the very short time allowed to accomplish it. The *Public Finance Act* specifies that the Crown financial statements be prepared within two months of balance date and that the audit be complete within a month after that. Accomplishing this large, novel and complex task within the specified timeframe required: firstly, considerable groundwork; secondly, detailed planning at a departmental and consolidated level; and thirdly, tight project control

.028 The ground was prepared prior to the actual conduct of the audit in several ways. First, the Crown financial statements were not produced until accrual accounting had been in place in departments for at least two years and departmental managers were comfortable with the new system. This also meant that the auditors were not having to cope with a host of departmental issues with no precedent at the same time that they were trying to cope with novel issues at the whole of government level. Second, the inquiry by the Finance and Expenditure Committee provided an opportunity for State enterprises and Crown entities in particular to air their concerns and early warning of likely major problems was provided. Some advance agreement on issues such as inclusion of the Reserve Bank in the “parent” entity and the method of combination was established thus saving time which might otherwise have been consumed in debate later on. The process of preparing draft accounting policies allowed departments to raise concerns, while the Audit Office’s involvement enabled the audit perspective (in particular, what evidence would be required) to be built in at the same time. In effect, it was a case of auditing in process rather than after the event. Had there not been a consistent effort to think ahead to the implications of decisions for audit, it would have been impossible to complete the audit in the time available.

.029 Once the audit was under way, completion of the task on time required careful identification and scheduling of tasks, frequent monitoring of progress and constant communication between the Audit Office, individual auditors (some from the private sector) and the Treasury. The Audit Office found it useful to have one senior person responsible for overall management of the audit and another to deal with specific issues (e.g., accounting policy issues) as they arose. Having completion times specified in legislation helped to ensure that all parties took seriously the requirement to work quickly. Throughout the process, and even in the face of some last-minute problems, the Audit Office and the Treasury maintained a positive outlook and remained convinced that the task could, and would, be completed on time.

Materiality

.030 Internationally, there was no guidance available on the appropriate materiality levels to use for accrual-based financial statements for whole governments. The operating statement was not too much of a problem as the standards traditionally used for cash-based statements of government’s expenditure (half to two per cent) could be used. The balance sheet posed a greater problem because, until the valuations were completed, no-one really knew how large the balance sheet would be. Valuations of assets such as infrastructure and heritage assets, national parks and military equipment promised to be very large. Also, as noted earlier, small changes in assumptions underlying actuarial valuations of pensions could have a significant impact on the liability side.

.031 At about this time, the Institute was redefining materiality in its accounting standards. The emphasis was on the effect on decision making by readers and it was this concept that the Audit Office adopted: first, in deciding what items could "safely" be left out initially thus avoiding time-consuming debate (monuments were an example); and, second, in determining its own planning materiality levels. As a result, the Audit Office decided to adopt two materiality levels for the financial statements - one for the operating statement and another, higher level, for the balance sheet. Parliamentary concern over expenditure had traditionally meant a low materiality level for expenditure statements of governments and it seemed appropriate to maintain this level for accrual-based operating statements. To have adopted this level for the balance sheet as well would have required far too much work without any equivalent benefit in terms of judgments made by parliamentarians or other readers.

.032 The Auditor-General provided Parliament with a short explanation of materiality in his 1993 report accompanying the audited Crown financial statements. In the same report he also provided Parliament with assurance that the auditors insist on correction of all material errors and that most errors are adjusted for, even if the amounts are below the materiality level.

Completeness

.033 Audit techniques for ensuring completeness did not differ in kind from those generally adopted in the public and private sectors. However, there were a number of reasons why completeness was a particularly crucial and high-risk issue in the case of the Crown financial statements. First, cash-based accounting systems had not encouraged systematic recording of assets with the result that there could be no assurance that asset registers were complete while some items had not been recorded at all. Second, historical accident and considerable restructuring of government departments meant that records could be scattered across several departments or Crown entities; in this respect the fact that the Audit Office had knowledge of the entire public sector was helpful in identifying and locating information. Occasionally items could "fall between the cracks" because of ownership changes; for example the Crown's major stamp collection was valued neither by New Zealand Post nor by the Museum of New Zealand during the process of transferring it from one to the other. A third issue was that required statements such as the Statement of Commitments did not have an in-built check provided by a double entry book-keeping system.

.034 In general, the Audit Office used its own knowledge of the public sector together with the knowledge of relevant experts (for example the Valuer General in the case of land) to identify assets and liabilities which should be included. Audit directors who had worked with the relevant department in the previous year were asked to identify items which needed to be included. Responsible managers were asked to sign off on the completeness of asset registers. Old files and records were reviewed and databases run against one another to check for completeness. For example, in the case of the conservation estate, the two major databases - that held by the Valuation department and that held by the Conservation department were run against one another. As this was a large exercise, consuming considerable computer time it required significant cooperation from the two departments. The Audit Office therefore had to explain the nature of audits in order to persuade the departments that their cooperation was crucial to the Crown financial statements. Also important in determining what was to be included or excluded was the definition of Crown land; for this the Audit Office obtained a legal opinion. Experts within government were used where no outside sources of expertise were available.

.035 While the first set of Crown financial statements included all the major assets, both the Audit Office and the Treasury were aware that a number of smaller items (e.g., small pieces of railway land, school houses, sections of road) would have to be added in subsequent years. This situation was disclosed in the Crown financial statements. The Audit Office also explained the situation in its reports to Parliament and in its advice to the Finance and Expenditure Committee at the time of the financial reviews. Some comfort was also obtained from the fact that the initial omissions resulted in understatement rather than overstatement of balance sheet strength and that the extension of the Crown reporting entity to include SOEs and Crown entities in 1993 would swamp a number of the additions to asset balances. It was also agreed that the inclusion of additional assets in the first two years would be effected through changes in equity rather than being taken through the operating statement.

.036 Elimination of inter-entity transactions provides some measure of assurance as to consistency and completeness. The approach the Audit Office adopted with was to require departments to agree their inter-entity elimination with each other. To date, only transactions between the Crown, core departments and the Reserve Bank (i.e., not SOEs and Crown entities) have been eliminated. This was probably helpful in the early years as it would have been a technically difficult task to cope with on top of resolving numerous other accounting and auditing issues. Now that the process for preparing and auditing the Crown financial statements has become more routine, it is possible to reconsider the feasibility of fully consolidating the entire Crown estate.

Training

.037 The Institute Auditing Standard 3 (Skills and Competence) requires that audits "be performed and the report prepared with due professional care by persons who have adequate training, experience and competence in auditing." In the case of the Audit Office, a lack of familiarity with commercial accounting and consolidations was not a particular problem as it might have been in other jurisdictions. As mentioned earlier, all the auditors were qualified accountants and all had been trained in commercial accounting methods and company consolidations. They also had the opportunity to apply this knowledge since the Audit Office audited government commercial entities including State-owned enterprises, producer boards, electricity companies, licensing trusts and local authority trading enterprises and had adopted the practice of rotating auditors around these. Additionally, it had recruited staff from the private sector - a practice greatly facilitated by the State Sector Act 1988 which allowed each government department to make its own employment decisions and pay salaries as it saw fit. The Audit Office also placed its staff on secondment to the private sector in order to acquire expertise.

.038 Internally, Audit New Zealand (the operational arm of the Audit Office) had an established practice of running technical seminars and issuing circulars on technical matters. During the period of central government audits, weekly seminars for technical staff were held with additional seminars on specific issues of importance if necessary. Externally, the Audit Office found it essential to educate others as to the nature of the audit role in order that operations would run smoothly. Parliamentary reports were also used to educate parliamentarians and departmental managers on accounting and financial management matters.

Reporting

.039 Viewing the objectives as improved accounting and financial management and public confidence in the systems and reports, the Audit Office was keen to avoid a qualified audit opinion if at all possible. It was inevitable, however, that some items could be controversial given theoretical and practical problems of valuation and, in some areas, the absence of established GAAP. Where there were problems or controversies, the Audit Office encouraged full disclosure and explained the situation in its own report to Parliament. For example, it has regularly commented on the accounting policies adopted in its report accompanying the Crown financial statements. Consistent with the Audit Office's belief in maintaining public confidence and encouraging improvement, the Auditor-General has not raised controversial issues in his audit opinion (see Appendices 3 and 4). In successive commentaries on accounting policies he has praised achievements to date while indicating to Parliament areas where further developments can be expected in the future (for example, see Appendix 4).

CHAPTER 5

CONCLUSION

.040 New Zealand now has over four years of experience in auditing whole of government financial statements on a full accruals basis and is in a position to share some lessons with other countries.

.041 First, it is vital that all key players - the central financial agency, individual departmental managers, politicians and auditors - have a shared vision and common commitment. Legal requirements help generate common commitment but cooperation at a personal level is also important. Better accounting and the production of financial statements must not be viewed as ends in themselves although a concrete and visible product can give its preparers a sense of achievement. Each of the parties must be convinced of the benefits to themselves - departmental managers need to see the scope for better management of resources, parliamentarians are persuaded by possibilities of improved efficiency and accountability and policy makers by the enhanced information available. All have a stake in more complete and more reliable information and hence on assurance provided by the auditors. After an initial period of “departmentalism” under the state sector reforms of the late 1980s in New Zealand, the production of Crown financial statements provided an opportunity for collaboration, and a visible expression of government in its entirety, thus demonstrating the possibility of a corporate approach.

.042 Second, potential problems need to be aired as early as possible and principles established and agreed before trying to tackle specific issues in actual cases. The audit perspective (in particular, the need for evidence and completeness) also needs to be built in early. While conceptual framework projects internationally have often been criticized, New Zealand experience in developing the Crown financial statements was that concepts can be very helpful in resolving issues where there is no GAAP. Consistency is easier to obtain if individual entities are required to adopt common principles and policies than if a consolidation is attempted after each department has taken its own course of action.

.043 Third, the ordering of the process is important. New Zealand did not attempt to produce whole of government financial statements until a level of comfort with accrual accounting had been established within departments and managers could see the benefits which had resulted. Neither did it proceed to consolidation of the whole Crown estate immediately but attended first to the core government departments. Groundwork also needs to be laid in terms of the expertise available to the legislative auditor. If commercial accounting expertise is not already available in house, time needs to be allowed to train staff and/or to acquire or contract in the relevant expertise and educate them in the workings of government.

.044 Finally, the auditor may accomplish more by maintaining a positive attitude - both with respect to itself and with respect to those audited. Given a belief that what is required in legislation can be achieved, much can be learned simply by embarking on the exercise rather than trying to resolve all technical details in advance. The auditor may also effect more improvement in accounting and financial management by praising efforts to date and identifying areas for further development rather than by focusing exclusively on existing deficiencies.

.045 To the extent that other countries are larger, communication is more difficult, existing audit personnel lack relevant skills or mobility between public and private sector is otherwise restricted, they may have more difficulty than New Zealand in auditing whole of government financial statements on a full accruals basis. On the other hand, as a result of New Zealand’s attempts to tackle novel issues and other developments (such as use of actuarial valuations), there is now considerably more guidance available than there was in 1991. The fact that such an audit has been carried out, together with the existence of guidance, should provide other countries with encouragement.

APPENDIX 1

STEPS IN THE DEVELOPMENT OF CROWN ACCRUAL FINANCIAL STATEMENTS

(Appendicies for this Discussion Paper are only available
in the hard copy, please contact the IFAC Secretariat)

APPENDIX 2

THE LEGISLATIVE AUDIT IN NEW ZEALAND

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APPENDIX 3(A)

EXAMPLE OF AUDIT OPINION 1992-1994

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APPENDIX 3(B)

EXAMPLE OF AUDIT OPINION 1995

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APPENDIX 4

EXAMPLE OF AUDITOR-GENERAL'S COMMENTARY ON THE CROWN ACCOUNTING POLICIES

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