

Central Government Update

SPRING 2007

A newsletter for the Central Government clients of Audit New Zealand

AUDIT NEW ZEALAND

Mana Arotake Aotearoa

Welcome to this edition of Audit New Zealand's Central Government Update. We hope you'll find it useful and informative.

There are two articles that will be particularly relevant to you in the context of the 2007/08 year:

- The appropriate setting of non-financial performance measures for next year's 2008/09 Statements of Intent – within the context of a framework that clearly links your entity's outcomes (what you are trying to achieve) to your outputs (what your entity is going to do to achieve those outcomes). Ann Webster has described what was learnt when this year's Statements of Intent were reviewed.
- The transition to International Financial Reporting Standards (IFRS) for almost all entities started on 1 July 2007 (some were slightly keener and adopted IFRS a year earlier). Some of the audit ramifications arising from this are set out in Robert Cox's article.

As you may be aware, we have been reviewing the effectiveness of the procurement policies of a large number of government departments and Crown entities. We'll be giving you an overview of our findings in our next newsletter (once this audit round has been completed). I think you'll find



the information to be very useful in improving your organisation's policies.

Finally, we'll be running our regular Technical Updates for departments and Crown entities before Christmas, so you can expect to receive your invitation soon.

In the meantime, please don't hesitate to contact your Audit Director for more information about any of our articles.

We also welcome your feedback on the newsletter – please feel free to suggest topics for future articles that would be of interest to you and your organisation.

Stephen Lucy, Director
Email: stephen.lucy@auditnz.govt.nz
Tel: 04 496 3099

Audit New Zealand's sector newsletters are back!

We are pleased to provide our Central Government and Crown Entity clients with news and information to help you better plan for your annual audit. From time to time *Central Government Update* will also provide information on our Specialist Assurance Services (SAS) and Information Systems Audit and Assurance (ISAA) work as well. We work collaboratively with the Office of the Auditor-General on this newsletter to ensure that our clients have the most current information on good practice and we hope that you find it valuable and useful.

Audit New Zealand services

As well as offering audit services, we support the Central Government sector through our:

- tax services, including compliance reviews and tax position assurance
- assurance services, including:
 - tender and procurement
 - contract management
 - project management
 - asset management.

Central Government Update is available in pdf form on our website at www.auditnz.govt.nz.

We are also happy to send you an email version, but in compliance with the Unsolicited Electronic Message Act 2007, please request this by emailing us at newsletter@auditnz.govt.nz.

For more information
www.auditnz.govt.nz/central-government

Improving reporting of non-financial measures and targets



Ann Webster
Assistant Auditor-General,
Research and Development

Last year, Kevin Brady wrote to government departments and Crown entities advising that we would be placing greater emphasis on the appropriateness of the service performance information in Statements of Service Performance (SSP).

This emphasis involves focusing on service performance reporting, in particular the “appropriateness” of the service performance measures used to give better effect to the 2004 amendments to the Public Finance Act 1989 and the Crown Entities Act 2004. This increased focus will be reflected in the assessments we provide in our reports to Ministers and select committees.

We have been reviewing Statements of Intent (SOI) to determine the context for SSP performance measures as well as entities’ process and rationale for selecting them.

So far, our reviews of SOIs have been useful and thought-provoking. In recent years, we’ve observed generally good development in SOIs, especially in their medium-term components. We have also noticed positive improvements in SOIs’ accessibility and presentation.

Our observations suggest that there are three common areas that could be improved. These areas generally relate to the completeness and integration of outcome and output measures in developing 2008/09 SOIs. We’ve come up with some guidelines to help clients ensure continued progress.

Providing measures and standards for outcomes

Many of our clients have done quite a bit of work on the clarity of the intermediate and ultimate outcomes to which entities contribute. However, measures and standards for this information (as required by the Public Finance Act and the Crown Entities Act) are often omitted. In our view, given that entities do not control outcomes, it is not sensible to regard ‘standards’ for outcome measures as ‘targets’.

However, entities can be clearer about a number of matters in their outcome information:

- the current state of the outcome sought (to provide a benchmark position that you can track progress against);
- the direction of change sought (so you can track and assess progress against outcomes); and
- the intended impact of outputs on outcomes (so readers can understand and evaluate the logic of the relationship between outcomes and outputs).

Improving the completeness of output performance measures

The SOI is intended to provide integrated information about the outcomes, purposes, and services of an entity, as well as risks and the general environment within which it operates. Therefore, within the SOI, the forecast SSP for the delivery of outputs should be understandable in the context of the medium-term information.

A common observation is that the selection of output performance measures within the forecast SSP does not appear to be sufficiently complete in the light of the other SOI information, including the medium-term component and the description of

the output class. This creates a sense that the forecast SSP has been ‘bolted on’ and it is often not clear how, in actual output services, an entity is taking steps to deliver on its outcomes and objectives. This raises questions about the selection and relevance of the forecast SSP performance measures. For example, policy advice and similar advisory and monitoring outputs areas commonly have reasonably low-level process performance measures. However, these outputs have the potential to present richer information that would better integrate the medium-term and forecast SSP information.

Providing comparative information

We’ve already commented that a ‘current state’ position of outcomes is often not provided. Likewise, it is common for most performance measurement information not to include comparative information about levels of achievement. All measures should provide historical baseline data or other relevant information to aid understanding of their context and provide a basis for evaluating change, as well as allowing an assessment of whether targets represent reasonable best estimates of actual anticipated performance.

Relevance of service performance reports

To be relevant, service performance reports (SOIs and SSPs) should:

- be presented within the context of the entity’s strategic objectives, past performance, and current environment (including government themes, as appropriate, and other themes and considerations, such as sustainable development);
- show clear and logical links among entity-level objectives (and themes), outcomes, outputs, performance measures, and performance standards (so that the rationale for their selection is clear);
- as appropriate, meet the information requirements of stakeholders (including reporting different levels and layers of information) and be useful for decision making; and
- be clearly linked to the financial information, including significant areas of planned expenditure.

Managing funding to NGOs



Nicola White
Assistant Auditor-General,
Legal

Public entities increasingly work with non-government organisations (NGOs) across a wide range of areas. NGO relationships are now widespread in government activity on economic development, social services, health, education, recreation, sport, culture, and the environment. Often those relationships involve providing some funding to an NGO, either to purchase services or as a grant of some kind.

Audit New Zealand does not directly audit NGOs, but we do have a responsibility to assess the use of public money and the public sector's performance, both in managing that money and in achieving the outcomes they are working towards. We increasingly find that we need to consider the funding relationships between public entities and NGOs.

This work has created new challenges, not least because the special characteristics of NGOs need to be recognised and respected. NGOs are usually not-for-profit organisations – often with charitable purposes. They are self-governing and generally rely heavily on voluntary contributions of time and money. They are increasingly recognised as a valuable part of society and the economy, and are sometimes referred to as the “third sector”.

Funding relationships with NGOs can take a variety of forms and may have a number of objectives. Often the overall relationship with an NGO may be more like a mutual long-term partnership than a simple transaction for an immediate and particular purpose. Or there may be elements of both.

The Office of the Auditor-General's (OAG) 2006 good practice guide, *Principles to underpin management by public entities of*

funding to non-government organisations describes a funding continuum to show that arrangements can range from grants with very few conditions attached, to long-term relational arrangements, to highly specified contracts with detailed requirements and milestones.

The same idea is also often captured by describing funding arrangements as:

- **buying** – where the public sector is purchasing goods or services from the NGO;
- **investing** – where the public sector is providing funds to develop an NGO's capability, to achieve the longer-term benefit of a stronger third sector; or
- **donating** – where the public sector is effectively giving public money to an NGO, either for general use or for a particular purpose.

Wherever in that continuum a particular arrangement sits, the same general principles will be relevant. The 2006 good practice guide sets out an expectation that all funding arrangements will be managed consistently with the principles of:

- lawfulness
- accountability
- openness
- value for money
- fairness and integrity.

Although that 2006 report was focused on NGOs, in fact these principles apply to any situation where a public entity is spending or allocating public money. Another useful source of advice is the Treasury publication, *Guidelines for Contracting with Non-Government Organisations for Services Sought by the Crown*.

The guidelines set out in these documents are now providing the basis for a

range of audit work, including work under the auspices of the annual audit, special assurance projects, and OAG performance audits. In particular, Audit New Zealand has developed an audit methodology which it will be applying to some government departments and Crown entities over the next year. It examines the management controls that public entities have in place to cover their relationship with NGOs, and looks at how these controls are being applied in practice.

The OAG has carried out performance audits on the allocation of grant funding in specific entities, including Te Puni Kokiri, the Foundation for Research, Science and Technology, and New Zealand Trade and Enterprise. It is working on two performance audits on the funding relationship with NGOs in the health sector.

The issues presented by these projects are challenging and interesting; the methodologies and questions are new, and will be developed further as we gain more experience. Internationally, there is growing recognition that tackling society's difficult problems cannot be done by governments alone; they need to work with other sectors, including the community and voluntary sector. Working out how those relationships are best managed, so that public accountability needs are met in a way that recognises the capacity limits and independence of voluntary organisations, is a challenge everywhere and the subject of much active debate. It is a debate in which we are actively involved.

The OAG's good practice guide *Principles to underpin management by public entities of funding to non-government organisations* is available at www.oag.govt.nz

Special thanks to Martin Richardson, Associate Director, Specialist Assurance Services, for contributing to this article.

Changes to the tax treatment of relocation costs

On 24 October the government announced that it will introduce changes to ensure that employer payments for employee relocation expenses are not taxable. The proposed changes are intended to remove uncertainty over the tax treatment of these payments, and will apply to payments made over the last four years, as well as to future payments.

Once this change has been enacted, a number of Central Government organisations will be entitled to claim a refund for tax paid on relocation costs.

Helpful information on the New Zealand equivalents to International Financial Reporting Standards (NZ IFRS)



Robert Cox
Director and Head of
Accounting

Since 1 July 2007, central government has been accounting in keeping with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS). Monthly reporting of financial results to the Treasury and internal management reporting should now all be on an NZ IFRS basis.

Those of you who have been running parallel NZ IFRS reporting in spreadsheets outside your financial systems will need to bring these separate NZ IFRS elements within your general ledger for the 2007/08 year.

By now most central government entities will have completed the restatement of the financial results for the year to 30 June 2007 under NZ IFRS. These restated numbers will be the comparative figures that departments, Crown entities, and State-owned enterprises (SOEs) will publish in their first NZ IFRS annual reports (for the year to 30 June 2008).

The 2007 NZ IFRS financial information needs to be audited because it will be published as the comparative financial information in the 2007/08 annual reports. It will also be consolidated into the financial

statements of the Government (FSG) under NZ IFRS.

The Office of the Auditor-General (OAG) will be auditing the consolidated 2007 NZ IFRS financial information. The OAG requires auditors of the larger departments, Crown entities, and SOEs to complete the audit of the 2007 NZ IFRS financial information and provide the OAG with audit clearance for FSG consolidation purposes by 14 December 2007.

Treasury Circular 2007/08 dated 31 May 2007 sets out the Treasury's reporting timetable for departments and the larger Crown entities and SOEs. This circular sets the date of 18 December as the final date by which audited 2007 NZ IFRS financial information can be resubmitted to Treasury.

For the smaller departments, Crown entities, and SOEs, the timing of the audit of the 2007 NZ IFRS financial information is a matter to be agreed by the entity and the auditor. Given Audit New Zealand's need to provide audit clearance on the larger agencies' 2007 NZ IFRS information by mid-December, our preference will be to address the audits of 2007 NZ IFRS financial information of smaller agencies in early 2008.

One aspect of the audit of the 2007 NZ IFRS information that entities should consider is the extent to which they want to use this

exercise to formalise and obtain audit sign-off on their NZ IFRS annual report formats, including the format of note disclosures. The amount of disclosure required under the new standards is significantly greater than the previous requirements. For some requirements (such as NZ IFRS 7: *Financial Instruments: Disclosures*), entities will need to choose the most appropriate means of meeting the standard's requirements.

Audit New Zealand will be publishing model NZ IFRS-compliant financial statements for departments and Crown entities in the last quarter of 2007. However, even with a model as a guide, we expect that some entities will find creating NZ IFRS-compliant financial statements a challenge. Generally, we would recommend that entities complete these and insert all the comparative figures for the note disclosures, and obtain audit sign-off of these, as part of the audit of the 2007 NZ IFRS financial information.

If you have any queries about the transition to NZ IFRS or audit requirements, you should contact your Audit New Zealand Audit Director. Complex technical queries about the interpretation of NZ IFRS for specific transactions will be referred to our specialist technical accounting team.

You can access the Treasury Circular mentioned in this article by visiting www.treasury.govt.nz.

Tax treatment of payments to board members



Jason Biggins
Director, Tax

The updated fees framework for payments to members of statutory and other Crown bodies (Cabinet Office Circular CO (06) 08) provides further guidance from the Inland Revenue Department on the tax treatment of these payments.

In general, fee payments derived by board members are not subject to GST, but are subject to withholding tax.

The circular mentions that for tax purposes, fee payments are derived by the appointed member, unless the member is performing the service as an agent or representative

of another entity and there is a requirement for the fees to be paid to that entity.

Arguably, this exception could apply if the board member was a partner in a law firm or Chartered Accountants (CA) firm or was an employee of another public authority. We have yet to receive confirmation from Inland Revenue on this point.

It is interesting to note that the circular states that fees derived by the board member should only be paid to another entity if withholding tax has already been deducted.

There is no comment about the tax treatment of allowances paid to members. However, the circular does state that Inland Revenue has the ability to grant exemption determinations where part of a withholding payment is regarded as reimbursement of expenditure incurred in production of

income, and that determinations can be sought from the Commissioner of Inland Revenue accordingly.

An exemption of this nature was provided by Inland Revenue for payments made to members of school boards. However, for payments made to members of local authorities, Inland Revenue concluded that withholding tax should generally be deducted from all payments, including mileage allowances. Only direct reimbursements of work-related expenses could be treated as exempt.

We are hoping to receive further clarification from Inland Revenue on these matters.

Cabinet Office Circular CO (06) 08 is available on the Department of Prime Minister and Cabinet website: www.dpmc.govt.nz.
