

## **Presentation by Finance and Expenditure Committee Chair**

**ACPAC April 2017**

### **Following up on audit reports – how can parliamentary oversight add value?**

#### Introductions

I am here with the Hon Clayton Cosgrove from the New Zealand Labour Party, and Andy Gardner, the Clerk of the Finance and Expenditure Committee.

Martin Mathews, the New Zealand Controller and Auditor-General is also here. Prior to his taking up the position on 1 February 2017, he was the Secretary for Transport from 2008 until June 2016, the Chief Executive of the Ministry of Culture and Heritage for 10 years, and before that an Assistant Auditor-General in the Parliamentary Group of the NZ Office of the Auditor-General (the OAG).

Colleen Pilgrim, a Sector Manager in the OAG Parliamentary Group is also attending. She leads work on supporting parliamentary scrutiny.

The following provides an understanding of the relationship between New Zealand's Finance and Expenditure Select Committee and the OAG, and how select committees and the Auditor-General can best work together to achieve maximum impact on the performance of the public sector, and provides some examples of good and bad practice in how committees have dealt with OAG reports, along with some thoughts for the future.

#### **Background and role of the Finance and Expenditure Committee**

The Finance and Expenditure Committee (FEC) is one of 13 subject select committees established at the commencement of each Parliament. It currently has 11 members, five from the National Party, three from the Labour Party, and one member each from the ACT Party, the Green Party, and the New Zealand First Party.

Under the Standing Orders, the FEC's subject areas for legislation, Annual reviews and the Estimates are the auditing of the financial statements of the Government and its departments, and Government finance, revenue and taxation. In this role the committee is closely involved with the organisations

that administer or oversee Government policy in this area. These include The Treasury, the Inland Revenue Department, and the Reserve Bank of New Zealand. Through the broader audit mandate and role as an Office of Parliament, the Auditor-General assists the FEC in exercising its important constitutional role of parliamentary scrutiny.

While the FEC's functions are broadly similar to those of the other 12 subject committees, it is set apart by the leading role it plays in the parliamentary oversight and scrutiny of proposed and actual Government expenditure, and of the annual performance of Government departments, Crown entities, public organisations, and State enterprises.

The committee coordinates the examinations of the Budget and the annual reviews by all the Parliaments select committees. Under Standing Orders, all Estimates of appropriations and Annual Reviews are referred in the first instance to the FEC. The committee may decide to consider these itself or to refer them on to one of the 11 other select committee if the subject matter is best suited to that committee.

Similarly, while all reports of the Controller and Auditor-General are automatically referred to FEC, if a report is primarily within the terms of reference of another select committee, FEC may refer the report to that committee for consideration. In this Parliament to date, since November 2014, committees have reported on 37 Controller and Auditor-General reports, and the FEC retained 19 of them for its own consideration. It has so far reported on 14 of those.

The committee which ends up with the report has an obligation under Standing Orders to produce its own report to the House on its consideration of the Auditor-General's report. There are no prescribed requirements for what the report must contain, or the date by which it must report by.

While it is up to the committee to decide how it wishes to consider the Auditor-General's report, in its letter to whichever committee is receiving it, the FEC makes it clear that the OAG is available to brief the committee on the contents of the report should the committee wish, in order to encourage committees to hear from the OAG.

For the reports it retains, the FEC committee has a general policy of hearing from the Auditor-General for about 30 minutes on each report before deciding

what step to take next. This allows members to be fully briefed on the report and its findings, and provides members with the opportunity to ask detailed questions of the OAG officials who compiled the report. .

### **Role of the Office of the Auditor-General**

The Auditor-General is an Officer of Parliament. The OAG is independent of the Government and is not controlled by a Minister, although technically the Speaker of the House is the “responsible Minister” in respect of its funding. That said, the Speaker has no role in the OAG’s operational decisions. In this respect the OAG is statutorily independent.

The OAG has a staff of about 370 spread over seven locations around the country. It also makes wide use of private-sector auditing firms to assist with carrying out financial audits for about 3,700 public entities – a large proportion of these are small entities, such as schools. Each year, the Office of the Auditor-General audits all government agencies – or makes sure that these audits are undertaken by approved auditors. That typically involves them visiting and examining the books of all of the organisations that they audit several times each year.

They provide the results of these audits to select committees during the Annual review and Estimate examination processes. They appear in front of the committee as advisers, thus allowing the committee to hear them in private and allowing them to provide very good and very frank advice about the public agency or budget appropriation that the committee is about to examine.

As well as a range of shorter reports, and the advice it gives select committees for the Estimates and Annual reviews, the Auditor-General produces 15-20 performance audit reports each year,. These are presented to Parliament. According to the content of each report, they are then referred by the Finance and Expenditure Committee to the appropriate subject select committee.

The OAG undertakes these performance audits under the Public Audit Act 2001 and examines whether:

- public entities are carrying out their activities effectively and efficiently;
- public entities are complying with their statutory obligations;
- any act or omission of a public entity has resulted or may have resulted or may result in waste; and

- any act or omission shows, or appears to show, a lack of probity or financial prudence.

This wide remit allows the Auditor-General to examine any aspect of public spending in order to provide the public with an independent assurance that public entities are operating and accounting for their performance in a manner consistent with Parliament's intention when it provided the funding to the entity.

### **How can select committees add value to the OAG reports**

Select committees appreciate this necessary and high quality auditing work on the public's behalf. It greatly informs committees about the performance of public entities so that they can be held to account.

In turn, to assist the OAG continue this work there are several ways in which select committees can add weight to the issues the OAG has brought to its attention to help make sure they do not sink without trace.

Select committees can directly ask the chief executive and senior managers of the entity about the issues raised by the OAG either during annual review hearings or at a hearing focusing solely on a report of the Auditor-General. These committee hearings are, by default, in public and are often reported by the media, giving greater exposure to the issues discussed.

A select committee report can make it plain that it has concerns about a particular issue the Auditor-General has brought to its attention, and that it expects to see the entity improve its performance in an area in future. Often committees reinforce this by commenting in the report that they will investigate an entity's progress at its next select committee appearance, giving impetus to the entity to improve.

The reports that the OAG makes to assist committees with their annual review and Estimates examinations contain suggested lines of inquiry and questions that members can ask of either the entity or Minister. Committees generally adopt the OAG questions and requiring written responses to the questions from either the entity or the Minister. The responses can inform both the committee and the OAG for the purpose of future examinations and audits.

The OAG advises that the response of committees to reports of the Controller and Auditor-General is a powerful motivator to those entities which have been

examined. Where the committee expects change and signals its own intention to follow-up, that and the fact that the committee's findings are public creates a strong impetus for change.

If, after hearing from the OAG, the committee feels that a report raises questions that should be answered directly by the entity which is the subject of the report, committees are able, and encouraged to, request that the entity appear before the committee. Sometimes committees decide in advance to hear from both the OAG and the entity concerned, and perhaps also from other key stakeholders, at the same time, thus allowing the committee to optimise its time and enquire more effectively into the issue.

Committees can, and have, call for public submissions on OAG reports where they feel there is benefit in receiving public input on the issues raised by the report.

If a committee feels strongly enough about an issue in an OAG report the committee may make formal recommendations to the Government that action be taken to address the issue. Under Standing Orders the Government must respond to the committee's recommendations within 60 working days.

### **Examples of how committees have considered OAG performance reports.**

Three examples of how select committees have handled OAG performance reports, which from the viewpoint of adding value to a report's findings represent the great, the good, and the bad. The first two are instances of when committees have taken seriously the issues raised by OAG reports and have worked extensively to ensure the issues raised are rectified.

The third is an instance of a report that illustrates the problems that an OAG report dealing with a politically sensitive subject can run into, in that, for largely political reasons, an issue was not addressed.

#### **The Great**

Several years ago, the OAG presented a report on the standard of services provided by rest homes. The report noted that people who live in rest homes are some of the most vulnerable in society, so effective arrangements are important.

The report found that the system for certifying that rest homes had not met the necessary health and disability criteria. It also found the rest home auditing that

was undertaken was inconsistent, sometimes of a poor standard, and that there was evidence of conflicts of interest which could potentially compromise the independence of the audit.

The report was referred to the Health Committee, and after hearing from the OAG it felt concerned enough about the issue that it decided to call for public submissions on the OAG's report. It ended up with 8 submissions from members of those involved with rest homes and care of the elderly.

After hearing from the OAG and from the submitters, the committee wrote a detailed report to the House. The report made several formal recommendations to the Government. Among them were that the Government instruct the Ministry of Health and District Health Boards to implement all the OAG's recommendations in its report, and that in future rest home auditing be undertaken by accredited bodies approved by the Ministry of Health.

The Government's response agreed with the committee that action was needed to improve the monitoring of rest homes. It reported that the Ministry of Health was actively addressing the OAG's recommendations, and was strengthening the Ministry's oversight of how it oversees the auditing of rest homes, and would cancel the accreditation of several auditing agencies that had performed poorly.

The OAG carried out a follow up to the audit report and reported its findings about 3 years later. The follow up audit showed that a wide range of improvements made, across all of the areas raised in the Auditor-General's follow-up report.

## **The Good**

OAG reports can shed light on areas of the public sector that have little in the way of accountability or parliamentary scrutiny. In 2014 an OAG report did just this with a report into community licensing trusts. Community licensing trusts sell alcohol and provide hospitality services in order to raise funds to distribute to their communities.

The OAG's audit highlighted that there is no comprehensive oversight of the licensing trusts aside from their elected community trustees. There is no central or local government agency or select committee with overall oversight or monitoring responsibility for licensing trusts. This lack of coherent oversight

was concerning given the substantial assets some licencing trusts manage on behalf of their communities, collectively worth around \$384 million.

Some, especially the smaller trusts were not well resourced and struggled to comply with their accountability requirements. They also lacked the necessary management and administrative capability needed for their financial reporting. Some would also resist public sector auditing because of the audit fees involved.

The Justice and Electoral Committee's public examination of this report was the equivalent of lifting an old log that had been sitting in the same place for years and watching all the creatures underneath it suddenly exposed to sunlight go scurrying for cover.

After hearing from the OAG on the report the committee called in the New Zealand Licensing Trusts Association, which is the industry body for the sector, although it does not have any statutory duties or powers to intervene in its members activities. The Association acknowledged the OAG's report was a "wakeup call" and undertook to improve the performance of its members in future.

The OAG's follow up audits to the committee have reported that the Association has indeed become active in developing measures to assist the licensing trust sectors transparency, in particular it was working to lifting the capability of the smaller trusts to meet their accountability requirements and strengthen their internal controls. The OAG's regular update reports will keep the committee informed of how these pleasing first steps will develop in the long run.

Although the Justice and Electoral Committee has yet to make its report to the House, it will be interesting to see if the committee will recommend that significant changes be made that will improve the transparency of licensing trusts.

This serves as an excellent example of an OAG report shining a light onto an area that obviously needed improvement. This was backed up by a select committee taking the concerns raised seriously, and indicating Parliament's strong expectation that reform was needed to ensure public accountability in the licensing trust sector.

**The bad**

In 2013 the OAG presented a performance report that was critical of a New Zealand Defence Force project that intended to achieve savings of \$20 million per year by re-designating 1,400 military positions as civilian roles.

The report concluded that the project would only be partially successful as it would only realise \$14 million in savings per year, and that only 600 military positions would be civilianised. The OAG was critical of the defence force for embarking on the project before it had determined how many positions it would need in the future, and because it had been executed in a way that lowered military morale and increased attrition rates, reducing the force's capability.

The civilianisation project had received a high level of mostly critical coverage in the media, and this report further highlighted this. The report was referred to Foreign Affairs, Defence and Trade Committee, which, following a fiery debate on the matter, decided, by majority, not to hear from the OAG and to simply report back to the House with no actual consideration of the OAG report.

In the committee's report to the House, which allows members to put in dissenting views if they disagree with the majority, the opposition in its minority view was highly critical of the government members of the committee for blocking the committee from taking any action on the OAG report. They noted that while the findings of the committee may have been intensely embarrassing to the government, in a parliamentary democracy the committee's responsibility is to keep an oversight of policy and policy failures, so that mistakes will not be repeated. They also berated the majority on the committee for reneging on its democratic and good governance responsibilities.

As well as highlighting the partisanship divisions on the committee, this example illustrates the difficulty in having a government majority committee looking into OAG reports that may cause potential embarrassment for the Executive.

### **The future**

At this stage, select committees in NZ do not formally review whether entities have followed up the recommendations of the Auditor – there could be potential for doing this in the future.

In the meantime, committees are assisted by the OAG conducting follow up audits to gauge an entity's progress in implementing changes that were recommended. If progress is unsatisfactory, the committee would be able to

question the entities lack of progress either in its annual review hearing or by calling it in to explain itself in a briefing. .

Recent changes to Parliament's Standing Orders allow committees to write to the Business Committee requesting that the House set aside time to debate important select committee reports, thus giving more prominence to the report. While this has yet to happen with a report focused on an issue the OAG has raised, it is something that we can consider doing.