

INVESTIGATION 3

Stakeholders and their use of audits

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Chapter 1: Introduction

This is the third report into the value of public audit. Investigation 1 provides an extended literature review of research on the value of auditing in general, and includes public sector auditing research and private sector auditing research that is relevant to the public sector. It suggests a number of explanations for audit in the public sector to be of value, including: agency/ monitoring, information/ signalling, insurance, organizational control, confirmation hypothesis, and risk management (Hay et al., 2016). Investigation 2 utilised a literature and document review to analyse the concept of public value more closely, how SAIs deliver value through their activities, and what is being done to examine similar issues in other countries. Building on this, Investigation 3 is an independent investigation using existing published reports and other means of communication to examine the New Zealand Office of the Controller and Auditor-General (OAG) as a specific Supreme Audit Institution (SAI) and asks: who are the stakeholders affected by the most important parts of public information; who are their representatives who use public information; and how is information used and relied on? This investigation also recognises how the environment of public information is changing.

From the analysis of New Zealand and other SAIs' annual reports, as well as annual and strategic plans, Investigation 2 showed that the New Zealand OAG uses these documents to report measures of public value. Specifically, these reports show Operating Capacity (Moore, 2013) as the OAG leads by example, publishing a budget and strategic plan, having a clean audit, reporting on the quality of its staff, and its governance (Cordery & Hay, 2016). Through these three reports, New Zealand's OAG also shows it is responsive to its stakeholders by reporting on how it assesses stakeholder needs, using citizens' complaints and consulting with Parliament in developing its work schedule. These three reports also show strong Legitimacy and Sustainability (Moore, 2013), as the OAG reports on its legislative authority and, dissimilar to some other SAIs, how it works within its funding allocation. While New Zealand's OAG does not report having had a recent external peer review, it does have an independent panel which reviews its outsourcing of auditing and invites professional peer reviewers to comment on audits undertaken, providing a measure of trust (Cordery & Hay, 2016).

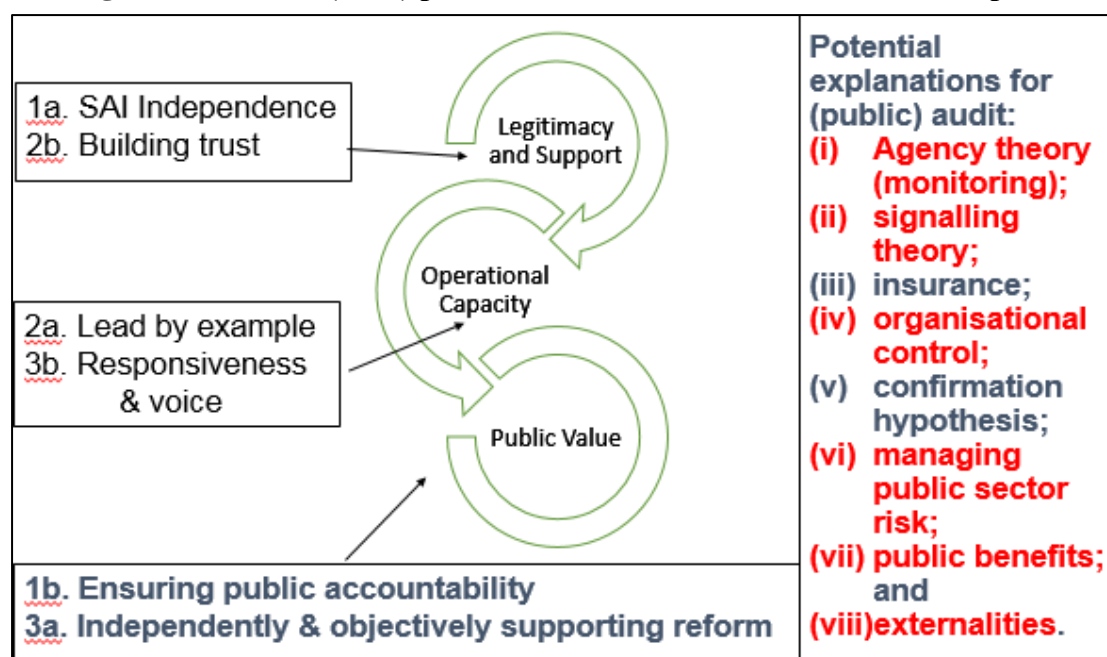
Investigation 2 notes that these three reports provide evidence of Public Value (Moore, 2013) specifically linking to the following explanations for public audit:

- agency/monitoring as it reports on the number of completed audits, timeliness, and the number of unqualified reports;
- information/signalling mechanism by improving the quality of auditees' reports and through benchmarking services to the public sector.
- both agency and signalling through satisfaction surveys from the OAG's auditees.
- organisational control due to the number of reports tabled in Parliament, recommendations made to improve efficiency and effectiveness, the extent to which these have been taken-up by auditees, and the number of better practice guides published; and
- how it manages public sector risk by ensuring public sector accountability (Cordery & Hay, 2016).

While the OAG does not provide information on the dollar value of funds saved due to the audits it undertakes (as do the United Kingdom and the United States), it does provide evidence of positive externalities by reporting on its overseas influence and input. However, in respect of the confirmation hypothesis and insurance explanation for public audit, Cordery and Hay (2016) found no evidence of them in the three reports used for Investigation 2.

A summary of Investigation 2 is provided in Figure 1 (which is a replica of Figure 3 from Investigation 2) where the black and red highlighted words are those that comprise public value and the red words those that have been indicated by information in the OAG's annual report, annual and strategic plans.

Figure 1: Moore's (2013) public value delivered in selected SAIs' reports



1.1. Investigation 3

This investigation focuses on stakeholders and considers the broad range of OAG activities and the reports it publishes. As well as the first two investigations and published reports, Investigation 3 is informed by public sources including Select Committee hearings and reports, summaries of external media, financial reports, a number of interviews with the OAG's staff and some internal documents specifically requested to inform this investigation.

1.2. Method

In order to analyse the stakeholders who use the OAG's information, how they use it and rely on it, this research built on the theoretical frameworks developed in Investigations 1 and 2 to analyse the OAG's published reports, public sessions (for example, Select Committee discussions), stakeholder and client surveys, media commentary, other social media, and commentary from other stakeholders. The authors also undertook a number of interviews and two focus groups with OAG staff. Specifically, we asked:

- (i) What information do stakeholders demand?
- (ii) How do stakeholders use it?
- (iii) What are the important financial issues that stakeholders raise?

- (iv) What are the important nonfinancial issues that stakeholders raise which are relevant to auditing?
- (v) How does the OAG respond to these issues and these stakeholders?
- (vi) Is there accounting or other information that stakeholders demand but they do not get in the normal course of events?
- (vii) How do you/ the Office respond to that need?
- (viii) What do you perceive will be the future demands from stakeholders, given the environment for public information is changing?

Ethics approval was obtained from Victoria University of Wellington for the interviews and focus groups. Staff were assured of anonymity, therefore where interviewee data is used, three sets of pseudonyms are used which indicate the area in which the staff member/s work. These are: PT (Policy Team), SM (Sector Managers) and OA (Other Areas). Individuals are identified numerically within that schema.

Nevertheless, although external documents were used, no external parties were interviewed for this stage of the research, which limits the conclusions that may be made about actual use of OAG data. Investigation 4 proposes research approaches to obtain information from external stakeholders.

1.3. Paper outline

The paper proceeds as follows: in Chapter 2 we present the audit communications with the stakeholders (and representatives) affected by the most important parts of public information. Specifically, this analysis considers how this information is used and relied on, it also maps these communications to the theoretical frameworks developed in Investigation 1 and 2.

In Chapter 3 we present a literature and document review of how the environment for public information is changing. The final chapter discusses the findings, provides limitations and signals opportunities for more research in Investigation 4.

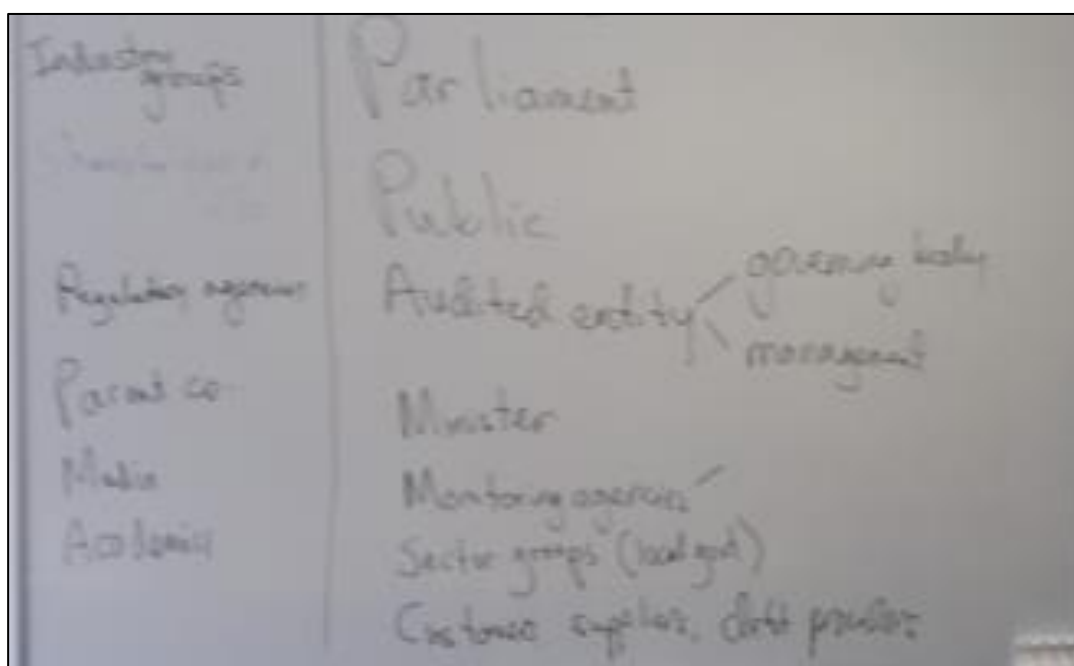
Chapter 2: Audit communications and stakeholders

2.1 Audit communications with stakeholders (and representatives) affected by the most important parts of public information

Given the argument from Investigation 1 that the value of public audit can be perceived by considering theoretical explanations for audit, Table 1 summarises the findings from Investigation 1 as to the prominent stakeholders who are most likely to be affected by OAG information and the main types of published information that they are expected to use. This list is taken mainly from literature discussed in Investigation 1. The published information provided and/or expected by the theoretical explanations for audit is small in number and, while it includes internal documents (management letters and reports about audits), most prior research focuses on a limited range of external documents: the audited annual report, reports to Parliament, information on audit committees/independent directors, and performance audits and inquiries (as shown in Table 1).

Table 1 also includes the measures of value that SAIs have used (see Investigation 2, Table 4). While Investigation 2 did not link public value to specific stakeholders, from a re-analysis of that literature, Table 1 infers which stakeholders would be most likely to be the primary beneficiary of the value of audit. The documents in Table 1 are numbered to coincide with the sub-sections in this report, which analyse how New Zealand's OAG demonstrates its ongoing relevance to citizens, Parliament and other stakeholders as it is expected to under the International Standard of Supreme Audit Institutions (ISSAI) 12: *The Value and Benefits of SAIs – making a difference to the lives of citizens* (International Organization of Supreme Audit Institutions, 2013 (INTOSAI)). While INTOSAI (2013) does not identify specific 'stakeholders', it nominates entities and individuals with whom SAIs should have relationships. Interviewees confirmed the stakeholders of the OAG include: Parliament (select committees in particular), "those charged with public sector governance" (in central and local government) (principle 3, ISSAI 12), the audited entities themselves (specifically chief executives and senior management teams), the public and media as their representatives, professional accountants and their membership bodies and INTOSAI and its members. Some interviewees suggested an even wider range (see Illustration 1).

Illustration 1: Photo of stakeholders identified in focus group.¹



Thus, this section analyses each type of information and examples of the assumed stakeholders to assess the OAG's demonstration of relevance (see also Appendix 1 for international examples of value from Investigation 2).

¹ The lists read "Parliament; Public; Audited entity – governing body, management; Minister; Monitoring agencies; Sector groups (local govt); Customers, suppliers, debt providers" and "Industry groups; Shareholders of SOEs; Regulatory agencies; Parent co; Media; Academics."

Table 1: Matching explanations for audit to stakeholders and the information they use (from Hay et al., 2016, Cordery & Hay, 2016))

Explanation	Benefits of the audit (Hay et al., 2016)	Example beneficiary of audit (Hay et al., 2016)	Example measures of value of public audit used by SAIs (Cordery et al., 2016)
Agency theory (monitoring explanation)	<p>Management letters (1) ←</p> <p>Audit Committee? (mixed) (4) ←</p> <p>Reports to Parliament (3) ←</p> <p>Audited annual reports (2) ←</p>	<p>Management (auditee) ←</p> <p>Parliament (and governance) ←</p> <p>Voters (including the media) ←</p> <p>(Hay, 2001, 2003; e.g. Streim, 1994)</p>	<p>Feedback from auditees about quality of audit (9)</p> <p>Number of completed audits, number of unmodified reports (2)</p>
Information (or signalling) explanation	<p>Management letters (complements agency theory) (1) ←</p> <p>Audited annual report (2) ←</p> <p>Lack of media scandals (10) ←</p>	<p>Management (auditee) ←</p> <p>Investors</p> <p>Rationally ignorant voters ←</p> <p>‘The Public’ (including the media) ←</p> <p>(Gore, 2004; Green & Singleton, 2009; e.g. Pallot, 2003)</p>	<p>Feedback from auditees about quality of audit (9)</p> <p>Reports that quality of the underlying reports has improved (7)</p>
The insurance (or ‘deep pockets’) explanation	<p>Taking the blame as an ‘independent scapegoat’ (complements agency & signalling theories) (10) ←</p>	<p>(as extrapolated from for-profit entities)</p> <p>Management (auditee)</p> <p>Government (and governance)</p> <p>‘The Public’ (including the media)</p> <p>Lenders & other business partners</p>	No data

Explanation	Benefits of the audit (Hay et al., 2016)	Example beneficiary of audit (Hay et al., 2016)	Example measures of value of public audit used by SAIs (Cordery et al., 2016)
		(Green & Singleton, 2009; e.g. Wallace, 1980)	
The organizational control explanation	Management letters (1) Reports to Parliament (3) Performance audits and inquiries (5)	Management (auditee) Parliament (and governance) other stakeholders (e.g. Funnell, 1994; Hay, 2003)	Recommendations made to improve efficiency and effectiveness (1) & (5) Number of reports tabled with Parliament (or appropriate body) (3) Better practice guides (to management) (1) & (7)
The confirmation hypothesis	Audited information (e.g. annual report) (2) Unaudited information which is later confirmed by audited information (6)	(as extrapolated from for-profit entities) Management (auditee) Government ‘The Public’ (including the media)	No data
Risk management and corporate governance	Audit Committee/ Independent Directors* (4) * These from annual report or other document.	Management (auditee) Government ‘The Public’? (including the media) (Bedard & Compennolle, 2014; e.g. Jensen & Payne, 2003; Knechel & Willekens, 2006)	Strategic Plans to ensure public sector accountability (7)

Explanation	Benefits of the audit (Hay et al., 2016)	Example beneficiary of audit (Hay et al., 2016)	Example measures of value of public audit used by SAIs (Cordery et al., 2016)
Public benefits, externalities, public choice and other explanations	None listed	<p>Policy-makers legislating for the public good</p> <p>Those interested in “New Zealand Inc” (e.g. professional accountants and their membership bodies, INTOSAI and its members)</p> <p>(Hay, Simpkins, & Cordery, 2016; Schelker & Eichenberger, 2010; The World Bank, 2007)</p>	<p>Contribute to Bills (9)</p> <p>Report overseas influence and impact (8)</p> <p>SAI’s reputation, including audit standards, funding, peer reviews, etc. (8) (from Legitimacy and Support and Operating Capacity – Moore, 2003)</p>

2.2 Specific communications and stakeholders

2.2.1 Management Letters

Assumed stakeholders: Management (agency theory; signalling; organizational control); Parliament (and governance), and other stakeholders (management control when it results in better practice guides and recommendations are made to improve efficiency and effectiveness).

An important way in which audits provide value to stakeholders is through assessing internal control and making recommendations for improvements. This can be done through unpublished management letters (or similar documents with another title). In some settings, publicly available reports on internal control are issued. In the New Zealand public sector environment, management letters are generally private letters from the auditor to the management, but in some cases information similar to that reported in the management letter is presented as advice to a Select Committee and then becomes available on the New Zealand Parliament website. There are also reports to Ministers which contain similar information and are available on the same website after being presented to select committees.

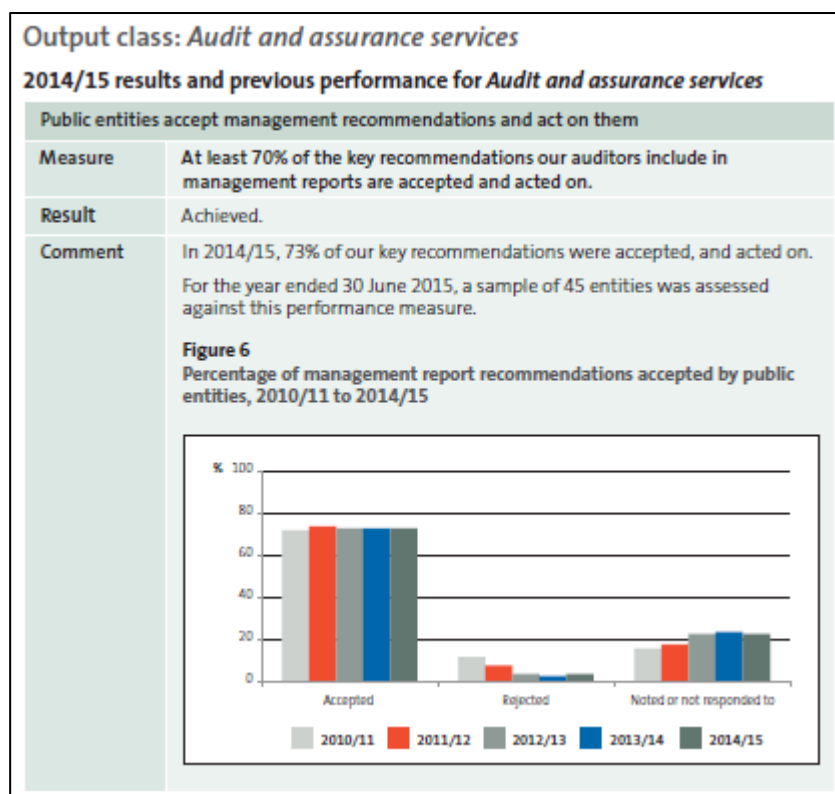
The recommendations provide value to a range of stakeholders including management of the entity, those charged with governance, Parliament and possibly wider groups of stakeholders and Investigation 2 noted that being held to account for these recommendations is one way to ensure that they will have an effect (Jantz, Reichborn-Kjennerud, & Vrangbaek, 2015). It may be possible to make the information in management letters even more useful to stakeholders.

Reporting on internal control is an area where auditing around the world is changing. In some settings, auditors are required to evaluate internal controls, obtain evidence that the controls are in place and report on their effectiveness. The Sarbanes-Oxley Act passed in the United States in 2001 requires auditors to assess and publicly report on any material weaknesses in internal control for large listed companies. Similar requirements have been introduced in China and Japan.

In New Zealand, there is no similar requirement. However, under auditing standards, auditors must assess the effectiveness of internal controls, and report any weaknesses found to management. These weaknesses are not usually reported in public, but the

OAG reports on an overall basis about whether recommendations to management are accepted by management and acted on (see Illustration 2).

Illustration 2: the OAG reporting on management report recommendations
(source: OAG annual report 2015, p.18).



The information that the OAG uses to prepare the chart in Illustration 2 is drawn from a sample of 45 management letters for a broad selection of larger entities.

The management letter also often refers to other risks or accounting issues, and these appear to be similar to a related issue, Key Audit Matters arising in the audit. There are emerging requirements for the auditors of listed companies to include Key Audit Matters in their audit reports (see section 3.3.1). Similar matters are also currently included the OAG's annual review briefings to Select Committees.

We reviewed a selection of the management letters which were used to prepare Illustration 2. We also examined Select Committee annual reviews, OAG reports to Select Committees and letters to Ministers (these were obtained from the NZ Parliament website). We attended two Select Committee annual reviews.

We found that Illustration 2 was based on 194 recommendations made in the 45 management letters, of which 138 were accepted, 39 noted, 7 rejected and 10 not responded to. We also found from reviewing the letters that in some cases although management accepted a recommendation, they did not resolve the problem, and the issue was still outstanding in the next year. We also observed that some entities had a large number of weaknesses (as many as 23). In some cases, the OAG briefing reported that the management control environment of the financial information system and controls “need improvement” (see also Table 2). In at least one case, this situation recurred from the previous year.

Investigation 2 noted Morin’s (2011) concerns about using just one measure for the success of an audit. Internationally, the measurement of accepted recommendations has ranged from 21% (Raudla, Taro, Agu, & Douglas, 2015) but more typically in the 70-90% range (Azuma, 2004; Lonsdale, 2000). Nevertheless, in concert with other measures used by the OAG, the following suggestions could be considered to make the information developed in the audit and used in preparing the management letters more useful.

- (a) When reporting whether entities accept management recommendations and act on them, it would be useful to show the number of recommendations resolved by the time of the next audit and the number of those not resolved, as well as whether they have been accepted by management. This will provide a stronger measure of whether management takes action on recommendations compared to whether they are taken note of. It will also provide useful information to other stakeholders about not only the value of the audit function, but the state of internal control in the New Zealand public sector as a whole.
- (b) When publishing the number of recommendations reported and the number accepted and acted, it would be worthwhile to collect a consolidated total of the number of recommendations made across all audits, instead of using a sample. This can then be broken down according to whether the recommendations relate to material weakness or not, and by the number of recommendations related to large entities. This change will have the benefit of a more comprehensive measure of the level of internal control across the New Zealand public sector,

and how it is changing over time. The cost of counting the number of recommendations for each audit is not likely to be high.

- (c) Investigating the costs and benefits of introducing similar requirements as those in the SOX framework for larger entities, whereby management and auditors are required to report on whether effective controls are in place. Bedard and Graham (2014) argue that while reporting on internal control in the United States was unwelcome, it has had benefits. They suggest that “not far behind is the potential requirement that governments publicly report on the effectiveness of their controls as a part of their stewardship of public monies” (2014, p. 319).² Reporting on internal controls, and auditing those reports, seems particularly relevant for entities that are responsible for publicly-owned resources. The application of such a requirement for public funds is arguably more advantageous in the public sector than in the large private sector companies covered by SOX, because of the interest of many taxpayers and voters in minimising waste. Nevertheless, there are several issues to consider including the costs of introducing this requirement to auditees and to auditors; and the issue of how to decide which public sector entities to apply it to, taking into account perhaps issues like their size and level of public interest.

2.2.2 Audits/Audited annual report

Assumed stakeholders: Parliament and voters (agency theory especially when they know how many audits have been undertaken and are unmodified); investors (signalling); management (confirmation hypothesis).

In this section, information about audits and audit reports is provided. In addition, commentary on auditing standards (which are how stakeholders know that the audits are completed to a high standard) is also provided.

² A similar type of reporting is also required in the UK, see for example, the Accounts and Audit Regulations 2015 s.4 which require a responsible financial officer to make assertions about the accounting information system and controls, for local authorities.

Audits/audit reports

Information about the number of audits is available from the Annual Plan, as shown in in Illustrations 3-6.

Illustration 3: Number of audits (Source: OAG Annual Plan 2015/16, p.6)

Figure 1
Summary of our 2013/14 audit portfolio

	Entities	Subsidiaries and related entities	Total
Central government entities			
Government departments	37	17	54
Crown research institutes	7	28	35
District health boards	20	27	47
Tertiary education institutions	29	111	140
Other Crown entities	65	81	146
Other central government entities	85	22	107
State-owned enterprises and mixed-ownership companies	18	104	122
Rural education activities programmes	14	-	14
Schools	2461	-	2461
Local government entities			
Local authorities	78	-	78
Council-controlled organisations		180	180
Exempt council-controlled organisations		28	28
Other local government entities		63	63
Energy, port, and airport companies			
Energy companies	24	47	71
Airport companies	19	4	23
Port companies	12	24	36
Other public entities			
Fish and game councils	14	1	15
Licensing and community trusts	20	19	39
Administering bodies and boards	38	-	38
Cemetery trusts	95	-	95
Māori trust boards	11	-	11
Section 19 entities	6	-	6
Total	3053	756	3809

We also examined a more detailed analysis of the audit portfolio. There has been a very small decline in the number of entities audited, from 3,898 in 2011 to 3,789 in 2015, of which 79 fewer entities are under the heading “Crown entities – other.”

Fees and hours are relatively unchanged from year to year. The annual report gives some information about fees and opinions and timeliness:

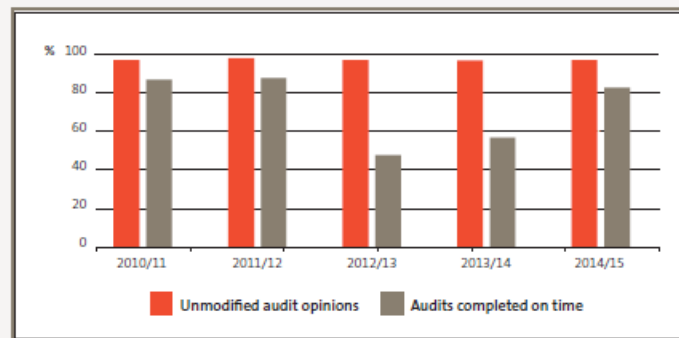
Illustration 4: Audit opinions and timeliness

(Source the OAG Annual Report 2014/15, p.10-11)

Figure 3 illustrates trends across the public sector for timeliness (as indicated by audits completed on time) and reliability of information (as indicated by the issue of unmodified audit opinions). For example, timeliness of audit completion across the public sector has improved. This year, 83% of public entities' audit reports were signed within the statutory time frame, compared to 57% in 2013/14, when ongoing problems with Novopay delayed completion of school audits. Although there were significantly fewer payroll problems than in the previous two years, delayed production of year-end payroll reports resulted in delays for some school audits. We note that, while it is improving, timeliness of audit completion has not yet returned to the levels that were being achieved before the Novopay problems.

The percentage of unmodified audit opinions across the public sector remains steady. This year, 97.3% of audit opinions were unmodified, similar to previous years (97.1% in 2013/14 and 97.4% in 2012/13).

Figure 3
Percentage of unmodified audit opinions and audits completed on time, 2010/11 to 2014/15



Timely public release of annual reports is also an important part of accountability for public resources. We currently collect data about timeliness of public release only for local authority annual reports. For 2013/14, 92% of local authority annual reports were publicly available on time. Although this is a reduction from 99% in 2011/12 and 96% in 2012/13, we have few concerns about this trend given our knowledge of the factors affecting the performance of the local government sector. We will continue to monitor local authorities' timely public release of annual reports for the year to 30 June 2015. We will also consider whether we need to collect data for other sectors for future reporting.

The annual report also summarizes assessments of internal controls:

Illustration 5: Internal controls

(Source the OAG Annual Report 2014/15, p.1-12)

Results for the central government sector (excluding schools) show a mixed picture for management control environment (MCE), financial information systems and controls (FISC), and service performance information and associated systems and controls (SPIASC). Figure 4 shows an improvement in some areas and a decline in others. We have applied particular effort to encouraging the improvement of service performance information, and note the increase in "very good" ratings from 1% in 2010/11 to 9% in 2013/14.

Here is the fee part:

Illustration 6: Audit fees

(Source the OAG Annual Report 2014/15, p.16)

Figure 5 summarises the movements in audit fees from 2012/13 to 2014/15, based on the agreed audit fees at the time the analysis was prepared. It shows how changes in the time spent on audits and the average hourly cost of carrying out audits have affected fees. The figures exclude additional audit fees negotiated with public entities as a result of unforeseen problems arising after audit fees had been agreed. These are usually the exception. However, for the school audits for the years ended 31 December 2012 and 31 December 2013, additional audit fees were agreed with the Ministry of Education for the extra audit work resulting from problems with the payroll system for teachers (Novopay). While this was not necessary for the 2014 school audits, some additional audit work continues as a result of those problems. We are continuing to work with the Ministry of Education to minimise the effect of the Novopay problems on auditors' costs and audit fees.

Figure 5
Changes in audit fees, 2012/13 to 2014/15

Sector	2012/13 to 2013/14				2013/14 to 2014/15			
	Increase in total fee	Because of changes in time	Because of changes in charge-out rate	Number of entities	Increase in total fee	Because of changes in time	Because of changes in charge-out rate	Number of entities
Central government	1.8%	0.3%	1.5%	396	2.4%	0.2%	2.2%	409
Local government	4.2%	3.6%	0.6%	421	2.3%	0.3%	2.0%	455
Schools	1.9%	-0.9%	2.8%	2426	2.7%	0.3%	2.4%	2404
Total	2.6%	1.2%	1.4%	3243	2.4%	0.2%	2.2%	3268

Examples of audit opinions with modifications or other variations include the Ministry of Health, and other health-related entities, that received qualified opinions over the limited control on information from third party providers. The RNZAF Museum Trust Board received an adverse opinion due to not recognizing museum assets. The opinion on the financial statements of the Department of Prime Minister and Cabinet included an emphasis of matter, arising from uncertainties over the Canterbury earthquakes.

In local government and licensing trusts, 40 of the 720 audit reports were modified: 3 with a disclaimer of opinion, 5 an adverse opinion and 32 were qualified (OAG, 2016c). Generally these entities were small, although one of the qualified opinions was for a Local Authority. Modified opinions, especially adverse opinions are relatively rare. While the Local Government and Environment Select Committee had not met to review the OAG's (2016c) report at the time of writing, we note that it did not raise the issue of modifications as a matter of concern, following a similar result for the 2013/4 audits.

We further note that many of the same entities received modified opinions in both the 2013/4 and 2014/5 years (OAG, 2015c, 2016c). In these cases, it would be useful to know what impact the opinion has on stakeholders, i.e. management, voters and ratepayers.

We were not able to find a similar detailed summary of the audit opinions issued on the central government sector. We noted that there is at least one qualified opinion (on the Ministry of Health). It might be useful for users wishing to assess that state of the New Zealand public sector as a whole for a report summarising all of the opinions issued to be made available, providing more detail than the percentage of modified opinions as shown in the OAG's annual report (e.g. see Illustration 4).

Auditing standards

In order for stakeholders to value audits in the public sector, it will help them to know that the audits are done to a high standard. We examined the auditing standards used for audits carried out on behalf of the OAG. We were interested in whether the OAG can make a statement, as the Australian counterpart does, that its audits fully comply with the same standards as in the private sector.³

We found that the Auditor-General's Auditing Standards include the Auditing Standards issued by the External Reporting Board in their entirety, plus additional requirements or commentary on public sector issues. These standards are called ISA (NZ). The Introduction to the Auditor-General's Auditing Standards states that:

“The Auditor-General's Auditing Standards (the Standards) are based on the standards issued by the External Reporting Board (the XRB) that apply to all assurance practitioners who carry out statutory audits in New Zealand.”
(<http://www.oag.govt.nz/2014/auditing-standards/docs/01-introduction.pdf>)

There are also additional standards for performance audits and other specific areas, and requirements to report certain issues to the OAG. Where there are separate standards, these are supplements to the usual standards on public sector issues, e.g., issues related to effectiveness and efficiency and financial probity in AG 315, Identifying and

³ Although in the US there is a different set of standards for public sector audits that is not the case in Australia and New Zealand. This point allows for the SAI to demonstrate its high level of auditing standards. The ANAO website states that “. . . its work is governed by its auditing standards, which adopt the standards applied by the auditing profession in Australia.” Obtained from <https://www.anao.gov.au/about/legislation-and-standards> 25 May 2016.

Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment.

One exception, which is more of form than of substance, relates to the wording used in audit reports. The reports contain the same information, with variations to take account of issues such as reporting on Statements of Service Performance. However, the order of the elements of an audit report varies from the order set out in the ISA (NZ). In the standards used by the OAG the audit opinion is provided before a statement of the responsibilities of the governing body. In the version promulgated by the XRB, the statements of responsibilities come before the opinion (the standard is ISA (NZ) 700).

We noted one minor point: the OAG website (<http://www.oag.govt.nz/our-work/about-auditing/setting-auditing-standards> visited 19 May 2016) still says “The Auditing Standards consist of the ethical and professional standards of the New Zealand Institute of Chartered Accountants (NZICA), supplemented by the Auditor-General’s Statements, and (where there is no NZICA standard) the Auditor-General’s Specific Standards.” This statement should be updated as the AuASB now sets New Zealand’s auditing standards.

It would be quite reasonable to assert in information sources such as the OAG website that “OAG audits are governed by its standards, which adopt the standards applied by the auditing profession in New Zealand.” Making a statement to this effect is likely to have a positive effect useful in convincing stakeholders of the value of public sector audits. We note that audit opinions issued on public sector audits already assert that audits are “in accordance with the Auditor-General’s Auditing Standards, which incorporate the International Standards on Auditing (New Zealand).”

2.2.3 Reports to Parliament

Assumed stakeholders: Parliament and voters (agency theory organisational control especially when they know how many reports have been tabled).

The World Bank (2001, p. 2) notes that the Westminster model includes the SAI reporting to a multiparty Public Accounts Committee (PAC) which will also call other witnesses and report “to the full parliament for comment and action”. Barrett (1996)

suggests that Parliament is the ‘principal client’ of the SAI, although he also comments on the interdependence between an SAI and a PAC when the latter recommends the budget appropriation for the SAI. Nevertheless, the ability of an SAI to report to a Parliamentary Committee is an important aspect of its independence (Norton & Smith, 2008; Noussi, 2012). Accordingly, ISSAI 12 (INTOSAI, 2013 s. 3.1-2, 3.-5) states SAIs should develop relationships, provide information and assist PACs to take appropriate action. As noted in Investigation 2, the Dutch SAI is one of the SAIs that monitors and reports whether their work has been mentioned in the Budget Bill, whether its auditors are invited to present a report to a Standing Committee, and whether Members of Parliament (MPs) press ministries to take the actions recommended by the SAI (Lonsdale, 2000).

PACs work on behalf of Parliament to hold the public sector to account for its use of resources. In New Zealand, all reports from the Auditor-General (2012) to Parliament are referred to the Finance and Expenditure Committee (FEC). The FEC may refer a report to another select committee, and staff brief or advise any of these Select Committees on these reports as required. The Auditor-General (2012, p. 9) notes that the staff’s work with Select Committees is governed by a Code which “explains the circumstances that determine when the Auditor-General acts as a witness or as an advisor to a select committee”. The Auditor-General (2012) is an example of attempts to raise the technical capability of Select Committees, as called for by Reichborn-Kjennerud and Johnsen (2015) and Santiso (2015). In New Zealand:

... the Institute of Directors runs orientations for local government, Local government runs inductions of their new members, Parliament has an induction for its new members ... [and the OAG] gave each new MP a little pack of what they needed to know. (OAI)

And this appears to be useful as a Sector Manager noted:

... of course it depends on the political interest, but political interests will depend on the degree of public interest usually. And I think there’s, from my experience, been a step change in the way in which committees come at it. They used to schedule in their financial review hearings as they were called then, to get them over as fast as possible and they had as little interest as possible and it was really a bit of a drag. Whereas now I find they’re really pretty focussed on what they’re doing. (SM1)

This research analysed the 162 publicly available reports made by Select Committees in the 12 months between 15 May 2015 and 14 May 2016, which are specifically

concerned about the performance of entities and which had OAG input.⁴ This time period covered Vote Estimates emanating from the May 2015 budget, through to analysis of public sector entities' annual reviews. The reports were analysed as to whether financial issues were raised or not. These were further broken down into whether they were of a technical (accounting) nature or were more generally about the financial business of the entity. The summary is presented in Table 2.

⁴ Data was downloaded from: <http://www.parliament.nz/en-nz/pb/sc/documents>. OAG input included audit reports, reports on annual reviews and vote estimates, performance reports and other reports. Verbal advice was also provided to the committees.

Table 2: Select Committee Information

Parliamentary Select Committee	# of committee reports	# with nothing to report	# with no financial issues	Financial accounting issues raised	Improvements
Commerce	19	1	2	Technical: Lack of segment reporting in a for-profit entity; Profit affected by needing to fair-value financial instruments General: Costs of regulation; costs of contract delays/ procurement savings; value for money queried (x2); expenditure on fitout (x 2); staff costs (x 2); funding levels; costs to New Zealanders; IT costs; agribusiness hub.	Needed: 2 Occurred: 3
Education and Science	11	1	3	Technical: Presentation does not match accounts; qualified audit report and report late. General: Staff costs (redundancies); Fitout; Parent donations.	Needed: 1 Occurred: -
Finance and Expenditure	22	4	4	Technical: Accounting for earthquakes/liabilities – is it correct; consolidation problems; decluttering of financial statements; low levels of unappropriated expenditure; timeliness. General: Fares to public; IT project (x 2); staff costs/bonuses; cost-benefit analysis queried; value for money.	Needed: 1 Occurred: 3
Foreign Affairs and Trade	7	-	1	Technical: Depreciation/valuation method may not be appropriate; measurement of performance/effectiveness. General: Agribusiness hub (x 2); IT project;	Needed: 1 Occurred: 1
Government Administration	27	16	2	Technical: - General: Public levies queried; public relations spending; budget/funding.	Needed: 2 Occurred: 2

Health	17	9	1	Technical: Are all accruals actually liabilities?; immaterial errors would increase profit substantially. General: Reserves/funding levels	Needed: 2 Occurred: -
Justice and Electoral	11	5	3	Technical: - General: Public charges queries	Needed: 2 Occurred: -
Law and Order	8	-	7	Technical: - General: IT.	Needed: - Occurred: -
Local Government and environment	10	1	3	Technical: Key Management Personnel register is poor; audit committees. General: Programme delays; Public charges.	Needed: 1 Occurred: 1
Māori Affairs	5	-	2	Technical: Poor performance measures. General: IT	Needed: 3 Occurred: -
Offices of Parliament	3	1	-	Technical: - General: -	Needed: - Occurred: -
Primary Production	6	-	5	Technical: - General: Query economic benefits	Needed: - Occurred: -
Social Services	8	1	4	Technical: - General: Concerns about costs and performance measures.	Needed: - Occurred: 1
Transport and Industrial Relations	10	3	2	Technical: - General: Staff bonuses; investment returns; public charges; funding model; local/central government mix; public trust and confidence increase.	Needed: - Occurred: -

As can be seen in Table 3, 110/164 (67.1%) of the reports made by Select Committees were annual reviews of entities, 33/164 (20.1%) considered vote estimates, 7/164 (4.3%) responded to OAG performance reports on specific entities/programmes, 9/164 (5.5%) responded to OAG reflections and overviews, and 5/164 (3%) considered issues regarding the OAG itself.

Table 3: Types of reports made by Select Committees, by committee name.

Parliamentary Select Committee	Annual Review	Vote Estimate	Performance Audit	Overview/ Reflection	OAG Business
Commerce	18	1	-	-	-
Education and Science	9	2	-	-	-
Finance and Expenditure	8	3	3	5	3
Foreign Affairs and Trade	4	3	-	-	-
Government Administration	20	6	-	1	-
Health	15	1	1	-	-
Justice and Electoral	7	4	-	-	-
Law and Order	4	3	1	-	-
Local Government and environment	5	3	-	2	-
Māori Affairs	3	2	-	-	-
Offices of Parliament	-	1	-	-	2
Primary Production	5	-	1	-	-
Social Services	5	2	-	1	-
Transport and Industrial Relations	7	2	1	-	-
Total	110	33	7	9	5

Further, Table 2 shows that 42 (26%) Select Committee reports to Parliament had “nothing to report”, and 39 (24%) did not mention any financial issues. Nevertheless, a number mentioned business concerns raised by the Committees that were of a financial nature. These included concerns about: the extent of fares being charged to the public, funding levels, value for money being delivered, programme and IT project delays and/or cost overruns, and staff costs – either redundancies, bonuses being paid, or the number and mix of staff at different salary levels (as shown in the financial reports). Topical matters, such as the agribusiness hub in Saudi Arabia, concerned particular Committees.

In addition, Table 2 shows that Select Committees raised a number of technical financial issues directly from the financial reports and audit. These included: asset and liability valuation methods, audit qualifications, performance measures, and presentation issues. In addition, the OAG report on timeliness of reporting of public entities was well received, with the FEC stating it should be repeated annually. That committee also applauded the OAG report of probity in the public sector. It is apparent that Parliament is keen to hold these public entities to account for meeting reporting expectations. Therefore, staff find that:

From us, the demand tends to be for analysis or insight into what the statements are telling. (SM2)

So that's our advisory role, as opposed to the audit role, but having audited financial and non-financial information, like any audit, puts a stamp of reliability on that information so the users can then rely on it. (SM3)

In considering management control systems, and financial and performance information systems, in 15 cases, the relevant Select Committee noted that improvements were needed, and in 11 entities, that improvements recommended by the OAG had been made. This is not a high number, but recognises the stance of the OAG to build relationships, whilst retaining independence, as:

the way to improve the public sector is through the people in the public sector. You can do it by forcing it on people, but people tend to sustain change and improvement if you can persuade them to do it ... Because to achieve our ultimate goal of improving the public sector and the public's trust in it, we need those chief executives and senior managers to be listening to what we're doing, taking the lessons and implementing them in their organisations. (OA1)

Table 3 notes that 5 reports concern the OAG directly. These include the review by the FEC, appointment of the external auditor and consideration of the OAG's vote estimate. From Select Committees' feedback and reports, it is apparent that they appreciate and value the OAG's input.

Nevertheless, we understand that lower levels of scrutiny occur for local government. In particular we were advised that there is a lack of enquiry from the Department of Internal Affairs, and low levels of enquiry from the public. On a general basis, the OAG's reports on local government audits (for example, OAG, 2016c) can assist

Parliament, but it would be useful to ensure that when concerns with local government and others are raised a public body will hold them to account.

It is noted that, in addition to the work of PACs, media activity will enhance the effect of an audit report (Morin, 2008, 2014). Such activity is dealt with in section (2.1.9).

2.2.4 Corporate Governance - Audit Committees

<i>Assumed stakeholders: Management and parliament (agency theory); management/independent directors (managing public sector risk).</i>

Commenting on steps that could “strengthen the independence of auditors and provide greater public confidence in their performance”, Barrett (2002, p. 9) notes the importance of enhancing corporate governance and especially the role of audit committees. Further, there is a need for good governance over shared programmes/policy delivery as government becomes “joined-up” (Victorian Auditor-General’s Office, 2012). The Federation of European Accountants (FEE) (2014) argue for good two-way communication between the auditor and audit committee.

The OAG examined governance in the New Zealand public sector in the recent report, “Reflections from our audits: Governance and accountability.” The Auditor-General commented: “In my opinion, the quality of governance in the public sector can be improved. It is not working as well as it should in some entities and problems have occurred and will continue to do so, unless the standard is raised” (page 3). As a focus group member noted:

[Governing boards] are there as stakeholders to represent Parliament or the public of New Zealand in that particular piece of business and so there’s these different layers of stakeholder. (PT1)

Accordingly:

... one of the things we have been doing and pushing really hard is audit and risk committees in local government ... When they have a new mayor’s school ... what we did there was push very hard, ‘you should set up an audit and risk committee’ and we have said, you should have independent members on it, because that’s a way to get the financial expertise to ask the right questions, into the system. (OAI)

The OAG also provides guidance on audit committees. We found that in some cases, entities have audit committees, but do not mention them in annual reports, and information about them is not made available on websites. Fama and Jensen (1983, p. 315) argue that an important part of making independent directors effective is that they are highly motivated because their personal reputation as experts is being put at risk, and they will be diligent to avoid damage to their reputations. Srinivasan (2005, p. 292) shows that audit committee members lose other board positions when their company misstates its financial reports.

We recommend that consideration is given to the issue of whether public sector entities should be encouraged to disclose the membership and activities of their audit committees.

2.2.5 Other types of assurance

Assumed stakeholders: Management, parliament and other stakeholders (organisational control, especially when recommendations are made to improve efficiency and effectiveness).

So the question of what is a public sector audit is a question like, how long is a piece of string? And even in this office, we sometimes find it a challenge to talk about it, because audit in the strictest sense is, you're giving an attest opinion. You're giving some assurance and an attest opinion. But we do much more than that. (SM2)

I think even, though, if you look at the changes that have happened in the Local Government Act for additional information that's reported alongside the annual report, since 2010 ... there have been almost annual, new requirements for local authorities to produce and report and have audited additional financial information in a prescribed format. (SM4)

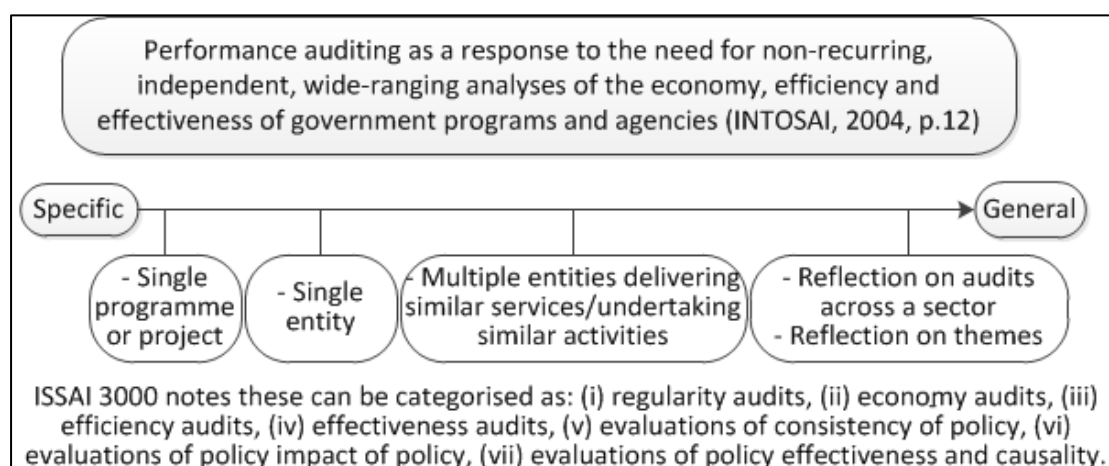
The quotes above show that that assurance is provided on a range of data, not just the annual financial accounts. These can include attesting to information for a debt provider (SM5, PT2), or an insurance liability report (SM3) as well as a range of non-financial data.

As noted in Investigation 2, in addition to financial statement and compliance audits, SAIs undertake performance audits and respond to issues raised by citizens, Parliament

and other stakeholders (The World Bank, 2001).⁵ ISSAI 3000 (INTOSAI, 2004, p. 11) describes performance auditing as the “independent examination of the efficiency and effectiveness of government undertakings, programs or organizations, with due regard to economy, and the aim of leading to improvements”. Performance audits therefore include auditing in the sense of examination, but also evaluation of economy, effectiveness and efficiency. Performance auditing is increasingly significant and also includes the promotion of best practice through benchmarking reports (Barrett, 1996). In addition, Inquiries are undertaken in response to issues raised by stakeholders.

Gendron et al. (2001) argue that SAIs have become ‘problem-solvers’ and this is evident in New Zealand where the OAG (2012) notes that recommendations for improvements include highlighting examples of good practice.⁶ Indeed, the range of ‘performance audits’ continues to expand, encompassing a continuum from assessments of single programmes or projects, to reflections on sectoral audits or themes, as depicted in Figure 2.

Figure 2: Continuum of performance audits and inquiries



In New Zealand’s OAG, the Performance Audit Group carries out a number of performance audits each year across the spectrum shown in Figure 2, whereas the Legal Group manages inquiries undertaken under Section 18 of the Public Audit Act 2001. While the OAG (2012) notes it is not a “complaints” agency, inquiries arise from

⁵ Investigation 2 summarised academic analysis of the value of performance audits (Etverk, 2002; Morin, 2001; Reichborn-Kjennerud, 2013).

⁶ This is also supported by ISSAI 12 (INTOSAI, 2013, s. 3.5).

written complaints or requests. After due consideration, a small number of these result in major inquiries or public reports. Nevertheless:

... if somebody has an issue that's not in our portfolio, we try and send them to the right place. So if it's a human rights issue, we send them to Human Rights. If it's information we send them off to the Ombudsman - and there are a large number of agencies we can send them to. (OA1)

Dealing with this range of inquiries has resource implications for the Office, but also creates opportunities to liaise and complement the structures that New Zealand has in place for the public to demand accountability.

We analysed all of the OAG published reports for the year ended to 31 May 2016, categorising them as shown in Figure 2 and further differentiating between: (i) inquiries, (ii) progress reports (which follow-up prior performance audit reports and include which recommendations have been acted on and which are still in progress), (iii) performance audits and (iv) reflections. The difference between a performance audit and a reflection is that the former is as a result of specific audit activity over and above the annual audit cycle, whereas reflections typically analyse a number of audits across a sector, or in respect of a particular theme. The results are presented in Table 4.

Table 4: Other types of assurance reports from the OAG, by category and type.

Parliamentary Select Committee	Inquiry	Progress Report	Performance Audit	Reflection
Single programme or project	2	5	1	-
Single entity	1	-	-	-
Multiple entities delivering similar services/ undertaking similar activities	-	1	2	-
Reflection on audits across a sector/report on themes	-	1	4	4
Total (21)	3	7	7	4

In addition to the above, from the OAG's Annual Plan (published in June 2015) (OAG, 2015a) and Draft Annual Plan for consultation in April 2016 (OAG, 2016b), a further 7 projects are still in progress in 2016 (OAG, 2016b), comprising: 1 single programme, 1 single entity, 4 multiple entities and 1 across a whole sector. (At the time of writing,

two reports are still in progress: one is a progress report across a sector, the other a performance audit in an entity). As well as written publications, the OAG follows up specific reports with blogs and videos, such as that by Mike Scott, Marcus Jackson and Bill Robertson who discuss performance reporting and the performance audit on managing financial assets in the public sector.⁷ However, staff noted:

... the discipline required then is to make sure it's accurate and can be disseminated properly, quickly and not misunderstood or taken out of context. So, as with anything where you try and break something down to a digestible soundbite, you've got to make sure it's the right soundbite, if I can put it that way. (OA2)

Table 1 lists the assumed stakeholders as management, Parliament and others, and as the publications listed in Table 4 are publically available, it is apparent that 'others' includes the public at large. For these other types of assurance, these include:

... particular people that have concerns about an aspect of the operation of the state sector which they're complaining about. And we have the other side of that coin: the entities or the people about which the people might be writing in or that we are aware of otherwise. (OA2)

Again, the notion that the OAG is not a 'policeman' is reflected in the manner in which other audits and inquiries in particular are undertaken:

We're there to make things better. So we have to be sensitive and practical and prudent about how we deal with them about an issue and how we describe something which is come up or how we engage with them and be as open as we can be without divulging things we're supposed to and those sort of things. (OA2)

In respect of the inquiries:

... a core part of the inquiries' function is telling a story that can't be gleaned or understood. Or if it can be understood, putting it in a way which is more digestible or able to be understood. An example recently was someone said that, yes, we can tell the story, all the information's out in the public and that's fine, but if you put it all together it will be six boxes and no one's going to be able to discern the story from six boxes of information. So if we can tell it in 25 pages, much easier to be out there, to inform the debate and to describe what's happened. (OA2)

Nevertheless, due to the resources that inquiries consume (typically these take 12 months), the topics are chosen carefully for their impact on the public sector – ensuring

⁷ See blog.oag.govt.nz/accountability/performance-reporting.

its accountability and efficiency. These are also subject to quality assurance within the office (PT2).

A number of interviewees expressed the balancing act between ensuring that the investigations in this ‘other assurance’ is published in a timely manner, but are also not rushed or presented shoddily. A challenge for the OAG is to increase the pace and reach of its other assurance, within its current resources.

In recent times, auditing and assurance in the private sector have extended to include reporting on other issues apart from the financial report. These areas include environmental, social and sustainability reporting by the entity (Simnett, 2014). We recommend that the OAG could also consider these areas as ways of providing value to stakeholders in future.

2.2.6 Unaudited information which is later confirmed by audited information

Assumed stakeholders: Management and government, “The Public” (voters and members of the community) (confirmation hypothesis).

Investigation 1 explains how, under the confirmation hypothesis, audits are still important even when unaudited information is widely used. This is because the audited financial statements provide confirmation of earlier announcements (Ball, Jayaraman, & Shivakumar, 2012). This explanation could be highly relevant for the public sector. Many stakeholders such as citizens in their capacity as taxpayers and ratepayers are very unlikely to look up audited financial statements. Nevertheless, they obtain information from sources such as the media or announcements by public sector entities, and they probably assume that this information is reliable. It might be very useful for auditors to consider what unaudited announcements are made, and consider whether they are consistent with the audited financial statements that are later released.

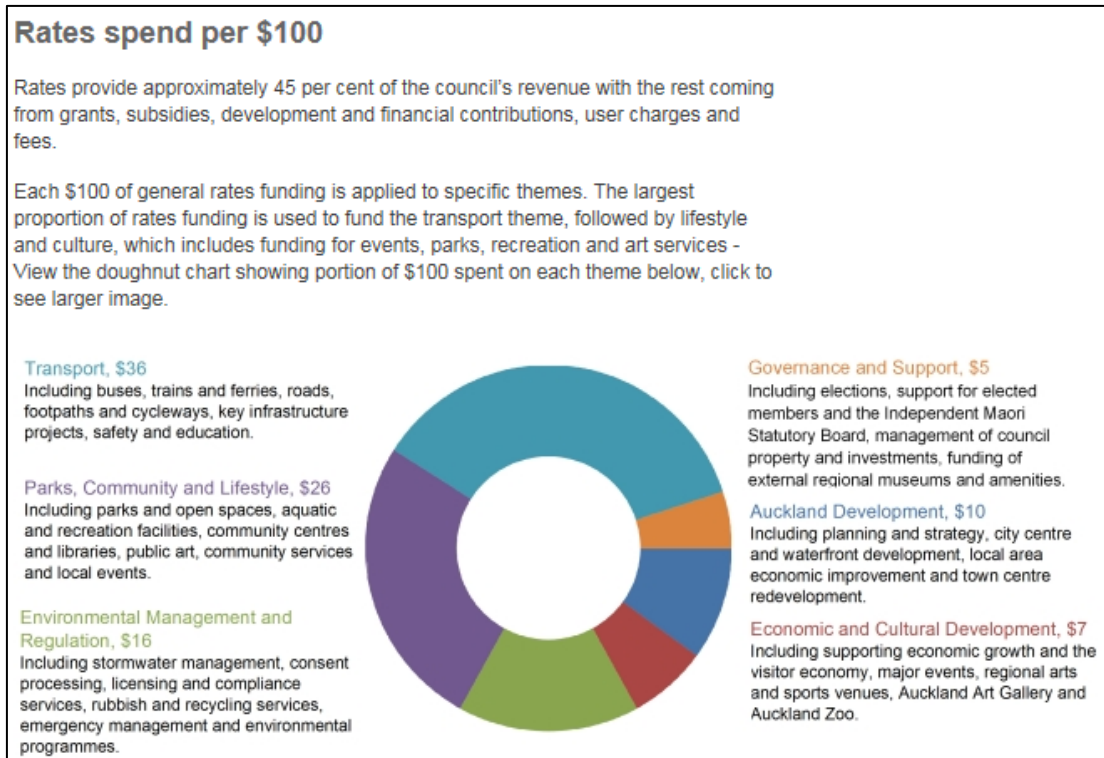
Some examples of unaudited announcements that stakeholders might rely on include these situations:

- (a) Councils usually make announcements about how much their rates are and what they are used for. Illustration 7 provides a recent example from Auckland

Council. In that case, ratepayers probably think that such information is reliable. In practice, they are unlikely to check it against the financial statements. Unlike the financial market examples that Ball et al. (2012) were referring to, there are unlikely to be analysts who would draw attention to any discrepancy between earlier announcements and audited results. Since the news media do not appear to check unaudited announcements against later audited information, it could be a valuable part of public auditing to check such announcements against audited financial statements.

- (b) At one select committee hearing that we attended, the CEO commented not only on the previous year's profit and revenue, but also made a statement of expected revenue and profit for the current year. The announcement about the year ahead is unaudited, but presumably Members of Parliament might rely on it, and later on it ought to be consistent with the audited accounts (or if there is a difference, they should be given the opportunity to ask for an explanation). We also noted that sometimes differences occur between estimated annual results reported in the May budget estimates and the annual results in the end of year reports. Typically no explanation is provided.
- (c) The broad range of announcements on financial or service performance made by public sector entities could also be considered by the auditors of these entities to ensure that they are not inconsistent with audited reports.

Illustration 7: From the Auckland Council website⁸



In addition to an unaudited base, in one focus group, surprise was expressed that few government entities provide summary reports (*PT3*) which are reasonably common in the not-for-profit sector in New Zealand and the public and not-for-profit sector in the UK. It was suggested that this might be because legislation doesn't require it (*PT4*). As users may find full reports difficult to understand, it would be useful for the OAG to consider whether to encourage entities to produce summary reports.

2.2.7 Ensuring public sector accountability

Assumed stakeholders: Rationally ignorant voters and the public (signalling, especially when it is reported that the quality of the underlying reports has improved; managing public sector risk, shown by strategic plans to ensure public sector accountability).

Investigation 2 noted that SAIs have primarily an accountability purpose, geared towards democratic and constitutional accountability, but also towards learning

⁸ Downloaded from <http://www.aucklandcouncil.govt.nz/EN/ratesbuildingproperty/ratesvaluations/billingpayment/Pages/howyourratesarespent.aspx> 17 May 2016

(Noussi, 2012; Pallot, 2003). Therefore, ensuring public sector accountability is an exercise with a goal to investigate as part of the regulatory system (under agency theory), to report findings to Parliament, and to enable “stakeholders and clients and key external stakeholders [to have] and accurate, timely and clear diagnosis of important performance dimensions” (Noussi, 2012, p. 47). Highlighting performance that affects citizens in general is a clear indication of public value (Moore, 2013).

In addition to Management Letters (see section 2.1.1) and Reporting to Parliament (see section 2.1.3), other types of assurance (see section 2.1.5), especially the reflections, or better practice guides, assist the OAG to achieve its outcomes of “appropriately responsible public sector behaviour” and a “high performing public sector” (OAG, 2014b). These outcomes should arise when critiquing stakeholders are empowered to use OAG advice and as public entities respond to areas of improvement that have been noted by these stakeholders or by the OAG (OAG, 2014b). One measure the OAG uses to measure its effectiveness is through auditee and Parliamentary surveys.

Undertaking a quality audit – auditee and Parliamentary surveys

Satisfaction of auditees is an output class for the OAG – as can be seen in the Annual Report (OAG 2015a). In respect of public entities overall, the 2015 Colmar Brunton survey shows satisfaction is 87% - a 2% increase on the prior year.⁹ The client surveys themselves are extensive, with specific feedback obtained on aspects of the audit, auditors’ skills, knowledge and so on. These are reported by service provider and by sub-sector. Hence, the OAG has a wealth of information to encourage audit service providers to improve in deficient areas. The survey reports include qualitative as well as quantitative data, although there is an issue with the statistical significance when there are small numbers of respondents.

The OAG also undertakes ‘stakeholder engagement’ which included (in 2012 and 2013) interviews with Select Committees, their Chairs and senior managers of Treasury. These are specific, in that recommendations of particular groups are reported verbatim and ascribed to one of the 10 interviewees. Overall, the OAG is seen as being helpful in providing appropriate reports and advice. These surveys, contracted from Touchstone, were augmented in 2014 by Martin Jenkins who surveyed 25 (named)

⁹ The prior years’ client satisfaction surveys for the years ending 2012-2014 were undertaken by Ignite Research.

senior public officials and select committee Chairs (OAG, 2015a). Select committee respondents were satisfied with briefings (see (iii) above), and the OAG was seen to be in an enviable position. We understand these issues have been discussed in depth at senior management levels within the OAG.

Improving reporting quality

Other measures of improved public sector accountability include feedback that the quality of the underlying reports has improved. In respect of New Zealand's public sector entities, the OAG (2014a) notes that, on average, central government is moving towards maturity in budget management and financial controls (that is, their competent systems are sustainable). A mix of entities are moving towards maturity in governance and accountability, and reporting value, but the systems are not well developed (OAG, 2014a). The environment for accountability has changed, due to new statutes and financial reporting standards (OAG, 2016d). The OAG is a regular submitter to the External Reporting Board (XRB) on auditing, assurance and financial reporting standards and also has staff involved in the XRB's sub-committees. Yet we could not find whether, in the 12 months ended 15 May 2016, the OAG made submissions on any Parliamentary Bills.

It would be useful if the OAG published its submissions on its website so that these could be readily available for interested parties.

2.2.8 Evidence of Legitimacy and Support (independence and building trust) and overseas influence

Assumed stakeholders: Those interested in "New Zealand Inc" (externalities including reports on overseas influence and impact; the SAI's reputation, audit standards, funding, peer reviews, etc.).

Measuring trust through surveys

The OAG's (2014b, p. 5) vision is "that our work improves the performance of, and the public's trust in, the public sector". The Strategic Plan notes that the OAG can contribute to external change in "appropriately responsible public sector behaviour" and a "high performing public sector" (OAG, 2014b, p. 5). However, it also notes that

the organisation is relatively small, and it is understood that not all change (positive or negative) can be attributed to the OAG's actions.

Accordingly, the OAG consistently measures New Zealand's ranking on the Worldwide Governance Indicators and the State Services Commission's Kiwis Count Survey, having as a measure that these will have been improved or at least maintained (e.g. OAG, 2015a). The Worldwide Governance Indicators are an aggregate of many different surveys and are reported by sub-category in the OAG's Annual Report (OAG, 2015a). The Kiwis Count Survey (State Services Commission, 2015) is run quarterly and asks respondents *Overall, to what extent do you trust the public service?* While levels of trust based on respondents' recent experience increased 2% from 2014 to 2015 (to 79%) and is markedly higher than 2007, respondents' perception of trust fell 2% to 43%. However the State Services Commission (2015) notes that the perception of trust measure is still trending upwards. In addition to these measures, other measures are available, as discussed in Appendix 2. These include:

- the International Budget Partnership (IBP) (2015) Open Budget Survey (including 4/118 questions analysing an SAI's independence);
- the Center for Public Integrity – Global Integrity Report (this does not include New Zealand in its analysis, but analyses SAIs' independence and, to a small extent, its reporting practices) (Noussi, 2012);
- the Public Expenditure and Financial Accountability Assessment Reports (limited to developing countries only, but which includes sub-questions on SAIs' independence, leading by example and reporting to Parliament)) (Noussi, 2012);
- the OECD (2015) reports on the Gallup Poll: Confidence in Government which shows New Zealand as 4th most trusted government in the world (the questions are limited to "confidence" in government rather than the presence of a SAI). The OECD (2015) also uses the World Values Survey, but this is being revamped, with trust in government to be part of their new questions.¹⁰ None of

¹⁰ As noted in <http://www.worldvaluessurvey.org/WVSContents.jsp>. The outcome is expected in July 2016.

the other barometers used by the OECD (2015) include New Zealand data (Eurobarometer, Latinobarómetro and Edleman Trust Barometer -see <http://www.edelman.com/insights/intellectual-property/2016-edelman-trust-barometer/global-results/trust-in-asia-pacific-middle-east-africa-2016/>); and

- INTOSAI's IDI Development Initiative (IDI, 2014) (which reports on developing countries' SAIs' capacities and needs, to support reform).

Further, Transparency International rates perceptions of public sector corruption, including administrative and political corruption. New Zealand has recently ranked at 4th in the world, dropping from first equal in 2012 and 2013, to second in 2014.¹¹ The least corrupt are perceived to be the military, followed by public sector groups such as the education system, medical and health, the judiciary, NGOs, police and public officials/ civil servants (in that order).

In addition, the Institute of Governance and Policy Studies (IGPS) (2016) recently released the results of a survey of 1,000 New Zealanders entitled "Who do we trust?". In relation to government, it asked respondents how much trust they had in local government *to do the right thing*, with 57% reporting some trust and 44% reporting little or no trust (rounding means these do not add to 100%). Specifically, 37% believed that they trusted local government less now than three years ago. However, 50% had a reasonable amount or great deal of trust that local governments would *deal successfully with local and community problems* (IGPS, 2016). The other institutions the survey enquired about were not relevant to the OAG's overarching outcome.

In summary, the measures of trust available are a proxy only for the OAG's overall outcome sought of a "Trusted Public Sector". The State Services Commission (2015) Kiwis Count Survey is regular and provides a measure of the public's experience with government services, but it does not consider local government (which is considered by IGPS, 2016). It is difficult to distinguish between the improvements that can be attributed to the OAG and those attributable to other factors, respondents' perceptions of politicians (local and national), and other factors within the economy that may affect the results.

¹¹ See: <http://www.transparency.org/cpi2015>

Indeed, the OECD (2013, p. 4) “concluded that existing surveys fall short of what is needed for monitoring, benchmarking and understanding this complex phenomenon”, suggesting that there should be better understandings of how trust is measured, that surveys should be more frequent, and that existing measures should be refined to enable governments to address the causes of distrust. Accordingly, the OECD’s (2013) statistical division is working on measures that nations could use within household surveys to more effectively measure trust in government. This is expected during 2016. In the interim, showing an ability to be “the best in the world” may provide a better measure of the direct impact of the OAG, but we recommend that better measures of trust be followed up and used.

Reviews of the OAG

As noted in Investigation 2, a number of SAIs commission external international peer reviews to ascertain their efficiency and effectiveness generally or in specific areas (Australian National Audit Office, Office of the Auditor-General of Canada, Rigsrevisionen, Algemene Rekenkamer, & Government Accountability Office, 2012 of the SAI of India; e.g. Bundesrechnungshof, Cour des Comptes, & Riksrevisionen, 2014 of the European Court of Auditors). The OECD also undertakes wider peer reviews which may also question the underpinning legislation and structure of the SAI (e.g. OECD, 2014 of Chile’s SAI). Some 16 years, ago the Australasian Council Of Auditors General (2001) undertook a peer review of New Zealand’s OAG, finding that it effectively meets the needs of its key stakeholders. During that year, when the third reading of the Public Audit Act was introduced (see: Hay et al. 2016 – Investigation 1), the OAG was challenged to meet the highest standards of integrity and impartiality to maintain its high standing in Parliament (NZPD, p.8675).

Seven years later, Pat Barrett and an Australasian team also reviewed the OAG, using a similar methodology as the 2001 review. Improvements were noted following the strengthening of the Auditor-General’s position under the new Public Audit Act. Again it found that the OAG “is a relatively small but highly regarded organisation both in New Zealand and internationally” (Barrett, 2008, p. 7). Indeed, there was “considerable process rigour around quality assurance” (Barrett, 2008, p. 9), and any concerns raised were minor. The OAG (2012) notes these international peer reviews are a regular feature. It will be important to ascertain the focus of the next peer review to ensure that it highlights weaknesses as well as strengths.

We noted in Investigation 1 and 2 that: (1) in recent years private sector auditors are now usually subject to independent inspection and (2) that the OAG of NZ is something of an outlier in not having a statutory requirement for a periodic review although we recognise that this can impair independence. However, we understand that the OAG is negotiating with the FMA to have a quality review on the audit systems for FMC entities audited by the OAG (under s. 15A of the public Audit Act 2001) and similarly has an MOU with CAANZ for practice review. This specific independent audit oversight is positive. We also recommend that regular quality, external peer reviews be investigated.

Reporting on overseas influence

It was noted in Investigation 2 that reporting on overseas influence and input can demonstrate an SAI's relevance to its citizens, Parliament and other stakeholders and enable it to independently and objectively support reform (Cordery & Hay, 2016). We were advised that, for example, the OAG has had positive feedback from other INTOSAI members about its respect of review reports and other performance reports. Further,

... we've currently got in the Performance Audit Group a Swedish lady who's here to find out how we do things and what we do, to take that to Sweden. She's here for three months, which I think also shows that what we're doing is obviously appreciated by the Swedes - that they're prepared to invest somebody to be here for that time. (OAI)

Nevertheless, this is a small part of the OAG's work.

2.2.9 Evidence of Operational Capacity¹²

Assumed stakeholders: Management (agency and signalling when auditees feel they have had a quality audit); Policy-makers legislating for the public good (externality when the SAI contributes to Bills); citizens and interest groups who get their information from published sources such as media reports; news media themselves who have an interest in reporting important public information.

Responsiveness and voice: media

As noted in Investigation 2, ISSAI 12 (INTOSAI, 2013 s. 6.4) emphasises the media's role "to facilitate communication with citizens". Such communication can augment

¹² Note that auditing standards which are part of leading by example, are included in 2.1.2.

reporting to parliament (Morin, 2014), as can ‘open government’ (James & Davies, 2004), especially when media and citizen pressure leads to change (Raudla et al., 2015).

The OAG collects information on media coverage and we obtained these reports. We reviewed the OAG’s Media Round Up documents for three selected months (July 2015, November 2015 and February 2016). The news items concentrated on political matters of the time. Many items were about various parties discussing or suggesting that the Auditor-General should become involved or investigate issues, or they commented on actions or reports by the Auditor-General. The media discussed financial statement auditing much less, although there was some discussion. In particular, local newspapers sometimes discussed the release of the annual report of their local council. In addition (in July 2015) local media often reported the adoption by local councils of their long term plan. The Auckland Council’s LTP was particularly widely discussed and controversial (and several news items and letters to the editor were concerned with the Auditor-General’s address to city councillors when they were making their decision). News reports of some other councils adopting their LTP included reference to comments by Audit New Zealand staff.

Other news items that related to financial statements and audit opinions included:

- An opposition MP (David Cunliffe) brought up the issue of a qualified audit opinion (on the Tertiary Education Commission) during Parliamentary questions on one occasion.
- The Hamilton City Council was reported as making an announcement of an unaudited annual surplus. This is another use of unaudited information, which under the confirmation hypothesis is reasonable so long as it is confirmed later.
- The media reports also provided some evidence about the use of unaudited information. One political group (New Zealand First) has suggested that more public announcements should be audited.¹³ However, if announcements are reliably confirmed by later financial statements, then that approach may not be necessary.

¹³ Through its proposed Better Public Service Target Results Independent Audit Bill.

Overall the media reports show that stakeholders sometimes, and in some places, see audit reports on financial statements as valuable.

The OAG also uses social media including Facebook, LinkedIn, Twitter and Instagram, and has a blog. The OAG uses social media in a number of ways and reaches substantial numbers of stakeholders. Examples include:

- Facebook. The Facebook page, “The Auditor-General of New Zealand” is liked by 412 Facebook members (as at 8 June 2016). It is a lively source of current information about audit activities and reports released by the OAG. It includes video material presented by OAG staff and links to reports and other material such as the OAG blog.
- Twitter. “Auditor-General NZ” has 1,171 followers on Twitter as at 8 June 2016. Twitter includes frequent announcements of reports and other activities by the OAG, and draws attention to blog posts and relevant tweets by others.
- Instagram. 109 Instagram users follow “auditorgeneralnz”, The Auditor-General of NZ. Instagram is mainly used for illustrations of the wide range of entities for which the Auditor-General is responsible, and also includes announcements of reports released, and other news about the OAG.
- Blog. The blog, <http://blog.oag.govt.nz/> is used for discussions by OAG staff of topical issues. The most recent blog post at 8 June 2016 was from 4 May 2016. There were about ten blog posts in the last 12 month period.
- The OAG also has an extensive email list that provides announcements about reports. The email announcements often include links to summaries of the announcements, video material and a feedback form. The list is open for anyone to join.

Social media is employed by the OAG to disseminate news and general information. It appears to have an audience of information users. We did not find references to financial reports or audit opinions on social media, however.

News media themselves are a stakeholder who have an interest in reporting important public information, and are also an important intermediary with the public and other interest groups. In 2012 the OAG commissioned a Media Opinion Audit by Busby Ramshaw Grice (2012). The report is marked “in confidence.” It is generally

favourable. Busby Ramshaw Grice (2012) obtained information by interview and questionnaire from 18 media representatives. The media representatives respected the Auditor-General and her role in holding people to account, and viewed the OAG favourably in comparison to other “government” organisations. The media representatives understood that sometimes there are limits to the extent to which the Auditor-General can comment. They noted that not all media people, or members of the public, are aware of the OAG or understand its role. There were comments that media would like the OAG to take part in broadcast media, making comments for radio and television. This is backed up by Raudla et al. (2015) (as reported in Investigation 2), that media attention by itself does not lead to change in audited organisations, but does when there is political debate. It would be useful for the OAG to consider monitoring and reporting the extent to which audit work leads to pressure for change from other stakeholders, including Parliament.

Responsiveness and voice: Assessing public stakeholders’ satisfaction

An INTOSAI survey notes that citizens are the most important stakeholders (United Nations Department of Economic and Social Affairs, 2013). In addition to the OAG undertaking regular surveys of auditees, senior managers from the public sector and select committee chairs, UMR Research Limited surveyed the general public to ascertain their impressions of the OAG, its role in enhancing trust and confidence in Parliament or in generating reforms in the public sector. These are hampered by low awareness of the OAG and its role – although the role is valued. A similar situation happened in Mexico, where the SAI engaged journalists to make short videos describing the SAI’s activities in an accessible way (United Nations Department of Economic and Social Affairs, 2013). In New Zealand, Martin Jenkins notes survey fatigue, so it may be useful to engage a set of more informed stakeholders to provide feedback to the OAG. The Auditor-General regularly makes presentations in communities and she noted:

...the first one I did, I was a bit taken back. Nobody knew what audit meant ... but now I talk about what an audit is. I talk about what an auditor-general is, how you get one, what we do and [get] real engagement from it ... I raise reports that are in that community’s area ... [and] I have never underestimated the interest you can get out of an audience for any of the reports.

It should be noted that the OAG seeks to communicate clearly so that “people can easily understand and act on what the Auditor General says”, as noted when the OAG won the plain English award in 2010.¹⁴ Further, the OAG liaises with the media, runs websites, uses social media (e.g. LinkedIn, Twitter and Instagram), uses its intranet¹⁵ and other means to ensure that its core messages are communicated well. There is a push to develop more responsive ways of communicating, and to take a citizen focus which has a number of angles to it. For example:

... we've got a project started which is about staff as ambassadors. So helping to lift those skills of our staff and the confidence of our staff to actually talk about the Office's work, whether they're talking to family and friends or if they have a particular job to go out and speak on behalf of the Office. (OA3)

[And]

We've said that we would consult with the public on our annual work programme and this is the first year that we actually have and it - in a formal sense. So we ran a citizen panel and we had Colmar Brunton help us to run an online forum and discussion group, and we talked to them, to the people involved, members of the public who were selected from Colmar Brunton's pool, about the information theme that we plan to do for 2016/17, and asked them about their experiences with getting information and sharing ...in the public sector. (OA3)

The intentional development of two-way relationships and consulting citizens, moves New Zealand's OAG ahead of a one-way citizen relationship where citizens are only 'informed' but do not respond to the SAI (United Nations Department of Economic and Social Affairs, 2013). A two-way relationship includes conducting regular public opinion surveys and actively engaging with, for example, unions and not-for-profit organisations as well as members of Parliament, to guide the workplan. In-depth two-way relationships engage citizens in a “partnership for decision-making” and this is undertaken by an even smaller group (of mainly developing countries) use every media available to them (United Nations Department of Economic and Social Affairs, 2013, p. 14). This report highlights, for example, India's “Passion for public accountability” LinkedIn project, and the Indonesian SAI's moves to engage the public more actively (United Nations Department of Economic and Social Affairs, 2013).

¹⁴ Information downloaded from <http://www.scoop.co.nz/stories/PO1009/S00121/auditor-generals-office-takes-plain-english-award.htm>.

¹⁵ This raises the topic of OAG staff as a key stakeholder in the process, as noted in the quote below.

The OAG recently engaged Colmar Brunton to undertake a “Citizen Panel” on how the general public obtains, uses and provides information to public sector organisations. This was to inform the development of the programme “Information” for the 2016/17 work plan. Data was collected through a 2-day online forum and group discussion. Participants highlighted the usefulness of government websites and enquiry lines, but also cited examples of poor service and the need for information sharing across the public sector. Accordingly, New Zealand’s OAG understands that:

... we also need to be helping to promote change in the way that the system works. So ... how we listen and how the public sector listens. So this is again, about joining up to the citizen. And if we start asking questions about how public entities have listened to their stakeholders who aren’t their ministers or their boards or, you know, senior management but how they listen to the public and design their services, I think ... there’s an important role potentially for the auditor-general. (OA3)

It is necessary to develop better relationships with individuals and groups outside of regular stakeholders to ensure this systematic change. Other SAIs have successfully engaged with unions and not-for-profit organisations (as noted above) and it would be useful to identify which groups would be best to make specific contact with in New Zealand.

2.2.10 Insurance Explanation

Assumed stakeholders: Rationally ignorant voters and the public (signalling); Management, Government and governance, “the public”, lenders and other parties in business relationships with entities that are audited (insurance explanation – complementing agency and signalling theories).

The understanding behind the insurance hypothesis is that auditors (who take out professional indemnity insurance), may be sued as a scapegoat for an entity’s management failures. In Investigation 1, we discussed how this explanation may apply in a slightly different way, whereby the auditor acts as an “insurer” of the reputation of public sector entities and managers. If there are errors, and the OAG accepts responsibility, then any damage to the reputation of the management of the entity making the errors might be less. However, in some cases the insurance explanation applies even more directly, with financial report users taking legal action against the

OAG. These are rare events in the public sector, although the 2014 survey of stakeholders warned that the Kaipara District Council's mismanagement of the Mangawhai community wastewater scheme between 1996 and 2012, had tarnished the 'brand of the Office', despite the OAG's appropriate response. As noted in Investigation 1, there have been several cases (one in 1949 and another in the 1990s) where legal action for monetary losses has been brought against the Auditor-General of New Zealand (Green & Singleton, 2009, pp. 82 & 145) and the recent settling of the Kaipara District Council's complaint is a further example of the insurance hypothesis in action.¹⁶ This provides a further example of this way of achieving a certain type of value of public audit for some stakeholders.

2.3 Conclusion

This chapter has presented the audit communications with different stakeholders of the IAG. It has mapped those communications against the frameworks developed in Investigations 1 and 2 and made a number of recommendations on specific issues. The next chapter presents a literature and document review on how the environment for public information is changing.

¹⁶ See: <http://www.nbr.co.nz/article/auditor-general-coughs-more-5-million-kaipara-audit-mistakes-sl-186853>

Chapter 3: The changing environment for public information

3.1 How might the public sector be changing?

The lines between the public and private sector are less able to be drawn, with ‘sector-bending’ as the public sector enters collaboration with the private sector through formal alliances such as Public Private Partnerships (PPPs), Social Impact Bonds, and more informal collaborations¹⁷ (Barrett, 2000; Carpenter & Gray, 2010). These and similar arrangements bring differences in legal and accountability arrangements, raising questions as to how (or whether) the public good is being delivered (Barrett, 2000; Carpenter & Gray, 2010).¹⁸ In this space, The Association of Chartered Certified Accountant’s (ACCA’s) (2014) report “Breaking out: public audit’s new role in a post crash world”, notes that performance audits can uncover issues. Following evidence of poor accountability by private sector contractors, ACCA (2014, p. 11) recommends extension of performance audits “to provide parliaments and citizens with independent assurance that public services are delivered by the private sector efficiently and effectively”. There is also a need for transparency in the processes used to outsource/involve the public sector when commercial sensitivity may mean the contract is not public.

The changing world also requires more research and investment in appropriate infrastructure (social and physical) (ACCA, 2014). For example, Des Pearson, the Victoria Auditor General (2012) noted that demographic changes require public sector entities to undertake more research so that their services and infrastructure meet citizens’ needs. As information will be more transparent, it also requires entities to ensure they have better information, better controls over information and use it in an informed manner.

¹⁷ For instance, low decile schools in New Zealand receive breakfasts from a cereal company (Sanitarium), a milk processor (Fonterra), volunteers and government funds: “Kick Start” downloaded from: <https://www.msd.govt.nz/about-msd-and-our-work/newsroom/stories/2014/kickstart.html>

¹⁸ As seen in the Commerce Committee’s serious concerns that Kordia Group Limited’s argument of commercial sensitivity meant the Select Committee could not ascertain “the proportion of its revenue from network services to free-to-air broadcasters ... [or] its broadcasting and telecommunications revenues”, thus making it difficult to ensure public value was being delivered (New Zealand House of Representatives, 2016, p. 2).

Nevertheless, these issues are being raised in a public sector which faces resource constraints (Grace et al., 2012; ACCA, 2014) and therefore must manage its finances more effectively and efficiently. Cross-sector reports can provide very useful guidance, such as those from the OAG on managing financial assets, governance and accountability, and being ready for the future (Controller and Auditor-General, 2014a, 2016a, 2016d).

3.2 How might citizen's expectations be changing?

Thomas (2013) notes that the place of 'the public' needs to be re-thought in public management, specifically urging public sector managers to consider the public as customers, citizens and partners. The arguments of New Public Management (NPM) place the public as customer readily enough, and the wave of "New Public Governance" where increasingly government contracts out and partners with others, spurs co-production and collaboration (Thomas, 2013). Thomas (2013) notes that the consideration of the public as citizens pre-dates both of these ways of managing but persists and that engaging citizens is a necessary part of democracy. He also raises the challenges in doing this, as citizens who engage "seldom constitute a population cross-section ...[and] can be costly" (Thomas, 2013, p. 792), giving reasons to shy away from engagement. From a policy point of view, he recommends that public sector entities must have a need for more information, be able to articulate their constraints and be prepared to share decision-making authority. Thomas (2013) encourages entities to initiate public involvement in decision-making early, to be committed to utilising the results and to anticipate issues. While an SAI may often want to engage the public for reasons other than decision-making, his other recommendations are also useful – to employ a variety of techniques and offer multiple opportunities for the public to be heard.

In a reflection on the 2013 public sector audits, the OAG (2014a, p. 27) noted that "public expectations about communication and service are changing". Citizens expect that the public sector will provide better service delivery and better value for money (Barrett, 2000). Technology means that information should be more readily available, and also has the added benefit of joining-up government and therefore reducing fragmentation. Social media links citizens across physical and social boundaries,

making it incumbent on the public sector to engage both within the sector and with citizens, to ensure good communication about expectations and performance (OAG, 2014a, 2015d). There is also:

... a challenge to be grasped in the new digital age, is the relationship between open communication, fast and accessible information, and yet the need for – in some situations – confidentiality and natural justice considerations where you consult before you go public on things, because people might be affected - and ensuring that we are open but don't compromise the integrity of our work. (OA2)

The FEE (2014) discusses another angle on technology, with the ability of Big Data and data mining to enable SAIs to introduce grading or rating of public sector entities to ensure greater consistency and better governance. Robust criteria would be required to be developed for such grading.

Globalisation is another issue facing the public sector (Barrett, 2000; Grace et al., 2012); the ready transfer of funds and corruption which “threatens the integrity of markets, undermines fair competition ... destroys public trust, increases the cost of capital ... despite the plethora of documented corporate governance guidelines and codes of conduct” (ACCA, 2014, p. 23). Such undermining of public trust is evident with the release of confidential Mossack Fonseca papers.¹⁹ Nevertheless, these challenges are not the auditor’s alone, as the “pinnacle of the system of accountability for the use of public money is the role for the PAC” (ACCA, 2014, p. 27)

Another reason for changes in public expectations, and in the way the public relate to information, comes from the “new media environment”. In the current changing environment, there are frequently fewer resources available to news media organizations around the world, and as a result the media have less interest in investigative journalism. As noted: “Investigative journalists are a vanishing species” (Walton, 2010). Other changes in the “new media environment” include (1) internationalisation; (2) new communications techniques and (3) trends for journalists to present a more personal viewpoint (Liebes & Kampf, 2009). As a result of all of these trends, it is less likely that news media will be interested in local news items about relatively routine items such as annual financial reports and audits. This may explain

¹⁹ For example, <http://www.stuff.co.nz/business/79801529/panama-papers-keys-former-lawyer-has-further-mossack-fonseca-links><http://www.stuff.co.nz/business/79801529/panama-papers-keys-former-lawyer-has-further-mossack-fonseca-links>.

why there were comparatively few news items about accounting reports and audit opinions. In addition, there are recent trends to change media relations, so that entities with news to report make it easier for journalists to find it, by using social media (Waters, Tindall, & Morton, 2010). The OAG appears to be actively engaging with these trends in its use of social media.

3.3 How might audit be changing?

The environment of auditing, and auditing itself, are changing. Changes to auditing and its environment are explored in Hay et al. (2014). These include:

- Auditing research has grown exponentially in the last 30 years (Hay et al, 2014, p. 352). There is increasing use of auditing research by affected parties such as standard setters and oversight bodies. This set of investigations is another such example.
- Audit quality, how to define and how to measure it, is a current topic of concern to bodies such as the IAASB and to researchers (Hay et al., 2014, p. 3520).
- Oversight and inspection of auditors has been introduced widely around the world, especially in private sector settings (Hay et al. 2014, p. 353).
- There are impending requirements for new audit reports that provide much more information to stakeholders (Hay et al, 2014, p. 353).
- Auditing is increasingly seen as part of a set of corporate governance tools, which should fit into the context of the other tools including internal control, internal audit, independent directors and the audit committee (Hay et al, 2014, p. 354). The optimum balance among these mechanisms, the extent of regulation required and how to meet public expectations are still being worked out.
- Reporting by auditors on the internal control of an entity has been adopted in some jurisdictions (including the United States, China and Japan) but not others (such as New Zealand) (Hay et al, 2014, p. 355).
- There are new areas beyond financial statements in which independent assurance is being provided by independent audit firms and other providers. These include environmental, social and sustainability reporting (Hay et al, 2014, p. 355).

- Auditing is now more global, and the same auditing standards (ISA) are used for most audits in most countries, with the exception of the United States (Hay et al, 2014, p. 161).

We have taken note of these changes in Investigations 1, 2 and 3. Our recommendations about independent inspection of audit work, reporting on internal control and assurance on sustainability reporting are consistent with these changes. The other elements of the changing environment have also been taken into account.

While many write about the future focus on performance audits, Grace et al. (2012) note the ‘watchdog’ role of public auditors will remain their core business. Standard financial audits will be affected by changes such as real-time auditing, which bring the need for better skills both in the SAI and the public sector (Barrett, 2000). The FEE (2014) query whether real time reporting will actually require real time auditing, but skills will have to be developed. The area in which this is most obvious is in the time it takes to undertake performance audits and inquiries (as previously noted).

The same publication also notes that increased reporting by auditors to the public is often resisted by practitioners, because it increases the risk of liability to the auditor (Johnson, 2012).

David Walker (in ACCA, 2014), believes that auditors should intervene earlier in a project’s life cycle, to limit failure. He further argues that analysis of service delivery is an important factor in audit’s future, and the New Zealand OAG provides examples of this in its performance audits (for example, Controller and Auditor-General, 2015d). Nevertheless, he acknowledges that “public expectations must not run ahead of possibility. The public may need to be educated ... to what auditors can accomplish” (ACCA, 2014, p. 5). On the contrary, Caroline Gardner (Auditor General of Scotland) in the same report, notes that “one job of audit is to identify and promote good practice” and cites New Zealand as being exemplary in this respect (ACCA, 2014, p. 21).

Environment and climate change are concerns of citizens (ACCA, 2014), and even more than a decade ago, sustainability reporting (Triple-bottom line reporting) was raised as a future concern for SAIs (Barrett, 2000). With the new Service Performance Reporting proposals in New Zealand, it may be the case that public sector reporting on this and similar issues, will become more extensive.⁷

Chapter 4: Recommendations and conclusions

This report sought to analyse which stakeholders are affected by the most important parts of public information, who their representatives are and how information is used and relied upon. The data was limited to examining existing published reports and undertaking a small number of interviews, focus groups and select committee attendances. Nevertheless, it has analysed New Zealand's OAG's audit beneficiaries from the perspective of explanations for audit and measures of value in respect of public audit.

In the first section of this chapter, the recommendations made in chapters 2 and 3 are re-presented and matched to stakeholders in Table 5. Secondly, this investigation's fuller analysis of the OAG is summarized against the measures of value considered in Investigation 2, leading to the positive assessment that the OAG provides diverse reports on how it delivers public value through its audit activities.

4.1. Recommendations in respect of stakeholders (by audit communication)

In Section 2.2.1, we noted that management letters can satisfy four explanations for audit (agency theory, the information (or signaling) and organizational control explanations and management control). Nevertheless, management letters are not public documents, although they do inform the advice provided to the Select Committees. There are two measures of value in this respect: (i) the feedback from auditees about the quality of the audit and (ii) recommendations made to improve efficiency and effectiveness. In respect of the former, the OAG already undertakes regular, in-depth surveys on auditee (management) satisfaction and receives feedback to improve audit engagements. In terms of the latter (recommendations to increase efficiency and effectiveness), we recommend:

1. When reporting whether entities accept management recommendations and act on them, it would be useful to show the number of recommendations resolved by the time of the next audit and the number of those not resolved, as well as whether they have been accepted by management. This will provide a stronger measure of whether recommendations are taken note of. It will also provide useful information to a wide range of stakeholders about not only the value of

the audit function, but the state of internal control in the New Zealand public sector as a whole.

2. In publishing the number of recommendations made and the number accepted and acted upon, it would also be worthwhile to collect a consolidated total of the number of recommendations made across all audits, instead of using a sample (as occurs currently). This can then be broken down according to whether the recommendations relate to material weakness or not, and by the number of recommendations related to large entities. This change will have the benefit of a more comprehensive measure of the level of internal control across the New Zealand public sector, and how it is changing over time. The cost of collating this information is not likely to be high.
3. Investigation into the costs and benefits of introducing requirements similar to those in the SOX framework for larger entities, whereby management and auditors are required to report on whether effective controls are in place. Bedard and Graham (2014) argue that while reporting on internal control in the United States was unwelcome, it has had benefits. They suggest that “not far behind is the potential requirement that governments publicly report on the effectiveness of their controls as a part of their stewardship of public monies” (2014, p. 319). The public reporting on internal controls, and audit of those reports, seems particularly relevant for entities that are responsible for publicly-owned resources.

Section 2.2.2 outlines the core activity of the OAG - audits and the audited annual report. This activity can be explained by agency theory, it signals quality, and also may confirm previously released (but unaudited) results. We recommend:

4. To develop a fuller understanding of the impact of modified audit reports on stakeholders, i.e. management, voters and Parliament through Investigation 4.
5. Although the OAG publishes a detailed list of the types of opinions issued for local government audits, we were not able to find a similar detailed summary of the audit opinions issued on the central government sector. It might be useful for users wishing to assess that state of the New Zealand public sector as a whole for a report summarising all of the opinions issued to be made available,

providing more detail than the percentage of modified opinions as shown in the annual report (OAG, 2015a).

In Section 2.2.3, reports to Parliament/Select Committees (which are useful under agency theory, and the organizational control explanation) are discussed. A number of financial and business-related issues are raised in Select Committees. We found that these Committees are supported well by OAG staff and guides (See: OAG, 2012). Such reports also provide evidence of the risk management explanation for audit, especially when the OAG seeks to ensure public sector accountability. We:

6. Endorse the recommendation of the Finance and Expenditure Select Committee that the OAG regularly repeats its report “Being accountable to the public: Timeliness of reporting by public entities” (OAG, 2015b) as this raises public awareness of how accountable entities are.
7. Recommend investigation into the usefulness of a mechanism where concerns with entities outside of central government can be escalated to a public body that could hold them to account (especially given the number of modified audits from many of the same entities each year).

Corporate Governance and Audit Committees are discussed in Section 2.2.4 as audit committees assist in the governance of public entities (suggesting agency theory and managing public sector risk). We note that the OAG provides guidance and the Institute of Directors is also actively involved in providing education for public sector governors. We recommend that:

8. Consideration be given to the issue of whether public sector entities should be encouraged to disclose the membership and activities of their audit committees.

In Section 2.2.5 we note that other assurance such as performance audits and Inquiries are provided under the organizational control explanation. We noted:

9. A number of interviewees expressed the balancing act between ensuring that the investigations in this ‘other assurance’ are published in a timely manner. A challenge for the OAG is to increase the pace and reach of its other assurance, within its current resources.

Section 2.2.6 discussed unaudited information which is later confirmed by audited information (the confirmation hypothesis). We note that in many cases unaudited information is announced and it is later assumed to be supported by audited information, consistent with the confirmation hypothesis. Nevertheless, we found no real evidence of this, as, for example, local authorities produce unaudited summaries of their reports (to ratepayers), but as far as we are aware management or users do not request that these be audited either before they are published or during a typical annual audit. We recommend:

10. As the annual report is in an entirely different format to such summaries, it may be useful to check a sample of these unaudited announcements to understand whether such summarised information is useful and faithfully represents the audited information.

We further note that, as users may find full reports difficult to understand, it could be useful for the OAG to investigate whether to encourage entities to produce summary reports.

The above is summarised in Table 5.

Table 5: Recommendations by stakeholder

Recommendation (by section)	Stakeholders who would benefit
<u>Section 2.2.1: Management letters</u> 1. Show number of recommendations accepted and resolved 2. Publish total number and type of recommendations (rather than a sample) 3. Include report on internal controls	<ul style="list-style-type: none"> • Management • Parliament/governors • Other stakeholders who can learn from these letters' recommendations
<u>Section 2.2.2: Audits/audited annual report</u> 4. Deepen understanding of impact of modified annual reports 5. Summarise audit opinions by central as well as local government	<ul style="list-style-type: none"> • Parliament • Voters (including the media) • Investors • Management
<u>Section 2.2.3 Reports to Parliament</u> 6. Regularly repeat report on timeliness of reporting by public entities	<ul style="list-style-type: none"> • Parliament • Voters (including the media)

7. Investigate escalation of concerns regarding entities outside ventral government	
<u>Section 2.2.4 Corporate Governance - Audit Committees</u> 8. Consider encouraging disclosure of membership of public entities' audit committees	<ul style="list-style-type: none"> • Management • Parliament • Independent Directors (governance)
<u>Section 2.2.5 Other types of assurance</u> 9. Balance timeliness and reach of these reports	<ul style="list-style-type: none"> • Management • Parliament • Other stakeholders
<u>Section 2.2.6: Unaudited information which is later confirmed</u> 10. Check a sample of unaudited announcements for veracity	<ul style="list-style-type: none"> • Management • Government • 'The Public' (including the media)

4.2. Public Value of audit

In this section, we summarise an assessment of the OAG against the framework of public value developed in Investigation 2. Six further recommendations are made within this framework.

Legitimacy and Support

Legitimacy and Support, a core focus of public value (Moore, 2013), is obtained from being independent and trustworthy. This draws on principle 1 of ISSAI 12 (INTOSAI, 2013): "Safeguarding the independence of SAIs" and sections 8.4-5, 9.2 & 9.4 "Being trustworthy through transparent information and audit" (Cordery and Hay, 2006, p.9). In respect of trust and confidence in SAIs, Investigation 2 found that trust was built by: high quality performance reports, independent review of outsourced audits, and peer reviews of the SAI. Section 2.2.5 discussed the issuance of "other audits", and it is apparent that these are high quality and are highly valued. However, when comparing SAIs around the world, we noted that New Zealand is exceptional in not having a requirement for an independent external peer review, or some equivalent process, on a regular basis. In respect of reviews, we recommend:

11. A framework for regular external international peer review, and continued inspection of audit processes by independent bodies (such as the FMA and CAANZ).

While legitimacy and support primarily focuses on the SAI, the OAG also uses the regular management of trust in the public sector to assess what changes may be able to be attributed to the OAG's actions. The "Kiwi Counts" measure is one proxy and the public sector scores highly, although the recent IGPS (2016) is at odds to that measure. We recommend:

12. That more thoroughly-substantiated measures of the extent of trust by the community in the public sector that reflect directly on the influence of the OAG, be developed and used.

Operational Capacity

Operational capacity, the second core focus of public value (Moore, 2013), will enable a SAI to achieve its desired result. It is obtained from "Leading by example" ("Audit quality and ethics", "Trained staff", and "Quality of governance" (sections 8.1, 8.3-4, 9.1, 9.3 and principles 10-12 of ISSAI 12)), and "Being responsive", and "Communicating effectively" (principles 5-6 and sections 1.1-3) (Cordery and Hay, 2016, p.9). In respect of leading by example, Investigation 2 noted that the OAG publishes an audited annual report, as well as strategic and annual plans. Leading by example also includes undertaking high quality audits, by having high quality staff, being well governed and showing leadership (for example on environmental reporting). We note the OAG is highly thought of²⁰ and is showing leadership through its intention to prepare an Integrated Report (<IR>). In addition, another reason that users can appreciate that audits meet a high standard is by being aware that they meet accepted international standards, and that they meet the same standards as other auditors such as those in the private sector. In the case of OAG audits, the relevant standards are the International Standards on Auditing (ISA). OAG audits comply with these standards, in addition to specific public sector standards, and it may help to demonstrate the value

²⁰ For example, the annual report noted that 87% of public entities surveyed were satisfied with their audit. The respondents commented on the expertise of the audit staff and their relationships with auditees.

of public audit if the compliance with these standards is made more widely known. We recommend:

13. That the OAG asserts that public sector audits in New Zealand utilises the international standards applied by the New Zealand auditing profession.

In respect of responsiveness and voice, section 2.2.9 of this report shows that a broad media strategy is followed by the OAG. In addition, the OAG actively seeks to engage citizens and to assess their satisfaction with the OAG. Nevertheless, we recommend:

14. As not all media people, or members of the public are aware of the OAG or understand its role, consideration should be given to a campaign to more effectively engage stakeholders in assisting the OAG. This should include stakeholders who may not have been worked with before. For example, Other SAIs have successfully engaged with unions and not-for-profit organisations (as noted above) and it would be useful to identify which groups would be best to make specific contact with in New Zealand.
15. Drawing on comments that media would like the OAG to take part in broadcast media, we recommend that the OAG makes selective comments for radio and television.

Public value

Public value is an individual strategic point and an overriding public value which includes all three parts of Moore's (2013) strategic 'triangle'. This occurs through "Ensuring public sector accountability" by "Auditing public sector entities", "Reporting on results" (principles 2 & 4, INTOSAI, 2013), "Enabling public sector governors to discharge their responsibility effectively" as well as being a "Credible source of independent and objective insight" (principles 3 & 7, sections 1.2, 5.2 & 5.5, INTOSAI, 2013) (Cordery and Hay, 2016, p.9).

Ensuring public sector accountability speaks to agency theory, signalling and control explanations for audit. The OAG (as do some other SAIs) strategically plans to ensure public sector accountability (this assists in managing public sector risk) and works to increase capacity across the sector, especially through published reflections on themes and sectoral audits, as well as support for Select Committees. This research found the

Parliamentary Select Committees engage with the OAG reports and ask pertinent questions. Nevertheless, the OAG does not place a dollar value on savings as do the SAIs in UK and UK (Cordery and Hay, 2016). We recognise these have problematic methodologies and may have limited applicability.

In respect of independently and objectively supporting reform, the OAG's 'other assurance' reports (especially reflections as noted above) provide a signal to entities of expectations and good practice. Such "good practice" guides further confirm the audit hypothesis of organisational control, as do OAG submissions on Bills, Exposure Drafts and Consultation Documents. It has already been noted that the OAG could make these directly publicly available to provide evidence of value. Further, it is important to ensure that Parliament makes good laws. The OAG makes submissions to Parliament and other governmental organisations:

16. It would be useful if the OAG published its submissions on its website so that these could be readily available for interested parties.

4.3. Conclusion

This research has analysed the ways in which the OAG provides benefits to stakeholders who are affected by the actions of the OAG and its reports. It finds that many of the benefits of audit that are asserted in the private sector are evident also in the public sector. However a wider range of stakeholders is involved and it is likely that the benefits or harm caused by public audit will have a greater impact than a private sector audit. For this reason, the OAG reports not just to Parliament, but also publicly, is open about stakeholder feedback on its services and strives to improve public sector accountability through its activities and influence. In general, we were able to conclude that the OAG can demonstrate value to shareholders in many ways. The recommendations set out above are intended to enhance the value of public audit.

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APPENDIX 1: International examples from Investigation 2

Moore's Public	Categorisation	ISSAI 12 principles (Ppl)	International Examples from Investigation 2
Legitimacy & Support	SAI Independence	1.	<ul style="list-style-type: none"> • Assertions of independence; • Delivering audits on budget; • Need for more resources.
	Building trust	9.4, 8.5, 9.2 & 9.4	<ul style="list-style-type: none"> • Peer reviews ; • National and international indicators of trust, government or office; • Using focus groups or panels of experts for performance reports; • Independent review of outsourced auditing.
Operational capacity	Lead by example	8.1, 8.3, Ppl 10, 11 & 12 8.4-8.5, 9.1-9.4	<ul style="list-style-type: none"> • Annual reports (with clean audit report), annual plan & strategic plans; • Budget published; • Report on audit fee increases; • Report on staff quality & efficiency; • Quality of governance, ethical standards, quality assurance, internal audits, use of audit standards; • Environmental strategy and results of sustainability programme.
	Responsiveness and voice	Ppl 5, ppl 6 & s. 1.1-1.3	<ul style="list-style-type: none"> • Ensure users and managers find audit reports understandable; • Providing summary/recognise key stakeholders; • Recognise digital era; • Citizens' complaints and Parliament's concerns directs work; • Count press releases, website visits, number of mentions in Parliament; • Assess stakeholder expectations and needs.
Public Value	Ensuring public sector accountability		<ul style="list-style-type: none"> • (Agency theory, signalling and organisational control explanations) • Strategic plans to ensure public sector accountability (manage public sector risk); • Dollar value of funds saved due to audits (showing public benefits); • Developing networking relationships with other agencies including raising Parliamentary oversight body competency.

	Independently & objectively supporting reform	<ul style="list-style-type: none"> • Number of completed audits and timeliness, number of unqualified reports issued (agency); • Reporting that quality of underlying reports have improved including timeliness (signalling); • Number of reports tabled with Parliament (or appropriate body), recommendations made to improve efficiency and effectiveness (and their take-up), or just number of meetings with Parliament (organisational control); • Feedback from auditees (agency, signalling); • Better practice guides (including on governance in the sector, contribute to Bills, benchmarking (towards organisational control)) • Report overseas influence and input (externalities)
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APPENDIX 2: Quantitative international surveys overview

A: International Budget Partnership – Open Budget Survey

As noted in Investigation 2, the International Budget Partnership (IBP, 2015) notes that, for international agreements addressing such matters as climate change to be successful: (i) countries' budgets must be open to analysis, (ii) citizens must be able to meaningful critique budget decisions, and (iii) such global spending must be subject to strong independent oversight. Hence, in addition to analysing the strength of the first of these two, the IBP's (2015) Open Budget Survey 2015 of 102 countries assesses the strength of each country's two formal oversight institutions, its legislature and SAI. This 2015 survey (the most recent of five such surveys which first began in 2006) found an average score for SAI strength of 65 out of 100, with 43 countries scoring below 60. New Zealand scored at the top (88/100) but scored over 60 on only three out of the four indicators (open budget data, citizen engagement, strength of the legislative, and strength of the SAI).

Strong SAIs will be able to scrutinise public spending due to their independence and resourcing, while lower scores represent weaknesses in both (IBP, 2015). They note concern that "in the majority of countries, including those that score above 60, the quality assurance systems for supreme audit institution reports are either deficient or non-existent (IBP, 2015, p. 5). The four indicators (out of 118 in total across the survey) are as follows:

- i. independence from the executive (based on security of tenure (ISSAI 12, s. 1.2) and who determines the SAI's budget);
- ii. level of discretion on work plan (see also ISSAI 12 ppl 1);
- iii. whether the SAI has an independent quality control system to assess the quality of their Audit Reports (see also ISSAI 12 s. 11.6); and
- iv. whether the SAI has adequate resources to fulfill its mandate (see also ISSAI 12, s. 1.8) (IBP, 2015).²¹

While only a small percentage of the total survey, the IBP carefully interrogates the SAI's strength as a vital part of countries' openness in a global society. They note an independent SAI's role "is to scrutinize the use of public funds, diagnose potential problems, and propose solutions" with legislatures "using audit recommendations and analyses to hold the executive to account" (IBP, 2015, p. 51) underpinning its importance.

B: Center for Public Integrity - Global Integrity Report²²

A US-based non-profit organisation it depends on more than 1,200 country experts across more than 100 countries. Its 2011 report was the last in the full series and its website notes it is revamping its database and methodology for the 2015 report. in Noussi (2012) notes they use 25 sub-questions on Supreme Audit Institutions and take

²¹ "Most of the survey questions require researchers to choose from five responses. Responses "a" or "b" describe best or good practice, with "a" indicating that the full standard is met or exceeded, and "b" indicating the basic elements of the standard have been met. Response "c" corresponds to minimal efforts to attain the relevant standard, while "d" indicates that the standard is not met at all. An "e" response indicates that the standard is not applicable, for example, when an OECD country is asked about the foreign aid it receives. Certain other questions, however, have only three possible responses: "a" (standard met), "b" (standard not met), or "c" (not applicable)" (IBP, 2015, p. 61).

²² see www.globalintegrity.org

the mean of three sub-questions in providing a ranking. These are below. New Zealand is not on their list of countries covered, hence it cannot be used in this study.

- Q.58 In law, is there a national supreme audit institution, auditor general or equivalent agency covering the entire public sector?
- Q.59: Is the supreme audit institution effective?
 - o 59a: In law, the supreme audit institution is protected from political interference.
 - o 59b: In practice, the head of the audit agency is protected from removal without relevant justification.
 - o 59c: In practice, the audit agency has a professional, full-time staff.
 - o 59d: In practice, audit agency appointments support the independence of the agency.
 - o 59e: In practice, the audit agency receives regular funding.
 - o 59f: In practice, the audit agency makes regular public reports.
 - o 59g: In practice, the government acts on the findings of the audit agency.
 - o 59h: In practice, the audit agency is able to initiate its own investigations.
- Q.60: Can citizens access reports of the supreme audit institution?
 - o 60a: In law, citizens can access reports of the audit agency.
 - o 60b: In practice, citizens can access audit reports within a reasonable time period.
 - o 60c: In practice, citizens can access the audit reports at a reasonable cost.
- The following questions also concern external auditing but are not used to calculate the SAI index: 20e, 20f, 21d, 21e, 22f, 29d, 29h, 33d, 33g, 38c, 38g, 46e, 46i. See <http://www.globalintegrity.org/information/downloads> (Last Accessed on October 24, 201) (Noussi, 2012, p. 64, footnote 106)

C: Public Expenditure and Financial Accountability Assessment Reports

This is a multi-donor partnership founded in 2001 and located in the World Bank headquarter offices (Noussi, 2012). As such, it relates to developing countries only, and New Zealand is not assessed. Nevertheless, the indicators may be of interest. Pillar VII of a Public Financial Management system is “External Scrutiny and Audit”, although audit of revenue, payroll and internal controls are indicators in Pillar V (Predictability and control in budget execution). Pillar VII includes:

- 30. External audit
 - o 30.1 Audit coverage and standards
 - o 30.2 Submission of audit reports to the legislature
 - o 30.3 External audit follow-up
 - o 30.4 Supreme Audit Institution independence
- 31. Legislative scrutiny of audit reports
 - o 31.1 Timing of audit report scrutiny
 - o 31.2 Hearings on audit findings
 - o 31.3 Recommendations on audit by the legislature
 - o 31.4 Transparency of legislative scrutiny of audit reports²³

²³ Downloaded from <http://www.pefa.org/sites/pefa.org/files/PEFA%202016%20FINAL%2016-01-29.pdf>.

D: OECD reports on Report on Trust in Government

OECD (2000) is largely a qualitative summary of what should be in a trustworthy government and has a short 3-4 pages on what each country has. There is no ranking.

OECD (2013) notes that several international surveys collect data on citizens' trust in government (see Table 1.1). Nevertheless, there is little comparability and it is hard to work out how citizen trust is changing over time.

Table 1.1. **International surveys measuring trust or confidence in government**

Name of survey	Number of OECD countries covered	Years covered and frequency	Measurement	Answer scale
World Gallup Poll	34	2005-12 (annually)	Confidence in national government	2: yes/no
World Values Survey	25	4 waves: 1989-93; 1994-98; 1999-2004; 2005-08	Confidence in the government	4: a great deal/quite a lot/not very much/not at all
Eurobarometer	23	2003-13 (biannually)	Trust in government	2: tend to trust/tend not to trust
Edelman Trust Barometer	15	2001-13 (annually)	Trust in government	9 point scale: 1 means "do not trust at all" and 9 means "trust them a great deal"
Latinobarómetro	3	1995-2012 (annually)	Trust in government	4: a lot/some/a little/no trust

Table from OECD (2013, p. 23)

E: INTOSAI International Development Initiative

INTOSAI's International Development Initiative (IDI, 2014) also reports on SAIs' capacities and needs in order to better support reform. However this is for developing countries only.