

# Local Government: Results of the 2003-04 Audits



**Report of the  
Controller and Auditor-General**

*Tumuaki o te Mana Arotake*

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**Report of the  
Controller  
and Auditor-General**

*Tumuaki o te Mana Arotake*

**on**

**Local Government:  
Results of the  
2003-04 Audits**

**Presented to the House of Representatives pursuant  
to section 20 of the Public Audit Act 2001**





Hon Margaret Wilson MP  
Speaker  
House of Representatives  
WELLINGTON

Madam Speaker

I am pleased to forward this report to you for presentation to the House of Representatives pursuant to section 20 of the Public Audit Act 2001.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'K B Brady', written over a faint blue line.

K B Brady  
Controller and Auditor-General

Wellington  
18 July 2005





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# Introduction

This report is our “annual report” on the audits for 2003-04 of the local government sector in the Auditor-General’s portfolio under the Public Audit Act 2001. Most of these audits are of regional and territorial local authorities and their subsidiary entities that were established under and governed principally by the former Local Government Act 1974 (the 1974 Act).

The Local Government Act 2002 (the 2002 Act) has replaced the 1974 Act. The 2002 Act has had a significant effect on the audits covered in this report. The full accountability effect of the 2002 Act will be in 2004-05 when all councils will, for the first time, be reporting against their Long-Term Community Council Plan (LTCCP), adopted in either 2003 or 2004.

## Purposes of this report

The purposes of this report are to:

- tell Parliament and the local government sector about matters arising from carrying out our role as auditor of the sector;
- describe examples of our expectations of “best practice” on various matters of financial management and reporting, governance, and administration; and
- describe the ongoing planned work we are doing in preparation for our expanded role under the 2002 Act.

## Contents of this report

The contents of this report are grouped into 5 parts:

Part 1 (pages 9-43) reports on matters that arose during the course of the 2003-04 annual audits. We have again identified those entities on whose financial reports we have issued a non-standard audit report during the past year (see paragraphs 1.201-1.214).



## INTRODUCTION

Part 2 (pages 45-60) deals with other issues that arose during 2003-04 that have some longer-term consequences or raised particular questions. We have commented on a number of areas we gave particular attention to during our audits last year (or came to our attention through our inquiries work), and have highlighted issues for local authorities to consider in the future. We have provided some comment on a range of matters we have dealt with, including Manukau City Council's provision of resource and building consents, the STV vote count processing failure at the 2004 local authority elections, certain land transactions, water and sanitary services, and decisions made in relation to donations.

Part 3 (pages 61-87) looks at specific matters associated with planning and reporting under the 2002 Act. We note issues that need to be taken into account when preparing an Annual Report and Summary Annual Report under the new Act. We also focus on what we have observed from the LTCCPs prepared for 2003-04 and our approach to the audit of the 2006-07 LTCCPs.

Part 4 (pages 89-92) outlines topics that we anticipate reporting on in the next 12 months.

Part 5 (pages 93-97) reflects on the operation of the Local Authorities (Members' Interests) Act 1968. It also contains a review of the small Provincial Patriotic Council sector.

## Issues arising from the 2003-04 audits



B.29[05b]

### 1.1 Review of the 2003-04 year

- 1.101 The effects of legislative change again dominated the 2003-04 financial year for local authorities:
- the Local Government (Rating) Act 2002 had its full effect on the rating processes and setting of rates in 2003-04; and
  - the Local Government Act 2002 (the 2002 Act) became largely operational, with Part 6 dealing with planning, decision-making, and accountability increasing its effect.
- 1.102 Nine local authorities had elected to “go early” and plan for the 2003-04 year, using as a basis the newly introduced (transitional) Long-Term Council Community Plan (LTCCP). This required their reporting to be in line with the full requirements of the “new” Act. In contrast, the other 77 local authorities completed their accountability obligations under the previous regime set out in the “old” Act (the Local Government Act 1974).
- 1.103 Despite all local authorities being well aware of their reporting deadlines, the timeliness of reporting to communities with their audited annual report was mixed (see paragraphs 1.301-1.318 for the results of our monitoring of the timeliness of local authority reporting to communities). Regrettably, there was no overall improvement over previous years.



## ISSUES ARISING FROM THE 2003-04 AUDITS

### ONE

1.104 Matters affecting 2003-04 included:

- Some local authorities reset their rates to accommodate issues identified in their original setting of rates (see paragraphs 1.503-1.514).
- Associated with the reform of the sector was the creation of new entities known as “council controlled organisations” (CCOs). The 2002 Act’s definition was broader than the similar requirements in the 1974 Act, and attracted some attention from within the sector to seek exemption from the planning and accountability regime associated with being a CCO (see paragraphs 1.601-1.623).

1.105 During the 2004 calendar year, a number of issues arose which are worthy of note:

- For 7 local authorities, their triennial elections were affected by a process failure in counting the STV-based votes cast for their councils. The Office of the Auditor-General was requested to provide independent assurance to 6 of those 7 authorities before their Electoral Officers were able to declare the successful candidates (see paragraphs 2.201-2.229).
- We dealt with a number of inquiries. This included a number of issues related to decision-making – particularly involving consultation – initiated by ratepayer inquiries associated with land transactions. One particular transaction is noted (see paragraphs 2.101-2.109).
- The sector also raised issues with us about complying with the water and sanitary assessment requirements of Part 7 of the 2002 Act.

1.106 As well as dealing with the new requirements of the 2002 Act as they applied in 2003-04, local authorities also maintained focus on how the 2002 Act is affecting their planning processes now and through to 2006-07. The Auditor-General is required for the first time to meet a statutory duty of reporting on all local authorities’ LTCCPs for the period commencing 2006-07.

1.107 We reflect on a number of observations from our review of those authorities that did prepare LTCCPs in 2003-04 (see paragraphs 3.219-3.229).



## 1.2 Non-standard audit reports issued

### Introduction

ONE

1.201 This article covers non-standard audit reports issued during the year 1 April 2004 to 31 March 2005 in the broader local government sector, and outlines the nature of those reports.<sup>1</sup>

### Why are we reporting this information?

1.202 An audit report is addressed to the readers of an entity's financial statements. However, all public entities are creatures of statute, and are ultimately accountable to Parliament. We therefore consider it important to draw Parliament's attention to the range of matters that give rise to non-standard audit reports.

1.203 In each case, the issues underlying a non-standard audit report are drawn to the attention of the entity and discussed with its governing body.

### What is a non-standard audit report?

1.204 A non-standard audit report<sup>2</sup> is one that contains:

- a **qualified audit opinion**; and/or
- an **explanatory paragraph**.

1.205 The auditor expresses a **qualified audit opinion** because of a disagreement or a limitation on scope. The type of opinion will be either an "adverse" opinion (explained in paragraph 1.208), or a "disclaimer of opinion" (paragraph 1.210), or an "except-for" opinion (paragraph 1.211).

1.206 The auditor will include an **explanatory paragraph** (see paragraphs 1.212-1.213) in the audit report in order to draw attention to:

- a breach of law; or
- a fundamental uncertainty.

1.207 An explanatory paragraph is included in the audit report in such a way that

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1 We report separately on entities that are part of the Crown reporting entity, and other public entities not within the local government portfolio, in our yearly report on the results of audits for central government.

2 A non-standard audit report is issued in accordance with the Institute of Chartered Accountants of New Zealand Auditing Standard No. 702: *The Audit Report on an Attest Audit* (AS-702).



## ISSUES ARISING FROM THE 2003-04 AUDITS

it cannot be mistaken for a qualification of the opinion.

### ONE

#### *“Adverse” opinion*

- 1.208 An “adverse” opinion is expressed when there is disagreement between the auditor and the entity about the treatment or disclosure of a matter in the financial statements and, in the auditor’s judgement, the treatment or disclosure is so material or pervasive that the report is seriously misleading.
- 1.209 Expression of an “adverse” opinion represents the most serious type of non-standard audit report.

#### *“Disclaimer of opinion”*

- 1.210 A “disclaimer of opinion” is expressed when the possible effect of a limitation on the scope of the auditor’s examination is so material or pervasive that the auditor has not been able to obtain sufficient evidence to support, and accordingly is unable to express, an opinion on the financial statements.

#### *“Except-for” opinion*

- 1.211 An “except-for” opinion is expressed when the auditor concludes that either:
- the possible effect of a limitation on the scope of the auditor’s examination is, or may be, material but is not so significant as to require a “disclaimer of opinion” – in which case the opinion is qualified by using the words “except for the effects of any adjustments that might have been found necessary had the limitation not affected the evidence available to the auditor”; or
  - the effect of the treatment or disclosure of a matter with which the auditor disagrees is, or may be, material but is not, in the auditor’s judgement, so significant as to require an “adverse” opinion – in which case the opinion is qualified by using the words “except for the effects of” the matter giving rise to the disagreement.

#### *Explanatory paragraph*

- 1.212 In certain circumstances, it may be appropriate for the auditor to include in the audit report additional comment, by way of an explanatory paragraph, to draw attention to a matter that is regarded as relevant to a proper understanding of the basis of opinion on the financial statements.
- 1.213 For example, it could be relevant to draw attention to the entity having



## ISSUES ARISING FROM THE 2003-04 AUDITS

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breached its statutory obligations, or to a fundamental uncertainty that might make the going concern assumption inappropriate.

### Non-standard audit reports issued during the year 1 April 2004 to 31 March 2005

ONE

1.214 The following table outlines the nature of the non-standard audit reports issued during the year 1 April 2004 to 31 March 2005.

#### *Full “adverse” opinions*

Name of entity	Financial statements period ended	Reason for opinion
Hawke's Bay Cultural Trust	30 June 2004	The Trust did not recognise the full value of the collection assets it owns; nor the associated depreciation expense in its financial statements. These are departures from Financial Reporting Standard No.3: <i>Accounting for Property, Plant and Equipment</i> , which requires collection assets not previously recognised to be recognised at fair value and depreciated.
Oamaru Racecourse Trustees	30 June 2003	The Trustees breached the law by transferring their operations to another party, which was contrary to the Trustees' statutory obligations. As a result of the transfer of operations, the financial statements did not contain all the assets and liabilities, nor all the revenues and expenses that they otherwise would have, had the transfer not occurred.



## ISSUES ARISING FROM THE 2003-04 AUDITS

ONE

Name of entity	Financial statements period ended	Reason for opinion
Charleston Goldfields Hall Board	30 June 1996 to 30 June 2002 <sup>3</sup>	The Board did not prepare its annual financial statements in accordance with the Public Finance Act 1989, and the financial statements did not comply with generally accepted accounting practice in New Zealand. In addition, the Board did not maintain appropriate accounting records, and the limited financial information presented did not fairly reflect the Board's assets, liabilities, receipts and payments.
Millerton Hall Board	30 June 2003	The Board did not prepare its financial statements in accordance with the Public Finance Act 1989, and the financial statements did not comply with generally accepted accounting practice in New Zealand. However, the limited financial information presented did fairly reflect the Board's assets, liabilities, receipts and payments.

### *Partial "adverse" opinions*

Name of entity	Financial statements period ended	Reason for opinion
Southland Museum and Art Gallery Trust Board Incorporated	30 June 2004	The Board did not recognise the museum collection assets it owns; nor the associated depreciation expense in its financial statements. These are departures from Financial Reporting Standard No. 3: <i>Accounting for Property, Plant and Equipment</i> , which requires museum collection assets not previously recognised to be recognised at fair value and depreciated. We expressed an unqualified opinion on the statement of cash flows.

<sup>3</sup> A single audit report was issued covering the 7 years ended 30 June 2002.



## ISSUES ARISING FROM THE 2003-04 AUDITS

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Name of entity	Financial statements period ended	Reason for opinion
Wairarapa Cultural Trust	30 June 2004	The Trust did not recognise all the collection assets it owns; nor the associated depreciation expense in its financial statements. These are departures from Financial Reporting Standard No. 3: <i>Accounting for Property, Plant and Equipment</i> , which requires collection assets not previously recognised to be recognised at fair value and depreciated. In addition, we were unable to verify some material revenues because of limited controls over these revenues prior to being recorded.
Tasman Bays Heritage Trust Incorporated and Group	30 June 2003	The Trust and group did not recognise the value of donated additions to the exhibit and collection assets and did not provide depreciation on exhibit and collection assets. These are departures from Financial Reporting Standard No. 3: <i>Accounting for Property, Plant and Equipment</i> , which requires donated exhibit and collection assets to be recognised at fair value and depreciation to be charged on exhibit and collection assets. We expressed an unqualified opinion on the statement of cash flows for both the Trust and the group.
Otago Museum Trust Board	30 June 2004	The Board did not recognise all of the museum collection assets it owns in the Statement of Financial Position. This is a departure from Financial Reporting Standard No. 3: <i>Accounting for Property, Plant and Equipment</i> , which requires museum collection assets not previously recognised to be recognised at fair value. We expressed an unqualified opinion on the statements of cash flows and service performance.

ONE



## ISSUES ARISING FROM THE 2003-04 AUDITS

**ONE**

Name of entity	Financial statements period ended	Reason for opinion
Museum of Transport and Technology Board	30 June 2004	The Board did not recognise the museum collection assets it owns; nor the associated depreciation expense in its financial statements. These are departures from Financial Reporting Standard No. 3: <i>Accounting for Property, Plant and Equipment</i> , which requires museum collection assets not previously recognised to be recognised at fair value and depreciated. We expressed an unqualified opinion on the statements of cash flows and service performance.

### *Partial “disclaimers of opinion”*

Name of entity	Financial statements period ended	Reason for opinion
Tasman Bays Heritage Trust Incorporated	30 June 2004	We were unable to form an opinion on the statement of financial position because the Trust did not recognise collection and exhibit assets donated to the Trust during the period 1 July 2000 to 30 June 2003. We were unable to form an opinion on the statement of financial performance because the Trust did not account for the depreciation expense on all the collection and exhibit assets it owns. In addition, the Trust did not account for a material impairment of the building from which it operates. We expressed an unqualified opinion on the statement of cash flows.



## ISSUES ARISING FROM THE 2003-04 AUDITS

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Name of entity	Financial statements period ended	Reason for opinion
DC Tynan Trust <sup>4</sup>	31 March 2004	The financial statements of the Trust had not previously been audited. We therefore did not form an opinion about the comparative information. The amount of certain comparative assets and liabilities enters into the determination of the current year's result, and we were therefore unable to form an opinion about whether the financial performance of the Trust was fairly stated. In our opinion, the financial position of the Trust was fairly stated.

ONE

### *“Except-for” opinions*

Name of entity	Financial statements period ended	Reason for opinion
Waitomo District Council and Group	30 June 2004	We disagreed with the Group recognising a prior period adjustment, in the 2003 comparatives, in the statement of movements in equity. Financial Reporting Standard No. 7: <i>Extraordinary Items and Fundamental Errors</i> allows for the recognition of a prior period adjustment only in the event of a fundamental error, and in our view the error was not fundamental.
Owhango Public Hall	30 June 2000, 30 June 2001 and 30 June 2002	The Board did not provide budgeted figures in the statements of financial performance, financial position and cash flows, and it also did not provide a statement specifying the financial performance to be achieved. These are departures from the statutory reporting requirements of the Public Finance Act 1989.
Oakura Reserve	30 June 2003	The Board did not provide budgeted figures in the statements of financial performance, financial position and cash flows. This is a departure from the statutory reporting requirements of the Public Finance Act 1989.

<sup>4</sup> A council-controlled organisation (CCO) controlled by Waitomo District Council.



## ISSUES ARISING FROM THE 2003-04 AUDITS

**ONE**

Name of entity	Financial statements period ended	Reason for opinion
Whatitiri Domain Board	30 June 2003	The Board did not provide budgeted figures in the statements of financial performance, financial position and cash flows. This is a departure from the statutory reporting requirements of the Public Finance Act 1989.
Matata Recreation Reserve Board	30 June 2003	The Board did not provide budgeted figures in the statements of financial position and cash flows. This is a departure from the statutory reporting requirements of the Public Finance Act 1989.
Ruakaka Reserve Board	30 June 2004	The Board did not provide budgeted figures in the statements of financial performance, financial position and cash flows. This is a departure from the statutory reporting requirements of the Public Finance Act 1989.
Terawhiti Licensing Trust	31 March 2000	Some of the Trust's records of cash sales could not be located and there were no satisfactory audit procedures on which we could rely to verify those cash sales. In addition, we were unable to verify a write-down of property, plant and equipment in 2000 that was based on a stock-take of property, plant and equipment in 2001.
Mapiu Domain Board	30 June 2003	The Board did not provide budgeted figures in the statements of financial performance, financial position and cash flows, and it also did not provide a statement specifying the financial performance to be achieved. These are departures from the statutory reporting requirements of the Public Finance Act 1989. In addition, we were unable to verify some material revenues, because of limited controls over those revenues prior to being recorded.



## ISSUES ARISING FROM THE 2003-04 AUDITS

B.29[05b]

Name of entity	Financial statements period ended	Reason for opinion
Carparking Joint Venture <sup>5</sup>	30 June 2004	We were unable to verify some material revenues because of limited controls over those revenues prior to being recorded.
Village Pool Charitable Trust <sup>6</sup>	30 June 2004	We were unable to verify some material revenues because of limited controls over those revenues prior to being recorded.
Kaiteriteri Recreation Reserve Board	30 June 2004	We were unable to verify some material revenues because of limited controls over those revenues prior to being recorded.
Marton Aquatic and Leisure Trust <sup>7</sup>	30 June 2003	We were unable to verify some material revenues because of limited controls over these revenues prior to being recorded.
Manukau Beautification Charitable Trust <sup>8</sup>	30 June 2003	The financial statements of the Trust had not previously been audited. We therefore did not form an opinion about the comparative information. The amount of certain comparative assets and liabilities enters into the determination of the current year's result, and we were therefore unable to satisfy ourselves about whether the financial performance of the Trust was fairly stated. In our opinion, the financial position of the Trust was fairly stated.
Waste Disposal Services <sup>9</sup>	30 June 2004	We disagreed with the accounting treatment of the landfill improvements asset. The asset was overstated because capitalisation of the closure and post-closure costs in 2003 was not applied back over the periods to which they related, and therefore depreciation for previous periods was understated.

ONE

- 5 A joint venture between Christchurch City Council and Addington Raceway Limited.  
6 A CCO controlled by Hastings District Council.  
7 A CCO controlled by Rangitikei District Council.  
8 A CCO controlled by Manukau City Council.  
9 A CCO subsidiary of Manukau City Council.



## ISSUES ARISING FROM THE 2003-04 AUDITS

**ONE**

Name of entity	Financial statements period ended	Reason for opinion
S J Ashby Boatbuilders Limited <sup>10</sup>	30 June 2004	The financial statements of the Company had not previously been audited. We therefore did not form an opinion about the comparative information. The amount of certain comparative assets and liabilities enters into the determination of the current year's result, and we were therefore unable to satisfy ourselves about whether the financial performance of the company was fairly stated. In our opinion, the financial position of the Company was fairly stated.

### *Explanatory paragraphs*

Name of entity	Financial statements period ended	Reason for opinion
Central Hawkes Bay District Council	30 June 2004	The Council had not complied with the Local Government Act 1974 in setting operating revenues at a level adequate to cover all projected operating expenses. In particular, the Council, having consulted its community as part of the Annual Plan process, had resolved not to set operating revenue at a level adequate to cover the decline in service potential (depreciation) relating to its bridges.
Central Plains Water Limited <sup>11</sup>	30 June 2004	We drew attention to uncertainties surrounding the going concern assumption. The validity of the going concern assumption was dependent on the successful outcome of the proposed issue of shares to obtain the necessary capital to continue operations.

<sup>10</sup> A CCO subsidiary of Far North District Council.

<sup>11</sup> A CCO subsidiary of Selywn District Council.



## ISSUES ARISING FROM THE 2003-04 AUDITS

B.29[05b]

ONE

Name of entity	Financial statements period ended	Reason for opinion
Whisper Tech Limited <sup>12</sup>	30 June 2003	We drew attention to uncertainties surrounding the going concern assumption. The validity of the going concern assumption was dependent on the parties to the Whisper Tech Joint Venture (JV) and significant shareholders in the company supporting the JV, because it was the exclusive licensee of the company's assets and intellectual property and there was uncertainty about the viability of the JV.
The Papatoetoe Licensing Trust	31 March 2003 and 31 March 2004	We drew attention to uncertainties surrounding the going concern assumption. The validity of the going concern assumption was dependent on the Trust receiving financial support from a secured creditor or obtaining other sources of funding.
Opuia Marina Management Limited <sup>13</sup>	30 June 2004	We highlighted that the going concern assumption had not been used in the preparation of the financial statements, because the company's assets and business operations were sold.
Pirongia Mountain Afforestation <sup>14</sup>	15 December 2003	We highlighted that the going concern assumption had not been used in the preparation of the financial statements, because the entity was disestablished on 15 December 2003.
Hastings Tourism Facilities Trust <sup>15</sup>	30 June 2004	We highlighted that the going concern assumption had not been used in the preparation of the financial statements, because the Trust's activities were transferred to the Hastings District Council on 1 July 2004.
Whangarei District Council Sinking Fund Commissioners	30 June 2004	We highlighted that the going concern assumption had not been used in the preparation of the financial statements, because the entity was disestablished on 30 June 2004.

<sup>12</sup> A joint venture between Orion New Zealand Limited (a subsidiary of Christchurch City Council) and Meridian Energy Limited.

<sup>13</sup> A CCO subsidiary of Far North District Council.

<sup>14</sup> A CCO controlled by Waipa District Council.

<sup>15</sup> A CCO controlled by Hastings District Council.



## ISSUES ARISING FROM THE 2003-04 AUDITS

**ONE**

Name of entity	Financial statements period ended	Reason for opinion
Tasman Bay Stevedoring Company Limited Employee Share Trust <sup>16</sup>	30 June 2004	We highlighted that the going concern assumption had not been used in the preparation of the financial statements, because the Trust was to be wound up.
Hawke's Bay Economic Development Agency Incorporated <sup>17</sup>	30 June 2004	We highlighted that the going concern assumption had not been used in the preparation of the financial statements, because the Agency's operations were to be transferred to a new entity on 1 January 2005.
Far North District Council Sinking Fund Commissioners	30 June 2004	We highlighted that the going concern assumption had not been used in the preparation of the financial statements, because the Fund was to be wound up within 12 months.
Bay of Plenty Provincial Patriotic Council	30 September 2004	We highlighted that the going concern assumption had not been used in the preparation of the financial statements, because the Council had declared its intention to wind up its operations, subject to approval from the Minister of Veterans' Affairs.
Ngunguru Reserve Board	30 June 2002 and 30 June 2003	We highlighted that the going concern assumption had not been used in the preparation of the financial statements, because the Reserve Board was closed on 11 September 2003.

<sup>16</sup> A subsidiary of Port Nelson Limited.

<sup>17</sup> A joint venture between Napier City Council, Hastings District Council and Hawkes Bay Regional Council.



## 1.3 Timeliness of Annual Reporting

ONE

- 1.301 The annual reports of local authorities provide information that assists communities to assess the performance of those authorities. For this process to be effective, that information must be comprehensive and timely.
- 1.302 Each year, we examine the timeliness of annual reporting by local authorities to their communities.
- 1.303 In 2003-04, all local authorities were required to report for the first time under the provisions of the Local Government Act 2002 (the 2002 Act). However, this meant that the sector was reporting under two different timing regimes. Under section 279, local authorities could now base their planning either on new provisions relating to the Long-Term Council Community Plan, or on the previous annual plan provisions of the Local Government Act 1974 (the 1974 Act).<sup>18</sup>
- 1.304 Nine of the 86 local authorities elected to “go early”<sup>19</sup> – in other words, to base their planning for the 2003-04 financial year on the LTCCP requirements of the 2002 Act. The other 77 authorities elected to base their planning on the 1974 Act provisions.
- 1.305 For the early 9, the 2002 Act imposed 2 timing requirements<sup>20</sup>:
- The annual report, containing the auditor’s report, must be adopted within 4 months of the end of the financial year.
  - Within one month after the adoption of the annual report, the local authority must make its audited annual report and a summary of that report publicly available, along with an auditor’s report attesting that the summary “represents, fairly and consistently, the information regarding the major matters dealt with in the annual report”.

18 Section 279(1) of the 2002 Act enabled local authorities to prepare an LTCCP for the period beginning either 1 July 2003 or 1 July 2004. The relevant LTCCP planning provisions are contained in section 93. While the 2002 Act repealed the 1974 Act, section 281(1) enabled local authorities electing to plan under the 1974 Act to do so “as if [the provisions of the 1974 Act] had not been repealed by this Act”.

19 These 9 local authorities became collectively known as “the early 9”.

20 See sections 98(3) and 98(4) for the reporting requirements, and section 99 for the audit provisions.



## ISSUES ARISING FROM THE 2003-04 AUDITS

### ONE

- 1.306 The other 77 local authorities were required<sup>21</sup> to adopt their annual reports within 5 months of the end of the financial year; that is, 30 November 2004. There was no requirement for these authorities to publish a summary of their annual report; nor to make the audited annual report available within a specified time after its adoption by the council.
- 1.307 In our view, the new requirements followed by the early 9 (which will apply to all local authorities for the 2004-05 financial year) are a significant improvement on the “lesser” requirements of the 1974 Act – both in terms of timeliness and the “user-friendliness” of the information to be provided to the community. The summary required by section 99 of the 2002 Act should not only help communities to better understand the action, performance, and position of their local authorities, but should also improve the accountability of those authorities.
- 1.308 The timing of the preparation and publication of the audited annual reports is determined by the local authority. The audit process fits into the approach adopted by the local authority.
- 1.309 Of all 86 local authorities in 2003-04:
- the audits of 3 were completed by 31 August 2004 (4 in 2002-03);
  - the audits of 17 were completed by 30 September 2004 (16);
  - the audits of 23 were completed by 31 October 2004 (23);
  - the audits of 41 were completed by 30 November 2004 (43) – of these, 25 were completed in the fourth week of November (25); and
  - the audits of 2 were completed after 30 November 2004 (nil).
- 1.310 All except 2 local authorities were in a position to adopt their audited annual reports within the statutory time limit. One of the early 9 was required to adopt its report by 29 October, but its audit opinion could not be given until 17 December 2004.<sup>22</sup> The other local authority also exceeded its statutory time limit of 30 November 2004. This authority’s opinion was given on 17 March 2005, but it has yet to formally adopt its audited annual report.

21 See section 283 of the 2002 Act for the requirements, which are essentially those of section 223E of the 1974 Act.

22 This local authority adopted its annual report with audit opinion on the same day as receiving the opinion; that is, 17 December 2004.



## ISSUES ARISING FROM THE 2003-04 AUDITS

B.29[05b]

ONE

- 1.311 In our view, the timeliness of annual reporting by local authorities to their communities did not improve during 2003-04. This is very disappointing, given that 2003-04 gave 77 local authorities the chance to bring their annual reporting processes forward in the knowledge that they would have to do so for the 2004-05 year. Many local authorities will need to manage their year-end reporting better if they are to meet their statutory obligations within the required 4 months. The compressed timescale will require councils to manage their time with greater precision.
- 1.312 We also reviewed the timing of the release of annual reports to the community. As already noted, there was a 1-month requirement (including audited summaries) for the early 9. The remaining 77 local authorities had no statutory prescription.
- 1.313 For 2003-04:<sup>23</sup>
- 21<sup>24</sup> local authorities released their annual report within 5 working days of the adoption of their audited annual report.
  - 16<sup>25</sup> local authorities released their annual report between 6 and 10 days after adopting their audited annual report.
  - 33 local authorities released their annual report between 11 and 20 days after adopting their audited annual report.
  - the remaining 16 local authorities required more than 20 days to release their audited annual report after its adoption, with 6 exceeding 30 days.
- 1.314 For 2003-04, the early 9 were legally required to release both the audited annual report and an audited summary within one month of adopting the audited annual report. The clearance performance for 2003-04 was:
- 8 of the early 9 released the audited annual report within one month.<sup>26</sup> The ninth local authority exceeded the statutory requirement by one day.

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23 No comparative figures are available for 2002-03.

24 Includes one local authority, which released its non-adopted annual report and summary within 5 days of receipt of the audit opinion. However, this authority did not correctly adopt its audited annual report until 3 February 2005.

25 Includes the one local authority yet to adopt its audited annual report. Once it had received the audit opinion, this authority did publish its annual report (with attached audit opinion) on its website within 8 working days.

26 With reference to paragraph 1.310, note that this figure includes one of the early 9, which could not complete its statutory annual reporting within the required 4 months of 30 June 2004. However, once this authority adopted its audited annual report on 17 December 2004, the audited annual report was released immediately to the community.



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- Only 6 of the early 9 provided an audited summary within the required one month of adoption of the audited annual report. Of the remaining 3, one took 34 days, one 63 days, and one is yet to successfully produce an audited summary.<sup>27</sup>
- 1.315** In addition to the early 9, 3 other local authorities voluntarily produced audited summaries of their adopted annual reports. These councils provided the summaries within one month of adopting the audited annual report.
- 1.316** The performance of local authorities in accounting effectively to their communities is therefore mixed. It is important to recognise that accountability is not achieved until the audited information is released to ratepayers and communities.
- 1.317** Most local authorities will need to give this matter greater attention in 2004-05 to ensure that their reporting not only encompasses audit clearance but also informs their communities on a timely basis; especially in a summarised, user-friendly form.
- 1.318** We will continue to monitor the performance of local authorities in meeting their important accountability responsibilities.

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<sup>27</sup> At the time of writing, this local authority was working with an audit service provider to meet its statutory obligation to provide its community with an audited summary annual report.



## 1.4 Planning for conversion to the New Zealand equivalents of International Financial Reporting Standards

ONE

1.401 Last year, we reported on the decision to convert to reporting in accordance with International Financial Reporting Standards (IFRS)<sup>28</sup>, and the consequent issues emerging for local authorities. In this part, we provide an update on the progress made towards the transition to the New Zealand equivalents of IFRS (NZ IFRS<sup>29</sup>), and highlight some of the implications for the local government sector.

### Background

1.402 In December 2002, the Accounting Standards Review Board (ASRB) announced its decision that New Zealand entities would be required to apply new standards, based on IFRS, for reporting periods beginning on or after 1 January 2007. Entities have the option to apply the new standards from reporting periods beginning on or after 1 January 2005.

1.403 While we expect the majority of public sector entities to adopt the new standards for their first reporting period beginning on or after 1 January 2007, we expect local authorities will adopt these standards for their reporting period beginning 1 July 2006. This is because:

- Councils are required to produce Long-Term Council Community Plans (LTCCPs) by 30 June 2006, covering a minimum of 10 years starting 1 July 2006. Councils will subsequently be required to report against these plans.
- Councils will want to try to avoid having to present information under two different sets of standards in the one LTCCP. If councils delay adoption until the latest possible date, then the first year of their 2006 LTCCP will be under the old standards, with the remaining 9 years under the new standards.

28 The term IFRS is used to refer to International Accounting Standards Board (IASB) standards. The standards comprise:

- International Accounting Standards (IASs), inherited by the IASB from its predecessor body, the International Accounting Standards Committee (IASC), and the interpretations of those standards.
- International Financial Reporting Standards (IFRS) – the new standards being issued by the IASB, and the interpretations of those standards.

29 NZ IFRS will comprise:

- New Zealand equivalents of International Accounting Standards (NZ IASs), and the interpretations of those standards.
- New Zealand equivalents of International Financial Reporting Standards (NZ IFRSs), and the interpretations of those standards.



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- 1.404 Adopting the new standards from 1 July 2006 will require local authorities to restate their opening statement of financial position as at 1 July 2005. This is necessary because the financial statements for the year ending 30 June 2007 must include comparative information for the 30 June 2006 year using the new standards.
- 1.405 We understand that some council controlled organisations and other controlled entities (e.g. port companies) are considering adopting NZ IFRS at a date different to their controlling local authority shareholders. If any of these entities choose to adopt NZ IFRS at a date different to their local authority shareholders, they will have to maintain 2 sets of information. One set would be in accordance with the policies adopted for their own reporting, while the other would be in accordance with the reporting requirements of their parent (for reporting to their local authority shareholders for consolidation purposes).

### ASRB approval of the NZ IFRS “stable platform”

- 1.406 On 24 November 2004, the ASRB approved the initial suite of standards for NZ IFRS. The adoption of these standards is the culmination of 2 years of intensive work by standard setters and those few parties (including the Office of the Auditor-General) that have been providing submissions on the exposure drafts of NZ IFRS.
- 1.407 The initial group of approved NZ IFRS is described as the “stable platform”. This term is used by the International Accounting Standards Board (IASB) to describe the standards to be applied by countries moving to adopt IFRS from 2005. The approved NZ IFRS “stable platform” is the New Zealand equivalent of the IASB’s “stable platform”.
- 1.408 Some aspects of the “stable platform” are still being developed by the IASB. The IASB has a number of projects in progress that are likely to lead to changes to IFRS and, consequently, to NZ IFRS and the “stable platform” before NZ IFRS are adopted by the local government sector, which we expect to be in the year to 30 June 2007.

### One set of standards for all reporting entities

- 1.409 The current set of standards in New Zealand is “sector-neutral”, in that the standards have been developed for all reporting entities, and the same standards apply to both profit-oriented and public benefit entities<sup>30</sup>. IFRS, on the other hand, have been developed with a focus on profit-oriented entities.

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<sup>30</sup> Public benefit entities are reporting entities whose primary objective is to provide goods or services for community or social benefit, and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity shareholders. They include most public sector entities.



NZ IFRS have preserved the format, language and structure of IFRS but the ASRB has decided that a single set of standards should continue in New Zealand, applying to both profit-oriented and public benefit entities.

- 1.410** In our view, there are a number of benefits in retaining a single set of standards, including efficiency in applying the standards (preparers and auditors can achieve a better understanding of a single set of standards), and more clarity and cross-sector comparability for readers of financial reports. However, it is important to appreciate that, while the standard setters in New Zealand have been able to preserve one set of standards, those standards can no longer be considered sector-neutral. This is because the adaptations made to IFRS (in accordance with the ASRB's guidelines – see paragraph 1.411 below) have resulted in differing requirements for public benefit entities and profit-oriented entities in some circumstances.

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## Guidance for public benefit entities

- 1.411** In June 2003, we raised concerns with the ASRB that inadequate consideration was being given to the effects of changes to standards on public sector reporting. After discussion, the ASRB established the following guidelines<sup>31</sup> to be used in adapting IFRS in New Zealand:

- The IFRS disclosure requirements cannot be reduced for profit-oriented entities.
- Additional disclosure requirements can be introduced for all entities.
- The IFRS recognition and measurement requirements for profit-oriented entities cannot be changed.
- Recognition and measurement requirements can be amended for public benefit entities, with a rebuttable presumption that amendments are based on existing International Public Sector Accounting Standards (IPSAS)<sup>32</sup> or existing New Zealand Financial Reporting Standards (FRS).
- The introduction of guidance materials for public benefit entities should be based on the same principles as those applying to the amendment of recognition and measurement requirements (see previous bullet point).
- The elimination of options in IFRS is permitted for all entities, on a case-by-case basis. Where an IFRS permits options that are not allowed in an existing FRS, a strong argument would need to be made in order for the ASRB

<sup>31</sup> Accounting Standards Review Board Release 8, paragraph 27.

<sup>32</sup> IPSAS are developed and issued by the International Public Sector Accounting Standards Board of the International Federation of Accountants, for application to public sector entities.



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to agree to the retention of such options in the NZ IFRS. In reaching a view on this issue, the ASRB will be mindful of the approach adopted by the Australian Accounting Standards Board.<sup>33</sup>

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1.412 In our view, the provision of additional guidance on the application of NZ IFRS to public benefit entities is crucial to ensure that NZ IFRS are relevant and appropriate for the New Zealand public sector environment. We are concerned that valuable guidance, built up over a decade and based on our experience as the first country to apply accrual accounting in the public sector, could disappear. We will continue to work closely with standard setters to try and ensure that this does not happen.

1.413 A number of the recently approved NZ IFRS include some additional requirements that apply to public benefit entities. However, we believe that further guidance is required, and that this needs to be addressed as a priority. In our view, the main areas where additional guidance should be provided are:

- *How to distinguish a public benefit entity from a profit-oriented entity* – A number of public sector entities exist both for the benefit of the public and to make a profit, and it is debatable whether they fall within the definition of a public benefit entity. In addition, we note that most public sector entities are ultimately controlled by a public benefit entity (primarily the Crown or a local authority). This creates issues where consolidated groups contain a mix of public benefit entities and profit-oriented entities (e.g. a local authority parent with a council controlled trading organisation as its subsidiary). In such circumstances, there will be a temptation for all subsidiary entities to be treated as public benefit entities, which may not be appropriate. We acknowledge that the Financial Reporting Standards Board of the Institute of Chartered Accountants of New Zealand has issued an Exposure Draft providing some guidance on this aspect.
- *The application of NZ IAS 16: Property, Plant and Equipment to public benefit entities, particularly in relation to infrastructural assets* – Much of the guidance needed is already contained in the current standard on property, plant and equipment (FRS-3), and could be supplemented by the knowledge gained in the public sector from applying that standard. The guidance should address such issues as componentisation, component accounting, classification of assets into classes, and calculating depreciated replacement cost (e.g. guidance on optimisation).

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33 One of the functions of the ASRB is to liaise with the Australian Accounting Standards Board, with a view to harmonising New Zealand and Australian financial reporting standards (section 24, Financial Reporting Act 1993).



- *How to determine whether a public benefit entity controls another entity*
  - The current consolidation standard (FRS-37) includes extensive guidance that has been built up, through the experience of applying consolidation principles in the public sector, over the last decade. The nature of relationships and arrangements between entities frequently differs markedly between the public sector and the private sector, meaning that FRS-37 can be difficult to apply in the public sector where ownership interests are less well defined. Notwithstanding this, the guidance in FRS-37 has proven to be very useful in seeking to apply the standards.
- *The application of non-financial performance reporting* – NZ IFRS appear to have carried forward most of the guidance in terms of reporting non-financial performance information. In our view, however, NZ IFRS have not gone far enough regarding non-financial performance reporting. It is debatable whether any of the carried-forward material has any standing, given that NZ IFRS state that they are developed for application to financial statements, and acknowledge that statements of service performance are not financial statements but rather part of a financial report. There are statutory requirements for local authorities to report non-financial performance, and that information is required to be prepared in accordance with generally accepted accounting practice (GAAP). Reporting of non-financial performance is important to the local government sector because of these requirements. To ensure that non-financial performance reporting remains at a level consistent with current New Zealand FRS, it is essential, in our view, that changes be made to NZ IFRS to remove room for debate about the authority of non-financial reporting requirements in New Zealand FRS.

1.414 We will continue to raise the issue of guidance for public benefit entities with those parties responsible for setting standards in New Zealand. Our strong preference is for such guidance to form an integral part of the new standards, rather than be seen as an “add on” for the public sector.

## **Impact of the new standards**

1.415 The approval of the “stable platform” of NZ IFRS provides a degree of certainty, enabling entities to plan for the transition and assess the implications for their financial reporting. We are currently analysing the changes between the approved NZ IFRS and current NZ GAAP. We have been working closely with the Society of Local Government Managers (SOLGM), which has been assisting the local government sector in terms of providing training in relation to the adoption of NZ IFRS.



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1.416 In general terms, we expect that:

- there will be changes to the values at which some assets and liabilities are measured;
- there will be some assets and liabilities recognised for the first time (e.g. derivative financial instruments); and
- there may be some assets no longer recognised (e.g. internally generated intangibles).

There will also be increased disclosures in the notes to the financial statements.

1.417 One area of significant change is in the accounting for financial instruments, an area where there is no current New Zealand FRS. The new NZ IFRS establish rules for the recognition and measurement of financial assets and liabilities. There will be an increased requirement to account for financial instruments at fair value, including derivative financial instruments. This is likely to increase the volatility of reported financial performance. While there are options to reduce this volatility through the adoption of hedge accounting, the criteria that need to be met for adopting hedge accounting are onerous (e.g. in terms of hedge effectiveness, and in record keeping). As a result, such options will not be worthwhile for some entities.

1.418 Other areas where the requirements of NZ IFRS are significantly different from current FRS requirements, and which may significantly affect local authorities and local authority controlled entities, include:

- deferred tax (the whole approach to accounting for deferred tax is changing, and will result in more deferred tax assets and liabilities being recognised by those local government entities that pay tax – e.g. council-controlled trading organisations);
- business combinations (including a prohibition of goodwill amortisation, which is replaced by an annual impairment test);
- redeemable preference shares (under NZ IFRS many preference shares will be reclassified as debt rather than equity; this will affect financial ratios, and may require careful communication with lender institutions and credit agencies);
- property, plant and equipment (including increased disclosures, and a requirement for profit-oriented entities to account for asset revaluations on an asset-by-asset basis rather than the current class basis);
- related parties (including disclosures of compensation for “key management personnel”); and



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- biological assets (including assets such as forestry, and a requirement to account for changes in annual asset revaluations through the statement of financial performance.)
- 1.419 The degree to which individual entities are affected will depend on the types of assets and liabilities that they have, and the transactions that they enter into. For some local authorities, the impact is likely to be limited, and managing the transition to NZ IFRS is therefore likely to be uncomplicated. However, this will not be the case for all local authorities.
- 1.420 The Financial Reporting Standards Board has issued Financial Reporting Standard – 41: *Disclosing the Impact of Adopting New Zealand Equivalents to International Financial Reporting Standards*. FRS-41 proposes mandatory disclosure in the annual report of issuers<sup>34</sup> of information about the implications of adopting NZ IFRS, and planning for the transition to NZ IFRS. Although most entities within the local government sector are not issuers, FRS-41 encourages other entities to also provide the disclosures. In our view, such disclosures are helpful. They demonstrate that entities are planning for the transition to NZ IFRS, and provide an early indication to stakeholders of the likely impact of the transition.
- 1.421 We agree that appropriate communication with stakeholders on the transition to NZ IFRS is important. This will include bankers and lenders, in relation to loan covenants and the financial measures used to assess credit worthiness and credit ratings. Other stakeholders include the users of financial statements, including ratepayers, community groups, employees (possibly with elements of remuneration linked to reported financial performance), and Parliament.
- 1.422 We have outlined above some of the implications for accounting and financial reporting (to the extent they are known at this stage). The workload and training requirements for finance teams in some local authorities may need to increase, if the transition to NZ IFRS is to progress smoothly. New policies and procedures will need to be determined in some areas, and systems may need adapting (e.g. in entities with complex financial instrument transactions, to meet fair value and hedge accounting requirements). The transition to NZ IFRS is likely to result in additional costs through the transition period.
- 1.423 In general, we would expect local government entities, with appropriate assistance from SOLGM, to have the capability and resources to cope with the challenges of the transition to NZ IFRS. However, the local government sector does include some smaller councils that have limited resources to apply to the transition of NZ IFRS. We will continue to work with the local government sector to ensure that all councils properly assess the impact of the transition to NZ IFRS.

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34 FRS-41 uses the concept of an “issuer” as defined in section 4 of the Financial Reporting Act 1993.



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1.424 The local government sector is planning to adopt NZ IFRS a year earlier than central government. We expect the lessons from the local government transition experience to be extremely helpful for the central government transition.

### Effect on auditors

1.425 The transition to NZ IFRS is also a significant challenge for the Office of the Auditor-General, and the auditors appointed to audit entities on behalf of the Auditor-General.

1.426 Auditors need to be trained in the requirements of the new standards, and audit approaches will have to be reviewed and adapted to meet the revised reporting requirements. There will be additional audit work required, in relation to restated opening balance sheets and comparative figures, and in assessing revised policies and processes (such as those required for hedge accounting). This additional work will need to be included within an already tight work programme, and will have some implications for audit fees.

1.427 We fully expect to be able to meet these challenges, and we have established a major project in the Office of the Auditor-General to ensure that our auditors are ready to audit in an NZ IFRS environment.

### Summary

1.428 Significant progress has been made over the past year towards the implementation of NZ IFRS, but much work remains to be done. A major achievement has been the ASRB's approval of the "stable platform" of NZ IFRS.

1.429 We have some concerns that, to date, insufficient priority has been given to guidance on applying NZ IFRS to public benefit entities. We will continue to liaise with standard setters over the matters identified in paragraph 1.413.

1.430 The approval of the "stable platform" means that there is now some certainty from which to assess the impact of the transition to NZ IFRS. However, all the implications of the transition are not yet fully clear. As well as affecting financial reporting, the transition may require amendments to processes and systems. The changes will be significant for some local authorities, but less so for others.

1.431 The conversion to NZ IFRS will affect the workload and training requirements of finance teams in some local authorities. We will continue to work closely with SOLGM as it continues to provide assistance to the local government sector.

1.432 The Office of the Auditor-General has a significant project under way, to ensure that our auditors are ready to audit in an NZ IFRS environment.



## 1.5 Implementation of the Local Government (Rating) Act 2002

ONE

### Introduction

1.501 Local authorities collected rates under the Local Government (Rating) Act 2002 (the Rating Act) for the first time in 2003-04. Our previous reports to Parliament have covered a range of issues that local authorities and our auditors have dealt with under the Rating Act.<sup>35</sup>

1.502 The purpose of this article is to discuss 2 rating issues that came to the attention of this Office, and our auditors, in the course of the 2003-04 audits.

### Resetting rates

1.503 Section 119(1) and (2) of the Rating Act provides that –

*Local authority may set rates again*

- (1) *A local authority may set a rate again in the financial year in which the rate was set.*
- (2) *Subsection (1) applies if –*
  - (a) *the local authority determines that it is desirable to set the rate again because of –*
    - (i) *an irregularity in setting the rate; or*
    - (ii) *a mistake in calculating the rate; or*
    - (iii) *a relevant change in circumstances; and*
  - (b) *setting the rate again will not increase the amount of rates assessed to any rating unit.*

1.504 The purpose of section 119 of the Rating Act, and the related section 120 dealing with the “replacement of invalid rates”, is to enable councils to fix rating defects without needing special validating legislation every time something goes wrong with the procedures or circumstances change (as was required by the Rating Powers Act 1988). However, while section 119 provides an administratively easier option for local authorities wanting to correct such defects, we expect it to be rarely used.

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35 See *Local Government: Results of the 2001-02 Audits*, parliamentary paper B.29[03b], pages 57-62, and *Local Government: Results of the 2002-03 Audits*, parliamentary paper B.29[04b], pages 67-79.



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- 1.505 One local authority decided that its rates should be reset because it had failed to recognise the implications of a revaluation of properties at the time those rates were set. The revaluation had resulted in one group bearing a substantial increase in rates relative to other residents in the district, and the local authority considered this to be “a relevant change in circumstances” under section 119(2)(a)(iii).
- 1.506 Another local authority assumed that its resolutions adopting the annual plan and funding impact statement also formally set the proposed rates referred to in those documents. As a result, it failed to pass the separate rates-setting resolution required by section 23 of the Rating Act. The local authority decided this was “an irregularity in setting the rate” under section 119(2)(a)(i), and accordingly relied on section 119 to reset its rates.
- 1.507 In both circumstances, the local authorities concerned took legal advice and we accepted the positions they arrived at. However, we thought it useful to set out our views on the application of section 119(2)(a).
- 1.508 Section 119(2)(a) prescribes 3 alternative tests, and councils should take considerable care in considering whether any of these tests apply before deciding that it is “desirable to set the rate again”. In our view, each of the tests must be approached on the basis of the natural meaning of the words used.

### *Irregularity*

- 1.509 “Irregularity” does not have a technical or statutory meaning. One plain but useful definition of the word is “not in conformity with the law prescribing and regulating that process”.<sup>36</sup>
- 1.510 In that regard, any failure by an individual council to comply with a requirement for a separate rates resolution could be considered a type of “irregularity”. The omission of a particular step in the process of setting a rate may also constitute an irregularity.

### *Mistake*

- 1.511 A situation in which a local authority is given wrong figures that result in an error in setting the rates, or rates that do not reflect the intentions of that local authority, could constitute a “mistake”. However, it is unlikely to apply to a situation where the council simply overlooks the implications of a rating decision.

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<sup>36</sup> *Re The Election for Mayor of the Far North District* [1993] DCR 769.



### *Relevant change in circumstances*

- 1.512 The word “circumstances” could be read in 2 different ways – as a fact or condition connected with the council’s rate as a whole or any part of it, or (more narrowly) as the financial or material circumstances of an individual ratepayer in relation to the rate. In our view, the circumstances in question must relate to the rate itself.
- 1.513 There also needs to be a “change” in circumstances. That change must have taken place since the rate was originally set, and it must also be “relevant” to the rate itself (e.g. affecting its necessity or integrity). These conditions could provide a council with a basis for deciding that it is “desirable” to set the rate again.
- 1.514 In our view, simply changing one’s mind, or realising afterwards that the rate is unduly harsh on some ratepayers, does not meet the test of “a relevant change in circumstances”. On the other hand, events such as the following examples could amount to a “relevant change” in the circumstances relating to the rate:
- a natural disaster that imposes property-related costs on the community; or
  - a financial windfall for the council.

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### **Surpluses from targeted rates**

- 1.515 A targeted rate is a rate set to fund a specific function, or group of functions, under section 16 or 19 of the Rating Act.
- 1.516 A local authority may set a targeted rate for more than one activity or a group of activities, if its funding impact statement so provides. In some instances, it is inevitable that a local authority will be left with a surplus after collecting a targeted rate (e.g. when the activity for which the rate was set did not proceed, or it was only partially completed).
- 1.517 The issue of whether a surplus from a targeted rate can be used for *another* purpose, unrelated to the purpose for which it was originally raised, has been considered by at least one local authority that we are aware of.
- 1.518 There is no provision in either the 2002 Act or the Rating Act that specifies how a local authority may use a surplus from a targeted rate. However, using such a surplus for another purpose without consulting those who paid the rate is inconsistent with a number of principles and specific requirements in both Acts.



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- 1.519 For example, section 3 of the Rating Act states that one of the purposes of the Act is to ensure ... *that rates are set in accordance with decisions that are made in a transparent and consultative manner.* Section 14 of the 2002 Act states that ... *a local authority should conduct its business in an open, transparent, and democratically accountable manner.*
- 1.520 In deciding how to use a surplus from a targeted rate, a local authority should consider the decision-making provisions of Part 6 of the 2002 Act, any relevant local authority policies, and the quantum of the surplus. As a minimum, the local authority should ask the ratepayers who paid that rate whether they agree with it being used for another purpose.
- 1.521 A secondary issue is how such surpluses should be accounted for. We think it is important that a local authority is able to demonstrate how it applied a targeted rate. It therefore needs to be able to account separately for the use of surpluses from targeted rates.
- 1.522 We will continue to keep a watching brief on this issue.



## 1.6 Small controlled entities

**ONE**

- 1.601** In our 2002 report, we discussed the impact on the local government sector of the extended definition of “public entity” in section 5 of the Public Audit Act 2001.<sup>37</sup> We noted that the Public Audit Act extended the mandate of the Auditor-General in the sector, by making the Auditor-General the auditor of any entity “controlled” by one or more local authorities as well as local authorities themselves. We outlined the “control” test in the Public Audit Act, which uses both legal and accounting definitions of control.<sup>38</sup>
- 1.602** In our 2003 report, we noted that the definition of “council-controlled organisation” in the 2002 Act is slightly wider than the definition of controlled “public entity” under the Public Audit Act, as it uses a threshold of 50% for control.<sup>39</sup> We noted too that the definition of “council-controlled organisation” in the 2002 Act is wider than the definition of a local authority trading enterprise under the 1974 Act, as it includes both profit and non-profit entities.
- 1.603** The impact of these definitions is that the Auditor-General is the auditor of about 150 trusts and incorporated societies associated with local authorities, that were not previously subject to our audit. A large number of these entities are charitable trusts.
- 1.604** Since 1 July 2003, these entities have had to comply with the accountability and reporting requirements for council-controlled organisations under the Local Government Act 2002, which are generally more complex and onerous than those that applied under their trust deeds or rules. The enactment of the Charities Act 2005 and changes arising from the review of the Financial Reporting Act 1993 will impact further on the accountability of charitable entities in the local government sector.
- 1.605** This article comments on the issues and developments that may impact on the accountability of trusts in the local government sector, including:
- audit arrangements for entities exempted from the accountability regime in the 2002 Act;
  - the Charities Act 2005; and
  - review of the Financial Reporting Act 1993.

<sup>37</sup> *Local Government: Results of the 2000-01 Audits*, parliamentary paper B.29[02c], pages 65-67.

<sup>38</sup> The relevant approved financial reporting standard, for the purpose of the Public Audit Act, is FRS-37: *Consolidating Investments in Subsidiaries*.

<sup>39</sup> *Local Government: Results of the 2001-02 Audits*, parliamentary paper B.29[03b], pages 31-37.



### Audit arrangements for exempt council-controlled organisations

#### ONE

1.606 Section 7 of the 2002 Act provides for certain entities to be exempted from being a council-controlled organisation (CCO). There are 2 means by which exemption may be given:

- *By the Governor-General, on a recommendation from the Minister of Local Government* – This provision is aimed at entities that are already subject to appropriate accountability under their own Acts. Therefore, the Minister must be satisfied that the entity’s accountability under its own Act is appropriate for the purposes of the 2002 Act. The Governor-General has recently exempted the Otago Museum Trust Board and the Museum of Transport and Technology Trust Board from being CCOs.
- *By the council, for “small” organisations* – This provision addresses concerns about compliance costs for small non-profit trusts. The 2002 Act does not define “small”, but a local authority cannot exempt a council-controlled trading organisation and, in exempting a non-profit entity, must have regard to:
  - the nature and scope of the activities provided by the organisation; and
  - the costs and benefits, if an exemption is granted, to the local authority, the entity and the community.

1.607 Once exempted under section 7 of the 2002 Act, an entity is not subject to any of the requirements of that Act, including the requirement to prepare financial statements for audit by the Auditor-General. However, in the majority of cases an entity that is within the definition of “council-controlled organisation” is likely to also be a controlled “public entity” under the Public Audit Act. Where that is the case, the Auditor-General must still audit the entity’s financial statements where an audit is required.<sup>40</sup>

1.608 An entity such as a trust or incorporated society may be required to prepare financial statements and have them audited under its trust deed or rules. An exemption given by a local authority from the accountability regime for CCOs under the 2002 Act does not negate such a requirement.

1.609 Therefore, where an exempted CCO is a public entity by virtue of the control test in section 5 of the Public Audit Act, the Auditor-General will continue to be the exempted CCO’s auditor. The audit will be conducted under the authority of the Public Audit Act, rather than the 2002 Act. Where the CCO’s trust deed or rules contain no audit requirement, we would no longer need to audit an exempt CCO’s financial statements (but would remain its auditor for any other purposes).

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<sup>40</sup> Section 15, Public Audit Act 2001.



## **Audit fees for small non-profit CCOs**

- 1.610 In 2004, Local Government New Zealand (LGNZ) asked the Government to support an amendment to the Public Audit Act to provide that the Auditor-General would not be the auditor of “small” entities exempted from being CCOs under the 2002 Act. The background to the request was a concern about small non-profit entities, not previously audited by the Auditor-General, whose audit fees had increased following enactment of the Public Audit Act 2001 and the 2002 Act.
- 1.611 LGNZ noted that the 2002 Act allows certain non-profit CCOs to be exempted from accountability requirements if the criteria in section 7 are met, and believed that such entities should also be exempt from public audit under the Public Audit Act in order to reduce compliance costs. We are not aware that the Government has responded to LGNZ on this issue.
- 1.612 We have asked our auditors to advise us of any exemptions granted by local authorities for small CCOs as part of the 2005 audit, so that we can assess any impact on audit arrangements and gain an understanding of the number of entities involved. Since LGNZ raised the issue, the Charities Act has been enacted and the review of the Financial Reporting Act 1993 has progressed. These developments impact on financial reporting and audit of charities. We intend to have further discussions with LGNZ on the issue.

**ONE**

## **Charities Act 2005**

- 1.613 Many non-profit CCOs are incorporated charitable trusts or incorporated societies with charitable purposes. They are subject to the Charities Act 2005, which was enacted in April 2005 with staggered commencement provisions. The broad intention of the Act is to enhance the accountability of the charitable sector.
- 1.614 The Charities Act establishes a new Crown entity, the Charities Commission, which is responsible for running a registration, reporting and monitoring system for charities. Those charities that wish to retain or gain income tax-exempt status from the Inland Revenue Department will be required to register with the Commission.
- 1.615 One of the accountability requirements in the Charities Act is a requirement for charitable entities to prepare an annual return within 6 months of balance date and forward it to the Charities Commission. The content of the annual return is to be determined by regulations made under the Act, but is likely to include certain financial information. On receipt of the annual return, the Commission is required to examine the entity’s activities to determine that the entity continues to qualify for registration as a charitable entity.



## ISSUES ARISING FROM THE 2003-04 AUDITS

- 1.616 The Charities Act will add to the legislative compliance obligations for CCOs that wish to register as charitable entities, regardless of whether an entity is exempted from being a CCO under the 2002 Act.

### ONE

## Review of the Financial Reporting Act 1993

1.617 The Ministry of Economic Development is undertaking a review of the Financial Reporting Act 1993.<sup>41</sup> The Ministry consulted on a discussion paper on phase 2 of the review between November 2004 and February 2005. The discussion paper proposes that the Financial Reporting Act would determine only the content of financial reporting standards (i.e. what must be reported and how). In other words, the Act would set generally accepted accounting practice (GAAP). The obligation to produce financial reports in accordance with the Financial Reporting Act (i.e. who must report) would be left to other specific pieces of legislation, such as the Companies Act and the Charities Act.

1.618 In line with this general approach, the discussion paper proposes that reporting obligations of charitable entities registered under the Charities Act would be determined by that Act. It proposes that all registered charitable entities should be required to produce financial reports in accordance with a 3-tier reporting framework differentiated on level of income (see table below). The reporting obligations, including audit, would differ depending on the size of the entity – small charitable entities would be required to comply with only very simple reporting requirements. The required content for financial reports would be determined by financial reporting standards.

	Income	Possible reporting requirements	Audit requirement
Small	Less than \$100,000	Receipts and payments	None
Medium	From \$100,000 to \$2,500,000	Accrual accounting	Independent review
Large	Greater than \$2,500,000	Requirements based on IFRS <sup>42</sup>	Full audit

41 See the Ministry's discussion paper *Review of Financial Reporting Act Part II* at [http://www.med.govt.nz/buslt/bus\\_pol/bus\\_law/corporate-governance/financial-reporting/part-two/discussion/discussion-10.html](http://www.med.govt.nz/buslt/bus_pol/bus_law/corporate-governance/financial-reporting/part-two/discussion/discussion-10.html).

42 International Financial Reporting Standards.



## ISSUES ARISING FROM THE 2003-04 AUDITS

B.29[05b]

- 1.619 Significantly for non-profit charitable CCOs, the discussion paper proposes that there would be no duplication of financial reporting requirements, and that financial reporting requirements in the Charities Act would over-ride any requirements in other Acts (unless the CCO is established under a specific Act, in which case the specific Act would apply).
- 1.620 This may impact on the accountability regime for charitable trusts that are CCOs under the 2002 Act, as it would mean that small charitable CCOs would not need to comply with GAAP and would either not need to be audited or would not be subject to a full audit. While this would reduce compliance costs for small entities, and may go some way to addressing the concerns raised by LGNZ about audit costs, the “higher standard” should always apply.
- 1.621 However, the review does not propose that non-financial reporting requirements in other Acts will be affected. Charitable entities that are CCOs would therefore still need to report on their non-financial performance against their statement of intent (unless exempted under section 7).
- 1.622 In the case of charitable CCOs, we consider that a CCO that is a registered charity under the Charities Act should meet the accountability requirements of the 2002 Act, even though it would not need to meet any of those requirements if covered by the Charities Act only.
- 1.623 We will monitor developments in this area and report further on these issues as appropriate.

ONE



## Other issues arising during 2003-04



B.29[05b]

### 2.1 Review of resource and building consent processing, compliance and complaints – Manukau City Council

**2.101** In June 2004, members of the public and elected representatives of Manukau City Council (MCC) raised concerns about a number of building and resource consent issues. As a result, MCC asked Audit New Zealand to review its systems for:

- processing resource and building consents;
- monitoring compliance with their conditions; and
- dealing with complaints.

**2.102** We reviewed MCC's documentation for those 3 areas, along with a sample of consent files relating to 25 separate properties throughout Manukau City. We interviewed a wide range of staff within the environmental services division of MCC to gain an understanding of how the relevant policies and procedures were applied in practice. We also interviewed senior staff within MCC, elected members of the Council, and members of the public who had raised specific concerns.



## OTHER ISSUES ARISING DURING 2003-04

### TWO

2.103 We found that MCC's resource and building consent and compliance units were operating in an environment of increasing pressure, characterised by a number of problems that we believe are common to the local government sector:

- a shortage of appropriately qualified and experienced staff;
- high staff turnover and staff in acting positions for long periods;
- performance assessment that focuses on the quantity of consents processed or compliance visits undertaken;
- statutory timeframes that have not been amended since 1992;
- significant growth in the numbers of consents to be processed; and
- increasing complexity of the issues being highlighted (particularly in the building consent area).

2.104 We made 55 recommendations to improve MCC's procedures across the 3 areas reviewed. Our recommendations broadly covered:

- improved documentation of the procedures for processing consents, to provide evidence that the work performed and the conclusions reached are of an acceptable standard;
- further guidance to staff in exercising their decision-making roles, and the provision of appropriate training;
- appropriate quality assurance processes, to provide assurance over the quality of decision-making;
- processes to enhance the quality of the information received, to reduce the amount of rework required to fully process consents (including possible increased use of the council's right to reject incomplete applications);
- formalised risk management processes, to better align the work effort to the risks faced;
- improved monitoring processes, to ensure that a more holistic view of the property is taken, and that resource and building consents monitoring is further integrated;
- providing more clarity around the processes for reporting and actioning breaches of consents in a timely manner; and
- processes to significantly strengthen the complaints system.



## OTHER ISSUES ARISING DURING 2003-04

B.29[05b]

- 2.105 Given the factors identified, these recommendations may well apply to other local authorities operating in the same environment.
- 2.106 In addition, a number of higher-level issues arose from our review that are likely to be common across the local government sector:
- Linkages between the planning policy and consent processing and monitoring areas. We believe that analysing consent activity and feeding the results back into planning policy will produce significant benefits. The area includes consents regularly granted for infringements of District Plan rules, non-compliance or unconsented work, and complaints arising from development activity.
  - Linkages between consents, compliance, and enforcement. It appears that organisational structures may be encouraging a “silo” nature that does not support effective, integrated decision-making.
  - Linkages between building and resource consents. Again, organisational structures do not necessarily support the overlapping skill sets needed to ensure integrated decision-making.
  - Risk management. Although risk management may be undertaken informally, there is no formalised risk framework to guide staff in identifying and dealing with risk issues. Many risks that councils face are “managed” without a full understanding of the implications of the “management action”.
- 2.107 The results of our review were reported to MCC in early-September 2004. The Council accepted them and took immediate steps to address the issues raised. A task force was established to implement the changes required, guided by a specialist project manager.
- 2.108 MCC staff were empowered to identify and implement the changes themselves, although, where specialised skills were required (e.g. in developing the risk management framework), outside assistance was called in. An independent peer reviewer was engaged to provide assurance that the programme of action was appropriate and being carried out.
- 2.109 MCC has invited Audit New Zealand to review progress one year from the beginning of the original review.

TWO



## 2.2 Local Authority STV Elections – October 2004

### TWO

- 2.201** Triennial elections for local authorities were held on 9 October 2004, along with those for District Health Boards (DHBs) and Licensing Trusts. A number of local authorities and licensing trusts chose to base their elections on the single transferable vote (STV) system. The majority of local authorities, however, retained the first past the post system (FPP). All DHB elections were conducted on an STV basis.
- 2.202** The New Zealand STV-based electoral system requires voters to rank candidates on the basis of preference. A computer-based system then analyses the results and determines the successful candidate(s) once the manually cast votes have been digitised for processing.

### Background

- 2.203** The majority of elections were completed successfully over the weekend of 9 and 10 October. However, the STV elections associated with vote-processing company electionz.com and its sub-contractor Datamail encountered major processing problems.
- 2.204** In the 3 weeks leading up to 9 October, the Electoral Officers (EOs) had progressively passed validly cast votes to electionz.com and Datamail for processing, but during the weekend of final counting a number of these votes were found not to have been correctly entered into the STV calculator.<sup>1</sup> The problem occurred during the “transformation” stage when manual voting papers were converted to computer-readable, digitised data for input into the calculator.
- 2.205** Seven local authorities, 18 DHBs, and one licensing trust were affected, all of which had contracted electionz.com to process the votes cast. The immediate effect was that EOs were unable to finalise the results of the elections they were each responsible for.
- 2.206** In response, electionz.com and its contractor, Datamail, reviewed and enhanced their procedures and controls to allow the vote count to be completed.

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<sup>1</sup> The “STV calculator” takes the digitised data and, based on preferences cast, calculates the electoral winners. The number of votes not processed correctly varied from authority to authority. For background on the STV elections and some of the key concepts, see [www.stv.govt.nz](http://www.stv.govt.nz).



## Our involvement

- 2.207 We were approached by 6 of the 7 local authorities affected, the 18 DHBs, and the one licensing trust, with support from their relevant EOs. We agreed to provide assurance that these enhanced procedures and controls were operating as they should, and that all validly cast votes received by electionz.com were being processed effectively into the STV calculator<sup>2</sup>.
- 2.208 This represented a unique challenge for the Office of the Auditor-General, which has no formal or statutory role in local authority elections. Nor had the Office previously been asked to become involved in either an STV or an FPP election.
- 2.209 There were limits to our assurance. For example, we could not provide assurance over the work or judgements of the EOs in providing the votes cast in their elections to electionz.com.
- 2.210 Our work involved:
- observing the recovery process once the initial issues were identified;
  - assessing the reasonableness of the improved processes and controls implemented by electionz.com and Datamail; and
  - verifying the subsequent results.
- 2.211 Throughout the project, we liaised regularly with a “stakeholders group” assembled by the Department of Internal Affairs, and a grouping of affected EOs.

TWO

## The impact of our intervention

- 2.212 The first request for assurance was received from Wellington City Council on 12 October. The other local authorities, the DHBs, and the licensing trust, quickly followed with requests of their own. From 14 October we were on-site at the premises of electionz.com/Datamail in Petone until the final outstanding results were cleared on 5 November.
- 2.213 It was agreed with the “stakeholders” that the enhanced system needed to be trialled for accuracy on 3 local authorities and one DHB. This process was time-consuming and was not completed until 28 October – a full 14 days after we arrived on site and 16 days after Datamail’s recovery programme began. The results of the trials had to satisfy both the affected EOs and ourselves as independent assurance providers.

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2 The operation of the STV calculator was not in question, and it was not our role to review it. It had been developed before the elections, and was subject to separate, independent certification as required by section 19AB of the Local Electoral Act 2001.



## OTHER ISSUES ARISING DURING 2003-04

### TWO

- 2.214 Once the enhanced processes and controls had been trialled and proven, the results of the other 21 organisations were cleared in the following 8 days.
- 2.215 Clearly, the Local Electoral Act 2001 did not envisage an independent party verifying the actual results of validly cast votes; nor did the public entities affected expect to have to ask for our involvement. Of necessity, that involvement added to the time taken to clear the election results.
- 2.216 However, the key influence on timing was the failure of a data processing system pivotal to determining the results. This failure occurred in the compressed time of an election weekend, and was exacerbated by the fact that it happened at the end of the voting period and not in the weeks leading up to 9 October.
- 2.217 Revised procedures and controls had to be introduced across 2 organisations, which meant a lengthy recovery period – much to the frustration of EOs, public entities, candidates, and public alike.
- 2.218 If existing processes and controls had operated accurately in the first place, there would have been no need for third-party intervention.

### Our observations

- 2.219 The review of the 2004 local authority elections currently being undertaken by the Justice and Electoral Committee (refer following section) may deal with this issue in more detail.
- 2.220 While the Select Committee may identify ways to improve the staging of STV-based elections, the events we dealt with related to processes and controls. They did not concern the underlying foundation of an STV voting system.
- 2.221 Deriving the results of an STV-based election requires the use of computer systems, including an STV calculator. A comprehensive control environment is required to ensure that vote counting processes work as intended. Attention should be given to the processes and the controls over both aspects of the vote count – the physical handling of voting papers and the computer systems on which the count is reliant.
- 2.222 From our involvement in the events following 9 October, we conclude that:
- the roles and responsibilities of EOs and counting contractors should be clear, well understood, and formally documented;
  - the complete “end-to-end” counting process should be formally documented; and



- information system controls over vote processing should be aligned with “best practice” in such areas as change control, data completeness checks, systems testing, and the identification (and recording) of contingency procedures.

2.223 As a corollary, EOs should:

- recognise that, in using a vote count contractor, they need a good understanding of that contractor’s approach in order to monitor the voting process;
- understand the key steps taken by that contractor, including receiving voting papers, their “transformation” into digitised data, the input of that data into the STV calculator, and reconciliation and control checking; and
- consider the need for, nature of, and extent of any verification of the proposed system before the vote count begins.

2.224 Timing is significantly affected if third parties have to become involved in the election process, either to resolve specific issues or to provide external confidence in the results finally released. Hence, it is important that all parties recognise the impact of a failure in the physical or information systems environment of an election. EOs and contractors should therefore consider the risks associated with the vote count, and implement strategies to reduce risk where necessary.

2.225 The heightened tension of the voting process requires good communication between EO and contractor. This allows any problems in the process to be addressed and the information needs of stakeholders to be met effectively, including inquiries from candidates, the public entity involved, media, and the public.

## The Select Committee inquiry

2.226 The terms of reference for the current inquiry by the Justice and Electoral Committee extend well beyond issues associated with the failure of electionz.com and Datamail systems. They include a review of key elements of electoral systems, the impact of voting papers covering both FPP and STV-based elections, and the extent and adequacy of voter education.<sup>3</sup>

2.227 Committee members, however, have already met some of the key parties involved in the vote processing failure that delayed the 2004 election results. Their investigation should help to ensure that future STV-based elections do not encounter the same problems that local authorities and other public entities experienced last year.

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3 The full terms of reference for this inquiry are located at [www.clerk.parliament.govt.nz/Programme/Committees/Submissions/je2004elections.htm](http://www.clerk.parliament.govt.nz/Programme/Committees/Submissions/je2004elections.htm).



## OTHER ISSUES ARISING DURING 2003-04

### TWO

2.228 We are aware that other interested parties, including the Electoral Working Party of the Society of Local Government Managers (SOLGM), are assessing the issues surrounding this matter.<sup>4</sup> This may also help to ensure that the problems encountered do not recur.

2.229 The Office of the Auditor-General found itself in an unprecedented situation during the 2004 local authority elections, in performing the role of independent verifier of the vote count. It is our hope that the inquiry and reviews of the Select Committee and others will ensure that we have no need to repeat such a role.

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<sup>4</sup> We note that SOLGM has an existing publication *Code of Good Practice for the Management of Local Authority Elections and Polls*.



## 2.3 Sale of Endowment Land

- 2.301** In our 2001 report, we discussed the findings of our review of local authorities' compliance with the procedures in the Local Government Act 1974 (the 1974 Act) for the sale and disposal of land, particularly endowment land.<sup>5</sup> We had received a number of complaints about those procedures, and asked our auditors to review a small sample of property transactions at each local authority. Our aim was to assess each authority's compliance with the legal requirements, as well as to consider any concerns that the authorities themselves had about the requirements.
- 2.302** On the whole, we found that councils were aware of the legal requirements and complexities involved in the disposal of land. We noted that the legal requirements of the 1974 Act were reasonably prescriptive, and that the review of the Act then being undertaken provided an opportunity to reconsider them.
- 2.303** While the Local Government Act 2002 (the 2002 Act) made some changes to requirements concerning the disposal of land, we continue to receive enquiries from councils and complaints from ratepayers.
- 2.304** In this article, we discuss the requirements in the 2002 Act concerning the disposal of endowment land, and highlight some issues that have arisen in complying with those requirements.

TWO

### Local Government Act 2002

- 2.305** The 2002 Act made some changes in the area of land disposal and removed some of the rules that applied. Unlike under the 1974 Act, a council does not now need to give public notice of its intention to sell or lease land on each occasion, but it does have to consider the planning and decision-making framework in Part 6 of the 2002 Act.
- 2.306** As well, specific procedures continue to apply to endowment land, in terms of both a council's ability to dispose of such land and its use of sale proceeds. The provisions of the 2002 Act are in some respects more restrictive than the 1974 Act, as a council must include information about its intentions in its draft LTCCP, rather than give public notice of each intended disposal. The relevant provisions of the 2002 Act are as follows.

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5 *Local Government: Results of the 1999-2000 Audits, parliamentary paper B.29[01a], pages 61-66.*



## OTHER ISSUES ARISING DURING 2003-04

### TWO

**2.307** Section 140 requires a council to retain endowment or trust property for the purpose for which the property was vested in the council. However, section 140(4)(b) authorises a council:

- to sell or exchange such property unless disposal is expressly prohibited by the terms of the endowment or trust; and
- to use the proceeds of sale or exchange for a purpose identified in accordance with section 141.

**2.308** Section 141 states that a council must not exercise the power to sell or exchange given by section 140(4)(b) unless –

- 1 The proposed use of the proceeds of sale is consistent with the terms of the endowment; and
- 2 The council has first included in its draft LTCCP a statement of–
  - (a) its intention to sell or exchange the property; and
  - (b) the use to which the proceeds of the sale or exchange will be put; and
- 3 The council has adopted the LTCCP in accordance with Part 6 of the Act.

**2.309** Additional requirements apply where the Crown was the donor of the property.<sup>6</sup> In other cases, the council must make a reasonable attempt to notify the donor of the property, or his or her successor, of its intention to sell the property.<sup>7</sup>

**2.310** Councils have taken different approaches to meeting the requirements of section 141, and some councils that adopted early LTCCPs (i.e. for the period commencing 1 July 2003) have had to amend them when planning to dispose of endowment properties. The following 2 examples illustrate the different approaches.

### *Example 1*

**2.311** A council that had not included its intention to sell a particular piece of endowment property in its LTCCP amended it to provide for the sale and to advise the community of its intended use of the sale proceeds. Part of the property was a building in the central city leased predominantly to community groups. Following the amendment to its LTCCP, and after considering public comment, the council sold the particular property.

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<sup>6</sup> The council must notify the Minister of Land Information and the Minister in Charge of Treaty Negotiations of its intention to sell or exchange the land – section 141(1)(c).

<sup>7</sup> Section 141(1)(d).



## Example 2

TWO

- 2.312 Following a review of its endowment land portfolio, a council decided to dispose of several leasehold properties during the period of its LTCCP. The council's LTCCP for 2003-2013 referred to the review and described its property portfolio in general terms. The LTCCP said that the proceeds from sale of endowment land would be used to purchase replacement endowment land. The document did not describe the nature, number or type of the council's endowment properties, and did not refer to any specific property intended for disposal; nor did it give the estimated expenses and revenue associated with the disposal of the properties.
- 2.313 The council amended its LTCCP to include information about the projected expenses and revenue associated with the sale of endowment land, and information about other amendments to the LTCCP. At that time, the Auditor-General was required to audit an amendment to a local authority's first LTCCP, even though the original document had not been audited.<sup>8</sup>
- 2.314 The council provided us with a list of properties intended for sale so that we could verify the forecast expenses and revenue figures to be included in the amended LTCCP. However, the statement of proposal for the amendment did not identify particular properties that were to be sold.
- 2.315 As well as a number of leasehold urban properties, the council intended to dispose of part of a block of rural land that had been vested in it by statute. A ratepayer asked us to consider whether the council had met the requirements of section 141 in relation to that particular land.
- 2.316 We found that the council's proposed use of the sale proceeds was consistent with the original vesting. However, we considered that the council had not provided sufficient information in the statement of proposal to amend its LTCCP in respect of its intention to sell part of the particular property (or indeed any particular property) and its proposed use of the sale proceeds.
- 2.317 We noted that the proposed use of the sale proceeds was slightly different from the general statement in the LTCCP that sale proceeds would be reinvested. While the statement of proposal did not provide members of the public with an opportunity to comment on the council's intentions in relation to the particular land, the council had consulted interested persons in its area. Therefore, we did not think that those persons had been disadvantaged through the lack of information in the statement of proposal.

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<sup>8</sup> This requirement was removed by the Local Government Act 2002 Amendment Act 2004.



## **Comment on the requirements of section 141**

**TWO**

- 2.318** Our understanding is that the intention of section 141(1)(b) is to provide members of the public with an opportunity to comment on a proposed sale or exchange of endowment land and the intended use of the proceeds. This requires councils to provide sufficient information about their intentions to ensure meaningful consultation.
- 2.319** The approach may differ, depending on the size of each council's endowment property portfolio. We think it would be unduly onerous for a council with a large number of endowment properties of the same or similar type to list all properties intended for sale (and to have to amend the LTCCP if a property of that type but not on the list were to be sold). However, we also think that an LTCCP should contain a description of the nature and type of endowment properties that are to be sold or exchanged to give members of the public enough information on which to comment.
- 2.320** Councils may have a range of endowment properties, including urban leasehold properties held for income-generating purposes, and land vested under legislation for the benefit of a particular area. Where that is the case, general statements in the LTCCP covering all types of endowment property do not appear to provide the public with sufficient information to fully meet the requirements of section 141.



## 2.4 Power to make donations

2.401 A question was asked of our Office after major flooding in the lower North Island in February 2004 concerning the lawfulness of council donations to other councils whose districts or regions were affected by the floods.

TWO

2.402 It is part of how local government operates in New Zealand – and one of its admirable qualities – that resources and expertise are shared in a way that takes advantage of collective experience and promotes good practice. Likewise, donations of this kind are made in the spirit of helping out neighbours in times of need. The majority of NZ communities are likely to support such donations.

2.403 The Department of Internal Affairs newsletter of 8 April 2004 advised as follows –

### *Donations by Local Authorities*

*An issue that arose in the recent severe floods was the ability of councils to provide relief funding to other councils or organisations outside their district, city, or region. Although the ‘full capacity’ provisions of section 12(2) of the Local Government Act 2002 give councils extensive powers, the areas in which these powers can be used are restricted by sections 12(4) and 12(5). These sections require that a territorial authority or regional council must exercise their functions under section 12 wholly or principally for the benefit of its district or region.*

*This seems clearly to prevent a local authority from simply donating money or resources to another local authority.*

*Section 12(6), however, does allow local authorities to enter into joint undertakings, joint activities, or co-operative activities. These terms are not defined in the Act and do not appear elsewhere in the Act. The limitations of section 12(4) and 12(5) do not apply to such joint or co-operative arrangements.*

*It is likely, therefore, that some assistance could be provided by one local authority to another local authority if it were done as a joint activity etc under section 12(6).*

2.404 We saw no reason to question this view, and advised that one council making donations to another was unlikely to constitute a breach of the law, assuming that:

- the local authorities involved benefited collectively; and
- reciprocal support was expected in time of need.



## OTHER ISSUES ARISING DURING 2003-04

### TWO

- 2.405 However, under sections 12(4) and 12(5) of the 2002 Act, donations must primarily benefit a council's particular community. This is likely to be a difficult test to meet, and appears to preclude many types of donations for purposes outside a particular district or region.
- 2.406 We recommend that the Department of Internal Affairs take steps to satisfy itself that the current statutory provisions give effect to Parliament's intentions with respect to councils' ability to grant donations.



## 2.5 Preparation of Water and Sanitary Services Assessments

TWO

**2.501** Under section 285 of the 2002 Act, territorial authorities were to have adopted Water and Sanitary Services Assessments by 30 June 2005 after involving their communities through the Act's special consultative procedures.

**2.502** Sections 126 and 127 of the 2002 Act require territorial authorities preparing such assessments to consider:

- the quality, quantity and adequacy of supply of drinking water and wastewater discharge systems available within the district for each community;
- the current and estimated future demands for water and sanitary services within a district;
- the options available to meet forecast demands, and an assessment of the suitability of each option for the district and each community in it;
- the territorial authority's intended role in meeting the forecast demands; and
- a statement of the authority's proposals for meeting forecast demands, including proposals for any new or replacement infrastructure.

**2.503** During 2005, a number of councils advised us that they intended to prepare their assessment proposals in conjunction with their 2006 LTCCPs so that these could be considered along with the wider range of services councils provide (or need to consider providing).

**2.504** Our understanding of the process is that, by 30 June 2005, those councils would be in a position to:

- meet the information requirements of sections 126(1)(a)-(d) and 127 (a) and (b); and
- consult the Medical Officer of Health on the information required by section 128.



## OTHER ISSUES ARISING DURING 2003-04

### TWO

2.505 However, by this date, these councils would not have been able to:

- assess their options to meet current and estimated future demands for water and sanitary services within their districts;
- determine their intended role in meeting these demands; and
- provide proposals for meeting forecast demands, including proposals for any new or replacement infrastructure.

2.506 We could see merit in councils' view that their proposals for meeting current and future demands should be integrated with their 2006 LTCCPs to allow their communities to set priorities and make choices. However, in following the process outlined above, those councils would breach the 2002 Act's timing requirements for the adoption of Water and Sanitary Services Assessments.

2.507 After consulting the Department of Internal Affairs and the Ministry of Health, we advised councils contacting us that we would not regard the issue as a breach of the law on which we would have to publicly report, provided that:

- the councils had used their "best endeavours" to meet the information requirements of sections 126 and 127, and had consulted the Medical Officer of Health; and
- where the required information had not been included in the assessments due by 30 June 2005, the councils had identified the deficiencies in that information and how they intended to address them.

2.508 Our auditors will be monitoring councils that have not complied with the Water and Sanitary Services Assessment provisions of the 2002 Act by 30 June 2005, to ensure that this is done in conjunction with the 2006 LTCCPs.

## Reporting under the Local Government Act 2002



B.29[05b]

### 3.1 Role of the Auditor-General in the accountability framework of local government

**3.101** The Auditor-General is the auditor of local authorities, council-controlled organisations and subsidiaries of council-controlled organisations under the Local Government Act 2002 (the 2002 Act) and the Public Audit Act 2001. Local authorities and council-controlled organisations are “public entities” under the Public Audit Act. Section 15 of the Public Audit Act requires the Auditor-General to audit the financial statements and other information that a public entity is required to have audited.

**3.102** The 2002 Act sets out the range of “other information”, in addition to annual financial statements, that local authorities and council-controlled organisations are required to have audited:

- a local authority’s draft Long-Term Council Community Plan (LTCCP);
- a local authority’s adopted LTCCP;
- a local authority’s amendment to an LTCCP;
- a local authority’s compliance with the content requirements applying to the annual report and statements required to be made by the local authority in the annual report;
- a local authority’s summary of its annual report;
- a local authority’s expenditure on advertising a reorganisation proposal; and
- a council-controlled organisation’s performance targets and other measures by which performance was judged in relation to the organisation’s objectives.



## REPORTING UNDER THE LOCAL GOVERNMENT ACT 2002

### THREE

**3.103** The 2002 Act sets several new requirements for local authorities and the Auditor-General in the area of reporting and audit, including an audited LTCCP, an enhanced annual report (aspects of which are audited), and an audited summary annual report. The most significant of the new requirements are the audited LTCCP and audited summary annual report.

**3.104** The succeeding sections of Part 3 contain a brief outline of the 2002 Act's requirements and our comments on each of the following aspects:

- our preparations for the audit of local authorities' 2006 LTCCPs, and observations on LTCCPs adopted in 2003 and 2004;
- how 9 local authorities met some of the new reporting requirements in their first annual reports under the 2002 Act; and
- issues arising in local authorities' preparation of summaries of LTCCPs, annual plans and annual reports.



## 3.2 Preparing for the audit of Long-Term Council Community Plans

THREE

**3.201** From 2006, the Auditor-General has a new statutory duty to issue an opinion on a local authority's draft and final LTCCP under sections 84(4) and 94 of the 2002 Act.

### Our guiding principles

**3.202** Both the LTCCP, and the requirement for it to be audited, are unique to New Zealand. While other local government jurisdictions have auditor involvement in prospective information, the inclusion of an audit within the Act is a unique response to the specific legislative arrangements for New Zealand local government in a context of general empowerment.

**3.203** Our collective understanding – that of auditors, councils, and communities – of the 2002 Act's challenge to promote sustainable long-term well-being, and our respective roles in this process, will develop over time. The Auditor-General, as the public sector's auditor, has a unique opportunity to add value for:

- communities – in enhancing councils' LTCCP preparation so that communities are consulted on robust and realistic plans that provide a basis for subsequent accountability of councils;
- elected members and councils – in giving additional confidence that community needs are understood and planned for through robust and integrated planning systems, and that decisions are based on relevant considerations and quality information; and
- Parliament and other stakeholders of local government – in providing confidence that the local government system is supporting the delivery of activities essential to communities' well-being over the long term and in a sustainable way.

**3.204** With 2006 being the first time the Office takes up this audit function, we are committed to maximising the value we can provide. The audit of the LTCCP was not in the Local Government Bill as introduced, but was recommended for inclusion by the majority of members of the Local Government and



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Environment Committee. In developing our approach, we have been conscious of the intention of Parliament as expressed by the 2002 Act, and the view of the Select Committee in the majority report on the Local Government Bill. When recommending the inclusion of an audit of LTCCPs, the Select Committee said:

*We suggest a further requirement of audit in relation to the long-term council community plan. ... This contributes to the information necessary for communities to assess the quality of the long-term plan in the draft stage and after adoption.*

**3.205** The Select Committee had received several submissions proposing some form of statutory authority with power to review, and even overturn, local authority decisions. In commenting on those submissions, the Committee concluded that existing review mechanisms (such as public audit and the Ombudsmen) were adequate. However, it reported that:

*We consider that there is a need for checks on the processes, financial management and general fairness of local authorities. ... We also consider that the introduction of a requirement for an audit report on the quality and adequacy of information and assumptions on which forecasts and performance measures are based will help reduce the need for review mechanisms. As discussed above, the audit report will be prepared at the draft stage of the long-term council community plan. This should reduce the chance of poor planning being put into practice.*

*We recognise that this provision may add to the costs and time involved in preparing draft plans. However, it is essential that communities be enabled to participate in long-term planning for their locality.*

### Our approach

**3.206** In developing our approach to the LTCCP audit, we have striven to maximise our adherence to relevant professional standards, and our application of good auditing practice. However, we recognise that preparing an LTCCP relies on making informed and reasonable judgments about the future, rather than always being supported by facts or evidence. We are therefore taking a flexible approach, that attempts to recognise the reality of the context and constraints in which councils operate, while allowing for good practice within the general empowerment framework of the 2002 Act to emerge over time. To this extent, our methodology relies on the application, as appropriate, of:

- requirements and principles of the 2002 Act (including the sustainable development principles);



- requirements of generally accepted accounting practice (GAAP);
- existing sector good practice (for example, National Asset Management Steering Committee asset management guidelines); and
- identified good practice in the sector emerging out of audit enquiries.

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**3.207** Our audit work focuses first on systems, because we consider that councils' planning systems are vital to the preparation of a robust LTCCP. We also doubt that there will be sufficient time to complete our audit work after a proposed LTCCP statement of proposal (SOP) has been prepared. We hope that, by focusing on systems, rather than on specific decisions or forecast amounts only, good practice will be encouraged and that, over time, this will give communities greater confidence in the robustness and quality of the LTCCP.

**3.208** We are aware that the sector is concerned about the compliance cost of our audit work, both in time and effort and in financial cost. In respect of cost, we have tried to balance 3 things:

- a desire to minimise the cost of the audit to the sector and ratepayers;
- a commitment to ensuring that the overall benefits of the audit justify the cost; and
- remunerating our audit service providers fairly, so that we can continue to offer quality auditing services to the public sector.

**3.209** We have also taken the following measures to try to maximise consistency in approach across our local government auditors – Audit New Zealand, Deloitte and Ernst & Young – and to minimise the impact of our audit work on councils' time and resources:

- A move away from contracting audits to an allocation model. This was done to give councils certainty and consistency in audit arrangements, and to allow expertise in LTCCP and local government audits to grow among auditors.
- Preparation of a range of standard audit documentation to provide consistency and minimise duplication of audit work. This applies to our LTCCP audit methodology, as well as standard engagement arrangements and reporting documents, and is providing standard support and training that is shared among all our auditors.
- Providing several “checkpoints” at which audit work will be centrally reviewed to confirm the consistency and fairness of our approach to each council.



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- 3.210 We recognise that the LTCCP is a plan, and that plans, of necessity, are not based on information that is certain. We will not be seeking to second-guess councils' financial and performance estimates. Rather, we will be seeking confidence that estimates are reasonably based. In order to provide a good basis for consultation and decision-making in the preparation of the LTCCP, and for subsequent decisions and accountability to the community, we expect that both draft and final LTCCPs will be based on a council's best available information, and best estimates, at the time of issue.
- 3.211 Our major focus will be on the SOP for the LTCCP, as this is the key document for public consultation. Our interest in the final adopted LTCCP is therefore primarily to ensure that changes made, through consultation and final decisions, have been appropriately reflected in the adopted LTCCP.
- 3.212 In developing a methodology to address our reporting responsibility under the 2002 Act and the concerns of the Select Committee, we have looked internationally for audit techniques that would help us to effectively address the principles provided to guide councils' judgements in key areas (such as decision-making and consultation) within the general empowerment that the Act provides.
- 3.213 A particular element of that methodology is self-assessment. While this is an experimental approach, we were aware that mayors and chief executives in the United Kingdom had evaluated self-assessment as the most useful tool used by the United Kingdom Audit Commission in undertaking Comprehensive Performance Assessments of local authorities in a statutory context similar to our Act. In deciding to use this approach, we consulted, developed, and tested the assessment with sector representatives.
- 3.214 While there are challenges in organising and resourcing the Office to perform audits that occur only once every 3 years, overall we believe that the Office is in a good position to respond to the challenge of the LTCCP audit, and we expect to deliver a range of benefits in doing so.
- 3.215 The following diagram sets out our intended audit approach, based on ISAE 3000<sup>1</sup> and adapted as appropriate to reflect the intentions and specific requirements of the 2002 Act. A full diagram of this methodology and an outline of our approach is available on our website [www.oag.govt.nz](http://www.oag.govt.nz).

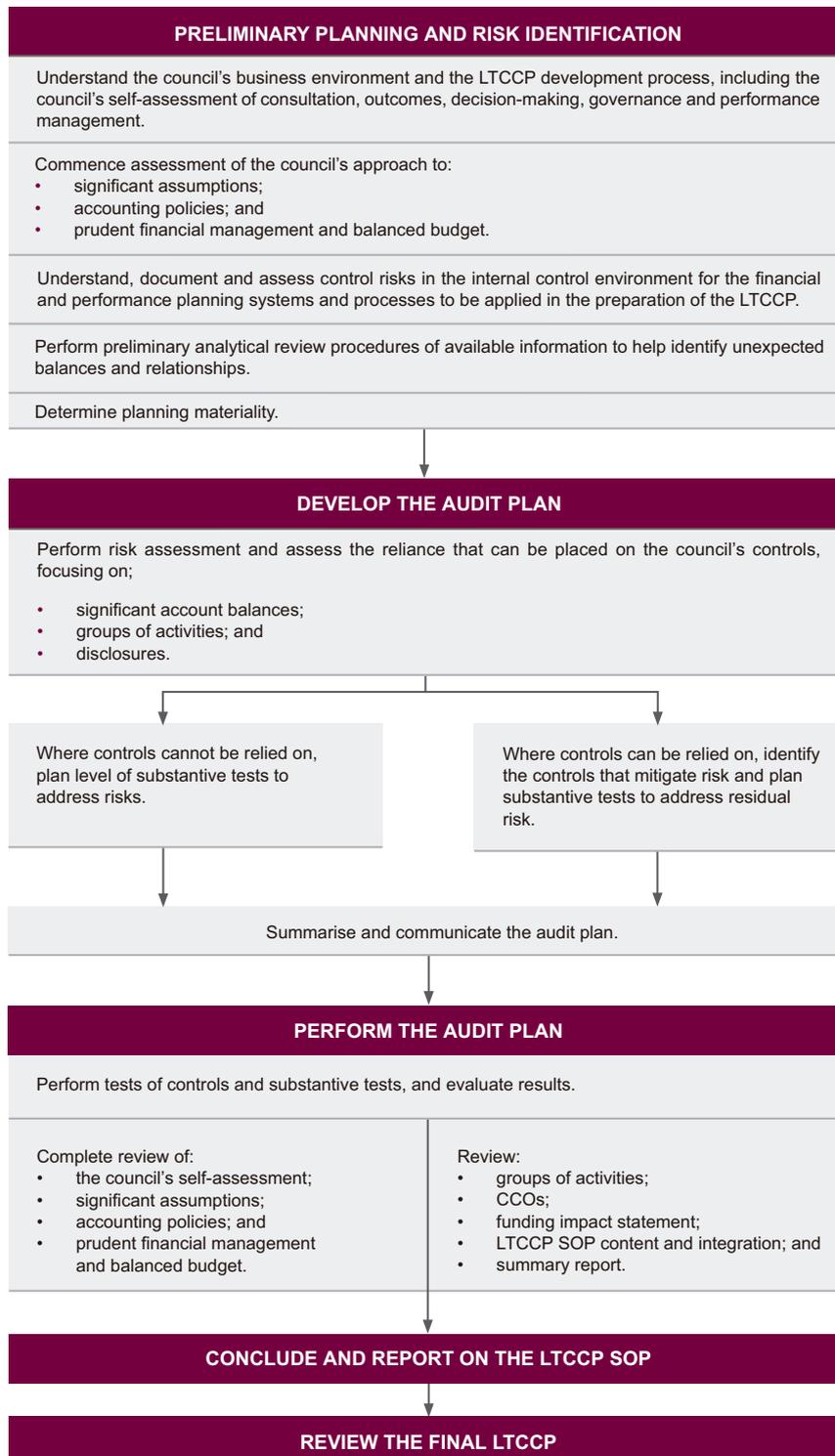
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<sup>1</sup> International Standard on Assurance Engagements, issued by the International Federation of Accountants (IFAC).



## Summary of our LTCCP audit approach

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### The challenge for councils

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3.216 In our view, the key areas of challenge for councils in preparing and subsequently reporting on LTCCPs lie in the following areas:

- *Outward focus* – that councils have an active approach to understanding community views, consult with interested people, collaborate with other stakeholders where appropriate, and have a clear logic flow that links community well-being and desired outcomes to the activities of the council. An information base that aids an understanding of the impact of external sustainability issues for ratepayers, and on council activities, should support this outward focus.
- *Use of “best estimates”* – that this concept is applied across the range of areas in which a council is required to make estimations, including assumptions and financial and performance target estimates. A best estimate has two key elements – use of best information and application of best judgement. This is not to suggest that an LTCCP can provide a perfect picture of what will occur. Rather, by using best estimates, the council and its stakeholders are in the best position to understand and assess the impact of options and choices, both in adopting the LTCCP and in subsequent decision-making. We believe that both the 2002 Act and GAAP include a requirement to consider the impact of future price changes when preparing financial estimates – although we recognise the potential for issues in the development, application, and presentation of such information. We are working with the Society of Local Government Managers (SOLGM) Financial Management Working Party to consider how these matters can be addressed in ways that allow best estimates to be prepared for minimum cost in time and resources, and with greatest clarity in public information.
- *Integration* – that information within the LTCCP presents a coherent and consistent representation of the council’s future plans that reflects the underlying information, assumptions and policies, plans and strategies of the council.

3.217 We are aware that many councils are working intently to address these key challenges for their upcoming 2006 LTCCPs, building off the lessons learnt from preparing Long-Term Financial Strategies<sup>2</sup> and 2003 and 2004 LTCCPs. We think this is wise, and encourage councils to take an active project management approach to this work, the pressure of which has been intensified by the move to International Financial Reporting Standards<sup>3</sup>.

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2 Arising out of the Local Government Amendment Act (No. 3) 1996.

3 See paragraphs 1.401-1.432 of this report.



**3.218** The Act provides a framework for continual development of best practice in local government. We expect that, with experience and time, the process of preparing a quality LTCCP that addresses the key challenges of outward focus, best estimates and integration should become easier in subsequent years. Through our LTCCP audit work, we expect to be in a good position to provide feedback and information to the sector to assist this good practice to emerge.

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## **Observations on 2004 LTCCPs**

**3.219** We asked our local government auditors to consider the integration of the information presented in LTCCPs prepared during 2003-04 and adopted for June 2004, and to assess whether the LTCCPs were complete in the sense of containing all material required by the 2002 Act. The 9 councils that adopted an LTCCP in 2003 were not included in this exercise. In reviewing the presentation of the LTCCP, we did not attempt to assess the quality of the underlying information on which it was based, as this will be part of the first audit of LTCCPs in 2006.

**3.220** 2004 LTCCPs reflect their transitional basis in that:

- Councils were not required to have completed a community outcomes process under sections 91 and 92 of the 2002 Act. Many councils, particularly the smaller councils, elected to use existing information or to take part in regional processes for the development of community outcomes. Both of these approaches were acceptable as interim measures, but the processes for the development of community outcomes require more careful development and public consultation in order to support the rationale for council activities and service levels.
- Territorial authorities were not required to have prepared Water and Sanitary Services Assessments and Waste Management Plans under sections 126 and 127 of the 2002 Act; they were due to be completed by June 2005. Councils' 2006 LTCCPs will include the results of these assessments and plans, as well as any role councils intend to take in providing these services, and any development work they will undertake to address identified community needs. Therefore, for some councils, information relating to these services will be considerably more developed in the 2006 LTCCP than in the 2004 LTCCP, reflecting the result of the Water and Sanitary Services Assessments.



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#### *Group of activity service-level information*

- 3.221 Our auditors reported that about half of the councils had not covered service-level information well, including performance measures and targets in 2004 LTCCPs. Service levels were generally not specified and, as a result, the relevance and appropriateness of the performance management framework was difficult to assess. Where a service could be implied from information (for example, through reference to qualities such as “safe”, “efficient” or “continuous”), these qualities frequently did not feature in measures and targets to be used to assess performance.
- 3.222 Performance measures tended to have a short-term focus, or were either very broad at a community level, or very detailed at the service level. There was a reliance on user or resident satisfaction feedback – which, in many instances, may have been appropriate – but other service dimensions of the activity that might have been addressed through other measures were neglected.
- 3.223 The 2002 Act also requires councils to consider any significant negative effects that any of their activities may have on the social, environmental, economic and cultural well-being of the local community. While many councils had given such potential effects consideration, performance information did not appear to have been developed, reflecting key risks or potential negative effects that may require monitoring and mitigation. In our view, the monitoring and reporting of potential negative effects is likely to be most usefully considered as part of the performance monitoring framework.
- 3.224 It is likely that users of LTCCPs would have difficulty in many instances in understanding how the performance measures and targets demonstrate whether a service was achieving its intent – and therefore whether the actual performance can be meaningfully assessed.

#### *Group of activity asset information*

- 3.225 Overall, the asset information requirements of Part 1 of Schedule 10 of the 2002 Act were met by many councils, but with about a quarter not covering asset information well in their 2004 LTCCPs. Clause 2(1)(d)(i) of Schedule 10 requires the reasons for additional asset requirements to be identified by demand or consumption, and by service provision levels or standards. A common issue was the lack of information on the first leg of that requirement – how the need for additional requirements had arisen in terms of demand or consumption.



### *Group of activity financial information and financial policies*

**3.226** Our auditors' reviews suggested that about a third of councils had areas in which financial information and policies could be improved.

**3.227** For the financial information in groups of activities, LTCCPs:

- did not describe the rationale for the selection of revenue mechanisms in terms of section 101(3), although in many instances this information was included in Revenue and Financing Policies. In our view, describing the selection of funding methods and the reasons for these is most likely to be useful to users of the LTCCP if dealt with (along with information about the activity, its asset requirements and funding and costs) in the group of activity information.
- did not appear to provide the financial information required about groups of activities for a 10-year period – rather providing generally either one year's or 3 years' information, or estimates that flattened out after the first 3 years. This suggests that, in some instances, information was rolled out for years 4 to 10, rather than being built through a modelling system that incorporated expected asset and other demands to continue the maintenance of service levels.
- had confused presentation of key financial information such as revenue, operating expenditure and capital expenditure. Clear presentation of group of activity financial information that aggregates to the council estimates is important to a user's overall ability to assess the likely financial position of the council and to their confidence in the plan.

**3.228** For the financial policies under sections 100 to 111 that councils were required to prepare and present in the LTCCP, some policies were still in development at June 2004, and some gaps in the coverage of the statutory contents were noted by auditors. These omissions were raised with the individual councils concerned.

### *Integration between community outcomes, asset information, service levels and long-term financial forecasts*

**3.229** Perhaps the greatest challenge in preparing an LTCCP, and one that will need further development in 2006, is integrating the range of information to present a coherent and complete future plan for the 3 key sets of group of activity information – service levels, assets, and financial information. Generally, where integration was not well done, the linkages between levels of service

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and financial planning were unclear or incomplete, and much of the information retained an annual or, at best, 3-year focus. Many councils said that 2004 information was an interim position because they were still developing both asset management plans and community outcomes.

### Other issues on which the Office was asked for advice

3.230 Since the passing of the 2002 Act in December 2002, the Office has been asked for its views on a number of matters associated with the preparation and adoption of LTCCPs, some of which we outline below.

#### *Managing changes between the draft and final LTCCP*

3.231 In relation to adopting annual plans, and more recently in relation to adopting LTCCPs, councils have asked us what they should do where a significant change is proposed or occurs during a special consultative procedure and the change has not been signalled in the SOP for the consultation.

3.232 While we are not aware of any consideration by the courts of the appropriate response in these circumstances, we have given some thought to the consultation and decision-making provisions of the 2002 Act. We provide the following general suggestions when councils contact us for advice:

- Any change requiring a decision by the council is subject to the decision-making provisions in sections 76-80 of the 2002 Act. In contemplating the inclusion of any decision in the LTCCP/annual plan that has not been signalled in the SOP, a council particularly needs to consider sections 77, 78 and 79. These relate to:
  - identification and assessment of all reasonably practicable options and in relation to land or bodies of water, taking account of the interests of Māori (section 77);
  - consideration through the stages of decision-making of community views (section 78); and
  - making judgements about how to comply with sections 77 and 78, having regard to the significance of the matters affected by the decision, including the principles relating to local authorities, the council's resources, and the scope and opportunity to consider views and preferences (in particular, such judgements are to be made about the extent to which options are identified and their benefits and costs quantified, and the extent and detail of information considered and written records kept).



- Where a council, as a result of considering its decision-making responsibilities, considers that it does not have wide enough spread of community views given the significance of the proposed change, it should consider how such views could be obtained. This could result in a council deciding to:
  - extend the consultation period on the LTCCP to allow more views to be provided;
  - conduct additional consultation alongside the special consultative procedure being used for the LTCCP; or
  - take the decision out of the context of the special consultative procedure for the LTCCP into a separate consultation and decision-making process (while ensuring that the adopted LTCCP appropriately reflects this course).
- Councils should note that, where a decision is one to which section 97 relates, the proposal must be included in an LTCCP SOP prepared under section 84.

### *Variations and amendments to LTCCPs*

**3.233** A concern we have been aware of through our work with the 9 councils that adopted an LTCCP in 2003 relates to how amendments and changes are identified and the processes associated with these.

**3.234** The relevant provisions of the 2002 Act relating to the status of decisions in the LTCCP and variations and amendments to this document appear to be:

- section 93(3), which states that each LTCCP has a 3-year life span;
- section 96, which provides that a resolution to adopt an LTCCP or annual plan does not constitute a decision to act on any specific matter within the plan;
- section 97, which provides that a local authority must not make certain decisions unless the decision is explicitly provided for in the LTCCP and was included in an SOP for an LTCCP or LTCCP amendment; and
- other sections that constrain a council from making a decision without including it in an SOP prepared under section 84 for a draft LTCCP.



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These are:

- section 102, which requires that any changes to the financial management policies set out are amendments to the LTCCP; and
- section 141, which relates to a proposed sale or exchange of endowment land.
- Sections 85 and 95, which require a council to prepare an SOP in adopting an annual plan. The SOP for the annual plan must include:
  - information included in the LTCCP for the year to which the plan relates about each group of activities, and the reasons for any departures from the information set out in the LTCCP;<sup>4</sup> and
  - the annual budget and funding impact statement, and any variations of these from the LTCCP financial statements and funding impact statement.
- Section 80, which requires a council, when making decisions, to identify any inconsistencies with any policy adopted by the council or any plan required by the 2002 Act or any other Act.

**3.235** The 2002 Act therefore provides a framework in which change is both expected and accommodated. This framework emphasises understanding the impact of changes, and disclosing to and consulting with communities where these impacts are likely to be significant.

**3.236** Our advice to councils considering changes to their LTCCPs has been that:

- Each LTCCP lasts for 3 years, and the 2002 Act does not contain a mechanism for a council to make minor changes to the LTCCP and reissue it during that 3-year period. The only way to amend the LTCCP is to use the amendment process set out in the 2002 Act.
- A council is not bound to implement any specific decision in its LTCCP, but is required to prepare an SOP and use the special consultative procedure for certain types of decisions, either as part of adopting the LTCCP or for making an amendment to it. Other variations and departures occur through general decision-making and the annual planning information in respect of each year, and should be explained within the annual plan.
- In working with these provisions, a council will need to make judgements about how far to go in explaining variations. For example, in our view, where a variation is an ongoing adjustment, it would be sensible to signal this to the community and discuss the effect of it on the LTCCP.

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<sup>4</sup> See section 85, and clause 2(2) of Schedule 10.



- In making specific decisions, a council should note any inconsistencies with the LTCCP, or any policy or plan, and provide information about the impact of these inconsistencies in any material prepared to support or implement the decision.
- For practical management purposes, a council is likely to find it useful to flow such changes into their LTCCP model as they occur, so that the model remains live and the collective effect of changes can be seen and understood throughout its 3-year period. Maintaining the LTCCP as a “live system” is also likely to make the preparation of a new LTCCP every 3 years a more manageable exercise.

**3.237** We acknowledge that a number of amendments are likely to occur between 2004 and 2006 as councils refine the processes by which financial and service estimates are incorporated into their existing LTCCP. Ideally, those amendments should be infrequent, because communities should be able to rely on the adopted LTCCP as a reasonable indication of the council’s intentions. Communities are also reasonably entitled to expect that, where changes are proposed, they will be dealt with in a manner that:

- makes the change, and the reasons for and impact of the change, clear;
- enables community consultation and feedback on a similar basis to that by which the LTCCP was adopted; and
- provides confidence that the integrity and robustness of the LTCCP remains, so that its proposals can be relied on.

**3.238** Some councils have suggested to us that they expect to make amendments annually, because that is the way they operate. However, one of the purposes of the LTCCP is to promote a long-term focus to council planning. Our hope therefore is that, as councils become more familiar with the longer-term planning focus, the need for significant annual change will be minimised. Nevertheless, the view of these councils suggests a need for ongoing monitoring of the extent to which it is practical to take such a long-term focus, given the uncertainties associated with many activities of councils.

### *Observations on amendments to LTCCPs adopted in 2003*

**3.239** There were 20 individual amendments among 6 of the 9 councils that adopted LTCCPs in 2003 that we were involved with because of an issue with the 2002 Act. Although LTCCPs adopted in 2003 or 2004 did not need to be audited, transitional provisions in the 2002 Act did not exempt



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amendments to these LTCCPs from audit. The 2002 Act was amended in 2004 to remedy this anomaly.<sup>5</sup> However, we consider it useful to describe the circumstances that generated the need for these amendments:

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- Fifteen amendments resulted from decisions to change or adopt the section 102 funding and financial policies that had not previously been included in the 2003 LTCCPs. We expect amendments of this nature to decline as councils become more familiar with the new policy requirements.
- Three changes arose as a result of section 97 (decisions to significantly alter service levels, transfer ownership or control of a strategic asset, construct, replace or abandon a strategic asset, that will significantly impact on the costs to or capacity of a council). The volume of these amendments may reduce as councils become more confident with the requirements for information about assets and service levels. However, ongoing amendments of this nature seem likely and appropriate.
- Two changes resulted from information about intended sale of endowment land not being included in the 2003-2013 LTCCP, which therefore required an amendment under section 141. The extent to which councils can predict whether they will want to sell or exchange endowment land will vary according to how active the council is as a property investor. Those with few properties will probably have clear intentions about the future use of endowment land that could be included in LTCCPs. However, those that are actively managing their endowment land as a source of revenue may wish to be more opportunistic. Overall, it is fair to say that we expect amendments of this nature to continue beyond 2006 – particularly from those councils managing a portfolio of endowment properties.<sup>6</sup>

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<sup>5</sup> Local Government Act 2002 Amendment Act 2004.

<sup>6</sup> For a further discussion of the approaches to section 141, see paragraphs 2.301-2.320 of this report.



## 3.3 The annual report

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**3.301** The 2002 Act contains a comprehensive planning and reporting regime that builds on the 1974 Act but contains some new elements, including a requirement to include in the annual report:

- the results of any measurement undertaken during the year of progress towards achievement of the community outcomes to which each group of activities of the local authority relates;
- a description of any identified effects that any activity within each group of activities has had on the social, economic, environmental, or cultural well-being of the community; and
- an audited statement of any significant acquisitions or replacements of assets during the year, and the reasons for those acquisitions or replacements, and the reasons for any significant variation between planned and actual acquisitions and replacements.<sup>7</sup>

**3.302** The 2002 Act requires the Auditor-General to report on whether a local authority has complied with these requirements.<sup>8</sup>

**3.303** In this article, we review how the 9 local authorities that prepared annual reports under the 2002 Act for the year ended 30 June 2004<sup>9</sup> approached these requirements. We focus on some of the requirements in clause 15 of Part 3 of Schedule 10 that are new for local authorities, rather than on all of them.

**3.304** All local authorities must meet these requirements in their annual reports for the year ending 30 June 2005. This review should assist the other local authorities to meet the requirements.

### Sustainable development reporting

**3.305** One of the purposes of the 2002 Act is that local authorities play a broad role in promoting the social, economic, environmental, and cultural well-being of their communities, “taking a sustainable development approach”. In performing that role, local authorities must act in accordance with the principles in section 14 of the 2002 Act, one of which states that, in taking a sustainable development approach, a local authority should take into account:

<sup>7</sup> These requirements are in clause 15 of Schedule 10.

<sup>8</sup> Section 99(1)(b).

<sup>9</sup> Only the 9 local authorities that prepared an LTCCP for the period beginning 1 July 2003 had to prepare an annual report under the 2002 Act for the year ended 30 June 2004.



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- the social, economic, and cultural well-being of people and communities;
- the need to maintain and enhance the quality of the environment; and
- the reasonably foreseeable needs of future generations.<sup>10</sup>

**3.306** The 2002 Act requires local authorities to plan for and report on the impact of their activities on the social, economic, environmental, and cultural well-being of their local communities. A local authority's LTCCP must include descriptive information about each group of activities. In particular, the LTCCP must describe, in relation to each group of activities of the local authority:

- the activities within the group of activities;
- the rationale for providing those activities (including the community outcomes to which they contribute);
- intended service levels and estimated expenses of providing the activities; and
- how performance will be measured.

**3.307** A local authority must also identify in the LTCCP any "significant negative effects" of its activities on the social, economic, environmental, and cultural well-being of the local community.<sup>11</sup>

**3.308** Like the LTCCP, the content of the annual report is partly based around reporting on each group of activities. The annual report must:

- identify the activities (this duplicates the requirement in the LTCCP);
- identify the community outcomes to which the group of activities primarily contributes;
- report the results of any measurement undertaken during the year of progress towards the achievement of those outcomes;<sup>12</sup> and
- describe any identified effects that any activity within the group of activities had on the social, economic, environmental, or cultural well-being of the community.<sup>13</sup>

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<sup>10</sup> Section 14(1)(h).

<sup>11</sup> Clause 2, Schedule 10.

<sup>12</sup> The LTCCP must state what measures will be used to assess progress towards the achievement of community outcomes – clause 1(f), Schedule 10.

<sup>13</sup> Clause 15, Schedule 10.



- 3.309 In addition to including the information required by Part 3 of Schedule 10<sup>14</sup>, the annual report must also contain the auditor’s report:
- on the financial statements; and
  - on the local authority’s compliance with the requirements of Schedule 10 that apply to the annual report.
- 3.310 The Auditor-General must therefore report on whether a local authority’s annual report is complete, in the sense of containing the information required by Part 3 of Schedule 10, and whether the local authority has complied with the requirements of Schedule 10. For non-financial information, this requires assessing and reporting on whether a local authority has included the information required by Part 3 of Schedule 10 in its annual report in the form and manner required by Part 3.
- 3.311 It can be seen that the 2002 Act reflects the sustainable development approach, in terms of both its core purposes and principles and the planning and reporting framework. As well as the 3 considerations usually associated with sustainable development – social, economic, and environmental well-being – the 2002 Act has the promotion of “cultural well-being” as one of the purposes of local government and therefore a core consideration for local authorities.
- 3.312 As well as auditing the LTCCP, the Auditor-General has a role in assessing and reporting on whether local authority annual reports comply with the requirements of Part 3 of Schedule 10, including the requirement to report any measurement of progress towards achieving community outcomes, and the impact of a local authority’s activities on social, economic, environmental, and cultural well-being.

## **Review of “the early 9” annual reports on sustainable development reporting**

- 3.313 We have reviewed the annual reports of the 9 councils that adopted an LTCCP for June 2003. These councils were Dunedin City, Greater Wellington Region, Hutt City, Manukau City, Masterton District, Waitakere City, Wanganui District, Wellington City and Western Bay of Plenty District.
- 3.314 The new reporting requirements are listed below with commentary about how these requirements were addressed by the 9 councils.

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14 Part 3 of Schedule 10 sets out the content requirements for the annual report under the following 7 headings:

- group of activities;
- council-controlled organisations;
- financial statements;
- remuneration issues;
- severance payments;
- statement of compliance; and
- general.



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### *Identification of community outcomes the group of activities primarily contributes to (clause 15(b), Schedule 10)*

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- 3.315 Some councils distinguished between community outcomes and council strategic goals, while others took the community outcomes and indicated what the council would be doing to support them. One council gave each significant activity a heading, but it was not clear whether it was a community outcome or not.
- 3.316 Most councils aligned their financial statements with groups of activities, showing the linkage of council activity to community outcomes.
- 3.317 As councils prepared the 2003 LTCCP under transitional provisions, we would expect the subsequent annual report to reflect the developmental nature of the community outcomes. However, councils will need to take care to differentiate between community outcomes and council-specific objectives and measures.

### *Results of measurement of progress towards the achievement of community outcomes (clause 15(c), Schedule 10)*

- 3.318 The 9 councils took a variety of approaches. In one case, targets and progress were provided, which were more of an action update than a performance (outcome) assessment. One council had developed a set of community indicators for the community outcomes, and provided a range of performance measures for its own work.
- 3.319 One council had a separate sustainable development report that provided measures of community outcomes, and indicated progress towards those outcomes, supported by a corporate sustainability report that noted goals and measures of the performance of the organisation itself. Another council provided several reports, separated into the 4 aspects of well-being (e.g. a social indicators report or an economic indicators report).
- 3.320 Care will need to be taken to ensure that reporting on progress in measuring achievement of community outcomes consists of more than action updates. While it is useful and necessary for councils to report on what they have done, measures also need to be designed to capture the impact of the action taken.



*Description of any identified effects of any council activities on the social, economic, environmental, and cultural well-being of the community (clause 15(d), Schedule 10)*

**THREE**

- 3.321** This is an area still under development at the time these annual reports were prepared. Few of the 9 councils explicitly included a consideration of effects in their annual report.
- 3.322** Several councils took the route of providing separate reports for each aspect of well-being, while others noted that frameworks to enable them were in preparation. While separate reports for each aspect of well-being are logical, there is a risk that this kind of approach may result in an environment that creates 4 new “silos”. The 2002 Act does not require the 4 aspects of well-being to be translated into a specific form of reporting. Indeed, other provisions emphasise the importance of integration in order to support decision-making and co-ordination.<sup>15</sup> Councils therefore have the discretion to choose the manner of presentation that best allows such integration to occur.
- 3.323** More than one council noted that a reporting framework was under development. It should be noted that the 2002 Act asks councils to describe the effects of their activities, not to reiterate their aims.
- 3.324** There is a relationship between a council’s own service performance monitoring and reporting and the monitoring that the 2002 Act requires it to provide to the community on the wider achievement of the community outcomes. A council therefore needs to be clear about the framework within which it assesses how well its activities and services are contributing to the community outcomes they are intended to help achieve.
- 3.325** Overall, the descriptions that reported on the 15(d) requirement provided clear signals to communities about where the agreed direction lies and what actions the council is taking to support those goals, and provides linkages to what council funding will be required to achieve them. While improvements are expected to be made in terms of clarity of information and improved frameworks for thinking about and identifying the costs of activities, these first reports based on the 2003 LTCCPs provide a clear indication that many councils are coming to grips well with the intent of the new legislation and are providing good information to their respective communities.

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<sup>15</sup> See, for example, sections 91(2)(d) and 93(6).



## REPORTING UNDER THE LOCAL GOVERNMENT ACT 2002

### THREE

### Reporting on service levels

- 3.326 Clause 15 in Part 3 of Schedule 10 contains further content requirements for the annual report. The annual report must include an audited statement comparing actual service levels for the group of activities against the intended levels of service provision (as set out in the LTCCP for that year), and giving the reasons for any significant variance between actual and expected service provision. The 1974 Act contained a similar requirement – a local authority's financial statements had to include a statement of service performance, and that statement was to be audited.
- 3.327 As this is not a new requirement for local authorities, we do not focus on it in this article.

### Statement of acquisition and replacement of assets

- 3.328 The 2002 Act contains more detailed requirements than the 1974 Act for the provision of information about local authority assets.
- 3.329 The annual report must include an audited statement:<sup>16</sup>
- describing any significant acquisitions or replacements of assets undertaken in the year and giving reasons for those acquisitions or replacements; and
  - giving the reasons for any significant variation between the acquisitions and replacements projected in the LTCCP and those actually made.
- 3.330 The information in the annual report therefore links to the LTCCP – the LTCCP must contain detail about the management of local authority assets, including how their maintenance, replacement and renewal will be undertaken and how costs will be met.<sup>17</sup>
- 3.331 This requires each local authority's auditor to audit its statements on the matters referred to in paragraph 3.329.
- 3.332 All information in plans and reports prepared under the 2002 Act must be prepared in accordance with generally accepted accounting practice (GAAP), where GAAP applies.<sup>18</sup>

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<sup>16</sup> Clause 15(e) and (f), Schedule 10.

<sup>17</sup> Clause 2(1)(d), Schedule 10.

<sup>18</sup> Section 111.



*Comment on the 9 local authorities' statements about asset acquisition and replacement*

**THREE**

- 3.333** Significant asset acquisition and replacement is noted in planning financial forecasts, and is therefore represented in the budget sections of the annual report.
- 3.334** All councils reported any significant variances to the budgeted capital expenditure, and noted the reasons for a significant variation between budgeted and actual amounts. Financial variances were in the financial section of the reports, such as the Statement of Financial Position.
- 3.335** However, capital expenditure changes were usually listed as part of the reporting on the groups of activities section of the report. While this has the advantage of information on one topic being kept together, a determined inspection of the whole report would be required to ascertain any major variations between the LTCCP and actual achievement of what was planned.
- 3.336** Under the scheme of the 2002 Act, asset acquisitions and replacements form part of the group of activities set of information in both the LTCCP and the annual report. We therefore believe that presenting information within each group of activities is consistent with the requirements of the 2002 Act where:
- a council has considered the presentation needs of readers of the annual report and structured information to address these needs (including the ability of readers to relate the report to the LTCCP and annual plan on which it is reporting); and
  - the information is clearly identifiable within the structure of the annual report.



## 3.4 Summaries of LTCCPs, annual plans, and annual reports

### THREE

#### **Accessibility and readability**

**3.401** A long-standing concern with the statutory requirements for public consultation on annual plans (and now LTCCPs too), and for the presentation of annual reports, has been the size of the documents concerned, which inhibits accessibility for many members of the public.

**3.402** The 2002 Act seeks to address this concern by providing for certain summaries to be prepared by local authorities. For example:

- Section 83(1)(a) requires that, where the special consultative procedure is to be used, the local authority must prepare a statement of proposal (SOP) and also a summary of the information contained in the SOP. Since the special consultative procedure is required by sections 93(2) and 95(2) to be used in adopting, respectively, an LTCCP and an annual plan, it means that an SOP and a summary of the SOP must be prepared for all LTCCPs and annual plans.
- In respect of annual reports, section 98(4) requires, in a more direct manner, that a local authority must make publicly available its annual report, and a summary of the information in its annual report, within 1 month after adoption of its annual report.

**3.403** The 2002 Act also describes the extent of public availability for these summaries, although the wording varies.

- For summaries of SOPs, section 89(c) requires them to be distributed as widely as reasonably practicable (in such manner as is determined by the local authority, having regard to the matter to which the proposal relates) as a basis for general consultation.
- For summaries of annual reports, section 98(4) simply requires them to be made publicly available.<sup>19</sup>

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<sup>19</sup> See section 5(3) for the definition of “publicly available”.



**3.404** There are similar provisions to promote accessibility by the public to the more lengthy SOPs and the underlying plans.

- Section 83(1)(c) requires SOPs to be made available for public inspection at the principal public office of the local authority, and such other places as the local authority considers necessary in order to provide all ratepayers and residents of the district with reasonable access.
- For LTCCPs and annual plans, sections 93(10)(a) and 95(7)(a) respectively contain the same requirement as for annual reports, i.e. simply to make them publicly available within one month after adoption.

**3.405** In our view:

- The main readers of summaries are likely to be lay readers. Summaries should therefore be capable of being readily understood by such readers. Informed readers, such as interested community groups, analysts, professionals or specialists, are more likely to seek the more detailed information contained in the full plan or report.
- In many instances, the summaries will be the full extent of the information that most of the community will have about the council. Each summary must therefore be able to stand alone, without the need to refer to the base document, unless more detailed information is sought.

**3.406** Guidance developed by the Society of Local Government Managers contains suggestions for good practice in preparing summaries that achieve these principles, as well as including:

- suggestions about communicating and distributing the summary; and
- thoughts about the different content and considerations that might feature in the various SOP summaries required and the annual report summary.

**3.407** This is a useful initiative that should be helpful to the sector in preparing summaries.

**3.408** In particular, the summaries of the LTCCP, annual plan and annual report should be seen as a coherent and discrete set of accountability information. The annual report summary should therefore provide information linking back to the LTCCP and annual plan summaries.



## REPORTING UNDER THE LOCAL GOVERNMENT ACT 2002

### THREE

- 3.409 Several councils contacted us to ask about the material that a summary of the SOP for the annual plan is to cover. With the exception of the annual report summary, a summary is of the SOP rather than the LTCCP or annual plan document to which the SOP relates. This is relevant because the SOP includes the proposed plan to be adopted as well as setting out additional information requirements. For example:
- The SOP for the LTCCP is required to include the details, reasons and options for a proposal to which section 97 applies. This information is not required by Part 1 of Schedule 10 – Information to be included in LTCCPs.
  - The SOP for the annual plan is required to include the Schedule 10, clause 2(2) information for the year about groups of activities, whereas the full annual plan document is required to contain only the annual budget and Funding Impact Statement.
- 3.410 Councils should be aware of this, and ensure that LTCCP and Annual Plan summaries are a fair representation of the major matters of both the content requirements set out in Schedule 10 for each document and the SOP requirements under sections 84 and 85.

### Timing of annual report summaries

- 3.411 We also dealt with enquiries about one of the councils that had adopted an LTCCP in 2003 and was therefore required to prepare its annual report including the new requirement for a summary under the 2002 Act.<sup>20</sup>
- 3.412 This council had published its annual report summary – as required by the Act within one month of adopting its annual report. Unfortunately, this timing coincided with the run-up to local authority general elections, and led to community concern that the summary was being used as a council-funded advertising opportunity for sitting councillors who were standing for re-election.
- 3.413 Such concern and such timing may not be entirely avoidable. However, a council should always ensure that a summary is a fair representation of the major matters, and is therefore set out impartially without providing a platform for political promotion. Councils should be particularly sensitive to this type of risk in pre-election periods.

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<sup>20</sup> All other councils will be required to prepare annual report summaries along with their annual reports once they begin reporting under the 2002 Act, which occurs in the first year of their 2004 LTCCPs.



## 2004 LTCCP SOP summaries

3.414 We also reviewed the 2004 LTCCP SOP summaries to assess the extent to which these summaries had addressed their statutory purpose under section 89(c).

THREE

3.415 Overall, councils had made good efforts to use the summaries for their intended purpose. We assessed the extent to which these summaries covered the major matters in the LTCCP SOPs, and concluded that:

- over 50% of councils' summaries had covered all the major matters;
- 36% had omitted a small number of major matters; and
- just over 10% had not covered a number of major matters.

3.416 In general, the matters omitted related to major projects proposed, but we were surprised that hardly any councils included financial information in their summaries. While we understand the view of councils that the public find financial information difficult to understand, we believe that it has a valid place in the consultation and accountability processes between a council and its community. We have suggested that financial information be kept brief, and should provide:

- a financial overview of the council, using 5 major lines from the statements of financial performance and financial position; and
- information about financial impacts that the community is likely to be interested in, such as rating information and information about the financial impact of specific proposals that the community is being consulted on.

3.417 Given the use of the summary as a vehicle for general consultation, we also asked our auditors to consider whether the LTCCP SOP summaries would be accessible to a general readership. We concluded overall that:

- 23% were well written and presented;
- 36% were adequately written and presented; and
- 41% had areas in which presentation and writing could be improved.

3.418 We encourage councils to refer to the SOLGM publication *Good Practice for Summaries* to assist in summary preparation.



## Areas of focus for 2005-06



B.29[05b]

### 4.1 Proposed performance audits and studies for 2005-06

- 4.101 Performance audits and studies are significant audits covering issues of effectiveness and efficiency or matters of “best practice”. They enable the Auditor-General to provide greater breadth and depth of assurance in key areas of central and local government activity, or to provide guidance on areas of major audit interest.
- 4.102 To determine our annual work programme, we undertake a comprehensive process of strategic audit planning that includes identifying topics for performance audits and studies. Information on this planning process is set out in our Annual Plan.<sup>1</sup>
- 4.103 The following performance audits and studies have been proposed for the local government sector in 2005-06.

#### **Economic development funding (West Coast)**

##### *Background*

- 4.104 In 2001, the West Coast received a one-off payment of \$120 million to assist the West Coast economy to adjust to the Government’s policies on the ending of logging of Crown-managed indigenous forests. The community expected substantial benefits from that funding, but at least 2 high-profile investment failures resulted from it. One of them involved the Auditor-General in an extensive inquiry into the financial collapse of a plastics factory initiative.

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<sup>1</sup> *Annual Plan 2005-06*, parliamentary paper B.28AP(05), pages 40-43.



## AREAS OF FOCUS FOR 2005-06

### FOUR

4.105 While the failure of particular initiatives has attracted high-profile publicity, there has been no overview of how economic development funding has been invested and applied on the West Coast.

#### *What is the potential impact of this performance audit?*

4.106 Our proposed performance audit will examine how the West Coast economic development funding has been invested, and whether the application of the funding was effective. The Local Government and Environment Committee will be offered a briefing on the results of our audit.

### **Disasters – Maintenance and capacity of flood protection assets**

#### *Background*

4.107 In 2004, two significant civil emergencies – both floods – occurred within 6 months of each other. These emergencies stretched existing flood protection schemes and community and national response capabilities. With affected communities still coping with the flow-on effects, there has been concern about the ability of regional council flood protection schemes to protect such communities. Public and community awareness of the 2004 floods is high, and there is a clear expectation that local authorities will maintain adequate flood protection schemes. In a 1998 report to Parliament<sup>2</sup>, we raised concerns about local authorities' management of flood protection assets.

#### *What is the potential impact of this performance audit?*

4.108 Our proposed performance audit will review the site management practices of relevant local authorities, including their management of flood-related assets, and their procedures when floods occur. The audit will assess the effectiveness of flood protection assets associated with the two 2004 floods, and would aim to improve local authority management of such assets. The Local Government and Environment Committee would be offered a briefing.

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<sup>2</sup> *First Report for 1998, parliamentary paper B.29[98a], pages 49-53.*



## Local authority decision-making

### *Background*

FOUR

- 4.109 The 2002 Act imposes principle-based decision-making obligations that local authorities are working to understand and embed in their management processes, in order to give best effect to their purpose of promoting long-term, sustainable well-being, and democratic decision-making and actions. Local authorities also face risks if their decisions can be shown to be unreasonable, or if due process has not been observed.
- 4.110 Following passage of the 2002 Act, high-level guidance material was produced by sector organisations and the Department of Internal Affairs. As local authorities have developed more experience in implementing the 2002 Act, however, a need for more specific advice has emerged. We have dealt with a number of complex ratepayer enquiries about local authorities' decision-making obligations and consider that we now have sufficient experience to distil and reflect the good practice emerging from the sector.

### *What is the potential impact of this performance audit?*

- 4.111 Our proposed performance audit would aim to provide advice to local authorities on their principle-based decision-making obligations. The Local Government and Environment Committee would be offered a briefing.

## Procurement guidelines update

### *Background*

- 4.112 Our procurement guidance requires updating to deal with general procurement issues and to clarify its application to local government procurement decisions. We are aware that there are other sources of procurement guidance, and that some issues that we have considered in inquiries (such as sole-source procurement) have not yet been included in our guidance.



## AREAS OF FOCUS FOR 2005-06

### FOUR

#### *What is the potential impact of this study?*

- 4.113 Our proposed study would update the Auditor-General's procurement guidance. Through this study, we would maintain the relevance of our published guidelines to current practice, and ensure that they apply to situations faced by both central and local government. The aim would be to improve the management of procurement activities by public entities. The relevant Select Committee(s) would be offered a briefing.

### **Rates postponement – Reverse mortgages**

#### *Background*

- 4.114 A small number of local authorities are providing rates postponements as reverse mortgages. This is an initiative made possible by the new powers under the Local Government (Rating) Act 2002. Legislative, accounting, debt management, and financial prudence issues need to be considered for such initiatives.

#### *What is the potential impact of this study?*

- 4.115 Our proposed study would identify the extent to which the rates payment option is being taken up by ratepayers in the early stages of such schemes, and assess local authority compliance with appropriate statutory responsibilities. It would also address arrangements for prudent management of the potential impact of these schemes on local authorities. The study would seek to improve the management of reverse mortgages. The Local Government and Environment Committee would be offered a briefing.

## Other matters



B.29[05b]

### 5.1 Conflicts of interest

#### **New guidance on the law about conflicts of interest**

- 5.101** The Auditor-General has statutory functions in administering the Local Authorities (Members' Interests) Act 1968. We have taken a proactive role in recent years in raising awareness of the Act among local authority members and officers.
- 5.102** The main way we assist local authorities to comply with the Act is by publishing a guide that sets out our understanding of the law and our expectations of members. Every 3 years or so, we update the publication. We published a new edition in 2004.
- 5.103** The Act deals only with pecuniary interests. However, in response to an increasing number of queries and requests for guidance on other types of conflict of interest, we have now expanded the scope of our publication. As a result, the 2004 edition contains new material about non-financial conflicts of interest.
- 5.104** Our publication is now called *Conflicts of Interest: A Guide to the Local Authorities (Members' Interests) Act 1968 and Non-pecuniary Conflicts of Interest*.<sup>1</sup> It discusses pecuniary and non-pecuniary conflicts of interest, and covers both the Local Authorities (Members' Interests) Act and the common law rule against bias. The guide explains the legal requirements that apply to local authority members at meetings, and offers practical guidance for dealing with particular situations.

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<sup>1</sup> ISBN 0-478-18121-3.



## OTHER MATTERS

### Ethical dimensions of conflicts of interest

#### FIVE

- 5.105 Our *Conflicts of Interest* publication focuses on the legal obligations of members of a local authority in their formal decision-making at authority meetings. Yet, managing conflicts of interest in the public sector often involves more than just a consideration of the law.
- 5.106 The term “conflicts of interest” can be used to describe a range of other behaviour that may be regarded as unethical, although not necessarily unlawful. An example could be where a problem arises outside the confines of formal decision-making at a local authority meeting, or where it relates not to a member but to an employee. There may be no doubts over legality, but the situation may nevertheless be questionable. Accordingly, local authorities and their advisers also need to carefully consider how to manage the ethical dimensions of conflicts of interest.
- 5.107 While not concerned specifically with local government, our November 2004 report, *Christchurch Polytechnic Institute of Technology’s management of conflicts of interest regarding the Computing Offered On-Line (COOL) programme*,<sup>2</sup> examines the nature of public sector conflicts of interest in that broader ethical context. It sets out what the Auditor-General considers to be generally accepted expectations when conflicts of interest arise in relation to a person working for a public entity.
- 5.108 We commend this report to local authorities. We expect that they will refer to the guidance outlined in that report (and to the other sources of guidance referred to in it) when making decisions about how to manage conflicts of interest that arise in the course of their business.

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2 ISBN 0-478-18123-X. See, in particular, Foreword, Part 2, and Appendix 1.



## 5.2 Provincial Patriotic Councils

### Introduction

FIVE

- 5.201 The purpose of this article is to provide an update on the financial performance of provincial patriotic councils since we last reported on the sector in the year 2000.<sup>3</sup>
- 5.202 Under section 40 of the Patriotic and Canteen Funds Act 1947 (the Act) and section 15 of the Public Audit Act 2001, the Auditor-General is the auditor of 15 statutory bodies. They are:
- the Patriotic and Canteen Funds Board (the Board); and
  - 14 provincial patriotic councils.
- 5.203 The Act provides for the administration and control of money raised for patriotic purposes, and of the accumulated profits and surplus property of the former Canteen Board. The function of the Board and the provincial patriotic councils (within their districts) is to administer funds in accordance with the Act for the relief, assistance, and support of discharged servicemen and their dependants.

### The Patriotic and Canteen Funds Board

- 5.204 Until 2002, the Board's main activity was the administration of 4 war veterans' homes. In that year, the Board decided that each home stood a better chance of financial survival if its governance was localised and community support and responsibility encouraged. To this end, the Board agreed to devolve the administration of the homes to 4 separate trusts.
- 5.205 By the end of November 2002, the transfer of assets and liabilities to each of 3 trusts was completed, and 3 of the homes were operating under new administration. The trust arrangement for the Levin Home for War Veterans did not proceed and it was sold to Presbyterian Support Central, a charitable trust set up under the Charitable Trust Act 1957. The Board retained residual funds only to cover remaining administrative expenses.
- 5.206 The 3 homes are now administered as follows:
- Ranfurly Home in Auckland, administered by the Ranfurly Trust;

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<sup>3</sup> Our *Second Report for 2000*, parliamentary paper B.29[00b], pages 117-119, reported on the financial performance of provincial patriotic councils for the 1998-99 year.



## OTHER MATTERS

### FIVE

- Rannerdale Home in Christchurch, administered by the Rannerdale Trust; and
- Montecillo Home in Dunedin, administered by the Montecillo Trust.

**5.207** The Patriotic and Canteen Funds Amendment Act 2005 that came into force on 17 May disestablished the Patriotic and Canteen Funds Board by repealing all references to it in the 1947 Act and making consequential changes to other Acts.

### Provincial patriotic councils

**5.208** The main source of income for provincial patriotic councils is interest on investments, which is used for purposes associated with the welfare of returned servicemen. Examples of this type of assistance include:

- grants to organisations to fund home deliveries, or assist with the maintenance of veterans' homes and gardens;
- payments towards the cost of mobility equipment and care; and
- grants toward the cost of refurbishing veterans' accommodation in rest homes.

**5.209** Our 2000 report noted that any council intending to cease operations would continue to formally exist until wound up by statute.

**5.210** Since that report, the following councils have ceased to operate:

- The Auckland Provincial Patriotic Council agreed sometime in late-1999/early-2000 to wind up its activities. A final audit was undertaken for the 6-year period ended 30 September 1999. It was resolved that the balance of the funds held by the council be transferred to the Ranfurly Trust.
- The Waikato Provincial Patriotic Council agreed in July 1999 to wind up its activities. A final audit was undertaken for the year ended 30 September 1999. It was resolved that the balance of funds held by the council be transferred to the Hamilton RSA Veterans Home Trust.
- The Hawke's Bay Provincial Patriotic Council agreed in November 2000 to wind up its activities. A final audit was undertaken for the year ended 30 September 2000. It was resolved that the balance of funds held by the council be transferred to the Levin Home for War Veterans.



## OTHER MATTERS

B.29[05b]

### Overview of financial performance

5.211 The information in this overview is based on figures extracted from the 30 September 2003 annual report of each council.

FIVE

Council <sup>4</sup>	Income \$	Expenditure \$	Surplus/(Deficit) \$	Equity \$	Decrease (Increase) in Equity since 1998-99 <sup>5</sup> \$
Northland	6,231	7,797	(1,566)	136,082	8,813
Bay of Plenty	2,936	5,479	(2,543)	55,290	9,850
East Coast	3,562	13,139	(9,577)	45,973	37,619
Taranaki	24,499	25,124	(625)	396,166	(6,298)
Wellington <sup>6</sup>	1,948	5,201	(3,253)	5,295	(4,972)
Marlborough	1,070	705	365	13,841	3,604
Nelson	1,715	9,368	(7,653)	37,602	31,088
Westland	602	11,272	(10,670)	13,887	41,833
Canterbury	14,101	8,292	5,809	96,126	13,082
Otago <sup>7</sup>	6	25	(19)	719	80
Southland	1,487	10,039	(8,552)	41,535	10,575
Patriotic and Canteen Funds Board <sup>8</sup>	344,072	4,680,766	(4,336,694)	71,497	12,220,375

### Conclusion

5.212 Some of the 11 remaining provincial patriotic councils will want to continue their operations in support of returned servicemen. However, given the level of equity and operations shown in our table, others will prefer to wind up, and a number have indicated that they would like to do so. Veterans' Affairs New Zealand (a semi-autonomous body within the New Zealand Defence Force) is working with these councils to establish an appropriate organisational structure for the future.

4 This table does not include Auckland, Waikato and Hawke's Bay provincial patriotic councils (see paragraph 5.210).

5 We last reported on the financial performance of provincial patriotic councils for the 1998-99 year.

6 The Wellington council figures are for the 2003 year, but are unaudited.

7 The Otago Provincial Patriotic Council has been inactive since 1994, but financial statements continue to be prepared and audited.

8 These figures reflect the fact that, during the 2002-03 year, the Board assigned the homes under its administration to 3 trusts and sold the remaining home.

## Recent Publications by the Auditor-General

Other publications issued by the Auditor-General in the past 12 months have been:

- Ministry of Justice: Performance of the Collections Unit in collecting and enforcing fines
- The Local Authorities (Members' Interests) Act 1968: Issues and options for reform
- Effectiveness of controls over the taxi industry
- Government and parliamentary publicity and advertising
- Civil Aviation Authority: Certification and surveillance functions
- Ministry of Fisheries: Follow-up report on information requirements for the sustainable management of fisheries
- Pharmaceutical Management Agency: Changes to the frequency of medicine dispensing
- Horizons and Otago Regional Councils: Management of freshwater resources
- Annual Plan 2005-06 – B.28AP(05)
- The Auditor-General's auditing standards
- Central Government: Results of the 2003-04 audits – B.29[05a]
- Progress in implementing key recommendations of the 1996 Transport Committee inquiry into truck crashes
- Assurance audit of the Annual Performance Report of the Electricity Commission for the period ended 30 June 2004
- Department of Conservation: Administration of the Conservation Services Programme – Follow-up audit
- Ministry of Defence and New Zealand Defence Force: Further report on the acquisition and introduction into service of Light Armoured Vehicles
- New Zealand Trade and Enterprise: Administration of grant programmes
- New Zealand Trade and Enterprise: Administration of the Visiting Investor Programme
- Christchurch Polytechnic Institute of Technology's management of conflicts of interest regarding the Computing Offered On-Line (COOL) programme
- Annual Report 2003-04 – B.28
- Inquiry into the Ministry of Education's monitoring of scholarships administered by the Māori Education Trust
- Conflicts of Interest – *A Guide to the Local Authorities (Members' Interests) Act 1968 and Non-pecuniary Conflicts of Interest*

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