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Parliamentary paper

Local  
government:  
Results of the  
2008/09 audits

Office of the Auditor-General  
PO Box 3928, Wellington 6140

Telephone: (04) 917 1500  
Facsimile: (04) 917 1549

Email: [reports@oag.govt.nz](mailto:reports@oag.govt.nz)  
[www.oag.govt.nz](http://www.oag.govt.nz)

# Local government: Results of the 2008/09 audits

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

June 2010

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Hon Dr Lockwood Smith MP  
Speaker  
House of Representatives  
WELLINGTON

Mr Speaker

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

Yours faithfully

A handwritten signature in black ink, appearing to read 'Lyn Provost', written in a cursive style.

Lyn Provost  
Controller and Auditor-General

Wellington

10 June 2010

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# Introduction

This is our report on the 2008/09 audits of the local government sector. Most of these audits were of regional and territorial local authorities and their subsidiary entities. This report also covers aspects of the energy sector, with a continued focus on electricity line businesses, and the airport sector.

The local government sector is now well used to reporting under the requirements of the Local Government Act 2002 (the Act).

In keeping with the Act, local authorities prepared their annual reports for 2008/09 in the context of the 2006-16 long-term council community plans (LTCCPs). During 2008/09, local authorities prepared and adopted new LTCCPs, covering the 10-year period 2009-19. The 2009-19 LTCCPs became operative from 1 July 2009 and are now the basis of local authorities' annual financial and performance accountability to their communities.

This was the third year after the sector's adoption of the New Zealand equivalents to International Financial Reporting Standards (NZ IFRS). As a requirement of the Act, local authorities have to prepare annual reports on a basis consistent with NZ IFRS.

## Purpose of this report

The purpose of this report is to:

- tell Parliament and the local government sector about matters arising from carrying out our role as auditor of the sector;
- describe some of the inquiries we carried out in the sector since our last report;
- highlight some matters and make some observations on other sectors; and
- summarise the findings from our performance audits and other work carried out during the year that relate to local government and other sectors covered in this report.

## Review of 2008/09

The local government sector has come through the 2008/09 financial year in reasonably good shape. The sector as a whole faces some significant challenges in 2009/10 and beyond – for example, the reforms of local government in Auckland, and making further improvements in the reporting of performance information.

## Annual reporting

We comment on four key aspects of local authorities' annual reporting. We discuss:

- the timeliness of local authorities in reporting audited results to their communities;

- the approach taken by local authorities to report on achieving community outcomes, the difference they are making to community well-being, and the details of significant assets that they acquired or replaced;
- those entities within the sector that received a non-standard audit opinion; and
- how those local authorities most significantly affected by leaky homes account for their liabilities.

Overall, the results were mixed. Local authorities have improved the timeliness of their reporting. However, there is still scope for local authorities to improve how they report on their performance. Performance reporting remains a key focus for this Office, and the local government sector is not the only sector that needs to improve.

When we report on the results of our 2009/10 audits, we intend to focus on how local authorities report their actual results of performance rather than merely reporting against intended achievements.

### **Non-standard audit opinions**

Some entities, or types of entity, receive a non-standard audit opinion year after year. The most obvious examples are public entities that hold heritage assets, such as museums. Accounting standards require most heritage assets to be valued and depreciated. Most museums do not value their heritage assets and, because we have to express an opinion based on accounting standards, we have continued to issue non-standard audit opinions in many cases.

Because of the Auckland reforms and the change to one Auckland council on 1 November 2010, we had to issue non-standard audit opinions in 2008/09 for public entities that will be dissolved on 31 October 2010. Our audit opinion needed to recognise that the annual reports of those entities are prepared on a dissolution basis rather than the normal “going concern” basis.

### **Leaky homes**

In May 2010, the Government announced a proposed financial assistance package for homeowners with leaky homes. If a homeowner opts to take up the financial assistance package, the proposal would see the Government providing funds to meet 25% of an eligible homeowner’s repair costs. Local authorities would be required to contribute 25% of the repair costs, and the homeowner would pay the remaining 50%.



Regardless of whether homeowners make claims under the new package or through the systems currently in place, local authorities can still expect to pay a significant proportion of the bill for repairs to leaky homes. As a result, how local authorities account for leaky home liabilities is increasingly important.

As in previous reports, we describe the varying accounting treatments used by the local authorities that are most heavily affected by leaky home liabilities. The uncertainties involved make it difficult for local authorities to accurately recognise their liabilities. Leaky home liabilities could significantly stretch the resources of the affected local authorities (and their communities).

### **Inquiries**

This report also outlines the major inquiries that we have carried out since our last report. For example, in December 2009, we published our findings on the conflicts of interest of four elected members of Environment Canterbury. This inquiry highlighted the issue of personal financial conflicts, which continues to be debated extensively within the sector.

## **Beyond 2008/09**

### **Auckland “super city”**

The change to one Auckland council is dominating the local government sector. The change, including the process of change, is massive, and most local government entities (councils and subsidiaries alike) are watching the change with close interest.

The change will create new mechanisms within local government – including a mayor with some new executive powers, and local boards that are responsible for more than the population of many other local authorities.

The change to one Auckland council also significantly affects this Office. We outline some of those challenges in Part 5. For example, the transition will change the nature, incidence, and timing of a number of substantial audits. Auditing the closing position of dissolving entities will be complex, but is important because it will provide the basis for the opening position for Auckland Council and its new group structure.

### **Auditing performance information**

We have updated our approach to the audit of 2009/10 annual reports and, in particular, the audit of the performance information included in these annual reports. Part 6 describes the work that we have been doing.

Through our wide contact with the sector, we have outlined our concerns about the quality of performance information and our intention to apply more scrutiny to it in 2009/10. This will be one of the significant outcomes from our work in 2009/10 and will feature more in next year's report.

### **Managing water demand and assets**

We conclude with brief comments about our recent report on how local authorities were managing future demand for drinking water and the associated water reticulation assets.

Water is increasingly recognised as a significant and finite resource. Water-related assets are expensive for communities to develop and maintain. The management of freshwater increasingly demands public attention. In our view, the management of freshwater by local authorities will also increasingly demand the attention of this Office.

# Part 1

## Timeliness of annual reporting

- 1.1 The annual reports of local authorities provide information that helps communities to assess the performance of their local authorities. For this process to be effective, the information needs to be comprehensive and timely.
- 1.2 Each year, we examine the timeliness of annual reporting by local authorities.
- 1.3 Under the Local Government Act 2002 (the Act), each local authority is required to:
- complete and adopt its annual report, containing audited financial statements, within four months after the end of the financial year;<sup>1</sup>
  - make its annual report publicly available within one month of adopting it; and
  - make an audited summary of the annual report publicly available within one month of adopting the annual report.<sup>2</sup>
- 1.4 The local authority decides when the audited annual reports and summaries will be prepared and published, within the requirements of the Act.

### Summary

- 1.5 The timeliness of annual reporting by local authorities was significantly better for 2008/09 than it was for the previous two years. Only one local authority did not meet the statutory deadline for adopting its audited annual report.<sup>3</sup>
- 1.6 It is important that local authorities recognise that accountability is not achieved until the audited information is made available to ratepayers. In this respect, local authorities have generally improved their timeliness in making their annual reports publicly available.
- 1.7 Some local authorities still need to improve the timeliness of making their summary annual reports available. Summary annual reports are often more user-friendly than annual reports. Therefore, it is important that local authorities make their summary annual reports available without delay, to allow prompt audit clearance and to inform their communities.

1 If the date when the audit of a public entity's financial statements must be completed by falls on a non-working day, then the Interpretation Act 1999 requires that the statutory deadline date be read as the next working day. In 2008/09, the last possible date for completing and adopting the annual report was 2 November 2009.

2 The actual timing required of any local authority is determined by when it completes and adopts its annual report. In 2008/09, the last possible date for making the annual report and the summary of the annual report publicly available was 2 December 2009.

3 For 2007/08, eight local authorities did not meet the statutory deadline for adopting their annual reports.

## Adoption of annual reports

- 1.8 Figure 1 shows the dates when the audits of local authorities were completed and the annual report adopted (these two events almost always occur on the same day). It shows that, for 2008/09, 84 local authorities (99%) adopted their annual report by the statutory deadline.

**Figure 1**

When local authority audits were completed, for 2008/09 and the previous year

When the audit was completed	Annual reports for 2008/09	Annual reports for 2007/08
Within 2 months after the end of the financial year	3	2
Between 2 and 3 months after the end of the financial year	13	14
Between 3 and 4 months after the end of the financial year	68	61
<b>Subtotal: Number meeting statutory deadline</b>	<b>84</b>	<b>77</b>
Between 4 and 5 months after the end of the financial year	1	6
More than 5 months after the end of the financial year	0	2
<b>Total</b>	<b>85</b>	<b>85</b>

- 1.9 For 2008/09, only one local authority breached the statutory deadline. This local authority has generally been able to meet its accountability requirements in previous years. Extraordinary matters prevented the Council from complying in 2008/09. This one local authority (1%) compares with eight local authorities (9%) for the 2007/08 year and 16 local authorities (19%) for the 2006/07 year.<sup>4</sup> As at 30 November 2009, five months after the end of the financial year, there were no outstanding annual reports for 2008/09. In comparison, for the 2007/08 year, the audits of two local authorities were not completed by 30 November 2008.
- 1.10 Since 2006/07, there has been a significant improvement in the number of local authorities meeting their statutory deadline for completing and adopting their annual reports. In 2006/07, the transition to reporting under the New Zealand equivalents to International Financial Reporting Standards was a significant contributing factor for local authorities failing to meet the statutory deadline. It would appear that reporting on this basis is no longer a factor in the timing of reporting.
- 1.11 The eight local authorities that did not meet the statutory deadline for audit completion in 2007/08 did meet it in 2008/09.

<sup>4</sup> Controller and Auditor-General (2008), *Local government: Results of the 2006/07 audits*, Wellington.

## Public release of annual reports

- 1.12 We also looked at when local authorities released their annual report to the community. The Act allows one month for public release from when a local authority adopts its annual report. Figure 2 shows the performance of local authorities in meeting this deadline.

**Figure 2**

**When local authorities released their annual report, for 2008/09 and the previous year**

Number of days after adopting the annual report	Annual reports for 2008/09	Annual reports for 2007/08
0-5 days	34	23
6-10 days	10	8
11-20 days	13	18
21 days to one month	27	34
<b>Subtotal: Number meeting statutory deadline</b>	<b>84</b>	<b>83</b>
One month to 40 days	1	1
41-50 days	0	0
57 days	0	1
<b>Total</b>	<b>85</b>	<b>85</b>

- 1.13 Figure 2 shows a slight improvement in the number of local authorities meeting the statutory deadline. There was a significant change in the number of local authorities publishing their annual report within 10 days of its adoption, rising from 31 (36%) for the 2007/08 year to 44 (52%) for the 2008/09 year. Most local authorities make their annual report available to the public on their website. In our view, local authorities should be able to publish their annual report on a website within a few days of adopting their report.

## Public release of summary annual reports

- 1.14 We also reviewed the timing of the release of audited summary annual reports. The Act requires both the audited annual report and an audited summary to be released within one month of the annual report being adopted. Releasing an audited summary is important for the accountability of local authorities. Summary annual reports generally provide the best means for communicating key matters in the annual report – in other words, summary annual reports can help make financial statements, which often appear overly complex, reasonably simple and understandable. Summary annual reports are also the easiest document to circulate and make widely available.

- 1.15 The performance of local authorities in making summary annual reports available within the statutory deadline has decreased by one local authority, as shown in Figure 3. However, the number of local authorities that released their summary annual report within 10 days more than doubled (from 12 for the 2007/08 year to 26 for the 2008/09 year).

### Figure 3

When local authorities released their audited summary annual report, for 2008/09 and the previous year

Number of days after adopting the annual report	Annual reports for 2008/09	Annual reports for 2007/08
0-5 days	20	10
6-10 days	6	2
11-20 days	18	13
21 days to one month	30	50
<b>Subtotal: Number meeting statutory deadline</b>	<b>74</b>	<b>75</b>
One month to 40 days	10	3
41-50 days	0	1
51-60 days	0	4
61-84 days	0	1
85-100	0	1
Not yet issued (at 31 March 2010)	1	0
<b>Total</b>	<b>85</b>	<b>85</b>

- 1.16 Eleven local authorities did not provide their communities with audited summary annual reports within one month of adopting their annual report, compared with 10 in 2007/08. In our view, this is unsatisfactory.
- 1.17 There were two local authorities that did not comply with the requirement to provide an audited summary annual report to their communities within the statutory deadline in either of the past two years.<sup>5</sup> Far North District Council did not publish its summary annual report within the statutory deadline in the last three years. At the time of writing, Far North District Council still had not published its 2008/09 summary annual report.
- 1.18 Local authorities need planning and time to summarise an annual report and publish the summary annual report. However, as with publishing the annual report, it is a known obligation. We emphasise the need for local authorities to

<sup>5</sup> Otorohanga District Council and Opotiki District Council did not publish their annual report summaries within the statutory deadline in either of the past two years. However, both improved their timeliness considerably from the year before. Otorohanga District Council's annual report summary was just four days late, and Opotiki District Council's summary was nine days late.

project manage the production, audit, and publication of their annual report and their summary annual report.

- 1.19 We were pleased to see that more local authorities published their annual report and summary simultaneously, or near simultaneously, because of sound planning. We encourage this good practice and see no reason why it could not be standard practice for the whole sector.





## Part 2

# Reporting on activities in the annual report

- 2.1 In this Part, we review how local authorities have met the requirements in the Local Government Act 2002 (the Act) to include certain information in their annual reports.
- 2.2 Local authorities are required to report:
- how they will measure progress toward achieving community outcomes;
  - what difference they are making to the social, economic, environmental, and cultural well-being of their communities; and
  - the details of any significant assets they have acquired or replaced.
- 2.3 This is the sixth year that we have reported to Parliament about how well local authorities are meeting these particular requirements. Every year, we have seen annual reports that make the required information clearly available and annual reports that do not.
- 2.4 It is clear from our previous reviews of reporting by the sector,<sup>6</sup> and from our review of annual reports for 2008/09, that substantial improvements are still needed. We have again concluded that local authorities' reporting is below the standard we expect.
- 2.5 These reporting requirements in the Act are currently under review. Simplification has been signalled, but there is still more the sector could do to improve the reporting of its performance.
- 2.6 In future years, we expect to see better reporting against these requirements in annual reports, given the improvements we have seen in the long-term council community plans (LTCCPs) for 2009-19.
- 2.7 We will be considering our reporting options and obligations where local authorities fail to provide relevant information or do not coherently address the reporting requirements of the Act.

### The requirements in the Local Government Act 2002

- 2.8 The Act contains a comprehensive planning and reporting framework to help each local authority engage with its community on its intended actions (the planning phase), and to account for its actual performance against those intentions in the annual report (the reporting phase).
- 2.9 The Act requires the Auditor-General to audit aspects of local authorities' planning and reporting phases. We do this by auditing LTCCPs, which reflect local

<sup>6</sup> *Local Government: Results of the 2003/04 Audits*, pages 61-87; *Local government: Results of the 2004/05 audits*, pages 14-16; *Local government: Results of the 2005/06 audits*, pages 14-21; and *Local government: Results of the 2006/07 audits*, pages 27-35; *Local government: Results of the 2007/08 audits*, pages 15-24.

authorities' intentions for the next 10 years, and by auditing local authorities' annual reports.

- 2.10 The Act contains disclosure requirements for groups of activities relating to the LTCCP planning phase. These requirements establish a framework for reporting actual performance in the annual report. The requirements are set out in clauses 1 and 2 of Schedule 10 of the Act.
- 2.11 Clause 15 of Schedule 10 focuses on the reporting phase through the annual report. Disclosure requirements include disclosures about:
- any measurement of progress in achieving community outcomes;
  - identified effects of local authority activities on the social, economic, environmental, and cultural well-being of their communities; and
  - details about significant assets acquired or replaced.

### Reporting groups of activities

- 2.12 The reporting requirements for groups of activities<sup>7</sup> apply whether the activities are provided by the local authority, by a council-controlled organisation, or through any other delivery method.
- 2.13 Local authorities can group activities, as they consider appropriate, for the purposes of delivery, planning, and reporting.
- 2.14 The Act requires the annual report to be structured based on those groups of activities. For each group of activities, the annual report must identify:
- the activities within the group of activities;<sup>8</sup> and
  - the community outcomes to which the group of activities primarily contributes.<sup>9</sup>
- 2.15 For each group of activities, the annual report must also:
- report the results of any measurement of progress in achieving community outcomes;<sup>10</sup> and
  - describe any identified effects that any activity within the group of activities has had on the social, economic, environmental, or cultural well-being of the community.<sup>11</sup>

7 An "activity" is defined in the Act as a good or service provided by, or on behalf of, a local authority or a council-controlled organisation, and a "group of activities" includes one or more related activities.

8 Clause 15(a) of Schedule 10.

9 Clause 15(b) of Schedule 10.

10 Clause 15(c) of Schedule 10.

11 Clause 15(d) of Schedule 10.

- 2.16 As well as information about any measurement by a local authority of progress in achieving community outcomes and any identified effects of activities, the annual report must include an audited statement of service performance:
- comparing actual levels of service for each group of activities against the intended levels of service (as set out in the LTCCP that covers that year); and
  - giving the reasons for any significant variation between actual and expected levels of service provision.<sup>12</sup>
- 2.17 The annual report must also include one further audited statement that:
- describes and gives reasons for any significant acquisitions or replacements of assets in the year; and
  - explains any significant variation between the acquisitions and replacements projected in the LTCCP and those actually made.<sup>13</sup>

### What local authorities need to do to meet these requirements

- 2.18 Because of the above requirements, the annual report must include information about community outcomes, community well-being, levels of service provision, and asset acquisitions and replacements, to enable the community to evaluate the local authority's performance.
- 2.19 Figure 4 summarises the relevant legislative requirements about disclosing information in both the LTCCP (during the planning phase) and the annual report (during the reporting phase).
- 2.20 The darker shaded boxes show where, within the reporting phase, we focused our review and assessment of the 2008/09 annual reports.

<sup>12</sup> Clause 15(e) of Schedule 10.

<sup>13</sup> Clause 15(f) of Schedule 10.

**Figure 4**  
**Summary of related requirements for disclosing information in the long-term council community plan and annual report for each group of activities**

LTCCP (requirements are set out in clauses 1 and 2 of Schedule 10)	Annual report (requirements are set out in clause 15 of Schedule 10)
Describe the community outcomes, how they have been identified, how the local authority will contribute to their achievement and work with others to further them, and how they fit with other local authority strategies and processes.	
State the measures that will be used to assess progress towards achieving community outcomes.* State how the local authority will monitor and report on the community's progress towards achieving community outcomes (which must not be less than once every three years).**	In relation to each group of activities, report the results of <b>any measurement</b> carried out during the year of progress towards achieving community outcomes.
For each group of activities, identify the activities within them.	For each group of activities, identify the activities within them.
Identify the rationale for delivery of the group of activities (including the community outcomes to which the group of activities primarily contributes).	Identify the community outcomes to which the group of activities primarily contributes.
Outline any significant negative effects that any activity (within the group of activities) may have on environmental, economic, social, or cultural well-being.	Describe <b>any identified effects</b> that any activity within the group of activities has had on environmental, economic, social, or cultural well-being.
Include a statement of intended service level provision for each group of activities.	Audited statement of service level provision.
Identify detailed information about assets required for each group of activities, including information about forecast acquisition and replacement.	Audited information about acquisition and replacement of assets.

\* Clause 1(f) of Schedule 10.

\*\* Clause 1(g) of Schedule 10 and section 92(1).

2.21 In reviewing the 2008/09 annual reports, we focused on the three aspects more darkly shaded in Figure 4 for the following reasons:

- For the first aspect, reporting any measurement towards achieving community outcomes, we expected that some local authorities would have finalised the three-yearly progress report required by section 92. We expected those local authorities to have reported this in the annual report, along with any other measurement that was carried out during the year.

- For the two other aspects (describing identified effects, and information about acquiring or replacing assets), our previous reviews have shown that these are the least well addressed of the annual report requirements specified in the Act. They are also important elements of accountability.

### Measuring progress towards achieving community outcomes

- 2.22 Community outcomes are a core part of the community engagement and accountability framework within the Act.<sup>14</sup> Section 91 requires local authorities to carry out a process to identify community outcomes at least once every six years.
- 2.23 A local authority needs to decide, and state in the LTCCP, how it will measure and monitor progress in achieving community outcomes. It does this so that it can report on that progress in the three-yearly report required by section 92(1) and by clause 1 of Schedule 10.
- 2.24 Having consulted with other organisations and the community on desired outcomes, local authorities must work with relevant organisations and groups to agree on monitoring and reporting procedures, including how the local authority will use any monitoring done by those other organisations or groups.
- 2.25 The reporting requirement for the annual report is for a local authority to include the results of any measurement carried out during the year of progress towards achieving the desired community outcomes.
- 2.26 This can include any three-yearly reports completed in the year, but should also include any other measurement that has been carried out.
- 2.27 If no measurement is carried out in the year, we would generally expect a statement confirming this in the annual report.
- 2.28 In our view, the three-yearly report of progress towards achieving community outcomes should be finalised when the information it contains will be of most value for both a local authority and its community in preparing the next LTCCP. This means that the report should be prepared sooner than the latest date allowed by the Act.
- 2.29 Last year, we expected that some of the 2007/08 annual reports we reviewed would contain information about three-yearly reports, given the lead time involved in drafting and consulting on the next LTCCP (the final version of which had a statutory deadline of 30 June 2009) and the desirability of having the progress report available. About a quarter of local authorities had completed

<sup>14</sup> Community outcomes are under review as part of the current Transparency, Accountability and Financial Management reform, because there are concerns about the cost of the “outcomes process”. See paragraphs 2.62 and 2.63.

three-yearly reports on their progress in 2007/08 in achieving community outcomes, and disclosed this in their 2007/08 annual reports.

- 2.30 As part of our audit of the 2009-19 LTCCP, we asked local authorities about their intentions for producing a report based on section 92. Most local authorities that had not completed a three-yearly report in 2007/08 were finalising, or were planning to finalise, the three-yearly reports in the 2008/09 financial year.
- 2.31 Where local authorities failed to finalise the three-yearly report in time to benefit the preparation of the 2009-19 LTCCP, there is a risk that the LTCCP fails to capture all the relevant information about its community. There is also a risk that a local authority might need to amend its LTCCP because new information comes to light through the three-yearly report after the LTCCP is finalised.

### What we found

- 2.32 A few local authorities had completed three-yearly reports during 2008/09, and disclosed this in the 2008/09 annual reports. Some of these local authorities provided a summary of the three-yearly report findings in the annual report. However, some local authorities merely stated that they had completed the three-yearly report, without providing any useful information about the findings. In our view, this does not meet the requirements of the Act.
- 2.33 Some of the local authorities provided comprehensive disclosures, and integrated this reporting with their other annual reporting and their performance management frameworks. Others did not.
- 2.34 Overall, the disclosures made by local authorities did not meet our expectations. Many local authorities did not provide the readers of the annual report with any indication of measurements carried out, or when any measurements were likely to be completed.
- 2.35 We expect a local authority to ensure that its performance management framework is an integrated package that links community outcomes with performance measures, targets, and levels of service. With such a linked framework, it is easier for local authorities to report on progress in achieving community outcomes and the identified effects of activities.
- 2.36 We will continue to monitor this, especially in the 2009/10 financial year. In 2009/10, local authorities will be reporting for the first time against their latest performance frameworks, as outlined in their 2009-19 LTCCP.

## Identified effects of activities on community well-being

- 2.37 Another core part of the framework of the Act is the promotion of environmental, social, economic, and cultural well-being in the local authority's region, city, or district.
- 2.38 Local authorities must involve the community when promoting these four aspects of community well-being.
- 2.39 They are also required to report in their annual report on "any identified effects" (positive and negative) that any activity has on the social, economic, environmental, and cultural well-being of the community.
- 2.40 The fact that an effect must be "identified" means that it must be a measured or observed effect. A local authority needs a system for measuring the effects of its activities so that it can report on them.
- 2.41 We appreciate that this is not easy. It can be challenging for a local authority to identify and report on the full range of effects that an activity may have on social, economic, environmental, and cultural well-being. Some effects are more easily identified than others. For example, the positive environmental and social effects of a local authority's activities to improve recreational water quality in its district can be more easily measured and identified than the effect of providing museums, art galleries, and community centres on social and cultural well-being.

### What we found

- 2.42 Overall, we observed little improvement in the information presented in the 2008/09 annual reports compared with the previous year. A significant proportion of local authorities still did not meet the requirements of clause 15(d) of Schedule 10 – that is, these authorities did not effectively identify the effects of activities on the well-being of the community. These requirements have been in place for five years, and we expected a better performance.
- 2.43 Many local authorities discussed the effects of their activities. However, many of the effects they identified appeared to repeat their aim or objective for that activity rather than report an identified effect. Local authorities need to distinguish between intended and identified effects. For example, the general statement in an annual report that "this activity contributes to economic and social well-being through protecting the safety of residents" is describing an intended effect rather than an identified effect.
- 2.44 Many local authorities failed to explicitly link any discussion of effects of activities to community well-being. Some of these links could be inferred, but

this depended on the quality of the local authority's performance management framework, and in many cases these links were not clearly made.

- 2.45 Under the Act, an annual report is required to report any identified effects, negative or positive. Consistent with reporting against its LTCCP, which requires a local authority to outline any significant negative effects of its activities, a number of local authorities continue to identify only negative effects in their annual report.
- 2.46 A number of local authorities usefully discussed the risks associated with the effects of activities and how these were being managed. Local authorities that prepared better disclosures had highlighted the effect of their activities and projects on community well-being.
- 2.47 Overall, we conclude that many local authorities are still not meeting the requirements of clause 15(d) of Schedule 10 – to clearly report the identified effects of activities on the four aspects of community well-being. We are disappointed at the lack of progress made.
- 2.48 To better meet the requirements of clause 15(d), local authorities could, in particular:
- move from restating local authority aims in the annual report to identifying effects;
  - move to specific consideration and analysis of the effects of activities rather than make generalised statements; and
  - ensure that the performance management framework is an integrated package that links community outcomes and the rationale behind their activity to performance measures, targets, and levels of service. With such a linked framework, it is easier for local authorities to report on progress towards community outcomes and the identified effects of activities.

### **Acquisition and replacement of assets**

- 2.49 The Act, through the LTCCP and the annual plan, creates the framework against which the annual report discloses actual results. This includes how assets will be maintained, replaced, and renewed, and how costs will be met.
- 2.50 Significant asset acquisitions and replacements are noted in planning financial forecasts, and are disclosed in the activity sections of the LTCCP.
- 2.51 The annual report must contain a statement describing any significant acquisitions or replacements of assets, giving the reasons for those acquisitions or



replacements, and explaining any significant variation between acquisitions and replacements projected in the LTCCP and those actually made.

- 2.52 The Act requires us to audit the statements that set out the acquisitions and replacements of assets.

### What we found

- 2.53 We saw only marginal changes in the information presented in the 2008/09 annual reports compared with the previous years. A significant number of local authorities still did not comply with the requirements of clause 15(f) of Schedule 10.
- 2.54 Some local authorities reported significant variations between the LTCCP and the actual asset programme. Few provided meaningful explanations for these variations.
- 2.55 Local authorities that did provide information on, and reasons for, the variations did so in different places in the annual report and, in some cases, in several places. Unless the variation and its reasons are clearly identified and explained in the same section, it is not easy to determine the difference between the LTCCP or annual plan projections and the actual expenditure or acquisitions that occurred during the year.
- 2.56 In some cases, variations between actual expenditure and projections were noted in the report by the mayor, chairperson, or chief executive, and in the financial statements and the statement of service performance. Providing high-level information on significant asset decisions in the mayor's or chairperson's report is useful for the public. However, the mayor's or chairperson's report is not subject to audit, and cannot include all the information required by the Act.
- 2.57 A small number of local authorities provided a list of all assets acquired and disposed of as a separate section in the annual report. They included the reasons for acquiring or disposing of those assets. Where the information and explanations were clear and thorough, they provided useful information about the local authorities' acquisitions and replacement of assets.
- 2.58 Where variations were reported in the financial statements section, they were often aggregated and not linked to the groups of activities to which the relevant assets related. This does not provide the most accessible information to the community about specific actions carried out by the local authority for significant assets, and does not provide the link to activities required by the Act.

- 2.59 Putting asset information with the other required disclosures of financial information and levels of service provision within the group of activities to which it relates keeps this information usefully together in one place.
- 2.60 Overall, we conclude that a significant number of local authorities still do not clearly address the requirements of clause 15(f). This is usually because they do not explain the reasons for the acquisition, replacement, or variation. In some cases, the local authority completely failed to address the requirements.
- 2.61 We remain concerned about this. Asset acquisition and replacement are important for sustaining and developing services and providing confidence to the community that those services will be affordably provided in the long term. Most local authority plans – including the LTCCP – centre on the sustainable delivery of desired levels of service. Identifying an appropriate asset development programme that incorporates acquisition and replacement is central to demonstrating sustainability of services. Without reporting actual performance against this information, an important aspect of accountability is missing, and information useful to the reader is not available.

### Legislative reform

- 2.62 We note the current review of various provisions of the Act, including the nature and scope of reporting on activities. In our view, the review is warranted. Our findings, set out in successive reports, show that the sector is not managing this aspect of reporting particularly well. It matters because progress against outcomes and performance intentions (including asset maintenance and acquisition) are integral to any useful accountability report of a public entity.<sup>15</sup>
- 2.63 The reform process is yet to conclude its Parliamentary phases. Although there is a general call for simplification and clarity in such reporting – which we generally support – there is still much that local authorities can do to ensure that their plans and reports effectively disclose their service delivery intentions and performance to their communities.

<sup>15</sup> See also our June 2008 discussion paper, *The Auditor-General's observations on the quality of performance reporting*.

## Part 3

# Non-standard audit reports issued in 2009

3.1 In this Part, we report on the non-standard audit reports issued during the 2009 calendar year on the financial statements of entities within the local government portfolio of audits.<sup>16</sup>

### Why are we reporting this information?

3.2 An audit report is addressed to the readers of an entity's financial statements. However, all public entities are ultimately accountable to Parliament for their use of public money and their use of any statutory powers or other authority given to them by Parliament. Therefore, we consider it important to draw Parliament's attention to the matters that give rise to non-standard audit reports.

3.3 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?

3.4 A non-standard audit report<sup>17</sup> is one that contains:

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

3.5 An auditor expresses a **qualified opinion** because of:

- a disagreement between the auditor and the entity about the treatment or disclosure of a matter in the financial statements; or
- a limitation in scope because the auditor has been unable to obtain enough evidence to support, and accordingly is unable to express, an opinion on the financial statements or a part of the financial statements.

3.6 There are three types of qualified opinions:

- an "adverse" opinion (see paragraphs 3.10-3.11);
- a "disclaimer of opinion" (see paragraph 3.14); and
- an "except-for" opinion (see paragraphs 3.17-3.18).

<sup>16</sup> The local government portfolio of audits includes regional, city, and district councils, licensing trusts, airports, council-controlled organisations, council-controlled trading organisations, energy companies, port companies, and Sinking Fund Commissioners. We report separately on entities within the central government portfolio in our yearly report on the results of audits for that sector.

<sup>17</sup> A non-standard audit report is issued in accordance with the New Zealand Institute of Chartered Accountants Auditing Standard No. 702: *The Audit Report on an Attest Audit*.

- 3.7 The auditor will include an **explanatory paragraph** (see paragraphs 3.21-3.22) in the audit report to emphasise a matter such as:
- a breach of law;
  - a fundamental uncertainty; or
  - a significant judgement affecting the financial statements.
- 3.8 Auditors are required to ensure that an explanatory paragraph is included in the audit report in such a way that it cannot be mistaken for a qualified opinion.
- 3.9 Figure 5 outlines the decisions to be made when considering the appropriate form of audit report.

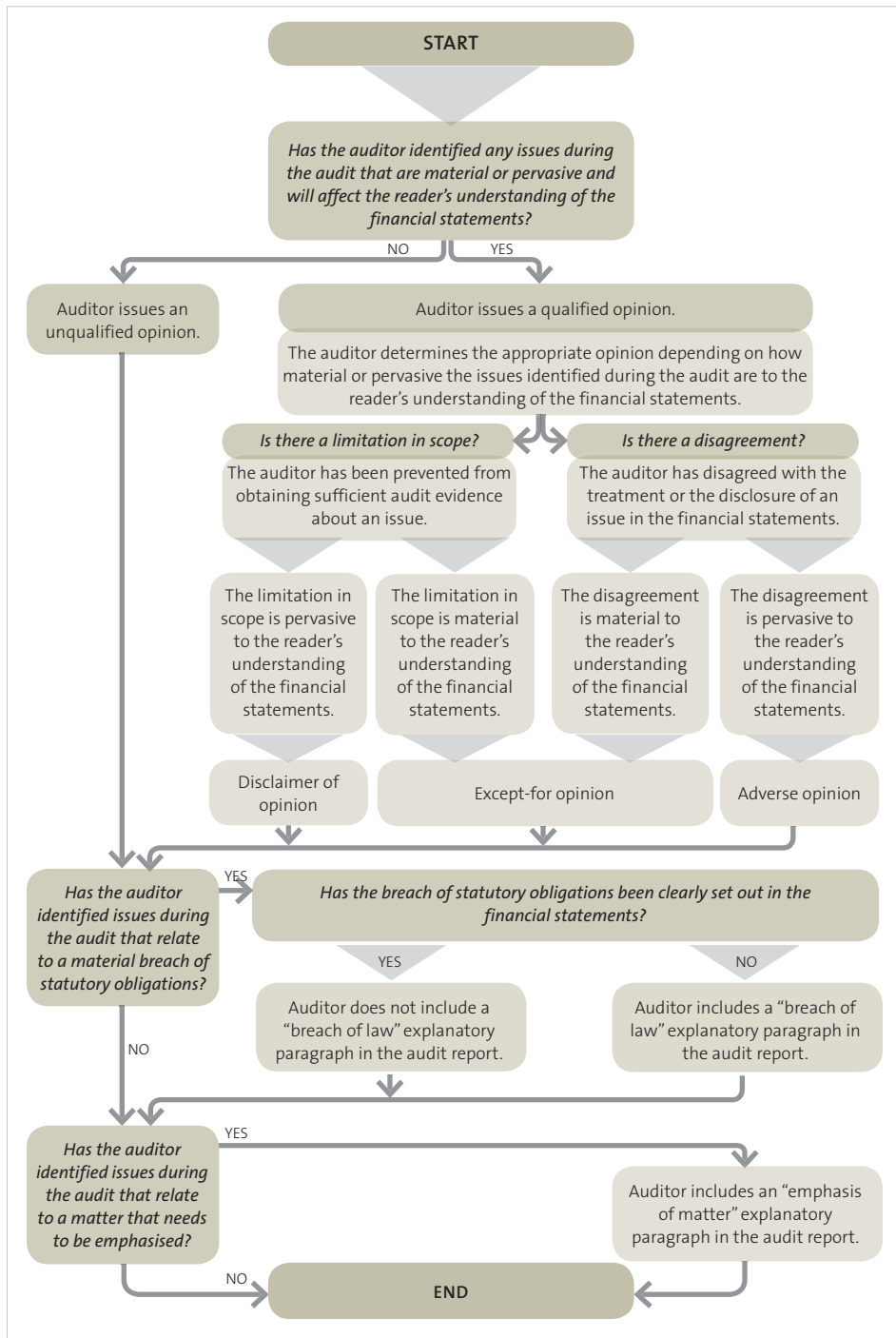
### Adverse opinions

- 3.10 An adverse opinion is the most serious type of non-standard audit report.
- 3.11 An adverse opinion is expressed when the auditor and the entity disagree 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.
- 3.12 During 2009, adverse opinions were expressed for eight entities. In this and the following sections, where an entity is directly or indirectly controlled by one or more city or district councils, we have listed the councils in footnotes:
- Far North Regional Museum Trust (for financial years ended 30 June 2007 and 30 June 2008);<sup>18</sup>
  - The Canterbury Museum Trust Board;
  - The Museum of Transport and Technology Board;
  - Otago Museum Trust Board;
  - Southland Museum and Art Gallery Trust Board Incorporated;<sup>19</sup>
  - Hawarden Licensing Trust;
  - Charleston Goldfields Hall Board; and
  - Millerton Hall Board.
- 3.13 The Appendix sets out the details of the adverse opinions.

<sup>18</sup> Far North District Council.

<sup>19</sup> Gore District Council, Invercargill City Council, and Southland District Council.

**Figure 5**  
Deciding on the appropriate form of audit report



## Disclaimers of opinion

- 3.14 A disclaimer of opinion is expressed when the scope of an auditor's examination is limited, and the possible effect of that limitation is so material or pervasive that the auditor has not been able to obtain enough evidence to support an opinion on the financial statements. The auditor is accordingly unable to express an opinion on the financial statements as a whole or on part of them.
- 3.15 During 2009, a disclaimer of opinion was expressed for Winton Racecourse Reserve Trustees.
- 3.16 The Appendix sets out the details of the disclaimer of opinion.

## Except-for opinions

- 3.17 An except-for opinion is expressed when the auditor reaches one or both of the following conclusions:
- The possible effect of a limitation in the scope of the auditor's examination is (or may be) material, but is not significant enough to require a disclaimer of opinion. 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.
  - The effect of the treatment or disclosure of a matter with which the auditor disagrees is (or may be) material, but is not significant enough to require an adverse opinion. The opinion is qualified by using the words "except for the effects of" the matter giving rise to the disagreement.
- 3.18 An except-for opinion can be expressed when the auditor concludes that a breach of statutory obligations has occurred and that the breach is material to the reader's understanding of the financial statements. An example of this is where a local authority subsidiary has breached the requirements of the Local Government Act 2002 because it has not prepared a statement of intent. The subsidiary is therefore unable to prepare performance information that reflects its achievements measured against performance targets.
- 3.19 During 2009, except-for opinions were expressed for 19 entities:
- Auckland Regional Transport Network Limited;<sup>20, 21</sup>
  - Manukau Building Consultants Limited;<sup>22</sup>
  - Safer Papakura Trust;<sup>23</sup>

<sup>20</sup> Auckland City Council.

<sup>21</sup> The audit report also included an explanatory paragraph that referred to the new local government structure for the Auckland region.

<sup>22</sup> Manukau City Council.

<sup>23</sup> Papakura District Council.

- Invercargill City Council;
- Invercargill City Holdings Limited;<sup>24</sup>
- Wanganui Incorporated;<sup>25</sup>
- West Coast Snowflake Limited (for financial years ended 31 March 2008 and 31 March 2009);
- Village Pool Charitable Trust;<sup>26</sup>
- Tauranga City Venues Limited;<sup>27</sup>
- Te Kauwhata Licensing Trust (for financial years ended 31 March 2006 and 31 March 2007);
- Queenstown National Bank Events Centre Trust;<sup>28</sup>
- Varroa Agency Incorporated;
- Westland Holdings Limited (for financial years ended 30 June 2007 and 30 June 2008);<sup>29</sup>
- Lakes Engineering Limited;<sup>30</sup>
- Pemberton Construction Limited;<sup>31</sup>
- Whangarei Art Museum Management Group;<sup>32</sup>
- Newtons Coachways (1993) Limited;<sup>33</sup>
- Canterbury Economic Development Company Limited; and
- Manawatu Community Trust.<sup>34</sup>

3.20 The Appendix sets out the details of the except-for opinions. In some cases, the audit opinion was qualified for more than one reason.

24 Invercargill City Council.

25 Wanganui District Council.

26 Hastings District Council.

27 Tauranga City Council.

28 Queenstown-Lakes District Council.

29 Westland District Council.

30 Queenstown-Lakes District Council.

31 Waikato District Council.

32 Whangarei District Council.

33 Dunedin City Council.

34 Manawatu District Council.

## Explanatory paragraphs

- 3.21 In certain circumstances, it may be appropriate for the auditor to include additional comments in the audit report. Through an explanatory paragraph, the auditor emphasises a matter that they consider relevant to a reader's proper understanding of an entity's financial statements.
- 3.22 For example, an explanatory paragraph could draw attention to an entity having breached its statutory obligations for matters that may affect or influence a reader's understanding of the entity's financial statements. In this situation, the audit report would normally draw attention to the breach only if the entity had not clearly disclosed the breach in its financial statements.
- 3.23 During 2009, there were eight main types of matters emphasised by auditors in explanatory paragraphs. The first two types – with a total of 38 non-standard opinions – relate to the reforms of the governance arrangements in Auckland.

### Auckland governance reform

- 3.24 The first type of matter is financial statements of the eight local authorities appropriately prepared on a dissolution basis<sup>35</sup> and referring to the new local government structure for the Auckland region:
- Auckland Regional Council;
  - Auckland City Council;
  - Franklin District Council;
  - Manukau City Council;
  - North Shore City Council;
  - Papakura District Council;
  - Rodney District Council; and
  - Waitakere City Council.
- 3.25 The second type of matter is financial statements of 30 subsidiaries of Auckland local authorities referring to the new local government structure for the Auckland region:
- Auckland Regional Council's subsidiaries:
    - Auckland Regional Transport Authority;
    - Auckland Regional Holdings Limited; and
    - Ports of Auckland Limited.

<sup>35</sup> Similar disclosures referring to the new local government structure for the Auckland region were made in the summary audit reports of the local authorities. Such disclosures may have been included in the audit reports of debenture trust deeds and sinking funds where these were issued.



- Auckland City Council's subsidiaries:
  - ARTNL Britomart Limited;
  - Westhaven Marina Limited;
  - Westhaven (Marina Extension) Trust;
  - Westhaven (Existing Marina) Trust;
  - Downtown Marinas Limited;
  - Metrowater;
  - Metrowater Community Trust;
  - Auckland City Water Limited; and
  - Aotea Centre Board of Management.
- Manukau City Council's subsidiaries:
  - Manukau City Investments Limited;
  - Te Puru Community Charitable Trust;
  - Waste Disposal Services;
  - Manukau Water Limited;
  - Manukau Leisure Services Limited;
  - Tomorrow's Manukau Properties Limited;
  - Tomorrow's Manukau Properties (Flat Bush) Limited; and
  - Manukau City Council Sinking Fund Commissioners.
- North Shore City Council's subsidiaries:
  - NSC Holdings Limited;
  - Enterprise North Shore Trust;
  - North Shore Heritage Trust;
  - The North Shore City Performing Arts Centre Management Board Trust; and
  - North Shore Promotions New Zealand Limited.
- Rodney District Council's subsidiary:
  - Rodney Properties Limited.
- Waitakere City Council's subsidiaries:
  - Waitakere City Holdings Limited;
  - Waitakere Properties Limited; and
  - Waitakere Enterprise Trust Board.
- Subsidiary jointly owned by six local authorities:
  - Watercare Services Limited.

## Other explanatory paragraphs

- 3.26 The third type of matter is serious financial difficulties faced by the entities. Entities whose audit reports included such explanatory paragraphs were:
- Waitomo District Council; and
  - Inframax Construction Limited.<sup>36</sup>
- 3.27 The fourth type of matter is disclosure of the depreciation of buildings and improvements over a 60-year period when the lease on these buildings was for only 20 years with a renewal right of 20 years. Pakuranga Arts and Cultural Trust<sup>37</sup> was the only entity whose audit report included such an explanatory paragraph.
- 3.28 The fifth type of matter is fundamental uncertainty about the validity of the “going concern” assumption. Entities whose audit reports included such an explanatory paragraph were:
- Central Plains Water Trust;<sup>38</sup>
  - Westroads Limited;<sup>39</sup>
  - Westroads Greymouth Limited;<sup>39</sup> and
  - Westland Holdings Limited.<sup>39</sup>
- 3.29 The sixth type of matter is financial statements appropriately prepared on the going concern assumption because the financial statements contained appropriate disclosures about the use of the going concern assumption. Entities whose audit reports included such an explanatory paragraph were:
- New Zealand Mutual Liability RiskPool;
  - Timaru District Promotions Trust;<sup>40</sup> and
  - S C Aoraki Development Trust.<sup>40</sup>
- 3.30 The seventh type of matter is where the going concern assumption was appropriately not used because the entities had been disestablished. Entities whose audit reports included such explanatory paragraphs were:
- Hurunui Holdings Limited;<sup>41</sup>
  - Hawke’s Bay Airport Authority;<sup>42</sup>

<sup>36</sup> Waitomo District Council.

<sup>37</sup> Manukau City Council.

<sup>38</sup> Selwyn District Council.

<sup>39</sup> Westland District Council.

<sup>40</sup> Timaru District Council.

<sup>41</sup> Hurunui District Council.

<sup>42</sup> Hastings District Council and Napier City Council.

- Taupo District Economic Development Advisory Board;<sup>43</sup>
- Ngā Tapuwāe Community Facilities Trust;<sup>44</sup>
- Forever Beech Limited (for financial years ended 30 June 2008 and 30 June 2009);
- North Shore City Council Sinking Fund Commissioners;
- The Hutt City Council Sinking Fund Commissioners;
- Waitakere City Council Sinking Fund Commissioners;
- Dunedin City Council Sinking Fund Commissioners;
- Bay of Plenty Regional Council Sinking Fund Commissioners;
- Proudly Papakura Trust;<sup>45</sup> and
- TTCF West Auckland Limited.

3.31 The eighth type of matter is where breaches of statutory obligations were disclosed in the audit reports. Entities whose audit reports included such explanatory paragraphs were:

- Riccarton Bush Trustees;<sup>46</sup>
- Te Kohaka o Tuhaitara Trust;<sup>47</sup>
- Whakatane Airport Authority;<sup>48</sup>
- Balfour Cemetery Trust (for statement of accounts covering two years ended 31 March 2008); and
- North Shore Domain and North Harbour Stadium Trust Board (for financial years ended 28 February 2007 and 29 February 2008).<sup>49</sup>

3.32 The Appendix contains more information about the explanatory paragraphs that were included in the audit reports.

43 Taupo District Council.

44 Manukau City Council.

45 Papakura District Council.

46 Christchurch City Council.

47 Waimakariri District Council.

48 Whakatane District Council.

49 North Shore City Council.



## Part 4

# Local authority exposure to liabilities from leaky home claims

### Summary

- 4.1 Provisions amounting to \$201.1 million have been included in the 2008/09 financial statements of the six local authorities most significantly affected by the leaky homes issue. This is an increase of \$33.2 million, or 20%, on the amount disclosed a year earlier.
- 4.2 The six most affected local authorities are getting better at reporting their leaky home liabilities. We are continuing to see small improvements that indicate an overall refinement in the information that local authorities disclose, and in the information on which the disclosures have been based. However, the uncertainties associated with assessing the future liabilities for leaky home claims remain high.
- 4.3 Overall, the amount that these six local authorities have disclosed as contingent liabilities in their 2008/09 financial statements – \$378.2 million – has decreased from last year. This has led to increased provisions recognised in the financial statements. It is clear that leaky home liabilities remain a significant issue for these six local authorities in particular, and for the local government sector as a whole.
- 4.4 It is important to note that the amounts disclosed as provisions (\$201.1 million) and as contingent liabilities (\$378.2 million) are not the complete future liability for these six local authorities, because three of them have still not quantified and disclosed in their financial statements an estimate for claims yet to be made. The extent of liability recognised by the local authorities is already significant. The full extent of the liability for the local government sector is potentially much greater.
- 4.5 The situation is now worse because RiskPool<sup>50</sup> no longer provides insurance cover for this type of claim. From June 2009, no insurance companies are providing cover to local authorities for their leaky home liabilities. Insurance cover had been progressively reducing during the last three years. The lack of any cover adds to the significance and financial effect of the leaky homes issue for the sector.

### Background

- 4.6 In 2007, we considered the annual reporting requirements of local authorities in accounting for liabilities from leaky home claims. We issued guidance to our auditors to help them assess leaky home liabilities for each stage of the claims process. The principles included in our guidance were given to local authorities by their appointed auditor.

<sup>50</sup> More information about RiskPool is available on the Civic Assurance website – [www.civicasurance.co.nz](http://www.civicasurance.co.nz).

- 4.7 In our reports, *Local government: Results of the 2006/07 audits*<sup>51</sup> and *Local government: Results of the 2007/08 audits*,<sup>52</sup> we considered the disclosures made by the six most significantly affected local authorities and assessed how well their disclosures were aligned with the guidance we had issued. Here, we update our findings from the disclosures included in the 2008/09 financial statements.
- 4.8 In 2007, when we started monitoring the leaky home liability issue, the six most significantly affected local authorities were Auckland City Council, Christchurch City Council, North Shore City Council, Rodney District Council, Waitakere City Council, and Wellington City Council. Four of these local authorities will be incorporated within the boundaries of the new Auckland “super city”.
- 4.9 Manukau City Council and Tauranga City Council now also face a high level of claims.<sup>53</sup> Other local authorities have some claims against them, but the number and value of these claims is much lower. However, to compare disclosures with our previous years of analysis, we have reviewed the same six local authorities we originally identified in 2007.
- 4.10 If we included Manukau City Council and Tauranga City Council, this would add \$1.1 million to the total amount accounted for as provisions by the six local authorities that we focus on here. In their 2008/09 financial statements, neither Manukau City Council nor Tauranga City Council accounted for future liabilities from leaky homes, either as provisions or as quantified contingent liabilities.

### Provisions and contingent liabilities

- 4.11 Simply put, in the interests of transparent reporting and accountability, there is an important difference between recording a leaky home liability as a provision and recording it as a contingent liability. Provisions are included within the balance sheet of the financial statements. Contingent liabilities are included in the Notes to the financial statements – they are less obvious to the reader, and may not be quantified. The assumptions and estimation methods for provisions and any contingent liabilities are supposed to be clearly explained, so that readers of the financial statements can understand how accurate the amounts might be.

### Categories of claims facing local authorities

- 4.12 We identified three categories of claims that local authorities need to consider when assessing their current and future exposure to liability for leaky homes. Each category represents a progressively increasing level of uncertainty about the extent of a local authority’s financial obligations:

51 Published in June 2008, and available on our website at [www.oag.govt.nz](http://www.oag.govt.nz).

52 Published in June 2009, and available on our website at [www.oag.govt.nz](http://www.oag.govt.nz).

53 In 2007, Manukau City Council and Tauranga City Council had claim levels that were significantly below the six most affected local authorities. Now, they have claims levels higher than those of Rodney District Council.

- category one – claims that have been investigated and reviewed, and the amount of the total claim and the local authority's share has been confirmed;
- category two – claims that are still being investigated and confirmed, which includes work to assess whether other available parties will share the liability and work to assess the costs; and
- category three – claims that might be made against local authorities between now and the end of the statutory limitation period but that have not yet been lodged, which includes issues that might not yet have been identified by the home owner.

4.13 Categories two and three are of greatest concern to local authorities because of the associated high level of uncertainty. These categories reflect the “tail” of the leaky home liability facing the country.

### Accounting treatment

- 4.14 The accounting standard that applies to accounting for leaky home liabilities is New Zealand Equivalent to International Accounting Standard 37: *Provisions, Contingent Liabilities and Contingent Assets* (NZ IAS 37). This standard provides the definitions and criteria to identify whether a liability should be accounted for as a provision or disclosed as a contingency. The most relevant element of the criteria for leaky home liabilities is the assessment of whether a liability, which needs to be estimated, can be calculated with enough reliability to meet the definition of a provision.
- 4.15 Our guidance to auditors on the appropriate accounting treatment based on the categories of claims was:
- category one – a provision for the confirmed amount should be recorded in the financial statements;
  - category two – a provision for the estimated amount should be recorded in the financial statements; and
  - category three – a provision should be recorded in the financial statements if an actuarial assessment has been obtained and is reliable; otherwise it should be disclosed as a contingent liability.
- 4.16 In practice, identifying category two and category three claims has proved more complex than we anticipated when we wrote our guidance. In our guidance, we assumed that an actuarial assessment, particularly if carried out by professional actuaries, would be enough to meet the requirements of NZ IAS 37 and facilitate accounting for the liability within the financial statements. However, the estimation processes used to assess category two and category three liabilities,

whether done in-house or by a professional actuary, have, in many cases, not been reliable enough to enable the resulting estimation to be accounted for as a provision in the financial statements. The estimation processes are not reliable enough because there are too many variables that apply to each individual leaky home case.

### Approach taken by local authorities

- 4.17 The six local authorities made few changes to the disclosures in their 2008/09 financial statements compared with those in their 2006/07 and 2007/08 financial statements, other than the reassessment. In all cases, the local authorities were facing increases in the amount of leaky home liabilities.

### Accounting for category one claims

- 4.18 All six local authorities continued, as they did in 2007/08 and earlier years, to appropriately provide for notified and confirmed claims.

### Accounting for category two claims

- 4.19 For category two claims, all six local authorities increased the amount from that provided in the 2007/08 financial statements. One local authority improved its approach to accounting for leaky home liabilities by making provisions for category one and two claims, where it had previously provided only for category one claims and treated the remainder of the liabilities as contingencies. Another local authority made the same change in 2007/08. These changes reflect an ongoing improvement in the quality of the information disclosed in the local authorities' financial statements. We are pleased to see this trend.
- 4.20 As we noted in the previous two years, the six local authorities continue to vary in how they treat claims that have been notified but not yet investigated and confirmed. In many instances, based on the information disclosed in the financial statements, it is not clear what approach the local authorities have taken to account for this category of claims. In some instances, the local authority has divided category two claims into two parts. The part where a higher level of certainty has been obtained has been accounted for as a provision, while the remainder has been treated as a contingent liability. None of the local authorities following this approach included in their disclosures an explanation of the basis that they had used to make such a distinction.
- 4.21 We observed last year that the six local authorities were using actuaries and other professional expertise to assess leaky home liabilities, but the reliability of the estimate can be uncertain even when an actuarial assessment has been completed. This situation continues and, in many instances, still prevents the local authority from meeting the requirements of the accounting standard.



NZ IAS 37 requires the estimate to be reliable. The disclosure of the assumptions and uncertainties surrounding the estimate should enable the liability to be treated as a provision and not a contingent liability.

- 4.22 Because of this, three of the six local authorities have continued to disclose category two claims as contingent liabilities rather than account for them as provisions in the balance sheet.
- 4.23 In our view, there is also considerable scope for local authorities that have accounted for category two claims as provisions in the financial statements to provide clearer and more descriptive explanations of the assumptions and uncertainties on which the provision is based.

#### Accounting for category three claims

- 4.24 The approach to disclosing contingent liabilities continues to vary. With future leaky home claims, all six local authorities included some disclosure in their financial statements acknowledging a contingent liability. Two of the six included a quantified contingent liability for future leaky home claims in their 2008/09 financial statements. The remaining four local authorities have all recorded the issue as part of their contingent liability disclosures, but without quantifying the estimated future cost to the local authority.
- 4.25 There is room for all six local authorities to improve the clarity of their explanations of their contingent liability disclosures. One of the six local authorities has included an estimate of the total liability for all parties involved, not just the local authority's specific share of potential costs. Two of the six local authorities have disclosed their use of an actuarial assessment to gain an understanding of the extent of the liability they might face in the future. Other local authorities imply the use of actuarial assessments, but this is not clearly stated.

#### Total amounts disclosed as contingent liabilities

- 4.26 This year, there has been a decrease in the total amount the six local authorities have disclosed as contingent liabilities. The main reason for the overall decrease is Auckland City Council's decrease of \$77 million. Auckland City Council improved the accuracy of its assessments, allowing it to reduce its contingent liabilities and increase its provisions for leaky home claims.
- 4.27 Also, home owners are filing increasingly more accurate claims and actuaries are able to refine their estimation process because of the acquired knowledge from the increasing number of settled claims. However, for the sector as a whole, much uncertainty remains despite the professional expertise that actuaries are able to contribute to the estimation process.

- 4.28 We accept that the uncertainties linked with the assumptions that an actuary is required to make do not provide the desired level of clarity. Nevertheless, the increased involvement of actuaries in the assessment of these liabilities has contributed to improved disclosure in the financial statements of the six local authorities in the past three years. The decreased liability recorded by Auckland City Council for the 2008/09 year is particularly strong evidence of the refinement of these liabilities that is occurring.

### Reduced insurance cover for leaky home claims

- 4.29 Local Government Mutual Funds Trustee Limited (RiskPool), a mutual fund created by local authorities to provide liability protection, is the main insurer for local authorities. Because of the extremely high value of the claims related to leaky homes, RiskPool has progressively reduced the extent of insurance cover for leaky home claims during the last three years. Until June 2009, this was reflected in annual limits for insurance cover for those local authorities with a great many or particularly costly claims. From June 2009, RiskPool has completely excluded leaky home claims from its insurance cover. This leaves local authorities with no insurance cover for this already very costly type of liability.
- 4.30 In June 2009, RiskPool had to make a call for capital funding from its members<sup>54</sup> because of high deficits in the fund. RiskPool expects to make further calls for funding during 2009/10. RiskPool was not fully reinsured for all years of the fund because full reinsurance for leaky homes was not available.<sup>55</sup>
- 4.31 The costs of the June 2009 call for funding, and expected future calls, combined with the withdrawal of insurance cover, contribute to the substantial burden that leaky home claims are placing on local authorities.

### 2010 Budget announcement

- 4.32 In May 2010, the Government announced a proposed financial assistance package for homeowners with leaky homes. If a homeowner opts to take up the financial assistance package, the proposal would see the Government providing funds to meet 25% of an eligible homeowner's repair costs. Local authorities would be required to contribute 25% of the repair costs, and the homeowner would pay the remaining 50%.
- 4.33 It is unclear at this time whether this proposal will have any effect on the extent of the liability faced by local authorities.

<sup>54</sup> Membership of RiskPool is open to all local authorities.

<sup>55</sup> RiskPool (June 2009), *Annual Report*, pages 2-4.

## Part 5

# Reforming local government in Auckland

- 5.1 The reform of local government in Auckland began in 2009, after the report of the Royal Commission on Auckland Governance (the Royal Commission) and the Government's decision to initiate the reform process. The reforms are currently in progress, with the new Auckland Council due to be operational from 1 November 2010.
- 5.2 In this Part, we:
- provide an overview of some aspects of the reforms; and
  - describe the effect of the reform on the role and work of the Auditor-General.

### Background to the reforms

- 5.3 The Royal Commission was established in October 2007. It completed its work and reported its findings and recommendations in March 2009.
- 5.4 The Government moved quickly to begin the reform process, and made certain decisions about its direction and the course it would follow. Legislation initiating the reforms was introduced into Parliament and was enacted as the Local Government (Tamaki Makaurau Reorganisation) Act 2009 on 23 May 2009. Further legislation was introduced and enacted as the Local Government (Auckland Council) Act 2009 on 22 September 2009. A third bill, the Local Government (Auckland Law Reform) Bill, was introduced into Parliament on 10 December 2009 and passed on 3 June 2010.
- 5.5 The reform legislation makes special provision for local government in Auckland in addition to the statutory provisions – including the Local Government Act 2002 (the Act) – that apply generally to the local government sector. The legislation provides for the transition from the current structure to the new structure. It also provides for some unique features of the new structure that will distinguish the Auckland local government arrangements from arrangements elsewhere in New Zealand.
- 5.6 The legislation provides for the dissolution of existing local authorities in Auckland<sup>56</sup> and for the creation of a new Auckland Council, as a unitary local authority, from 1 November 2010, together with a new group structure that includes substantial council-controlled organisations. Some of these organisations will deliver public services to ratepayers that many other local authorities deliver directly.
- 5.7 The legislation also provides for the establishment of the Auckland Transition Agency to prepare for and oversee the transition to the new Auckland Council,

<sup>56</sup> Auckland City Council, Auckland Regional Council, Franklin District Council, Manukau City Council, North Shore City Council, Papakura District Council, Rodney District Council, and Waitakere City Council.

including approving certain decisions by existing local government organisations in Auckland.

- 5.8 In addition, the reform legislation requires the Local Government Commission to determine the relevant boundaries for local boards within the region covered by Auckland Council, and to determine a new southern regional boundary that will also affect the neighbouring local authorities.<sup>57</sup>

## The role of the Auditor-General and the effect of the reforms

### The overall approach of the Auditor-General

#### The Auditor-General's mandate

- 5.9 The Auditor-General is the auditor of all public entities in New Zealand, in accordance with the Public Audit Act 2001. The Auditor-General has a number of areas of interest, including matters of waste, performance, and probity.
- 5.10 Under the Public Audit Act, the Auditor-General is required to audit certain accountability documents. We refer to these audits, which are conducted on behalf of the Auditor-General by our appointed auditors, as our non-discretionary work. Generally, this work relates to the audit of financial statements (including statements of service performance) within annual reports and, for local authorities, the audit of their long-term council community plans (LTCCPs).
- 5.11 In addition, the Public Audit Act allows the Auditor-General to perform other work, which we refer to as discretionary work. The Auditor-General chooses to carry out performance audits and inquiries (either at the Auditor-General's own initiative or in response to requests) under these provisions.

#### The general effect of the reforms on the Auditor-General's mandate

- 5.12 The broad responsibilities of the Auditor-General set out in the Public Audit Act are not changing with the reforms in Auckland. However, the reforms do affect how the Auditor-General carries out those responsibilities.
- 5.13 The transition between old and new arrangements brings a number of risks, and the Auditor-General wants to be assured and to provide assurance that these risks are being managed well. For example, significant change programmes can create tensions between achieving change and its objectives on the one hand, and maintaining necessary due process (such as appropriate procurement practice) on the other hand. Those charged with implementing the reforms need to carefully manage these tensions.

<sup>57</sup> Waikato District Council, Hauraki District Council, and Environment Waikato.

- 5.14 Once established, the new local government arrangements in Auckland will be significantly different from the previous arrangements, both in their nature and scale. They will significantly affect the delivery of important public services. The new arrangements differ from arrangements elsewhere in the local government sector, and could change the relationship between local and central government.
- 5.15 Together, these factors mean that the reforms in Auckland have a significant effect on the way that the Auditor-General's role is carried out.
- 5.16 The Auditor-General is monitoring the reforms with a view to identifying the short-term and longer-term effects, and planning the appropriate responses to them.

#### **The effect on the Auditor-General's non-discretionary audits**

- 5.17 The reforms change the incidence, timing, and content of the accountability documents that Auckland's local government entities are required to prepare. Accordingly, the reforms have a significant effect on the approach that the Auditor-General's appointed auditors need to take in carrying out non-discretionary audits during the transition.

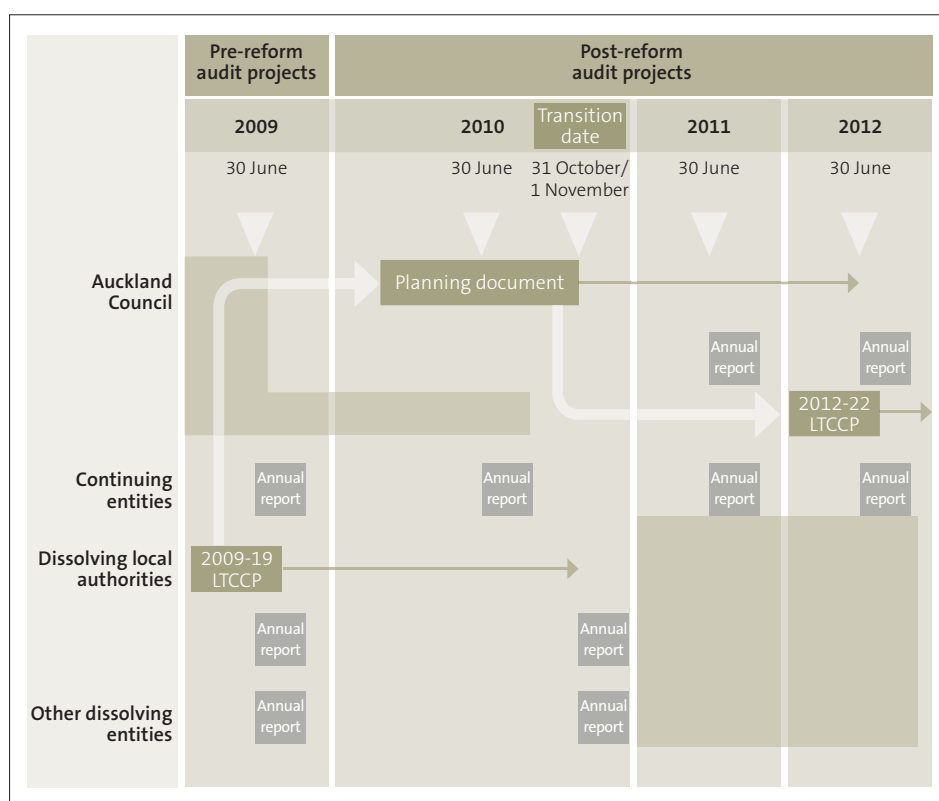
#### **Audit of the Auckland Transition Agency**

- 5.18 The Auditor-General must audit the Auckland Transition Agency. This entity will exist until the transition date of 1 November 2010, and will then be dissolved. It is required to prepare one annual report covering the whole of its period of existence, from May 2009.

#### **Audit of local government entities in Auckland**

- 5.19 The reforms involve the dissolution of some existing local government entities in Auckland and the creation of others. Some entities' scale and operations will be significantly different. For example:
- from 1 November 2010, eight local authorities will be replaced by the new Auckland Council;
  - the Auckland Regional Transport Authority will be replaced by Auckland Transport, which will be a larger and more integrated regional operation; and
  - Watercare Services Limited will become a fully integrated regional water company.
- 5.20 Figure 6 summarises the effect of the reforms on the incidence and timing of our audits of local government entities in Auckland during the transition period.

**Figure 6**  
Non-discretionary audits during the transition period



### Non-standard audit opinions already issued

- 5.21 Where entities are expected to continue operating, the “going concern” assumption is applied when the financial statements are prepared. Where legislation provides for dissolution, the going concern assumption is not appropriate and the accountability documents must reflect this.
- 5.22 The Auckland reform process was begun before local authorities’ 2009-19 LTCCPs were completed, and before the 2008/09 annual reports for local authorities and related council organisations were finalised.
- 5.23 Accordingly, local authorities could not prepare accountability documents for 2008/09 (LTCCPs and annual reports) using the going concern assumption, and had to disclose this fact. These accountability documents also had to disclose the uncertainty about the reforms and their potential effect.

- 5.24 The 2008/09 accountability documents (annual reports) for related council organisations could appropriately be prepared using the going concern assumption because their dissolution was not provided for in legislation at the time they were finalised. They did, however, have to reflect uncertainty about the reforms and their potential effect.
- 5.25 Furthermore, the local authorities neighbouring Auckland to the south had to consider disclosing uncertainty about the effect of the likely boundary changes for the Auckland region, because they could be materially affected by these changes.
- 5.26 As a result of the above factors, we issued non-standard 2008/09 audit opinions for Auckland local authorities and related council organisations, and for two of the three local authorities on the southern Auckland border (for the third local authority, the matter was considered immaterial at the time). These opinions were unqualified, but were non-standard because they drew attention to the disclosures made by the entities of uncertainties about the reforms, and, in the case of existing Auckland local authorities, to the inapplicability of the going concern assumption.
- 5.27 For 2008/09, our appointed auditors issued non-standard audit opinions for 38 affected Auckland entities and for two local authorities neighbouring the Auckland region. Figure 7 sets out a summary of these opinions.

**Figure 7****Non-standard 2008/09 audit opinions arising from the Auckland reforms**

	Going concern assumption applied?	Uncertainty about reform and its effect?
<b>Existing Auckland local authorities (8)</b>		
2009-19 LTCCP	No, highlighting basis used	Yes, highlighting disclosure of uncertainty
2008/09 annual report	No, highlighting basis used	Yes, highlighting disclosure of uncertainty
<b>Neighbouring local authorities to the south of Auckland region (3)</b>		
2009-19 LTCCP		
Hauraki District Council	Yes	Not considered material for audit purposes
Waikato District Council and Environment Waikato	Yes	Yes, highlighting disclosure of uncertainty
2008/09 annual report	Yes	Not considered material
<b>Other related Auckland organisations (30)</b>		
Annual reports	Yes	Yes, highlighting disclosure of uncertainty

- 5.28 We discussed non-standard audit opinions issued in the local government sector in Part 3.

**Effect on Auckland local government entities' public accountability documents in 2010**

- 5.29 We expect that local government entities in Auckland will need to take a similar approach to their 2010 accountability documents to that taken in 2009. For some entities, this is because of dissolution, and, for others, because there will continue to be uncertainty about the reforms and their potential effect. For these reasons, we also expect our appointed auditors to issue non-standard audit opinions for audits that will be completed in 2010.
- 5.30 Existing local authorities in Auckland are dissolved by legislation from 1 November 2010, together with some related council organisations. Legislation requires that final annual reports for these entities must be prepared up to the date of dissolution. For 2009/10, their historical financial year-end of 30 June is changed to 31 October in 2010 to accommodate a final 16-month reporting period. The dissolving local authorities are also required to prepare plans for the final four months of their existence to supplement the annual plans that were already in place up to 30 June 2010 before the reform process began. In reporting for the 16-month period up to dissolution, local authorities will need to report against the combination of the annual plan up to 30 June 2010 and the additional four-month plan up to 31 October 2010 required by the Auckland reform legislation.
- 5.31 Although the reforms dissolve some related council organisations, others will continue but will be affected by the reorganisation of the Auckland Council's group structure. These council organisations retain a 30 June financial year-end in 2010.

**Special arrangements required for consolidation information in some cases**

- 5.32 The annual reports of dissolving entities that are required to be prepared up to 31 October 2010 and that are required to include consolidated financial statements will need to reflect information about subsidiaries and other related council organisations that is prepared up to 31 October 2010. Where those subsidiaries and other related council organisations are not dissolving, and therefore retain the usual 30 June financial year-end, parent entities will need to make special arrangements with those entities for the relevant information to be provided to them for consolidation purposes.



### Responsibility for finalising accountability reports after dissolution

- 5.33 Entities remain fully responsible under their respective legislative frameworks for activities up to the date of dissolution. In practice, the final annual reports for those entities can be finalised only after the dissolution date. It is crucial in reforms of this nature that appropriate practical arrangements are put in place to ensure that this can be achieved.
- 5.34 The Auckland reform legislation sets out the responsibility for completing these final annual reports, as shown in Figure 8.

**Figure 8**

### Responsibility for completing the final annual reports of entities that will be dissolved

Entities that will be dissolved	Responsible entities
Local authorities	Auckland Council
Council organisations	Receiving organisations – those organisations that assume the dissolving entities' assets and operations
Auckland Transition Authority	Under the Public Finance Act 1989, the Minister of Finance can allocate responsibility

- 5.35 We expect that dissolving entities will:
- continue to fulfil current legislative responsibilities; and
  - where necessary, take steps to complete the work in the period before dissolution that is required to help with the eventual completion of accountability documents after dissolution.
- 5.36 We expect that those charged with overseeing the reforms will ensure appropriate continuity and handover of relevant information and knowledge in the lead up to, and beyond, the dissolution date. We also expect that enough priority will be given to completing the historical accountability documents of dissolving entities by those new and surviving entities charged with responsibility for finalising them.
- 2011 and beyond**
- 5.37 In 2011, Auckland public entities revert to a 30 June financial year-end, and planning and reporting requirements (and our audit of the latter) will be based on this date. Accordingly, new entities established by the reform have a shortened first reporting period of eight months starting on 1 November 2010 and ending on 30 June 2011.

5.38 In 2012, these entities will revert to a normal 12-month reporting period ending on 30 June.

#### **Auckland Council's planning document**

5.39 LTCCPs of existing local authorities (which are audited) continue to be operative until dissolution on 1 November 2010.

5.40 The new Auckland Council is required by the reform legislation to prepare a planning document that is operative from 1 November 2010. The planning document will provide a basis for planning and reporting from the first day of Auckland Council's existence. For Auckland Council's first eight months, the planning document will stand in place of the annual plan required under the Act and in place of the LTCCP required under the Act. The legislation makes special provisions for the planning document, including a requirement that it be audited.

5.41 In 2012, Auckland Council will be required to prepare its first LTCCP in keeping with the Act's requirements, and on the same basis as all other New Zealand local authorities.

#### **The effect on the Auditor-General's discretionary work**

5.42 Since the start of the reform process, we have seen an increase in the volume of requests for us to carry out inquiries, and a change in the nature of some of these requests.

5.43 As a result of the reforms, we have put plans in place for how we monitor the reforms and how we use our discretionary resource in appropriate ways.

5.44 Our annual plan for 2010/11 includes a number of projects that address issues directly and indirectly relevant to the Auckland reforms. For example, we plan to carry out specific projects that cover:

- a performance audit and report to Parliament that considers the demand for water in the Auckland region; and
- reports to Parliament about matters arising, and lessons learned, from our audit of Auckland Council's planning document and from our final audits of the dissolving entities.

## Part 6

# Service performance information

### Summary

- 6.1 All local authorities must have robust performance management frameworks and meaningful levels of service, measures, and targets. Otherwise, it is difficult for the community and the local authority to clearly understand its performance and effectiveness.
- 6.2 Since 2003, local authorities have used their long-term council community plans (LTCCPs) to further refine their performance planning and monitoring practices. This should give the local government sector an advantage over other parts of the public sector when it comes to performance reporting.
- 6.3 The recently appointed Auditor-General has expressed general disappointment that performance reporting has improved very little in the last 15 to 20 years, despite considerable effort by many. She considers that better performance information and reporting will help address the current and ongoing challenges for the public sector, and has asked for continued support to achieve improvement.
- 6.4 In this Part, we set out what we did in 2009/10 to implement enhancements to our statutory duty to attest to the statement of service performance information in local authorities' annual reports. From 2009/10, auditors of local authorities will not only be reporting on whether the annual report reflects the local authority's performance for the year expressed by the existing measures in the LTCCP, they will also be checking that the annual report's use of these measures provides an adequate basis for the informed assessment of the local authority's actual service performance. Service performance information<sup>58</sup> provides primarily non-financial information that records the output delivery performance of a public entity against specified objectives.
- 6.5 We are currently drafting a publication that showcases better practice performance measures from selected 2009-19 LTCCPs. The publication is intended to promote discussion rather than be a technical guide on performance measures for various activities.

### Background

- 6.6 During the last couple of years, we have reviewed and updated our approach to auditing performance information and have been phasing in improvements to how we audit this information. During 2009, we consulted on and finalised a revision of the Auditor-General's auditing standard on performance information

<sup>58</sup> For ease of reading, in this Part we use the term "performance information" when referring to service performance information.

(AG-4),<sup>59</sup> which is available on our website ([www.oag.govt.nz](http://www.oag.govt.nz)). The previous version of this standard required auditors to attest to whether the statement of service performance (SSP) fairly reflected the standards of service delivery *compared with the forecast standards* in the forecast SSP. Auditors applied this standard in auditing the 2008/09 annual report performance information.

- 6.7 The key change in the revised standard is that auditors will be required to attest to whether the SSP fairly reflects *actual service performance* for the year. This is a subtle wording change but an important change to the reporting required from local authorities and the judgement required by auditors. The change will mean that auditors will be expected to increase their focus on the appropriateness of the service reported by local authorities.
- 6.8 AG-4 (revised) *The Audit of Service Performance Reports* is effective for audits of service performance reports of local authorities for periods beginning on or after 1 July 2009.

## Introduction of the Auditor-General's revised standard for auditing service performance reporting

- 6.9 The auditing standards set standards for auditors, not for those who prepare external financial and non-financial reports. AG-4 (revised) starts from the principle that our audit approach should be consistent with the approach we take to auditing financial information, varying to reflect the nature of the matters of audit interest. The changes of emphasis in the revised standard reflect legislative changes, local authorities' improved description of levels of service, and management and public expectations.
- 6.10 Given the new requirements, the focus of our work will be on:
- confirming that the performance framework remains appropriate, taking into account any changes in activity since the LTCCP was prepared (taking assurance to the full extent permissible from the audit work performed on the LTCCP);
  - the quality of the overall "story" the performance reporting tells;
  - the reliability and accuracy of the reporting;
  - the completeness of the reporting against the performance framework outlined in the LTCCP; and
  - compliance with relevant legislation (in particular, Schedule 10 of the Local Government Act 2002).

<sup>59</sup> The revised AG-4 is intended to apply to audits of local authorities and government departments, and of Crown entities that are required to prepare a statement of intent and statement of service performance under sections 139 and 150 of the Crown Entities Act 2004. This excludes the audit of service performance reports of other Crown entities (such as tertiary education institutions and those Crown entities required to prepare and report against a statement of corporate intent) and council-controlled organisations whose service performance reporting requirements are governed by other legislation.

- 6.11 A key change in our audit approach is that auditors will consider financial and non-financial elements of the audit together, to take into account how the local authority manages and delivers its services, how it manages its finances, and how service delivery affects its finances.
- 6.12 During the 2009-19 LTCCP audits, our auditors assessed whether the performance frameworks set out in local authorities' LTCCPs would be supported by:
- good quality monitoring and reporting of what was actually achieved during the year;
  - levels of service, systems, and controls that are used in practice; and
  - a good quality assurance system that gives assurance about the quality and relevance of information.
- 6.13 In some instances during the 2009-19 LTCCP audits, our auditors were concerned that the specific service level measures and targets provided in LTCCPs may not result in reasonably complete and balanced reporting. However, the specific service levels, when taken with the other information provided about the activity as a whole, did give a more useful basis for an informed assessment. Local authorities were advised that, in preparing annual reports against their LTCCPs, they should provide information for each activity as a whole, to allow readers to make an informed assessment of the achievements for financial management of service delivery and assets.

### Issues that may affect audit opinions

- 6.14 There are a range of circumstances under AG-4 (revised) that could cause us to modify the audit opinion on the service performance report, or otherwise require explanation in the audit report. These include:
- the annual report not reflecting actual service performance against outputs or performance measures, or targets or results being omitted or inappropriately or poorly reported on;
  - unexplained and significant variations to the previous year's results and LTCCP forecast results;
  - omitted, inappropriate, or poor reporting on material outputs, performance measures, targets, or results;
  - results for material performance measures that cannot be substantiated, or deficient systems and processes for performance information;
  - non-compliance with laws and regulations for approval, format, publication, and circulation of plans and service performance reports; and
  - insufficient, inconsistent, or misleading management commentary in the service performance report, or between service performance and financial results.

- 6.15 We are yet to consider the effect of different circumstances on the nature of the audit opinion and will be working carefully through issues that arise in auditing under AG-4 (revised) as we carry out the 2009/10 audits of local authorities.

### **Implications for local authority audits**

- 6.16 The local government sector has an important advantage over the rest of the public sector through its developing practice of planning and monitoring performance through LTCCPs.
- 6.17 Effective performance reporting is:
- useful;
  - appropriate; and
  - presented in a structured, systematic, and logical way.
- 6.18 The revised auditing standard outlines how auditors assess local authorities as preparers of service performance reports. Our expectation is that local authorities will report against their actual achievements, including a description of achievements – assuming they have adequate performance information and controls, and there is an internal quality assurance process that gives confidence about the quality and relevance of the information. This is where local authorities should focus their efforts to get the maximum benefit from our increased audit effort.
- 6.19 We recognise that we have a key role to play in providing assurance about performance information, and that we must work with local authorities to meet the reasonable expectations of residents, ratepayers, and other stakeholders for useful information to underpin the system of accountability.

### **Better practice examples discussion paper**

- 6.20 We are currently drafting a publication that showcases better practice performance measures from selected 2009-19 LTCCPs. The purpose of this publication is to highlight the better examples from common performance measures within those LTCCPs, and to suggest improvements for preparing 2012-22 LTCCPs. The 2009-19 LTCCP is, in most instances, the third 10-year plan that local authorities have produced in accordance with the Local Government Act 2002. Our forthcoming publication is intended to promote discussion rather than be a technical guide on performance measures for various activities.

## Part 7

# Inquiries since July 2008

### The overall picture of our inquiries work

- 7.1 In our last two annual reports to Parliament,<sup>60</sup> we have noted that the inquiries function of the Office is coming under increasing pressure. The volume of requests has increased and, more significantly, the scale and complexity of the issues we are being asked to consider has also increased. In particular, in 2008/09, our work was dominated by a number of large and high-profile inquiries that we were asked to carry out by public entities or by their responsible Ministers.
- 7.2 In this Part, we discuss:
- how we approach requests for inquiries;
  - recurring issues raised in requests; and
  - three major inquiries in the local government sector that we completed in 2008/09:
    - leasing arrangements between the Thames-Coromandel District Council and a councillor;
    - Auckland Regional Council’s management of the visit of the LA Galaxy football team; and
    - Auckland City Council’s management of footpath contracts.

### The number of requests for inquiries we receive

- 7.3 In 2008/09, we received a total of 271 requests for inquiries, and carried forward 27 from the previous year. We completed responses to 254 requests and carried forward 44 to the next year. A significant volume of our overall inquiries workload continues to be generated by the local government sector. More than 150 of the 271 requests received and 170 of the completed responses related to local government matters. Of the matters that resulted in inquiry work by us, more than 70% were in the local government sector.

### Focus on the Local Authorities (Members’ Interests) Act 1968

- 7.4 We have also carried out several significant inquiries and noted an unusual level of work related to the Local Authorities (Members’ Interests) Act 1968. The question of whether councillors have financial or other conflicts of interest in decisions made by their local authority has become a more significant part of our work. In particular, during the last year or more, we investigated possible breaches of the Local Authorities (Members’ Interests) Act 1968 in the Thames-Coromandel District Council and Environment Canterbury. We discuss these issues separately later in this Part (Thames-Coromandel District Council, see paragraphs 7.28-7.37) and in Part 8 (Environment Canterbury, see paragraphs 8.12-8.42).

<sup>60</sup> *Annual Report 2007/08, September 2008 and Annual Report 2008/09, September 2009.*

## How we approach requests for inquiries

- 7.5 We receive a large number of requests for inquiries each year. Often, we receive a number of requests about the same issue if it is a matter of public controversy. Most requests do not result in an inquiry. Some raise issues that are outside our mandate, have not yet been raised directly with the relevant public entity, or are better dealt with by another organisation. In such cases, we advise correspondents that we cannot assist, and may suggest other steps they could take.
- 7.6 For those requests that we decide are correctly directed to us, we consider each one to determine the most appropriate way to proceed. Factors we consider include the seriousness of the issues raised, whether we consider an inquiry to be in the public's interest, and whether we have the resources to consider the issues.
- 7.7 We classify inquiries into three categories – “routine”, “sensitive”, and “major” – depending on the seriousness of the issues raised. A routine inquiry involves straightforward issues, and can often be carried out either by a review of documents or through correspondence and discussion with the public entity. It will not usually result in a published report. We always advise the correspondent of our conclusions and the reasons for them, and in some instances we advise the public entity of the matter.
- 7.8 Sensitive and major inquiries involve more complex issues and may attract a broader level of public interest and attention. During these inquiries, we will often review the entity's files and may also formally interview people. We sometimes report the results of these inquiries publicly, as well as advise the correspondent and the entity.

## The role of the Auditor-General, and its limits

- 7.9 The correspondence we receive shows that many people do not understand the role of the Auditor-General, and its limits. For example, we get a wide range of requests asking us to:
- intervene in decision-making by local authorities;
  - injunct or stop activities and contracts;
  - make a judgement about the legality of actions; or
  - review individual decisions with which the correspondent disagrees.
- 7.10 It is often not our role to consider or review the matters raised or we have no power to provide the response that is sought. In such cases, our response inevitably disappoints the correspondent and adds to their frustration.



- 7.11 Therefore, we are working to improve the information we make available about the role of the Auditor-General and our approach to requests for inquiries, so that it is easier for people to understand when we can usefully get involved and why.
- 7.12 Our primary function is to audit public entities. We have some capacity to examine in more detail issues of concern that are raised with us, but there are limits to that capacity. Therefore, we choose carefully which requests for inquiries we follow up. We examine requests to identify whether the issues raised suggest financial impropriety, problems with the organisation's overall governance and management, or other systemic or significant concerns that may be important for the organisation or the sector, or be of general public interest. We do not see the Auditor-General's office as an avenue for resolving individual complaints or concerns about how a public entity has handled a particular matter.
- 7.13 Pressure on our inquiries function and resourcing means that we are getting stricter about which issues we take up, and about not engaging in extended correspondence on routine matters. In particular, we are working to streamline our processes for responding to routine inquiries, so that we can concentrate our efforts on the more substantial issues considered in sensitive and major inquiries.

## Recurring issues raised in requests

### Challenges to the decision-making process

- 7.14 We noted last year<sup>61</sup> that we often receive complaints that a local authority has not complied with the decision-making process set out in the Local Government Act 2002 (the Act). This is particularly common when the authority is making decisions about major and expensive projects, such as infrastructure development. For example, during the last year we have been asked to look at the way in which decisions were made about sewage schemes and treatment plants, aspects of the Dunedin sports stadium development, the Nelson Performing Arts Centre, the Christchurch School of Music proposal, and the Indoor Community Sports Centre in Wellington.
- 7.15 Requests of this kind are sometimes from lobby groups that are opposed to the development, or even from councillors who are unhappy with the majority decision of the council. Although the concerns with the decision and the process may be genuine, in practical terms, people often hope that asking us to inquire may stall or stop the process. That is rarely the result, because the Auditor-General has the power only to inquire and report, and has no power to intervene. Moreover, inquiries into such issues take time, whereas the project is usually driven by its own more complex timetable and continues to proceed.

61. *Local government: Results of the 2007/08 audits*, June 2009, Part 5.

- 7.16 Only a court can rule conclusively on whether the authority has complied with the detail of the legislation. We note that the requirements of the Act's decision-making provisions have been tested in the courts several times recently and that the case law is not yet settled. The Local Government Act 2002 Amendment Bill also proposes amendments to the relevant provisions. It is not the role of the Auditor-General to make detailed or definitive rulings on the application of these provisions to particular facts.
- 7.17 When we do inquire into such matters, our focus is on the practical question of whether we can see sound administrative and decision-making processes operating, and whether we have any doubts about overall compliance with the legislative requirements.

### **Non-financial conflicts of interest**

- 7.18 The other major theme running through the requests for inquiry that we receive is conflicts of interest. We discuss financial conflicts of interest and the specific rules in the Local Authorities (Members' Interests) Act 1968 in Part 8. Here we discuss allegations that elected members are participating in decisions in which they have a non-financial conflict of interest. The suggestion of a conflict of interest can arise for a number of reasons, including because the councillor:
- is a member of, or employed by, another organisation (and so may have a conflict of roles);
  - may have relatives in relevant roles; or
  - may have strong political views on the issue (suggesting bias or predetermination).
- 7.19 Concerns of this kind are regularly raised with us by members of the public, local authority staff, and other councillors. Sometimes it is clear that there is a political dimension, for example, if the councillor in question is opposing the position of the correspondent on the issue. In other cases, the question is raised with us because there is a genuine technical concern about the legal risk to the decision-making process that is being created by the possible conflict of interest. And sometimes, the concern is simply from a member of the public who thinks that the involvement just cannot be right.
- 7.20 In legal terms, judgements about the existence, significance, and effect of non-financial conflicts of interest are complex and highly fact-specific. In particular, they involve balancing the realities of a political decision-making forum and process (an elected local authority) with the procedural expectations that have developed in administrative law to ensure fair and proper decision-making.

- 7.21 Although the Auditor-General has a specific formal role with financial conflicts of interest in the local government sector, we do not have any special role with non-financial conflicts of interest. In our successive good practice guides, we have traditionally offered some guidance on the general issues that public entities should be thinking about, and the general principles that apply. However, we have no enforcement role and cannot give formal rulings.
- 7.22 In our experience, most council staff are able to provide informed and practical advice to councillors on these issues. If staff have major concerns about a particular current or potential issue, we encourage them to get specific legal advice rather than to seek general guidance from us. That said, we understand that, at times, staff find it helpful to talk an issue through in general terms. In such cases, we are happy to act as a sounding board, and to provide general comments on the approach being developed.

### General behaviour of elected members

- 7.23 Another recurring theme in the correspondence we receive is concern about the general behaviour of elected members. The conduct in question is not usually related to any particular activity or expenditure, but is a more general concern. Examples include concerns about elected members who may be disclosing confidential information inappropriately, refusing to co-operate with ordinary council processes and systems, deluging council staff with unreasonable requests for information, refusing to take advice on legal risks they are creating for the council, or simply perceived as rude or abusive.
- 7.24 The nature of democracy in the local government sector is that local authorities are made up of a mix of people with a range of styles and political beliefs. They do not always get on with each other. It can be challenging for a group of elected individuals to become a coherent and well-functioning governance and decision-making body, despite their differences. It requires a measure of give and take on all sides, as the group settles into agreed processes for allowing different perspectives to be aired without undermining their ability to get business done.
- 7.25 The Act requires each local authority to adopt a code of conduct for its members that sets out the expectations on such matters. The local authority can amend the code of conduct. The aim is that each local authority agrees on the set of rules that will regulate the behaviour of its members at a personal and political level. Some codes of conduct include mechanisms for investigating breaches and applying sanctions. These sanctions also operate at the political level. In general, we do not see it as appropriate for the Auditor-General to get involved in matters of personal and political discipline. Councillors are elected members – if a

ratepayer is unhappy with the general behaviour or attitude of a councillor, their primary recourse is the ballot box. Accordingly, we will usually decline requests to inquire into the general behaviour of elected members.

- 7.26 Similarly, we do not have any role in providing guidance on or inquiring into compliance with council standing orders. These are internal matters for councils to deal with.

### Requests from sitting councillors about current issues

- 7.27 A final theme to note is that we are regularly approached by elected members raising concerns about decisions made by their own council. In general, we expect elected members to be able to raise their concerns directly with the council rather than involving us. They have access to the chief executive for administrative and management matters. Policy questions and other matters are debated around the council table, and they have an opportunity to voice their concerns in that forum. It will not usually be appropriate for us to revisit an issue that has already been debated and decided on at the council table.

## Thames-Coromandel District Council leasing arrangements

- 7.28 We were asked to inquire into aspects of how the Thames-Coromandel District Council (the Council) managed leasing arrangements for a block of land on Moewai Road, Whitianga. The Council leased the land to Mr Sieling before he was elected to the Council in 2007. Our inquiry considered how the Council had managed the lease for the land and had handled Cr Sieling's interest in the lease.

### The Council's management of the lease

- 7.29 Most local authorities have extensive land holdings. Our findings from this inquiry reinforce the importance for all local authorities to have effective systems and processes to manage their land well on behalf of their communities.
- 7.30 Our expectation, and the expectation of any ratepayer, would be for a lease of land to be formally documented as soon as possible after any agreement was negotiated. A formal lease agreement provides clarity about the terms and conditions of the lease of the land that had been agreed by the two parties.
- 7.31 We found and reported<sup>62</sup> that the Council had not effectively managed the land, because it did not formally document a lease agreement or have arrangements in place to manage its interests in the land. The lack of a formally documented lease agreement caused confusion when council staff provided advice to the Council about possible and best uses for the land. Council staff were proposing alternative

<sup>62</sup> *How the Thames-Coromandel District Council managed leasing arrangements for Council land in Whitianga*, February 2010.

uses for the land without recognising that Cr Sieling had legally enforceable rights and obligations effectively equivalent to a lease.

### The handling of Cr Sieling's interest in the lease

- 7.32 It is important that any conflicts of interest are identified and managed appropriately, to ensure that fairness, transparency, and objectivity are maintained.
- 7.33 As a councillor, Cr Sieling received the full agenda papers for the Council Service Delivery committee meeting, outlining proposals for alternative uses for the land.
- 7.34 We considered the reasonableness of the administrative process followed by the Council for distributing council agenda papers. The Council's administration systems did not adequately support the management of conflicts of interest, because council staff did not consider whether to withhold agenda papers about the land from Cr Sieling.
- 7.35 At the meetings to discuss the land, Cr Sieling took steps to declare a conflict of interest and remove himself from discussions about the land in his role as a councillor. However, Cr Sieling did make a presentation at the public forum of the Council's Service Delivery Committee, advising the Committee that he had a lease on the land and wanted to continue this arrangement. Our guidance for members of local authorities about the law on conflicts of interest states that:
- Having declared a pecuniary interest and left the formal confines of the meeting, you are entitled, as a private citizen, and consistent with the rights of any member of the public, to address comments to the meeting from that area of the room where the public is able to be present.<sup>63</sup>*
- 7.36 Our Office discussed this matter with Cr Sieling. He noted that he was of the view that discussing the matter in the public forum was the only way he could prevent his rights as a private citizen from being overridden by the Council's actions. He knew that the Council had been provided with incorrect or incomplete information and believed that speaking publicly was his only option to correct the situation.
- 7.37 In our view, Cr Sieling handled his interest in the land in a reasonable manner.

<sup>63</sup> *Guidance for members of local authorities about the law on conflicts of interest*, June 2007, page 34.

## Auckland Regional Council: Management of the LA Galaxy event at Mount Smart Stadium

- 7.38 In December 2008, the Auckland Regional Council (the Council) hosted an exhibition football match between the Los Angeles-based LA Galaxy team (which included international football star David Beckham) and an Oceania “All Stars” team at Mount Smart Stadium.
- 7.39 The Council organised and promoted the event and took on all of the financial risk, rather than entering into a risk-sharing arrangement with the LA Galaxy team or a promoter. The event resulted in a loss to the Council of \$1.88 million because far fewer people bought tickets to the match than the Council had expected.
- 7.40 In December 2008, after receiving a request from the chairman of the Council, the Auditor-General agreed to review the Council’s handling of the event. The Auditor-General decided an inquiry was warranted because of the size of the loss, and because there was public interest in how that loss came about. We completed our inquiry and reported our findings publicly in January 2010.<sup>64</sup>
- 7.41 We concluded that, despite the efforts of the council officers involved, the loss occurred because the LA Galaxy/Oceania “All Stars” match was the wrong event, at the wrong time, for the wrong price.
- 7.42 Our inquiry focused on the governance of Mount Smart Stadium and its position in the Council’s structure and operations, and on the Council’s systems for monitoring and overseeing large events such as the LA Galaxy/Oceania football match.
- 7.43 Mount Smart is one of several reserves for which the Council is responsible. However, we found that the Mount Smart operation did not fit well with the Council’s other functions and operations, and the Council had not, at the time, considered or agreed on suitable governance and business models for it. Although there was a general view within the Council that Mount Smart Stadium needed to operate commercially, the decision to promote the LA Galaxy event was made without a formal business strategy or a clear policy about the level of commercial risk that the Council was willing to assume.
- 7.44 The Council took on the role of promoter of an event for the first time. The Council understood the nature of the business risk – that all profits or losses would accrue to the Council – but underestimated or even discounted the possibility of a loss.
- 7.45 We spoke to managers of other stadiums and similar facilities, mostly in public ownership. We noted different business models, but common to all was a clear appreciation of the risk involved in events promotion, and a preference to avoid that risk as much as possible.

<sup>64</sup> Auckland Regional Council: Management of the LA Galaxy event at Mount Smart Stadium, January 2010.

- 7.46 Our report noted that there is a tension inherent in operating commercially in the public sector. Public officials must ensure that publicly owned assets are used effectively and efficiently for the benefit of the community (which might include earning income from those assets) and without waste or extravagance. The obligation to use the facility efficiently means that the entity cannot decline to carry out commercial activities. Yet business opportunities rarely come without risk. The public sector commercial manager needs to balance the need to exploit business opportunities and take on business risk with the obligations of being a steward of public assets.
- 7.47 We commented that the problem is exacerbated by having several competing facilities in Auckland, mostly also in public ownership. We also noted the proposed establishment of a new council-controlled organisation to operate major facilities and events in Auckland as part of the Auckland local government reforms.
- 7.48 The Council carried out its own review of the LA Galaxy/Oceania “All Stars” event. We were satisfied that the Council had correctly identified the problems with its governance and management of Mount Smart Stadium, and that it was taking appropriate steps to address those problems.

### **Auckland City Council: Management of footpaths contracts**

- 7.49 In May 2009, after receiving a request from the Auckland City Council (the Council), the Auditor-General agreed to carry out an inquiry into the Council’s management of its footpaths contracts. Our inquiry was completed, and the findings publicly reported, in February 2010.<sup>65</sup>
- 7.50 The Auditor-General was aware of, and concerned about, persistent allegations that the Council had mismanaged its footpaths contracts. During the eight-year period that our inquiry covered, the Council’s expenditure on footpaths work amounted to more than \$190 million. Therefore, the Council’s footpaths contracts were financially significant, and the allegations raised questions about the integrity of the Council’s processes for managing them and about potential over-payments. The allegations also raised questions about the behaviour and conduct of the Council’s staff involved in managing its footpaths contracts.
- 7.51 Our inquiry considered several specific allegations. It also considered the wider strategic and organisational context for the Council’s approach to footpaths over an eight-year period and the relevant administrative procedures that were applied. Our inquiry also considered the adequacy of various internal reviews and investigations of footpaths work carried out for, or by, the Council.

<sup>65</sup> *Auckland City Council: Management of footpaths contracts*, February 2010.

- 7.52 Overall, we found that the Council's processes and procedures for managing its footpaths contracts – while still evolving – were reasonable and had been applied adequately. We found no fundamental flaws or gaps in the Council's contract management processes, no apparent evidence of corruption at any level, and no waste. However, in keeping with most large and complex asset management systems, we did find some areas where the Council could improve its administrative processes. Accordingly, we made four recommendations and a number of relatively minor comments and suggestions.
- 7.53 The concerns that were raised publicly had some basis in fact. Our inquiry showed that the concerns were not as serious as they originally appeared, and were dealt with appropriately. For example, the instance of an individual accepting a gift did not compromise the integrity of the 2009 footpaths contract procurement process, and was appropriately dealt with as a personnel issue. We were satisfied that the Council had the necessary controls and procedures to mitigate the potential for this type of situation to happen, and to mitigate any effect if it did happen again.
- 7.54 Our inquiry confirmed that the Council had a reasonable basis for accepting the footpaths measurements that underpinned the payments it made under the footpaths contracts. It had been alleged that measurements were inadequate in some cases, resulting in over-payments by the Council.
- 7.55 Our inquiry also found that the Council's own internal review and investigation of various matters arising under its footpaths contracts had been adequate and reasonable.



## Part 8

# How the Local Authorities (Members' Interests) Act 1968 operates

- 8.1 We are aware that how the Local Authorities (Members' Interests) Act 1968 (the Act) operates has created some concern in the sector during the last year or more. In this Part, we discuss:
- what the Act does;
  - the Auditor-General's role under the Act;
  - how we approach investigations into possible breaches of the Act;
  - our investigation into possible conflicts of interest by Environment Canterbury councillors;
  - the process and decisions that followed our investigation into Environment Canterbury;
  - general principles to consider when applying the Act; and
  - problems with the Act and the need for reform.

- 8.2 This discussion is intended to provide the sector with more certainty about how we are approaching the Act's requirements, and what people need to do to comply. It also highlights that there are some problems with the Act that cannot be solved without legislative reform.

### What the Act does

- 8.3 The Act is unusual in the public sector. It sets some firm rules on the management of financial conflicts of interest for elected members and backs these rules with criminal offences and penalties. The Act is also unusual in that it gives the Auditor-General a decision-making and approval role, and also a prosecuting function.
- 8.4 The Act has two main rules, which we refer to here as the contracting rule (in section 3 of the Act) and the participation rule (in section 6 of the Act):
- The contracting rule prevents a councillor from having interests in contracts with the local authority that are worth more than \$25,000 in a year, unless the Auditor-General approves the contracts. Breach of the rule results in automatic disqualification from office.
  - The participation rule prevents a councillor from participating in a decision in which they have a financial interest, other than an interest in common with the public. The Auditor-General can approve participation in limited circumstances. Breach of the rule is a criminal offence, and conviction results in automatic disqualification from office.
- 8.5 Both rules have a complex series of subsidiary rules about their scope and exceptions.

8.6 For many years, our work under the Act has mostly related to administering the contracting rule and requests for approval of contracts. In the past, queries or complaints about the participation rule were less frequent – usually when councillors sought approval to participate in a particular decision. However, that pattern has been changing during the last two years. We have seen a significant increase in the number of allegations that councillors are participating in decisions that they should not, as well as in the number of general requests for advice.

### The Auditor-General's role under the Act

8.7 The Auditor-General has two formal roles under the Act:

- to consider applications for approvals or exemptions under both rules; and
- to investigate and, if necessary, prosecute councillors who breach the Act.

8.8 We have a strong focus on providing guidance and assistance to help councillors and council staff to do the right thing and avoid breaches of the Act. For many years, we have published a guide to the Act,<sup>66</sup> which we update around the time of local authority elections. Occasionally, we provide training on the Act's requirements and our administrative processes for applications. We also regularly talk through issues with council staff or councillors when they are uncertain about what to do.

### How we approach investigations into possible breaches of the Act

8.9 Our approach to investigating potential breaches of the Act has traditionally been low key. We are aware that investigations inevitably involve intrusion into the personal financial affairs of the councillor because we need to understand the extent and nature of their personal financial interests. The fact of an investigation can also affect a person's reputation, even if the investigation determines that they have not breached the Act. If the investigation suggests that a councillor has breached the Act, the issues can be tested in court. Therefore, our usual approach is not to publicise this work, or to provide details of our findings and analysis.

8.10 However, during the last year or more, we have investigated publicly made allegations of breaches of the Act that have attracted considerable local public interest. In those situations, we have decided that it better serves the public interest for us to report more fully on our investigations and conclusions.

8.11 We have recently noted an increase in the number of allegations of breaches being made to us, many of which prove not to be well-founded when we investigate. We are concerned about the personal and administrative cost for

<sup>66</sup> The most recent version is *Guidance for members of local authorities about the law on conflicts of interest*, June 2007.

the individuals and council staff when we investigate a breach, particularly if the allegation and the fact of an investigation are also made public. We intend to consider carefully which complaints warrant investigation and to require some evidence of a potential breach rather than simple assertions before we respond.

## Our investigation into possible conflicts of interest by Environment Canterbury councillors

### The complaint and the facts

- 8.12 We received a complaint in July 2009 that three councillors at Environment Canterbury (the Council) had breached section 6 of the Act by discussing and voting on a proposal to recover the costs of managing water resources. A complaint about a fourth councillor was added later.
- 8.13 The proposal that the Council considered was to recover \$2.2 million (31%) of its water management costs from holders of certain types of consents, through charges imposed under section 36 of the Resource Management Act 1991 (the RMA). Previously, all the costs had been met from general rates. The proposed charges would be limited to holders of permits to take ground water and surface water, and to holders of permits to discharge contaminants either to land or water. The charges would differ depending on the location and type of the consent, and the amount of water taken and/or type of contaminant discharged.
- 8.14 Four councillors were potentially affected by the proposal, because they or their spouse held relevant consents either in their own name or through companies in which they were shareholders.
- 8.15 The proposal came to the Council at two meetings in 2009. The first meeting was on 5 March 2009, when the Council – as part of the draft long-term council community plan (LTCCP) process – was required to vote on whether to approve the draft fees and charges for 2009/10 for consultation. Three of the four councillors participated in the discussion and voting. One councillor abstained.
- 8.16 The Council then met on 4 June 2009 to consider submissions and adopt the final LTCCP. There were a number of motions put to the Council at the meeting about the charging proposal. All four councillors participated in the discussions and decisions made during this meeting.
- 8.17 Council staff calculated that the effect of the charges on two councillors would have been small and would have been outweighed by their savings in general rates. For the other two councillors, the charges would have been more significant, with overall net costs of \$977 and \$1,628.

### Our analysis

- 8.18 We began our analysis by considering whether the four councillors had a financial interest in each of the decisions. We concluded that at the point of the first decision, in March, the proposal included several different options and could still change significantly as a result of the consultation. There was enough uncertainty about the final shape of the proposal for us to be satisfied that at that point the councillors could not be regarded as having a reasonable expectation of loss or gain of money as a result of the decision being made. Therefore, they did not have a financial interest in that decision.
- 8.19 The decision in June was different, because by then submissions had been received and the Council was making final decisions on what charging regime to implement. At this point, we regarded the councillors as having a reasonable expectation that the proposal would affect them financially. Therefore, each of them had a financial interest in these decisions.
- 8.20 We carefully considered whether the councillors' financial interests could be regarded as interests in common with the public. Most decisions about rating and charging, including targeted schemes, are broad enough in their application to be regarded as affecting the public generally. We gathered information on the number of ratepayers in the region, and the proportion of them who held RMA consents. A further subset held consents that would be subject to the proposed water charges – about 2.7% of ratepayers. We concluded that the interests of those consent holders were different in kind and extent from the interest of the general public (whose rates would slightly decrease), and that they formed a small and clearly identified subset of the population.
- 8.21 On balance, it was our judgement that the interests of the four councillors, who as consent holders were subject to the charges, were not interests that could be regarded as interests in common with the public.
- 8.22 We went on to consider the various exceptions in the Act, and concluded that none applied in this situation. Therefore, all four councillors had breached the Act, despite the fact that some of them had very small interests. However, we noted that this was the type of situation where we would have considered an application to approve participation, if the councillors had applied for an exemption in advance.

### Our decision on prosecution

- 8.23 Next, we had to consider whether it would be appropriate to prosecute in this situation. We concluded that it would not, for several reasons. One of the councillors had specifically sought legal advice about this issue, and had shared it with the other councillors. That advice had said that they were able to participate.

Although we disagreed with the advice, councillors had taken advice on what was appropriate. Other relevant factors included that we would have seriously considered permitting participation if we had been asked at the right time, and that the financial interest for most of them was small.

- 8.24 We were aware that our judgement on whether a financial interest existed was a finely balanced one, and highly fact-specific. We knew that our decision on prosecution might also be controversial. Therefore, we asked the Crown Law Office to review our decision. That Office agreed both that a breach of the Act had occurred on these facts and that it was not appropriate to prosecute.
- 8.25 Given the level of public interest in our investigation and the issues relating to the Council and water management in the region, we released a full report explaining our decision in December 2009.<sup>67</sup>

## The process and decisions that followed our investigation into Environment Canterbury

### The decisions that Environment Canterbury still had to make

- 8.26 Our investigation focused on decisions that had already been made. However, the Council had to make further decisions on the proposed water charges because the implementation of the charges had been deferred to allow further and more detailed community consultation.
- 8.27 Therefore, the Council, on behalf of all four councillors, applied for exemptions to enable them to participate in the decisions that were to come. These decisions related to the final shape of the charging scheme and its implementation, followed by the incorporation of the effects of that decision in the next budget and annual plan.
- 8.28 After further consultation, the detailed implementation of the scheme had changed a little and so the Council provided us with updated information on the charges that would apply to each councillor. Each councillor also gave us a summary of their financial situation, to enable us to assess the significance of the charges.

### Approvals to participate because the interests were not significant

- 8.29 Three of the councillors had interests that we regarded as insignificant in terms of the Act. The test in the Act is that the financial interest is so remote or insignificant that it cannot reasonably be regarded as likely to influence the councillor's participation.

<sup>67</sup> Investigation into conflicts of interest of four councillors at Environment Canterbury, December 2009.

- 8.30 For the four councillors, the effects were predicted to be:
- under \$40;
  - between \$50 and \$300;
  - between \$600 and \$1,800; and
  - between \$1,200 and \$9,000.
- 8.31 We considered these effects against the total expenses of each person's businesses. Given that these were farming or rural businesses, the total outgoings were generally large.
- 8.32 For the first three councillors, we concluded in each case that the effect was insignificant in the context of the individual's financial situation and could not reasonably be regarded as influencing the councillor's views. Therefore, we gave general approval for them to participate in all of the remaining decisions on this issue.
- 8.33 We decided that we could not give an approval under this provision for the fourth councillor. We regarded a potential charge of up to \$9,000 as significant enough that it could reasonably be regarded as influencing her views.

### **Our decision on an application to participate on democratic grounds**

- 8.34 We then considered whether to grant approval to the fourth councillor under section 6(4) of the Act. Under this provision, we can grant approval when we are satisfied that applying the prohibition would impede the transaction of business by the local authority or that participation would be in the interests of electors.
- 8.35 The factors that we identified as relevant included:
- The decision on whether and how to impose the water consent charges was to be taken first and separately from the more general decisions on the overall annual plan and budget for the year.
  - The constituency represented by the councillor was a large rural one likely to be affected by the proposed charges, so the question of representation was important. However, the primary purpose of the representative role is to ensure that the views of the community are understood when decisions are made. In this case, the Council was already well informed about the views of the community as it had carried out a significant amount of consultation, including very recent and specific local consultation.
- 8.36 We decided that the fourth councillor's personal financial interest was direct and significant enough that she should not be able to participate in the Council's decision on 11 February 2010, which was specifically on the adoption of the funding methodology for those charges. Although the representative role is

important, we regarded the perspective of those she represented as being well understood by the Council. Therefore, we did not grant her a declaration to enable participation in that particular decision.

### **Our approach to participation in the more general decisions that followed**

- 8.37 We took a different view on the decisions that followed, which related to more general business about the overall budget and annual plan. We considered that the councillor did not have a financial interest in those more general decisions, even though they incorporated the effects of the decision on the water charges. Therefore, the prohibition was limited to the specific decision on applying the charges and the methodology to be used. Given the democratic context, we regarded it as important to limit the disqualification to the direct decisions only.
- 8.38 We confirmed this view for the Council for all of the planning decisions that followed, and continued to regard it as appropriate for all councillors to participate in those general matters.

### **Overall comments**

- 8.39 The Council's situation presented a particularly complex set of issues, and involved an unusual combination of circumstances. We do not expect such issues to arise frequently.
- 8.40 The key issue was whether the interests of the councillors could be regarded as interests in common with the public. The particular characteristics of the type of user charges being proposed, and the fact that the subset of the population to whom they would apply was so small and readily identified, were both significant.
- 8.41 Another factor was that the decisions in question were whether to adopt the charges and what charging methodology to apply. So, the effect of them on the individuals was reasonably clear and direct.
- 8.42 For the councillor whose financial interest was very small, it is arguable whether that needed to be recognised and approved at all. But for the other councillors, the financial interest was significant enough that it was appropriate to seek approval to participate, given the way the Act is written.

### **General principles to consider when applying the Act**

- 8.43 We are aware that our decision in this case has caused some concern in the sector. We have received many requests for advice and guidance since then, and several requests for approvals to participate. Our decision has also come up regularly in our general discussions with local authorities.

- 8.44 Although we see the Council's situation as relatively unusual, we note that it highlights that the Act is not well designed for the decision-making needs of modern local authorities. In particular, it is not well equipped for dealing with targeted rating and charging decisions, and a "user pays" environment. We discuss these problems below.
- 8.45 We are concerned that many individuals and elected members have become unduly risk-averse as a result of the publicity about this decision. We emphasise that the Council's situation involved an unusual combination of factors; we do not expect similar situations to arise very often. General charging and rating decisions of this kind would usually be covered by the "interest in common with the public" test.
- 8.46 To help councillors and council staff, we are producing further guidance material on the principles and factors to apply to work out whether there is a financial interest that might prohibit them from participating in council decisions. For those who wish to apply to us for approvals to participate, we will be making clear what information we need to be able to process the application promptly. We summarise that guidance here.

### **What is the decision being made?**

- 8.47 The nature of a particular decision can be important. There are many situations where the decision is in fact a procedural one, or a more general decision – for example, a decision to approve an overall budget to be included in a consultation process – rather than a decision on whether to agree to a specific proposal.
- 8.48 We recognise the importance of the democratic context in which the Act applies. Therefore, we take a cautious approach to disqualification so that any limits on participation resulting from the Act are clearly defined. Although a councillor may be disqualified from participating in a specific decision as a result of a financial interest, we are often able to determine that the interest does not prevent them from participating in more general decisions that may incorporate the result of the specific decision. Again, Environment Canterbury's situation provides a useful illustration of this approach, in that the fourth councillor was able to participate in the subsequent overall budget and planning decisions, despite her personal interest in the specific proposal on water charges.

### **Do I have a financial interest in that decision?**

- 8.49 Deciding if you have a financial interest in a decision can be difficult. The Act's definition of what counts as a financial interest includes many scenarios. The interest can be direct or indirect and can be held by you or your spouse. Certain company interests are also specifically included.



8.50 Having identified a relevant interest, it is also important to check that the interest will actually be affected by the particular decision that is to be made. Often, we find that a councillor has a financial interest in an issue, but that it will not be affected by the decision that the authority is about to take. For example, the decision may only be to raise an issue for discussion or to begin a research or consultation process. That decision may not have any particular effect on the councillor's financial interest.

8.51 In a number of our recent decisions, we have emphasised the importance of this aspect. The definition of financial interest that we use is:

*Whether, if the matter were dealt with in a particular way, discussing or voting on that matter could reasonably give rise to an expectation of a gain or loss of money for the member concerned.*

8.52 This point picks up on the concept of "reasonable expectation". Many council proposals move slowly through many stages – from a general idea, through development and consultation, to a firm proposal and implementation. When a proposal is in the early stages of general discussion and development, it may not be far enough advanced or clear enough for the councillor to have a "reasonable expectation" of gain or loss. There may be a general possibility, but nothing concrete enough to amount to an expectation. That obviously changes as the issue moves towards a fully developed proposal ready for adoption and implementation. Councillors need to be careful in recognising when a proposal reaches the stage where it affects their financial interest and they should no longer participate in the decision-making process.

### **Is the interest in common with the public?**

8.53 There are no hard and fast rules on whether an interest is held in common with the public. However, the two extremes are simple. For example:

- A general rating decision clearly affects everyone and the interests of councillors in that decision will be in common with the interests of all ratepayers.
- A decision that affects property values in one street that includes a councillor's home or business clearly affects only a small number of people and affects them directly. The councillor's interest is not held in common with the public.

8.54 In between these two extremes there is considerable room for judgement. We do not consider it possible to define a simple threshold of the number of people who need to be affected, or a percentage of the population, or the size of the effect on the individual – although all of these factors may at times be relevant. In each case, the individual facts will matter.

- 8.55 After our decision about Environment Canterbury, a number of people seem to have assumed that any targeted rate or charge will automatically cause a problem for the councillors that it affects. We do not agree with that view. Almost all rating decisions, including targeted rates, will affect interests that are held in common with the public. The same is likely for most charging and “user pays” decisions.
- 8.56 For several complaints that we received during the last year or more, we concluded that targeted decisions that affected councillors as part of a group were not problematic. In those cases, the group represented a reasonable proportion of the relevant population and was defined in general terms. The effect of the decision on any individual property was also far from clear. By contrast, in the decision about Environment Canterbury, the affected groups were quite specifically identified and were a small subset of the general population, and the effect of the charge on them was different in kind and extent from the effect on others.

### Do any of the other exceptions apply?

- 8.57 The Act lists a number of detailed exceptions when the participation rule will not apply. We do not go through these here, but note that checking them is another important step as people consider how the Act applies to their situation.

### Could I apply for approval to participate?

- 8.58 If a councillor has a financial conflict of interest covered by section 6 of the Act, it is possible to apply for approval to participate. There are two ways in which we can approve participation:
- Section 6(3)(f) allows the Auditor-General to grant an exemption if, in our opinion, a councillor’s interest is so remote or insignificant that it cannot reasonably be regarded as likely to influence the councillor when voting or taking part in the discussion.
  - Section 6(4) allows the Auditor-General to grant a declaration enabling a councillor to participate if we are satisfied that:
    - the application of the rule would impede the transaction of business by the authority; or
    - it would be in the interests of the electors or inhabitants of the district that the rule should not apply.

### What information do we need to assess applications?

- 8.59 For an application under either of these provisions, we need to understand in reasonably precise terms both the nature of the decision that is to be made by the local authority and the nature and extent of the councillor’s financial interest.

That information is important to enable us to assess whether there is a financial interest in the particular decision that is covered by the Act. We also need this information to assess how significant the decision and the personal interest are. In practice, it is often helpful if the authority is able to provide us with a draft copy of the paper that is to be submitted.

#### **Applying under section 6(3)(f) of the Act**

8.60 When we are considering an application under section 6(3)(f) of the Act, we need to understand how directly the proposed decision is connected to the person's interest (the remoteness ground). We also need to understand how large or important the personal interest is. That means we need reasonably precise information (if it is available) on the value of the cost or benefit that will result from the decision. It is also useful to be able to assess any cost or benefit in the context of the overall financial situation of the person or business. A cost that might be significant at an individual level may not be so important if it is borne by a large business.

8.61 The test in the Act is an objective one. Although the views of the councillor about how significant the interest is and whether it is shaping their position on the issue are relevant, they are not determinative. Ultimately, we must assess how significant the interest looks to an observer.

8.62 For example, in the situation of Environment Canterbury, we concluded that potential financial effects ranging between \$40 and \$1,800, in the context of sizeable farming and business operations, could be regarded as insignificant and unlikely to affect the councillors' views. However, we did not consider that a financial effect of up to \$9,000 could objectively be seen as insignificant, even in the context of a major farming property.

#### **Applying under section 6(4) of the Act**

8.63 We need additional information when we are considering applications under section 6(4) of the Act. To assess whether the rule would "impede the transaction of business", it is useful to receive information on how many councillors might be prevented from participating, how significant the decision is for the region and the authority, and any other information that can help explain to us why it might be problematic if a councillor was not allowed to participate.

8.64 For example, we have at times granted applications on this basis when a number of councillors might otherwise have been prevented from participating in a decision on the future of a major council shareholding in a listed company.

8.65 To assess whether it would be "in the interests of electors or inhabitants" for a councillor to be able to participate, we need to assess the benefits of allowing that

councillor to participate against the risk that their participation could be regarded as distorting or tainting the decision. Therefore, we need information on why that councillor's participation is important. It may be because they have particular expertise or knowledge, or provide an important link with another organisation or community group. It may be that the issue is so significant for the community that the participation of all elected members is seen as more important than any individual interests. There may be a strong representation argument that the views of a particular group or community would not otherwise be able to be represented at the council table.

- 8.66 For example, we have granted an application on this basis when the decision related to a council position in a submission on a long-term plan being prepared by another organisation, and the relevant councillor provided an important link with, and voice for, the most affected section of the community. The council saw it as an important part of its role in the consultation process to give voice to that community and saw the particular councillor as critical to that process, even though the person was also potentially directly affected.
- 8.67 In general, we are happy to receive applications and to then ask the council staff or the affected councillor for any further information that we need. In practice, however, these issues tend to arise with some urgency because the potential conflict is often identified shortly before the meeting in question. When a decision is needed within a few days, it is helpful if the initial application is as comprehensive as possible.

### Problems with the Act and the need for reform

- 8.68 In June 2005, the then Auditor-General published a discussion paper<sup>68</sup> highlighting practical difficulties with the current Act and suggesting options for how it might be improved. We have reiterated our concerns about working with such an outdated Act a number of times since then, in our regular annual reports and reports on our work in the local government sector. In our view, the problems with the Act are increasing.
- 8.69 When we published the discussion paper in 2005, we suggested that the contracting rule could be repealed completely but that there may be benefit in keeping a revised version of the participation rule.

### Problems with the contracting rule

- 8.70 Our concerns about the problems with the contracting rule were heightened during the 2007 local authority elections. Our *Annual Report 2007/08* included the following comment:

<sup>68</sup> *The Local Authorities (Members' Interests) Act 1968: Issues and options for reform*, June 2005.

*We have recorded our view many times in recent years that the Act is in need of reform. It is poorly drafted, it operates unevenly, and the rationale for some of the requirements is unclear. Our experience with the 2007 local authority elections highlighted that the difficulties with the Act have practical consequences and can have a significant effect on the operation of the local democratic process. Resulting from the 32 requests for guidance that we dealt with, four people were either prevented or discouraged from standing as candidates because of the contracting rules in the Act, and two others had to rearrange their personal affairs to be eligible to be candidates. We remain of the view that the Act in its current form does little to strengthen democracy at the local level.*

- 8.71 Our view now is that the contracting rule also adds a level of compliance cost to the sector because staff from our Office and from councils around the country regularly have to go through routine approval processes on standard matters. The \$25,000 financial threshold has not been updated since 1982 and so more contracts now require approval.

#### **Problems with the participation rule**

- 8.72 Developments during the last two years now suggest that the participation rule is also becoming difficult to operate in practice. There is a risk that the Act applies blunt rules and cumbersome approval procedures to matters that require reasonably subtle and immediate judgement. Our decisions on Environment Canterbury are a good example of the complexity of the issues. We appreciate that others may consider that the approval processes and tests that the Act requires us to administer may not be the best way to manage potential conflicts of interest in situations of this kind. It is also questionable whether a criminal sanction is appropriate in this kind of situation.
- 8.73 The Act is out of step with the approach taken to managing conflicts of interest in governance bodies in the Crown Entities Act 2004 and other similar legislation in the state sector. In other sectors, the legislation may set out declaration requirements, and sometimes even rules on participation, but these are left to the entity to manage and administer. Failure to follow the requirements may result in breaches of duty to the organisation or political accountability of some kind. It is very unusual to have an independent third party making final decisions on who can and cannot participate and for the criminal law to be used as a penalty.
- 8.74 We also note that, in some situations, the financial interest regulated by the Act may be only part of the issue, and perhaps not even the major risk. The Act regulates only financial interests. It does not regulate more general conflicts of interest, which may arise as a result of other roles that the councillor has or their personal associations. We have discussed situations with council staff where

there were significant concerns about a councillor's non-financial interests, and a marginal concern about the financial interests regulated by the Act. In those circumstances, it may give a misleading impression if we confirm that the Act does not prevent participation. Councillors can sometimes derive false comfort from such advice, and take it to mean that they are free to participate, when in fact their participation may still create general legal risks for the council's decision-making.

- 8.75 Finally, we note that the Act's rules and processes for decisions on participation are unwieldy in practice, and do not fit well with the complex consultation and decision-making requirements of the Local Government Act 2002. Again, the situation of Environment Canterbury provides a good example. The many different stages of the decision-making process – as the issue progressed from broad idea, to a concrete proposal, to consultation at various points, and finally to implementation and incorporation into budgets and plans – all required careful and specific consideration under the Act. This was time-consuming and complex for us, council staff, and the councillors concerned.

### Progress on reform

- 8.76 The Department of Internal Affairs had begun to review the Act, based largely on the discussion paper we published in 2005. However, that review has not been a priority given the range of other legislative reforms that are currently under way in the local government sector.
- 8.77 The needs and practices of the sector have changed considerably since we published our discussion paper. The work that we have had to carry out under the Act has also changed during that time. In particular, problems with applying the participation rule in section 6 have become more apparent in recent years.
- 8.78 We are now of the view that it would be better to review the Act as a whole, from a first principles perspective. Its basic approach is out of step with other public sector legislation, and the practical difficulties and compliance costs of the current regulatory approach are becoming more acute.
- 8.79 We will continue to discuss these concerns with the sector, with Local Government New Zealand, officials, and the Minister of Local Government, as appropriate.

## Part 9

# Audit aspects of the electricity sector

- 9.1 In this Part, we:
- provide an overview of the electricity sector, and our role within it;
  - discuss aspects of our role in auditing some regulatory aspects of the country's electricity lines businesses; and
  - discuss the State-owned enterprises (SOEs) within the electricity sector, and some financial aspects of those SOEs.

### Overview of the electricity sector

- 9.2 The electricity sector supplies residential, commercial, and industrial customers with electricity through a variety of public and private entities.
- 9.3 The sector has four main components:
- generation (electricity production stations);
  - transmission (the high-voltage network known as the national grid);
  - distribution (electricity lines companies); and
  - retail (electricity retail companies that compete to buy wholesale electricity and to sell it to consumers).
- 9.4 In 2010, changes are likely to the structure and functioning of the electricity sector, arising from the Ministerial Review of the Electricity Market. The review, initiated by the Minister for Energy and Resources, has led to the introduction of draft reform legislation into Parliament (the Electricity Industry Bill). The proposals in that Bill include dissolving the Electricity Commission and reallocating its existing functions to a new entity (the Electricity Authority) and to some other existing entities. They also include transferring some electricity generation assets between the SOEs active in the sector, and also transferring responsibility for the Whirinaki facility to one of the SOEs.
- 9.5 The Auditor-General, as the auditor of all public entities in New Zealand, audits most of the entities in the electricity sector, including the SOEs involved in generating, transmitting, and selling electricity. The Auditor-General is also the auditor of 21 of the 29 local lines companies.
- 9.6 Policy matters relating to the electricity sector are dealt with by the Ministry of Economic Development. The Commerce Commission and the Electricity Commission, both Crown entities, regulate different aspects of the electricity sector.
- 9.7 The electricity sector is recognised as a significant sector in the government's National Infrastructure Plan.<sup>69</sup>

<sup>69</sup> National Infrastructure Plan (March 2010), available at [www.infrastructure.govt.nz/plan/mar2010](http://www.infrastructure.govt.nz/plan/mar2010).

## Electricity lines businesses – regulations and our audits

9.8 In this section, we provide:

- an overview of the electricity lines business sector; and
- a summary of the audit opinions that we issued, under aspects of the regulatory framework, to electricity lines businesses.

9.9 We note that the audit work associated with the regulatory framework is additional to our statutory role in auditing the annual reports of electricity lines businesses.

### Overview of electricity lines businesses and regulations

9.10 Electricity lines businesses manage assets that are financially substantial and a critical part of the wider national energy infrastructure.

9.11 In July 2008, Vector Limited sold its Wellington electricity network to a new company, Wellington Electricity Distribution Network Limited (later renamed Wellington Electricity Lines Limited), an entity jointly owned by Cheung Kong Infrastructure Holdings Limited and Hong Kong Electric Holdings Limited. The introduction of Wellington Electricity Lines Limited increased the number of electricity lines businesses in New Zealand to 29.

9.12 Electricity lines businesses are seen as local monopolies that could, without regulation, abuse that position. They are regulated by the Commerce Commission through provisions issued under Part 4 of the Commerce Act 1986. The overall purpose of Part 4 is set out in section 52A:

*... to promote the long-term benefit of consumers ... by promoting outcomes that are consistent with outcomes produced in competitive markets such that suppliers of regulated goods or services –*

- (a) have incentives to innovate and to invest, including in replacement, upgraded and new assets; and*
- (b) have incentives to improve efficiency and provide services at a quality that reflects consumer demands; and*
- (c) share with consumers the benefits of efficiency gains in the supply of the regulated goods or services, including through lower prices; and*
- (d) are limited in their ability to extract excessive profits.*

9.13 The major frameworks for regulating the sector are:

- the default/customised price-quality regime; and
- the information disclosure regime.



- 9.14 The default/customised price-quality regime sets benchmarks for the delivery of prices and quality. These benchmarks are expressed as price and quality thresholds. The detailed requirements of the regime were covered by the Commerce Act (Electricity Distribution Thresholds) Notice 2004 and a 2006 amendment to that notice. These requirements cover financial years up to 31 March 2009. From 1 April 2009, electricity lines services are subject to default/customised price-quality regulation under subpart 9 of Part 4 of the Commerce Act, as amended by the Commerce Amendment Act 2008.
- 9.15 The information disclosure requirements are set out in the Electricity Distribution (Information Disclosure) Requirements 2008. These requirements were published in October 2008 and significantly changed and expanded the previous disclosure requirements.
- 9.16 Because of the timing of the new information disclosure requirements, electricity lines businesses had to publish the required information for the years ended 31 March 2008 and 31 March 2009 during the 2009 calendar year.
- 9.17 Both the information and the threshold disclosure requirements need independent audit and assurance work, additional to the statutory audit required to attest to the financial statements of an individual electricity lines business.
- 9.18 Under the information disclosure requirements, the Auditor-General has to be the regulatory auditor where she is the statutory auditor of the annual financial statements. The Auditor-General was the auditor of 21 out of the 28 electricity lines businesses in the 2007/08 financial year and 21 out of the 29 electricity lines businesses in the 2008/09 financial year.

### **Audit opinions issued under the information disclosure requirements**

#### **Nature of audit opinions**

- 9.19 Of the 21 information disclosure audit opinions issued on behalf of the Auditor-General for the year ended 31 March 2008, four were qualified (2006/07: one qualified audit opinion). In the year ended 31 March 2009, five of the 21 audit opinions were qualified.
- 9.20 Two audit opinions for the year ended 31 March 2008 were qualified because of limitations in the availability of independent evidence to support reported information about the performance of electricity lines businesses in meeting the regulated quality thresholds, particularly about recorded faults, and control data used in the System Average Information Duration Index (SAIDI) and the System Average Interruption Frequency Index (SAIFI). A severe storm was the reason for one of these limitations, because it caused extensive outages throughout the network and accurate records could not be kept by the business at that time.

- 9.21 Of the other two qualified opinions for the year ended 31 March 2008, one related to the non-disclosure of required information. The other opinion was qualified because the Board of Directors would not provide the auditors with the representations they sought about whether the entity kept proper records of the number and duration of faults, and the number of customers affected by each fault.
- 9.22 Four audit opinions for the year ended 31 March 2009 were qualified because of limitations in the availability of independent evidence to support reported information about the performance of electricity lines businesses in meeting the regulated quality thresholds, particularly about recorded faults, and on control data used in SAIDI and SAIFI. The same entity that was affected by a storm in the year ended 31 March 2008 was also affected by a storm in the 2009 financial year.
- 9.23 The other qualified opinion issued for the year ended 31 March 2009 was related to non-disclosure of “Fault Information per 100 circuit kilometres by Voltage and Type” as required by the information disclosure requirements. This entity also received a qualified audit report in the year before.
- 9.24 The qualified audit opinions show that the electricity lines businesses do not always have independent controls in place for the systems they use to report faults. The lack of independent controls means that auditors cannot attest to the reported performance. We expect entities to have appropriate controls and systems to accurately report information requirements, and have enough independent controls for auditors to verify that the information recorded is materially correct.
- 9.25 Electricity lines businesses are entering their third year of reporting against the Electricity Distribution (Information Disclosure) Requirements 2008. We expect those lines businesses that have received qualified audit opinions to be looking for ways to ensure that there are enough controls in place to record and support the information they report.

#### **Timeliness of audit opinions**

- 9.26 The deadline for publishing and publicly disclosing the required information for the year ended 31 March 2008 was extended from 28 February 2009 to 10 April 2009. Of the 21 electricity lines business audited on behalf of the Auditor-General, two failed to meet the deadline.
- 9.27 For the year ended 31 March 2009, the deadline for publishing and publicly disclosing the required information was within five months after the end of the financial year – that is, 31 August 2009. One of the 21 electricity lines businesses failed to meet this deadline. This entity had also failed to meet the deadline in the 2008 financial year.

- 9.28 We are disappointed to note that any entity has failed to meet its statutory deadline. The failure suggests a lack of commitment to timely reporting. The requirement to publish and publicly disclose electricity information is a known obligation.

### Concluding comments

- 9.29 Our role in the electricity lines business sector is more extensive than issuing opinions on annual financial statements. Auditors also have an extensive role in issuing opinions on the disclosures required under the regulatory frameworks that govern the sector.

## Financial aspects of the electricity-related State-owned enterprises

- 9.30 In this section, we provide:
- an overview of SOEs' objectives and accountability arrangements, and their involvement in the electricity sector; and
  - a summary of financial aspects of the SOEs involved in the electricity sector.

### Objectives and accountability of SOEs

- 9.31 Under section 4 of the State-Owned Enterprises Act 1986 (the SOE Act), SOEs' principal objective is to:
- ... operate as a successful business, and to this end, to be –*
- (a) *As profitable and efficient as comparable businesses that are not owned by the Crown; and*
  - (b) *A good employer; and*
  - (c) *An organisation that exhibits a sense of social responsibility by having regard to the interests of the community in which it operates and by endeavouring to accommodate or encourage these when able to do so.*
- 9.32 Shareholding Ministers, who hold the SOE shares on behalf of the Crown, are responsible to Parliament for the SOE's performance of the functions given to them by the SOE Act. The shareholding Ministers for the electricity SOEs are the Minister of Finance and the responsible Minister – the Minister for State-owned Enterprises.
- 9.33 The Crown Ownership Monitoring Unit within the Treasury (formerly the Crown Company Monitoring Advisory Unit) monitors all SOEs on behalf of the shareholding Ministers.

- 9.34 The key accountability documents for SOEs are the statement of corporate intent (SCI), the annual report, and the half-yearly report.
- 9.35 The SCI must be finalised before the start of each financial year and must include specified information, including information about objectives, activities, targets and measures, and dividends.
- 9.36 SOEs' annual reports must be finalised within three months of each financial year ending 30 June. The annual report must include audited financial statements and:  
*... such information as is necessary to enable an informed assessment of the operations of the State enterprise and its subsidiaries, including a comparison of the performance of the State enterprise and subsidiaries with the relevant statement of corporate intent.*<sup>70</sup>
- 9.37 The responsible Minister must present to Parliament the SCI for the forthcoming period, and the annual report for the past period, within 12 days of finalising the annual report.
- 9.38 Within two months of each half-year period ending 31 December, an SOE must deliver to its shareholding Ministers a report of its operations for that half-year.
- 9.39 The Auditor-General is the auditor of all SOEs. In this role, she is responsible for the annual audit of the financial statements included within the annual report, and other aspects of the Auditor-General's mandate provided for by the Public Audit Act 2001.

### SOEs in the electricity sector

- 9.40 There are five SOEs in the electricity sector.
- 9.41 The Electricity Corporation of New Zealand Limited is a residual entity, left after assets were transferred in 1999 to the newly established SOE generators at the time. The Electricity Corporation of New Zealand Limited will eventually be wound up.
- 9.42 Transpower New Zealand Limited is the owner and operator of the national grid.
- 9.43 The three SOE generators are Genesis Energy Limited, Meridian Energy Limited, and Mighty River Power Limited. All of these companies are also involved in electricity retailing.

<sup>70</sup> State-Owned Enterprises Act, section 15.

## Summary of financial aspects

- 9.44 In the financial year ended 30 June 2009, the SOEs involved in the electricity sector<sup>71</sup> reported total revenue of \$5.7 billion and post-tax profits of \$206 million. These figures were lower than the previous year (2008: revenue of \$6.9 billion and profits of \$417 million), which was heavily affected by the weather conditions of the winter of 2008.
- 9.45 In their annual reports, each electricity SOE discloses an amount described as “underlying profit”. The underlying profit amount is different to the profit in the financial statements that has been determined in keeping with approved financial reporting standards. The term “underlying profit” is not defined in financial reporting standards, but it typically excludes the effects of accounting for changes in the value of financial instruments and “one-off” transactions.
- 9.46 We encourage public entities to include information in their annual reports that is likely to be relevant to users. However, we have some unease about the practice of disclosing underlying profits because:
- there is no guidance about what underlying profit is, or how it is arrived at, and therefore inconsistent practices are likely among different entities;
  - the underlying profit amount has significant prominence in the annual report and has the potential to overshadow the financial information prepared in keeping with financial reporting standards; and
  - the underlying profit amount is not always clearly labelled as supplementary information that is additional to the information required by financial reporting standards.
- 9.47 The SOEs also reported operating cash flows of \$1.1 billion. After investing cash of \$1.2 billion, and after other cash movements relating to financing, these companies increased their overall cash balances by \$43 million in 2008/09.
- 9.48 The electricity sector SOEs are a significant part of the Crown’s overall SOE portfolio. They had combined total assets of \$17.3 billion as at 30 June 2009, and net assets of \$9.7 billion. These represent about one-third of the total asset values for all SOEs included in the Financial Statements of the Government of New Zealand.<sup>72</sup>
- 9.49 The combined post-tax profit generated by these SOEs in 2009 represents an overall return on assets and net assets of 1.2% and 2.1% respectively.
- 9.50 Figure 9 summarises the recent financial results, position, and cash flows of the SOEs involved in the electricity sector.

71 Transpower New Zealand Limited and the companies generating and retailing electricity (or “gentailers”) – Genesis Energy Limited, Meridian Energy Limited, and Mighty River Power Limited.

72 Including KiwiRail and Air New Zealand.

### Some aspects of our annual audit work

- 9.51 As part of our appointed auditors' audit of annual financial statements, we assess SOEs' management control environments, and their financial information systems and controls.
- 9.52 In 2009, we assessed all electricity sector SOEs as either good or very good in these aspects. This means that we considered they had either no or some relatively minor aspects to improve. We made recommendations to the respective boards and management to address these where applicable.
- 9.53 We do not assess SOEs' service performance information and associated systems and controls, which we do assess in a number of other sectors. This is because such information is outside the scope of the audit we are required to complete.
- 9.54 In practice, SOEs in the electricity sector provide additional information in their annual reports, including reporting against their SCI as required by the SOE Act. They also provide a range of information on corporate social responsibility and sustainability matters, including some reporting against recognised international frameworks. Although this information is not audited, some of it is subject to independent assurance provided at the SOEs' request.

### Concluding comments

- 9.55 Through our appointed auditors, we audit most of the companies involved in the electricity sector, which includes the transmission, generation, distribution, and retail of electricity in New Zealand.
- 9.56 The SOEs active in the electricity sector are substantial businesses, and manage assets that are significant both in financial terms and in securing critical supply.

**Figure 9**  
**Summary of financial aspects of State-owned enterprises involved in the electricity sector**

<b>Genesis</b>			
<b>Year</b>	<b>2010 1st half \$m</b>	<b>2009 \$m</b>	<b>2008 \$m</b>
Revenue	961.4	1,957.1	2,436.6
Post-tax profit	64.6	(135.7)	99.1
Assets		2,585.4	2,706.7
Net assets		1,392.8	1,406.8
Operating cash flows		262.9	209.1
Investing cash flows		(238.9)	(254.0)
Financing cash flows		(9.1)	47.3
Net cash flows		14.8	2.4
<b>Meridian</b>			
<b>Year</b>	<b>2010 1st half \$m</b>	<b>2009 \$m</b>	<b>2008 \$m</b>
Revenue	925.5	1,892.4	2,600.0
Post-tax profit	142.5	89.3	128.6
Assets		7,177.3	7,197.7
Net assets		4,284.1	4,204.6
Operating cash flows		313.5	342.6
Investing cash flows		(476.8)	(271.5)
Financing cash flows		139.4	(47.9)
Net cash flows		(23.9)	23.2
<b>Mighty River Power</b>			
<b>Year</b>	<b>2010 1st half \$m</b>	<b>2009 \$m</b>	<b>2008 \$m</b>
Revenue	521.8	1,119.9	1,178.6
Post-tax profit	73.9	159.6	111.0
Assets		4,388.1	4,058.0
Net assets		2,621.6	2,257.7
Operating cash flows		317.1	207.4
Investing cash flows		(221.8)	(345.3)
Financing cash flows		(72.5)	85.0
Net cash flows		22.8	52.9

<b>Transpower</b>			
<b>Year</b>	<b>2010 1st half \$m</b>	<b>2009 \$m</b>	<b>2008 \$m</b>
Revenue	379.6	699.3	644.2
Post-tax profit	60.3	92.9	78.1
Assets		3,106.4	2,844.3
Net assets		1,399.9	1,307.5
Operating cash flows		250.3	330.3
Investing cash flows		(253.1)	(434.7)
Financing cash flows		32.6	110.7
Net cash flows		29.7	6.3
<b>Totals</b>			
<b>Year</b>	<b>2010 1st half \$m</b>	<b>2009 \$m</b>	<b>2008 \$m</b>
Revenue	2,788.3	5,668.7	6,859.4
Post-tax profit	341.3	206.1	416.8
Assets		17,257.2	16,806.7
Net assets		9,698.4	9,176.6
Operating cash flows		1,143.8	1,089.4
Investing cash flows		(1,190.6)	(1,305.5)
Financing cash flows		90.4	195.1
Net cash flows		43.4	84.8



## Part 10

# Our audits and the airport sector

- 10.1 In this Part, we describe the Auditor-General's role in auditing the public entities within the airport sector. The airport sector is diverse and includes privately owned airports, council-owned airports, joint ventures between councils and the Crown, and public companies (for example, Auckland International Airport).
- 10.2 We also provide an overview of the financial performance of the publicly accountable entities. This Part continues our practice of reporting, in turn, the financial performance of the smaller sectors that fall within the Auditor-General's mandate.
- 10.3 We also discuss the audit work and disclosures required by the corporatising of Hawke's Bay Airport Authority, which took effect from 1 July 2009.

### Overview of the airport sector and the Auditor-General's role

- 10.4 The Auditor-General audits 18 airport authorities and airport companies. They are publicly accountable entities because their majority shareholders are publicly owned. The requirement for the Auditor-General to audit them is set out in the Public Audit Act 2001.
- 10.5 In 1985, the Government embarked on a wide programme of reform to improve the efficiency of public enterprises through contestable service delivery. Most airports were corporatised and constituted as companies. Major airports, such as those in Auckland and Wellington, were corporatised and eventually sold. The Ministry of Transport also negotiated new arrangements with a number of local authorities, with which it owned or operated airports on a joint venture basis.
- 10.6 For the year ended 30 June 2009, there were seven airport authorities operated on a joint venture basis between local authorities and the Crown, and therefore within the Auditor-General's mandate. The Ministry of Transport oversees the Crown's interest in joint venture airports.
- 10.7 On 1 July 2009, Hawke's Bay airport was corporatised and a new legal entity, an airport company, was created to own and manage the airport. The assets were transferred to the new company. The Napier City Council, Hastings City Council, and the Crown are shareholders of the new company.
- 10.8 Seven airport companies within the Auditor-General's mandate are 100% owned by councils, and are known as council-controlled trading organisations. One airport company, Omarama Airfield Limited, is 50% owned by a council and 50% owned by an incorporated society. Omarama Airfield is within the

Auditor-General's mandate because the Local Government Act 2002 considers an organisation to be council-controlled when a council has a 50% or greater equity share in it.

- 10.9 Along with local councils, the Crown also partially owns the following airport companies that are structured as council-controlled trading organisations:
- Christchurch International Airport Limited;
  - Dunedin International Airport Limited;
  - Invercargill Airport Limited; and
  - Hawke's Bay Airport Limited (a council-controlled trading organisation from 1 July 2009).
- 10.10 The Crown's interest in these airport companies will be managed through the Crown Ownership Monitoring Unit within the Treasury.
- 10.11 Some airfields are also managed by councils (that is, the airport is not a separate joint venture or company). We have not included the operations of these airfields in this report.
- 10.12 The companies operating Auckland, Christchurch, and Wellington international airports are subject to information disclosure regulations under the Commerce Act 1986. Of these three, only Christchurch International Airport Limited is audited by the Auditor-General. The appointed auditor of Christchurch International Airport Limited conducts the audit of the information disclosure regulation statements. The work associated with the regulatory framework for the airport is additional to our statutory role in auditing the financial statements within the company's annual report.

### **Overview of the financial performance of the airport sector**

- 10.13 This section provides an overview of the financial performance of the publicly accountable entities in the airport sector. These entities vary significantly in size.
- 10.14 Figure 10 summarises the financial results and position of the airport sector, based on the most recently audited financial statements.

**Figure 10**  
Summary of the 2009 financial results and position of the airport sector

Entity name	Airport/ operations revenue	Profit (pre-tax)	Equity	Total liabilities	Total assets
	(\$000)	(\$000)	(\$000)	(\$000)	(\$000)
<b>Joint venture airports</b>					
Hawke's Bay Airport Authority	2,729	1,249	13,789	1,565	15,354
New Plymouth Airport Authority	1,418	(6)	24,990	6,251	31,242
Taupo Airport Authority	431	(255)	9,278	1,112	10,390
Wanganui Joint Venture Airport	400	(314)	9,928	1,462	11,390
Westport Airport Authority	105	(137)	3,017	653	3,671
Whakatane Airport Authority	218	(42)	716	59	775
Whangarei District Airport	407	40	4,437	822	5,259
<b>Wholly council-owned airport companies</b>					
Hokitika Airport Limited	259	29	2,612	149	2,761
Marlborough Airport Limited	1,119	(173)	1,513	2,881	4,394
Nelson Airport Limited	4,312	1,687	6,422	3,570	9,992
Palmerston North Airport Limited	4,090	658	31,526	9,302	40,828
Queenstown Airport Corporation Limited	11,308	2,352	17,379	32,098	49,477
Rotorua Regional Airport Limited	2,548	(125)	1,907	292	2,198
Waikato Regional Airport Limited	8,251	1,515	70,074	22,165	96,239
<b>Partly council-owned airport companies</b>					
Christchurch International Airport Ltd	86,774	22,089	560,117	182,904	743,021
Dunedin International Airport Limited	7,549	(733)	31,368	29,214	60,583
Invercargill Airport Limited	2,621	170	7,049	5,336	12,385
Omarama Airfield Limited	116	24	1,191	31	1,222
<b>Total</b>	<b>134,655</b>	<b>28,028</b>	<b>797,313</b>	<b>299,866</b>	<b>1,101,181</b>

- 10.15 Of the publicly accountable airport entities, total assets at the end of the 2009 financial year were \$1.1 billion. Total equity was \$797 million. The total reported operating revenue these entities generated was \$135 million, and total reported pre-tax profits were \$28 million.
- 10.16 Based on the reported financial results, the overall returns on closing equity<sup>73</sup> and assets<sup>74</sup> for 2008/09 were therefore 3.52% and 2.55% respectively.
- 10.17 Financial returns expressed as percentages are significantly affected by the approaches taken to asset valuation and depreciation. These approaches reflect a historical cost component that is likely to result in the returns being overstated when compared with alternative approaches that reflect more current replacement values.
- 10.18 Four airport companies paid dividends to their shareholders for 2008/09 (2007/08: three).
- 10.19 The operating revenues and pre-tax profits reported in 2008/09 were down from reported results in the previous financial year.
- 10.20 Many airports reported in their annual reports that the global recession had affected their business – there has been a decline in domestic and international passengers for many airports. For example, Air New Zealand suspended international flights from Hamilton airport from April 2009 after the number of passengers flying to Hamilton from Australia on Air New Zealand flights reduced. However, after Air New Zealand's decision, Pacific Blue announced its decision to operate international flights from Hamilton, as of 1 September 2009.

### The Auditor-General's role in auditing Hawke's Bay Airport

- 10.21 In October 2006, the Government announced its decision on the future governance structure of the remaining airports in which it is a joint-venture partner. Hawke's Bay and New Plymouth airports were given the option to corporatise.
- 10.22 Hawke's Bay Airport was corporatised on 1 July 2009 and the assets transferred to a new company. The Crown has a 50% shareholding in the new company.
- 10.23 The corporatisation of Hawke's Bay Airport means a change of governance structure, with a company board appointed. Hawke's Bay Airport will now be able to raise its own capital to fund development. Under the previous joint venture arrangement, the airport relied on the joint venture partners agreeing on any future investment.

<sup>73</sup> The return on equity is the pre-tax profit divided by equity.

<sup>74</sup> The return on assets is the pre-tax profit divided by total assets.

- 10.24 The appointed auditor of Hawke's Bay Airport Authority issued a non-standard audit opinion on the financial statements for the year ended 30 June 2009. The audit opinion referred to the fact that the financial statements were prepared on a disestablishment basis. The opinion also referred to appropriate additional disclosure in the financial statements about the corporatisation.
- 10.25 The financial statements disclosed that a new company, Hawke's Bay Airport Limited, will take over the business, assets, and liabilities from 30 June 2009 at fair value, as agreed in the asset transfer agreement dated 1 July 2009.
- 10.26 The financial statements of Hawke's Bay Airport Authority for the year ended 30 June 2009 measured the assets and liabilities at their realisation values on transfer to the new company, as recorded in the asset transfer agreement for the corporatisation of Hawke's Bay Airport.



## Part 11

# Planning to meet the forecast demand for drinking water

- 11.1 In February 2010, we published the performance audit report *Local authorities: Planning to meet the forecast demand for drinking water*. We carried out this performance audit of local authorities to help us form a view about how well prepared the country is to meet the likely future demand for drinking water.
- 11.2 Access to good quality water for drinking, bathing, clothes washing, and cooking is essential to our health and well-being. In a country that, as a whole, has reliable annual rainfall, numerous lakes, rivers, and streams, and a small population, the public expects supplies of drinking water to be secure for years to come.
- 11.3 Local authorities are responsible for supplying drinking water to about 87% of the country's population, and they manage water supply infrastructure estimated in 2009 to be worth \$11 billion. Each year from 2009 to 2019, local authorities collectively have budgeted for about \$605 million on operational expenditure and \$390 million on capital expenditure to maintain and manage water supplies.
- 11.4 There are many challenges involved in supplying good quality drinking water now and forecasting demand in the future, and concern has been raised publicly that some local authorities may not be well equipped for the task. Some local authorities face more challenges than others, depending on a variety of environmental, economic, and social factors.

### The local authorities we audited

- 11.5 The local government sector is large and diverse, so we selected a representative sample of eight local authorities.
- 11.6 The eight local authorities that we selected for our performance audit were Tauranga City Council, Opotiki District Council, South Taranaki District Council, Kapiti Coast District Council, Nelson City Council, Tasman District Council, Christchurch City Council, and Central Otago District Council. We thank them all for their participation and assistance.
- 11.7 We did not audit any local authorities in the Auckland region because we plan to do a separate performance audit when the transition to one local authority for Auckland is complete.

### What we found

- 11.8 All eight local authorities are able to ensure the security of drinking water supply in their districts at present. However, providing security of supply into the future depends on, in some instances, significant improvements in forecasting, planning, and upgrading infrastructure. Some of the challenges, such as increasing

competition for access to water, the need to reduce consumption, and the costs associated with upgrading infrastructure are only likely to increase in difficulty.

- 11.9 Only three of the eight local authorities in our sample were managing their drinking water supplies effectively to meet future demand for drinking water. Nelson City Council, Tasman District Council, and Tauranga City Council had forecasting techniques that were reasonably detailed and likely to be accurate enough. They had good planning behind their strategies to meet the forecast demand, and were consistently implementing those strategies. As a result of this effective management, they were well placed to meet the forecast demand for their drinking water.
- 11.10 Christchurch City Council, Opotiki District Council, and Kapiti Coast District Council were adequately managing their drinking water supplies, and were adequately placed to meet the forecast demand for drinking water. They had more work to do to improve the accuracy of their forecasts and implement their strategies to meet future demand.
- 11.11 South Taranaki District Council and Central Otago District Council were poorly placed to meet the forecast demand for drinking water. They had a significant amount of work to do to improve forecasts and upgrade drinking water supply infrastructure.
- 11.12 We made eight recommendations in our report. We encourage all local authorities to consider the applicability of each of these recommendations, and implement any that are relevant to them.

### **Improving how supplies of drinking water are managed**

- 11.13 Opportunities for local authorities to improve how they manage their drinking water supplies include:
- improving the information available for demand forecasting;
  - using more tools to assess and verify the reliability of their demand forecasting;
  - preparing comprehensive demand management plans; and
  - putting more emphasis on improving the efficiency of their drinking water supply systems.
- 11.14 In our view, local authorities need to put more emphasis on the efficiency of their water supply systems. That emphasis should include, among other things, active leakage and pressure control programmes. This should result in more efficient and sustainable use of water. It should also result in savings on expenditure on new infrastructure because any infrastructure upgrades will be sized and timed more accurately to meet actual demand.



- 11.15 One way to transparently measure progress would be to use an industry benchmarking tool to assess performance and encourage continuous improvement. An example is the *Water New Zealand Pilot National Performance Review 2007/08*,<sup>75</sup> which involved eight water supply authorities. Another example is the *Auckland water industry annual performance review 2006/07*.<sup>76</sup>
- 11.16 Although all of the eight local authorities were using some water demand management tools, we consider that the next step is to prepare water demand management plans that integrate strategies for water supply and demand and are tailored to local circumstances. This will enable local authorities to get more benefits from water demand management.
- 11.17 The benefits of more comprehensive and integrated water demand management plans include:
- saving capital costs through delaying or eliminating infrastructure development;
  - achieving cost savings in wastewater management through reducing the water that goes through the system;
  - saving operating costs associated with energy and maintenance, in both the treatment of water to a potable standard and its reticulation;
  - delivering consumer benefits from lower water- and energy-related costs; and
  - promoting the resilience of the overall water system, by reducing competing demands for water in areas where water resources are constrained.
- 11.18 It is essential that local authorities also consider drought strategies as part of their management of water demand to minimise the effect that a lack of water can have on a community.

### Follow-up since our report was published

- 11.19 It is important to note that those local authorities in an adequate or poor position to meet the forecast demand are improving how they manage their drinking water supplies. They know what they need to do and are implementing improvements. For example, since the fieldwork for this audit was carried out in late 2008, the two local authorities that we considered to be poorly placed have made changes that will improve how they monitor, manage, and predict water demand:
- South Taranaki District Council has completed upgrades on its main water supply system for Hawera. This includes installing a new water treatment plant, new water intake, new production bores, and two new reservoirs that have enhanced the security of the drinking water supply. South Taranaki

75 Available from Water New Zealand ([www.waternz.org.nz](http://www.waternz.org.nz)).

76 Available from Auckland City Council ([www.aucklandcity.govt.nz](http://www.aucklandcity.govt.nz)).

District Council is also installing water meters and improving its information about water use, which is enabling it to run its water supply systems more efficiently.

- Central Otago District Council has installed water meters for 80% of the connections to the Cromwell water supply. The remainder are scheduled for 2010/11. It has also installed an additional pump station for the Alexandra water supply, which will lower water pressure and reduce pumping costs and water leakage.

11.20 Provided those improvements continue, within the next 10 years these local authorities should be better placed to meet the forecast demand for drinking water.

## Part 12

# Local authority elections – issues to watch out for

- 12.1 Local authority elections are a time of robust debate and political contest. That is as it should be. But the heightened political environment of an election creates a number of challenges for the administration of local authorities. The Auditor-General usually receives a range of requests for advice and inquiries on election-related issues. We do not have a role in regulating the general conduct of candidates during an election – that is a matter for the political sphere. However, we do have a role in commenting on the use of local authority resources, whether financial or staff.
- 12.2 Because local authority elections will be held in October 2010, we considered it timely to include in this report some advice on election-related issues that have arisen in the past. In this Part, we discuss our general approach to three issues that regularly arise:
- communication in the pre-election period;
  - election candidates and the Local Authorities (Members' Interests) Act 1968 (the Act); and
  - decision-making by councils after the election.

### Communication in the pre-election period

#### General principles

- 12.3 The general practice in the local government sector is to treat the three months before the election as the pre-election period, during which additional protocols may be needed. There are some simple principles that need to be balanced in any pre-election period:
- Council staff need to maintain their neutrality.
  - The public funds that councils administer should not be used for electioneering or to benefit one candidate over another.
  - Councillors are still in office during the election campaign and remain responsible for the activities of the organisation.
  - Ordinary business has to continue despite the election, which includes ongoing communication with the (voting) public.
- 12.4 Balancing these principles in practice can be difficult. New and detailed issues can arise where the right response is not obvious, and councils may need to judge the risks involved carefully. Also, the political context means that the level of scrutiny and potential for challenge is often very high. From an administrative perspective, the election period is a time for caution.

### Learning from previous issues

- 12.5 We reported on the issues that arose in the last local authority elections in our 2006/07 report on local government issues.<sup>77</sup> In particular, we were pleased to note that we received no complaints about the content of the annual reports and summaries released around the time of the elections. These reports can generate complaints if they are perceived as too heavily promoting existing office holders. We encourage all local authorities to continue to take particular care with the content of these documents.
- 12.6 We noted four issues that resulted in complaints to the Auditor-General, where local authorities could usefully consider their level of risk before the next election. They are:
- collaborative community relationships;
  - public events and launches;
  - councillor and mayoral columns and other communication channels; and
  - communication from council staff.

#### **Collaborative community relationships**

- 12.7 One local authority had a collaborative arrangement between the council and a community centre that included assistance to publish a regular community newspaper. The newspaper's electoral coverage in one edition excluded some candidates, and the council was criticised for its role in the publication. This issue highlights the risk when local authorities support community communication processes where they do not control the content. We encourage authorities to consider their range of collaborative activities to ensure that they understand and manage this risk as much as possible.

#### **Public events and launches**

- 12.8 The use of council resources for public events, such as opening ceremonies or project launches, can be a regular cause of complaints. In the pre-election period, such events can be perceived as a publicly funded platform for the incumbent mayor or councillors to promote their achievements. We inquired into one such complaint during the last election and concluded that the approach that had been taken was reasonable. Nonetheless, we encourage councils to consider the risks around large events in the pre-election period. We are aware that many councillors try to reduce the number of major events that they attend during the election campaign.

<sup>77</sup> *Local government: Results of the 2006/07 audits*, June 2008, Part 11.

**Councillor and mayoral columns and other communication channels**

- 12.9 It is common for mayors and councillors to prepare regular columns or commentary on their activities for council newspapers, websites, or other council-funded communication channels. Councils may also provide a measure of support for public communication by the mayor and other nominated spokespeople.
- 12.10 During an election period, these communication channels can create risk, as the political significance of the commentary will be higher. A column can change from being a useful vehicle for communicating ordinary council business to something that is seen as a vehicle for political campaigning by the current office holder.
- 12.11 Many councils have policies that suspend such columns during a defined pre-election period. This is a very simple way of removing the risk. However, to ensure that ordinary council business continues, it may be necessary for council staff to take responsibility for ongoing communication during this period. Other councils find other ways of managing the risks, including having the content of such columns checked by a senior staff member.
- 12.12 We encourage councils to address this issue directly and decide how they will manage the need to maintain ordinary business and continue to carry out their responsibilities, while ensuring that council resources are not used, or perceived to be used, to give electoral advantage.

**Communication from council staff**

- 12.13 Communication from council staff is another risk area. During the last election, we saw one example of such communication that we thought was inappropriate. The communication in this case was perceived by many to be a staff member contributing directly to the political debate and supporting one side. We encourage chief executives to make sure that staff are well briefed on the risks and any special or temporary procedures that may be introduced during the period of the election campaign. Although staff may, at other times, have a fairly free hand in providing information directly to the public or the media, additional constraints may need to be put in place during this period.
- 12.14 Another difficulty can be in managing contact between staff and those who are working on election campaigns. Candidates and their staff may seek a range of information from the council about current activities, policies, and costs. Responding to these requests can be a fraught activity because it is important that election candidates are treated equally and that the information they receive is manifestly neutral and factual. Writing protocols to ensure equal treatment of requests from current office holders and other candidates can be an important protection. We are aware that some authorities are already considering how they will manage this type of risk for the forthcoming elections.

### Our overall advice

- 12.15 Most local authorities are familiar with our 2004 publication, *Good Practice for Managing Public Communications by Local Authorities*. The overall advice in that report stands. We encourage each local authority to adopt its own clear policy and set of working rules that it agrees to abide by as a way of managing the issues of communicating during election periods. The policy and working rules should have regard to the principles identified in our good practice guide. A clearly agreed approach of this kind helps councillors and staff, and enables the council to respond easily to any concerns raised by ratepayers.
- 12.16 As explained in this Part, we also encourage councils to think separately about three different areas of potential risk that may require some management:
- councillors communicating with the community;
  - staff communicating with the community; and
  - staff communicating with candidates.

### Election candidates and the Local Authorities (Members' Interests) Act 1968

- 12.17 The Act contains some complex rules for election candidates. For example, the contracting rule can sometimes mean that a person would need to rearrange their financial and business affairs to be able to stand as a candidate. The basic rule in section 3 of the Act is that you cannot be elected to a local authority if you have current contracts with the authority under which you will be paid more than \$25,000 in that financial year. The same rule applies to people who are appointed to local authorities, and to people elected or appointed to committees of local authorities.
- 12.18 The Act contains a series of exceptions, which are designed to remove the prohibition if there is unlikely to be any real opportunity to influence the value of the contract once you are elected. A current contract will not disqualify a candidate if:
- the obligations under the contract have been completed (that is, the goods or services have been provided) and the price is already fixed;
  - the obligations under the contract have not been completed, but the price that will be paid is already fixed, subject to any amendments or additions allowed for in the contract;
  - the obligations under the contract have not been completed, and the amount to be paid is not fixed, but the contract is for less than 12 months; or

- the obligations under the contract have not been completed, the amount to be paid is not fixed, and the contract is for more than 12 months, but the candidate agrees with the authority to relinquish the contract within a month of being elected.

12.19 The Auditor-General has no power to give retrospective approvals for contracts that are in place at the time of the election and would disqualify the candidate at that point. If the value of a current contract only exceeds the \$25,000 some time after the election, it is possible for us to give an approval, including a retrospective approval, in the usual way.

12.20 We encourage council staff and all potential candidates to consider the rules of the Act carefully. If potential candidates have ongoing contracts with the authority that may cross the financial threshold, they should seek advice on whether these rules will prevent them from standing for office. They can also refer to our good practice guide on the law of conflicts of interest<sup>78</sup> for further guidance.

### Decision-making by councils after the election

12.21 After the last local authority elections, we received several complaints about newly elected councils deciding to immediately change or reverse decisions of the previous council. We reported on the approach we took to these complaints in a previous report to the sector.<sup>79</sup> We regarded them as raising important issues about the relationship between the decision-making requirements of the Local Government Act 2002 and the democratic and political context of local authority decision-making.

12.22 We commented that:

*Councillors and mayors will have opinions, will have campaigned on those opinions, and will wish to implement decisions consistent with their opinions and campaign messages. They will take office with publicly stated views on a wide variety of policy issues, and may have a sense of obligation to honour what they may see as commitments made to voters. In practice, the ability of any individual to implement their policies and commitments will depend on their ability to influence the collective decision-making of the local authority, and on the status of any existing decisions or commitments by the local authority.*

12.23 In each case, we concluded that the relevant council was able to make the decision under the Local Government Act. However, there were steps that the councils could have taken to make the decision-making process more transparent. This would have enabled the community to more easily see and understand the basis on which the council was making the decision.

<sup>78</sup> *Guidance for members of local authorities about the law on conflicts of interest*, June 2007.

<sup>79</sup> *Local government: Results of the 2007/08 audits*, June 2009, Part 5.

- 12.24 Similar issues may arise after the next election. We encourage councils and staff to consider what steps they can take to promote transparent decision-making, accountability, and community understanding, while helping newly elected authorities to make appropriate decisions. It may also be helpful to address the requirements of the Local Government Act in any papers being prepared, so it is clear how they are being met.



# Appendix

## Details of the non-standard audit reports issued in 2009

These details relate to non-standard audit reports issued during the 2009 calendar year. Where an entity is directly or indirectly controlled by one or more city, district, or regional council, we have listed them in brackets.

### Adverse opinions

#### **Far North Regional Museum Trust (Far North District Council)**

*Financial statements year ended: 30 June 2007*

We disagreed with the Trustees not recognising the museum collection assets of the Trust, nor the associated depreciation expense, in the Trust's financial statements. These are departures from Financial Reporting Standard No. 3: *Accounting for Property, Plant and Equipment*, which requires museum collection assets to be recognised and depreciated in the financial statements. We were also unable to form an opinion on the comparative information presented for the Trust because control over donation revenue before it was recorded was limited for the year ended 30 June 2006.

#### **Far North Regional Museum Trust (Far North District Council)**

*Financial statements year ended: 30 June 2008*

We disagreed with the Trustees not recognising the museum collection assets of the Trust, nor the associated depreciation expense, in the Trust's financial statements. These are departures from Financial Reporting Standard No. 3: *Accounting for Property, Plant and Equipment*, which requires museum collection assets to be recognised and depreciated in the financial statements.

#### **The Canterbury Museum Trust Board**

*Financial statements year ended: 30 June 2009*

We disagreed with the Trust Board not recognising the museum collection assets of the Museum Trust, nor the associated depreciation expense, in the Museum Trust's financial statements. These are departures from New Zealand Equivalent to International Accounting Standard 16: *Property, Plant and Equipment*, which requires museum collection assets to be recognised and depreciated in the financial statements.

#### **The Museum of Transport and Technology Board**

*Financial statements year ended: 30 June 2009*

We disagreed with the Board not recognising the museum collection assets of the Museum, nor the associated depreciation expense, in the Museum's financial statements. These are departures from New Zealand Equivalent to International Accounting Standard 16: *Property, Plant and Equipment*, which requires museum collection assets to be recognised and depreciated in the financial statements.

#### **Otago Museum Trust Board**

*Financial statements year ended: 30 June 2009*

We disagreed with the Trustees not recognising the museum collection assets of the Trust, nor the associated depreciation expense, in the Trust's financial statements. These are departures from New Zealand Equivalent to International Accounting Standard 16: *Property, Plant and Equipment*, which requires all assets to be recognised and depreciated in the financial statements.

**Southland Museum and Art Gallery Trust Board Incorporated (Gore District Council, Invercargill City Council, and Southland District Council)**

*Financial statements year ended: 30 June 2009*

We disagreed with the Trustees not recognising the museum and gallery collection assets of the Trust Board, nor the associated depreciation expense, in the Trust Board's financial statements. These are departures from New Zealand Equivalent to International Accounting Standard 16: *Property, Plant and Equipment*, which requires all assets to be recognised and depreciated in the financial statements.

**Hawarden Licensing Trust**

*Financial statements year ended: 31 March 2009*

We disagreed with the Trustees not preparing the financial statements in accordance with New Zealand equivalent to International Financial Reporting Standards (NZ IFRS), as required by the Sale of Liquor Act 1989. Because we were unable to carry out audit procedures to obtain adequate assurance about the impact of NZ IFRS on the Trust's financial statements, we were unable to form an opinion on whether the Trust's financial statements fairly reflected the financial position as at 31 March 2009 and the results of its operations for the year ended 31 March 2009. However, had the Trustees been permitted to prepare financial statements in accordance with the financial reporting standards that applied before the introduction of NZ IFRS, then, in our opinion, the financial statements would have fairly reflected the Trust's financial position as at 31 March 2009 and the results of its operations for the year ended on that date.

**Charleston Goldfields Hall Board**

*Financial statements year ended: 30 June 2008*

We disagreed with the Board not preparing its annual financial statements in accordance with the Public Finance Act 1989, including the requirement that those financial statements be prepared in accordance with generally accepted accounting practice. However, the limited financial information presented did fairly reflect the Board's assets, liabilities, receipts, and payments.

**Millerton Hall Board**

*Financial statements year ended: 30 June 2007*

The Board did not prepare annual financial statements in accordance with the Public Finance Act 1989, and their financial statements do not comply with generally accepted accounting practice in New Zealand. However, the limited financial information presented did fairly reflect the assets, liabilities, receipts, and payments of the Board.

## Disclaimers of opinion

**Winton Racecourse Reserve Trustees**

*Financial statements year ended: 30 June 2005*

We were unable to form an opinion on the statement of accounts for the year ended 30 June 2005 because we did not attend the closing inventory and livestock count and as a result did not have assurance about the quantities and condition of inventory and livestock recognised in the statement of position. We were unable to verify certain revenues because of limited controls over the receipt of that revenue for the year ended 30 June 2005. We were also unable to form an opinion on the comparative information for the six years ended 30 June 2004 as some financial records were lost, and we were not able to gain assurance over the statement of accounts for that period because any misstatement of these balances would affect the comparative information as well as the current year's financial position and results.

## Except-for opinions

### **Auckland Regional Transport Network Limited (Auckland City Council)**

*Financial statements year ended: 30 June 2009*

Our audit was limited because the Company did not comply with section 68 of the Local Government Act 2002 by not reporting actual performance against the planned performance, even though it has prepared a Statement of Intent for the period 1 July 2009 to 30 June 2012. We noted the disclosures in the financial statements that refer to the new local government structure for the Auckland region. The Local Government (Tamaki Makaurau Reorganisation) Act 2009 established a single unitary authority (the Auckland Council) that will be responsible for governing the entire Auckland region from 1 November 2010. Decisions had to be made on the Auckland Council's structure and operations, including how the Board of Management would be vested and integrated.

### **Manukau Building Consultants Limited (Manukau City Council)**

*Financial statements year ended: 30 June 2009*

Our audit was limited because the Company corrected previous overestimations of the percentage-completion of its building consents inspections. The correction was carried out in accordance with the New Zealand Equivalent to International Reporting Standard 8: *Accounting Policies, Changes in Accounting Estimates and Errors*. However, due to incomplete data in the previous year, the Company was unable to fully and adequately quantify the effect of the correction. We noted the disclosures in the financial statements that refer to the new local government structure for the Auckland region. The Local Government (Tamaki Makaurau Reorganisation) Act 2009 established a single unitary authority (the Auckland Council) that will be responsible for governing the entire Auckland region from 1 November 2010. Decisions had to be made on the Auckland Council's structure and operations, including how the Company would be vested and integrated.

### **Safer Papakura Trust (Papakura District Council)**

*Financial statements year ended: 30 June 2009*

Our audit was limited because the Trust did not prepare a Statement of Intent for the year ending 30 June 2009 as required by the Local Government Act 2002 and, therefore, was unable to prepare performance information that fairly reflected its achievements measured against its performance targets. We noted the disclosures in the financial statements that refer to the new local government structure for the Auckland region. The Local Government (Tamaki Makaurau Reorganisation) Act 2009 established a single unitary authority (the Auckland Council) that will be responsible for governing the entire Auckland region from 1 November 2010. Decisions had to be made on the Auckland Council's structure and operations, including how the Trust would be vested and integrated.

### **Invercargill City Council**

*Financial statements year ended: 30 June 2009*

Our audit was limited because the Council included unaudited figures relating to its associate company, Bond Contracts Limited, in its financial statements. As a result, there were no satisfactory audit procedures that we could adopt to obtain sufficient evidence to confirm these unaudited figures.

### **Invercargill City Holdings Limited (Invercargill City Council)**

*Financial statements year ended: 30 June 2009*

Our audit was limited because the company included unaudited figures relating to its associate company, Bond Contracts Limited, in its financial statements. As a result, there were no satisfactory audit procedures that we could adopt to obtain sufficient evidence to confirm these unaudited figures.

**Wanganui Incorporated (Wanganui District Council)***Financial statements year ended: 30 June 2009*

Our audit was limited because the comparative information included the value of property, plant, and equipment vested on establishment on 31 October 2005, which could not be satisfactorily verified because the vested assets were not recognised at fair value at the date of vesting. Should there have been any misstatement of the carrying amount of property, plant, and equipment vested, then the loss on disposal, which was presented as comparative information, would be correspondingly misstated.

**West Coast Snowflake Limited***Financial statements year ended: 31 March 2008*

Our audit was limited because we were unable to obtain sufficient audit evidence to support the carrying values of office equipment and plant and equipment, which was stated at the Directors' estimate of net realisable value at 31 March 2008. We noted the disclosures in the financial statements that the going concern basis had appropriately not been used in preparing the financial statements because the company ceased business in December 2007.

**West Coast Snowflake Limited***Financial statements year ended: 31 March 2009*

Our audit was limited because during the year the Company recognised an impairment expense for plant and equipment, and we were unable to obtain sufficient audit evidence to support this expense. In addition, we were unable to obtain sufficient audit evidence to support the opening value of plant and equipment, which had been based on the Directors' estimate of net realisable value. We noted the disclosures in the financial statements that the going concern basis had appropriately not been used in preparing the financial statements because the Company ceased trading in December 2007.

**Village Pool Charitable Trust (Hastings District Council)***Financial statements years ended: 30 June 2008 and 30 June 2009*

Our audit was limited because we were unable to verify some material revenues due to limited controls over those revenues before they were recorded.

**Tauranga City Venues Limited (Tauranga City Council)***Financial statements year ended: 30 June 2009*

Our audit was limited because we were unable to verify some material revenues due to limited controls over those revenues before they were recorded.

**Te Kauwhata Licensing Trust***Financial statements years ended: 31 March 2006 and 31 March 2007*

Our audits were limited because we were unable to verify some revenues due to limited controls over those revenues and limited controls over stock on hand at the point of sale. We were also unable to verify the significant fluctuations of the catering account gross margin in 2007 because we could not verify the completeness of recorded revenue.

**Queenstown National Bank Events Centre Trust (Queenstown-Lakes District Council)***Financial statements year ended: 30 June 2008*

Our audit was limited because the Trust did not prepare performance information that fairly reflected its service achievements, as required by section 68 of the Local Government Act 2002.

**Varroa Agency Incorporated***Financial statements year ended: 30 June 2008*

Our audit was limited because the Agency did not prepare a statement of intent for the year beginning 1 July 2007, as required by the Local Government Act 2002, and was therefore unable to prepare performance information that reflected its achievements measured against its performance targets. We also noted a breach of the Local Government Act 2002 because the Agency did not prepare a statement of intent for the year beginning 1 July 2008.

**Westland Holdings Limited (Westland District Council)***Financial statements year ended: 30 June 2007*

Our audit was limited because the company did not prepare a statement of intent for the year beginning 1 July 2006, as required by the Local Government Act 2002, and was therefore unable to prepare performance information that reflected its achievements measured against its performance targets. We also noted a breach of the Local Government Act 2002 because the company did not prepare a statement of intent for the year beginning 1 July 2007.

**Westland Holdings Limited (Westland District Council)***Financial statements year ended: 30 June 2008*

Our audit was limited because the company did not prepare a statement of intent for the year beginning 1 July 2007, as required by the Local Government Act 2002, and was therefore unable to prepare performance information that reflected its achievements measured against its performance targets.

**Lakes Engineering Limited (Queenstown-Lakes District Council)***Financial statements year ended: 30 June 2008*

Our audit was limited because the company did not prepare a statement of intent for the year beginning 1 July 2007, as required by the Local Government Act 2002, and was therefore unable to prepare performance information that gave a true and fair view of its achievements measured against its performance targets.

**Pemberton Construction Limited (Waikato District Council)***Financial statements year ended: 30 June 2009*

Our audit was limited because the company did not prepare a statement of intent for the year beginning 1 July 2008, as required by the Local Government Act 2002, and was therefore unable to prepare performance information that fairly reflected its achievements measured against its performance targets. We noted the disclosures in the financial statements that the going concern basis had appropriately not been used in preparing the financial statements because the company was amalgamated with the parent company from 1 July 2009.

**Whangarei Art Museum Management Group (Whangarei District Council)***Financial statements year ended: 30 June 2009*

Our audit was limited because the Trust did not prepare a statement of intent for the year beginning 1 July 2008, as required by the Local Government Act 2002, and was therefore unable to prepare performance information that fairly reflected its achievements measured against its performance targets.

**Newtons Coachways (1993) Limited (Dunedin City Council)***Financial statements year ended: 30 June 2009*

Our audit was limited because the company did not prepare a statement of intent for the year beginning 1 July 2008, as required by the Local Government Act 2002, and was therefore unable to prepare performance information that gave a true and fair view of its achievements measured against its performance targets. We also drew attention to the fact that the company did not prepare a statement of intent for the year beginning 1 July 2009.

**Canterbury Economic Development Company Limited***Financial statements period ended: 30 June 2009*

Our audit was limited because the Company did not prepare a Statement of Intent for the year beginning 1 July 2008, as required by the Local Government Act 2002, and was therefore unable to prepare performance information that gave a true and fair view of its achievements measured against its performance targets.

**Manawatu Community Trust (Manawatu District Council)***Financial statements year ended: 30 June 2009*

Our audit was limited because the Trust did not prepare a Statement of Intent for the year beginning 1 July 2008, as required by the Local Government Act 2002, and was therefore unable to prepare performance information that gave a true and fair view of its achievements measured against its performance targets.

## Explanatory paragraphs – emphasis of matter

### Explanatory paragraph – emphasis of matter for local authorities in the Auckland region

We noted the disclosures in the financial statements that the going concern basis had appropriately not been used in preparing the financial statements because the Government decided to dissolve the existing local authorities and groups, and establish a new local government structure for the Auckland region. As a consequence of the dissolution of the local authorities, the group structure in its current form will also cease to exist. In accordance with the Local Government (Tamaki Makaurau Reorganisation) Act 2009, the functions, duties, and powers of the local authorities will become the functions, duties, and powers of a single unitary authority (the Auckland Council) that will be responsible for governing the entire Auckland region from 1 November 2010.

Decisions had to be made on the local authorities' structure and operations, including how the systems, plans, policies, assets, and liabilities of the local authorities, including their subsidiaries, would be vested and integrated. All the local authorities and groups expected the services currently delivered to continue to be delivered by the organisational structure put in place by the Auckland Council and, therefore, the assets and liabilities of the local authorities and groups would be relevant to the Auckland Council. For that reason, no adjustments had been made to the financial statements because of the dissolution basis of preparation.

Entities whose audit reports included such an explanatory paragraph for the financial year ended 30 June 2009 were:

- Auckland Regional Council;
- Auckland City Council;
- Franklin District Council;
- Manukau City Council;
- North Shore City Council;
- Papakura District Council;
- Rodney District Council; and
- Waitakere City Council.

## Explanatory paragraphs – emphasis of matter for local authorities' subsidiaries in the Auckland region

We noted the disclosures in the financial statements that referred to the new local government structure for the Auckland region. The Local Government (Tamaki Makaurau Reorganisation) Act 2009 established a single unitary authority (Auckland Council) that will be responsible for governing the entire Auckland region from 1 November 2010. Decisions had to be made on Auckland Council's structure and operations, including how the local authorities' subsidiaries would be vested and integrated.

Entities whose audit reports included such an explanatory paragraph for the financial year ended 30 June 2009 (controlling entity in bold) were:

### **Auckland Regional Council's subsidiaries:**

- Auckland Regional Transport Authority;
- Auckland Regional Holdings Limited; and
- Ports of Auckland Limited.

### **Auckland City Council's subsidiaries:**

- ARTNL Britomart Limited;
- Westhaven Marina Limited;
- Westhaven (Marina Extension) Trust;
- Westhaven (Existing Marina) Trust;
- Downtown Marinas Limited;
- Metrowater;
- Metrowater Community Trust;
- Auckland City Water Limited; and
- Aotea Centre Board Of Management.

### **Manukau City Council's subsidiaries:**

- Manukau City Investments Limited;
- Te Puru Community Charitable Trust;
- Waste Disposal Services;
- Manukau Water Limited;
- Manukau Leisure Services Limited;
- Tomorrow's Manukau Properties Limited;
- Tomorrow's Manukau Properties (Flat Bush) Limited; and
- Manukau City Council Sinking Fund Commissioners.

### **North Shore City Council's subsidiaries:**

- NSC Holdings Limited;
- Enterprise North Shore Trust;
- North Shore Heritage Trust;
- The North Shore City Performing Arts Centre Management Board Trust; and
- North Shore Promotions New Zealand Limited.

**Rodney District Council's subsidiaries:**

- Rodney Properties Limited.

**Waitakere City Council's subsidiaries:**

- Waitakere City Holdings Limited;
- Waitakere Properties Limited; and
- Waitakere Enterprise Trust Board.

**Subsidiary jointly owned by six local authorities:**

- Watercare Services Limited.

## Explanatory paragraphs – emphasis of matter for other entities

**Waitomo District Council**

*Financial statements year ended: 30 June 2009*

We drew attention to the serious financial difficulties of the Council and group, which incurred a loss of \$4.0 million because one of the subsidiary's borrowings were classified as current liabilities as a result of the subsidiary breaching its banking covenants. Since 30 June 2009, the subsidiary had managed the situation by renegotiating its banking covenants with its lender.

**Inframax Construction Limited (Waitomo District Council)**

*Financial statements year ended: 30 June 2009*

We drew attention to the serious financial difficulties of the company, which incurred a loss of \$4.9 million because the company's borrowings were classified as current liabilities as a result of the company breaching its banking covenants. Since 30 June 2009, the company had managed the situation by obtaining share capital from its shareholder and by renegotiating its banking covenants with its lender.

**Pakuranga Arts and Cultural Trust (Manukau City Council)**

*Financial statements year ended: 30 June 2009*

We noted the disclosures in the financial statements that refer to the Trust depreciating its buildings and improvements over a 60-year period when, in fact, the lease with the Manukau City Council for the land the buildings are on was for only an initial period of 20 years with a right of renewal for a further 20 years. However, with Auckland Council not coming into existence until 1 November 2010, Manukau City Council was not in a position to give assurance that Auckland Council would continue this lease.

**Central Plains Water Trust (Selwyn District Council)**

*Financial statements year ended: 30 June 2009*

We drew attention to uncertainties surrounding the going concern assumption. The validity of the going concern assumption was dependent on continued funding from Central Plains Water Limited or other sources. Central Plains Water Limited's continued existence depends on obtaining resource consents and obtaining further funding from existing shareholders or other sources.



**Westroads Limited (Westland District Council)***Financial statements year ended: 30 June 2009*

We drew attention to uncertainties surrounding the going concern assumption. The validity of the going concern assumption was dependent on successfully refinancing the loans or identifying other sources of funding.

**Westroads Greymouth Limited (Westland District Council)***Financial statements year ended: 30 June 2009*

We drew attention to uncertainties surrounding the going concern assumption. The validity of the going concern assumption was dependent on successfully refinancing the loans or identifying other sources of funding.

**Westland Holdings Limited (Westland District Council)***Financial statements year ended: 30 June 2009*

We drew attention to uncertainties surrounding the going concern assumption. The validity of the going concern assumption was dependent on successfully refinancing the loans or identifying other sources of funding.

**New Zealand Mutual Liability RiskPool***Financial statements years ended: 30 June 2008 and 30 June 2009*

We drew attention to the fact that the going concern basis had appropriately been used in preparing the financial statements. We noted that the Trustee of the RiskPool is able to levy members to cover any shortfall in equity in any funds.

**Timaru District Promotions Trust (Timaru District Council)***Financial statements year ended: 30 June 2009*

We drew attention to the fact that the going concern basis had appropriately been used in preparing the financial statements. We noted that an organisational review was being carried out.

**S C Aoraki Development Trust (Timaru District Council)***Financial statements year ended: 30 June 2009*

We drew attention to the fact that the going concern basis had appropriately been used in preparing the financial statements. We noted that an organisational review was being carried out.

**Hurunui Holdings Limited (Hurunui District Council)***Financial statements year ended: 30 June 2009*

We noted the disclosures in the financial statements that the going concern basis had appropriately not been used in preparing the financial statements because Hurunui District Council has resolved to transfer the assets and liabilities from the company back to the Council by way of an imputed dividend. The company will no longer continue to trade.

**Hawke's Bay Airport Authority (Hastings District Council and Napier City Council)***Financial statements year ended: 30 June 2009*

We noted the disclosures in the financial statements that the going concern basis had appropriately not been used in preparing the financial statements because the joint venture agreement was terminated from 1 July 2009.

**Taupo District Economic Development Advisory Board (Taupo District Council)***Financial statements year ended: 30 June 2009*

We noted the disclosures in the financial statements that the going concern basis had appropriately not been used in preparing the financial statements because the operations of the Board were transferred to the Enterprise Lake Taupo Trust.

**Ngā Tapuwāe Community Facilities Trust (Manukau District Council)***Financial statements year ended: 30 June 2009*

We noted the disclosures in the financial statements that the going concern basis had appropriately not been used in preparing the financial statements because the Trust was wound up as at 30 June 2009.

**Forever Beech Limited***Financial statements years ended: 30 June 2008 and 30 June 2009*

We noted the disclosures in the financial statements that the going concern basis had appropriately not been used in preparing the financial statements because the company ceased trading in July 2009.

**North Shore City Council Sinking Fund Commissioners***Financial statements year ended: 30 June 2009*

We noted the disclosures in the financial statements that the going concern basis had appropriately not been used in preparing the financial statements because the Sinking Fund was disestablished on 16 June 2009.

**The Hutt City Council Sinking Fund Commissioners***Financial statements year ended: 30 June 2009*

We noted the disclosures in the financial statements that the going concern basis had appropriately not been used in preparing the financial statements because the Sinking Fund was disestablished on 30 June 2009.

**Waitakere City Council Sinking Fund Commissioners***Financial statements year ended: 30 June 2007*

We noted the disclosures in the financial statements that the going concern basis had appropriately not been used in preparing the financial statements because the Sinking Fund was to be wound up within the next 12 months.

**Dunedin City Council Sinking Fund Commissioners***Financial statements year ended: 30 June 2008*

We noted the disclosures in the financial statements that the going concern basis had appropriately not been used in preparing the financial statements because the Sinking Fund was wound up on 30 June 2008.

**Bay of Plenty Regional Council Sinking Fund Commissioners***Financial statements year ended: 30 June 2007*

We noted the disclosures in the financial statements that the going concern basis had appropriately not been used in preparing the financial statements because the Sinking Fund was wound up on 30 June 2007.

**Proudly Papakura Trust (Papakura District Council)***Financial statements year ended: 30 June 2008*

We noted the disclosures in the financial statements that the going concern basis had appropriately not been used in preparing the financial statements because the Trustees decided to wind up the Trust on 30 June 2009.

**TTCF West Auckland Limited***Financial statements year ended: 30 June 2009*

We noted the disclosures in the financial statements that the going concern basis had appropriately not been used in preparing the financial statements because the company ceased trading on 31 May 2009.

**Riccarton Bush Trustees (Christchurch City Council)***Financial statements year ended: 30 June 2008*

We noted a breach of the Local Government Act 2002 because the Trust did not adopt a statement of intent for the year ended 30 June 2008, as required by section 64 of the Local Government Act 2002. However, we noted that the Trust had been able to report performance information against the overall operating objectives reported to Christchurch City Council.

We also noted the disclosure in the financial statements that the Trustees did not comply with the law by not adopting a statement of intent for the year beginning 1 July 2008 by the date by which it was required to be prepared, which was 30 June 2008.

**Te Kohaka o Tuhaitara Trust (Waimakariri District Council)***Financial statements year ended: 30 June 2009*

We noted a breach of the Local Government Act 2002 because the Trustees did not adopt a statement of intent for the period ended 30 June 2009, as required by section 64 of the Local Government Act 2002. However, we noted that the Trust had been able to prepare a statement of service performance against the statement of intent for 2007/08.

We also noted the disclosure in the financial statements that the Trustees did not prepare a statement of intent for the year beginning 1 July 2009 by the date by which it was required to be prepared, which was 30 June 2009.

**Whakatane Airport Authority (Whakatane District Council)***Financial statements year ended: 30 June 2009*

We noted a breach of the Local Government Act 2002 because the Authority did not prepare a statement of intent for the year beginning 1 July 2009 by the date by which it was required to be prepared, which was 30 June 2009.

**Balfour Cemetery Trust***Financial statements year ended: two years ended 31 March 2008*

We noted a breach of the Burial and Cremation Act 1964 because the Cemetery Trustees prepared one statement of accounts covering two years, from 1 April 2006 to 31 March 2008.

**North Shore Domain and North Harbour Stadium Trust Board (North Shore City Council)***Financial statements year ended: 28 February 2007*

We noted a breach of the Local Government Act 2002 because the Trust failed to have a June balance date, as required by the Act.

**North Shore Domain and North Harbour Stadium Trust Board (North Shore City Council)***Financial statements year ended: 29 February 2008*

We noted a breach of the Local Government Act 2002 because the Trust did not deliver to the shareholders and report to the public the results of the Trust's operations within three months of the year ended 29 February 2008.

# Publications by the Auditor-General

Other publications issued by the Auditor-General recently have been:

- Statement of Intent 2010–13
- Performance audits from 2008: Follow-up report
- Effectiveness of arrangements for co-ordinating civilian maritime patrols
- Draft annual plan 2010/11
- Auditor-General's inquiry into certain types of expenditure in Vote Ministerial Services – Part 1
- Local authorities: Planning to meet the forecast demand for drinking water
- Central government: Results of the 2008/09 audits
- Auckland City Council: Management of footpaths contracts
- Investigation into conflicts of interest of four councillors at Environment Canterbury
- Effectiveness of arrangements to check the standard of services provided by rest homes
- Ministry of Justice: Supporting the management of court workloads
- How the Thames-Coromandel District Council managed leasing arrangements for Council land in Whitianga
- Auditor-General's decision on parliamentary and ministerial accommodation entitlements
- Ministry of Education: Managing support for students with high special educational needs
- Ministry of Social Development: Changes to the case management of sickness and invalids' beneficiaries
- Annual Report 2008/09
- How the Ministry of Education managed the 2008 bus tender process
- New Zealand Defence Force: Progress with the Defence Sustainability Initiative

## Website

All these reports are available in HTML and PDF format on our website – [www.oag.govt.nz](http://www.oag.govt.nz). Most of them can also be obtained in hard copy on request – [reports@oag.govt.nz](mailto:reports@oag.govt.nz).

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Office of the Auditor-General  
PO Box 3928, Wellington 6140

Telephone: (04) 917 1500  
Facsimile: (04) 917 1549

Email: [reports@oag.govt.nz](mailto:reports@oag.govt.nz)  
[www.oag.govt.nz](http://www.oag.govt.nz)