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Parliamentary paper

Final audits
of Auckland's
dissolved councils,
and managing
leaky home
liabilities

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

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

Email: reports@oag.govt.nz
Website: www.oag.govt.nz

Final audits of Auckland's dissolved councils, and managing leaky home liabilities

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

June 2011

ISBN 978-0-478-32698-7 (print)
ISBN 978-0-478-32699-4 (online)

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Auditor-General's overview

My Office audited the financial and service performance statements in the final annual reports of the eight dissolved Auckland local authorities and 19 terminated council-controlled organisations. The former councils had significant final aggregate net assets of \$25.4 billion, before consolidating subsidiaries. I am pleased to report that the former councils reached most of their service performance targets in a time of tremendous change and uncertainty.

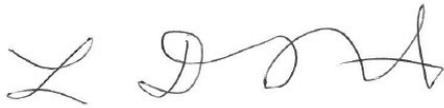
The Auckland reform legislation provided a framework for transferring responsibility for finalising the annual reports of former local authorities and council-controlled organisations to the entities that received their operations. All the reports were finished under this framework, although some were not finished and made available to the public within the required statutory time.

With the former entities' final annual reports now completed, Auckland Council must quickly establish its opening financial position to underpin its planning and reporting. Its opening position will vary from the former councils' aggregate closing position, because about \$18.9 billion in assets, together with related liabilities, became the responsibility of entities that the Council controls and because the Council must apply its own accounting policies to the balances it has inherited.

Auckland Council has begun to combine the former councils' frameworks for reporting service performance, both in its long-term plan and in its draft annual plan. The Council's overall performance framework must deal effectively with its emerging strategies and unique governance and accountability arrangements. These arrangements include decision-making and accountability shared between the governing body and local boards, and delivering key services through entities that the Council controls.

Part 3 of this report looks at the effects on local authorities of leaky home liabilities – effects greatest in cities, especially Auckland. I am pleased to note that accounting and disclosure for this improved in 2009/10, largely because of the preparations made for dissolving the former councils and identifying a good starting position for Auckland Council. I commend this approach.

The work the former councils did to prepare to be aggregated into the new Auckland Council sets a standard for other local authorities to consider for reporting. The work has shown that, for the local authorities most affected by leaky home claims, it is possible to estimate liabilities with sufficient reliability that they can be fully accounted for in the financial statements.

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

Lyn Provost
Controller and Auditor-General

1 June 2011

Part 1

Introduction

- 1.1 The Local Government (Tamaki Makaurau Reorganisation) Act 2009 (the Act) dissolved eight Auckland local authorities,¹ terminated 20 council-controlled entities that had been associated with them,² and established Auckland Council (the Council), which became operational on 1 November 2010.
- 1.2 The reform legislation required the former councils and the entities they controlled to prepare annual reports, including audited financial statements and, sometimes, statements of service performance, to cover the final 16-month period to 31 October 2010.
- 1.3 The Auckland Transition Agency, established to prepare the way for Auckland Council, was required to prepare a single final report that covered the whole of its period of operation from 23 May 2009 to dissolution on 31 October 2010.
- 1.4 The legislation assigned responsibility for finalising the annual report of each of the dissolved local authorities and terminated council-controlled organisations to the entity that received all or most of the former entity's operations.³
- 1.5 The 2009/10 annual reports of six of the eight former councils were completed and adopted within the statutory deadline. Since then, the remaining two former councils' annual reports, and the required summaries, have been completed and adopted, and made available to the public. None of the annual reports of the terminated council-controlled organisations were completed or made available to the public within the statutory deadline.
- 1.6 The former councils' financial statements included significant provisions for dealing with leaky home claims. As explained in Part 3, Auckland Council is the local authority most affected by such claims.

1 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.

2 These council-controlled entities are listed in Appendix 1. Auckland Transport Infrastructure Limited was wound up and struck off the companies register before the dissolution date, leaving 19 council-controlled organisations requiring annual reports for the 16-month period to 31 October 2010.

3 Appendix 2 lists the entities responsible for finalising the annual reports of entities dissolved or terminated by the Act.

Part 2

Matters for Auckland Council to consider

The significance of the former councils' annual reports

- 2.1 The last step in accounting for the performance of the former councils, before dissolution on 31 October 2010, was finalising their annual reports and summaries. This reported performance forms part of the former councils' legacy.

Establishing Auckland Council's opening position

- 2.2 The annual reports of the dissolved councils and terminated council-controlled organisations provide a starting point for Auckland Council. Now that they have been completed, the Council needs to quickly establish its opening position.
- 2.3 It is important that the Council moves quickly to establish its opening position, because this position determines:
- the reliability of its internal management monitoring and reporting arrangements;
 - the starting point for projections – the Council's planning document and its draft 2011/12 annual plan⁴ reflect estimated opening positions that will be superseded; and
 - the reported performance and position for the Council in its first annual report for the eight months to 30 June 2011.
- 2.4 Auckland Council's opening financial position differs from the aggregate closing position of the former councils because:
- the Auckland reform legislation provides for substantial assets and liabilities included in the former councils to be taken up by council-controlled entities, rather than by the Council; and
 - the former councils reported their results and net asset positions using different accounting policies, but the Council must apply a single set of consistent accounting policies in recording its opening position, and in reporting its transactions and results.

Management of transitional policies and systems

- 2.5 The former councils operated their own financial and non-financial reporting systems until dissolution. These systems were used in preparing the annual reports.
- 2.6 Auckland Council began to operate new systems and procedures on 1 November 2010, but has retained some systems of the former councils. For example, many of

⁴ Auckland Council (2011), *Draft Annual Plan 2011/12*, available at www.aucklandcouncil.govt.nz, was open for consultation at the time this report was being prepared.

the former councils' rating systems have been kept as the Council moves towards a single rating system.

- 2.7 The Council's reporting of financial and non-financial information will initially be based on former councils' funding policies and transitional systems. The Council will need to carefully manage the integration of its various policies and systems.

Aspects of the 2009/10 service performance results

- 2.8 All eight former councils achieved most of their service performance targets. The former councils provided different services to their communities and reported their service performance in the context of their respective activities and performance frameworks. These differed, although they did have some common features.
- 2.9 The framework for reporting service performance will increasingly need to reflect the unique aspects of the Council's structure.
- 2.10 The Council has begun to combine the activities and frameworks of the former councils into an effective activity structure. This emerging structure is reflected in *Auckland Council's Long-term Plan, 1 November 2010 – 30 June 2019*,⁵ and in the Council's *Draft Annual Plan 2011/12*, which was open for consultation at the time this report was being prepared. The Council will report its service performance against this combined structure in its annual reports in future.
- 2.11 The Council will continue to develop the framework within which it is accountable for, and reports, service performance. In preparing its long-term plan for 2012-22, the Council will need to consider the following:
- sharing new strategies and decisions between the governing body and local boards;
 - refining levels of service, including identifying them across the region and in local board areas; and
 - effectively combining the various disclosure requirements associated with the delivery of significant services by entities the Council controls.
- 2.12 The Council must take into account the new requirements introduced by the Local Government Amendment Act 2010, including mandatory disclosures for certain groups of activities.⁶ Standard performance measures, to be specified in regulations that apply beyond 2012, are to be used for reporting service performance for these groups of activities.

5 Auckland Transition Agency (2010), *Auckland Council's Long-term Plan, 1 November 2010 – 30 June 2019, Volume 1: Summary and context*, page 1, available at www.aucklandcouncil.govt.nz.

6 Activities for which separate disclosures are required are water supply, sewerage and the treatment and disposal of sewage, stormwater drainage, flood protection and control works, and the provision of roads and footpaths.

- 2.13 Some of these mandated groups of activities are provided through organisations the Council controls.⁷ Where this is the case, the required standard performance measures must be included in those organisations' statements of intent and reported against annually.
- 2.14 These changes will significantly affect disclosures relating to some activities to be carried out by Auckland Transport and Watercare Services Limited; namely, water supply, sewage treatment and disposal, and road and footpath activities.
- 2.15 In reporting performance, the Council will also need to consider how best to present financial information, which does not have to be consolidated (that is, excludes council-controlled organisations) for planning purposes⁸ but must be consolidated (to include council-controlled organisations) in annual reports.

Regulatory performance focused at governing body level

- 2.16 Auckland Council has combined all the regulatory functions of the former councils and includes these in its planning and regulation group of activities. The reform legislation makes the regulatory functions of the Council a matter for the governing body. These functions should be dealt with consistently across Auckland.
- 2.17 The seven former territorial local authorities had a range of measures and targets. All had measures and targets for processing building consents. For example, targets for compliance with deadlines ranged from 90% to 100%, and the former councils reported compliance between 77% and 100%.
- 2.18 All seven former territorial local authorities also had measures and targets for resource consent processing. Targets for complying with deadlines ranged from 70% to 100%, and the former councils reported compliance between 51% and 100%.
- 2.19 The Council plans to improve the performance of processing building consents. Its planning document⁹ for 2010/11 and its draft 2011/12 annual plan¹⁰ show a target of 100% compliance with deadlines.

7 Including Watercare Services Limited, which was jointly owned by the former councils, and becomes a council-controlled organisation in 2012.

8 In the long-term and annual plans.

9 Auckland Transition Agency (2010), *Auckland Council's Long-term Plan, 1 November 2010 – 30 June 2019, Volume 2: Visions, strategies and activities*, page 78.

10 Auckland Council (2011), *Draft Annual Plan 2011/12*, page 105.

Library performance: Decision-making and service at local board level

- 2.20 The former councils reported library services' performance using different measures and targets. Six of the former councils had targets for satisfaction with the library services that ranged from 74% to 94%. Their reported performance was between 70% and 93%.
- 2.21 Auckland Council has assigned library services to its community group of activities. The planning document sets out a consistent performance framework for library services that the Council provides, including performance measures and targets. These targets include user satisfaction targets, such as one of 85% for overall satisfaction with the services provided.
- 2.22 Decision-making for many aspects of library services has been initially allocated to local boards.¹¹ The draft 2011/12 annual plan disaggregates the levels of service and associated performance measures and targets for the Council's library services, and shows them at the local board level. It does so by including them, along with other activities where decision-making rests with local boards, in the first 21 draft local board agreements.
- 2.23 We noted in our December 2010 report, *Matters arising from Auckland Council's planning document*, that combining the activities and performance frameworks of the former councils means that levels of service are expressed as an average across Auckland. In practice, services are delivered at different levels in different parts of the region. The Council has not yet been able to identify meaningful levels of service for some activities within individual local board areas.
- 2.24 The 21 draft local board agreements included in the draft 2011/12 annual plan show the basis on which levels of service brought forward from the former councils, together with associated performance measures and targets, have been identified at the local board level.¹²

Reporting service performance in entities controlled by Auckland Council

- 2.25 The former councils used a range of measures and targets to report service performance by their subsidiaries.¹³

11 *Auckland Council's Long-term Plan, 1 November 2010 – 30 June 2019, Volume 3: Local boards*, page 103.

12 For example, see information and draft agreement for Waitemata Local Board in Auckland Council's *Draft Annual Plan 2011/12*, page 13. Levels of service are derived for individual local boards using actual local board data. Where local board data is not available, data relating to the relevant former council area is used. If neither of those two sources is available, regional data can be used.

13 Including Watercare Services Limited, which was jointly owned by the former councils, and becomes a council-controlled organisation in 2012.

- 2.26 Particularly significant are the Council's activities relating to transport and water. The former councils' transport and water activities were delivered by a combination of:
- direct provision, such as:
 - Auckland Regional Council's transport activities, and the roading activities of the other former councils; and
 - former territorial authorities' provision of retail water and wastewater services; and
 - provision through other entities, such as:
 - transport provision by the Auckland Regional Transport Authority;
 - retail water provision by entities controlled by the former councils; and
 - wholesale water provision through Watercare Services Limited.
- 2.27 The Council has combined the substantial transport and water activities of the former councils into substantial new groups of activities, delivered by Auckland Transport and Watercare Services Limited, respectively. The operations of the former Auckland Regional Transport Authority are also delivered by Auckland Transport. Watercare Services Limited will continue to deliver bulk water supply and other operations.
- 2.28 The framework for reporting 2010/11 service performance for the Council's groups of activities relating to transport and water (supply and wastewater)¹⁴ is reflected in the long-term plan.¹⁵ Further information about this framework, including performance measures and targets, is included in the disclosure about council-controlled entities.¹⁶
- 2.29 The framework for reporting service performance for transport and water has been developed further in the draft 2011/12 annual plan,¹⁷ which the Council will report against in 2011/12.

14 Stormwater activities are retained by Auckland Council.

15 Auckland Transition Agency (2010), *Auckland Council's Long-term Plan, 1 November 2010 – 30 June 2019, Volume 2: Vision, strategies and activities*, pages 121-130, and pages 140-149.

16 *Auckland Council's Long-term Plan, 1 November 2010 – 30 June 2019, Volume 4: Council-controlled organisations*, pages 7-25.

17 Auckland Council (2011), *Draft Annual Plan 2011/12*, activity information on pages 159-169, and pages 143-152; council-controlled organisations information on pages 210-214 and pages 233-236.

Aspects of the financial results for 2009/10

Former councils' annual reports and plans

- 2.30 The former councils prepared annual plans for the year ended 30 June 2010 before the reform legislation was fully enacted. These were incorporated as the first year within the 2009-19 long-term plans of the respective councils. The reform legislation required annual plans to be prepared by the former councils for their final four-month period up to 31 October 2010. For the 16-month period to 31 October 2010, each former council reported against the budgets included in these two annual plans.
- 2.31 Appendices 3 and 4 show the final reported net asset positions of the former councils on 31 October 2010 and their final comprehensive income for the 16-month period ending on that date. They also compare these in aggregate¹⁸ with the relevant budgets.
- 2.32 The former councils had overall net assets of \$25.4 billion as at 31 October 2010. This was \$0.2 billion lower than anticipated in their budgets.
- Liabilities were \$1.3 billion higher than budgeted – reflecting nearly \$1 billion of new borrowing, mainly by Auckland City Council and Manukau City Council, and significant new provisions for dealing with leaky home claims.
 - Assets were \$1.1 billion more than budgeted. Current assets, including the unspent portion of Manukau City Council's new borrowing, accounted for \$0.4 billion of this difference. Non-current assets were \$0.5 billion more, a sum that would have been greater if revaluations of tangible assets had been as high as anticipated by the former councils' budgets. Auckland City Council's new borrowing, lent to other councils as part of a co-ordinated approach taken to treasury operations, increased the investment component of its non-current assets.
- 2.33 The former councils' total comprehensive income for the 16 months to 31 October 2010 was \$0.7 billion less than had been anticipated. The main factors contributing to the shortfall were:
- lower-than-expected revaluations of fixed assets (\$0.3 billion lower than expected);¹⁹ and
 - expenditure that was \$0.4 billion more than expected, mainly because of additional provisions required for leaky home liabilities (\$0.2 billion more than the previous year) and unbudgeted spending arising from the reform (\$0.1 billion relating to redundancies and asset write-downs).

18 Appendices 3 and 4 show the non-consolidated final reported net asset positions and final comprehensive income. The numbers are aggregated without eliminating balances that are common across the former councils.

19 Figures rounded. See Appendix 4.

Adjustments arising from dissolution or termination

- 2.34 The annual reports of the former councils and council-controlled entities disclose the effects of the reform. These disclosures include details of adjustments and transactions reflected in the annual reports that arose from the reform, which relate to redundancies and asset write-downs totalling \$69 million. Of this, \$50 million relates to the former councils and was not budgeted for. Figure 1 provides a summary of the totals, and Appendix 1 sets out more detailed information.

Figure 1
Significant financial effects of dissolution

	Redundancies \$000	Asset write-downs \$000
Local authorities	27,228	23,063
Council-controlled organisations	3,433	14,853
Totals	30,661	37,916

- 2.35 Payments to former chief executives of the dissolved councils are included in the redundancy numbers shown in Figure 1. We reported separately on issues arising from the payments to chief executives in our November 2010 report, *Inquiry into payments to chief executives of dissolving local authorities in Auckland*.²⁰

Provisions for dealing with leaky home claims

- 2.36 The former councils' financial statements included significant additional provisions for dealing with leaky home claims. These provisions increased by \$245 million (from \$221 million to \$469 million). The higher provisions were generally not anticipated in the former councils' budgeting. There was better estimating of, and provision for, total potential liabilities, in preparation for the transition to Auckland Council. Appendix 5 sets out provisions made by the former councils as at 31 October 2010, compared with provisions made as at 30 June 2009.
- 2.37 Part 3 explains the issues relating to leaky home liabilities for a sample of local authorities. The new Auckland Council is the local authority most affected by the leaky home liability issue, and has the largest disclosed total potential liability for addressing it.

²⁰ See www.oag.govt.nz/2010/auckland-ceos-payments.

Assets identified as transferring to receiving entities

- 2.38 The annual reports of the former councils show significant activities being conducted through subsidiaries. Appendices 3 and 4 show, by deduction, that subsidiaries held \$2.7 billion of assets on 31 October 2010, and spent \$0.8 billion in the 16 months ending on that date.²¹
- 2.39 The annual reports of the former entities include disclosures about the reform and its effect. These disclosures identify the entities that would receive their operations following dissolution, and the book values of the assets and liabilities they would receive, as at 31 October 2010.
- 2.40 Auckland Council received the former councils' operations unless the reform legislation specified another receiving entity. Some operations and related assets were transferred to Waikato local authorities.²²
- 2.41 The Act specifies that substantial operations and related assets be transferred to the subsidiaries within the Council's new group structure. Appendix 6 shows that a total of \$18.9 billion of the former councils' assets, together with associated liabilities, were to be received by five Council subsidiaries: Auckland Transport, Watercare Services Limited, Auckland Council Investments Limited, Regional Facilities Auckland Limited, and Auckland Waterfront Development Agency Limited. Of this, \$16.4 billion relates to assets that transfer to Auckland Transport and Watercare Services Limited.
- 2.42 The \$18.9 billion of assets and associated borrowings transferred to the five subsidiaries are not included in the Council's opening balance sheet. However, these transfers have not depleted the Council's overall net asset position because the value of the transfers has increased the opening value of the Council's investments in subsidiaries by an equivalent amount.
- 2.43 As well as the assets noted above, the receiving entities gained operations and related assets from the termination of council-controlled entities. For example:
- Auckland Transport received the entire operations and assets of Auckland Regional Transport Authority;²³ and
 - Watercare Services Limited received the entire operations and assets of Metro Water Limited²⁴ and Manukau Water Limited.²⁵

21 The results for Watercare Services Limited were not consolidated into the results of the individual former councils because none of the former councils held a controlling share in that company's equity.

22 Waikato District Council, Hauraki District Council, and Environment Waikato.

23 Auckland Regional Transport Authority's total assets as at 31 October 2010 were \$0.4 billion.

24 Metro Water Limited's total assets as at 31 October 2010 were \$1.4 billion.

25 Manukau Water Limited's total assets as at 31 October 2010 were \$1.1 billion.

Part 3

Managing leaky home liabilities

How local authorities have dealt with leaky home liabilities

- 3.1 Provisions amounting to \$477 million were included in the 2009/10 financial statements of the six New Zealand local authorities most affected by leaky home claims. Four of those six local authorities, representing \$454 million of the total \$477 million of provisions, were former Auckland councils.²⁶ Provisions for all the former Auckland councils amounted to \$469 million at 31 October 2010 (see Appendix 5). Therefore, leaky home liabilities are a major issue for Auckland Council.
- 3.2 The six local authorities' increased total provisions for leaky home liabilities by \$275.9 million, or 236%, on the amount disclosed a year earlier.
- 3.3 Disclosures in the 2009/10 financial statements are much improved on previous years, largely because of the co-ordinated approach taken to calculating these liabilities in the former Auckland councils' final annual reports. The work carried out to calculate Auckland Council's liability has led to more refined and accurate estimates and much more detailed and transparent disclosures in the financial statements. We consider that the disclosures fully meet applicable accounting standards.
- 3.4 Overall, the amount the six local authorities disclosed as contingent liabilities in their 2009/10 financial statements was less than in the previous year's statements. Four of the local authorities did not record any contingent liabilities because they had obtained information with a sufficient level of reliability, allowing the full identified liability to be disclosed as provisions in the financial statements. This led to increased provisions in the financial statements.
- 3.5 In its 2010 Budget, the Government indicated that it intended to establish a scheme to faster resolve leaky home claims. The scheme had yet to be confirmed at the time of writing. The former Auckland councils took the new scheme into consideration in calculating provisions for leaky home liabilities. They indicated that if the scheme did not go ahead the costs to settle leaky home claims would increase by an estimated \$78.9 million.

26 Auckland City Council, North Shore City Council, Rodney District Council, and Waitakere City Council.

Our review of how six councils accounted for leaky home liabilities

- 3.6 In 2007, we considered the annual reporting requirements of the local government sector in accounting for leaky home liabilities. We issued guidance to our auditors to help them assess leaky home liabilities for each stage of the claims process. Their appointed auditors gave the authorities the principles included in our guidance.
- 3.7 Liabilities arising from leaky home claims involve important issues of transparent reporting and accountability. Recording a leaky home liability as a provision is different from recording it as a contingent liability. The balance sheets of financial statements include provisions. 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 must be clearly explained, so that readers of financial statements can understand how accurate the amounts might be.
- 3.8 In our reports to Parliament, we have 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.²⁷ Here, we update our findings from the disclosures included in the 2009/10 financial statements.
- 3.9 In 2007, when we began 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 councils have been dissolved and replaced by the new Auckland Council.
- 3.10 Now, Manukau City Council and Tauranga City Council also face many claims.²⁸ Other local authorities face fewer claims. However, to compare disclosures with our previous years of analysis, we have reviewed the same six local authorities we originally identified in 2007.
- 3.11 If we included Manukau City Council and Tauranga City Council, this would add \$14.8 million to the total amount accounted for as provisions by the six local authorities listed in paragraph 3.9. Tauranga City Council has recorded an unquantified liability for future liabilities from leaky home claims. Manukau City Council did not record any contingent liabilities, because all categories of claims were estimated with sufficient reliability to be recorded as provisions in the 2009/10 financial statements.

²⁷ *Local government: Results of the 2006/07 audits, Local government: Results of the 2007/08 audits, and Local government: Results of the 2008/09 audits.*

²⁸ In 2007, Manukau City Council and Tauranga City Council had claim levels that were significantly below the six most affected local authorities. Now, both have claims volumes higher than those of Rodney District Council.

The kinds of claims that local authorities face

- 3.12 We identified three categories of claims that local authorities must consider when assessing their current and future exposure to liability for leaky home claims:
- category one – claims that have been investigated and reviewed, where the total claim amount and the local authority's share have been confirmed;
 - category two – claims still being investigated and confirmed, with 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, including issues that might not yet have been identified by home owners.
- 3.13 Categories two and three are of most concern to local authorities because of the associated high level of uncertainty.

Accounting for leaky home liabilities

- 3.14 The accounting standard that applies to 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 assessing whether a liability that needs to be estimated can be calculated with enough reliability to meet the definition of a provision.
- 3.15 Our guidance to auditors on the appropriate accounting treatment 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.
- 3.16 Our monitoring of the sector up to 2009/10 found that identifying category two and category three claims was more difficult for local authorities than we had 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 allow accounting for the liability in the financial statements. We found that, in many instances, the

estimation processes used to assess liabilities for category two and category three claims, whether done in-house or by a professional actuary, were not reliable enough to allow the resulting estimation to be accounted for as a provision in the financial statements. The argument presented to support this approach has been that the estimation processes were not reliable enough because too many variables apply to each leaky home case.

How councils approached leaky home liabilities

- 3.17 Of the six local authorities included in this review, five made significant improvements to the disclosures in their 2009/10 financial statements compared with those in their 2006/07, 2007/08, and 2008/09 financial statements. The former Auckland councils aligned their approach before being amalgamated into the new Auckland Council. This meant a much more consistent approach to accounting for these liabilities, and clearer disclosures.

A changing approach to leaky home liabilities

- 3.18 During the transition to Auckland's new local government structure, it was important that accounting policies of all the former councils were aligned. Each former council carried out a detailed, consistent assessment of potential leaky home liabilities to prepare for Auckland Council taking these over. With minor exceptions, all the former councils accounted for the liabilities for leaky home claims in the same way in their annual reports.
- 3.19 Because of the differences in approach applied by these local authorities in previous years, and their unique circumstances, the effects on each of aligning the accounting approach varied. In some instances, there were large increases in provisions for leaky home liabilities. One local authority's provision increased by more than 4000% compared to 2008/09.
- 3.20 In 2009/10, the approach taken to completing the actuarial assessments of the future liabilities for the Auckland councils was significantly refined. As a result, the actuarial assessments were deemed reliable enough to allow all categories of liabilities to be disclosed as provisions in 2009/10. This meant \$378.2 million previously classified as contingent liabilities was reclassified as provisions.
- 3.21 When comparing liabilities of the former councils as disclosed in 2008/09 with those disclosed in 2009/10, it is appropriate to consider the total liabilities in the 2008/09 annual reports – both the provisions and the quantified contingent liabilities. For each council, these movements range from a total increase of 660% to a total decrease of 64%. Overall, the sum of total potential liabilities for the four Auckland councils decreased by \$114.7 million compared with 2008/09.

- 3.22 Wellington City Council significantly changed its approach to accounting for the liabilities for leaky home claims. In the 2009/10 year, the Council accounted for the legal costs associated with settling leaky home claims, and refined the basis of its actuarial assessment. Previously, the liability was assessed in relation to the repair-related costs only without including an assessment of the other costs incurred by the local authority to settle a claim. The total movement in the provision compared to the 2008/09 year is \$12.2 million. This actuarial assessment relates only to category two claims. This part of Wellington City Council's leaky home liability has been treated as an unquantified contingent liability.

Accounting for category one claims

- 3.23 All six local authorities continued to appropriately provide for notified and confirmed category one claims.

Accounting for category two claims

- 3.24 For category two claims, all six local authorities increased provisioning in 2009/10, compared with 2008/09. The primary drivers of the increases are explained in paragraphs 3.17 to 3.21. We note that, in the case of the four former Auckland councils, the disclosures supporting the amounts provided for in the financial statements are extensive and clearly identify the part of the provision that is for category two claims and the part that is for category three claims. The provisions made by the other two local authorities most affected by this issue relate only to category two claims.
- 3.25 The extensive and informative disclosures included by the former Auckland councils reflect a large improvement in the quality of the information disclosed in these local authorities' financial statements. The disclosures meet the requirements of NZ IAS 37 to provide disclosure related to the assumptions applied in calculating the estimated liability, and to provide information about the effect on the calculations of changes to the assumptions. We are pleased to see this information set out clearly in the financial statements, and consider that this approach should be considered by all other local authorities facing potential liabilities for leaky home claims.

Accounting for category three claims

- 3.26 The approach to disclosing category three claims has been more consistent than in previous years because of the aligned approach of the former Auckland councils. Paragraph 3.18 describes the approach taken by these local authorities. For these local authorities, the full extent of the estimated liability has been

included as provisions within the financial statements. In their 2009/10 financial statements, the remaining two of the six councils recorded being exposed to contingent liabilities for future leaky home claims, but did not quantify the estimated future cost to the local authority.

- 3.27 Given the former Auckland councils' extensive disclosures, we consider that other local authorities need to work with their actuaries to improve the accuracy and transparency of their disclosures related to category three claims.
- 3.28 We noted in previous years that home owners were filing increasingly more accurate claims. This, along with the knowledge acquired from the increasing number of settled claims, is helping actuaries to refine their estimation process. These reasons have been specifically noted in the disclosures made by the former Auckland councils as leading to the estimated future liabilities being assessed with sufficient reliability to be included as provisions rather than contingent liabilities.

Insurance matters related to leaky home liabilities

- 3.29 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 in recent years. The specific limits and parameters of insurance cover for claims before June 2009 vary for each local authority and for each year. The specific level of coverage is related to the number and value of claims for each local authority. From June 2009, RiskPool has completely excluded leaky home claims from its insurance cover, leaving local authorities with no insurance cover for this costly type of liability.
- 3.30 In June 2009, because of high deficits in the fund, RiskPool asked its members for capital funding. A further call was made on 1 July 2010. RiskPool indicated that further calls would be required and would be made on 1 July 2011 and 1 July 2012 to address the shortfall for claims from 2002 to the time when leaky home coverage was withdrawn. RiskPool was not fully reinsured for all years of the fund because full reinsurance for leaky home claims was not available.
- 3.31 Tentative details of the future calls were provided to members during 2009/10. On 1 July 2010, Auckland City Council and Christchurch City Council paid the full amount of their share of the calls signalled to be made between 1 July 2010 and 1 July 2012.

- 3.32 The costs of the calls for funding already made, the expected future calls, and the withdrawal of insurance cover, add to the burden that leaky home claims place on local authorities.
- 3.33 In completing our review of the disclosures made in the financial statements of the six most significantly affected local authorities, we noted some inconsistencies in how insurance recoveries are treated. In line with accounting standards, local authorities should calculate provisions for liabilities for leaky home claims and separately account for the proceeds of insurance recoveries. We noted that, in the few instances where disclosure covered this issue in previous years, insurance recoveries had been offset against total liabilities.
- 3.34 In considering the six councils' annual reports for 2009/10, we noted that the practice of offsetting insurance recoveries:
- has continued in some instances;
 - has been resolved for 2009/10 in others; and
 - in other instances has been resolved both for the 2009/10 year and by adjustment of the previous year's comparative figures.
- 3.35 The amounts involved are below our audit materiality thresholds. However, because of the inconsistencies identified, particularly among the former Auckland councils, we encourage local authorities, including Auckland Council, to address this matter.

The Government's financial assistance scheme

- 3.36 In May 2010, the Government proposed a financial assistance scheme for homeowners with leaky homes. The scheme provides for the local authority and the Crown to each pay 25% of the agreed repair costs. We understand that all of the local authorities significantly affected by the leaky home liability issue have agreed to participate in the scheme. All but one of the local authorities in this review noted in their 2009/10 financial statement disclosures that they intended to participate in the scheme. Christchurch City Council has made no specific disclosure on the matter.
- 3.37 The scheme is designed to speed up the resolution of leaky home matters for the homeowner and to reduce the extent of associated costs such as legal and other professional fees for all parties. In participating in the scheme, the homeowner will obtain a 25% contribution to repair costs, from both the local authority and the Crown, as full and final payment. The scheme places no limits on the right of the homeowner to pursue other remedies with third parties.

- 3.38 The Government indicated that the scheme would become operational in the first quarter of the 2011 calendar year. However, as of May 2011, the scheme was yet to be confirmed.
- 3.39 The former Auckland councils have made clear disclosures about the scheme and the implications it is assumed to have for their estimated liabilities. Auckland City Council, North Shore City Council, Rodney District Council, and Waitakere City Council disclosed that, if the scheme did not go ahead, their total provisions would increase by \$78.9 million. Manukau City Council indicated that its provisions would increase by \$4.2 million if the scheme were not to go ahead. The increases would reflect a combination of increased settlement costs and increased professional fees. Because the new scheme is expected to speed up the settlement process, it would reduce the costs associated with discounting for the changing value of money over time.
- 3.40 It does not appear that the new scheme has been factored into the provisions of the other two non-Auckland councils most affected by the leaky home liability issue.

Appendix 1

Summary of significant dissolution adjustments

	Redundancy costs \$000	Asset write-downs \$000
Former councils (8)		
Auckland City Council	5,408	12,000
Auckland Regional Council	1,663	604
Franklin District Council	768	–
Manukau City Council	4,551	1,559
North Shore City Council	4,108	–
Papakura District Council	745	–
Rodney District Council	1,871	–
Waitakere City Council	8,114	8,900
Totals	27,228	23,063
Council-controlled organisations (19)		
Aotea Centre Board of Management	411	–
ARTNL Britomart Limited	–	–
Auckland Regional Holdings Limited	–	–
Auckland Regional Transport Authority	342	–
Auckland Regional Transport Network Limited	17	–
Enterprise North Shore Trust	–	–
Manukau Building Consultants Limited	45	–
Manukau Enterprise and Employment Trust	126	–
Manukau Leisure Services Limited	235	–
Manukau Water Limited	605	330
Metro Water Limited	1,226	14,441
NSC Holdings Limited	–	–
Rodney Properties Limited	–	–
Sea + City Projects Limited	–	–
TMPL (Flat Bush) Limited	–	–
Tomorrow's Manukau Properties Limited	170	–
Waitakere City Holdings Limited	–	6
Waitakere Enterprise Trust Board	91	70
Waitakere Properties Limited	165	6
Totals	3,433	14,853

Appendix 2

Responsibility for finalising the reports of dissolved and terminated entities

The former councils and council-controlled organisations dissolved and terminated by the Auckland reform legislation prepared annual reports for their final 16-month period up to dissolution on 31 October 2010. These annual reports had to be completed by the entities that became responsible for them, and made available to the public within the usual statutory time periods after that date.

Figure 2
Responsibility for finalising the annual reports of dissolved and terminated entities

Responsible entity	Dissolved or terminated entity
	<i>Local authorities</i>
Auckland Council	The eight former councils
	<i>Council-controlled organisations – 20 in total</i>
Auckland Council	Auckland Regional Holdings Limited, NSC Holdings Limited, Waitakere City Holdings Limited, Manukau Leisure Services Limited, Manukau Building Consultants Limited, Waitakere Properties Limited, Rodney Properties Limited, Tomorrow's Manukau Properties Limited, TMPL (Flat Bush) Limited (9)
Auckland Transport	Auckland Regional Transport Authority, Auckland Regional Transport Network Limited, ARTNL Britomart Limited (3)
Watercare Services Limited	Metro Water Limited, Manukau Water Limited (2)
Auckland Waterfront Development Agency Limited	Auckland Transport Infrastructure Limited*, Sea + City Projects Limited (2)
Auckland Tourism, Events and Economic Development Limited	Waitakere Enterprise Trust Board, Enterprise North Shore Trust, Manukau Enterprise and Employment Trust (3)
Regional Facilities Auckland Limited	Aotea Centre Board of Management (1)

* Auckland Transport Infrastructure Limited was wound up and struck off the companies register before the dissolution date.

Six of the former councils had their annual reports completed, and made available to the public, on time before the end of February 2011. In March 2011, the annual reports and summaries of all six were made available to the public, and the annual reports of Papakura District Council and Auckland Regional Council were completed and adopted. In April 2011, Papakura District Council finalised its annual report and made its summary available to the public. Auckland Regional Council's summary was made available to the public within a month of its annual report being finalised.

None of the 19 terminated council-controlled organisations had their annual reports completed and made available to the public within the statutory time of before the end of January 2011. The Auckland Transition Agency completed its final financial statements on time in February 2011. They were presented to the House of Representatives in March 2011 as part of the Agency's final report.

Where entities failed to meet statutory deadlines for completing annual reports, this fact was disclosed in the annual reports.

The Local Government Act 2002 requires annual reports to be finalised by local authorities within four months of the financial period end (completed and adopted by resolution), and by council-controlled organisations within three months (delivered to the shareholders, and made available to the public). Every local authority must publish the annual report and a summary of the information it contains within a month of adoption. The Auckland reform legislation retained these deadlines. The statutory deadlines for completing the final annual reports of dissolved and terminated entities are shown in Figure 3.

Figure 3
Statutory deadlines and compliance dates for finalising annual reports of dissolved and terminated entities

Entity	Statutory deadline for completing annual reports
Dissolved local authorities	Annual report to be completed and adopted by 28 February 2011 Annual report and summary made available to public one month after completion and adoption (by 31 March 2011)
Terminated council-controlled organisations	31 January 2011
Auckland Transition Agency	Financial statements to be completed by 28 February 2011, then presented to the House of Representatives as part of the final report

With the receiving entities becoming responsible for finalising the annual reports, shareholders in terminated council-controlled entities were able to see those entities' annual reports in draft form before the statutory deadline. The annual reports were completed after the statutory deadline so were not made available to the public within the statutory time period. At the time of publishing, not all the completed annual reports of terminated council-controlled organisations had been made available to the public.

Financial statements included in entities' annual reports are usually prepared on a going concern basis, because the entity and its operations are expected to continue. However, the financial statements of the dissolved councils and terminated entities were prepared on a dissolution basis.

When financial statements are prepared on a dissolution basis, there can be substantial adjustments to the carrying values of assets and liabilities, and the resulting financial statements are significantly different from their going-concern equivalent. For example, the dissolution basis would apply to an entity that became insolvent, and the financial statements would then reflect distress sales of assets at heavily discounted values. In the context of the Auckland reform, however, where the operations of the former entities were generally being continued by the respective receiving entities, the relatively few significant adjustments relate to redundancies and asset write-downs.

All the financial statements included in the annual reports of dissolved councils and terminated entities were prepared appropriately on a dissolution basis. We drew attention in our audit opinions to the disclosures made in the annual reports about the effect of the Auckland reform, and the appropriate use of the dissolution basis of preparation. All of the financial statements made adequate disclosures, which included details of the adjustments made to the financial statements as a result of the reform.

Appendix 3

Summary of the final net assets of the former Auckland councils

This Appendix presents a summary of the former Auckland councils' final net assets as at 31 October 2010.

Former councils	Aggregated (including subsidiaries)*			Parent council only		
	Total assets	Total liabilities	Net assets	Total assets	Total liabilities	Net assets
	\$m	\$m	\$m	\$m	\$m	\$m
Auckland City Council	11,923	(2,068)	9,855	10,580	(1,756)	8,824
Auckland Regional Council	2,273	(616)	1,657	1,440	(224)	1,216
Franklin District Council	1,334	(110)	1,224	1,335	(111)	1,224
Manukau City Council	7,159	(1,046)	6,113	6,745	(870)	5,875
North Shore City Council	4,698	(618)	4,080	4,630	(614)	4,016
Papakura District Council	603	(96)	507	603	(96)	507
Rodney District Council	1,886	(396)	1,490	1,886	(396)	1,490
Waitakere City Council	3,097	(797)	2,300	3,094	(797)	2,297
Totals	32,973	(5,747)	27,226	30,313	(4,864)	25,449
Total budgeted				29,212	(3,545)	25,667
Variance between actual and budget				1,101	(1,319)	(218)

* Aggregated on a non-consolidated basis, without eliminating balances that are common across the former councils.

Appendix 4

Former councils' comprehensive income for their final 16 months

This Appendix summarises the former Auckland councils' final comprehensive income from 1 July 2009 to 31 October 2010.

Former councils	Aggregated*			Parent			
	Total revenue	Total expenditure	Other	Total revenue	Total expenditure	Other	Total comprehensive income
	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Auckland City Council	1,247	(1,290)	275	1,044	(1,059)	108	93
Auckland Regional Council	795	(731)	227	353	(350)	203	206
Franklin District Council	118	(116)	73	118	(117)	74	75
Manukau City Council	640	(649)	160	467	(497)	78	48
North Shore City Council	415	(445)	117	421	(436)	117	102
Papakura District Council	91	(62)	0	91	(62)	0	29
Rodney District Council	246	(244)	145	246	(244)	145	147
Waitakere City Council	387	(463)	37	382	(457)	36	(39)
Totals	3,939	(4,000)	1,034	3,122	(3,222)	760	660
Total budgeted				3,107	(2,815)	1,040	1,332
Variance between actual and budget				15	(407)	(280)	(672)

* Aggregated on a non-consolidated basis, without eliminating balances that are common across the former councils.

Appendix 5

Former councils' provisions for dealing with leaky home claims

This Appendix summarises the former Auckland councils' provisions for dealing with leaky home claims.

Former councils	2008/09 provision ^a	Increase in provision	2009/10 provision ^b
	\$m	\$m	\$m
Auckland City Council	160.5	134.7	295.2
Auckland Regional Council	Council has no liability		
Franklin District Council	–	0.9	0.9
Manukau City Council	0.5	13.8	14.3
North Shore City Council	44.9	61.4	106.3
Papakura District Council ^c	–	–	–
Rodney District Council	0.6	23.0	23.6
Waitakere City Council	14.0	14.8	28.8
Totals	220.5	248.6	469.1

a As at 30 June 2009.

b As at 31 October 2010.

c No material exposure (rural district).

Appendix 6

The assets of former councils and their receiving entities

This Appendix summarises the assets of the former Auckland councils and their receiving entities as at 31 October 2010.

Former councils	Receiving entity*					Total
	Auckland Transport	Watercare Services Limited	Auckland Council Investments Limited	Regional Facilities Auckland Limited	Auckland Waterfront Development Agency Limited	
	\$m	\$m	\$m	\$m	\$m	
Auckland City Council	4,318	1,461	348	778	181	7,086
Auckland Regional Council	368	–	701	72	213	1,354
Franklin District Council	769	153	–	–	–	922
Manukau City Council	2,610	1,069	274	–	–	3,953
North Shore City Council	1,314	1,207	–	–	–	2,521
Papakura District Council	251	84	–	–	–	335
Rodney District Council	899	328	–	–	–	1,227
Waitakere City Council	1,090	482	3			1,575
Totals	11,619	4,784	1,326	850	394	18,973

* All other assets of the former councils go to Auckland Council.

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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
Website: www.oag.govt.nz