

The Audit Environment

- 15.001 In our *First Report for 1998*¹ we noted that new requirements for financial management enacted in Part VIIA of the Local Government Act 1974 would not only impose considerable pressure on local authorities during 1997-98, they would also place considerable demands on our auditors. This observation remains relevant for 1998-99.
- 15.002 For 1997-98, our auditors completed the audit and issued the first audit reports on the nine local authorities that elected to comply early with the new financial management requirements.² The new requirements for the remaining 77 authorities took effect from 1 July 1998.
- 15.003 In planning the special matters we have identified for attention during the 1998-99 audits, we were mindful that local authorities will be busy meeting the new financial management obligations. Auditors will also be busy, working closely with local authorities to assist them to meet these obligations.
- 15.004 We are looking at a number of issues during 1998-99 that will culminate in a report to the individual authority or to Parliament, or both. Three issues will be followed up as part of the annual audit:
- identification of environmental obligations;
 - local authority borrowing; and
 - members' remuneration.
- 15.005 Projects on two other issues are currently in progress:
- a review of contracting out of local authority regulatory functions; and
 - an assessment of environmental management by unitary authorities.
- 15.006 In addition, we will be reviewing our *Suggested Guidelines for Advertising and Publicity by Local Authorities*.³

1 Parliamentary paper B.29[98a], page 91.

2 See pages 13-18 of this report.

3 Parliamentary paper B.29[96b], pages 99-112. See page 111 of this report.

Identification of Environmental Obligations

- 15.007 During 1998, the International Accounting Standards Committee issued a new standard IAS 37: *Provisions, Contingent Liabilities and Contingent Assets*. In New Zealand the Financial Reporting Standards Board (FRSB) has issued an exposure draft, ED-86: *Provisions, Contingent Liabilities and Contingent Assets*, which is substantially based on IAS 37.
- 15.008 One area that ED-86 and IAS 37 address is the treatment of environmental obligations, such as contaminated land. We are concerned that some local authorities (and other public sector organisations) have not yet fully identified and assessed a number of environmental obligations, and that these obligations could have significant future implications for the local authorities and their financial statements. Consequently, we have asked our auditors to gather information this year to assist us in responding to ED-86 and in our discussions with other interested parties – such as the Parliamentary Commissioner for the Environment and the Ministry for the Environment.
- 15.009 Auditors have been asked to:
- identify, through discussions with the entity and observation during their audit, whether the entity may have environmental obligations that have not been recognised in the financial statements;
 - provide details of any environmental obligations that an entity has recognised as a liability; and
 - ascertain whether regional councils and unitary authorities have prepared a register of known and potentially contaminated sites.

Accounting for Landfills

- 15.010 A “subset” of accounting for the wider issue of environmental obligations is accounting for landfills. We have considered IAS 37 in relation to the guidance we issued in 1997 on accounting for landfills.⁴ That guidance was based largely on guidance issued by the United States Governmental Accounting Standards Board and the Canadian Institute of Chartered Accountants.

⁴ *Managing and Accounting for Landfills*, parliamentary paper B.29 [97b], pages 53-60.

- 15.011 ED-86 and IAS 37 are not materially different from our 1997 guidance. The main difference relates to measurement of any liability. ED-86 and IAS 37 measure the liability based on the expenditure required to settle the present obligation at balance date. Our guidance suggested measuring the liability based on the volume of the landfill consumed and the present value of the estimated future cash outflows necessary to meet the obligation.
- 15.012 Local authorities should be planning to measure landfill obligations in accordance with the standard to be based on ED-86, and we have asked our auditors to pursue this. We expect that all local authorities should be recognising and reporting landfill obligations by 30 June 2000. Until the financial reporting standard on the subject is issued, we will accept measurement of the obligations based on either our 1997 guidance or ED-86/IAS 37.
- 15.013 For those local authorities that do not comply with the principles of our 1997 guidance, and where the effect is material, we will issue a qualified audit opinion on the 30 June 2000 financial statements.

Local Authority Borrowing

- 15.014 While the new financial management regime (enacted in Part VIIA of the Local Government Act 1974) provides local authorities with greater flexibility and freedom over borrowing, it also brings local authorities into line with other securities issuers. The added complexity has meant that many councillors and local authority staff are heavily reliant on advisers to provide the necessary skills and advice.
- 15.015 We are planning to report how local authorities have adapted to the new regime. We will also seek to identify instances where local authorities have entered into arrangements that place them at risk.
- 15.016 We have asked our auditors to gather information on each local authority's borrowing – including how much the authority has borrowed, at what rates of interest and for what term, what security has been offered, and whether the authority has obtained a credit rating. We will also be ascertaining the authorities' views on the benefits and disadvantages of the new regime, and whether there are any elements local authorities would like to change.

Members' Remuneration

- 15.017 A number of concerns have been raised about the level of payments made to members of local authorities. These concerns focus on the justification for the payments being made and the lack of incentive to minimise costs.
- 15.018 The actual payments to members, whether for chairperson allowances or meeting fees, are only a small part of the costs to the local authority on account of its members. Travel allowances can be considerable. In addition, the costs of staff time in servicing meetings must be taken into account.
- 15.019 Much of what has been written on the subject to date has been based on anecdotal evidence or on information provided solely by local authorities. The purpose of us gathering information is to provide an accurate and unbiased picture, so that any future decisions on the method or level of remunerating members is soundly based.
- 15.020 We have asked our auditors to gather information on, among other things:
- the level of payments for the year ending 30 June 1999 to the mayor or chairperson, and to councillors;
 - the split of remuneration between the mayor's/chairperson's allowance, meeting allowance, and travel allowance; and
 - the number of meetings attended.
- 15.021 Community boards and their members are specifically excluded from our review, because the nature of their activities varies greatly between authorities.

Contracting Out of Regulatory Functions

- 15.022 Local authorities have more recently started, or considered starting, contracting for the discharge of their regulatory functions – such as litter, animal, noise and parking control; health and liquor licensing; and issuing resource consents. Queenstown Lakes District Council (the Council) was one of the first local authorities to comprehensively contract out these types of functions.

15.023 With a view to developing guidance to other local authorities that are considering contracting out such functions, we are evaluating the extent to which the Council's new arrangements for its regulatory functions (both contracted and what remains in-house) meet the legislative requirements and the needs of its stakeholders.

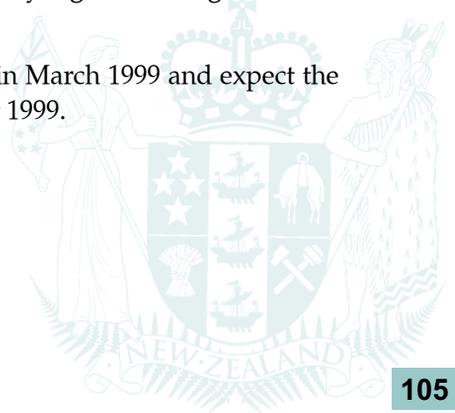
15.024 Specifically, our review will cover:

- what the Council was planning to achieve through contracting out – including the philosophy of the Council and any particular goals and objectives for the contracting out;
- the establishment of the contract with the private sector provider – including the process of selecting the provider;
- the contract itself – including contract terms and where responsibilities lie; and
- how the Council plans to monitor and manage the contract to achieve its original objectives – including reporting mechanisms that are in place.

15.025 The main audience for our report will be councillors, ratepayers, and staff of other local authorities considering these, or similar, types of arrangements. However, the report will have a number of other audiences, including:

- councillors, ratepayers and staff of the Council – for assurance about its arrangements;
- potential tenderers to other local authorities – for the purpose of developing their proposals; and
- the responsible organisations – should the report uncover issues that need clarification by legislation, regulation or public education.

15.026 We began work on the review in March 1999 and expect the report to be finalised in August 1999.



Environmental Management by Unitary Authorities

- 15.027 A unitary authority is a single centre of responsibility in its district for all functions of local government, such as under the Resource Management Act 1991. It combines the environmental management functions of regional councils and city/district councils. There are currently four unitary authorities – Gisborne District Council, Marlborough District Council, Nelson City Council, and Tasman District Council.
- 15.028 The Parliamentary Commissioner for the Environment and the Audit Office considered that a joint independent assessment of the unitary authority model would be a valuable contribution to the debate about the strengths and weaknesses of the current structure and systems of local government with respect to environmental management responsibilities.
- 15.029 Some have argued that the two-tier system of environmental management by regional councils and territorial authorities is unnecessary and inefficient. Others suggest that combining the two tiers of government, as in the unitary authority model, has the potential to create conflicts of interest between the regulatory and service delivery roles – for example, the granting of consents by the “regional” arm to operate the council’s “district” services such as sewage treatment plants and landfill sites.
- 15.030 The joint assessment is being undertaken in four stages.
- Stage one, in July 1998, comprised a preliminary visit to the Hawke’s Bay Regional Council in order to scope the exercise, and prepare the terms of reference and assessment criteria.
 - Stage two, carried out between 1 July and 31 December 1998, involved assessing the environmental management system of each of the four unitary authorities.
 - Stage three, carried out between 1 February and 31 March 1999, involved comparing and contrasting the environmental management systems of the unitary authorities with those of a selection of other authorities.

B.29[99b]

- Stage four, currently being carried out, involves completing a final report which combines the analysis, findings and recommendations from stages two and three. We expect the report to be completed in June 1999.

