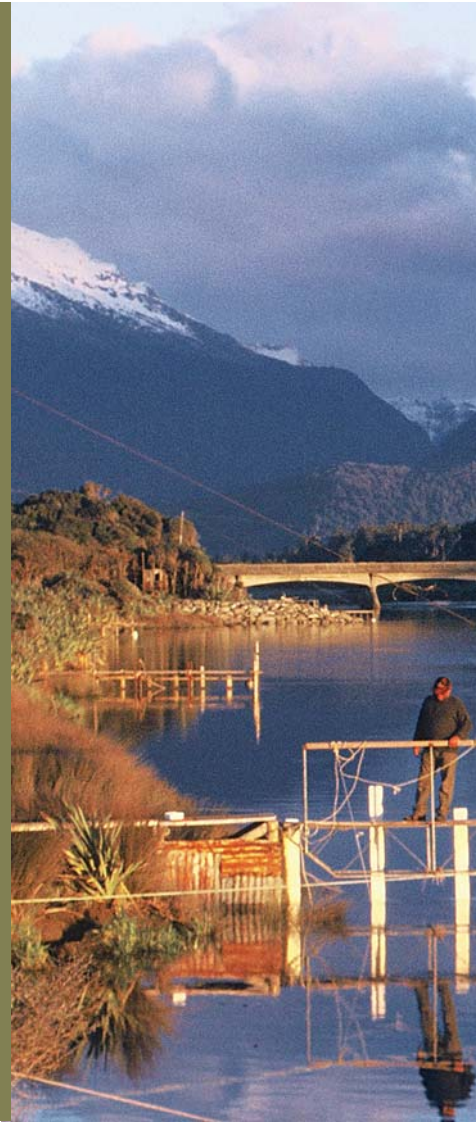




Performance audit report

Management of the West Coast Economic Development Funding Package





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Management of the West Coast Economic Development Funding Package

This is the report of a performance
audit we carried out under section
16 of the Public Audit Act 2001.

May 2006

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Foreword

In May 2000, a once-only payment of \$120 million was made to help the West Coast region's economy adjust to the Government's policies to end the logging of indigenous forest.

Of this funding package, \$92 million was placed with the West Coast Development Trust, and the remaining \$28 million was divided equally between the 4 West Coast local authorities (Buller District Council, Grey District Council, Westland District Council, and West Coast Regional Council).

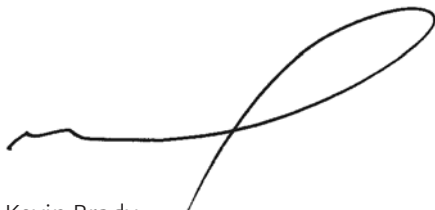
This report looks at how these 5 entities have managed the use of the funding package.

Overall, I found that the Trust has good systems to manage the investment of its funds. I recommend several improvements to the decision-making process used to distribute funds.

The local authorities have each taken a different approach to using and investing their share of the funding package. Where losses have been incurred, local authorities have learned from their experiences.

The West Coast region has made much progress in improving its economic well-being in recent years. While this audit does not comment on the collaboration and co-ordination between the Trust, the local authorities, and other stakeholders, it is important for the ongoing success of the region that these parties cultivate a supportive environment for regional collaboration on economic development matters.

I thank the West Coast Development Trust staff, Trustees, and Advisory Body members, the 3 district council Mayors, the regional council Chairman and Deputy Chairman, and the staff of the 4 local authorities, for their co-operation and assistance during this performance audit.



Kevin Brady
Controller and Auditor-General

1 May 2006

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Summary

In May 2000, Cabinet agreed to make a once-only payment of \$120 million (GST-exclusive) to help the South Island's West Coast economy adjust to the Government's policies to end the logging of indigenous forest.

Of this West Coast Economic Development Funding Package (the funding package), \$92 million was placed with the West Coast Development Trust (the Trust), and the remaining \$28 million was divided equally between each of the 4 West Coast local authorities (Buller District Council, Grey District Council, Westland District Council, and West Coast Regional Council).

We undertook a performance audit of the 5 entities.

We looked at the operation of the Trust and its management and use of its share of the funding package. In particular, we:

- looked at the governance arrangements for the Trust; and
- tested that the distribution of funds by the Trust has complied with its Deed of Trust.

We also examined what each of the 4 local authorities had done with their share of the funding package, and their involvement (if any) in economic development initiatives. We also assessed whether their investment policies met the requirements of the Local Government Act 2002, and whether each local authority had acted in keeping with its investment policy.

Governance of the West Coast Development Trust

The Trust must comply with its Deed of Trust (the Deed). The Deed sets out the Trust's purpose, functions, governance arrangements, powers, processes, and rules.

The Trust is governed by 12 Trustees, whose role is to direct and supervise the conduct of the Trust's business. The Trustees have set up several sub-committees to help run the Trust.

The Trustees have appointed an Advisory Body to act as expert advisors in distributing funds (of more than \$100,000) to business and community groups. The Advisory Body members have the financial, commercial, and entrepreneurial skills required by the Deed.

A Chief Executive and his staff support the Trustees and the Advisory Body.

Many of the people we spoke to during our audit (including past and present Trustees) consider that there are too many Trustees, and were concerned that

there are no skill requirements for Trustees. Trustees will raise this issue during a review by the Trustees and the Settlor (the Minister of Finance) of the Trust's operations, which is due by mid-2006.

Because all of the Advisory Body members are appointed for a term of 5 years, there is a risk that the whole Advisory Body could change at the same time. Losing, at one time, the experience held by the Advisory Body could result in delays for funding applicants, and inconsistency in decision-making.

Management of the Trust's investment of its share of the funding package

The Trust has earned about \$31 million in investment returns and interest since it received its \$92 million share of the funding package. The Deed requires the Trust to appoint investment advisors, prepare a plan for investing its funds, and to invest the funds in keeping with this plan. The Trust has met these requirements of the Deed. In addition, the Trust has established appropriate monitoring arrangements for its investments.

Governance of subsidiary companies

During its first 5 years, the Trust made equity distributions to companies which became part- and fully-owned subsidiary companies. In 2005, the Trust set up, and appointed Trustees as directors of, a holding company through which to manage its subsidiary companies. In our view, because there are no specific skill requirements for Trustees, it is important that the Trustees who act as holding company directors receive training to support them in this role. The Trust recognises the value of such training. Formal reporting from the holding company to the Trust is in place.

The Trust has appropriate procedures for appointing directors to the subsidiaries of the holding company. We noted one failure in the monitoring and reporting of business risks by a subsidiary company's managers to its directors. The failure led to the Trust being unaware of a significant risk to its investment. The Trust has learned from this experience, and is setting up regular monitoring and reporting arrangements for its subsidiary companies.

Conflicts of interest

We looked at the processes and policies for managing conflicts of interest for the Trustees, Advisory Body members, and Trust staff. All 3 groups were aware of the potential for conflicts of interest, and were declaring conflicts of interest as they arose. A register of declarations of interest is held for Trustees and Advisory Body members, and there is a conflicts of interest policy for staff of the Trust.

Maintaining confidentiality

The Trust is meeting the needs of fund applicants by maintaining the confidentiality of their personal information.

Evaluating the Trust's effectiveness

The Trust has thought about what the objects of the Trust mean, and has put in place high-level goals that aim to achieve the objects. However, the measures that the Trust has set for assessing progress towards the goals are not specific or measurable enough for the Trust to be able to use them to track its progress. In addition, the Trust does not currently report enough information on its progress towards achieving its goals to be accountable to its stakeholders. The Trust has told us that it will seek to provide this information to the community.

The Trust has made good use of market research surveys to ascertain whether it is seen to be operating effectively for the people of the West Coast.

Meeting the transparency and accountability requirements of the Deed of Trust

The Deed states that the Trust must conduct its affairs in a manner that is transparent and accountable to the people of the West Coast. We considered the extent to which this aspect of the Deed is being met, particularly when the Trust is undertaking projects significant to the region as a whole.

The Trust uses a range of ways to communicate with the community (such as media releases, and its website). It has mostly met the requirements of the Deed to make information available, and it has held public meetings to discuss its annual reports.

We appreciate that it is up to the Trustees to determine how to meet the transparency and accountability requirements of the Deed. However, several people we spoke to during the audit were concerned that the Trust was not meeting the transparency and accountability aspects of the Deed, and believed that Trust meetings should be held in public. Holding meetings in public is a valuable way to ensure public accountability, particularly as the Trust is becoming more heavily involved in regional projects. The Trust has recently resolved to hold a series of public meetings on regional economic development matters. We encourage the Trust to continue with this initiative.

Review of the Trust's operations

The Deed requires that the Trustees and the Settlor review the operation of the Trust before 30 June 2006. We consider that a periodic review of the Trust's

operations is a useful way to check that the Trust is operating effectively, particularly as the Trust's activities mature and expand into new areas. In our view, the planned review of the Trust should be repeated in another 5 years.

Distributing funds

Under the Deed, the Trust can distribute funds to applicants. According to the Deed –

... the Trust Fund may be applied and used exclusively by the Trustees for the following general purposes within New Zealand (the Objects), namely:

- (a) to promote sustainable employment opportunities in the West Coast region; and*
- (b) to generate sustainable economic benefits for the West Coast region; and*
- (c) to support projects which are not the ordinary day-to-day running, maintenance and upgrade of the infrastructure that is normally the responsibility of the local authorities or central government, provided such projects meet paragraphs (a) and (b)...*

All distributions must be made for the general purposes set out above (the objects of the Trust) and following the process set out in the Deed.

The Deed allows the Trust to distribute its net income, and up to 5% of the initial funding package, in any one year. The Trust has more than preserved the initial value of the funding package, and the value of the funds distributed has been in keeping with the Deed. The Trust has distributed about \$27 million in its first 5 years of operation.

The Trust has strategic and business plans, and policies for distributing funds. We were satisfied that the Trust has satisfactory procedures for processing applications for funding for business investment, and is improving its systems for processing applications for community funding.

Making decisions on distribution applications

We were concerned about some aspects of the decision-making process. The Trust must refer applications for more than \$100,000 to its Advisory Body for consideration. The Advisory Body recommends to Trustees whether a funding application should be declined or approved, and may recommend that an application be approved only if, in the Advisory Body's view, the application meets the objects of the Trust.

The Trustees cannot approve an application for more than \$100,000 without a recommendation to do so from the Advisory Body. The Trustees make the final decision on an application, and can either approve or decline the recommendation made by the Advisory Body.

The Advisory Body and the Trustees, when deciding whether to approve or decline an application for funds, have been mindful of the need to comply with the objects of the Trust.

However, this requirement has led to significant debate, because the objects of the Trust are open to interpretation. In our view, the Trust has not adequately defined how the infrastructure clause – item (c) within the objects of the Trust – should be interpreted.

There has also been debate about how applications for community funding fit within the objects of the Trust – particularly whether they promote sustainable employment opportunities, and generate sustainable economic benefits for the West Coast region.

We consider that the Trust is in a position to make a considerable contribution to the well-being of the West Coast region through funding community projects, but it needs to ensure at all times that the projects meet the objects of the Trust.

It could be argued that almost any application for community funding could promote sustainable employment opportunities or generate sustainable economic benefits, given that the funding could attract or help retain employees. However, it is unclear whether this was the intention of the funding package. We consider that this interpretation of the Deed should be clarified with the Settlor.

The Trust has been inconsistently dealing with applications for sponsorship (where funding is provided to an external party, for the primary benefit of that party). The Trust has treated some sponsorship arrangements as distributions (which the Trust must refer to the Advisory Body if the application is for more than \$100,000) and others as marketing and promotions (which do not need to be referred to the Advisory Body). In our view, applications for sponsorship should be treated as distributions. Accordingly, sponsorship applications for more than \$100,000 should be referred to the Advisory Body. We note that the Trust processed an application for sponsorship for more than \$100,000 without the Advisory Body considering it.

Before an amendment was made to the Deed, the Trustees were not able to distribute funds without a recommendation from the Advisory Body. The role of the Advisory Body in making decisions on applications is a critical check and balance to ensure that the Trust is effective in achieving its purpose. While the

Trustees have the ability to approve funding that does not exceed \$100,000, this does not preclude them from using the Advisory Body for advice on applications under this threshold. We consider that there is value in the Trustees seeking the opinion of the Advisory Body where there is uncertainty whether the objects of the Trust will be met, regardless of the amount applied for.

The Trustees set a minimum distribution amount of \$20,000 (which they have recently reduced to \$5,000) for business distributions, and \$5,000 for applications for community funding. The Trust has approved distributions for less than these amounts. This inconsistent application of policy may result in some potential applicants missing out on funding if they do not apply based on the policy, while others may apply and be approved. This is an unfair situation.

As well as deciding whether an application should be approved, the Trust must determine what terms and conditions are applied to the distribution of funds. One benefit in receiving funding from the Trust is that the Trust may be flexible in setting interest rates, and may make other concessions. The Trust has had no formal process for determining what interest rate it will apply to loans. A draft Credit Policy Manual now provides guidance for setting interest rates. The manual is an improvement on the informal process previously used for establishing loan conditions.

File management

The Trust uses “client” files to hold information about funding applications and distributions. The Trust’s client files did not contain all the information we expected – for example, many files did not contain the original application or the checklist used to process the application. While the minutes of Advisory Body and Trustee decisions on applications were frequently not in the files, Trust staff were able to provide these on request. Information on monitoring whether the terms and conditions of distributions had been met was also often missing from the files.

The Trust’s draft Credit Policy Manual outlines the documentation that must be kept in the client files.

Monitoring distributions

Trust distributions are usually subject to conditions – such as providing the Trust with regular financial reports and updates on progress towards achieving key performance indicators (KPIs). Where funding depended on KPIs, there was good monitoring and reporting of whether KPIs were achieved.

However, in some instances, funding recipients were not complying with the conditions agreed when the funding was approved. The Trust acknowledges that it has not been monitoring distributions as closely as it would like, and has now appointed more staff to keep up with this growing workload.

For the most part, the Trustees we spoke to were satisfied with the amount and quality of monitoring information provided on distributions.

Accessibility of the fund to the community

The Trust has contracted independent market research surveys of applicants. The results of these surveys show that applicants generally found the application forms easy to use, and Trust staff helpful. However, some surveyed applicants and others we spoke to considered that applying to the Trust was a difficult, expensive, and lengthy process. The Trust believes that, because of the nature of the applications it handles, it must research and properly consider applications. This takes time.

Some people we spoke to considered that the Trust could be more active in attracting new applicants. Having recently appointed more staff, who are introducing new initiatives (such as a business plan template for use by applicants, and encouraging local accountants to bring new business to the Trust through their clients), we consider that the Trust can now be more active in attracting applications for funding.

Management of the funding package by the local authorities

The \$7 million share of the funding package provided to each of the 4 local authorities in the West Coast region was given unconditionally. Each local authority chose to use or invest its share of the funding package in different ways.

Each of the 4 local authorities had an investment policy as required by the Local Government Act 2002. These policies differed in their approach to investing, and also the extent to which the policy met the requirements of the Local Government Act 2002.

While each local authority's investment policy outlined the investment objectives and the mix of investments allowed, none of the 3 district councils outlined procedures for acquiring new investments (as required by the Local Government Act 2002).

The investment policies for 2 of the 3 district councils did not comprehensively cover the procedures by which investment performance is to be reported to the

Council. Despite this, each local authority has established procedures for regular reporting on investments to the Council for monitoring purposes.

We did not find any significant instances where the local authorities had breached their investment policies.

The local authorities' approaches to the use or investment of their shares of the funding package have ranged from conservative to high-risk loan financing of business enterprises. The councils that invested in equities and became directly involved in providing economic development loans have suffered large actual or opportunity cost losses to their share of the funding package.

Buller and Westland District Councils opted to lend funds directly to businesses. These district councils have each had to make provisions to write off about 40% of the value of the economic development loans they made.

Grey District Council opted to take a facilitation approach to economic development – for example, through its support of Grey Regional Opportunities Workshop (GROW), and by funding the development of an industrial commercial property site.

West Coast Regional Council has not been involved in economic development initiatives.

The local authorities have learned from their involvement in direct loans to private enterprise business ventures to promote economic development, and investment in equities:

- The local authorities that adopted higher risk approaches for their share of the funding package have now resolved to adopt more conservative approaches to investing.
- All 3 district councils have reduced or ceased their direct involvement in economic development.

Our recommendations

We recommend that:

1. the Settlor and the Trustees of the West Coast Development Trust amend the Deed of Trust to stagger the appointment dates for Advisory Body members;
2. the West Coast Development Trust prepare more specific, measurable, and time-bound performance measures to determine and report on progress towards achieving its high-level goals;
3. the West Coast Development Trust provide more information in its annual report on progress towards achieving its high-level goals;

4. the Trustees and the Settlor of the West Coast Development Trust carry out another review of the operation of the Trust in 2011;
5. the West Coast Development Trust seek further legal advice on, or clarify with the Settlor, the interpretation of the infrastructure clause of the Deed of Trust;
6. the West Coast Development Trust clarify with the Settlor the interpretation of the Deed of Trust, and determine whether, and under what circumstances, community funding distributions meet the objects of the Trust;
7. the West Coast Development Trust treat sponsorship as a distribution;
8. the West Coast Development Trust consistently apply its policy on minimum distribution amounts. If the West Coast Development Trust considers that exceptions to the policy are appropriate, it needs to specifically state in its application and guidance documents that exceptions may be considered;
9. the West Coast Development Trust include all relevant information about funding applications and distributions in its client files;
10. the West Coast Development Trust increase its monitoring of successful funding applicants to ensure that the terms and conditions of funding agreements are met; and
11. Buller, Grey, and Westland District Councils revise their investment policies to meet the requirements of the Local Government Act 2002.

Part 1

Introduction

The West Coast Economic Development Funding Package

- 1.1 In May 2000, Cabinet agreed to make a once-only payment of \$120 million (GST-exclusive) to help the South Island's West Coast economy adjust to the Government's policies to end the logging of indigenous forest.
- 1.2 The \$120 million payment was split between the 4 West Coast local authorities (Buller District Council, Grey District Council, Westland District Council, and West Coast Regional Council) and an entity about to be formed – the West Coast Development Trust (the Trust).
- 1.3 Each local authority received \$7 million to use as it saw fit.
- 1.4 The remaining \$92 million was given to the Trust, which was established by the Crown, after regional consultation. The conditions attached to the \$92 million payment were set out in the Deed of Trust (the Deed), which was negotiated by the Settlor (the Minister of Finance) and a committee of West Coast mayors, local authority chief executives, and the West Coast Regional Council's chairperson.
- 1.5 The Deed states that the Trust is a charitable trust to benefit the present and future inhabitants of the West Coast region. According to the Deed –

... the Trust Fund may be applied and used exclusively by the Trustees for the following general purposes within New Zealand (the Objects), namely:

(a) to promote sustainable employment opportunities in the West Coast region; and

(b) to generate sustainable economic benefits for the West Coast region; and

(c) to support projects which are not the ordinary day-to-day running, maintenance and upgrade of the infrastructure that is normally the responsibility of the local authorities or central government, provided such projects meet paragraphs (a) and (b)...

The West Coast region

- 1.6 The West Coast region covers more than 23,000 square kilometres, or 8.5% of New Zealand's land area. The distance from the top to the bottom of the West Coast region is roughly the same as the distance between Auckland and Wellington.
- 1.7 The region's population of slightly more than 30,000 is spread throughout some 60 towns and settlements. The region is made up of distinct communities that have traditionally tended to act in a strongly independent manner.

- 1.8 The 3 districts which make up the region are:
- Buller district, which lies to the north of the region and has a population of about 10,000. Its main centre is Westport. The district has plentiful coal, gold, and limestone reserves, and boasts high agricultural production.
 - Grey district, which sits in the middle of the region and has a population of about 13,000. Its main centre, Greymouth, is the largest town in the region.
 - Westland district, which covers the southern part of the region and has a population of about 8,000. Its main town is Hokitika. The Franz Josef and Fox Glaciers provide for a strong tourism industry.

1.9 Figure 1 shows the 3 districts, and their location on the West Coast of the South Island.

1.10 In 2000, when the West Coast region received the funding package from the Government, its Gross Domestic Product was below the national average. Results of the 2001 Census found the median income of people in the West Coast region was \$14,600, compared with \$18,500 for all of New Zealand. The unemployment rate in the West Coast region was 6.7%, compared with 7.5% for all of New Zealand.

1.11 By June 2004, a regional growth rate of 5.6% had been achieved – the highest in the country, and well ahead of the national average of 4.3%. The unemployment rate had dropped to 3%, when the national rate was 4%. These changes can be attributed to a growth in the mining, agriculture, and tourism industries.

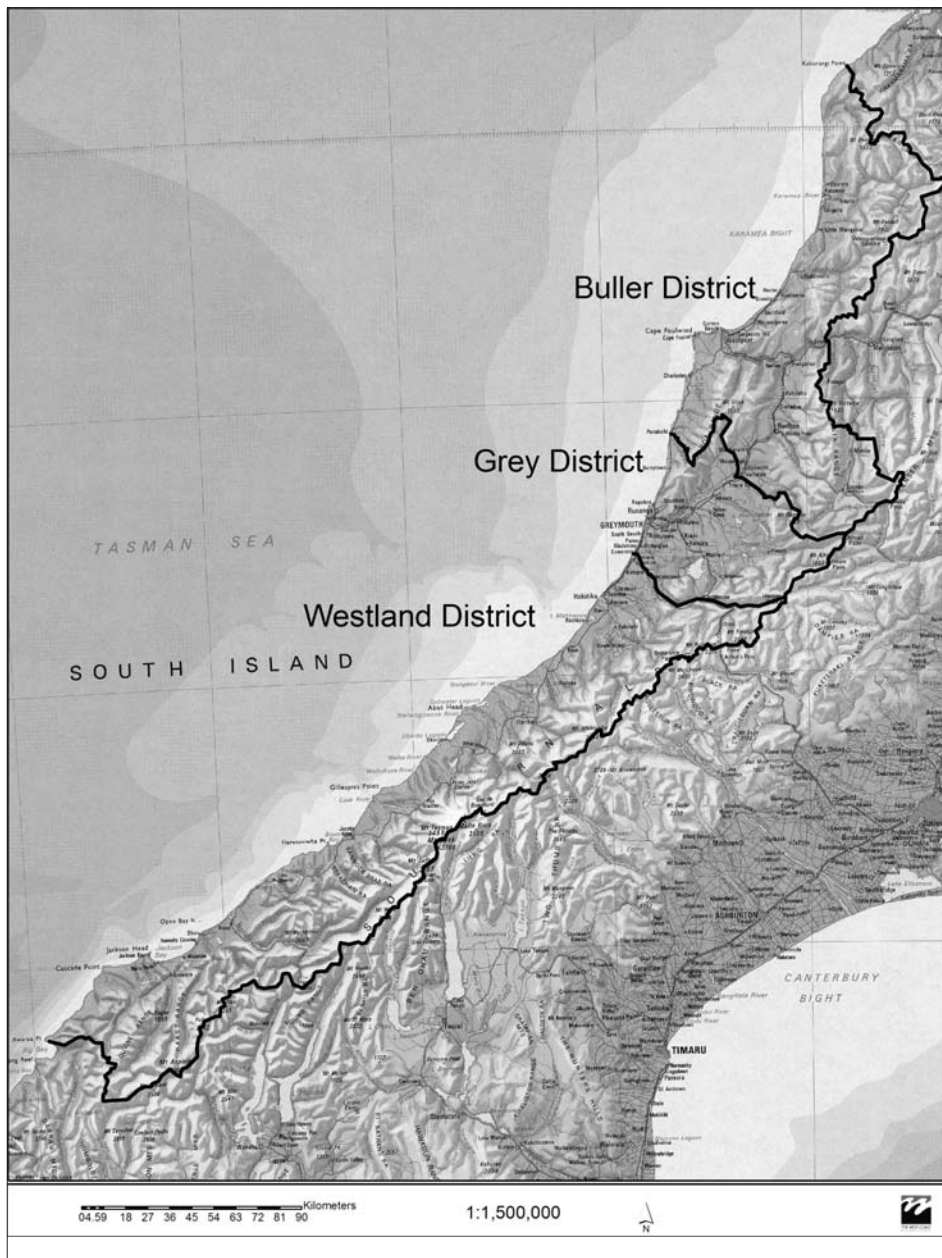
Why we conducted an audit

1.12 The provision of \$120 million to the West Coast region was a significant investment by the Government. Five years later, we thought it timely to conduct an audit to provide assurance to Parliament that the funding package was being managed appropriately, and that it is being used as Parliament intended.

1.13 We did not choose to do this audit because of publicity about the failure of particular initiatives undertaken by 2 district councils, using their share of the funding package. Rather, the aim of the audit was to take a regional view of the custodianship and use of the funding package.

1.14 The Trustees and the Settlor must review the operation of the Trust before 30 June 2006. The findings of our audit will inform that review.

Figure 1
The West Coast region



Purpose of the audit

- 1.15 The purpose of the audit was to:
- check that appropriate systems and processes were in place for managing the funding allocated to the West Coast local authorities and the Trust; and
 - test that the operation of the Trust, and the distribution of funds by the Trust, have complied with the Deed.

How we conducted our audit

- 1.16 To carry out our audit, we:
- accounted for how the funding package had been invested and used by each of the 4 local authorities and the Trust;
 - reviewed the files for all the business investments made by the Trust, and the files for all community funding and regional development projects for amounts greater than \$50,000; and
 - reviewed documents relating to investments and fund management by the local authorities and the Trust.
- 1.17 We also interviewed:
- past and current Trustees;
 - Advisory Body members;
 - the Trust's Chief Executive and staff;
 - the 3 Mayors;
 - the West Coast Regional Council's Chairperson and Deputy Chairperson; and
 - local authority Chief Executives and staff.

Part 2

Governance of the West Coast Development Trust

- 2.1 In this Part, we describe the Trust's:
- governance structure;
 - management of the investment of its \$92 million share of the funding package;
 - oversight of its holding company and subsidiaries;
 - management of conflicts of interest;
 - maintenance of confidentiality;
 - evaluation of its effectiveness;
 - compliance with the transparency and accountability requirements of the Deed of Trust; and
 - review of its operations.

Governance structure

- 2.2 The Trust must comply with its Deed of Trust (the Deed). The Deed sets out the Trust's purpose (the objects of the Trust), functions, governance arrangements, powers, processes, and rules.
- 2.3 The Trust is governed by a group of 12 Trustees. In addition, an Advisory Body acts as the Trust's expert advisors on distributing money to businesses and community groups to promote economic development. A Chief Executive and his staff support the Trustees and the Advisory Body. Each of these groups has an important role to play in the governance and management of the Trust.
- 2.4 The Trustees, the Chief Executive, and the trust staff manage the day-to-day operations of the Trust. However, in agreeing the terms of the Deed, the Settlor retained some powers, which are set out in the Deed. Specifically, the Settlor:
- will, together with the Trustees, review the operation of the Trust before 30 June 2006;
 - can raise and discuss with the Trustees any concerns about a proposed Advisory Body appointment;
 - can approve whether the Trust may distribute more capital than that specified by the Deed;
 - must give written consent before the Trustees can amend, revoke, or add to any of the provisions of the Deed;
 - must give written approval if the Trustees wish to wind up the Trust; and
 - will appoint a replacement independent Trustee, if one is not appointed 4 weeks after a vacancy occurs.

The West Coast Development Trustees

- 2.5 The 12 Trustees are:
- one appointed by the each of the West Coast local authorities – Buller, Grey and Westland District Councils, and West Coast Regional Council;
 - 6 elected Trustees (voted in by Buller, Grey, and Westland District Council electors);
 - one appointed by Te Rūnanga o Ngāi Tahu; and
 - one independent Trustee appointed jointly by the President of the New Zealand Law Society and the President of the New Zealand Institute of Chartered Accountants.
- 2.6 The Trustees can appoint one of their number to be the Chairperson of the Trust. The Chairperson has a role in overseeing and directing the activities of the Trust. The Chairperson does not have a casting vote, and the other Trustees may, by unanimous resolution, remove the Chairperson from that position. The current Chairperson has been the Chairperson since the Trust was formed.
- 2.7 The Trustees have set up some sub-committees to help run the Trust, including:
- a Finance and Audit Sub-committee;
 - an Investment Sub-committee;
 - a Marketing, Promotions and Business Development Sub-committee; and
 - a Chairs Sub-committee.
- 2.8 The role of the Trustees is to govern the Trust by directing and supervising the conduct of the Trust's business. In doing so, the Trustees are subject to legal rules and principles applying to trustees, and to the Deed. Under the Deed, the Trustees hold the Trust Fund on trust and may apply the Trust Fund for the defined purposes (objects) of the Trust. The Deed sets out the powers that the Trustees may exercise in order to give effect to the objects of the Trust, and for the general administration of the Trust.
- 2.9 The Trustees are required by the Deed to conduct their affairs in a manner that is transparent and accountable to the people of the West Coast. As well as the explicit rules and requirements in the Deed, the Trustees are subject to common law principles and rules that restrict what they can do with the Trust property, and standards by which their management of the Trust property is addressed.
- 2.10 The Trustees have several responsibilities under the Deed. These include:
- setting the strategic direction of the Trust;
 - establishing the policies and procedures for managing the Trust;
 - appointing the Chief Executive, Advisory Body, and investment advisor;

- receiving applications, and approving or declining the Advisory Body's recommendations for distributions;
- establishing, in conjunction with the investment advisor, the Statement of Investment Policies and Objectives; and
- monitoring the performance of the Chief Executive, Advisory Body, and investment advisor.

2.11 Most of the people we interviewed (including past and present Trustees) felt that there were too many Trustees. There is concern that having 12 Trustees creates significant administrative work for Trust staff, and meetings that are often very long because of the need for everyone to "have their say". We were told that many Trustee meetings run for a full day.

2.12 People suggested different ways to reduce the number of Trustees. Most of the people we interviewed agreed that there needed to be at least one Trustee elected from each of the 3 districts, and that the Ngāi Tahu representative should be retained. Most people we interviewed agreed that the local authority appointees were not necessary if there was an independent representative elected from within each district.

2.13 Several people were concerned that there were no skill requirements for Trustee membership. While the Deed requires that there is an independent Trustee appointed by the President of the New Zealand Law Society and the President of the New Zealand Institute of Chartered Accountants, there are no specific skill requirements for Trustees.

2.14 People were also concerned that many Trustees could leave at the same time. After the elections in 2004, only 3 of the original 12 Trustees remained on the Trust.

2.15 We understand that these issues will be raised by the Trust when agreeing the terms of reference for the review to be undertaken by mid-2006.

The Advisory Body

2.16 The Trustees, after discussions with the Settlor, appoint members of the Advisory Body. They are appointed for a term of up to 5 years. The Deed requires that there shall be at all times at least 3, and not more than 7, Advisory Body members.

2.17 Advisory Body members must have one or more of the following:

- specialist financial skills;
- specialist commercial skills; or
- specialist entrepreneurial skills.

- 2.18 When the Advisory Body was established, 4 members were appointed – 2 based in Christchurch, and 2 in Wellington. The 4 members remain on the Advisory Body. The Advisory Body members possess the financial, commercial, and entrepreneurial skills required by the Deed.
- 2.19 The functions of the Advisory Body are to:
- act as the Trust’s expert advisors in distributing funds to applicants;
 - analyse proposals; and
 - recommend whether applications for funding be declined or approved.
- 2.20 The Advisory Body could face similar succession issues as the Trustees if some or all Advisory Body members decided not to continue their involvement with the Trust after their 5-year term is complete. If many Advisory Body members left at the same time, the loss of their experience could mean delays and a reduction in consistency in recommendations on applications for funding. The positive relationship between the Advisory Body and Trust staff could be weakened.

Recommendation 1

We recommend that the Settlor and the Trustees of the West Coast Development Trust amend the Deed of Trust to stagger the appointment dates for Advisory Body members.

The West Coast Development Trust staff

- 2.21 The Trustees can appoint a Chief Executive, who is responsible for managing the Trust within the terms of the policies and procedures approved by the Trustees. The Chief Executive is responsible to the Trustees for achieving the management objectives set by the Trustees.
- 2.22 The Chief Executive can appoint the necessary staff to implement the policies and procedures approved by the Trustees. As at December 2005, in addition to the Chief Executive, the Trust employed 15 staff:
- 6 for undertaking education and training initiatives and regional projects;
 - 3 for processing and monitoring business distribution applications;
 - 3 providing secretarial support;
 - 2 in the finance and administration team; and
 - one business development and marketing officer.

Management of the investment of its share of the funding package

- 2.23 We considered how the Trust has managed the investment of its \$92 million share of the funding package. By “investment” we mean the measures taken by the Trust to improve the value of its funds. While the money that the Trust allocates to applicants may also be considered an “investment”, these allocations are referred to in the Deed and this report as “distributions”. We discuss the Trust’s management of distributions in Part 3.
- 2.24 The Trust has earned \$31 million in investment returns and interest since it received its share of the funding package. Figure 2 summarises the Trust’s investment and use of its share of the funding package, from 20 September 2000 to 31 March 2005. This summary reflects the parent accounts (the Trust) rather than the group accounts (which would include the Trust’s subsidiary companies).

Figure 2

Summary of the West Coast Development Trust’s investment and use of its share of the West Coast Economic Development Funding Package, from 20 September 2000 to 31 March 2005

	\$000
Opening capital 20 September 2000	92,000
Investment and interest income	31,033
Less Trust’s net operating costs	(5,641)
Less regional development projects and community funding	(5,007)
Less provision for doubtful distribution loans and equity investment	(2,219)
Trust funds at 31 March 2005	<u>110,166</u>
Made up of and reflecting:	
Assets	
Distribution loans and equity investments made	22,078
Less distribution loans repaid	(10,919)
Less provisions for doubtful distribution loans and equity investments	(2,219)
<i>Distribution loans and equity investments outstanding</i>	8,940
Investments	101,941
Bank deposits	2,037
Other assets	660
	<u>113,578</u>
Less liabilities	(3,412)
Trust net assets at 31 March 2005	<u>110,166</u>

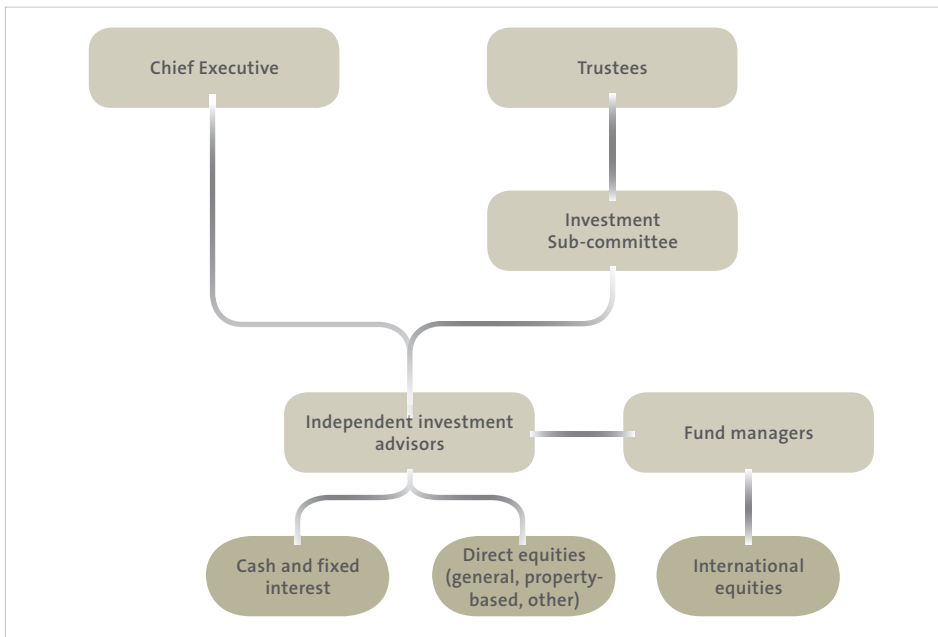
Appointment of investment advisors

- 2.25 We expected that the Trust would take professional advice on how to invest its share of the funding package.
- 2.26 Under Clause 14 of the Deed, the Trustees:
- are required to appoint a person or company to be an investment advisor to the Trust;
 - may, with the approval of the investment advisor, appoint one or more fund managers; and
 - must annually review the performance of the investment advisor and the fund manager.
- 2.27 After presentations from a range of investment advisory companies, the Trustees appointed Goldman Sachs JB Were (NZ) Limited and Bancorp Treasury Services Limited as investment advisors. These investment advisors recommend fund managers to the Investment Sub-committee. Accordingly, the Trust has engaged investment advisors and fund managers in compliance with the Deed.

Investment of the West Coast Development Trust's share of the funding package

- 2.28 Figure 3 shows how the Trust's investments are managed. The Trust's Chief Executive has responsibility for the day-to-day investment activities of the Trust, within delegated authority levels. The independent advisors work with the Chief Executive and the Investment Sub-committee (made up of Trustees) to manage the fixed interest and cash portfolio part of the Trust's investments. The fund managers are required to invest funds in asset classes set by the Trust.
- 2.29 We expected that the Trust would have a plan or strategy for investing the funds, and that funds would be invested in keeping with the plan or strategy.
- 2.30 The Trustees and the investment advisors have developed a Statement of Investment Policies and Objectives (SIPO), and a Treasury Policy. These 2 documents set out the investment objectives, the policy that the Trust has adopted, and how the objectives and policy are to be implemented.
- 2.31 Clause 13 of the Deed requires the Trustees to invest in keeping with the SIPO. The Trustees have done so.
- 2.32 Under the SIPO, the Trust must ensure that investments are managed to provide sufficient liquidity to meet cash flow requirements, and that the investment risk be limited by appropriate diversification within and between asset classes.

Figure 3
Managing the West Coast Development Trust’s investments



2.33 The Trust maintains investments in several asset classes. Figure 4 sets out the Trust’s investments by asset class as at 31 March 2005, and the limitations within which it is allowed to invest. One role of the Investment Sub-committee is to oversee that the Trust’s share of the funding package is invested in keeping with the asset class limitations.

Figure 4
The West Coast Development Trust’s investments by asset class, as at 31 March 2005

	Amount invested	Proportion of total	Limit as set in the SIPO
Cash	\$16,369,182	16.06%	100%
New Zealand fixed interest	\$57,993,243	56.89%	90%
Australasian equities	\$11,147,884	10.94%	15%
Australasian listed property*	\$3,579,901	3.51%	5%
International equities	\$8,152,512	8.00%	10%
Active trading fund**	\$3,355,304	3.29%	5%
Alternative investments***	\$1,343,304	1.32%	5%
Total	\$101,941,330	100%	

* Refers to investments in entities that are property-based.
 ** The active trading fund is used to participate in shorter term trading opportunities in the Australasian equity and fixed-interest markets.
 *** Refers to non-traditional investments, such as venture capital and hedge funds.

Monitoring and reviewing investment performance

- 2.34 We expected that the Trustees would annually review the SIPO, and the performance of the investment advisors and fund managers. We also expected that investment policies would be evaluated to see if expected results were being achieved, and if not, that amendments would be made.
- 2.35 The Trust's Treasury Policy states that the Trustees are responsible for approving and reviewing formally, at least annually, the SIPO and the Treasury Policy. Certain reports are required to be produced about the Trust's investments, including:
- daily market reports from the investment advisors and fund managers, as appropriate;
 - a monthly report to the Investment Sub-committee and Chairperson from the Chief Executive about Treasury activity and compliance and performance of the Trust's investments, except where there has been a breach of either the SIPO or the Treasury Policy, which must be reported immediately;
 - quarterly performance reports from the fund managers and the investment advisors;
 - quarterly performance, compliance, and activity reports from the Investment Sub-committee to the Trustees; and
 - an annual review by the Trustees of the Treasury Policy, the SIPO, and the performance of the fund manager.
- 2.36 The Treasury Policy also requires regular monitoring of the performance of the Trust's investments to:
- ensure compliance with the Deed and associated policies;
 - assess the extent to which the investment objectives are being achieved; and
 - compare the performance of the fund managers and returns achieved against a suitable peer group, such as a group of other professional fund managers.
- 2.37 The Investment Sub-committee is responsible for monitoring compliance, and the performance of the Trust's investment activities. This sub-committee continuously monitors, with the help of the investment advisors, the appropriateness of the adopted asset allocation strategy, the performance of the appointed fund managers, and other investment returns.
- 2.38 We review compliance with the SIPO as part of the annual financial audit. We are satisfied that the Trust has established appropriate arrangements to comply with the SIPO, and meet the requirements of the Deed.

Oversight of the holding company and subsidiary companies

Governance structure

- 2.39 In 2005, the Trust established a holding company (West Coast Development Trust Holding Company Limited) to hold its shareholdings in other companies (for example, its purchase of shares in Forever Beech Limited, West Coast Development Trust Research and Development Company Limited, and West Coast Development Trust Land Company Limited).
- 2.40 The establishment of a holding company has changed the ownership rights and responsibilities involved, as the Trust's ownership of the subsidiary companies is now indirect. The Trust owns the holding company, which in turn holds the shares in the Trust's other companies (subsidiary companies). In legal terms, this arrangement has transferred the Trust's rights and responsibilities, as owner of the assets concerned, to the holding company.
- 2.41 The Trust must consider how best to exercise governance and oversight of the subsidiary companies now that it no longer has direct ownership. The transfer of legal ownership of the relevant assets makes it essential that the Trust keeps close control over its holding company. This can be achieved in various ways, principally through the Trust's ability to appoint all of the directors of the holding company, and ensuring that the holding company provides the Trust with sufficient information on the activities and business direction taken by the companies in the group.
- 2.42 Accordingly, we expected:
- the board of the holding company and the subsidiary companies to have appropriate skills and experience to represent the Trust's interests, and to add value to the Trust's investment in the companies in question; and
 - the holding company to appropriately monitor the performance of its subsidiaries, and report accordingly to the Trust.
- 2.43 Such arrangements are necessary to protect the ability of the Trust to exercise strategic oversight of the companies in the group.
- 2.44 The Board of the holding company is made up of Trustees. As stated in paragraph 2.13, there are no skill requirements for Trustees. It is therefore important that Trustees who act as holding company directors have adequate training to support them in this role. The Trust recognises the value of such training.
- 2.45 The holding company has formally reported to the Trust through verbal reports, which are recorded in the minutes of Trust meetings. The Trust has recently

adopted a reporting regime which will see the minutes of holding company meetings being provided to the Trust.

Monitoring of subsidiary company performance

- 2.46 The Trust has protocols for selecting directors of its subsidiary companies, and takes professional advice when selecting potential directors. The directors are appointed based on the skills and experience the individuals can bring to the subsidiary. Once appointed, the directors are accountable to the Trust, through the holding company, for running the subsidiary companies.
- 2.47 The 2004-05 audit of one Trust subsidiary identified a significant risk to the Trust's investment. At the time of the financial audit, Trustees were unaware of these risks. We note that once our auditor brought this risk to the attention of the directors of the company, they reported the issue to the Trust.
- 2.48 This issue led us to have concerns about the level of monitoring and reporting of business risks by the manager of this subsidiary company to the company's directors.
- 2.49 We understand that the Trust has learned from this experience, and is setting up key performance indicators (KPIs) and regular reporting arrangements for its subsidiaries. For one subsidiary we looked at, the company's manager provided monthly reports to its directors. Monthly accounts were prepared in-house, and monitored at holding company meetings. For another subsidiary it has been agreed that there will be quarterly reporting against KPIs and financial performance, and 6-monthly shareholders' meetings.

Managing conflicts of interest

- 2.50 Given the size of the West Coast population, it is inevitable that conflicts of interest will arise for the Trustees, Advisory Body, and Trust staff. It is important that any conflicts of interest are identified and managed appropriately, to ensure that fairness, transparency, and objectivity are maintained.

Conflicts of interest for West Coast Development Trustees

- 2.51 Article 19 of the Deed sets out when a conflict of interest exists for a Trustee, and how such a conflict should be managed. A conflict of interest occurs for a Trustee when:
- the Trustee has been, is, becomes, or intends to become, associated with any company, partnership, organisation, group, or trust with which the Trustee is transacting or dealing in his or her capacity as a Trustee; or

- the interests or duty of the Trustee in any particular matter conflicts or might conflict with his or her duty to the Trust; or
- the Trustee is transacting or dealing as a Trustee with himself or herself in another capacity.

2.52 The Deed requires that, where a conflict of interest exists, the Trustee must declare the nature of the conflict at the meeting of the Trustees. The Trustee must not take part in any deliberations or proceedings (including voting or other decision-making) relating to that transaction. Further, the Chairperson may require the Trustee with a conflict of interest to leave the meeting, and may adjourn the meeting until that Trustee departs.

2.53 The past and present Trustees we interviewed were aware of the conflicts of interest requirements. As part of the induction of new Trustees held in April 2005, a local solicitor held a session on conflicts of interest. Further, the Trustees maintain a register of declarations of interest.

2.54 The Chairperson is responsible for deciding whether a Trustee has a conflict of interest, and whether the Trustee can participate in a discussion or should leave the meeting. During our audit we were told that, where the Chairperson had a conflict of interest, it was his decision whether he should leave the meeting or not.

2.55 A Deputy Chairperson has since been appointed, whose responsibilities include taking the chair when the Chairperson has a conflict of interest. In cases where the Chairperson and the Deputy Chairperson both have a conflict of interest, a Trustee without a conflict of interest is appointed to chair the meeting. We consider that this arrangement is appropriate.

Conflicts of interest for Advisory Body members

2.56 It is likely that conflicts of interest may arise for Advisory Body members because of their required skill mix, and their knowledge of business and industry in New Zealand. However, this risk is lessened because none of the Advisory Body members live on the West Coast.

2.57 The Deed does not explicitly deal with conflicts of interest for Advisory Body members. All the Advisory Body members were very aware of the need to declare any conflicts of interest. As with the Trustees, a register of declarations of interest is maintained. Advisory Body members declare any interest at the beginning of a meeting, and then leave the meeting for the discussion of that particular application for funding.

Conflicts of interest for West Coast Development Trust staff

- 2.58 At the time of our audit, the Trust did not have a formal conflicts of interest policy for its staff. The policy has since been written. Staff are required to report any potential conflicts of interest, and the policy makes provision for staff to be stood down from handling applications where a conflict of interest may exist.

Maintaining confidentiality

- 2.59 Maintaining the confidentiality of information provided to the Trust staff, Advisory Body, and Trustees is very important for applicants to the Trust. The Trust requires all Trustees to sign a confidentiality agreement stating that Trustees will not use any confidential information they receive through their position as a Trustee for any other purpose. People indicated that they were satisfied that information provided to the Trust remained confidential.
- 2.60 As part of the independent market research undertaken by the Trust, successful and rejected applicants were asked to assess whether they felt that the confidentiality of their information was protected. The research found that there is an assumption that information provided to the Trust is safe.
- 2.61 We consider that the Trust is meeting the needs of its fund applicants by maintaining the confidentiality of their personal information.

Evaluating the West Coast Development Trust's effectiveness

- 2.62 It is important that the Trust evaluate whether it is meeting the objects of the Trust –promoting sustainable employment, generating sustainable economic benefits, and supporting projects which are not normally the responsibility of local or central government.
- 2.63 We expected that the Trust would have set performance measures, and that the measures would allow the Trust to monitor its effectiveness over time. We expected that processes for measuring effectiveness would include consultation with the community.
- 2.64 The Deed states that the Trust must conduct its affairs in a manner that is transparent and accountable to the people of the West Coast. We expected that the Trust would meet this requirement.
- 2.65 Preparing a Strategic Plan was one of the first priorities for the Trust once it was established. The Strategic Plan:
- outlines how the Trust will achieve the objects of the Trust, as set out in the Deed;

- sets “high-level goals” to be considered when making investment decisions;
- identifies priority areas for investment; and
- identifies risks and potential risks to be mitigated.

2.66 The high-level goals set in the Trust’s Strategic Plan are:

- supporting and promoting sustainable regional economic and employment growth;
- ensuring that the West Coast becomes a “learning region”;
- building and facilitating social and community support and positive community attitudes;
- incorporating environmental sustainability and management in development and facilitating land and resource access;
- promoting a great attitude on the West Coast to development and success; and
- identifying, progressing, and supporting infrastructure requirements as permitted by the Deed.

2.67 The Strategic Plan also sets “action areas” for achieving the high-level goals. Examples of the Trust’s performance measures for monitoring progress are:

- business growth in the region;
- the number of apprentices placed, or supported in training;
- vibrant and revitalised towns; and
- the number of new initiatives developed and signed off.

2.68 We acknowledge that the Trust has thought about what the objects of the Trust mean, and has put in place high-level goals and supporting “action areas” that aim to achieve these objects. However, in their current form, the Trust’s performance measures are not specific or measurable enough for the Trust to be able to use them to monitor its progress towards achieving its high-level goals and the action areas that support them.

2.69 The Trust’s performance measures would be more useful if they included quantitative or qualitative targets, and deadlines for achieving them. For example, it would be useful if “business growth in the region” stated what business growth is now, what level of growth is desired and by when, and how that growth will be measured. It would also be useful if the Trust’s projects (for example, its project to improve the literacy rates of the region’s children) provided a link to the high-level goals, so the Trust could more easily analyse and report how its projects are contributing to its high-level goals.

- 2.70 During its annual strategic planning process, the Trustees consider the goals the Trust has set and how well the Trust is progressing to meet those goals. Progress against some of the goals is summarised at a very high level in the annual report – for example, the goal of “unemployment rate reduced” is recorded as “achieved”, but no further information is provided (that is, by how much unemployment has been reduced, or how this compares to the previous year).
- 2.71 It is important for the Trust to report externally on its performance, to allow its stakeholders to make informed judgements about the Trust’s achievements with the significant public resource it manages. The information that the Trust currently provides about progress towards achieving its high-level goals is not detailed enough for its stakeholders to hold it to account. Improving the performance measures would enable the Trust to report more meaningful information to the community about its effectiveness. The Trust has acknowledged that it will seek to provide this information to the community.

Recommendation 2

We recommend that the West Coast Development Trust prepare more specific, measurable, and time-bound performance measures to determine and report on progress towards achieving its high-level goals.

Recommendation 3

We recommend that the West Coast Development Trust provide more information in its annual report on progress towards achieving its high-level goals.

Self-evaluation of effectiveness

- 2.72 The Trust has commissioned a study of West Coast opinion leaders, businesses, and the wider community to measure awareness of, and attitudes towards, the Trust. This research, if repeated regularly, will allow the Trust to evaluate its public image over time. The information will help the Trust to ascertain whether it is seen to be operating effectively for the people of the West Coast region.
- 2.73 We were pleased that the Trust has sought input from the public about whether it is operating effectively.
- 2.74 The Trust also collects information on the economic performance of the region, in the form of bank surveys, Statistics New Zealand data, and regional performance indicator reports.

Meeting the transparency and accountability requirements of the Deed of Trust

- 2.75 The Trust has met the requirement in the Deed to present, and receive public comment on, its annual report at a public meeting held within 4 months of its balance date. It also met the requirements in the Deed to make other information available to the public, such as:
- the SIPO;
 - information about the number of applications received, the names of funding recipients, and the amounts of funding approved; and
 - the amount of the Trust's investments.
- 2.76 The Deed requires that a summary of the annual report be published in newspapers circulating in the West Coast region. The Trust acknowledges that it did not meet this requirement in 2001-02 and 2002-03. The requirement was met in 2003-04 and 2004-05.
- 2.77 The Trust also makes information available on its website (www.wcdt.org.nz) about the Trustees, Advisory Body, Trust staff, and how to make an application. In addition, the Trust puts out occasional newsletters and media releases, which describe recent distributions and other Trust activities.
- 2.78 However, some people we spoke to considered that the Trust was not transparent in its operation. They mentioned that Trustee meetings are not open to the public. Some mentioned that having meetings open to the public would provide a level of public accountability. They added that a perceived "veil of secrecy" can lead to suspicion – rightly or wrongly.
- 2.79 We consider that it is appropriate for Trustees to discuss applications for funding in closed session. There is a need to maintain confidentiality around personal, financial, and commercially sensitive information.
- 2.80 However, the Trust is becoming more involved in regional economic development projects (for example, a Tourism Strategy). We see no reason why discussions on matters of interest to the region as a whole could not be conducted in open session. The Trust has recently resolved to hold a series of public meetings on regional economic development matters. We encourage the Trust to continue with this initiative.

Reviewing operations

- 2.81 The Deed requires that the Trustees and the Settlor review the operation of the Trust before 30 June 2006. Such a review must include consultation with the West Coast local authorities, and appropriate Government Ministers. The review will take place about 5 years after the Trust was set up.
- 2.82 We consider that a periodic review of the Trust's operations is a useful way to check that the Trust is operating effectively to achieve its objectives, particularly as the Trust's activities mature and expand into new areas. We consider it appropriate for the planned review of the Trust to be repeated in another 5 years.

Recommendation 4

We recommend that the Trustees and the Settlor of the West Coast Development Trust carry out another review of the operation of the Trust in 2011.

Part 3

Distributing funds

- 3.1 In this Part, we discuss:
- the distribution process;
 - the management of distributions;
 - file management;
 - monitoring distributed funds; and
 - accessibility of funding to the community.
- 3.2 A key role of the Trust is to assess applications for funding from external parties. If the Trust approves an application, the funding allocated is referred to as a “distribution”.
- 3.3 The Trust makes 3 main types of distributions:
- business investment (providing finance and development capital);
 - regional development projects; and
 - community funding.
- 3.4 The Trust must distribute all funds in keeping with both the objects of the Trust (see paragraph 1.5), and the process set out in the Deed.
- 3.5 Distributions can be made in any form, and the Trustees have stated that they are prepared to consider applications for:
- lending money (including suspensory loans);
 - subscribing for shares or other equity in limited liability companies; and
 - guaranteeing or acting as a surety for a defined amount of indebtedness or exposure.
- 3.6 Trustees have also stated that they will consider applications for grants, provided the application does not have the potential to affect the charitable status of the Trust. They will not give grants for feasibility, investigation, marketing or planning studies to businesses, organisations, partnerships, or individuals operating for profit.
- 3.7 Figure 5 sets out the value of the funds distributed by the Trust, up to 31 March 2005.

Figure 5
Funds distributed by the West Coast Development Trust, from 2000-01 to 2004-05

Year	Business distributions	Regional development projects and community funding	Total distributed
2000-01	0	0	0
2001-02	\$797,000	0	\$797,000
2002-03	\$2,518,000	\$417,000	\$2,935,000
2003-04	\$7,248,000	\$828,000	\$8,076,000
2004-05	\$11,515,000	\$3,762,000	\$15,277,000
Totals	\$22,078,000	\$5,007,000	\$27,085,000

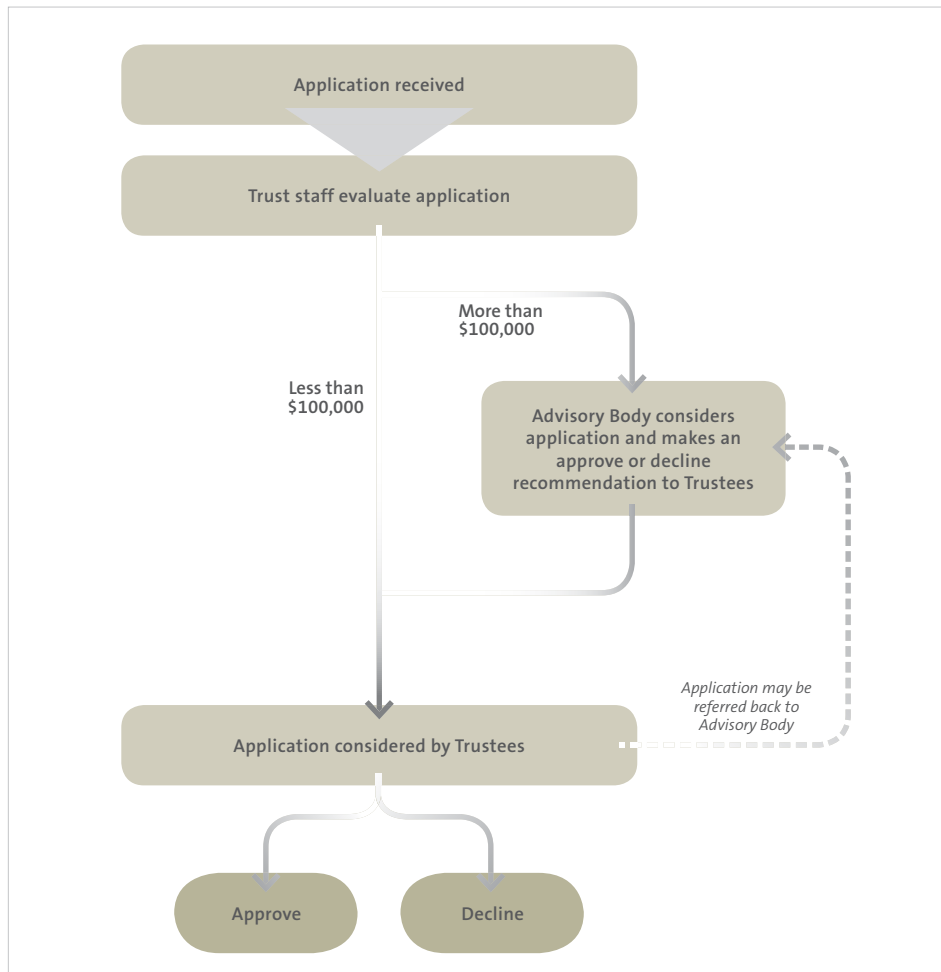
- 3.8 The amount of money likely to be available for distributing each year is projected to be about \$8-10 million. The Deed allows the Trust to distribute its net income and, once this has been distributed or set aside for distribution, the Trust may then also allocate up to 5% of the initial funding package in any one year.
- 3.9 The Trust has not distributed more than 5% of the initial funding package in any financial year, and its surpluses have more than covered the funds it has distributed. The Trust has more than preserved the value of the initial funding package. Accordingly, the Trust has met this aspect of the Deed.

The distribution process

- 3.10 Applications for distributions must pass through an assessment process that involves Trust staff, the Advisory Body (for applications for more than \$100,000) and the Trustees who, when considering an application, must consider:
- appropriate strategic development plans for the West Coast; and
 - whether other sources of funding or support are available, including assistance provided through industry or regional development policies and programmes of local authorities or central government.
- 3.11 The role of the Advisory Body is to give expert advice to the Trust on proposed distributions, analyse proposals, and recommend to Trustees that an application be declined or approved.
- 3.12 The Advisory Body can seek further information about an application, and engage external advisors to help in the review of applications, if required. It can recommend an application be accepted only if, in its opinion, the application promotes or satisfies the objects of the Trust, and if, in its opinion, the application aims to achieve self-sufficiency and sustainability.

- 3.13 The Trustees can either approve or decline the recommendation made by the Advisory Body. The Trustees may not approve an application for more than \$100,000 without a recommendation to approve it from the Advisory Body. The Trustees may refer an application back to the Advisory Body for further consideration, but may not refer an application back a third time, if the Advisory Body has twice recommended that it be declined.
- 3.14 In deciding on an application, the Trustees may also consider the objectives, roles, and activities of any other organisation involved in economic development activities in the West Coast region, and any other matters they believe are relevant. Figure 6 sets out the distribution application process.

Figure 6
Process for considering distribution applications



- 3.15 The process allows the Trustees to deal with applications for amounts less than \$100,000, without consideration by the Advisory Body. This has not always been the case, and is the result of an amendment to the Deed. The original Deed made no provision for the Trustees to approve applications without a recommendation from the Advisory Body.

Managing distributions

- 3.16 We expected that the Trust would have a plan or strategy for distributing funds.
- 3.17 The Trust's Strategic Plan (see paragraphs 2.65-2.67) is supported by a Business Plan. The Business Plan provides a framework for implementing the responsibilities in the Deed of Trust, and the goals set in the Strategic Plan. In addition, the Trust has policies for making distributions and granting community funding.

Systems for processing applications for business investment

- 3.18 We expected that the Trust would have a set of criteria to assess applications.
- 3.19 The Trust uses "client" files to hold information about funding applications. We reviewed the client files for all the applications for business investment, and the applications for regional development projects and community funding for more than \$50,000.
- 3.20 The Trust uses a checklist to process applications. The checklist prompts staff to assess applications against the objects of the Trust, and check whether alternative funding sources are available. The checklist also takes the application through a risk assessment process.
- 3.21 When preparing an application for consideration by the Advisory Body and Trustees, Trust staff put together an Executive Summary, which includes reference to how, in the opinion of Trust staff, the initiative in the application:
- meets the objects of the Trust,
 - has the potential to be self-sufficient and sustainable; and
 - is for an amount that does not exceed 90% of the cost of the project.
- 3.22 The Advisory Body and the Trustees use the information provided in Executive Summaries when deciding whether to approve or decline applications. Business Plans to support the application and other information are also provided to the Advisory Body.

Systems for processing applications for community funding

- 3.23 The Trust is now receiving more applications for funding from “not for profit” community groups, trusts, and incorporated societies. These applications are for “community funding”, and the Trust may give funds as a grant or donation, a sponsorship arrangement, a suspensory loan, or a loan.
- 3.24 Until recently, the Trust processed applications for community funding using the same forms and criteria as applications for business investment. This arrangement was not ideal, as parts of the process are not relevant for community funding applications.
- 3.25 The Trust recognised the need to put in place better systems for community funding, and employed a Community Analyst to oversee this. The Community Analyst has completed a review of the files for community funding, and found areas where improvements could be made. New application forms for community funding have also been created.
- 3.26 The Trust is considering changing the way it manages community funding. Whatever changes the Trust makes, it must still ensure that distributions are made in keeping with the objects of the Trust.

Deciding on applications for business investment

- 3.27 We expected that the distribution of funds would comply with the Deed, and that the Trust would consider applications consistently.
- 3.28 The wording of the objects of the Trust in the Deed is open to interpretation. Differences in interpretation have led to significant discussion and debate at Trustee and Advisory Body meetings.
- 3.29 As part of our audit, we discussed the interpretation of the infrastructure clause in the Deed with Trustees, Advisory Body members, and Trust staff. Different interpretations were offered, and many people considered that this is an unclear area.
- 3.30 The Trust prepared a draft policy on interpreting the infrastructure clause in the Deed, but did not adopt the policy. Instead, the Trust resolved to consider applications that may deal with infrastructure on a case-by-case basis. We acknowledge that both the Trustees and Advisory Body members have been mindful of the need to comply with the infrastructure clause.
- 3.31 The Trust has recently sought some legal advice on the interpretation of the infrastructure clause. The advice seeks to define the term “infrastructure”, but does not consider the clause as a whole – that is, it does not seek to define

the aspects of the infrastructure clause in relation to what is “normally the responsibility of the local authorities and central government”.

Recommendation 5

We recommend that the West Coast Development Trust seek further legal advice on, or clarify with the Settlor, the interpretation of the infrastructure clause of the Deed of Trust.

Deciding on applications for community funding

- 3.32 We expected that distributions for community funding would comply with the Deed.
- 3.33 The Trust was set up as a charitable Trust, to benefit present and future inhabitants of the West Coast region. The Deed states that the Trust Fund must be applied and used exclusively to promote sustainable employment opportunities, and to generate sustainable economic benefits, and is not to be used to support infrastructure projects that are normally the responsibility of local authorities or central government.
- 3.34 Some people we spoke to considered that the Trust could give funding to community groups and for community facilities because giving out this type of funding made the community a more desirable place to live. This then leads to population retention and growth – therefore generating economic benefits. Others thought that there was scope for the Trust to be involved in community projects for the good of the community. Conversely, another person thought that getting involved in community funding was a breach of the Deed.
- 3.35 These different perceptions and interpretations of the objects of the Trust make it difficult for Advisory Body members and Trustees to determine whether approving an application for community funding will promote sustainable employment opportunities and generate sustainable economic benefits for the West Coast region.
- 3.36 Some Advisory Body members we spoke to said that the Advisory Body has struggled to deal with community funding applications, because the role of the Advisory Body is to provide commercial judgements about applications – not whether one community group is more worthy of funding than another.
- 3.37 Some Advisory Body members also stated that some applications for community funding pushed the limits of the Deed. We note that, for the largest community funding distribution made by the Trust (about \$1.8 million for a literacy project), the Advisory Body did not comment on whether it thought the application met

the objects of the Trust; rather, it recognised that the Trustees had determined that the proposed project met the objects of the Trust. The Deed requires that the Advisory Body give an opinion on whether the objects of the Trust are met.

- 3.38 In another example, a charitable organisation applied for a grant. No employment was to be directly promoted, and there were no direct economic benefits to the West Coast region. The Trustees argued that there were significant indirect community benefits, and therefore the application met the objects of the Trust.
- 3.39 The Advisory Body twice recommended that the application be declined. The Trustees disagreed and, using their ability to approve applications that do not exceed \$100,000 without a recommendation from the Advisory Body, approved a grant of \$100,000.
- 3.40 In our view, the Trust is in a position to make a considerable contribution to the well-being of the community through funding community projects, but it needs to ensure that at all times projects meet the objects of the Trust.
- 3.41 It could be argued that almost any application for community funding could promote sustainable employment opportunities, or generate sustainable economic benefits, because the funding could make the West Coast region more desirable to existing or potential inhabitants. It is unclear whether this was the intention of the funding package. We consider that this interpretation of the Deed should be clarified with the Settlor.

Recommendation 6

We recommend that the West Coast Development Trust clarify with the Settlor the interpretation of the Deed of Trust, and determine whether, and under what circumstances, community funding distributions meet the objects of the Trust.

Distributions of more than \$100,000

- 3.42 The Deed requires that the Advisory Body consider all applications for more than \$100,000. We expected that the Trust would comply with this requirement of the Deed.
- 3.43 The Trustees have directly approved an application for sponsorship of more than \$100,000, without consideration or recommendation by the Advisory Body. The Trustees approved this application on the basis that it was for “marketing and promotion”, presumably because it was regarded as an administrative expense rather than a distribution, and therefore did not require Advisory Body consideration.

- 3.44 In our view, funds paid out in response to applications for sponsorship from external parties are distributions. While a sponsorship agreement may result in advertising for the Trust, it does not result in direct provision of goods or services to the Trust. Rather, funding is provided to an external party, and the external party is the primary beneficiary of the funding.
- 3.45 In addition, the Trust's guidance and application forms for community funding list "sponsorship" as a form of distribution that can be sought from the Trust.
- 3.46 The Trust has told us that it treats some applications for sponsorship as distributions, and others as marketing and promotions. This is inconsistent. All distributions, including sponsorship, must meet the objects of the Trust, and be administered in keeping with the process set out in the Deed. Applications for more than \$100,000 must be referred to the Advisory Body.
- 3.47 To determine whether a matter may properly be regarded as a distribution (rather than marketing or promotions), the Trustees should consider whether:
- it was initiated by a third party;
 - the use of the money primarily benefited the third party;
 - it involved a formal written application to the Trustees;
 - it was assessed against the Trust's usual criteria for distributions;
 - the money was paid to a particular person or used for a particular purpose;
 - the project was wholly undertaken and managed by someone other than the Trustees and employees of the Trust; and
 - the matter is something normally regarded as a distribution.

Recommendation 7

We recommend that the West Coast Development Trust treat sponsorship as a distribution.

Distributions of less than \$100,000

- 3.48 The original Deed did not provide for the Trustees to distribute funds without a recommendation from the Advisory Body. The Trust sought a change to the Deed that would allow the Trustees to approve distributions for less than \$100,000 without consideration by the Advisory Body. The Settlor agreed to this change to the Deed.
- 3.49 In agreeing to this change, the Settlor communicated to the Trust that his preference was that the Deed would also be amended to impose limits on the amount of money that could be approved directly by the Trustees each year. This

has been reflected in the Deed. Each year, the Trustees cannot distribute, without consideration by the Advisory Body, more than the higher of:

- 25% of the Trust's annual income; or
- \$1 million.

- 3.50 The Settlor also made clear that distributions made by the Trustees without consideration by the Advisory Body must be consistent with the objects of the Trust of promoting sustainable employment and generating economic benefits for the region.
- 3.51 The Settlor has advised the Trust that he considers that the role of the Advisory Body in making recommendations to the Trustees is a critical element of the checks and balances put in place to ensure that the Trust is effective in achieving its purpose. We consider that there is value in the Trustees seeking the opinion of the Advisory Body where there is uncertainty whether the objects of the Trust will be met, regardless of the amount applied for.

Observance of minimum distribution amounts

- 3.52 The Deed allows the Trustees to set a minimum distribution amount. At the time of our audit, this was set at \$20,000 for any application (in February 2006, the minimum distribution amount was reduced to \$5,000). The application forms for community funding state that those applications must be for a minimum of \$5,000.
- 3.53 Some distributions of less than \$20,000 for business investments, and less than \$5,000 for community funding, have been made. Inconsistent application of the policy for minimum distribution amounts leads to inequity in distributions – some applicants who need a smaller amount of funding will not apply (based on the policy), while others may apply and be approved.

Recommendation 8

We recommend that the West Coast Development Trust consistently apply its policy on minimum distribution amounts. If the West Coast Development Trust considers that exceptions to the policy are appropriate, it needs to specifically state in its application and guidance documents that exceptions may be considered.

Setting interest rates, loan conditions, and key performance indicators

- 3.54 If the Advisory Body recommends that an application be approved, it recommends to Trustees the amount of the distribution, and the terms and conditions of the distribution. While Trust staff may suggest an appropriate interest rate for loans, the responsibility (for distributions of more than \$100,000) for setting interest rates or providing guidance to Trustees on the rate of interest to be charged on loans lies with the Advisory Body.
- 3.55 The Trust promotes that it is flexible in terms and rates according to business situations. For instance, the Trust may make concessions to ensure solvency while a business becomes established, and to support cash flow and seasonal variations. We were told that the Advisory Body and the Trustees are careful to ensure that the terms and conditions of funding support the self-sufficiency and sustainability of the business, but also that they do not create private benefit or upset competitive businesses.
- 3.56 The Advisory Body, when setting interest rates or conditions on a distribution, considers:
- the applicant's ability to pay;
 - the affect on employment resulting from the distribution in a particular district;
 - how the Trust can support a fledgling industry or business; and
 - the level of security offered.
- 3.57 We were told that the interest rates set reflected the risk of the investment – higher risk meant a higher interest rate. This claim was inconsistent with our finding that 2 high-risk loans for large amounts of money were given interest-free.
- 3.58 Until recently, the Trust had no formal policy for setting interest rates on loans or for setting loan terms and conditions. The Trust now has a draft Credit Policy Manual, which states that pricing for funding should be a balance between the risk involved in the project, the desire to provide the project with the best chance of success, and the Trust's requirements to obtain a suitable return on its overall investment.
- 3.59 The draft Credit Policy Manual also states that, when setting an interest rate, the Trust should take into account:
- the overall risk profile of the applicant;
 - the overall quality of the security provided;
 - comparable interest rates in the wider market;

- the ability of the project to meet interest costs; and
 - the ongoing cost of monitoring and managing the investment.
- 3.60 While the draft Credit Policy Manual does not set out a fixed process for setting interest rates, it does provide more guidance than was previously available. The draft Credit Policy Manual also provides for interest-free, interest-only, and interest-concession periods to be given, and provides some guidance on when these may be used.
- 3.61 The draft Credit Policy Manual states that approved applications are expected to include suitable KPIs, which are to be agreed by the recipient and monitored by Trust staff.
- 3.62 Once the draft Credit Policy Manual is adopted, using it to establish loan conditions will be an improvement on the previous informal process.

File management

- 3.63 We expected that the Trust would maintain comprehensive files on applications that it has approved or declined. These files should include information on how each decision was made.
- 3.64 Many of the client files we looked at did not include the original application; nor did they record the application date. The checklist used by Trust staff to process the application was often not included in the file. In addition, information relating to the monitoring of distributed funds was often absent from the files.
- 3.65 Frequently, the minutes recording Advisory Body and Trustee decisions were not in the files. However, staff of the Trust were able to provide this information when we asked for it.
- 3.66 The draft Credit Policy Manual describes the information that should be held in client files.

Recommendation 9

We recommend that the West Coast Development Trust include all relevant information about funding applications and distributions in its client files.

Monitoring distributed funds

- 3.67 Trust distributions are usually subject to conditions, such as providing the Trust with regular financial reports, and updates on progress towards achieving KPIs. Staff of the Trust (Relationship Managers) are responsible for collecting the required monitoring information on funding recipients, making sure that

loan repayments are being made, and carrying out an annual review of each distribution.

- 3.68 We expected that each distribution would be subject to ongoing monitoring.
- 3.69 In some instances, funding recipients were not complying with the conditions of their loan agreements (for example, quarterly financial reports were not being submitted). Trust staff acknowledged that, with staff turnover and heavy workloads, they had not been able to monitor whether all required reporting was kept up to date.
- 3.70 The Trust has appointed more Relationship Managers to handle the increasing number of distributions that need to be monitored. The draft Credit Policy Manual also deals with maintaining contact with funding recipients, the information that should be included on file, and what should be done as part of an annual review of the distribution.
- 3.71 The draft Credit Policy Manual states that an annual review of the distribution should cover:
- the general performance of the borrower or management during the period under review (including adherence to funding arrangements);
 - an explanation of major balance sheet and trading results movement (including as appropriate, ratios, tax situation, and distributions);
 - the prospects for the coming year;
 - a security review;
 - collateral support;
 - for companies, comments on major transactions, and compliance with a solvency test;
 - any other matter which will help assess the financial health of the entity under review; and
 - adherence to loan covenants and conditions.
- 3.72 Where the funding relied on KPIs being achieved, there was good monitoring and reporting.
- 3.73 Monthly reports on distributions were made to Trustees. These reports included commentary on whether conditions of loans have been met, and recent activities with each business.
- 3.74 Some Trustees we spoke to said they were satisfied with the amount and quality of monitoring information they received from Trust staff on distributions. Another said that, if Trustees were not happy with the amount of information provided,

they would ask for more. Some Trustees also considered that the monitoring information provided had improved in recent months.

- 3.75 We consider that the Trust's arrangements for monitoring distributions have not been ideal. The Trust is strengthening its monitoring arrangements through its draft Credit Policy Manual, and reviewing its regular reporting to the Trustees.
- 3.76 Many of the businesses in which the Trust invests are high-risk (for example, they might have been declined funding by other lending institutions). The conditions set in loan agreements (such as a requirement to provide quarterly financial reports, or to employ a mentor) have been placed there by the Advisory Body to ensure that the Trust will be alerted if problems start to occur. This also ensures that the businesses receiving funding benefit from receiving guidance and having up-to-date information with which to make business decisions.

Recommendation 10

We recommend that the West Coast Development Trust increase its monitoring of successful funding applicants to ensure that the terms and conditions of funding agreements are met.

Ease of applying to the West Coast Development Trust

- 3.77 We expected that the Trust would be accessible to the community, and that good quality advice would be provided to potential applicants. We also expected that information about Trust services and application forms would be easy to understand and use.
- 3.78 The Trust has contracted independent market research surveys of applicants and the wider community. The surveys of approved and declined applicants aim to determine customer satisfaction with the application process, and identify opportunities for improvement. The surveys of opinion leaders and the wider community aim to establish awareness of and attitudes towards the Trust.
- 3.79 Surveyed applicants generally considered that application forms were clear and easy to use. Mostly positive comments were received about being able to contact Trust staff, and receiving clear explanations.
- 3.80 However, most applicants surveyed reported that they found applying to the Trust to be difficult and costly. Some people we spoke to during the audit also had the perception that applying for funding through the Trust was too difficult, took too long, and the terms and conditions offered were more onerous than those offered by banks.

- 3.81 The Trust concedes that this may be true in some cases, but notes that, while it is not trying to compete with banks, it can offer greater flexibility with interest rates and repayments, equity investments, governance, mentoring, and advice. In addition, because of the potentially high-risk nature of some of the distributions made by the Trust, it considers that significant research into applications is required.
- 3.82 The Trust advises applicants that 2 months is a realistic timeframe to find out if their application has been approved or declined. During this time, Trust staff carry out the research and credit checks required to prepare an Executive Summary, and the Advisory Body and the Trustees assess applications at their monthly meetings. Approving or declining an application can be much longer when more information is requested, or for large and complex applications.
- 3.83 Reducing the time it takes to process smaller applications was one reason for the Trust requesting the amendment to the Deed that allows Trustees to approve applications for less than \$100,000 without consideration by the Advisory Body.
- 3.84 We consider that independent market research surveys are a useful way for the Trust to receive information from applicants and the wider community on how the Trust is operating. This tool has been well used by the Trust.

Actively seeking applications

- 3.85 We expected that the Trust would actively seek opportunities for the community to access the Trust's funds.
- 3.86 Some people we interviewed as part of the audit considered that the Trust could be more active in attracting businesses to expand using Trust funding, or encouraging the setting up of new businesses.
- 3.87 Trust staff have met with local accountants to encourage them to bring new business to the Trust through their clients. The Trust is considering preparing a template for applicants to use when preparing Business Plans to accompany their applications.
- 3.88 The Trust has written an Enterprise Development Strategic Plan 2005-08, which focuses on identifying current and potential businesses, assessing their capabilities, and providing advice to help them grow – to benefit the businesses and the region.
- 3.89 We consider that, now that the Trust has more relationship management staff, it is better placed to actively encourage business applications.

Part 4

Management of the funding package by the local authorities

- 4.1 The 4 West Coast local authorities (Buller District Council, Grey District Council, Westland District Council, and West Coast Regional Council) each received \$7 million as their share of the funding package.
- 4.2 In this Part, we describe the approach that each local authority has taken to managing its share of the funding package, and its involvement in economic development initiatives (where applicable).
- 4.3 We expected all 4 local authorities to have appropriate systems and processes in place to manage their share of the funding package, and to meet the requirements of the Local Government Act 2002.
- 4.4 Under the Local Government Act 1974, which was in force when the local authorities received the funding package, each local authority had an obligation to prudently manage all revenues, expenses, assets, liabilities and investments. Similar requirements were carried over into the Local Government Act 2002; namely, that a local authority must –
- ... manage its revenues, expenses, assets, liabilities, investments, and general financial dealings prudently and in a manner that promotes the current and future interests of the community.¹*
- 4.5 A local authority must adopt various financial management policies, including an investment policy. Section 105 of the Local Government Act 2002 states that a local authority's investment policy must include policies for –
- (a) the objectives in terms of which financial and equity investments are to be managed; and*
- (b) the mix of investments; and*
- (c) the acquisition of new investments; and*
- (d) an outline of the procedure by which investments are managed and reported on to the local authority; and*
- (e) an outline of how risks associated with investments are assessed and managed.*
- 4.6 For each of the 4 local authorities, we:
- outline what each council has done with its share of the funding package;
 - describe their involvement (if any) in economic development initiatives;
 - assess whether their investment policies meet the requirements of the Local Government Act 2002; and

¹ Section 101(1), Local Government Act 2002.

- discuss whether each local authority has acted in keeping with its investment policy.

4.7 Each of the 4 local authorities has an investment policy, but these policies vary in the extent to which they meet the requirements of the Local Government Act 2002.

Recommendation 11

We recommend that Buller, Grey, and Westland District Councils revise their investment policies to meet the requirements of the Local Government Act 2002.

West Coast Regional Council

- 4.8 Between July 2000 and June 2005, West Coast Regional Council increased its \$7 million share of the funding package to more than \$9.5 million.
- 4.9 After receiving the \$7 million, West Coast Regional Council invested the money in a term deposit account until it decided on an investment strategy. After considering different investment options, the Council decided, on 31 July 2001, to invest in a portfolio of assets managed by Forsyth Barr Funds Management Limited (Forsyth Barr). Forsyth Barr still manages the portfolio for the Council.
- 4.10 Unlike the district councils in the West Coast region, West Coast Regional Council has not been actively involved in economic development initiatives.
- 4.11 Figure 7 summarises the Council's investment and use of its share of the funding package between 1 July 2000 and 30 June 2005. The Council has chosen to invest passively, rather than to actively use its share of the funding package.
- 4.12 West Coast Regional Council resolved from 1 July 2004 to no longer account for the funding package separately from other Council funds. From that date, all available funds have been managed as a single portfolio. For the purposes of this report and Figure 7, we have assessed the return for the 2004-05 financial year proportionately.²

West Coast Regional Council's investment policy

- 4.13 West Coast Regional Council has an investment policy that clearly sets out its objectives. The objectives of the investment portfolio are:
- the generation of capital gains to protect the real value of the portfolio; and
 - the creation of income to be used for Council activities, and reinvested to ensure further growth in the portfolio.

² Based on a proportionate share of the investment portfolio increase for that year, relative to the funding package percentage of the total portfolio at 30 June 2004.

Figure 7
Summary of West Coast Regional Council's investment and use of its share of the West Coast Economic Development Funding Package, as at 30 June 2005

	\$000
Opening capital 1 July 2000	7,000
Plus interest and dividend income to 30 June 2004	1,594
Plus interest, dividend and other income for 2004-05 (see Note)	1,140
Less transfer to the Council's bank for working capital	(200)
Balance at 30 June 2005	<u>9,534</u>
Made up of and reflecting:	
Share of the Council's investment portfolio at 30 June 2005	9,534
Funding package assets as at 30 June 2005	<u>9,534</u>

Note: In 2004-05, the Council changed the accounting policy for valuing its investment portfolio from cost to fair value. Included in the \$1,140,000 is an amount of \$484,000 relating to unrealised gains recognised because of this change in accounting policy.

- 4.14 The investment policy states that the objectives will be achieved by investing in a balanced investment portfolio, including:
- New Zealand cash (defined as wholesale money market instruments with a duration of up to 12 months);
 - New Zealand bonds (defined as New Zealand dollar denominated bonds issued by the New Zealand Government, or New Zealand corporations, local authorities, State-owned enterprises, and banks);
 - Australasian equities (listed on New Zealand and Australian stock exchanges);
 - international equities;
 - Australasian property; and
 - alternative asset classes (emerging market bonds, absolute return funds, and structural credit).
- 4.15 For the funds invested on West Coast Regional Council's behalf by its appointed fund manager, the investment policy sets out in detail the agreed asset classes and asset class benchmarks. The West Coast Regional Council and its investment advisors review these benchmarks and asset classes each year.
- 4.16 The investment policy also sets the procedures for acquiring new investments. For example:
- For managed funds, the fund manager has full discretionary authority to purchase and sell investments for the Council. However, this is subject to an agreement between the Council and the fund manager covering issues such as

investment objectives, detailed performance benchmarks, investment criteria, tactical asset allocations, and compliance reporting obligations.

- Funds managed directly by the Council can be invested only in a money market call deposit account with a New Zealand-registered bank. Only appropriate council staff can make these investments.

- 4.17 The investment policy sets out quite detailed reporting obligations. For example:
- the fund manager provides a report at the end of each month for each class of investments, showing full details of all transactions entered into during the period, and the performance of the investment during the period; and
 - details of both the fund manager's portfolio performance and the money market call deposit transactions are reported to the Council monthly by the Corporate Services Manager.
- 4.18 Forsyth Barr provides the Council with monthly reports setting out all movements that have occurred over the previous month for the portfolio. Councillors are provided with a monthly summary of the status of the funds invested. Forsyth Barr provides a more comprehensive quarterly report that includes commentary and analysis for performance of the portfolio during the preceding quarter.
- 4.19 Finally, the investment policy sets out a detailed approach to risk assessment and management. For example, the policy states that:
- West Coast Regional Council is a conservative investor. The asset class benchmarks referred to above reflect the Council's risk-averse nature.
 - Where periods of negative returns are possible, the fund manager is required to invest the fund in a manner that will limit the likelihood of negative returns occurring in any period.
- 4.20 In our view, West Coast Regional Council's investment policy meets the requirements of section 105 of the Local Government Act 2002.
- 4.21 We have assessed the council's compliance with its investment policy, and have not noted any significant breaches.

Buller District Council

- 4.22 Buller District Council's \$7 million share of the funding package had a balance of more than \$7.4 million at 30 June 2005.
- 4.23 After an investment workshop in August 2000, the Council resolved to engage Frank Russell Company (N.Z.) Limited (an investment services company) to invest its \$7 million share of the funding package, and \$6 million of existing surplus

funds, as a single portfolio. This \$13 million is held separately from other Council funds for the long-term benefit of the district's ratepayers.

- 4.24 In December 2000, the Council adopted an investment strategy for the portfolio that allocated 25% of this \$13 million to Managed Funds (Equities), and the remaining 75% to Managed Funds (Fixed Interest Securities).
- 4.25 The Council lost money with this investment strategy, and changed its investment policy in July 2002. The philosophy of the new investment policy was to optimise investment value and returns in the long term, while balancing risk and return considerations. Preference is to be given to conservative investment policies, despite the recognition that lower risk generally means lower return.
- 4.26 After the July 2002 review of its investment policy, the Managed Funds (Fixed Interest Securities) portion of the portfolio was realised and the funds were reinvested in keeping with the revised policy. The Council now invests only in bank deposits with registered New Zealand banks. The Council manages its bank deposits in-house.
- 4.27 In altering its investment policy, the Council resolved to continue to hold the Managed Fund (Equities) portion of the portfolio until such time as it recovered to the amount originally invested, and then to withdraw and reinvest in bank deposits. By March 2003, the balance of the funding package invested in the Managed Fund (Equities) – originally \$1.75 million – had fallen by about \$1.08 million to around \$0.67 million. Two years later, at 30 June 2005, the Managed Fund (Equities) investment had recovered to around \$1.68 million.
- 4.28 When the Managed Fund (Equities) investment recovered to its original investment amount, the Council opted to review its investment policy again. The review was undertaken in late 2005. We describe Buller District Council's revised investment policy in paragraphs 4.36-4.42.
- 4.29 Figure 8 sets out a summary of the investment and use, between 1 July 2000 and 30 June 2005, of Buller District Council's share of the funding package.

Figure 8
Summary of Buller District Council's investment and use of its share of the West Coast Economic Development Funding Package, as at 30 June 2005

	\$000
Opening capital 1 July 2000	7,000
Plus interest income	433
Plus share of net return on managed fund (fixed interest securities) investment	494
Less provision for doubtful economic development loans made	(430)
Less share of managed fund (equities) net loss of value	(67)
Balance at 30 June 2005	<u>7,430</u>
Made up of and reflecting:	
Economic development loans made	1,166
Less loan repayments received	(493)
Less provision for doubtful loan repayments	(430)
<i>Economic development loans outstanding</i>	<u>243</u>
Share of bank deposits and managed funds investments	<u>7,187</u>
Funding package assets at 30 June 2005	<u>7,430</u>

Buller District Council's involvement in economic development initiatives

- 4.30 Buller District Council decided that \$1 million could be drawn down and used for economic development loans. The Council has been directly involved in making loans to businesses to promote economic development in the district, as authorised by its investment policy.
- 4.31 The Council had an Economic Development Unit that was responsible for facilitating and assisting existing and new businesses to develop, expand, and create employment. A committee of the Council, the Economic Development Committee, oversaw economic development policies and also made recommendations to the Council, as appropriate.
- 4.32 Buller District Council gave economic development loans to 9 companies in the district. Of those 9 loans, 4 have been fully repaid, 4 have been partially repaid, and the Council has decided not to pursue repayment of the final loan. The latter loan was to develop and support West Coast Socks Limited, which subsequently collapsed.
- 4.33 Buller District Council's management of the West Coast Socks Limited investment has been heavily criticised by the media, and by the community. The Council considered whether a review of its processes for this investment was appropriate, but opted not to proceed. It was not within the scope of our audit to review in detail the Council's actions in its investment in West Coast Socks Limited.

However, we note that, despite having obtained a guarantee over the loan, there is little likelihood that the Council will recover the amount outstanding.

- 4.34 The Council's current investment policy states that any funds loaned for economic development must not exceed \$1 million. It also requires that security is obtained for the loans, and that interest and principal repayments are made in accordance with the loan agreement. Where an organisation defaults on repayments, the Council will take steps to recover the debt. An economic development funding policy has been written, and requirements for loan monitoring have been established.
- 4.35 Buller District Council's Economic Development Unit will remain inactive until the Council reviews its economic development strategy in 2006.

Buller District Council's investment policy

- 4.36 Buller District Council's investment policy is set out in its Long-term Council Community Plan. The investment policy includes the investment objectives, stating that –
- Council recognises its fiduciary responsibility as a public authority and any investments that it does hold should be at an appropriate level of risk, giving preference to conservative investment policies and avoiding speculative investments.*
- 4.37 The investment policy allows Buller District Council to invest in a mix of the following investment classes:
- equity;
 - loan advances;
 - property;
 - forestry; and
 - financial.
- 4.38 For each investment class, the investment policy sets out and defines the scope of each investment. The investment policy also sets out how risks associated with each investment are to be managed.
- 4.39 The investment policy sets out in some detail how the results of investments should be reported. In particular, the investment policy states that –
- All aspects of the investment process will be reviewed regularly, including, but not limited to:*
- *monthly reporting of investment results;*

- *regular review of investment strategies; and*
- *3-yearly review of investment policy.*

- 4.40 Accordingly, Buller District Council receives a monthly report from Council staff that summarises the status of all its investments, borrowings, and economic development loans. In addition, during the course of our audit, the Council was reviewing its investment strategies and its investment policy.
- 4.41 Buller District Council's investment policy does not set out the processes for acquiring new investments. However, given the limited nature of what the Council can invest in (only debt instruments), this is of limited concern.
- 4.42 We did not find any instances where Buller District Council's investment policy had been breached.

Grey District Council

- 4.43 Grey District Council's \$7 million share of the funding package had a balance of slightly under \$5 million at 30 June 2005.
- 4.44 When Grey District Council received its \$7 million, it opted for the first year of investment to adopt a "least risk" position, where it invested only in bank deposits, government and local government stock, and State-owned enterprise and corporate bonds. In March 2001, the Council decided to continue with that approach.
- 4.45 Grey District Council manages its share of the funding package in-house.
- 4.46 Of Grey District Council's share of the funding package, \$3.4 million has been used as part of the community's contribution towards a major sewerage upgrade in Greymouth. This contribution was made to support the Council's application to the Ministry of Health's Sanitary Works Subsidy Scheme.
- 4.47 In November 2003, the Council opted to allocate, on a population basis, the remaining funds into smaller funds for use by each community in the district. Each community can determine how it wishes to use its portion of the funding. No applications to use this funding have yet been lodged with the Council.
- 4.48 Small amounts of the investment income have been used for a water supply infrastructure upgrade and to make a non-repayable grant.
- 4.49 Figure 9 sets out a summary of Grey District Council's investment and use, between 1 July 2000 and 30 June 2005, of its share of the funding package.

Figure 9
Summary of Grey District Council's investment and use of its share of the West Coast Economic Development Funding Package, as at 30 June 2005

	\$000
Opening capital 1 July 2000	7,000
Plus interest income	2,066
Plus revenue from Economic Development Facilitation Fund* activities	239
Less expenditure for Greymouth sewerage upgrade	(3,409)
Less expenditure on Economic Development Facilitation Fund activities	(467)
Less cash funding for Greymouth water supply infrastructure upgrade	(110)
Less cash funding for economic development office and GROW**	(316)
Less non-repayable grant made	(30)
Balance at 30 June 2005	<u>4,973</u>
Made up of and reflecting:	
Industrial properties developed and available for sale (see Note)	155
Share of bank deposits and stocks and bonds	<u>4,818</u>
Funding package assets as at 30 June 2005	<u>4,973</u>

Note: The industrial properties available for sale were developed as part of the Economic Development Facilitation Fund activities. They are recorded at cost. Based on the sale prices attained for other properties developed and sold, their market value is probably about \$284,000 more than cost. If recognised, this would bring the value of the funding package at 30 June 2005 to around \$5,257,000.

* See paragraph 4.51.

** See paragraph 4.54.

Grey District Council's involvement in economic development initiatives

- 4.50 Grey District Council also chose to use \$1 million of its \$7 million share of the funding package to facilitate economic development within the district.
- 4.51 Of the \$1 million set aside for economic development, \$860,000 has been managed as an Economic Development Facilitation Fund, and used primarily for the development of an industrial commercial property site. As individual properties are sold, the proceeds are returned to the Facilitation Fund and are available for future initiatives. A protocol detailing the use of the Facilitation Fund was written, which included objectives for the scheme and requirements for applicants to meet. A Facilitation Committee was established to oversee the use of this fund.
- 4.52 The remaining \$140,000 has been set aside to help fund the development of the port.

- 4.53 Grey District Council used the interest from its investment of the funding package to fund an Economic Development Office, and employ an Economic Development Officer. However, Grey District Council no longer employs an Economic Development Officer or funds an Economic Development office, because of the Trust's active involvement in economic development.
- 4.54 The interest has also been used to help fund the Greymouth Regional Opportunities Workshop (GROW), which took a community development approach to the future of the district. GROW is now reviewing its role, given the work that is done by the Trust.

Grey District Council's investment policy

- 4.55 Grey District Council's 2-page investment policy sets out both the objectives of the investment policy and the investment mix. Broadly, the objectives of the investment policy include:
- optimising investment returns using low-risk investments;
 - ensuring that investments are "liquid" and sufficiently flexible;
 - managing capital losses as a result of interest rate movements; and
 - prohibiting speculative investments.
- 4.56 The investment policy allows Grey District Council to maintain investments in:
- equity investments and advances;
 - property investments (including land holdings);
 - forestry investments; and
 - treasury investments.
- 4.57 The investment policy does not set out any procedures for acquiring new investments.
- 4.58 In addition, the investment policy does not provide any rules for managing risks, even though the policy states that –
- Each investment or category will have its own unique characteristics and a specific risk management policy for each will be formulated for council approval and annual review.*
- 4.59 Grey District Council has not yet determined its approach to risk management.
- 4.60 Finally, the investment policy does not set out any procedures for reporting to the Council about the funding package. In practice, monthly reports are provided to the Council.

- 4.61 In our view, Grey District Council needs to review and update its investment policy. Specifically, the investment policy needs to:
- set out specific risk management policies for each investment class or category;
 - include the policy for acquiring new investments; and
 - provide an outline of the procedures by which investments will be managed and reported to the Council.
- 4.62 We did not find any instances where Grey District Council's investment policy had been breached.

Westland District Council

- 4.63 At 30 June 2005, the balance of Westland District Council's \$7 million share of the funding package was a little under \$5 million.
- 4.64 When Westland District Council received its \$7 million share of the funding package, it decided to set aside \$3 million for economic development. In June 2000, a committee of the Council called "Westland's Working" was set up, with the purpose of initiating economic development in the region.
- 4.65 After considering the recommendations of several fund managers and investment brokers, the Council decided to invest the remaining \$4 million in ASB Bank Limited's Managed Funds. The investment, in accordance with the Council's investment policy adopted on 29 June 2000, comprised 40% Australasian equities, 40% international equities, and 20% New Zealand fixed interest cash and bonds. Other surplus funds of the Council were also invested as part of the ASB Bank Limited portfolio. Withdrawals have been made since 2000. For the purposes of this report, we have considered only the \$7 million package, including the \$3 million administered on behalf of the Council by Westland's Working.
- 4.66 After the Council invested in ASB Bank Limited's Managed Funds, equities worldwide generally experienced a significant fall in value. The Council decided, in March 2003, to reinvest in less volatile, cash-based instruments. The effect of the fall in equities value was a loss of more than \$1.3 million.
- 4.67 Westland District Council updated its investment policy on 17 December 2004, with the objective of ensuring that the portfolio is managed in a prudent, competent, and conservative manner. Managed fund investments are now restricted to wholesale bond and cash investments, with entities holding a credit rating from Standard and Poor's of A or better. A prudential limit has been set for individual counter-party exposure. These funds are still managed by ASB Bank Limited's Managed Funds, in keeping with the Council's investment policy.

- 4.68 Figure 10 sets out a summary of Westland District Council's investment and use of its share of the funding package, between 1 July 2000 and 30 June 2005.

Figure 10

Summary of Westland District Council's investment and use of its share of the West Coast Economic Development Funding Package, as at 30 June 2005

	\$000
Opening capital 1 July 2000	7,000
Plus interest income	1,116
Less loss on managed fund equity investments	(1,338)
Less cash funding of Business Development Fund	(421)
Less cash funding of free building and resource consents	(191)
Less cash funding of biodiversity strategy for Westland	(350)
Less provision for doubtful economic development loans made	(582)
Less expenses associated with recovering economic development loans in default	(148)
Less operating costs associated with Westland's Working/Council	(163)
Balance at 30 June 2005	<u>4,923</u>
Made up of and reflecting:	
Economic development loans made	1,381
Less loan repayments received	(547)
Less provision for doubtful loan repayments	(582)
<i>Economic development loans outstanding</i>	252
Share of managed funds investment portfolio	4,671
Funding package assets at 30 June 2005	<u>4,923</u>

Westland District Council's involvement in economic development initiatives

- 4.69 The functions of Westland's Working included providing loans, funding the costs of building and resource consent applications, and operating the Council's Economic Development Unit. Westland's Working made 9 economic development loans on behalf of the Council.
- 4.70 Of the 9 loans made, 4 have been fully repaid, 4 have been partially repaid, and one – to FT Manufacturing (Westland) Limited (FT Manufacturing) – has the full balance still outstanding. FT Manufacturing was placed in liquidation in November 2003, and is in default of the terms of the loan.
- 4.71 In August 2003, we undertook an independent review of the Council's economic development loan processes. That review found many positive features in the

management of the loan processes. However, in the case of the loan to FT Manufacturing, there were significant weaknesses in the loan application process.

- 4.72 Westland District Council has decided that, since the establishment of the Trust, and the increase in economic activity in the West Coast region, there is less need for the Council to be involved in direct business lending.

Westland District Council's investment policy

- 4.73 It is a requirement of the Local Government Act 2002 that a copy of the investment policy is included in a council's Long-term Council Community Plan. Westland District Council included only a summary of its investment policy in its Long-term Council Community Plan.

- 4.74 Westland District Council's full investment policy explicitly sets out its objective, which is to ensure that "the portfolio is managed in a prudent and competent manner, in terms of the governing legislation".

- 4.75 The investment policy then states that the philosophy of Westland District Council is to optimise investment value and returns in the long term, while balancing risk and return considerations. The investment policy also acknowledges that, as Westland District Council is a public authority, any investment that it holds should be low-risk, with preference given to conservative investments, particularly in the case of short-term investments. The investment policy recognises that lower risk usually means lower returns.

- 4.76 The investment policy sets out a series of strategies aimed at ensuring that Westland District Council meets its investment aims. The investment policy sets out the mix of allowed investments. They are:

- equity;
- property;
- forestry;
- infrastructural assets;
- financial; and
- loan advances.

- 4.77 Although the investment policy provides further details about the rules relating to each type of investment, it does not set out any investment levels or benchmark returns for Westland District Council's managed fund investments, managed by a private sector provider. In our view, these should be set out either in the investment policy, or in the agreement with the private sector provider.

- 4.78 The investment policy refers to the procedure for acquiring new investments, giving the Manager Finance and Policy (with the approval of the General Manager) the power to approve individual transactions, provided they are within the scope of the recommended and approved general investment strategy that is documented in the investment policy.
- 4.79 In addition, the investment policy sets out some reporting obligations. For example:
- all transactions approved by the Manager Finance and Policy must be reported to Westland District Council's Finance Committee at the next meeting after the date of the transaction; and
 - the Manager Finance and Policy must report to the monthly Westland District Council meeting on the balance of all loans outstanding and any variations of loan made by Westland District Council for all loans.
- 4.80 However, the investment policy does not contain any reporting obligations by any person for the performance of the Council's investments. This needs to be reviewed. Despite the lack of reporting obligations, the Council is provided with information on investment performance at its monthly meeting.
- 4.81 Finally, the investment policy sets out an outline of how risks associated with some investments are assessed and managed (for example, in their general policy and credit and liquidity risk, as they relate to financial instrument investments), but the risk assessment does not cover all potential investment types.
- 4.82 In our view, Westland District Council's investment policy needs to be improved by providing further specific details about its managed fund investments, particularly:
- the reporting obligation of the fund manager; and
 - the asset class benchmarks (if any) that have been agreed.
- 4.83 In addition, Westland District Council needs to include a full copy of its investment policy in its Long-term Council Community Plan, rather than the summary currently provided.
- 4.84 We did not find any instances where Westland District Council's investment policy had been breached.

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

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