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Parliamentary paper

Local government:
Results of the
2006/07 audits





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Local government: Results of the 2006/07 audits

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

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Hon Margaret Wilson MP
Speaker
House of Representatives
WELLINGTON

Madam Speaker

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

Yours faithfully

A handwritten signature in black ink, consisting of a horizontal line that curves upwards and loops back to the left, ending in a small flourish.

K B Brady
Controller and Auditor-General

Wellington
17 June 2007

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Introduction

This is our report on the 2006/07 audits of the local government sector. Most of these audits were of regional and territorial local authorities and their subsidiary entities.

This is the third year that all regional and territorial local authorities reported under the full requirements of the Local Government Act 2002 (the Act). It is the first year after the sector's decision to adopt the New Zealand equivalents to International Financial Reporting Standards. Under the Act, the Long-Term Council Community Plan (LTCCP) is now the basis of a local authority's annual financial and performance accountability to its community. From 2006/07, each local authority reported against its audited 2006-16 LTCCP.

Purposes of this report

The purposes of this report are to:

- tell Parliament and the local government sector about matters arising from carrying out our role as auditor of the sector;
- comment on various financial management and reporting, governance, and administration issues;
- highlight some matters and make some observations on development contributions; and
- summarise the findings from some performance audits carried out during the year that affect local government.

Review of 2006/07

By the end of 2006/07, and particularly after the local government elections in October 2007, many local authorities started working on their project plans for preparing and adopting their 2009-19 LTCCPs. The 2009-19 LTCCPs will come into effect on 1 July 2009.

This start by local authorities was complemented by the effective work of the Society of Local Government Managers, in association with Local Government New Zealand, to help the sector by bringing together the lessons of the 2006-16 LTCCP and defining good practice. In addition, the National Asset Management Steering Group updated its important volume relating to identifying and describing levels of service. The new information was available to the sector after 30 June 2007.

These moves are an encouraging sign in contrast to the evidence of under-preparation for the 2006-16 LTCCP and the subsequent affect on our audits.¹ Local authorities will be maintaining a focus on planning for and preparing their LTCCPs for much of 2008/09.

¹ Controller and Auditor-General, *Matters arising from the 2006-16 Long-Term Council Community Plans*, June 2007.

The 2006/07 financial year was in the middle of the three-year period between elections. It should have been a comparatively quiet year leading up to the local authority elections. However, three matters particularly affected the sector:

- timeliness of reporting performance;
- amendments to LTCCPs; and
- the change to New Zealand equivalents to International Financial Reporting Standards (NZ IFRS).

Timeliness in reporting on performance

The sector has shown a negative trend in completing its reporting obligations for 2006/07. Sixteen local authorities (nearly 19% of all local authorities) were unable to complete the preparation and adoption of audited financial statements by the statutory deadline (the end of October, which is four months after the balance date). Seven (nearly 10% of the sector) were still unable to report by 31 December 2007. There is a real risk that at least two local authorities will be unable to adopt audited financial statements by 30 June 2008 – a full 12 months after their balance date.

While many in the sector are getting ready for their 2009-19 LTCCPs, a significant number of local authorities are still trying to finish their reporting from 2006/07.

The adoption of NZ IFRS clearly affected the workload of local authorities. However, 69 of the 85 local authorities were still able to cope within the existing statutory time limits.

While we were able to issue audit opinions in February 2008 on the financial statements for Invercargill City Council and its subsidiaries for the years ended 30 June 2005 and 30 June 2006, it remains one of the local authorities with unsigned financial statements for 2006/07. This continues to be an unsatisfactory result for the community of Invercargill.

Amendments to the Long-Term Council Community Plans

As the “middle year” between the last and the next required LTCCPs, local authorities continued to pursue a substantial number of amendments to their 2006-16 LTCCPs. This shows the prospective nature of LTCCPs and the dynamic nature of local authority work. Generally, the process for amendments worked well. However, we note that there are a number of financial policy amendments, mainly to comply with section 102(6) of the Act.

We continue to receive about 180 ratepayer enquiries annually – many of them about a local authority’s decision-making and consultation processes under the

Act and within the context of the adopted LTCCP. In most instances, we have been able to form the view that the processes used by the local authorities have been reasonable and there are no grounds for us to carry out an inquiry. We hope that our responses to ratepayers – while not always giving the response or redress they may want – help them understand the decision-making processes under the Act.

During the year, we published our guidance on observed good practice for decision-making and consultation by local authorities.²

Reporting on local authorities' achievements under the LTCCP is important – both on the levels of service they planned to provide to the community and on how they are contributing to promoting the well-being of the community. Local authorities are required, under clause 15 of Schedule 10, to report on these aspects in their annual reports, and we have continued to analyse and comment on this reporting. While the results are getting better there are still substantial improvements to be made.

We have raised this matter with the sector and identified that it will be an important focus of the audit of the 2009-19 LTCCPs.

New Zealand equivalents to International Financial Reporting Standards

Most local authorities adopted reporting against the new NZ IFRS in 2006/07. The adoption of NZ IFRS caused a great deal of work for all local authorities and has partially contributed to a less timely rate of reporting financial results to communities.

We hold a broader concern about the appropriateness of NZ IFRS for local authority reporting. The NZ IFRS add a level of complexity to reporting financial results, when there is a need for simplicity and clarity in reporting to the communities that local authorities serve. Instead, local authorities' notes to the financial statements have doubled in size even though they were designed to aid disclosure to the main financial statements. We are yet to be convinced this is a favourable or helpful trend.

We are specifically concerned that some standards (such as NZ IAS 23 on borrowing costs) will give rise to significant issues of concern to the sector when preparing the 2009-19 LTCCPs.

We continue to work with the Accounting Standards Review Board to seek an approach to standard setting that focuses on helping the reader of local authority and other public entities' accountability statements.

² *Turning principles into action: A guide for local authorities on decision-making and consultation*, September 2007.

Conclusion

Meeting the requirements of the Act and NZ IFRS dominated 2006/07. Many local authorities met the various requirements, including “living with the LTCCP”.

However, we remain concerned that some local authorities are not dealing well with meeting the Act’s requirements. Their inability to meet normal accountability requirements, combined with newly elected local authorities and the move into the next phase of LTCCP planning, means that these local authorities are already “on the back foot” in meeting the challenges of 2008/09.

Part 1

Timeliness of annual reporting

- 1.1 The annual reports of local authorities provide information that assists communities to assess the performance of their local authorities. For this process to be effective, the information must be comprehensive and timely.
- 1.2 Each year, we examine the timeliness of annual reporting by local authorities.
- 1.3 Under the Local Government Act 2002 (the Act), each local authority is required to:
- complete and adopt its annual report, containing audited financial statements, within four months of the end of the financial year;
 - make its annual report publicly available within one month of adopting it; and
 - make a summary of the annual report publicly available within one month of adopting the annual report.¹
- 1.4 The local authority determines the timing of the preparation and publication of the audited annual reports within the requirements of the Act. We work with local authorities to fit our audit process into the approach determined by the local authority.

Summary

- 1.5 The timeliness of annual reporting by local authorities for 2006/07 was disappointing. There was significant additional work required for the transition to reporting under New Zealand equivalents to International Financial Reporting Standards (NZ IFRS). However, a significant number of local authorities need to better plan the completion, adoption, and release of the annual report to report within the statutory deadlines.
- 1.6 It is important that local authorities recognise that accountability is not achieved until the audited information is made available to ratepayers in a user-friendly form (the annual report summary). An increasing number of local authorities need to give this matter greater attention to ensure that their reporting not only includes prompt audit clearance but also informs their communities promptly.
- 1.7 We will continue to monitor the performance of local authorities in meeting these important statutory deadlines. With the transition to NZ IFRS now complete, we expect significant improvements to occur for reporting about 2007/08.

Completion and adoption of annual reports

- 1.8 Figure 1.1 shows the dates when the audits of local authorities were completed, which gives an indication of when local authorities were able to adopt their

1 The actual timing required of any local authority is determined by when they complete and adopt their annual report. The last possible dates for 2006/07 were for completing and adopting the annual report – 31 October 2007, for making the annual report publicly available – 30 November 2007, and for making the summary annual report publicly available – 30 November 2007.

annual reports. It shows that only 69 local authorities, or 81%, were able to adopt their annual reports within the statutory time limit.

Figure 1.1
Date of completing 2006/07 local authority audits

Date completed in 2007	Number of local authorities, 2007	Number of local authorities, 2006
1 July to 31 August	3	3
1 to 30 September	18	17
1 to 31 October	48	63
Subtotal: Number meeting statutory deadline	69	83
1 to 30 November	5	1
After 30 November	4	0
Not completed by 31 March 2008	7	1
Total	85	85

- 1.9 This year, significantly fewer local authorities met the requirements of the Act. Additional work required for the transition to reporting under NZ IFRS significantly affected the results. However, those local authorities with annual reports that were not completed at the time of writing this Part show not only poor planning for the transition to NZ IFRS but also poor planning for routine elements of statutory annual reporting.
- 1.10 We note that, as at 30 November 2006, the only outstanding annual report was that of Invercargill City Council (see Part 2). In contrast, at 30 November 2007, there were 11 local authorities that still needed to complete their annual reports. Four of these were completed by the end of December 2007.
- 1.11 The seven local authorities with annual reports outstanding at 31 March 2008 (five months after the last possible statutory date for completing and adopting the 2006/07 annual report) were:
- Ashburton District Council;
 - Buller District Council;
 - Hurunui District Council;
 - Invercargill City Council;
 - Palmerston North City Council;
 - Selwyn District Council; and
 - Westland District Council.

- 1.12 These audits were delayed because:
- four local authorities provided poor quality and/or incomplete information to auditors;
 - three local authorities did not assess fair value movements adequately, leading to unplanned infrastructure asset revaluations;
 - staff changes or illness compounded poor project planning for three local authorities; and
 - in the case of Invercargill City Council, there were delays in resolving issues from previous years.
- 1.13 We are very concerned by this lack of commitment to the timely completion and adoption of annual reports because without timely reporting it is very difficult for communities to assess the performance of their local authorities.

Public release of annual reports

- 1.14 We also reviewed the timing of the release of the annual reports to the community. The Act allows one month for public release from when a local authority adopts its annual report. Figure 1.2 shows the performance of local authorities in meeting this deadline.

Figure 1.2
Public release of 2006/07 annual reports

Period after adopting annual report	Number of local authorities, 2007	Number of local authorities, 2006
0-5 days	20	20
6-10 days	12	6
11-20 days	10	15
21 days to one month	33	37
Subtotal: Number meeting statutory deadline	75	78
One month to 40 days	2	6
41-50 days	1	0
Not released by 31 March 2008	7	1
Total	85	85

- 1.15 Figure 1.2 shows a slight drop in the number of local authorities meeting the statutory deadline. This is balanced against an improvement in the number of local authorities publishing their annual report within 10 days of its adoption. Most local authorities make their annual report available to the public on their website. In our view, if publication is on a website, there are very few reasons for not publishing in a timely manner.

Public release of summary annual reports

- 1.16 We also reviewed the timing of the release of audited summaries of annual reports. The Act requires both the audited annual report and an audited summary to be released within one month of the annual report being adopted. In our view, releasing the audited summaries is important for the accountability of local authorities. These summaries are the most accessible information for the general readership, and the easiest document to circulate and make widely available. Figure 1.3 shows the performance of local authorities in releasing their annual report summaries.

Figure 1.3

Public release of audited summary of 2006/07 annual reports

Period after adopting annual report	Number of local authorities, 2007	Number of local authorities, 2006
0-5 days	6	5
6-10 days	5	2
11-20 days	12	16
21 days to one month	46	49
Subtotal: Number meeting statutory deadline	69	72
One month to 40 days	3	10
41-50 days	3	1
51-60 days	1	1
61-119 days	2	0
Not released by 31 March 2008	7	1
Total	85	85

- 1.17 The performance of the sector in making summaries of annual reports available within the statutory deadline has declined. However, we note that there has been an improvement in those releasing the audited summary annual report within 10 days.
- 1.18 Of those local authorities that had completed and adopted their annual report before 31 March 2008, nine did not comply with the requirement to make a summary report available within one month of adopting their annual report. We were particularly disappointed to note that of those nine, two local authorities did not meet this requirement in 2005/06 either.² This trend suggests a lack of commitment to timely reporting to the community.

2 Rodney District Council and Whangarei District Council have not published their annual report summary within the statutory deadline in either of the past two years. We note that the performance of both these councils declined in 2006/07, with the summaries being published within 42 days (33 days in 2005/06) and 47 days (32 days in 2005/06) respectively.

- 1.19 It requires planning and time to summarise an annual report and have it published. However, as with the publication of the annual report, it is a known obligation. We emphasise the need for local authorities to take a project planning approach to producing, auditing, and publishing their annual report and annual report summary.
- 1.20 We were pleased to see the more efficient local authorities achieving simultaneous publication of their summary and annual reports, because of sound planning. We encourage this approach within all local authorities.

Part 2

Invercargill City Council and its subsidiary companies

- 2.1 Invercargill City Council (the Council) and its subsidiary companies have consistently been unable to meet statutory requirements for the timeliness of annual reports.¹ We specifically drew attention to this for the first time in our 2005/06 report.²
- 2.2 Our appointed auditor has finally been able to conclude and report on the Council and its subsidiary companies for the financial years ended 30 June 2005 and 30 June 2006. The audit opinions were dated in February 2008, some 32 and 20 months after the end of the respective financial years.
- 2.3 The opinions for the Council were affected by the audit results of its subsidiaries and, in particular, its works company Bond Contracts Limited and its subsidiary company Bendigo Construction Limited. We had to issue a qualified audit opinion for the subsidiary company, which affected its parent company and ultimately the Council.³ Further, because of the delay in finalising the draft financial statements for Bond Contracts Limited and its subsidiary company, the audit was also affected by Bond Contracts Limited's shareholders agreeing to a partial sale of Bond Contracts Limited and its subsidiary company to an external investor.
- 2.4 As yet, we have been unable to issue an audit opinion on the Council and its subsidiary companies for the financial year ended 30 June 2007.

Implications for the Invercargill community

- 2.5 In 2005/06, we stated that the situation regarding the clearance of the financial statements was unsatisfactory. This remains the case given that the Council's annual report for 2006/07 remains outstanding.
- 2.6 In addition to the delay in concluding satisfactorily on their annual report, we also concluded adversely on the Council's 2006-16 LTCCP⁴ because the LTCCP did not fulfil its statutory purposes and was "not fit for purpose". Importantly, our opinion noted that it was not possible for us to affirm that the level of proposed expenditure during the life of the LTCCP will deliver the levels of service proposed or that the expenditure was consistent with the underlying information available to the Council. Further, the performance information could not be adequately linked to the disclosed performance measures. The Council could not identify that all funding of individual groups of activities came from appropriate sources

1 The comments in this Part relate to Invercargill City Council, Invercargill City Holdings Limited, and Bond Contracts Limited and Group.

2 See paragraph 1.103, *Local government: Results of the 2005/06 audits*, parliamentary paper B.29[07b], June 2007.

3 Refer to the Appendix. The qualifications for Bond Contracts Limited and Bendigo Construction Limited are detailed in the section "Disclaimers of opinion". The effect on Invercargill City Holdings Limited and Group is detailed in the section "Except-for opinions".

4 See pages 121 and 122, *Matters arising from the 2006-16 Long-Term Council Community Plans*, June 2007.

of funding. Therefore, we were unable to conclude that the LTCCP was financially prudent.

- 2.7 The combination of a lack of a credible plan and the difficulty in finalising the Council's annual reports means that the Invercargill community cannot hold its elected members to account. It also means that external auditors cannot give assurance that community resources have, or will be, managed appropriately.
- 2.8 We have noted recently that the councillors of Invercargill City have expressed concern about the lack of quality of the 2006-16 LTCCP. They have publicly stated that they expect management to improve the 2009-19 LTCCP. Therefore, we have met informally with the Council to discuss the most important aspects of preparing an LTCCP and matters associated with the ongoing delays in completing their annual report. Management have also expressed a commitment to rectify Council's planning and reporting.
- 2.9 While the Council has acknowledged the need to improve its accountability, we remain concerned that the Council's planning and reporting need to improve substantially. The current situation does not set a good example of responsible public management for other councils and communities.

Part 3

Amendments to Long-Term Council Community Plans

3.1 In this Part, we describe the legislative and operational processes for amending Long-Term Council Community Plans (LTCCPs). We also provide an overview of the amendments that have been carried out by local authorities since the adoption of 2006-16 LTCCPs.

Background

- 3.2 The Local Government Act 2002 (the Act) requires local authorities to have an LTCCP “at all times”.¹ The LTCCP must be audited² and the plan remains in force for three years.³
- 3.3 The LTCCP does not a commit a local authority to act. However, there are certain decisions that can only be made and acted on if they are provided for in the LTCCP. If these decisions are not already included in the LTCCP, an amendment is necessary. Decisions that require an amendment are:
- significant new activities proposed by regional councils (section 16);
 - significant alterations to an intended level of service provision for any major activity; the transfer of ownership or control of a strategic asset; the construction, replacement, or abandonment of a strategic asset; and decisions about an activity in the LTCCP affecting the capacity of, or cost to, the local authority (section 97);
 - amendments to funding and financial policies (section 102(6)); and
 - sale or exchange of endowment property (section 141).
- 3.4 Section 93(4) allows the LTCCP to be amended at any time. Section 84(4) requires every proposal to amend the LTCCP to be audited.
- 3.5 The LTCCP retains its adopted form unless it is amended. A local authority can seek an amendment only when it follows the special consultative procedure set out in section 93(5) of the Act.
- 3.6 A local authority may decide to amend an LTCCP at any time, although most amendments are likely to be considered with the annual planning process.
- 3.7 Each year a local authority is required to adopt an annual plan.⁴ The primary purpose of the annual plan is to support the adopted LTCCP (in enabling integrated decision-making). It outlines the proposed budget for the financial

¹ Section 93(1) of the Act.

² Section 94 of the Act.

³ Section 93(3) of the Act.

⁴ Section 95(1) of the Act. Note that, by virtue of section 95(4), the LTCCP constitutes the annual plan for the first year to which it relates.

year to which it relates. Its purpose includes “identify[ing] any variation from the financial statements and funding impact statement included in the LTCCP”.⁵

- 3.8 However, the annual plan, containing the LTCCP variations, does not replace the LTCCP. This means that the annual plan:
- does not replace the existing LTCCP “numbers” or other forecast information;
 - is adopted through the special consultative procedure,⁶ but it is not subject to audit; and
 - does not “amend” the LTCCP. Although a local authority will adopt an annual plan, it has no direct effect on the LTCCP. The existing LTCCP remains “in force” without change.
- 3.9 The annual plan sits alongside the LTCCP as a record of annual variations rather than being integrated with the existing LTCCP. We discuss the difference between a variation in an annual plan and an amendment to an LTCCP in paragraphs 3.22-3.24.

Overview of amendments by the sector

- 3.10 During the period from 1 July 2006 to 31 December 2007, 11 city councils, six regional councils, and 27 district councils completed 51 LTCCP amendment processes. These amendments addressed 155 issues that resulted in changes to their 2006-16 LTCCPs.
- 3.11 Three local authorities each proposed one amendment for consultation within four months of the adoption of the 2006-16 LTCCPs. Each of these local authorities has since carried out another amendment process (in the period to 31 December 2007). Four other local authorities also completed two amendment processes during the 2007 calendar year.
- 3.12 Forty-two local authorities carried out an LTCCP amendment process in conjunction with the 2007/08 annual planning process.
- 3.13 An LTCCP amendment process usually addresses between one to four major changes to the adopted 2006-16 LTCCP. However, a small number of amendments covered a greater number of issues. The largest number of issues within one amendment was 11.
- 3.14 After the consultation process and the assessment of public submissions, it was rare for the original amendment proposal to change. In the vast majority of cases, the amendment was adopted without any changes.

⁵ Section 95(5)(b) of the Act.

⁶ Section 95(2) of the Act.

Nature of amendments

- 3.15 The most common and significant amendment issue related to changes to the revenue and financing policies of a local authority. Twenty-three local authorities made changes of this kind. This was closely followed by 19 local authorities who made changes to their development contribution policies.
- 3.16 The requirements of section 102(6) of the Act force any change to a funding or financial policy to be an amendment. The 42 amendments noted in paragraph 3.12 ranged from very small changes to wording within these policies (with minimal effect on ratepayers) to much more substantial and complex changes reflecting fundamental changes to the previous policy. Usually the more complex changes were made only for a specified or limited sphere of activities rather than for all activities.
- 3.17 Interestingly, 12 amendments related to new capital projects or the start of new activities where the 2006-16 LTCCP had not included the operational or capital costs associated with the projects. Some indication of the project, as yet unspecified and uncertain, was often included in narrative to the 2006-16 LTCCP. In addition, four amendments related to significant cost increases for projects that had previously been included in the LTCCP. Another four amendments related to significant changes to the timing of large capital projects.
- 3.18 Other main areas where amendments were made were:
- changes to rating policies;
 - changes to underlying assumptions;
 - changes to levels of service;
 - changes to the structure of the performance management framework;
 - a proposal to sell endowment property;
 - a proposal to sell a strategic asset; and
 - the creation of a new council-controlled organisation.
- 3.19 There were a large number of other proposals that were unique to a particular local authority.
- 3.20 We and our appointed auditors have made a considerable effort to look for issues that may give rise to an LTCCP amendment. On the whole, there has been a high level of communication between the sector and auditors about these issues. In most instances, it is reasonably clear when an amendment process is triggered. However, particularly when issues arise that reflect a change in the intended level of service provision⁷ or a change to the cost of an activity,⁸ judgement is required

⁷ Section 97(1)(a) of the Act.

⁸ Section 97(1)(d) of the Act.

to assess whether the change is significant enough to trigger the amendment process.

- 3.21 Good communication between the sector and auditors is important to help promote consistency in the approach to issues where “significance” must be assessed.⁹ This will help to determine whether the issue should be processed through the annual plan or as an amendment.

Audit requirements for amendments

- 3.22 The audit requirement for an amendment reflects the distinction between a local authority adopting variations from the existing LTCCP (essentially for annual rating purposes) compared to making a change of such scale that it requires specific public consultation on the proposed changes and their impact and auditor’s assurance in the manner intended by section 84(4) of the Act. Under section 97 of the Act, the distinction is based on the “significance” of the matter proposed. If a change is deemed “significant”, then it must be treated as an amendment rather than a variation. Sections 16, 102, and 141 do not directly relate to “significance” but are specific events deemed to be significant by the Act.
- 3.23 The primary annual planning requirement for a local authority is to identify variations from existing plans (with the consequential effect on rating levels and levels of service). Where local authorities wish to change their previously expressed intent in a “significant” manner, they must pursue a separate amendment. While an amendment is subject to a separate consultation process, the Act recognises that it may be efficient for this to be carried out with an annual plan process. It needs to be clear to the community that it is being consulted on two counts – one on setting the annual plan for the year, and the other on a change to the 10-year plan.¹⁰
- 3.24 The main issue for a local authority is assessing what constitutes an amendment, in contrast to the normal and expected annual variations from the 10-year plan. We have noted since the adoption of the 2006-16 LTCCPs that this assessment often requires a significant amount of professional judgement. The difference between variations and amendments is not always clear cut.

⁹ In relation to section 97 of the Act.

¹⁰ Section 83A of the Act (the result of amendment in 2006) clarifies that the two consultations (annual plan and any amendment) can be pursued concurrently. It should also be noted that “amendments” are not limited to being concurrent with an annual plan process. A local authority can carry them out at any time during a year.

Reporting on the amended Long-Term Council Community Plan

The audit report

- 3.25 In contrast to the requirement to issue an audit opinion on the LTCCP Statement of Proposal and at the point when the LTCCP is adopted, there is no statutory responsibility for the auditor to report on the adopted amendment. However, section 84(4) of the Act requires that every proposal to amend the LTCCP is to be audited.
- 3.26 This position is unsatisfactory from both an auditor's and, more particularly, a reader's perspective. It does not make clear what has been audited during the LTCCP amendment process.
- 3.27 Without the specific legislative requirement for the auditor to issue an opinion, we felt there was a need to inform the reader about the amended LTCCP and the extent of the auditor's involvement. To achieve this, we established a process where a local authority is asked to add a statement or "alert" to the amended LTCCP document. This ensures that the reader is aware of the extent of audit review that the amended LTCCP has been subject to. The original opinion issued on the adopted LTCCP still remains part of the LTCCP and the "alert" is published alongside the original opinion.
- 3.28 In the longer term, we would prefer to see the Act clarified to resolve this reporting anomaly.

Format of reporting on the amended Long-Term Council Community Plan

- 3.29 The intent of the Act is that, once an amendment is adopted, the existing LTCCP is updated with that amendment, and the two documents merge.
- 3.30 Very few local authorities have produced a new "hard copy" of their amended LTCCP. In addition, we note that most local authorities that have completed amendments have not actually updated their LTCCP after adopting the amendment. For efficiency reasons, they have chosen to publish the amendment (on their website) as a separate document associated with the original LTCCP. Although this is not strictly consistent with the intent of the Act, we have accepted it as a practical and cost-effective approach. There needs to be a clear link between the two documents, and the amendment needs to be easily related to the original LTCCP.
- 3.31 We are satisfied that local authorities have been appropriately sensitive about the nature of the amendment when they have decided to attach the amendment to the original plan. They have also done so when publishing a new LTCCP document

with the amendment fully merged into the original LTCCP. This decision has largely been based on the extent to which the amendment generates consequential amendments to other parts of the original LTCCP.

Part 4

The right debate

- 4.1 A common challenge for local authorities when they prepared their 2006-16 Long-Term Council Community Plans (LTCCPs) was disclosing the right debate.
- 4.2 The right debate is about providing information that is relevant to the stakeholder, and being transparent. This requires a local authority to assess what the important issues are, what options – including the option adopted in the consultation document – are open to the community, and what all the implications associated with the issues are.
- 4.3 In our report to Parliament on matters arising from the 2006-16 LTCCPs,¹ we highlighted poor disclosure of the right debate as one of the disappointing features. This is a matter that our auditors will focus on as local authorities start to prepare their 2009-19 LTCCPs.
- 4.4 Until the LTCCP reflects these matters transparently and plainly for the reader, it is arguable that the statutory principles on which the LTCCP is based are not being met.
- 4.5 Since 2006, there has been much discussion and clarification about the concept of the right debate in the sector. We look forward to improved disclosures from all councils, because communities need to have confidence that the information they are consulted about is complete and relevant.

An example – Metrowater charges

- 4.6 In its 2006-16 LTCCP, the Auckland City Council (the Council) set out its plans for achieving its vision for the city to develop on an internationally competitive scale. The LTCCP outlined a significant capital expenditure programme as part of those plans. To fund the capital expenditure programme, the Council referred to, among different sources of funding, an increasing level of charitable payments from its subsidiary – Metro Water Limited (trading as Metrowater).
- 4.7 Metrowater provides retail water and waste services to Auckland consumers. It charges for its services and has made several charitable payments to its shareholder, the Council. In the five years before the 2006-16 LTCCP was published, those payments ranged from \$5 million to \$12 million a year.
- 4.8 The 2006-16 LTCCP anticipated that the charitable payments would increase and total \$324 million during the 10 years covered by the plan. This equates to an average of \$32 million each year.

¹ *Matters arising from the 2006-16 Long-Term Council Community Plans*, June 2007.

Inquiry by the Local Government and Environment Committee

- 4.9 The Local Government and Environment Committee (the Committee) received a petition asking for an inquiry into the “charging and other practices of Metrowater”.² The petitioners expressed concern that the increasing demand for charitable payments from the Council was increasing the charges associated with providing Metrowater’s services.
- 4.10 The Committee carried out an inquiry and its resulting report to the House of Representatives was strongly critical of the Council. The Committee considered that the Council had “misled” the Auckland community about the effect of the increased demand for charitable payments to help fund the Council’s capital expenditure programme.
- 4.11 In highlighting its development intentions for the city, the Council specifically disclosed the increasing level of charitable payments needed to fund the capital expenditure programme. The LTCCP also provided some comments on the effect this would have on Metrowater’s charges. It described that effect as “modest”.
- 4.12 The Council and Metrowater assessed that the projected increase in water charges would range from an initial nominal 6.5% in 2006/07 to an annual increase in water charges of 3-4%. However, it did not disclose this range in the LTCCP. The Committee was highly critical of this lack of disclosure, implying that the ratepayer and water consumer should have been shown the range of annual increases and that it was for ratepayers and consumers to determine if these increases were modest.

Issues raised by the Metrowater example

- 4.13 The Metrowater example raises some important issues about preparing an LTCCP and the consultation processes that local authorities should observe. It highlights the importance of the LTCCP:
- in setting the direction of a local authority, clearly describing that direction and associated plans, and the local authority’s approach to funding those plans – including the effect on the ratepayer or other funder;
 - in clearly describing the implications of the proposed direction and associated plans;
 - reflecting its pivotal role in a local authority’s consultation with its community to enable effective and complete feedback on that direction and funding; and
 - being written from a ratepayer-centred, rather than council-centred, perspective. The information disclosed not only needs to be complete but must also be capable of being understood by those being consulted.

² Petition 2005/106 of Penelope Bright and 40 others, presented to the House of Representatives in September 2007.

- 4.14 We recognise that what is adequate for one reader may not be for another. Local authorities must exercise judgement in what information they disclose and how they disclose it. In the Metrowater case, the Council genuinely considered that it had adequately disclosed its intentions to the community to enable effective consultation and, as auditors, we had assessed the disclosures as consistent with reasonable practice. That the Committee took a different view shows just how important the judgement about disclosure can be.
- 4.15 Since the audit of the 2006-16 LTCCPs, we have continued to express the view that one of the important dimensions of an LTCCP is that it focuses on the important issues, options, and implications of the future focus of a local authority – setting out “the right debate”.
- 4.16 We note the work of the Society of Local Government Managers in developing and recording good practice in this area.³ In its advice to the sector, it notes that the right debate is one of “four cardinal virtues” in preparing and delivering an LTCCP.
- 4.17 Disclosing the right debate will remain an important part of the 2009-19 LTCCPs and their usefulness. In our view, local authorities need to give significant attention to setting out those key issues with regard to the completeness of the information and its relevance to the community.

³ See the Society’s website (www.solgm.org.nz). There is a range of good practice manuals about the LTCCP, produced in association with Local Government New Zealand. The volume entitled *Piecing it Together* deals specifically with the right debate (see pages 8-10).

Part 5

Reporting on effects of activities in the annual report

- 5.1 The Local Government Act 2002 (the Act) contains a comprehensive reporting regime for local authorities. The audited annual report of each local authority is the main channel for reporting. Local authorities are required to plan for, and report on, the effect of their activities on the social, economic, environmental, and cultural well-being (the four community well-beings) of their communities.¹
- 5.2 The Act requires the Auditor-General to report on whether a local authority has complied with these requirements.²
- 5.3 In this Part, we review how local authorities approached these requirements, which are set out in clause 15(d) and 15(f) of Schedule 10 of the Act respectively. We focus on:
- the disclosure requirements of reporting on the effects of local authorities' activities in their annual reports; and
 - local authorities' statements of acquisition and replacement of assets.
- 5.4 This is the fourth time we have reported to Parliament on these disclosure requirements. In the past four years, we have observed a range of disclosures in response to the new requirements of the Act, from information being clearly available to the reader to no relevant disclosures at all. In some cases, information appears to be included in the annual report solely to meet the requirements of the Act, and is presented in such a way that it would be difficult for the reader to recognise the information as being included to meet the intentions of clause 15 of Schedule 10 of the Act (for example, it may be spread throughout the annual report rather than reported in one place).
- 5.5 To date, we have reported inadequate disclosures in our management letters to local authorities. Although we have observed some improvement in 2006/07, overall the reporting against the requirements of clause 15(d) and 15(f) of Schedule 10 of the Act remains well below what we would expect. As we move towards the 2009-19 Long-Term Community Council Plans (LTCCPs) round, we expect more from the local authorities' performance reporting. The reporting required by clause 15(d) and 15(f) of Schedule 10 of the Act, and other parts of clause 15, are integral to the effective operation of the performance management framework of every local authority.
- 5.6 We expect local authorities to define how they will monitor progress towards achieving community outcomes³ through their 2009-19 LTCCP. Local authorities should also put in place systems to improve current reporting against the other

1 Clauses 2 and 15 of Schedule 10 of the Act.

2 Section 99(1)(b) of the Act. In clause 15(e) and 15(f) of Schedule 10 of the Act, our obligation extends to actual verification of the information reflected in annual reports – in other words, we audit the disclosures.

3 Clause 15(c) of Schedule 10 of the Act.

requirements of clause 15 of Schedule 10 of the Act. Such systems need to capture, monitor, and evaluate progress towards achieving community outcomes. Therefore, we will be considering our reporting options and obligations where local authorities fail to provide relevant information that reasonably and coherently addresses the requirements of clause 15.

Background

- 5.7 To be able to meet the requirements of the Act, local authorities will need to prepare a comprehensive framework that links their monitoring of community outcomes, decision-making, and performance against levels of service to their reporting. Reports need to include the identified effects of activities on the four community well-beings. It is clear from our previous reports⁴ and the annual reports of local authorities that this is an area in which substantial improvement is still needed.
- 5.8 The Act requires LTCCPs to include frameworks for monitoring community outcomes.⁵ We also expect the report on progress to be published at a time when the information it contains will be useful to the community for preparing the next LTCCP. Such a report is required at least once every three years.
- 5.9 Figure 5.1 demonstrates the related requirements between the LTCCP and annual report planning and reporting.
- 5.10 The requirements in Figure 5.1 show that a local authority needs to understand how it will monitor progress towards community outcomes so that it can produce reports on the result of measuring that progress. Considering the best approach for achieving this continues to involve substantial debate.
- 5.11 Preparing the 2006-16 LTCCP obliged local authorities to distinguish between the requirement to report on community outcomes at least every three years, and the requirement to report on any measurement carried out that reflects a local authority's contribution to achieving outcomes through its activities. Focusing on the performance accountability framework, Figure 5.2 demonstrates how the Act envisaged the reporting framework for outcomes and levels of service.

4 *Local Government: Results of the 2003-04 Audits*, parliamentary paper B.29[05b], pages 61-87; *Local government: Results of the 2004-05 audits*, parliamentary paper B.29[06b]; pages 14-16, and *Local government: Results of the 2005/06 audits*, parliamentary paper B.29[07b], pages 14-21.

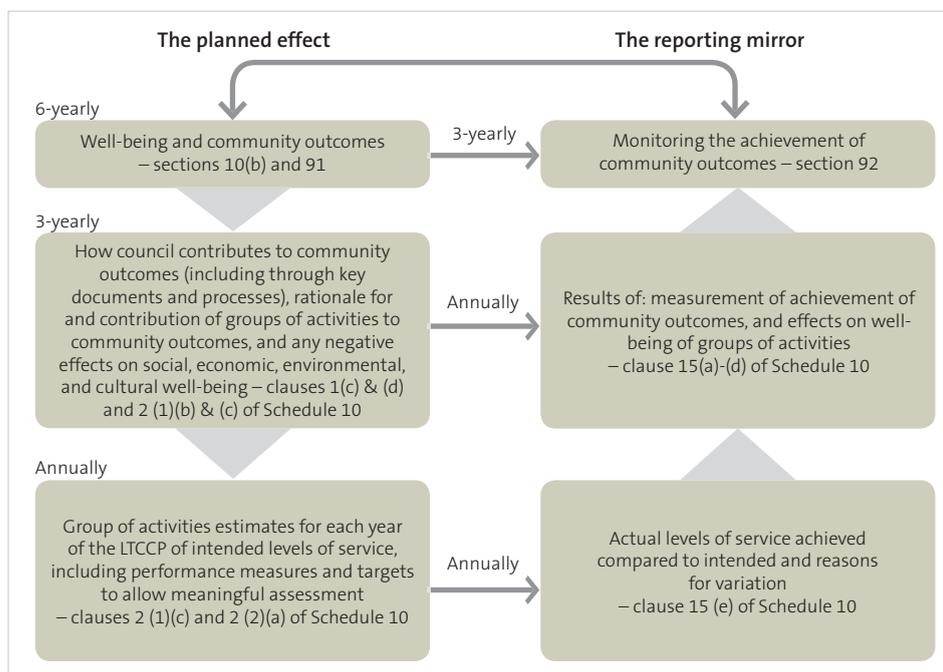
5 Clause 1(g) of Schedule 10 of the Act.

Figure 5.1
Related requirements in the LTCCP and annual report for each group of activities

LTCCP (clauses 1 and 2 of Schedule 10 of the Act)	Annual report (clause 15 of Schedule 10 of the Act)
Identify the activities within the group of activities.	Identify the activities within the group of activities.
Identify the rationale for delivery of the group of activities (including the community outcomes to which the group of activities primarily contributes).	Identify the community outcomes to which the group of activities primarily contributes.
State the measures that will be used to assess progress towards achieving community outcomes. State how the local authority will monitor and report on the community's progress towards achieving community outcomes (not less than once every three years).	In relation to each group of activities, report the results of any measurement carried out during the year of progress towards achieving community outcomes.
Outline significant negative effects any activity (within the group of activities) may have on the four community well-beings.	Describe the identified effects that any activity within the group of activities has had on the four community well-beings.
Identify additional or replacement assets needed to meet levels of service and/or demand – summary of clause 2(d).	Describe any significant acquisitions or replacements of assets, the reasons for the acquisitions or replacements, and the reasons for variances with the LTCCP.

Note: Group of activities, as defined in the Act, means one or more related activities provided by, or on behalf of, a local authority or council-controlled organisation.

Figure 5.2
The feedback flow of performance in the Local Government Act 2002



Focus for reviewing the 2006/07 annual reports

Identifying effects on the four community well-beings, and disclosing significant acquisitions

- 5.12 In the past two years, we have reviewed how local authorities approached the annual report requirements of clause 15 of Schedule 10 of the Act. The focus in 2005/06 was to find out whether local authorities had made progress in the second year that the requirement applied to all local authorities. This continues to be our focus.
- 5.13 As well as the requirements for each group of activities listed in Figure 5.1, the annual report must contain:
- an audited statement comparing the actual and intended levels of service provision, and giving the reasons for any variance between the actual and the expected service provision; and
 - an audited statement describing any significant acquisitions or replacements of assets carried out during the year, and giving the reasons for those acquisitions or replacements, and the reasons for any significant variation between planned and actual acquisitions and replacements.⁶
- 5.14 To date, the reporting under clause 15(d) and 15(f) of Schedule 10 of the Act has been the least well done of the annual report requirements.
- 5.15 As with most new planning and accountability provisions, we expected local authorities to show progress towards meeting these requirements. The progress is varied. Several local authorities indicated that they were continuing to do work in this area, particularly on identifying effects on the four community well-beings.
- 5.16 Some local authorities are still identifying how to monitor progress towards achieving community outcomes.⁷ If local authorities are having difficulty planning how to monitor progress, effective reporting on achievement is likely to continue to be a problem.

Identifying effects on the four community well-beings

What is required

- 5.17 Although the Act requires reporting against the four community well-beings, it does not specify how this is to be done.
- 5.18 A local authority needs to establish the framework within which it makes decisions and determines how well its own activities and services contribute to

⁶ Clause 15(e) and 15(f) of Schedule 10 of the Act.

⁷ As required by clause 1(g) of Schedule 10 of the Act.

community outcomes. It also needs to be able to report on the effects of these activities.

- 5.19 It can be challenging for a local authority to identify and report on the full range of effects that an activity may have on each community well-being. For instance, some activities, such as water management and building roads, are often identified by local authorities as having a positive effect on community well-being. A general statement of this type does not adequately identify the effects that such infrastructure could have on social cohesion or environmental well-being or biodiversity.

What local authorities did

- 5.20 Overall, we observed some encouraging changes in the information presented in 2006/07 annual reports compared to the previous year. We noted that about 28% of local authorities improved their disclosures, 67% of local authorities made no change to their disclosures, and 5% made changes that diminished the quality of reporting in comparison to previous years. However, despite these improvements, and the obvious efforts to increase disclosures and make improvements, more than 45% of local authorities still did not meet the requirements of clause 15(d) of Schedule 10 of the Act – that is, 45% of disclosures did not effectively identify the effects of activities on the well-being of the community. These requirements have now been in place for three years, and we had expected a better performance.
- 5.21 The local authorities that presented the most comprehensive disclosures in previous years continued to do so this year. Some of the local authorities that made changes to their disclosures this year are also meeting a high standard of disclosure. However, in our view, some local authorities have achieved only a minimal level of compliance and could significantly improve their disclosures. It is disappointing that there is little evidence that local authorities are seeking to improve their disclosures.
- 5.22 Most local authorities provided information on:
- the nature of their activities;
 - how activities contribute to one or more community outcomes;
 - how the activities were measured; and
 - their progress towards the objective.
- 5.23 Many local authorities discussed the effects of their activities. However, many of the effects identified appear to repeat a local authority's aim or objective for that activity rather than report an identified effect. Local authorities need to distinguish between an identified effect of an activity, as required by the Act, and

the effect they intend that activity to have. For example, the general statement that “this activity contributes to economic and social well-being through protecting the safety of residents” is describing an *intended* effect rather than an *identified* effect.

- 5.24 Under the Act, an annual report is required to report any identified effects, negative or positive. Consistent with reporting against its LTCCP, which requires a local authority to outline any significant negative effects of its activities, a small number of local authorities continue to identify only negative effects in their annual report. Although negative effects were thoroughly discussed in some of the reports, none of the reports that identified only negative effects met the requirements of the Act.
- 5.25 A few local authorities identified both negative and positive effects. These were presented as either written commentaries or in a table format.
- 5.26 A small number of local authorities provided information on the identified effect each activity had on each community well-being.
- 5.27 Other local authorities provided a report on each community well-being, outlining the local authority’s contribution and the effect of its activity on these areas.
- 5.28 Overall, we noted little change to the approaches taken this year to reporting identified effects compared to previous years.
- 5.29 Fewer local authorities reported that they were still developing the links between the outcomes, rationale, activity, performance measure, targets, and identification of effects in comparison to previous years. Most of those local authorities yet to meet the requirements of clause 15(d) of Schedule 10 of the Act indicate that they intend to do so. However, a few have yet to acknowledge and produce information to meet the new requirement.

Comments on identification of effects on the four community well-beings

- 5.30 We noted in our report in 2006⁸ that local authorities needed to ensure that their identification of the effects of activities was more than simply reporting on the activity of the local authority. As there has been little change to disclosures, the same comment still applies.
- 5.31 To better meet the requirements, local authorities could:
- move from restating local authority aims to identifying effects;
 - move to specific consideration and analysis of the effects of activities rather than make generalised statements; and

⁸ *Local government: Results of the 2004-05 audits*, parliamentary paper B.29[06b], page 16.

- ensure that the performance management framework is an integrated package that links community outcomes and the rationale for local authority activity to performance measures, targets, and levels of service. With such a linked framework, it is easier for local authorities to report on progress towards community outcomes⁹ and the identified effects of activities.¹⁰

Conclusion on current state of reporting against clause 15(d)

- 5.32 The sector is still a long way from meeting the requirements of clause 15(d) of Schedule 10 of the Act – to clearly report the identified effects of activities on the four well-beings. Most local authorities provided clearly accessible information on what the local authority did, how it intended to enhance community outcomes, why it carried out the activity, and how it measured performance. This reporting does not meet the requirements of clause 15(d) of Schedule 10 of the Act to describe identified effects (although it fulfils other accountability requirements for the clear reporting of local authority activities back to the community).

Statement of acquisition and replacement of assets

What is required

- 5.33 The Act, through the LTCCP and the annual plan, creates the framework against which the annual report discloses actual results. This includes how assets will be maintained, replaced, and renewed, and how costs will be met.¹¹
- 5.34 Significant asset acquisitions and replacements are noted in planning financial forecasts, and are disclosed in the budget sections of the LTCCP.
- 5.35 The annual report must include the information listed in Figure 5.1.

What local authorities did

- 5.36 We saw an encouraging amount of change in the information presented in the 2006/07 annual reports compared to the previous years. An improvement was evident in 22% of local authorities' disclosures in 2006/07. There was a broad range of improvements, from asset acquisition information to explaining variances against budgeted acquisitions and explaining the rationale for acquisition and replacement decisions. However, not all of these local authorities complied with the requirements of clause 15(f) of Schedule 10 of the Act.
- 5.37 Some local authorities reported significant variations between the LTCCP and the actual asset programme. Few provided information of any depth on the reasons for these variations.

⁹ As required by clause 1(g) of Schedule 10 of the Act.

¹⁰ As required by clause 15(d) of Schedule 10 of the Act.

¹¹ Clause 2(1)(d) of Schedule 10 of the Act.

- 5.38 Local authorities that did provide information on, and reasons for, the variations did so either as notes to the financial statements or as part of reporting on the group of activities in the Statement of Service Performance.
- 5.39 In some cases, major variations were noted between the report by the mayor, chairperson, or chief executive and the financial statements and the Statement of Service Performance.
- 5.40 A small number of local authorities provided a list of all assets acquired and disposed of as a separate section in the annual report. They included the reasons for the acquisition or disposal of those assets. Where the information and explanations were clear and thorough, they provided a snapshot of all local authority acquisitions and replacement of assets.
- 5.41 We were concerned that a small number of local authorities presented asset information to a lesser standard in 2006/07 than in the previous year. This trend was also noted during our 2005/06 review.

Comments on statements about significant asset acquisition and replacement

- 5.42 Providing high-level information on significant asset decisions (for example, advising of delays to, or bringing forward of, major asset acquisitions) in the mayor's or chairperson's report is useful for the public. However, the mayor's or chairperson's report is not subject to audit, and cannot include all the information required by the Act.
- 5.43 Where variations were reported in the financial statements section, they were often aggregated. This does not provide the most accessible information to the community about specific actions carried out by the local authority for significant assets.
- 5.44 As we noted in previous years, putting financial and asset information in the Statement of Service Performance keeps the information on one topic within each group of activities. However, unless the variation and its reason are also clearly stated in that section, it is not easy to determine the difference between the LTCCP or annual plan projections and the actual expenditure or acquisitions carried out during the year.

Conclusion on current state of reporting against clause 15(f)

- 5.45 A significant number of local authorities still do not clearly address the requirements of clause 15(f) of Schedule 10 of the Act, with up to half of them inadequate. This is usually because there is no explanation of the reasons for

the acquisition, replacement, or variation. In some cases, the local authority completely failed to address the requirements of clause 15(f) of Schedule 10 of the Act.

- 5.46 We remain concerned about this finding. Asset acquisition and replacement are important to sustaining and developing services. Most local authority plans – including the LTCCP – centre on the sustainable delivery of desired levels of service. Identifying an appropriate asset development programme that incorporates acquisition and replacement is central to demonstrating sustainability of services. Without this information, an important aspect of accountability is missing, and information useful to the reader is not available.
- 5.47 If we do not start to see improvements over time, we will be obliged to consider what effect failure to observe these requirements should have on our audit opinions.

Concluding comments

- 5.48 To be able to effectively meet the requirements of clause 15 of Schedule 10 of the Act, local authorities will need to have a comprehensive framework that links their monitoring of community outcomes, decision-making, and performance against levels of service to their reporting. Reports need to include the identified effects of activities on the four community well-beings. It is clear from our previous reports and the annual reports of local authorities that this is a challenge. It is an area in which substantial improvement is still needed.
- 5.49 We expect local authorities to define how they will monitor progress towards the achievement of community outcomes¹² through their 2009-19 LTCCP. They should also put in place systems to improve current reporting against the other requirements of clause 15 of Schedule 10 of the Act. We will be considering our reporting options and obligations where local authorities fail to provide relevant information that reasonably and coherently addresses the requirements of clause 15.

¹² Clause 15(c) of Schedule 10 of the Act.

Part 6

Approach to auditing the 2009-19 Long-Term Council Community Plans

- 6.1 The Auditor-General has a statutory duty to issue an audit opinion on a local authority's draft and final Long-Term Council Community Plan (LTCCP). The LTCCP articulates a local authority's strategy (informed by community desires and the reality of the community's circumstances). The LTCCP also provides an integrated view of the policies and actions required to support the strategy.
- 6.2 Both the LTCCP and the requirement for it to be audited are unique to New Zealand.
- 6.3 In 2006, we audited the long-term planning of local authorities for the first time. Throughout 2007, we have been reviewing the process and methodology for auditing LTCCPs.
- 6.4 This Part reports on how we have carried out the review, and provides information to Parliament on our approach to the 2009-19 LTCCP audit.

Background

Results from audit of 2006-16 Long-Term Council Community Plans

- 6.5 In 2007, we provided a substantial report to Parliament called *Matters arising from the 2006-16 Long-Term Council Community Plans*.¹ The report includes commentary from four experts on sustainable development, performance information, asset management, and financial management and strategies.
- 6.6 Although the 2006-16 LTCCPs had improved compared to the 2004-14 LTCCPs, we also reported on significant matters that are now being addressed by the sector in its preparation of the 2009-19 LTCCPs:
- the need for improvement in asset management planning;
 - the lack of linkage and flow in relation to the performance frameworks; and
 - the need for LTCCPs to be strategic and user-centred documents.

Sector activity since the 2006-16 Long-Term Council Community Plans

- 6.7 Good practice has been defined since 2006 by the sector through guidance material prepared by sector organisations, such as Society of Local Government Managers (SOLGM) material² and National Asset Management Steering Group (NAMS) guidance. The SOLGM guidance material includes:
- *Living through the LTCCP* – planning to plan, project management, managing the process;

1 Parliamentary paper B.29[07c].

2 *Towards 2009* initiative.

- *Piecing it Together* – preparing an LTCCP;
 - *Your Side of the Deal* – guidance on developing a performance management framework; and
 - *Dollars and Sense* – financial management.
- 6.8 Many local authorities have reviewed their 2006-16 LTCCP processes, started project planning for the 2009-19 LTCCP, and established LTCCP project teams. Some local authorities have started discussions with us and the auditor, which all parties have found useful.
- 6.9 A critical consideration is to “size” the task of preparing the 2009-19 LTCCP. Local authorities have been asking questions such as “Will it be a substantially new document or an incremental change?”
- 6.10 Other questions local authorities are asking are:
- “What will be the nature of the changes to the existing direction?” An early discussion with newly elected councillors about their policy parameters will be critical in determining this.
 - “What have the last two to three years told us about the well-being of our communities, or about the state of our infrastructure?”
 - “What were the results of the 2006-16 LTCCP planning process? For instance, are there areas of underlying information that need development?” (Further development could be required for underlying information for assets, for assumptions or for a more robust performance framework.)

Revising our methodology for the 2009 Long-Term Council Community Plan audit

- 6.11 During 2007 and early 2008, we reviewed the audit methodology and processes used for auditing the 2006-16 LTCCP. Much of our revision has been to align our approach to the SOLGM guidance material and the NAMS guidance (see paragraph 6.7).
- 6.12 We talked with the auditors and sector representatives, did our own internal quality assurance, and established a steering group of staff from the Office of the Auditor-General and auditors to guide the development of the 2009-19 methodology. The steering group has considered the quality assurance comments and drawn on other research and development work on performance management we have carried out since 2006.
- 6.13 We have worked with two “user groups” to provide an assessment of the usability and clarity of the methodology. One group assessed the methodology from an

auditor's perspective, and the other group brought together sector experts to assess whether sustainable development issues are addressed adequately.

- 6.14 We delivered initial training on our revised methodology to audit teams in March and April 2008, and we will be repeating this. We will provide support to our auditors during the process.
- 6.15 We have contributed to sector training days, and have met, and will continue to meet, with local authorities.

Approach to 2009-19 Long-Term Council Community Plan audit

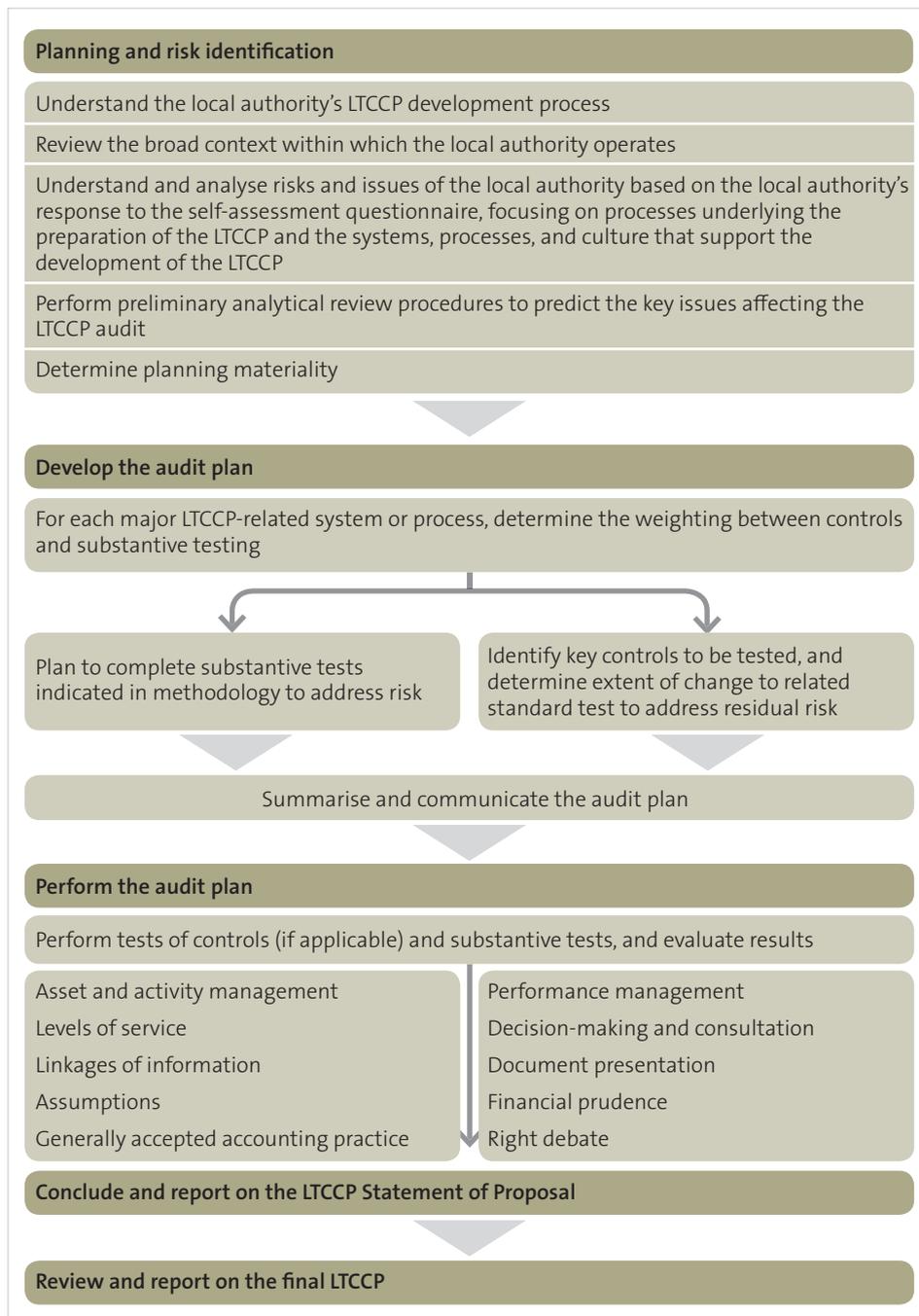
Audit methodology

- 6.16 The audit methodology has two main areas of activity:
- preparing for and planning the audit, expected to occur during the middle of 2008; and
 - carrying out the audit of the Statement of Proposal for the draft LTCCP, and the audit of the final LTCCP. Most of this work is expected to occur between February and June 2009.
- 6.17 Our revised methodology is set out in Figure 6.1.

First part of the audit – preparation and planning

- 6.18 This first part of the audit is mainly about the systems and practices used by the local authorities. It covers planning and risk identification, and the development of the audit plan, as shown in Figure 6.1. The audit focus is on the systems that underlie what goes into an LTCCP – such as governance, decision-making processes, consultation, engagement with Māori, preparation of asset and activity plans, clarity of financial strategy, and how local authorities are preparing and using performance frameworks. We are asking these questions because we recognise that the LTCCP is an aggregation of many decisions over time. The information and consultation on which these decisions are based form part of the statutory obligations and underlying information required of local authorities and on which we are required to report.
- 6.19 As in the 2006-16 LTCCP audit, a self-assessment by the local authority is part of audit planning. Auditors will use the self-assessment to become familiar with the local authority, but will primarily use it to identify risks for the audit.
- 6.20 The self-assessment requires each local authority to outline its systems that support working with outcomes, decision-making and consultation, and the

Figure 6.1
Summary of our revised LTCCP audit methodology



financial management provisions of the Local Government Act 2002 (the Act). The self-assessment will also help to identify the areas in which councils would like to improve.

- 6.21 Section 14(1)(h) of the Act requires local authorities to take "a sustainable development approach".
- 6.22 The self-assessment will help us to assess local authorities' responses to the section 14(1)(h) requirement in their decision-making and consultation, governance, and other processes during the preparation phase. Later in the audit process, we will consider how the local authority has made its approach to section 14(1)(h) evident, in its assumptions, asset and activity planning, and performance management information. We will not be assessing whether local authorities are achieving sustainable outcomes.

Second part of the audit – carrying out the audit

- 6.23 The second part of the audit is the audit of the LTCCP Statement of Proposal, and of the final LTCCP. Our primary approach is to identify, confirm, and assess local authorities' major processes and controls for information gathering, budgeting, preparing a performance framework, reviewing policies as required by the Act, and producing the LTCCP Statement of Proposal and adopted LTCCP.

Audit emphasis

- 6.24 Our audit methodology for the 2009-19 LTCCP includes a particular emphasis on whether local authorities:
- have implemented a sustainable development approach (section 14(1)(h) of the Act);
 - have provided clear information to the public about important issues, choices, and the implications of those choices – the "right debate"³ (section 93(6) of the Act);
 - show transparency in financial management strategies and prudence (section 101(1) of the Act);
 - have performance frameworks and measures that provide meaningful assessment of performance (clause 2(2)(a) of Schedule 10 of the Act); and
 - have provided adequate underlying information (section 94(1)(b) of the Act).
- 6.25 Our reporting obligations under sections 84(4) and 94(1) of the Act provide us with three "themes" or broad audit objectives:
- **quality of underlying information and assumptions** (section 84(4)(b) of the Act) – do your underlying processes support robust and relevant information going into the LTCCP Statement of Proposal?

³ See paragraph 6.59, and also Part 4 of this report for further discussion.

- **performance information** (section 84(4)(c) of the Act) – will the performance information provide a meaningful assessment of the service provided to the community?
- **legislative compliance** (section 84(4)(a) of the Act) – have you done what the Act requires in respect of the processes that support the preparation of the plan?

6.26 The three themes provide the structure for the audit modules and the basis for our reporting on the LTCCP Statement of Proposal and the final adopted LTCCP. However, as the LTCCP is an integrated planning document, the effects of the audit on each module may not be limited to that particular module. For instance, issues in the asset management plans could affect whether the performance information systems provide reasonable information.

Theme 1 – quality of underlying information and assumptions

6.27 The modules in this theme of the methodology are highly interrelated, reflecting the integrated nature of the LTCCP.

Module 1 – asset and activity management

6.28 This part of the audit will focus predominantly on examining the detail of a selection of groups of activities that have been identified through the audit planning process as being the main activities. The remaining activity areas will be examined on an overview basis.

6.29 The asset and activity management module focuses on assessing the control environment that has been established by local authorities for the development and recording of the activity, and activity information, underlying the groups of activities. The extent of detailed review of asset and activity management plans, and how much testing is needed of the flow of data from these plans into the financial model and the LTCCP document, will be based on the robustness of the control environment. The detailed review might be able to be reduced if controls are found to be of a sufficiently reliable standard.

Module 2 – levels of service

6.30 The focus in this module is on identifying levels of service as they are reflected in the performance management framework and disclosed in the LTCCP Statement of Proposal. The module also focuses on confirming the consistent application of the levels of service in the development of the underlying information on which the LTCCP is based.

6.31 This module is closely related to the requirements of module 6. Our focus in module 2 is on confirming consistency between the narrative descriptions of levels of service and the financial provisions to deliver the described level of

service, and confirming completeness of the financial reflection of the levels of service narrative. Our focus in module 6 is on the structure of the performance framework around those levels of service as a meaningful assessment of planned performance.

Module 3 – linkages of information and consistency with other plans and policies

- 6.32 The focus in this module is on confirming that the other plans and policies of local authorities have been accurately applied in the development of the LTCCP. The purpose of this work is to ensure that the LTCCP (particularly through the financial forecasts) is consistent with the commitments that local authorities have made through their adopted plans and policies.
- 6.33 Our consideration through this module will not be limited to checking the flow of numerical data from other local authority plans to the LTCCP. It will also consider the consistency of policies and strategies reflected in the narrative of these plans with the LTCCP.
- 6.34 We will also consider the presentation of local authorities' financial information in the group of activity statements in conjunction with this module.

Module 4 – assumptions

- 6.35 In developing an LTCCP, the local authority has to make assumptions about the future and take positions on various issues.
- 6.36 Clause 11 of Schedule 10 of the Act sets out the requirements for disclosing the assumptions underlying the financial and non-financial estimates that local authorities make in preparing their LTCCP. The disclosure of assumptions allows readers of the LTCCP to make their own judgement as to the assumptions' quality and reliability.
- 6.37 Our expectation is that local authorities will consider the applicability of assumptions that are broader than just financial in nature. There are many other assumptions of a more complex and strategic nature dealing with the uncertainties surrounding environmental, social, economic, and cultural changes in the future that local authorities also need to consider. Many of these more complex and strategic assumptions will relate to issues or events that may arise much further into the future than the term of the LTCCP, but for which preparation may be needed in the current LTCCP time frame.
- 6.38 Our audit will evaluate how appropriate and complete the forecasting assumptions and risks identified by local authorities for the development of the LTCCP are. We will also consider the application of the adopted forecasting assumptions and risk classifications to the development of the underlying information in the LTCCP.

Module 5 – Generally Accepted Accounting Practice

- 6.39 Our focus in this module is confirming that the prospective financial statements comply with the requirements of Generally Accepted Accounting Practice (GAAP) and in particular the requirements of the Financial Reporting Standard No. 42: *Prospective Financial Statements* (FRS-42).
- 6.40 FRS-42 requires prospective financial statements to be prepared based on the following general principles:
- The best information available is used.
 - The assumptions and resulting information are reasonable and supportable.
 - The information meets the qualitative characteristics, which means that they are understandable, relevant, reliable, and comparable.
- 6.41 FRS-42 also requires the accounting policies applied to the prospective financial statements to be those that the local authority intends to use in the future for reporting historical financial statements. Therefore, a critical part of developing GAAP-compliant forecasts is incorporating the most recent developments of the New Zealand equivalents to International Financial Reporting Standard (NZ IFRS) as it relates to the local authority during the life of its LTCCP.
- 6.42 FRS-42 includes a number of other requirements designed to help the reader understand the basis for preparing the financial forecasts.

Theme 2 – performance information

Module 6 – performance framework

- 6.43 Local authorities are required to provide services that meet the needs of their communities in an effective and efficient way.⁴ To demonstrate accountability for the delivery of these services, local authorities need to provide enough sound performance information in the LTCCP to show:
- the services that will be carried out and why;
 - the service levels required to meet the needs of their communities or other duties and intentions of the local authority; and
 - the planned level of service to be delivered.
- 6.44 Specifically, the LTCCP must include “a statement of the intended levels of service provision for the group of activities, including the performance targets and other measures by which actual levels of service provision may meaningfully be assessed”.⁵
- 6.45 The forecast service performance information includes the levels of service, the performance measures, and the performance targets. These should be set within

⁴ Section 14(1)(a)(ii) of the Act.

⁵ Clause 2(a) of Schedule 10 of the Act.

the broader context of social, economic, environmental, and cultural well-being. Community outcomes and local authorities' strategic objectives and duties should also be considered. Together, these elements comprise the performance framework.

- 6.46 Effective performance reporting expresses useful, appropriate performance information in a structured, systematic, and logical way, allowing the reader to readily understand and link the achievement of performance targets with the overall aims of a local authority.
- 6.47 Our focus will be on assessing whether the local authority has a comprehensive and systematic approach to performance management. We will assess the performance management framework by considering the main elements of the framework, the links, context, and logical flow, and the consistency with which the framework has been applied to groups of activities. We will also consider the quality of the forecast service performance information, particularly whether it will provide an appropriate basis for understanding and measuring the performance achievements of the local authority in the future.

Theme 3 – legislative compliance

Module 7 – decision-making and consultation

- 6.48 In this part of the audit, we will assess the quality and effectiveness of a local authority's decision-making and consultation processes leading up to the LTCCP. We will also assess the decisions proposed within the LTCCP Statement of Proposal. This will require evaluation of selected decision-making and consultation processes against the requirements set out in the Act.
- 6.49 Our audit will focus predominantly on the decision-making and consultation processes employed by the local authority. In making our assessment, we will review a sample of decisions and consultation processes.

Module 8 – document presentation

- 6.50 This module focuses on the legislative compliance of the LTCCP Statement of Proposal document, which is the document that the public sees. The module focuses on the information that the Act requires in an LTCCP, and the logical links that should be made between elements of the contents of the LTCCP to enhance the readability of the document.
- 6.51 We expect local authorities to have specific quality assurance checks to confirm the compliance of the Statement of Proposal, the Statement of Proposal

summary,⁶ and the adopted LTCCP, and to be confident with the presentation requirements.

Module 9 – financial prudence

- 6.52 The focus of this module is on evaluating local authorities' financial strategy and assessing whether that strategy, as presented in the LTCCP Statement of Proposal, is financially prudent and transparent. The module also focuses on the financial management principles and requirements that are set out in sections 100 and 101 of the Act.
- 6.53 Financial strategy is an important element of the articulation of the “right debate” (see paragraph 6.60). For consultation processes to be effective, it is important that the reader of the LTCCP Statement of Proposal is able to understand the strategy being used by the local authority. The reader should not need expertise in the analysis of financial statements to understand the strategy.
- 6.54 Although there is an inherent complexity in developing and applying a financial strategy, at the broadest level, we would expect a local authority to be able to articulate its strategy in terms of the following questions:
- What position do we want the local authority to be in at the end of the LTCCP period?
 - Why do we want the local authority to look like this in the future?
- 6.55 It is also important that a local authority is clear about its financial strategy – *who pays what, when, and why?*
- 6.56 Our focus in working through this module is on developing an understanding of local authorities' answers to these questions. We will evaluate whether the local authorities' strategies are prudent and presented in a transparent way to the readers of the LTCCP. It is not the auditor's role to “second guess” a local authority's policy decisions. Our focus will be on assessing the effects of a local authority's policies with respect to financial prudence.
- 6.57 Local authorities have been encouraged since the 2006-16 LTCCP round to articulate their financial strategy more clearly. We urge local authorities to consider how they will express their strategy as they develop their LTCCPs.

Module 10 – the right debate

- 6.58 The role of the LTCCP Statement of Proposal, and the Statement of Proposal summary in particular, is to support and foster the occurrence of the “right debate” in the community. For this “debate” to occur, and for it to be focused on the “right” issues, the LTCCP Statement of Proposal document must provide the community with enough balanced information about the **strategic and other key issues, choices, and implications** facing them. This will allow the community to

⁶ Section 89(a) of the Act requires local authorities to prepare a summary of the Statement of Proposal.

effectively evaluate the issues and therefore participate in the decision-making process led by their local authority.

- 6.59 Section 89(a) of the Act requires the Statement of Proposal summary to be a “fair representation of the **major matters** in the statement of proposal”. It has a pivotal role in ensuring that the right debate occurs, as it is the primary consultation document for the community. Therefore, it is essential that the summary is not only a fair reflection of the overall content of the LTCCP Statement of Proposal document, but also that it makes the **strategic and other key issues, choices, and implications** reflected in the LTCCP Statement of Proposal accessible to the community.
- 6.60 Our focus will be on assessing whether the:
- LTCCP Statement of Proposal and Statement of Proposal summary documents achieve an appropriate standard of readability and clarity for a moderately informed reader; and
 - issues that the local authority has focused on and presented in the Statement of Proposal are complete – have the LTCCP Statement of Proposal and the Statement of Proposal summary addressed the strategic and other key issues and choices that the community needs or wants to address, and have the implications of options been fully disclosed?

Audit timelines

- 6.61 The LTCCP draws together plans, policies, decisions, and information from throughout the organisation and its community. The LTCCP has complex and interrelated information needs. We recognise that local authorities will be preparing their LTCCP over an extended period.
- 6.62 We are aware that many local authorities and auditors want to have an “auditing as you go” approach. This is consistent with the approach in the audit methodology, which places considerable emphasis on planning the approach to, and audit of, the 2009-19 LTCCP.
- 6.63 The “auditing as you go” approach depends on good project management and good communication between a local authority and its auditor.
- 6.64 The broad phases of the 2009-19 LTCCP audit are shown in Figure 6.2.

Figure 6.2
Phases of the 2009-19 LTCCP audit

Period to 31 July 2008	<p>Formal arrangements and fees set in place</p> <p>Planning the audit, including considering the results from the self-assessment done by local authorities</p>
October 2008 to February 2009	Interim auditing fieldwork – “auditing as you go”
February 2009 to June 2009	<p>Completing auditing fieldwork on the LTCCP Statement of Proposal document</p> <p>Office of the Auditor-General-based review of all proposed opinions for consistency</p> <p>Final auditing fieldwork on the final LTCCP to be adopted after local authorities’ public consultation processes</p> <p>Delivery of opinions to local authorities</p>

Part 7

Transition to New Zealand equivalents to International Financial Reporting Standards

- 7.1 In this Part, we:
- comment on our increasing unease with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) for the public sector; and
 - report on the local government sector's experience with preparing annual financial statements in accordance with NZ IFRS for the first time in 2007.

Summary

- 7.2 We are becoming increasingly concerned about the credibility of NZ IFRS for the public sector. If appropriate and sensible changes are not made to NZ IFRS in the future, there is an increasing risk that the resulting set of standards will not be of high quality, nor ultimately “fit for purpose” for the public sector.
- 7.3 We have raised our concerns with the chairman of the Accounting Standards Review Board (ASRB) because we consider that continuing with the current approach is not in the best interests of the public sector. We consider that the ASRB understands the nature of our concerns and that the ASRB is trying to address the causes of the underlying problems within the current standard-setting environment.
- 7.4 The transition to NZ IFRS has been a significant challenge for the local government sector. Many local authorities coped extremely well with these challenges, while other local authorities have struggled. One result of this has been a significant increase in the number of local authorities that did not adopt their annual report within the statutory deadline.
- 7.5 The transition to NZ IFRS has also come at significant cost to the sector, particularly in terms of staff time. It remains to be seen whether the benefits of NZ IFRS will justify these additional costs.
- 7.6 Because of the variety of assets, liabilities, revenues, and expenses of local authorities and their controlled organisations, there were many different adjustments made in the transition to NZ IFRS.

Background

- 7.7 In December 2002, the ASRB announced its decision that New Zealand entities producing general-purpose financial statements would be required to apply new standards based on International Financial Reporting Standards (IFRS) for reporting periods beginning on or after 1 January 2007. Entities were given the option to apply the new standards from reporting periods beginning on or after 1 January 2005.

- 7.8 Nearly all local authorities and many of their subsidiaries and associated entities adopted these standards for their financial statements for the year ended 30 June 2007. To prepare their first NZ IFRS-compliant financial statements, local authorities had to establish an opening balance sheet as at 1 July 2005 and restate the figures for the year ended 30 June 2006 in keeping with NZ IFRS.

Increasing unease with NZ IFRS for the public sector

- 7.9 In our view, irrespective of the approach to setting financial reporting standards, an overriding objective of standard setting should be to set high quality standards that meet the needs of people using the financial statements of those entities that apply the standards.
- 7.10 The decision toward the end of 2002 to base New Zealand financial reporting standards on IFRS (which are written to be applied by large profit-oriented entities) was made with the acknowledgement that the needs of the public sector are different to the private sector. They would therefore, in some circumstances, require different treatment. In our view, NZ IFRS will result in high quality standards for the public sector only if they are seen to:
- specifically consider public sector issues and the needs of people using public sector financial statements;
 - incorporate appropriate changes to IFRS so that the public sector is able to sensibly apply them; and
 - incorporate appropriate guidance to assist the public sector to apply the standards.
- 7.11 We are becoming increasingly concerned about the credibility of NZ IFRS for the public sector. We consider that the three factors listed above are not happening in all instances. If appropriate and sensible changes are not made in the future, there is an increasing risk that the resulting set of standards will not be of high quality, nor ultimately “fit for purpose” for the public sector.

Concerns that public sector issues are inadequately addressed

- 7.12 We acknowledge that NZ IFRS provides a more complete set of standards than the standards previously applied. For example, under the previous standards there was no recognition and measurement standard dealing with financial instruments. NZ IFRS includes such a standard.
- 7.13 However, issues raised by public sector constituents about proposed standards do not always appear to be appropriately addressed. At the extreme, not appropriately addressing concerns can have serious implications for the usefulness of financial statements.

- 7.14 For example, widespread concerns were raised throughout the public sector about a requirement to capitalise borrowing costs to certain assets and its implication for depreciated replacement cost valuations of assets, which are common in the public sector, particularly in local government. No changes were made to the standards or guidance issued as a result of the concerns raised. We fear that the reliability of valuations will be seriously impaired as a result of the requirement to capitalise borrowing costs to certain assets. The scope of some audits may be limited, thereby affecting the nature of the audit reports issued. We also have reservations that the costs and benefits of compulsory capitalisation have not been adequately assessed.
- 7.15 Also, some types of non-commercial transactions, which are common in the public sector, do not appear to have been addressed in the development of some standards. Examples include:
- making “loans” to non-related entities, with no interest and/or no fixed repayment terms or flexible interest options and/or flexible repayment terms; and
 - providing funds documented as a loan, but otherwise exhibiting the characteristics of equity.
- 7.16 There have been very few disclosure changes made to NZ IFRS, meaning public sector entities are required to provide the same disclosures as large profit-oriented entities. People throughout the public sector have commented that NZ IFRS requires voluminous disclosures, many with questionable relevance to people using the financial statements of public sector entities. In some cases, NZ IFRS do not require disclosures that may be considered more relevant to those users. Once again, we have concerns that the costs and benefits of NZ IFRS disclosures may not have been adequately assessed for the public sector.
- 7.17 One of the important implications of standards that do not fully respond to the needs of the public sector is the increasing scope for different interpretations of the requirements in the standards. We are already seeing many cases where the requirements within NZ IFRS are interpreted differently. We are likely to need to produce significantly more interpretations of the requirements than we needed to under the previous standards. Our strong preference is for the standards to be clear so that public sector entities and their auditors consistently interpret the requirements — without us needing to issue numerous interpretations.
- 7.18 We have concerns with the manner in which standards are currently being developed, and in particular the criteria being applied to when changes are made to IFRS for public benefit entities. However, we are also becoming increasingly uneasy about the appropriateness of NZ IFRS for the public sector in the future.

- 7.19 We are aware of developments in international standard-setting that have us questioning the appropriateness of IFRS as the basis for public sector financial reporting standards in the longer term. The conceptual framework within which IFRS are set is undergoing revision (which could take five years), and early indications are that the revised framework will be heavily focused on cash flows and the information needs of investors, financiers, and creditors typically found in the private sector. Such a framework would be quite inappropriate for most of the public sector. In our view, it is going to become increasingly difficult to try and accommodate the public sector within such a regime.
- 7.20 Also, other big international projects to look at financial reporting in areas such as business combinations and liabilities have the potential to significantly change financial reporting in the public sector. Without adequately considering the needs of people using the financial statements prepared for public sector entities (and, as a consequence, appropriate changes to NZ IFRS for public benefit entities), the resulting standards will, in our view, undermine the quality of reporting by the public sector.

Concern that institutional arrangements may no longer be appropriate

- 7.21 We have now begun to question whether the right institutional arrangements are in place in New Zealand for setting financial reporting standards. Here, the decision was made to adopt IFRS for profit-oriented entities. Few if any changes have been made to IFRS so that profit-oriented entities in New Zealand can assert compliance with IFRS. In this respect, New Zealand has become a “standard taker”.
- 7.22 The International Accounting Standards Board is responsible for writing IFRS. New Zealand can therefore be only an influencer at best of standards for profit-oriented entities. However, the ASRB acknowledged in 2004 that, for most public sector entities, which are not profit-oriented, it would be necessary in the case of some IFRS to make changes to measurement and recognition requirements and to add disclosure requirements and/or give disclosure concessions so that those entities could apply the standards.¹
- 7.23 Given that acknowledgement, it seems that New Zealand is now only really “setting standards” for entities other than profit-oriented entities (that is, most of the public sector and other not-for-profit entities such as charities). Appropriate standards are needed for these entities, even though IFRS provides a base for those standards. Given this reality, the institutional arrangements that have been in place for many years in New Zealand, including the composition of the standard-setting board, need to be reviewed.

¹ Refer to ASRB Release 8 entitled *The Role of the Accounting Standards Review Board and the Nature of Approved Financial Reporting Standards* issued in May 2004.

Where to from here?

- 7.24 We have begun to voice our concerns publicly, and we have raised our concerns with the chairman of the ASRB because we consider that continuing with the current approach is not in the best interests of the public sector. We consider that the ASRB understands the nature of our concerns and that the ASRB is trying to address the causes of the underlying problems within the current standard-setting environment.
- 7.25 If real changes are not made to the current process soon, New Zealand will need to seriously consider moving to separate financial reporting standards for public benefit entities that better meet the needs of people using those entities' financial statements.

Local government experience with NZ IFRS financial statements

- 7.26 The transition to NZ IFRS has been a significant challenge for local authorities and council-controlled organisations. Finance teams have had to become familiar with the complex requirements of the NZ IFRS standards, to restate under NZ IFRS their financial information as at 1 July 2005 and 30 June 2006, and to meet the full NZ IFRS disclosure requirements in the 30 June 2007 annual report.
- 7.27 Many local authorities coped extremely well with these challenges, while other local authorities have struggled. As discussed elsewhere in this report, one consequence has been a significant increase in the number of local authorities that did not adopt their annual report within the statutory deadline. The late adoption of an annual report means that communities do not have timely information on the performance of their local authority. In a number of instances, the 2006/07 annual reports were not yet available to communities that were being consulted about the 2008/09 draft annual plan.
- 7.28 Although a small number of local authorities received qualifications in the audit report on their financial statements, they were not about issues arising from the adoption of NZ IFRS. This indicates that those local authorities that have completed their annual reports have managed to cope with the NZ IFRS requirements.
- 7.29 However, the transition to NZ IFRS has come at significant cost to the sector. The most significant cost has been for the time of local authority finance personnel, but there have also been significant external costs, mainly from consultants advising on NZ IFRS transition issues. There have also been additional audit fees incurred in the audit of the restated NZ IFRS-compliant figures for 1 July 2005 and

30 June 2006, as well as the additional NZ IFRS requirements in the 30 June 2007 financial statements. It remains to be seen whether the benefits of the transition to NZ IFRS will justify these additional costs.

- 7.30 One benefit of NZ IFRS may be increased consistency and comparability of the financial reporting by local authorities. The adoption of NZ IFRS has reduced the options that local authorities had in their accounting policies in areas such as financial instruments, investment properties, and forestry. In theory, this should lead to more consistent reporting. However, the complexity of the financial instruments standards, in particular, and the lack of guidance on how these standards should be applied to non-commercial instruments, increases the risk that the requirements might be interpreted differently.
- 7.31 Local authorities' first annual financial statements under NZ IFRS are significantly larger, in terms of the number of pages, than those before NZ IFRS. In part, this is a year one issue, with lengthy reconciliations and disclosures required to explain the transition. However, the disclosure requirements of NZ IFRS generally are significantly greater than under the previous financial reporting regime. It remains to be seen whether the readers of the annual reports will find this additional disclosure useful or even understandable.

What were the most common adjustments arising on transition to NZ IFRS?

- 7.32 Because of the variety of assets, liabilities, revenues, and expenses of local authorities and their controlled organisations, there were many different adjustments made in the transition to NZ IFRS. In the main, the adjustments that arose were consistent with our expectations of likely adjustments that we have reported in previous years.
- 7.33 We have summarised the more common NZ IFRS transition adjustments that arose for local authorities for the statement of financial position, the statement of financial performance, and the statement of cash flows.
- 7.34 The more common NZ IFRS transition adjustments in the statement of financial position were:
- reclassifying computer software from property, plant, and equipment to intangible assets;
 - taking the transitional option to use a fair value determined in a previous period as deemed cost for selected property, plant and equipment;
 - recognising derivative financial instruments (such as interest rate swaps and forward foreign exchange contracts) in the statement of financial position at fair value;

- recognising an employee entitlement liability for accumulating sick leave;
- writing down loans at less than a commercial interest rate to reflect their initial fair value;
- reclassifications between investments and cash and cash equivalents to meet NZ IFRS definitions;
- adjusting investment property carrying values to fair value from the previous requirement of net current value (by adding back anticipated costs of disposal);
- recalculating deferred tax balances in accordance with NZ IFRS requirements (for those council groups that include tax-paying entities);
- adjusting carrying values of equity investments to reflect NZ IFRS measurement requirements;
- recognising liabilities for financial guarantees provided by local authorities (particularly for not-for-profit organisations); and
- reclassifying assets classified as held-for-sale back into property, plant and equipment, where lengthy public sector disposal processes do not meet NZ IFRS criteria.

7.35 The more common NZ IFRS transition adjustments in the statement of financial performance were:

- accounting for the movements in the fair value of derivative financial instruments (which are now on balance sheet);
- accounting for the movements in the fair value of investment property (which could previously be transferred directly to equity);
- accounting for interest income now recognised on low or no interest loans (as the initial fair value write down is unwound and the loan written back up to face value by repayment date);
- accounting for movements in fair value of forestry assets (which previously were either deferred in equity or not recognised if accounting was based on cost);
- accounting for movements in sick leave liabilities; and
- accounting for movements in fair value of other financial instruments.

7.36 The more common NZ IFRS transition adjustments in the statement of cash flows were:

- reclassifications between investments and cash and cash equivalents to tie in with NZ IFRS criteria; and
- separating out the purchase of intangible assets (primarily computer software) from the purchase of property, plant and equipment.

- 7.37 As well as these adjustments, the NZ IFRS requirements resulted in some changed line items being presented on the face of the primary financial statements, or revised descriptors being used for certain line items.
- 7.38 To help the sector with the challenges of preparing the first NZ IFRS-compliant annual report, we produced model sets of NZ IFRS-compliant financial statements specifically for local authorities and for council-controlled organisations. Many local authorities followed the model, or elements of it, in preparing their NZ IFRS financial statements.
- 7.39 To continue to support the sector to meet its financial reporting obligations under NZ IFRS, we will revise these model financial statements when there are significant changes to the NZ IFRS reporting requirements.

Part 8

Non-standard audit reports issued in 2007

8.1 In this Part, we report on the non-standard audit reports issued during the 2007 calendar year on the annual financial statements of entities within the local government portfolio of audits.¹

Why are we reporting this information?

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

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

What is a non-standard audit report?

8.4 A non-standard audit report² is one that contains:

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

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

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

8.6 There are three types of qualified opinions:

- an "adverse" opinion (see paragraph 8.10);
- a "disclaimer of opinion" (see paragraph 8.14); and
- an "except-for" opinion (see paragraph 8.17).

8.7 The auditor will include an **explanatory paragraph** (see paragraph 8.21) in the audit report to emphasise a matter such as:

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

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

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

8.8 Auditors are required to ensure that an explanatory paragraph is included in the audit report in such a way that it cannot be mistaken for a qualified opinion.

8.9 Figure 8.1 outlines the decisions to be made when considering the appropriate form of audit report.

Adverse opinions

8.10 An adverse opinion is expressed when the auditor and the entity disagree about the treatment or disclosure of a matter in the financial statements and, in the auditor's judgement, the treatment or disclosure is so material or pervasive that the report is seriously misleading.

8.11 An adverse opinion is the most serious type of non-standard audit report.

8.12 During 2007, adverse opinions were expressed for seven entities. Where an entity is directly or indirectly controlled by one or more city or district councils, we have listed them in brackets:

- Pukaki Trust;
- Hawke's Bay Cultural Trust (Hastings District Council and Napier City Council);
- Far North Regional Museum Trust (Far North District Council);
- The Museum of Transport and Technology Board;
- The Canterbury Museum Trust Board (Christchurch City Council);
- Otago Museum Trust Board (Dunedin City Council); and
- Nelson Creek Recreation Reserve Board.

8.13 Details of the adverse opinions are set out in the Appendix.

Disclaimers of opinion

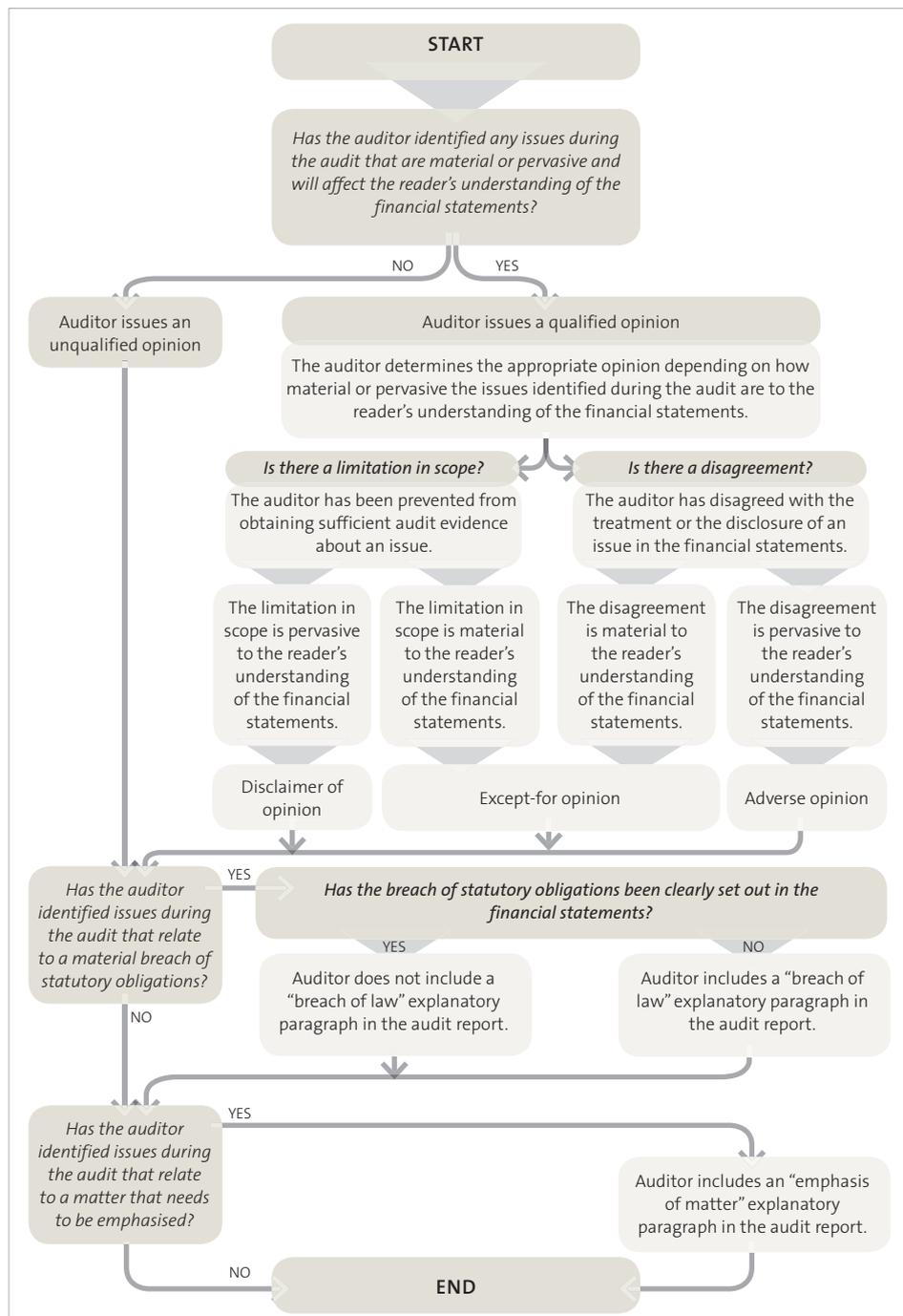
8.14 A disclaimer of opinion is expressed when the scope of an auditor's examination is limited, and the possible effect of that limitation is so material or pervasive that the auditor has not been able to obtain enough evidence to support an opinion on the financial statements. The auditor is accordingly unable to express an opinion on the financial statements or on part of it.

8.15 During 2007, disclaimers of opinion were expressed for the following entities, which are indirectly controlled by Invercargill City Council:

- Bendigo Construction Limited; and
- Bond Contracts Limited and Group.

8.16 Details of the disclaimers of opinion are set out in the Appendix.

Figure 8.1
Deciding on the appropriate form of audit report



Except-for opinions

- 8.17 An except-for opinion is expressed when the auditor reaches one or both of the following conclusions:
- The possible effect of a limitation in the scope of the auditor’s examination is (or may be) material, but is not significant enough to require a disclaimer of opinion. The opinion is qualified by using the words “except for the effects of any adjustments that might have been found necessary” had the limitation not affected the evidence available to the auditor.
 - The effect of the treatment or disclosure of a matter with which the auditor disagrees is (or may be) material, but is not significant enough to require an adverse opinion. The opinion is qualified by using the words “except for the effects of” the matter giving rise to the disagreement.
- 8.18 An except-for opinion can be expressed when the auditor concludes that a breach of statutory obligations has occurred and that the breach is material to the reader’s understanding of the financial statements. An example of this is where a local authority subsidiary has breached the requirements of the Local Government Act 2002 because it has not prepared a Statement of Intent. The subsidiary is therefore unable to prepare performance information that reflects its achievements measured against performance targets.
- 8.19 During 2007, except-for opinions were expressed for 22 entities. Where an entity is directly or indirectly controlled by one or more regional, city, or district councils, we have listed them in brackets:
- Upper Hutt City Council and Group;
 - Invercargill City Holdings Limited and Group (Invercargill City Council);
 - Inframax Construction Limited (Waitomo District Council);
 - Tasman Bays Heritage Trust Incorporated (Nelson City Council and Tasman District Council);
 - Aurora Energy Limited (Dunedin City Council);
 - Buller Health Trust (Buller District Council);
 - Cranberries New Zealand Limited;
 - Tiromoana Station Limited (Christchurch City Council);
 - Sister Cities New Zealand Incorporated (Hastings District Council);
 - Tourism Dunedin Trust (Dunedin City Council);
 - Tramway Reserve Trust (Selwyn District Council);
 - Westland Holdings Limited and Group (Westland District Council);
 - Marlborough Airport Limited (Marlborough District Council);

- Varroa Agency Incorporated (Environment Canterbury);
- Pemberton Construction Limited (Waikato District Council);
- Auckland Regional Transport Network Limited and Group (Auckland City Council);
- ARTNL Harbour Berths Limited (Auckland City Council);
- ARTNL Metro Limited (Auckland City Council);
- ARTNL Britomart Limited (Auckland City Council);
- East Otago Community Sports and Cultural Centre Trust (Dunedin City Council);
- Carparking Joint Venture (Christchurch City Council); and
- Village Pool Charitable Trust (Hastings District Council).

8.20 Details of the except-for opinions are set out in the Appendix.

Explanatory paragraphs

- 8.21 In certain circumstances, it may be appropriate for the auditor to include additional comments in the audit report. Through an explanatory paragraph the auditor emphasises a matter that they consider relevant to a reader's proper understanding of an entity's financial statements.
- 8.22 For example, an explanatory paragraph could draw attention to an entity having breached its statutory obligations for matters that may affect or influence a reader's understanding of the entity. In this situation, the audit report would normally draw attention to the breach only if the entity had not clearly disclosed the breach in its financial statements.
- 8.23 During 2007, explanatory paragraphs were included in the audit reports for 21 entities. Where an entity is directly or indirectly controlled by one or more regional, city, or district councils, we have listed them in brackets:
- New Zealand Mutual Liability Riskpool;
 - Whisper Tech Limited;
 - Whisper Tech Joint Venture;
 - Far North Holdings Limited and Group (Far North District Council);
 - Advance Whangarei Limited (Whangarei District Council);
 - Far North Developments Limited (Far North District Council);
 - ARRB Road Info Limited (New Plymouth District Council and South Taranaki District Council);
 - Wellington Regional Economic Development Trust (Wellington City Council, Hutt City Council, and Porirua City Council);

- America's Cup Village Limited and Group (Auckland Regional Council);
- Ngā Tapuwae Community Facilities Trust (Manukau City Council);
- Papatoetoe Licensing Trust;
- Invercargill Licensing Trust Sports Foundation;
- Invercargill Licensing Trust – Charitable Trust;
- Whakatane District Council Sinking Fund Commissioner (Whakatane District Council);
- Whakatane Airport Authority (Whakatane District Council);
- Hawke's Bay Tourism Trust (Hawke's Bay Regional Council, Hastings District Council, and Napier City Council);
- Hawke's Bay Economic Development Agency (Hawke's Bay Regional Council, Hastings District Council, and Napier City Council);
- Buller Health Trust (Buller District Council);
- Waikato Quarries Limited (Waikato District Council);
- Port Westland Limited (Grey District Council); and
- Tuam Limited (Christchurch City Council);

8.24 The reasons for the explanatory paragraphs are set out in the Appendix.

Part 9

Non-profit council-controlled organisations

- 9.1 In this Part, we comment on issues and developments for non-profit council-controlled organisations (CCOs) for the year ended 30 June 2007, including:
- reporting on performance; and
 - the number of CCOs that local authorities have exempted from the accountability requirements in the Local Government Act 2002 (the Act).

Background

- 9.2 Most non-profit CCOs are now meeting the SOI-related and broader accountability requirements expected by the Act.
- 9.3 However, a small but persistent number of CCOs are not adequately addressing their accountability obligations. For non-profit CCOs, there is the possibility, under section 7 of the Act, that they could be exempted from these requirements. It appears some local authorities are yet to fully address this matter.
- 9.4 The non-profit CCO sector includes entities associated with local authorities that deliver services on behalf of, or in partnership with, local authorities. The services include activities such as museums, libraries, swimming pools, and other community facilities such as theatres, sports grounds, and events centres. Many of the activities are regarded as charitable and are delivered by charitable trusts.
- 9.5 Non-profit CCOs have been subject to the accountability requirements of the Act since 1 July 2003. Before that, only local authority trading enterprises were subject to the accountability requirements.
- 9.6 The Auditor-General is currently the auditor of 91 non-profit CCOs. The Auditor-General also audits 118 council-controlled trading organisations and another 84 organisations that are related to local authorities but are not CCOs, including entities that have been exempted from being CCOs under section 7 of the Act.¹

Reporting on performance of council-controlled organisations

- 9.7 The Act's accountability requirements are generally more complex than those that apply to the non-profit entities under their trust deeds or rules.
- 9.8 An important part of the accountability framework for CCOs in the Act is the requirement to prepare an SOI at the start of the reporting period. The SOI should set out the CCO's planned objectives and activities for the next three years, and set the performance targets that the CCO must report against in its annual report. Local authorities have the opportunity to influence the direction of their CCOs

¹ Local authority trading enterprises were created by the Act's predecessor and are broadly equivalent to for-profit CCOs, called council-controlled trading organisations under the Act.

by commenting on draft SOIs. If a CCO has subsidiaries, it must prepare an SOI covering the whole group.

- 9.9 A CCO's annual report must include:
- a comparison of the performance of the CCO against measures and targets in the SOI; and
 - an explanation of any material variances between that performance and the SOI.
- 9.10 As well as auditing the financial statements of a CCO, we are required to report on the performance targets and other measures by which performance was judged against the entity's objectives. In other words, the audit opinion must cover the entity's report on its performance, measured against its SOI (performance information).
- 9.11 These requirements have applied to non-profit CCOs since the period starting 1 July 2004.² We have monitored compliance with these requirements for the last three years.
- 9.12 In 2007, we published a report of our performance audit on compliance with SOI requirements. The report examined compliance by 54 public entities in producing, and later reporting against, their SOIs. Our examination included CCOs and council-controlled trading organisations. We found broad compliance with legislative requirements by the public entities that we looked at, but were disappointed with the quality of performance targets used by some of those entities to measure their performance and later report on that performance.
- 9.13 Although most CCOs now have SOIs in place and report against them, seven (nearly 8% of the non-profit CCO sector) did not meet this important accountability requirement.³ For the years ended 30 June 2005, 30 June 2006, and 30 June 2007, we issued qualified audit opinions for several CCOs for failing to include performance information in their annual reports. They failed to do this because they did not have an SOI in place to report against. We were particularly concerned where CCOs did not have an SOI in place for the following period either. It is disappointing to note that, in some instances, a CCO has received a non-standard audit report for the same reason in consecutive years.
- 9.14 In some cases, the CCOs were inactive (for example, they were name protection companies). Although there may be little point in such entities producing an SOI, the requirement applies unless the local authority has exempted the CCO. We were surprised that local authorities had not more actively used the power in section 7 of the Act to exempt small non-profit CCOs from the accountability regime.

² Non-profit CCOs were not required to have an SOI in place for the period starting 1 July 2003.

³ See Part 8 for a complete description of the non-standard audit opinions issued. In addition to these seven non-profit CCOs, another 12 entities required to have an SOI had not completed an SOI as required.

- 9.15 We did not qualify the audit report of inactive CCOs (such as name protection companies or dormant companies that did not do anything during the year),⁴ provided the entity had disclosed the breach of law in its financial statements.

Exempted organisations

- 9.16 Section 7 of the Act provides for entities to be exempted from the requirements for CCOs. There are two ways in which a CCO may be exempted:
- The Governor-General, on a recommendation from the Minister of Local Government, can exempt a CCO that is already subject to appropriate accountability under an Act other than the Local Government Act 2002. The Minister must be satisfied that the entity's accountability under the other Act is of a similar nature and effect to that required under the Local Government Act 2002.⁵
 - A local authority can exempt small non-profit CCOs under section 7(3). The Act does not define "small", but a local authority cannot exempt a council-controlled trading organisation. When exempting a non-profit CCO, the local authority must consider the nature and scope of the activities provided by the CCO, and the costs and benefits of an exemption to the local authority, the CCO, and the community.
- 9.17 A local authority may revoke an exemption at any time. It must review any exemption within three years of granting it and then review the exemption at least every three years.
- 9.18 The power for local authorities to exempt small CCOs from the requirements was included in the Act to address concerns raised about compliance costs for small non-profit entities. Once exempted, an entity is no longer a CCO (for the period of the exemption) and is not subject to any of the accountability requirements of the Act.
- 9.19 An exemption under the Act does not affect accountability requirements in other legislation, such as the Incorporated Societies Act 1908 or the Charities Act 2005, or provisions in an entity's own trust deed or rules.
- 9.20 Several local authorities have inactive companies that meet the definition of a CCO. Examples of "inactive" companies are companies formed for name protection purposes or companies that used to carry out trading activities but are retained for tax or other reasons.
- 9.21 Where a former trading company is inactive, it is unlikely to be a council-controlled trading organisation and can therefore qualify for exemption by the local authority under section 7(3) of the Act.

⁴ See Part 8 for an explanation of a qualified opinion.

⁵ The Otago Museum Trust Board, the Canterbury Museum Trust Board, and the Museum of Transport and Technology Trust Board have been exempted by this procedure.

- 9.22 We reported last year⁶ on the extent to which local authorities had used the exemption power in section 7(3) since the enactment of the Act. We found:
- As at 30 June 2006, local authorities had exempted 74 entities under section 7(3).
 - Thirty-two of the 85 local authorities had used the exemption power.
 - The exempt entities were a mixture of small trusts and inactive companies – for example, companies formed for name protection purposes.
 - Forty-four trusts, 25 companies, and five other entities had been exempted.
 - City councils tended to have the most CCOs and had therefore made the greatest use of the exemption power, with Auckland City Council and Manukau City Council exempting 10 and nine entities respectively.
- 9.23 As part of the audit for the year ended 30 June 2007, we asked our appointed auditors for local authorities to advise us of any exemptions made or renewed in the period 1 July 2006 to 30 June 2007:
- As at 30 June 2007, local authorities had exempted a further 15 entities under section 7(3) and renewed a number of earlier exemptions.
 - As previously, the exempt entities were a mixture of small trusts and inactive companies.
 - Although some local authorities had renewed exemptions previously made, others appeared to be overdue for renewal.
- 9.24 Thirty-two local authorities have seen clear advantages in exempting a total of 89 entities. It is relevant that local authorities further review the rationale for exemption – especially for those non-profit CCOs where they are currently breaching the law but for which the full CCO provisions of the Act may be unwarranted.

Conclusion

- 9.25 We have commented in previous reports that local authorities and CCOs appeared to be slow to learn and meet the accountability requirements in the Act. We are pleased to note that, in the last couple of years, local authorities have been making use of the exemption power in section 7 of the Act to reduce compliance costs for small non-profit entities.
- 9.26 However, there are still a number of non-profit CCOs that may benefit from their related authority considering exemption from the Act's CCO requirements. Local authorities are urged to consider this matter, particularly where it may limit the level of administrative burden on a small non-profit CCO.

⁶ *Local government: Results of the 2005-06 audits* (June 2007), Wellington, page 25.

- 9.27 Most CCOs are now meeting the accountability requirements in the Act in terms of producing an SOI and reporting against it. We are less satisfied with the quality of the performance measures in the SOIs.
- 9.28 We are currently reviewing our audit approach to non-financial performance reporting in response to statutory changes in recent years (such as the Local Government Act 2002). For now, we are focusing on entities that report against outcome and output information (such as local authorities). When this work is complete, we will look at the reporting of performance for entities that assess performance against the achievement of corporate objectives (such as council-controlled organisations).

Part 10

Local authorities' exposure to liabilities from leaky home claims

- 10.1 The local government sector's exposure to liabilities from leaky home claims remains a significant issue. Early in 2007, there was widespread media coverage of the judgment in a leaky home case involving Waitakere City Council (the Dicks case).¹
- 10.2 To date, there are six local authorities that have been the most significantly affected by the leaky homes' issue (see paragraph 10.5). Liabilities amounting to \$117,153,000 have been included in the 2006/07 financial statements of these local authorities. These liabilities cover finalised claims, and claims that have been notified but not yet confirmed.² The methods of quantifying the unconfirmed claims vary between each local authority.
- 10.3 In addition, \$243,700,000 has been disclosed as contingent liabilities. This amount is made up of claims in the early stages of investigation where the amount and liable parties are yet to be confirmed (three local authorities), and the estimated future claims for one local authority. The estimate of future claims is not the complete future liability, as the five other significantly affected local authorities have not quantified an estimate for claims yet to be made. The extent of the liability recognised by these local authorities is already significant. The full extent of the liability to the local government sector is potentially substantially greater.

Background

- 10.4 In response to the publicity surrounding the Dicks case, we considered the annual reporting requirements on local authorities. Therefore, we issued a guidance paper to our auditors to help them with assessing and appropriately recording leaky home liabilities for each stage of the claims process. The principles included in our guidance paper were passed on to local authorities by their appointed auditor.
- 10.5 The leaky homes' issue has significantly affected the following six local authorities:
- Auckland City Council;
 - Christchurch City Council;
 - North Shore City Council;

1 In December 2006, the High Court found Waitakere City Council (the Council) liable to pay a homeowner damages for a leaky home. In *Dicks v Hobson Swan Construction Limited (in liquidation) & Ors (2006) 7 NZCPR 881*, the homeowner was awarded damages from the construction company, the builder, and the Council. The liability was allocated at 80% for the builder and construction company, and 20% for the Council. The construction company was in liquidation so the Council faced a higher liability. The Council was found to have breached its duty to exercise reasonable care and skill to ensure that the building work complied with the building code. In this case, the Council was required to have in place a system of inspections that checked for the presence of seals, and the Council should have made more inspections than it did.

2 Refer to paragraph 10.7 for an explanation of claims categories.

- Rodney District Council;
- Waitakere City Council; and
- Wellington City Council.

10.6 A number of other local authorities have some claims against them but the quantity and value of these claims is much lower. For the purposes of this Part, we reviewed the approach taken by the six local authorities listed above.

Summary of the categories of claims facing local authorities

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

- **category one** – claims notified to local authorities where investigation and review has taken place and the amount of the total claim and the local authority's share has been confirmed;
- **category two** – claims that have been notified to local authorities where investigation and confirmation of validity is still in progress, which includes work to assess the other available parties to share liability and to assess the costs; and
- **category three** – claims that will be made against local authorities between now and the end of the statutory limitation period but that have not yet been lodged, which includes issues that may not yet have been identified by the home owner.

10.8 Categories two and three are of greatest concern to local authorities because of the associated high level of uncertainty. These categories reflect the "tail" of the leaky homes liability issue facing the country.

Review of approach taken by local authorities

10.9 We reviewed the 30 June 2007 annual reports of the six local authorities most significantly affected by the leaky homes' issue. We assessed how well their disclosures were aligned with the guidance we had issued.

10.10 Five out of six of the local authorities included additional disclosure in their 2007 annual reports compared to the previous year. They did so in response to the guidance we had issued. These local authorities also noted that they had carried out additional work during 2006/07 to assess their future exposure to leaky home claims.

- 10.11 All six local authorities were appropriately providing for notified and confirmed claims (category one). This was unchanged from previous years.
- 10.12 The treatment of claims that had been notified but were yet to be investigated and confirmed (category two) continued to vary. However, the extent of disclosure had increased and consequently improved when compared to 2006. In previous years, most of these local authorities accounted for claims that had been notified but not yet confirmed as contingent liabilities. In the current year, most had accounted for an estimate of the future liability for these claims. Some local authorities had made more detailed disclosures or had more robustly quantified the contingent liability. Therefore, the disclosure of category two claims had improved.
- 10.13 However, in many cases it was not completely clear, based on the disclosures included in the annual reports, how local authorities had treated category two. Some of the local authorities appeared to have divided this category into two parts. They accounted for the element where they had obtained a higher degree of certainty as a provision and disclosed the remainder as a contingent liability. None of the disclosures explained the basis that the local authority had used to make such a distinction.
- 10.14 We expected that when an actuarial assessment of future claims was obtained by a local authority to estimate the amount of category two claims, it would provide sufficiently reliable information to bring the liability into the financial statements. In practice, local authorities did not, in all cases, obtain the expected level of reliability from actuarial assessments of this liability. Therefore, the amounts assessed often continued to be disclosed as contingent liabilities based on that uncertainty. However, contingent liabilities for this category were quantified more often than in previous years.
- 10.15 With the claims yet to be made towards the end of the statutory limitation period (category three), none of the local authorities was able to measure this obligation with enough reliability. Therefore, the local authorities could not disclose the liability in their financial statements. It is our understanding that these local authorities have obtained actuarial assessments, but the basis on which the actuarial assessment had been completed did not provide enough reliability to meet the accounting test for recognising a provision within the financial statements.
- 10.16 For future claims, five out of the six local authorities included some disclosure in their annual report acknowledging this issue as a contingent liability. Only one of these five local authorities included an estimated quantification of the liability. The remaining four local authorities acknowledged their exposure to such claims

but stated that they were unable to quantify the extent of exposure at this time. The sixth local authority included disclosure of a significant contingent liability for claims received in writing or claims where investigation was still in progress (category two). However, this local authority did not include any disclosure for claims not yet lodged.

- 10.17 We had hoped that, after obtaining actuarial assessments, local authorities would have a greater level of understanding of the extent of future liability, and that this would enable clearer and more complete disclosure of this issue in their annual reports. It is disappointing that this has not been the case. However, we understand the difficulties facing local authorities in obtaining a reliable assessment of future liability for this complex issue. We are satisfied that, where local authorities have obtained information that is reliable enough to meet the requirements of accounting standards, this is now being reported to the public.

Conclusion

- 10.18 The extent of reporting by local authorities about leaky home liabilities has improved during the past year. The lack of reliability of actuarial assessments remains problematic, and means that it is not possible to fully quantify and disclose the extent of contingent liabilities. Leaky home liabilities remain a significant issue for these local authorities in particular, and for the local government sector as a whole.

Part 11

Local authority communications in an election year

- 11.1 The 2007 local government elections were held on 13 October 2007. We received a number of complaints from ratepayers about expenditure by local authorities on communications before the elections.
- 11.2 The complaints included concerns that:
- local authority resources had been used to promote the electoral prospects of candidates, in print advertising material and at events funded by the local authority;
 - local authority resources had been used to promote the existing policies or proposals that were contested by candidates; and
 - local authority staff had communicated in ways that favoured existing councillors and not in a balanced and neutral way.
- 11.3 The Auditor-General has a role in considering whether local authority resources are used appropriately. He has no role in regulating electoral conduct more generally or the activities of candidates. The electoral officer for each district is responsible for the administration of the elections. Our focus is on the use of local authority funds on communications in the pre-election period.¹
- 11.4 In 2004, we published guidelines on good practice principles for public communications by local authorities.² Our guidelines are not binding on local authorities, but we consulted with the local government sector when preparing the guidelines and got general agreement on their content and relevance.
- 11.5 The guidelines encourage local authorities to adopt their own standards and policies. They apply where:
- the local authority meets the cost of the communication (wholly or in part); and
 - the person making the communication does so in an official capacity on behalf of the local authority or a community board.
- 11.6 The guidelines contain several principles relevant to communications in the pre-election period. They note that it is neither possible nor practicable to stop all communications during the pre-election period, and that routine council business must continue. It can require careful judgement to draw the line between ordinary and appropriate communication, and communication that could be seen as creating an electoral advantage.

¹ By “pre-election period”, we mean the three months before the close of polling day.

² *Good Practice for Managing Public Communications by Local Authorities*, available on our website (www.oag.govt.nz).

- 11.7 The principles discussed in the guidelines as relevant in a pre-election period are that:
- a local authority should not promote, nor be perceived to promote, the re-election prospects of members in a local authority-funded publication;
 - a local authority should exercise care in the use of its resources for communications that are presented in such a way that they raise, or could have the effect of raising, a member's personal profile in the community; and
 - a local authority's communications policy should recognise the risk that communications about members, in their capacities as spokespersons for the authority, during a pre-election period could result in the member achieving an electoral advantage at ratepayers' expense.
- 11.8 The guidelines state that photographs or information that may raise the profile of a member in the electorate should not be used during the pre-election period.
- 11.9 In 2004, we received complaints about the content of a local authority's summary of its annual report that was published and distributed in the period before the 2004 local authority elections. The concerns were that the summary was being used as a council-funded advertising opportunity for members who were standing for re-election. The summary included several photographs of members (about 25% of the content).
- 11.10 We wrote to all local authorities last year, asking that they take particular care with the content of their annual reports and summary annual reports published around the time of the 2007 elections. We were pleased that we did not receive any complaints about the content of the 2007 annual reports or summaries.

Concerns raised before the 2007 elections

- 11.11 In some cases, we referred people who raised concerns with us directly to the local authority concerned. This is in line with our general policy that people should raise concerns directly with the relevant public entity before they seek our intervention. We carried out more detailed work in considering a series of complaints, or complaints from more than one person about the same matter, about the actions of three local authorities. We outline these complaints, and our findings, below.

Using local authority resources to publish an "election supplement" in a community newspaper

- 11.12 A city council had an ongoing partnership agreement with a community centre that published a regular community newspaper. Council staff provided content for the newspaper, assisted with layout, design, and editing, and acted as the contact point for people in the community who submitted stories. The community

newspaper published a four-page “election supplement” with its August 2007 edition.

- 11.13 The August edition, including the election supplement, was produced by a councillor standing for re-election. The supplement included paid advertising by some candidates for the election, and an advertisement from Grey Power, Federated Farmers, and a citizens’ and ratepayers’ association endorsing several regional council candidates standing on a “rates control” platform. It also included unattributed articles about the main issues for the city council and adverse comment about the regional council’s performance in the areas of passenger transport and biosecurity.
- 11.14 Three regional councillors complained about the city council’s resources being used to fund the election supplement. They were concerned that the supplement contained editorial content potentially damaging to the regional council’s reputation through unattributed editorial opinion.
- 11.15 The city council staff were heavily involved in producing the general newspaper, but barely involved in producing the election supplement and not involved in its content. The city council had issued guidelines to all managers setting out a protocol to apply to all staff in the pre-election period. That protocol showed good understanding of the need for staff to maintain, and be seen to maintain, political neutrality. We were told that staff involved in the August edition operated in good faith. They assessed that their activities would be consistent with the guidelines if they limited their involvement to the normal production of the general newspaper.
- 11.16 In our view, this judgement did not give adequate weight to the risk of a perception of involvement in political activity. Outside observers would not see a material difference between the general paper and the election supplement, or be aware of the internal line that had been drawn. To an outside observer, council staff are the contact point for the paper and they collect and edit material for it. The paper included an election supplement that looked as if it had been produced as part of the overall newspaper. The fact that council staff were careful to ensure that they had no effective involvement in the electoral supplement was not visible to the public and therefore did not adequately manage the risk of a perception of political involvement.
- 11.17 This incident has highlighted a particular risk for local authorities when, as part of their ongoing activities, they support a community communication process where they do not control the content. The city council intends to take further steps to manage this risk in future, including more explicit advice to staff involved in such community communication activities.

Using local authority funds for events held close to the date of elections

- 11.18 A person was concerned about local authority funds being used for events held close to the date of elections. The concern raised was that the events would add to the profile of the mayor and existing councillors, and that publicity generated from the events would give them an electoral advantage. The events included opening ceremonies to celebrate the completion of capital projects. The cost of the opening events was around \$25,000.
- 11.19 The local authority explained to us the nature of the projects and the timing of the opening events. The projects were part of ordinary council business and the opening events were timed for their completion, not the local government elections. In each case, the project was slightly behind schedule which meant the opening event was closer to the elections than had been planned. The largest event, associated with the airport refurbishment, was delayed and held after the elections.
- 11.20 The local authority told us that it had formally approved proceeding with the openings even though they had been delayed and were held closer to the elections than planned. We regarded the local authority's approach as reasonable and did not have any concerns.

Councillor columns and use of "mayor's funds"

- 11.21 We received several complaints about the use of local authority resources for written columns by mayors and councillors on council websites. We also received a complaint about council-funded advertising material acknowledging that community projects had been supported or funded by the mayor.
- 11.22 In several instances, we advised the complainants to raise the matter directly with the local authority concerned.
- 11.23 One local authority decided to suspend columns and comments by the mayor and councillors in the pre-election period. This was a prudent approach and was consistent with our guidelines.
- 11.24 We considered that the expenditure of local authority funds on promotional material for a new community facility, and crediting the mayor for support or funding, would have been a breach of our guidelines had it occurred in the pre-election period. However, because the advertising occurred before that period, we asked the local authority to take account of the concern in future communications.

Communications by local authority staff

- 11.25 We received several complaints about communications by staff of local authorities. In some cases, the communications were letters to the editor, where a local authority staff member's comments were perceived as favouring existing councillors or criticising the candidates. We referred these complaints to the local authority's chief executive.
- 11.26 We received several complaints about a chief executive's column in a local newspaper entitled "Results not Hype". The chief executive had commented unfavourably on a rates cap proposal put forward by some candidates for election by saying "be careful what you wish for". The comments also implied support for the current mayor by referring to "respected leadership". The complainants were concerned that the chief executive had entered into the political arena by commenting on statements made by candidates, and this was not the role of a chief executive.
- 11.27 The chief executive's column was published free of charge by a local newspaper, so without the use of local authority resources. The mayor usually used the space provided for a column, but had suspended this during the election campaign to comply with the principles set out in our guidelines.
- 11.28 The column set out some information and comments about proposed rate increases in the currently adopted Long-Term Council Community Plan, in response to comments made by some candidates about capping rate rises.
- 11.29 Although no local authority resources were involved, the chief executive's column was still a formal communication on behalf of the local authority and the principles about neutrality were still relevant.
- 11.30 In assessing the comments in the "Results Not Hype" column, we considered in particular the title of the column, the comments about the rates cap proposal put forward by some candidates, and the "respected leadership" comment. As part of the routine business of local authority communication, we expected that any comment would be balanced and politically neutral.
- 11.31 We advised the chief executive and the complainants that we did not consider the column consistent with the good practice guidelines in three aspects – the title of the column, the comments relating to some candidates' rating policy, and the city's "respected leadership". We considered these aspects, taken individually and collectively, risked being perceived as lacking balance and political neutrality.

Concluding comment

- 11.32 In the local government sector in particular, it is common for people to raise a wide range of concerns with the Auditor-General. We do not have a role in the general conduct of candidates during an election. These are often matters of political debate or are regulated by other organisations.
- 11.33 Our focus is confined to the use of local authority resources, whether financial or staff, in activities that may be seen as supporting one candidate over another.
- 11.34 We have been pleased to observe that the sector generally shows good awareness of the issues and the need for care in the pre-election period. The examples discussed here illustrate that judgements on what is appropriate can be finely balanced, and need to take account of public perception.

Part 12

Local Authorities (Members' Interests) Act 1968

- 12.1 The Local Authorities (Members' Interests) Act 1968 (the Act) contains a number of rules to regulate conflicts of interest that may arise from the personal pecuniary interests of members of local authorities. The Office of the Auditor-General carries out the primary statutory functions under the Act.
- 12.2 We continue to receive a steady stream of requests for guidance about how the Act works, applications for formal approvals and exemptions, and complaints about alleged breaches of the Act.
- 12.3 We have recorded our view many times in recent years that the Act is in need of reform.¹ In 2005, we published a detailed report outlining our views on the difficulties with the Act and options for reform.
- 12.4 Each year we report on matters of interest about the Act.² This year, we discuss how the Act affects candidates for election and the particular difficulties that arose during the 2007 local authority elections. The experience in 2007 highlights that the difficulties with the Act have practical consequences and can have a significant effect on the operation of the local democratic process.
- 12.5 In this Part, we discuss the difficulties that the contracting rule can cause candidates for election (or newly elected members) with contracts that were entered into before their election.

Disqualification of candidates for election

The contracting rule

- 12.6 Under section 3(1) of the Act, a person is disqualified from being a member of a local authority if they are concerned or interested in contracts with the authority where the total of payments made, or to be made, by or on behalf of the authority exceeds \$25,000 in any financial year.
- 12.7 It is an offence for a person to act as a member of the local authority while disqualified under the contracting rule.
- 12.8 The contracting rule can raise issues for sitting members and prospective candidates for election.
- 12.9 We receive many requests for guidance, especially around the time of local elections, about whether a candidate is caught by the contracting rule. We cannot

¹ See *The Local Authorities (Members' Interests) Act 1968: Issues and Options for Reform*, June 2005; *Local Government: Results of the 2001-02 Audits*, parliamentary paper B.29[03b], 2003, part 2.4; and *Second Report for 2000: Local Government Matters*, parliamentary paper B.29[00b], 2000, part 7.

² Our general guidance about the Act is contained in our 2007 publication *Guidance for members of local authorities about the law on conflicts of interest*.

issue a “ruling” about a person’s eligibility for election, but we offer advice where we can.³

Exceptions to the contracting rule

- 12.10 The Act allows the Auditor-General to grant formal prior approval (and, in limited cases, retrospective approval) of a member’s interest in contracts that exceed the statutory limit. This has the effect of suspending the contracting rule for that case. We are frequently asked to exercise this power. It is surprisingly common, especially in small and rural districts, for a local authority to contract a business in which one of its members has an interest. Most of the time we are able to grant the approval sought, because we are satisfied that the contract has been handled in a fair and transparent manner, and that the authority is able to justify its decision.
- 12.11 However, we do not have the power to grant formal approvals for a candidate for election who is not yet a sitting member.⁴ Nor can we grant approval for a contract that was entered into before the person became a member.⁵
- 12.12 Instead, the Act contains some specific exceptions to the contracting rule that can apply to candidates for election.⁶ Contracts that come within these exceptions can be disregarded for the purpose of the contracting rule.
- 12.13 The wording of these exceptions is complicated and difficult to follow. For convenience, we paraphrase them as providing that a candidate for election will not be disqualified if the contract falls within any of the three following categories:
- if the work under the contract has already been performed and the amount to be paid is fixed;
 - if the work is still to be done, but the amount to be paid has been fixed in the contract (subject to amendments and additions allowed for in the contract); or
 - if the work is still to be done and the amount to be paid will not be known until the work is done, but the contract does not exceed 12 months or the person gives up the contract within a month of being elected.
- 12.14 The purpose of exceptions for contracts already in existence is presumably to permit situations where the capacity of the authority to influence future

3 However, our role in administering the Act does include prosecuting persons who we consider have breached the Act.

4 Crown Law has repeatedly advised us that our approval power cannot be used for persons who are not yet members, although this view has been contested by others.

5 One of the preconditions for retrospective approval in section 3(3)(aa) is that prior approval would have been granted had it been sought.

6 Sections 3(3)(f) and 3(3)(g).

payments under a contract is minimal, because the contract is effectively complete, the amount to be paid is fixed, or the contract is of relatively short duration. Therefore, the effect of the exceptions is that a person with an existing contractual relationship with the local authority should not be able to be elected as a member if the amount to be paid under the contract cannot be ascertained at the time of election (unless the contract is for a short term). Uncertainty in a service contract could arise either because the nature or extent of the goods or services to be provided is flexible or open-ended, or because the price for delivering the goods or services remains open to negotiation or other uncertainty.

- 12.15 Although the purpose is reasonably clear, there are difficulties in practice with these exceptions.

The exceptions can be hard to understand and apply

- 12.16 It can often be difficult to decide whether or not the amount to be paid under a contract can be regarded as “fixed”. It can also be hard to decide whether a variable or contingent component can be regarded as an “amendment” or “addition” allowed for in the contract. For example, sometimes the price is specified as a rate for each unit or hour where the number of units or hours is not known with certainty (or the price is a formula where a material factor may vary).⁷ Sometimes the price may be able to be renegotiated or adjusted during the life of the contract. Sometimes a price has both a fixed portion and a variable portion. Sometimes the main portion of the price will be “fixed”, but there is the possibility of contingencies. These sorts of situations can be complicated. The precise terms of the contract will often be critical.
- 12.17 There are other complexities with the exceptions. The long and complex drafting means they are hard to follow.⁸ They also contain ambiguity, with the result that it is not clear to some readers whether there are in fact two or three separate exceptions.⁹
- 12.18 The overall effect of this complexity and ambiguity is that it can be very difficult for potential candidates to know if they would be disqualified under the Act.

The exceptions can lead to harsh consequences for candidates

- 12.19 Sometimes a person will not be able to come within any of the statutory exceptions. This can lead to an overly harsh result, because the circumstances might seem quite acceptable. It may well be that the contracting process was

⁷ Our general view is that, if a contract’s price is specified as a “rate”, the amount to be paid is not “fixed”.

⁸ One sentence comprises 277 words, with 12 commas or semi-colons.

⁹ Our view is that the second of the three exceptions is *not* constrained by the requirements that the contract is to be for fewer than 12 months or be relinquished by the member. But this is not beyond all doubt. Some people have taken the view that those conditions apply to *all* contracts where the work is still to be done.

entirely fair and justifiable, and the equivalent situation would be approved if it arose after the person's election.

- 12.20 This is most often the case where the amount to be paid cannot be determined in advance and the contract is for more than one year. Sometimes the member can resolve the situation, for example, by relinquishing the contract within a month of being elected, or by removing their interest in the contract (such as by selling their shares and relinquishing any directorship). Those can be very significant steps for the individual, and may effectively mean that a person has to give up a business, or terminate a long-standing contract, to be elected.
- 12.21 Other cases may be even more problematic, if for instance:
- the member, while legally interested in the contract, may not have the power to relinquish it;
 - the member may not have relinquished the contract within a month of being elected; or
 - it may be impracticable or prohibitively expensive to one or both parties for the contract to be relinquished.
- 12.22 Because we cannot use our approval power here, there is no flexibility or discretion to deal with such cases. The contracting rule applies strictly to contracts that pre-date the member's election if the statutory exceptions do not apply.
- 12.23 The consequences can be even more unfortunate if the situation is not discovered until after the person has been successfully elected to the local authority. The newly elected member may have to vacate office.

Issues in previous years

- 12.24 In one instance in 2002, a member's disqualification was not discovered until months after the member had been sworn in. There was no scope for us to grant a retrospective approval, and the statutory exceptions did not apply. The member had to vacate office.
- 12.25 We also advised prospective candidates that they may be disqualified from being elected, once in 2003 and once in 2004.

Issues in the 2007 local elections

- 12.26 The contracting rule gave rise to numerous questions for prospective candidates during the 2007 local elections. We dealt with 32 requests for guidance about whether and how the contracting rule applied to candidates for election. Sometimes the candidates themselves contacted us. Sometimes the question was raised by the electoral officer or another official.

- 12.27 In most of these instances, the person was not disqualified. Some situations required detailed and careful consideration of the specific terms of the relevant contract, highlighting the complexity and ambiguity of the relevant legislative provisions. However:
- In one instance, a candidate withdrew from the election after we advised him that we considered he was disqualified from being elected.
 - In three instances, prospective candidates withdrew after preliminary discussions with us.
 - In two instances, candidates took steps to dissociate themselves from companies that were contracting with the local authority, after we had expressed the view that they were disqualified.

- 12.28 Several of the queries did not arise until after the election. In none of those cases was the person disqualified.

Options for the future

- 12.29 In our view, it is significant that in the 2007 local authority elections four people were either prevented or discouraged from participating as candidates, and two more had to rearrange their personal interests to participate. This came as a result of a legislative rule that is poorly drafted and has an unclear rationale. It does little to encourage or strengthen democracy at the local level.
- 12.30 It makes little sense that the Act has harsher consequences for people who have not yet been elected than for people who have already been elected. The risk of preferential treatment, undue influence, or significant and ongoing conflicts of interest will usually be smaller where the person was not a member of the local authority at the time the contract was entered into. Any concerns about influence when the contract comes up for review or renewal would be able to be managed in the usual way.
- 12.31 This is one of the issues that could usefully be addressed if the Act was reviewed by the relevant policy agencies. The difficulties with candidates for election could be resolved if our statutory approval power was extended to cover candidates (or contracts that pre-dated a member's election). We could then consider these situations on a case-by-case basis, as we do for contracts that arise during a member's term of office.
- 12.32 Alternatively, these difficulties could disappear altogether if the overall utility of the contracting rule was reconsidered. In previous reports where we have recommended a review and reform of the Act, we have expressed doubts about whether the contracting rule continues to serve a useful purpose at all.¹⁰

¹⁰ See our 2005 report *The Local Authorities (Members' Interests) Act 1968: Issues and options for reform*.

- 12.33 As long as the contracting rule remains the law, we are obliged to apply it as it stands. However, we will continue to raise our concerns about this Act with the relevant agencies.

Part 13

Inquiries during 2006/07

- 13.1 During 2006/07, we received about 170 requests for the Auditor-General to investigate the actions of local authorities. The Auditor-General has a mandate to inquire into a public entity's use of its resources, at his discretion. An inquiry usually involves looking into financial, accountability, governance, or conduct issues.
- 13.2 Our mandate does not enable us to consider the substance of decisions made by local authorities, as we do not have authority to "second guess" the judgement of elected members. However, we may decide to look at a council's decision-making process.
- 13.3 In this Part, we discuss some of the larger inquiries we carried out in the local government sector during 2006/07. The reports from the first two inquiries discussed below are available on our website.

Dunedin City Council and Otago Regional Council – stadium proposal

- 13.4 We inquired into the funding arrangements of the Dunedin City Council and Otago Regional Council (the Councils) for a new multi-purpose stadium proposed by the Carisbrook Stadium Charitable Trust (the Trust). In accordance with our mandate, we did not consider whether the Councils should support the stadium project – that is a matter for the members to decide.
- 13.5 We looked into this matter because of the amount of ratepayer funds that were being considered for the proposed stadium, the Councils' relationship with the Trust as a non-council-controlled organisation, and the uncertainty within the region about the nature of the Councils' involvement. We had received several requests for inquiries into the Councils' involvement with the proposed stadium, and the matter was of high public interest.

The stadium proposal

- 13.6 In February 2007, the Trust released a report that recommended building a new multi-purpose stadium in central Dunedin. The Trust expected the stadium to cost about \$188 million. The Dunedin City Council was asked to contribute \$91.4 million and the Otago Regional Council was asked to contribute \$37.5 million.
- 13.7 After consultation, the Dunedin City Council voted in June 2007 to provide funding for the Trust to continue with its feasibility work. The Council's resolution required the Trust to take various steps to confirm the viability of the project by 31 December 2007. The Council funded this work by allocating \$11.5 million

in 2007/08, with \$5.6 million of this depending on the work to take place by December 2007.

- 13.8 The Otago Regional Council decided to put on hold any decision about funding until there was a firm commitment from the Dunedin City Council about its involvement.

What we found

- 13.9 Overall, we found that the Councils' funding arrangements were appropriate for the investigatory phase of the project. We noted that the outcome of the Trust's investigatory phase was uncertain, and neither Council had committed to fully funding the project. We also commented that a formal and robust funding framework would need to be put in place should either or both of the Councils decide to make a firm commitment to fund the construction phase of the project.
- 13.10 The Dunedin City Council had adequately considered whether its initial contribution would enable it to decide on committing further funding to the project. The Council acknowledged that there was a risk associated with its initial contribution. It sought to reduce the risk by considering whether its initial contribution would enable a decision about further funding, whether the overall project costs were credible, and how the Council's \$91.4 million contribution could be funded if it decided to proceed.
- 13.11 The Dunedin City Council had appropriate accountability mechanisms and controls in place for this investigatory phase of the project. The Council also had the means to assess whether it was receiving value for money for the investigatory work. These included weekly meetings with the Trust, and controlled release of funding after an invoice authorisation procedure.
- 13.12 The accountability and control could have been enhanced by a commitment in writing between the parties, such as a memorandum of understanding. We also made some suggestions about the adequacy of the Trust's six-weekly reporting system and Dunedin City Council's systems for authorising payments to the Trust.
- 13.13 The Otago Regional Council had decided to put on hold any decisions about substantive funding of the proposed stadium, but had made relatively minor amounts of funding available to the Trust. The funding was provided indirectly through the Dunedin City Council and depended on the Dunedin City Council's arrangements with the Trust. We considered this appropriate for the investigatory phase of the project.

Our expectations should the project proceed

- 13.14 If the project proceeded and the Councils decided to provide funding for it, we would expect to see an enhanced funding framework put in place. This framework would be consistent with the phase of the project and appropriate to the structure of the project. It would require a greater degree of formality in the accountability and control arrangements between the Councils and the Trust.
- 13.15 We would expect to see a comprehensive funding agreement between the parties to protect the Councils in case the stadium project does not proceed as planned after any final commitment is given. We would also expect to see appropriate risk management strategies to protect the Councils, and their respective ratepayers, against construction and operational risks.
- 13.16 We note that the Dunedin City Council voted on 17 March 2008 to commit funding to the Trust for the stadium.

Queenstown Lakes District Council

- 13.17 We inquired into decision-making processes followed by the Queenstown Lakes District Council and the council-controlled organisation (CCO) that it established to provide regulatory and resource management services for the district. These services were being provided through a contract with Civic Corporation Limited (CivicCorp).

The CivicCorp contract and service delivery review process

- 13.18 The Council contracted CivicCorp in 1998 to provide regulatory and resource management services until 2003, and later renewed the contract for a further five-year term.
- 13.19 The Council had some concerns about CivicCorp's performance under the contract, which were compounded by a substantial increase in the number of resource and building consent applications being received. From 2004, there were discussions and negotiations between the parties about alleged breaches of the contract.
- 13.20 In 2006, the Council and CivicCorp began to discuss "life after the contract". It had become clear that the contract would not be renewed in 2008, and that CivicCorp would consider an early end to the contract. The parties reached an agreement in principle to look at the possibility of the Council purchasing CivicCorp.
- 13.21 While the Council was discussing performance issues under the CivicCorp contract, it also started to review how it wanted to deliver regulatory and resource management services. Several service delivery contracts were due to expire in

2008. The review had been signalled in the Council's 2004-14 Long-Term Council Community Plan.

- 13.22 The review resulted in the Council deciding to consider forming a CCO to deliver regulatory and resource management services. After consulting with the public about establishing a CCO for this purpose, the Council decided in March 2007 to form a CCO to provide regulatory and resource management services.
- 13.23 In June 2006, the Council started negotiations to purchase CivicCorp. The Council was concerned that CivicCorp would be unable to continue to deliver services through to June 2008 because of staffing difficulties.
- 13.24 In December 2006, the Council approved the components of the purchase price and authorised the Chief Executive to enter into an agreement to purchase CivicCorp, as agent for a company to be formed and conditional upon the outcome of the CCO process and due diligence checks. This decision was approved in March 2007 after the conditions were fulfilled.
- 13.25 Acting in its capacity as sole shareholder, the Council asked the CCO to purchase CivicCorp. The CCO board resolved to do so and purchased CivicCorp in April 2007. The companies merged into one, and are now known as Lakes Environmental.

What we found

- 13.26 The inquiry focused on:
- the Council's decision-making process for the delivery of regulatory and resource management services, including the service delivery review by the Council in 2005 and 2006, and its consultation and decision-making processes when establishing the CCO; and
 - the decisions by the Council and the CCO about the purchase of CivicCorp, including the process for determining the price.
- 13.27 Overall, the Council and the CCO followed good and appropriate processes.
- 13.28 We made some specific comments on certain aspects of the process leading to the purchase of CivicCorp:
- The negotiations to purchase CivicCorp were conducted by expert advisers, on behalf of the Council, under conditions of strict confidentiality. This adversely affected the Council's ability to consult with the public on the option of purchasing CivicCorp. The Council was able to rely on its awareness of community views gathered through the earlier service delivery review process and the consultation process to establish the CCO. However, if the Council had been able to be more explicit about the option of purchasing CivicCorp in the

statement of proposal about forming the CCO, then it might have received more views from the community.

- Some of the Council's assessments that decisions were not significant were made on the basis that the CCO, not the Council, was purchasing CivicCorp. We questioned whether this analysis adequately acknowledged the substance of the Council's actions and involvement. However, assessing those decisions as significant to the Council would not necessarily have required further consultation.
- The extent to which the Council considered the community's views when making decisions that led to the purchase of CivicCorp could have been clearer.

13.29 The Council's purchase of CivicCorp raised interesting questions about applying the consultation requirements in the Local Government Act 2002. For a local authority, there is a tension between being open and transparent in its actions and obtaining community feedback on commercial and sensitive transactions.

13.30 A local authority must structure its decision-making processes for significant and complex decisions – including commercial decisions – to ensure that it understands the views of the community at each stage of the decision-making process. This does not require a local authority to use any specific consultation process or procedure. However, getting the views of the community in the early stages of a decision-making process can inform later decisions.

13.31 This inquiry has highlighted that local authorities enter into long-term contracts without always considering in detail what will happen when the contract ends. Contracting out a specialised function, such as the delivery of regulatory services, can mean that internal expertise and knowledge is lost. This can lead to difficulties when the contract comes to an end. In the CivicCorp example, this was problematic because the limited market to supply regulatory services in the district reduced the options available to the Council.

Council staff with a personal interest in matters before their Council

13.32 We carried out an inquiry into a local authority after receiving information that some senior staff members at the Council were personally involved in matters being considered by the Council. We reported back to the Council, and include some wider points of interest from that inquiry in the paragraphs below.

13.33 The inquiry was about staff members who were shareholders and/or directors in companies that had various applications before the Council. The staff members had not initially declared any conflicts of interest, even though in some instances

the applications were coming through their section of the Council. No steps were taken to formally manage the conflicts. However, the staff members did try to ensure that they were not involved in decisions being made by the Council about these companies.

- 13.34 We discussed conflicts of interest in our report to the Council. General guidance on conflicts of interest is set out in our good practice guide, *Managing conflicts of interest: Guidance for public entities*.
- 13.35 The potential for conflicts of interest arose because the staff members were involved in companies that had applications before their employer. The risk increased because some of the staff worked in the sections that dealt with such applications. It also raised the risk of perceived impropriety on the part of the staff members concerned.
- 13.36 In this instance, staff involved in the companies decided not to tell other Council staff or councillors about their involvement because they did not want to receive any special treatment. They also thought that the matters should be judged on their merits. While we accepted that the staff members made their decision in good faith and with no improper motive, it was the wrong decision. The staff members should have declared the conflict at the outset so that it was openly acknowledged, and an appropriate response could have been agreed on and documented.
- 13.37 We expect senior staff members to recognise the need to ensure that a conflict of interest is documented. It is important that senior staff provide leadership in all areas involving questions of probity and appropriate conduct.
- 13.38 In our view, this judgement by staff illustrated a need for further guidance for staff members on such matters. Therefore, we suggested that the Council prepare clear policies and procedures for staff on how conflicts of interest should be managed, and train staff on the topic.
- 13.39 Conflicts of interest are less likely to cause problems when they are appropriately managed. An important aspect of managing conflicts of interest is being open and transparent about them. Members of governing bodies and officials should identify and disclose conflicts of interest as soon as they arise, then they or the entity should consider what action (if any) is necessary to avoid or reduce any effects of the conflict.
- 13.40 Once an interest has been declared, the decision about how to manage it will need to be reviewed if circumstances or the conflict change. A public entity should keep a written record of any disclosures of interest, and update the record as necessary if the nature of the interest or the approach for managing it changes.

- 13.41 We found no evidence that the Council employees used their positions to advance the interests of the companies they were involved with. We were satisfied that the staff members did not obtain any information in their role as employees that they used for their own advantage. We also did not find any evidence of attempts by the Council staff involved in the companies to influence the decision-making processes.
- 13.42 We understand that Council staff will, at times, be engaged in transactions with their Council in a personal capacity – for example, when applying for a building consent or resource consent. It is inevitable that conflicts of interest will arise. In our view, any conflicts that could arise from an interest in a resource consent application from a Council should be able to be managed with reasonably straightforward measures. Identifying and managing conflicts of interest of this kind should be routine business for a Council. However, these judgements must always be made in the context of the particular issue, the organisation, and the community.
- 13.43 Although these situations will always create some risk for the organisation, most conflicts of interest should be able to be managed adequately and with minimal disruption to usual processes. Noting the connection, ensuring that people do not process their own applications, and documenting that for the public record reduces the risks that conflicts of interest create for an organisation.
- 13.44 In our view, a public entity should require its staff to declare any personal interest that may affect, or could be perceived to affect, their impartiality in any aspect of their work. Declarations provide the basis for deciding the steps needed to manage any actual or potential conflict of interest. The most typical options involve excluding the staff member from the entity's work on a particular matter. It is important to complete the process by documenting it, because this is the step that responds to the risk of an adverse public perception. If the record shows only that a conflict existed, but not that any steps were taken to manage it, then the organisation risks criticism.
- 13.45 This inquiry highlighted that transparent and documented management of conflicts of interest is not only important in principle, but also protects public entities and their staff. Dealing with such issues in secret is likely to undermine public trust in the organisation and its processes.

Part 14

Financial performance of the fish and game council sector

Overview of the fish and game council sector

- 14.1 This Part provides an overview of the financial performance of the entities in the fish and game council sector. It continues our practice of reporting, in turn, the financial performance of the smaller sectors that fall within the Auditor-General's mandate.
- 14.2 Under section 15 of the Public Audit Act 2001, the Auditor-General is the auditor of the New Zealand Fish and Game Council (operating as Fish and Game New Zealand), 12 regional fish and game councils, and the New Zealand Game Bird Habitat Trust Board.
- 14.3 Entities in the fish and game council sector report under the Public Finance Act 1989 (amended by the Public Finance Amendment Act 2004) and the Crown Entities Act 2004. Fish and game councils must prepare financial statements that comply with generally accepted accounting practice and fairly reflect their financial position.
- 14.4 Fish and game councils have a statutory responsibility for the sports of freshwater fishing and game bird hunting. Their role is to manage, maintain, and enhance the sport's fish and game in the recreational interests of anglers and hunters. Each council has 12 members, elected from the holders of fishing and hunting licences of the region. The regional fish and game councils are supported by Fish and Game New Zealand, to which they each elect one member. Fish and Game New Zealand represents anglers and hunters on issues of national importance.
- 14.5 The New Zealand Game Bird Habitat Trust Board is a charitable organisation established under the Wildlife Amendment Act 1993. It is a fourth schedule Crown entity as defined by the Public Finance Act 1989. It is funded by Fish and Game New Zealand from the proceeds of its Game Bird Habitat postal stamp programme. The purpose of the trust is to improve New Zealand's game bird habitat and to improve the habitat of other wildlife.

Overview of financial performance

- 14.6 The information in Figure 14.1 is based on figures extracted from the most recently audited financial statements. Audit opinions are usually signed within four months of the balance date for all 12 regions and the two national bodies. The fish and game council sector has a 31 August balance date.

- 14.7 The benefit of having all financial statements for the fish and game councils completed on time is that assurance can be gained that the funds held for managing the councils are being correctly accounted for, without the risk of losing records as time goes on, as is a risk in many of the smaller sectors.
- 14.8 One of the major changes for the fish and game councils in the past three years has been the move to a national licence distributor called Eyede®. The councils previously had a manual, internal system for collecting licence fee revenue, maintained by each of the councils.
- 14.9 Eyede® streamlines how licences are sold and maintains a centralised database. The database also ensures information privacy between the 12 different regions through the use of usernames and passwords.
- 14.10 Although most fish and game councils use Eyede®, some use it only for internet, mail order, and telephone sales. They still use their own internal system for manual and agent sales. The few councils that take this approach are satisfied with its efficiency at this stage.

Figure 14.1

Summary of audited financial information for 2007, in the fish and game council sector

Entity name	Revenue (\$)	Expenses (\$)	Cash and investment funds held (\$)	Equity (\$)
New Zealand Fish and Game Council	2,313,944	2,367,971	1,581,092	1,474,594
New Zealand Game Bird Habitat Trust Board	122,849	105,246	703,479	778,087
Central South Island	1,034,313	921,516	79,248	715,310
Eastern	1,757,063	1,656,088	786,375	1,780,913
Hawke's Bay	433,292	382,354	549,684	798,229
Nelson-Marlborough	516,085	536,809	144,511	536,166
North Canterbury	1,297,932	1,152,389	537,978	1,054,418
Northland	352,595	337,059	749,010	841,908
Otago	1,484,906	1,236,676	896,109	2,306,152
Southland	1,217,225	1,121,584	317,878	904,722
Taranaki	294,719	213,402	342,224	806,352
Waikato/Auckland	958,550	896,193	758,675	976,978
Wellington	556,585	578,586	213,367	330,206
West Coast	290,262	247,603	536,635	629,912
	12,630,320	11,753,476	8,196,265	13,933,947

- 14.11 Although many fish and game councils would like to see an increase in participation and the number of licences sold, there are no concerns about the viability of the sector, as expenditure is generally well managed. Most fish and game councils have experienced reduced licence sales during the past decade (generally attributed to increasing fuel prices and the requirement to travel further as a result of access and water quality issues, and the competition provided by other recreational options). However, indications are that licence sales are levelling. Indeed, this year has signalled an improvement that is expected to continue into coming years.
- 14.12 The sector has informed us that fish and game councils are concerned that a significant portion of their expenditure is spent on habitat protection (for example, water conservation orders and legal challenges to resource consent applications for water abstraction and hydro-generation). Councils understand and consider that other public entities have direct statutory responsibility for habitat protection. In their view, if these entities fulfilled their role, it would enable fish and game councils to focus their resources on their core purpose of managing, maintaining, and enhancing sports fish and game.
- 14.13 Fish and game councils have been subject to the New Zealand equivalents to International Financial Reporting Standard (NZ IFRS) requirements from 2006/07. Discretion with the adoption date means that some will not adopt NZ IFRS until 2007/08. The transition has not significantly affected the sector yet. We do not anticipate any problems as the remaining fish and game councils move to NZ IFRS in the coming financial year.

Conclusion

- 14.14 The sector is generally well managed and it is pleasing to note its sound current state of affairs.

Part 15

Issues for provincial patriotic councils seeking to cease operations

- 15.1 In 2000¹ and 2005,² we reported on provincial patriotic councils. Our articles in both reports highlighted the lack of mechanisms for provincial patriotic councils to wind up their activities. However, in practice, a number of them have ceased to operate and others have indicated that they would like to do so.
- 15.2 Provincial patriotic councils are created by statute, so further legislation is needed to abolish them. The relevant legislation is administered by Veterans' Affairs New Zealand.³ We have raised with Veterans' Affairs New Zealand the need to promote legislation to allow these councils to choose to stop operating.
- 15.3 Without an effective mechanism to wind up the activities of such councils, the councils and our Office have adopted a pragmatic approach. In practice, a council will pass a resolution agreeing to wind up its activities. The council will also decide how to distribute any remaining funds. We then conduct an audit of the council's final set of financial statements. The council notifies Veterans' Affairs New Zealand that it no longer operates. The responsibility for removing the council from the statute book then rests with Veterans' Affairs New Zealand.

Northland Provincial Patriotic Council – steps taken to cease operation

- 15.4 Consistent with the approach outlined above, the Whangarei-based Northland Provincial Patriotic Council (the Council) transferred its remaining funds to The Northland District RSA Charitable Trust Incorporated (the Trust) on 30 July 2007, and effectively ceased to exist.
- 15.5 The Council remains a legal entity, despite transferring its remaining funds to the Trust and ceasing to operate. Our appointed auditor audited the final set of financial statements, up to the point of transferring the remaining funds to the Trust.⁴ Even though the Council continues to exist as a legal entity, it will not prepare any further accounts. Because the Council has ceased to operate, no further audits will be carried out.

1 *Second Report for 2000*, parliamentary paper B.29[00b], page 115.

2 *Local Government: Results of the 2003-04 Audits*, parliamentary paper B.29[05b], page 95.

3 Veterans' Affairs New Zealand is a semi-autonomous body within the New Zealand Defence Force.

4 Our statutory audit responsibility is based on section 40 of the Patriotic and Canteen Funds Act 1947 and section 15 of the Public Audit Act 2001.

- 15.6 The Council has for many years provided welfare-based support for returned servicemen and women in its district. However, in common with a number of other councils, it recognised that it was becoming less reasonable to maintain its operations.⁵
- 15.7 To cease its operations, the Council had to:
- identify a suitable recipient for the remaining funds – in this case, the Trust, which the Council noted was operating “with similar ideals and principles”;
 - advertise the Council’s intention to cease operating, transfer its remaining funds to the Trust, and invite comment;
 - inform Veterans’ Affairs New Zealand of its intention; and
 - arrange for our appointed auditor to audit the final set of financial statements.
- 15.8 On 30 July 2007, the Council transferred the amount of \$92,713 in cash and \$335 in assets to the Trust, and ceased operations. The Council noted that, in doing so, it was seeking “economies of scale” (with the Trust) and “strength in unity”.

Conclusion

- 15.9 The Council responded in a pragmatic and effective way to its circumstances.
- 15.10 A number of other councils have followed a similar course, and more councils are likely to face similar circumstances in the future. It would be desirable for the legislation to be amended to create an effective mechanism to recognise when councils cease to operate, and to stop them existing in law as well as in practice.

5 Our previous articles on provincial patriotic councils point out the diminishing size of the remaining councils in New Zealand and that a number of councils were similarly ceasing their operations and disbursing any remaining funds.

Part 16

Performance audits in the local government sector

- 16.1 Each year, we carry out a number of performance audits, special studies, and inquiries and report our findings to Parliament. In this Part, we discuss two reports relating to the local government sector that we published in the past year, and our proposed performance audit for 2008/09. They are:
- our good practice guide for local authority decision-making and consultation;¹
 - our performance audit report on liquor licensing by territorial authorities;² and
 - our proposed performance audit on how local authorities meet demand for water.

Guide for local authorities on decision-making and consultation

- 16.2 In 2007, we produced a report – *Turning principles into action: A guide for local authorities on decision-making and consultation*. It updated our previous guidance published in 1998, and supplemented the recent guidance material prepared by others in the sector, such as the Society of Local Government Managers and the Department of Internal Affairs.
- 16.3 The Local Government Act 2002 Act (the Act) sets out principles and obligations for local authorities to use in decision-making and consultation. Local authorities are working to embed these principles in their management processes to give best effect to their purpose of promoting long-term sustainable well-being and democratic decision-making and actions. Local authorities also face risks if their decisions can be shown to be unreasonable, or if due process has not been observed.
- 16.4 The Act has also reinforced the public's expectation of greater levels of participation in decision-making and consultation. We have dealt with a number of ratepayer enquiries about local authorities' decision-making and consultation obligations.
- 16.5 So far, the courts have had few opportunities to provide judicial guidance about how to interpret these principles. However, good practice is evolving.
- 16.6 Our updated guide is the combined view of our Office and a working party within the sector that we convened to advise us. The working party identified some areas of the Act that are difficult to implement, and the guide provides examples of good practice by local authorities in these areas. It does not attempt to define legislative compliance – rather, it presents a combined view and discussion on principles and current practice.

1 *Turning principles into action: A guide for local authorities on decision-making and consultation*, September 2007.

2 *Liquor licensing by territorial authorities*, November 2007.

- 16.7 Our expectation is that the guide will be of value to professional staff in local authorities and politicians in the local government sector, as well as to their communities.

Liquor licensing by territorial authorities

- 16.8 In November 2007, we published the results of a performance audit that looked at liquor licensing by territorial authorities.
- 16.9 Under the Sale of Liquor Act 1989 (the Act), territorial authorities have the status of District Licensing Agencies. They are responsible for considering applications and issuing licences for the sale and supply of liquor to the public. Our performance audit examined how territorial authorities were carrying out their liquor licensing responsibilities under the Act. They are, by and large, doing a good job.
- 16.10 However, we identified some important areas for improvement. In particular, not all District Licensing Agencies were sufficiently committed to monitoring and enforcing compliance with licence conditions and the Act. It is important that all District Licensing Agencies consider whether they have enough resources allocated to this compliance work, and follow active and systematic monitoring strategies.
- 16.11 While drawing on the results of our audits of selected authorities, the report also takes a broader perspective. For example, we set out principles for good practice, note better practice examples, and draw lessons for the sector. We have urged each local authority to consider our comments and review its own practices.
- 16.12 The audit team will discuss the results of the audit at local government and other appropriate forums.

Proposed performance audit on how local authorities meet demand for water

- 16.13 In 2008/09, we propose to carry out one performance audit in the local government sector. The proposed audit will look at strategies used by local authorities to meet the demand for water in their communities.
- 16.14 The decision to carry out a single performance audit in the sector in 2008/09, in part, recognises the substantial resources that we will allocate to auditing the 2009-19 Long-Term Council Community Plans of every local authority. The LTCCP audit work will be carried out throughout 2008/09.
- 16.15 Many territorial authorities play a significant role in supplying water to residents and communities in their district or region.

- 16.16 A local authority's ability to supply water of adequate quality and quantity is an essential service for the health and well-being of those residents and communities. To provide this service, local authorities need a sufficient and reliable water source and the necessary infrastructure to store, treat, and supply the water.
- 16.17 It is important for a local authority to consider and plan for the future demand for water so that it has adequate infrastructure and/or arrangements in place to meet the needs of its residents and communities.
- 16.18 The scope of our proposed performance audit has yet to be finalised. However, its purpose will be to provide assurance that selected territorial authorities have adequately assessed the future water demand of residents and communities in their district and have strategies in place to meet this demand. Our proposed audit is also likely to consider the strategies and approaches for managing demand for water as a factor in meeting water supply needs.

Part 17

Good practice guide on audit committees in the public sector

- 17.1 In March 2008, we published a good practice guide – *Audit Committees in the public sector* – to contribute to improved governance of public entities.
- 17.2 Audit committees can make a valuable contribution to improving the governance, and therefore the performance and accountability, of public entities. They have an important role in examining an organisation’s policies, processes, systems, and controls through providing objective advice and insight. In doing so, they can identify potential improvements to governance, risk management, and control practices.
- 17.3 An effective audit committee shows that an organisation is committed to a culture of openness and continuous improvement.
- 17.4 After some well-publicised international accounting and auditing failures in 2001 and 2002, there has been an increasing focus on the role of audit committees in the public and private sectors. Overseas regulatory bodies are intervening more to set clear governance and assurance standards and expectations. Although New Zealand might not legislate for mandatory audit committees, Parliament and the public expect the public sector to adopt governance principles that are consistent with good practice.
- 17.5 Our good practice guide sets out the principles and practices needed to set up and effectively operate an audit committee in the public sector. It also provides other useful resources, such as examples of committee charters, and checklists. The guide is not sector-specific because the principles and practices apply throughout the public sector.
- 17.6 The Auditor-General expects all public entities to consider setting up an audit committee in line with the good practices identified in our guide.

Appendix

Details of non-standard audit reports issued

These details relate to non-standard audit reports issued during the 2007 calendar year. **Where an entity is directly or indirectly controlled by one or more city or district councils, we have listed them in brackets.**

Adverse opinions

Pukaki Trust

Financial statements year ended: 30 June 2005

We disagreed with the Trustees ceasing to recognise the monetary value for an artwork asset it owns, and writing off the previous value of the artwork asset in its financial statements. The Trustees' decision resulted in an overstatement of the expenditure and deficit in the Statement of Financial Performance and an understatement of the assets and equity of the Trust. These are departures from Financial Reporting Standard No. 3: *Accounting for Property, Plant and Equipment*, which requires artwork assets to be recognised at fair value and depreciated.

Hawke's Bay Cultural Trust (Hastings District Council and Napier City Council)

Financial statements year ended: 30 June 2007

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

Far North Regional Museum Trust (Far North District Council)

Financial statements year ended: 30 June 2005

We disagreed with the Trustees not recognising the collection assets of the Trust, nor the associated depreciation expense, in the Trust's financial statements. These are departures from Financial Reporting Standard No. 3: *Accounting for Property, Plant and Equipment*, which requires collection assets not previously recognised to be recognised at fair value and depreciated. In addition, our audit was limited because we were unable to verify certain revenue because of limited controls over the receipt of that revenue.

The Museum of Transport and Technology Board

Financial statements year ended: 30 June 2006 and 30 June 2007

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

The Canterbury Museum Trust Board

Financial statements years ended: 30 June 2006 and 30 June 2007

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

Otago Museum Trust Board*Financial statements year ended: 30 June 2007*

We disagreed with the Trust Board not recognising the museum collection assets of the Museum Trust, nor the associated depreciation expense, in the Museum Trust's financial statements. These are departures from New Zealand equivalent to International Financial Reporting Standard No. 16: *Property, Plant and Equipment*, which requires museum collection assets not previously recognised to be recognised at fair value and depreciated.

Nelson Creek Recreation Reserve Board*Financial statements year ended: 30 June 2006*

We disagreed with the Board not preparing annual financial statements in accordance with section 41(2) of the Public Finance Act 1989 and not complying with generally accepted accounting practice. Our audit was limited because we were unable to verify certain revenue because of limited controls over the receipt of that revenue.

Disclaimers of opinion**Bendigo Construction Limited (Invercargill City Council)***Financial statements for year ended: 30 June 2005*

We were unable to form an opinion on the financial statements because of the potential effect of a limitation in evidence available to us. The evidence was limited because:

- The Board did not provide the representations that we sought.
- We were unable to verify certain revenue and expenditure because of limited controls over the completeness of revenue and expenditure.
- The financial statements of the company had not been previously audited, therefore we did not form an opinion about the comparative information or the effect of any misstatement of comparative figures on the results for the year ended 30 June 2005.

We noted the disclosure in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements because the company ceased trading on 30 June 2005. We noted the disclosure in the financial statements that referred to the fact that the Board did not prepare a Statement of Intent for the year beginning 1 July 2004 and consequently did not report group performance information because the company was to be wound up. We also noted a breach of the Companies Act 1993 because dividends were declared and paid despite the fact that the company had not satisfied the solvency test because its assets were less than its liabilities.

Bendigo Construction Limited (Invercargill City Council)*Financial statements for year ended: 30 June 2006*

We were unable to form an opinion on the financial statements because of the potential effect of a limitation in evidence available to us. The evidence was limited because the Board did not provide the representations that we sought. In addition, we drew attention to the fact that we did not form an opinion on the financial statements for the year ended 30 June 2005 because:

- The Board did not provide the representations that we sought.
- We were unable to verify certain revenue and expenditure because of limited controls over the completeness of revenue and expenditure.
- The company had not been audited for the year ended 30 June 2004 and any misstatement of that year's figures would affect the results for the year ended 30 June 2005.

We noted the disclosure in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements because the company ceased trading on 30 June 2005. We also noted the disclosure in the financial statements that referred to the fact that the Board did not prepare a Statement of Intent for the year beginning 1 July 2005 and consequently did not report group performance information because the company was to be wound up.

Bond Contracts Limited and Group (Invercargill City Council)

Financial statements for year ended: 30 June 2005

We were unable to form an opinion on the company and group financial statements because of the potential effect of a limitation in the scope of the audit. The scope of the audit was limited because:

- We were unable to determine the validity of the use of the going concern assumption because there were indicators that the assumption may not be appropriate and the Board did not provide satisfactory evidence to support the use of the assumption.
- The Board did not provide the representations that we sought.
- The company was unable to assess and determine whether some fixed assets were recorded at more than their recoverable amounts.
- The scope of the audit of the subsidiary, Bendigo Construction Limited, during the period it was an associate was limited and we were unable to confirm the share of the associate losses recorded by the company and group.

We noted the disclosure in the financial statements that referred to the fact that the Board did not prepare a Statement of Intent for the year beginning 1 July 2004 and consequently did not report group performance information.

Bond Contracts Limited and Group (Invercargill City Council)

Financial statements for year ended: 30 June 2006

We were unable to form an opinion on the company and group financial statements because of the potential effect of a limitation in the scope of the audit. The scope of the audit was limited because:

- We were unable to determine the validity of the use of the going concern assumption because there were indicators that the assumption may not be appropriate and the Board did not provide satisfactory evidence to support the use of the assumption.
- The Board did not provide the representations that we sought.
- The company was unable to assess and determine whether some fixed assets were recorded at more than their recoverable amounts.

We also drew attention to the fact that we did not form an opinion on the company and group financial statements for the year ended 30 June 2005 because:

- We were unable to determine the validity of the use of the going concern assumption.
- The Board did not provide us with the representations we sought.
- The company did not determine whether some fixed assets were recorded at more than their recoverable amount.
- We were unable to confirm the share of associate losses recorded by the company and group.

We noted the disclosure in the financial statements that referred to the fact that the Board did not prepare a Statement of Intent for the year beginning 1 July 2005 and consequently did not report group performance information.

Except-for opinions

Upper Hutt City Council and Group

Financial statements year ended: 30 June 2007

We disagreed with the value at which the Council and Group recognised operational, restricted and infrastructural asset classes in the financial statements. The Council and Group accounting policy is to recognise operational, restricted and infrastructural asset classes at fair value. We identified reliable indicators to suggest that it was likely there had been a material increase in the value of the operational, restricted, and infrastructure asset classes. On this basis the Council departed from New Zealand equivalent to International Accounting Standard No. 16: *Property, Plant and Equipment*, which requires classes of property, plant and equipment that are revalued to be revalued with sufficient regularity to ensure that they are not included at a value that is materially different to fair value.

Invercargill City Holdings Limited and Group (Invercargill City Council)

Financial statements years ended: 30 June 2005 and 30 June 2006

Our audit was limited because of:

- the scope of the audit of entities comprising the Bond Contracts Limited group (wholly owned by Invercargill City Holdings Limited) being limited;*
- limitations in evidence to support the carrying value of the company's investment in Bond Contracts Limited; and
- the Board not providing us with the representations we sought.

Inframax Construction Limited (Waitomo District Council)

Financial statements year ended: 30 June 2004

We disagreed with the Board only about comparative information because the Statement of Movements in Equity showed a prior period adjustment resulting from an error in the recognition of accrued revenue on maintenance contracts. This was a departure from Financial Reporting Standard No. 7: *Extraordinary Items and Fundamental Errors*, which allows for the recognition of a prior period adjustment only in the event of a fundamental error. In our view, the adjustment was not a fundamental error.

Tasman Bays Heritage Trust Incorporated (Nelson City Council and Tasman District Council)

Financial statements year ended: 30 June 2006

We disagreed with the Trustees only about comparative information because the value of collection and exhibition assets donated to the Trust between 1 July 2000 and 30 June 2003 had not been recognised in the Trust's financial statements for the year ended 30 June 2005. Non-recognition of collection and exhibition assets was a departure from Financial Reporting Standard No. 3: *Accounting for Property, Plant and Equipment*. We also noted a breach of the Local Government Act 2002 because the Trustees did not prepare a Statement of Intent for the year ended 30 June 2006.

Aurora Energy Limited (Dunedin City Council)

*Financial statements year ended: 30 June 2007***

We disagreed with the company recognising the reduction in its deferred taxation liability arising from the revaluation of its network assets in previous years directly through the statement of changes in equity. This is a departure from the requirements of the New Zealand Equivalent to International Accounting Standard 12: *Income Taxes*.

Buller Health Trust (Buller District Council)*Financial statements year ended: 30 June 2002*

Our audit was limited because the financial statements of the Trust had not previously been audited. Therefore, we did not form an opinion about the comparative information and noted that any misstatement of the comparative figures would affect the results for the year ended 30 June 2002.

Buller Health Trust (Buller District Council)*Financial statements year ended: 30 June 2003*

Our audit was limited in respect of comparative information only because the financial statements of the Trust had not been audited for the year ended 30 June 2001 and any misstatement of that year's figures would affect the results for the year ended 30 June 2002.

Buller Health Trust (Buller District Council)*Financial statements year ended: 30 June 2005 and 30 June 2006*

The Trust did not prepare a Statement of Intent for the years beginning 1 July 2004 and 1 July 2005 respectively, as required by the Local Government Act 2002. Therefore, it had not prepared performance information that fairly reflected its service achievements. We also noted a breach of the Local Government Act 2002 because the Board of Trustees did not prepare a Statement of Intent for the years beginning 1 July 2005 and 1 July 2006 respectively.

Buller Health Trust (Buller District Council)*Financial statements year ended: 30 June 2007*

The Trust did not prepare a Statement of Intent for the year beginning 1 July 2006, as required by the Local Government Act 2002. Therefore, it had not prepared performance information that fairly reflected its service achievements.

Cranberries New Zealand Limited*Financial statements year ended: 31 March 2006*

Our audit was limited because the financial statements of the company had not previously been audited. We therefore did not form an opinion about the comparative information and noted that any misstatement of the comparative figures would affect the results for the year ended 31 March 2006.

Cranberries New Zealand Limited*Financial statements year ended: 31 March 2007*

Our audit was limited in respect of comparative information only because the financial statements of the company had not been audited for the year ended 31 March 2005 and any misstatement of that year's figures would affect the results for the year ended 31 March 2006.

Tiromoana Station Limited (Christchurch City Council)*Financial statements year ended: 30 June 2006*

Our audit was limited in respect of comparative information only because the financial statements of the company had not been audited for the year ended 30 June 2004 and any misstatement of that year's figures would affect the results for the year ended 30 June 2005.

Sister Cities New Zealand Incorporated (Hastings District Council)*Financial statements year ended: 30 June 2004*

Our audit was limited in respect of comparative information only because we were unable to verify certain revenue because of limited controls over the receipt of that revenue for the year ended 30 June 2003.

Tourism Dunedin Trust (Dunedin City Council)*Financial statements year ended: 30 June 2006*

The Trust did not prepare a Statement of Intent for the year beginning 1 July 2005 as required by the Local Government Act 2002. Therefore, it had not prepared performance information that fairly reflected its service achievements. We also noted a breach of the Local Government Act 2002 because the Trust did not prepare a Statement of Intent for the year beginning 1 July 2006.

Tramway Reserve Trust (Selwyn District Council)*Financial statements year ended: 30 June 2005*

The Trust did not prepare a Statement of Intent for the year beginning 1 July 2004 as required by the Local Government Act 2002. Therefore, it had not prepared performance information that fairly reflected its service achievements.

Westland Holdings Limited and Group (Westland District Council)*Financial statements year ended: 30 June 2006*

The Company did not prepare a Statement of Intent for the year beginning 1 July 2005 as required by the Local Government Act 2002. Therefore, it had not prepared performance information that fairly reflected its service achievements. We also noted a breach of the Local Government Act 2002 because the Board did not prepare a Statement of Intent for the year beginning 1 July 2006.

Marlborough Airport Limited (Marlborough District Council)*Financial statements year ended: 30 June 2007*

The Company did not prepare a Statement of Intent for the year beginning 1 July 2006 as required by the Local Government Act. Therefore, it had not prepared performance information that fairly reflected its service achievements.

Varroa Agency Incorporated (Environment Canterbury)*Financial statements year ended: 30 June 2006 and 30 June 2007*

The Agency did not prepare a Statement of Intent for the years beginning 1 July 2005 and 1 July 2006 respectively as required by the Local Government Act 2002. Therefore, it had not prepared performance information that gave a true and fair view of its service achievements. We also noted a breach of the Local Government Act 2002 because the Board did not prepare a Statement of Intent for the years beginning 1 July 2006 and 1 July 2007 respectively.

Pemberton Construction Limited (Waikato District Council)*Financial statements year ended: 30 June 2007*

The Company did not prepare a Statement of Intent for the year beginning 1 July 2006 as required by the Local Government Act 2002. Therefore, it had not prepared performance information that gave a true and fair view of its service achievements. We also noted the disclosure in the financial statements that the Board did not prepare a Statement of Intent for the year beginning 1 July 2007.

Auckland Regional Transport Network Limited and Group (Auckland City Council)*Financial statements year ended: 30 June 2006 and 30 June 2007*

The Company did not prepare a Statement of Intent for the years beginning 1 July 2005 and 1 July 2006 as required by the Local Government Act 2002. Therefore, it had not prepared performance information that gave a true and fair view of its service achievements.

ARTNL Harbour Berths Limited (Auckland City Council)*Financial statements year ended: 30 June 2006*

The Company did not prepare a Statement of Intent for the year beginning 1 July 2005 as required by the Local Government Act 2002. Therefore, it had not prepared performance information that gave a true and fair view of its service achievements.

ARTNL Harbour Berths Limited (Auckland City Council)*Financial statements year ended: 30 June 2007*

The Company did not prepare a Statement of Intent for the year beginning 1 July 2006 as required by the Local Government Act 2002. Therefore, it had not prepared performance information to give a true and fair view of its service achievements. We also noted the disclosure in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements because the Company was to be wound up in the foreseeable future.

ARTNL Metro Limited (Auckland City Council)*Financial statements year ended: 30 June 2006*

The Company did not prepare a Statement of Intent for the year beginning 1 July 2005 as required by the Local Government Act 2002. Therefore, it had not prepared performance information that gave a true and fair view of its service achievements.

ARTNL Metro Limited (Auckland City Council)*Financial statements year ended: 30 June 2007*

The Company did not prepare a Statement of Intent for the year beginning 1 July 2006 as required by the Local Government Act 2002. Therefore, it had not prepared performance information to give a true and fair view of its service achievements. We also noted the disclosure in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements because the Company was to be wound up in the next 12 months.

ARTNL Britomart Limited (Auckland City Council)*Financial statements year ended: 30 June 2006 and 30 June 2007*

The Company did not prepare a Statement of Intent for the years beginning 1 July 2005 and 1 July 2006 as required by the Local Government Act 2002. Therefore, it had not prepared performance information that gave a true and fair view of its service achievements.

Tourism Dunedin Trust (Dunedin City Council)*Financial statements year ended: 30 June 2007*

The Trust did not prepare a Statement of Intent for the year beginning 1 July 2006 as required by the Local Government Act 2002. Therefore, it had not prepared information that fairly reflected its service achievements. We also noted the disclosure in the financial statements that referred to uncertainty over the continued financial support from the trust's parent, Dunedin City Council, and the Trust meeting its 2008 budget. The validity of the going concern assumption was dependent on the continued support and the trust meeting its 2008 budget.

East Otago Community Sports and Cultural Centre Trust (Dunedin City Council)*Financial statements year ended: 30 June 2006 and 30 June 2007*

Our audit was limited because we were unable to verify certain revenue because of limited controls over the receipt of that revenue.

Carparking Joint Venture (Christchurch City Council)*Financial statements year ended: 30 June 2007*

Our audit was limited because we were unable to verify certain revenue because of limited controls over the receipt of that revenue.

Village Pool Charitable Trust (Hastings District Council)*Financial statements year ended: 30 June 2007*

Our audit was limited because we were unable to verify certain revenue because of limited controls over the receipt of that revenue.

* The limitations in the scope of the audits of Bond Contracts Limited and Group for the years ended 30 June 2005 and 30 June 2006 are noted on page 107.

** We have been advised by the Board of its intention to withdraw and reissue the financial statements.

Explanatory paragraphs – emphasis of matter**New Zealand Mutual Liability Riskpool***Financial statements year ended: 30 June 2006*

We noted the disclosure in the financial statements that referred to the financials statements being appropriately prepared on the going concern basis because the Trustee of the Riskpool was able to levy members to cover any shortfall in equity in any fund.

Whisper Tech Limited*Financial statements year ended: 30 June 2005*

We noted the disclosure in the financial statements that referred to uncertainty about the viability of Whisper Tech Joint Venture (the Joint Venture), which was the exclusive licensee of the company's assets and intellectual property under a licence agreement. The validity of the going concern assumption depended on financial support from the parties to the Joint Venture that were also significant shareholders in the company.

Whisper Tech Joint Venture*Financial statements year ended: 30 June 2005*

We noted the disclosure in the financial statements that referred to uncertainty over the continued financial support of the joint venturers. The validity of the going concern assumption depended on that support.

Far North Holdings Limited and Group (Far North District Council)*Financial statements year ended: 30 June 2007*

We noted that the chairman's report contained alternative versions of the statement of financial performance and statement of financial position to the audited financial statements. We noted that the statements outlined in the Chairman's report did not comply with generally accepted accounting practice and were not audited.

Advance Whangarei Limited (Whangarei District Council)*Financial statements year ended: 30 June 2006*

We noted the disclosure in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements because the company was wound up on 30 June 2006.

Far North Developments Limited (Far North District Council)

Financial statements year ended: 30 June 2007

We noted the disclosure in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements because the company ceased operating.

ARRB Road Info Limited (New Plymouth District Council and South Taranaki District Council)

Financial statements year ended: 30 June 2007

We noted the disclosure in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements because of the Board's intention to wind up the company.

Wellington Regional Economic Development Trust (Wellington City Council, Hutt City Council, and Porirua City Council)

Financial statements year ended: 30 June 2007

We noted the disclosure in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements because of the Trustees' intention to wind up the trust.

America's Cup Village Limited and Group (Auckland Regional Council)

Financial statements year ended: 30 June 2006

We noted the disclosure in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements because the company was likely to be disestablished within 12 months.

Nga Tapuwae Community Facilities Trust (Manukau City Council)

Financial statements year ended: 30 June 2006

We noted the disclosure in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements because of the Trustees' intention to wind up the trust.

Papatoetoe Licensing Trust

Financial statements year ended: 31 March 2006 and 31 March 2007

We noted the disclosure in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements because of the Trustees' intention to wind up the trust.

Invercargill Licensing Trust Sports Foundation

Financial statements year ended: 31 March 2007

We noted the disclosure in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements because the Trust was likely to be wound up after 31 March 2007.

Invercargill Licensing Trust - Charitable Trust

Financial statements year ended: 31 March 2007

We noted the disclosure in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements because the Trust was likely to be wound up after 31 March 2007.

Whakatane District Council Sinking Fund Commissioners (Whakatane District Council)*Financial statements year ended: 30 June 2007*

We noted the disclosure in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements because the Sinking Fund was closed on 15 May 2007.

Explanatory paragraphs – breaches of law**Whakatane Airport Authority (Whakatane District Council)***Financial statements year ended: 30 June 2007*

We noted a breach of the Local Government Act 2002 because the Authority did not prepare a Statement of Intent for the year ended 30 June 2007. The Authority also did not have a statement of intent in place for the period beginning 1 July 2007.

Hawke's Bay Tourism Trust (Hawke's Bay Regional Council, Hastings District Council, and Napier City Council)*Financial statements year ended: 30 June 2006*

We noted a breach of the Local Government Act 2002 because the Trust did not prepare a Statement of Intent for the year ended 30 June 2006. We also noted the disclosure in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements because of the Trustees' intention to wind up the trust.

Hawke's Bay Tourism Trust (Hawke's Bay Regional Council, Hastings District Council, and Napier City Council)*Financial statements year ended: 30 June 2007*

We noted a breach of the Local Government Act 2002 because the Trust did not prepare a Statement of Intent for the year ended 30 June 2007. We noted the disclosure in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements because of the Trustees' intention to wind up the trust. We also noted the disclosure in the financial statements that the trust did not prepare a Statement of Intent for the period beginning 1 July 2007.

Hawke's Bay Economic Development Agency (Hawke's Bay Regional Council, Hastings District Council and Napier City Council)*Financial statements year ended: 30 June 2006*

We noted a breach of the Local Government Act 2002 because the Agency did not prepare a Statement of Intent for the year ended 30 June 2006. We noted the disclosure in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements because of the Trustees' intention to wind up the Agency.

Buller Health Trust (Buller District Council)*Financial statements year ended: 30 June 2004*

We noted a breach of the Local Government Act 2002 because the Trust did not prepare a Statement of Intent for the year beginning 1 July 2004.

Waikato Quarries Limited (Waikato District Council)*Financial statements year ended: 30 June 2006*

We noted a breach of the Local Government Act 2002 because the company did not prepare a Statement of Intent for the year ended 30 June 2006.

Port Westland Limited (Grey District Council)

Financial statements year ended: 30 June 2007

We noted a breach of the Local Government Act 2002 because the company did not prepare a Statement of Intent for the year beginning 1 July 2007.

Tuam Limited (Christchurch City Council)

Financial statements year ended: 30 June 2007

We noted a breach of the Local Government Act 2002 because the company did not prepare a Statement of Intent for the year ending 30 June 2007.

Publications by the Auditor-General

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

- Procurement guidance for public entities
- Public sector purchases, grants, and gifts: Managing funding arrangements with external parties
- The Accident Compensation Corporation's leadership in the implementation of the national falls prevention strategy
- Ministry of Social Development: Preventing, detecting, and investigating benefit fraud
- Guardians of New Zealand Superannuation: Governance and management of the New Zealand Superannuation Fund
- Annual Plan 2008/09 – B.28AP(08)
- Central government: Results of the 2006/07 audits – B.29[08a]
- The Auditor-General's Auditing Standards – B.28(AS)
- Responses to the Coroner's recommendations on the June 2003 Air Adventures crash
- Inland Revenue Department: Effectiveness of the Industry Partnership programme
- Audit committees in the public sector
- New Zealand Trade and Enterprise: Administration of grant programmes – follow-up audit
- Mental health services for prisoners
- New Zealand Agency for International Development: Management of overseas aid programmes
- Liquor licensing by territorial authorities

Website

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