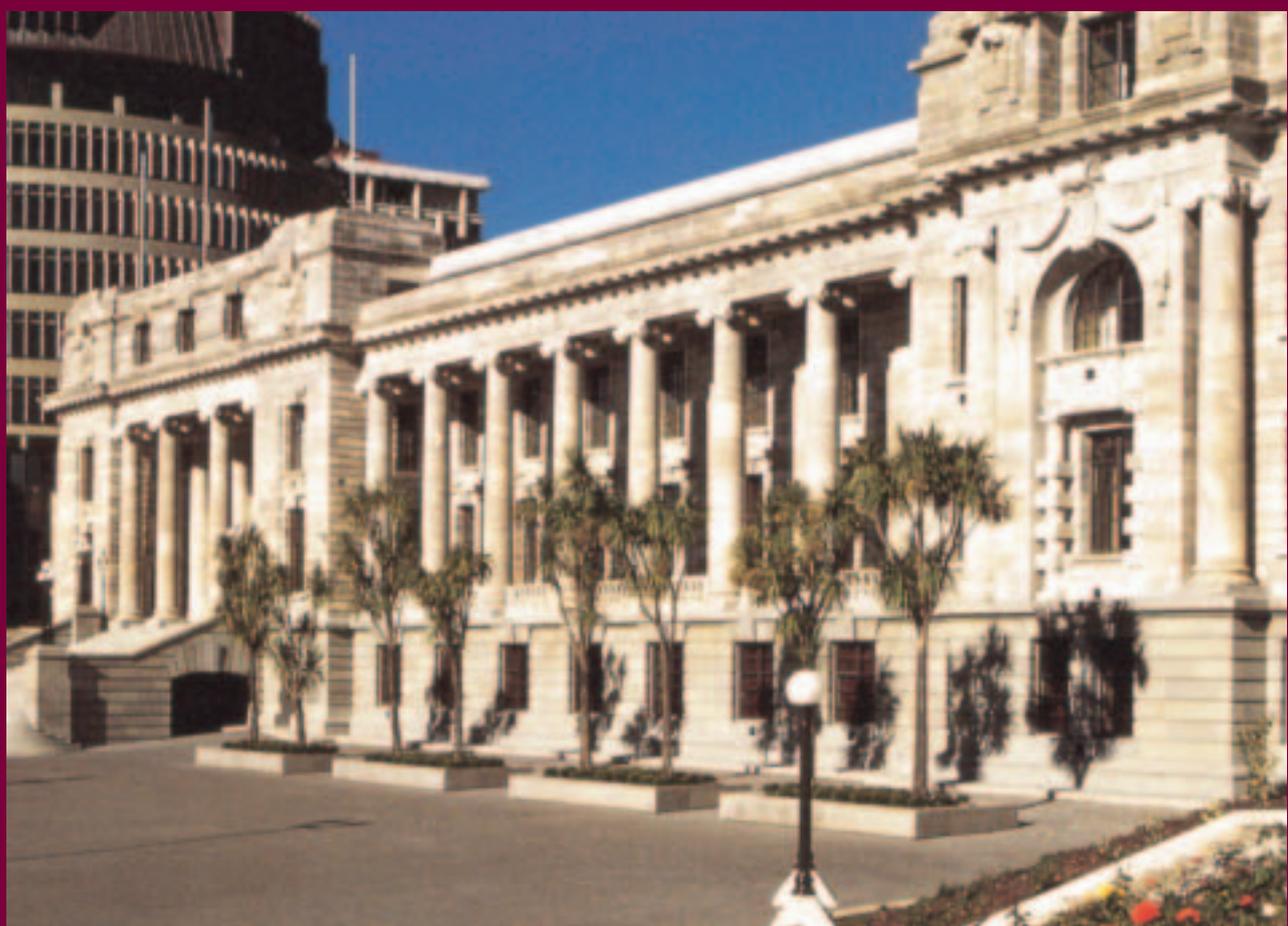


# Local Government: Results of the 2001-02 Audits

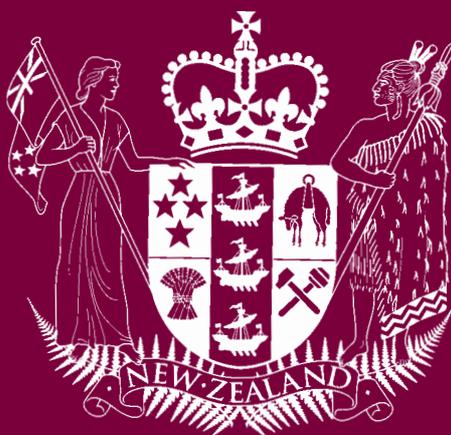


**Report of the  
Controller and Auditor-General**

*Tumuaki o te Mana Arotake*

**ISBN 0-478-18107-8**

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**Report of the  
Controller  
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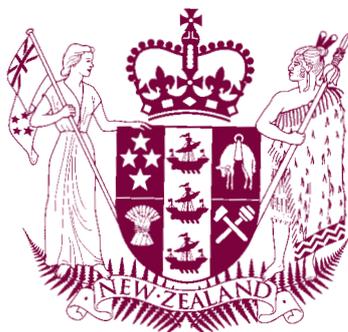
*Tumuaki o te Mana Arotake*

**on**

**Local Government:  
Results of the  
2001-02 Audits**

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





Rt Hon Jonathan Hunt  
Speaker  
House of Representatives  
WELLINGTON

Mr Speaker

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

Yours sincerely

A handwritten signature in blue ink, appearing to read 'K B Brady', written in a cursive style.

K B Brady  
Controller and Auditor-General

Wellington  
29 August 2003







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# Introduction

This report is our “annual report” on the audits for 2001-02 of the local government sector in the Auditor-General’s portfolio under the Public Audit Act 2001. Most of these audits are of regional and territorial local authorities and their subsidiary entities that were established and governed principally by the former Local Government Act 1974.

As we describe in paragraph 1.101 on page 11, the new Local Government Act 2002 has replaced that 1974 Act. In addition, the legislation under which local authorities levy and collect their income from rates has also been updated in the form of the Local Government (Rating) Act 2002.

The number of entities within the Auditor-General’s local government audit portfolio has also grown as a result of the definition of a “public entity” in the Public Audit Act including “controlled” entities. We discuss this consequence in section 2.1 of the report on pages 31-37.

## 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;
- identify areas that are, in our view, appropriate for legislative or other clarification or amendment; and
- describe examples of our expectations of “best practice” on various matters of financial management and reporting, governance, and administration.

## Contents of this Report

The contents of this report are grouped into four parts:

Part 1 (starting on page 9) reports on matters that arose during the course of the conduct of the 2001-02 annual audits. This year, we have chosen to identify those entities on whose financial reports – some of which relate to financial years before 2001-02 – we issued a qualified audit opinion (see pages 12-16).





## INTRODUCTION

Part 2 (starting on page 29) deals with other issues that arose during 2001-02 and have some longer-term consequences. Notable among these issues are the new public entities subject to the Auditor-General's audit under the Public Audit Act 2001 (see pages 31-37), and the outcome of and issues arising from a prosecution that we initiated under the Local Authorities (Members' Interests) Act 1968 (see pages 50-53).

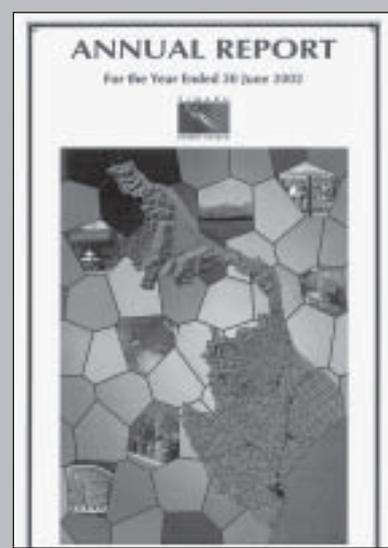
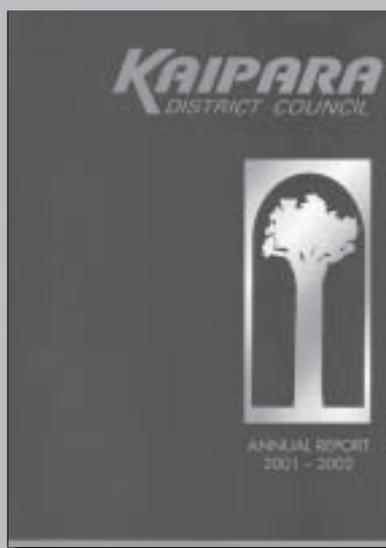
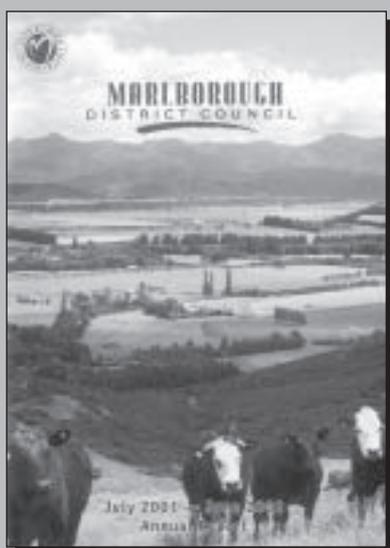
Part 3 (starting on page 55) describes some of the issues that we have identified for attention during this year's 2002-03 annual audits. We will give particular attention to local authorities' implementation of the two new major pieces of legislation under which they now operate – the Local Government Act 2002 and the Local Government (Rating) Act 2002 (see pages 57-62).

Part 4 (starting on page 71) provides a review and commentary on the recent financial performance of licensing trusts and their related entities. The scope of business activities conducted by them has become increasingly wide and complex, and some have been more successful than others in the changed environment.



One

# Issues from the 2001-02 Audits







## 1.1 Review of the 2001-02 Year

**ONE**

1.101 Local authority annual reporting and audit engagements for 2001-02 were conducted against a backdrop of actual and impending change:

- The Local Government (Rating) Act 2002 (which received Royal Assent on 30 March 2002) amended rating tools and practices for the 2003-04 financial year. Local authorities quickly began making the substantial changes to their rating systems and information requirements necessary to implement the changes on 1 July 2003; and
- The replacement of the Local Government Act 1974 by the new Local Government Act 2002 (which received Royal Assent on 24 December 2002).

1.102 Against this backdrop, the overall timeliness of local authority reporting – both the preparation of draft financial statements and the subsequent adoption of the audited results – continued the 2000-01 trend of “slipping back” towards the statutory deadline of 30 November 2002 (see pages 17-18).

1.103 A number of other matters affected the 2001-02 audit round:

- the revaluation of local authority infrastructural assets under the transitional arrangements of Financial Reporting Standard No. 3: *Accounting for Property, Plant and Equipment* (FRS-3) (see pages 20-21);
- the FRS-3 requirement that local authorities value and include heritage collections in their financial statements (see pages 19-20);
- the valuation and inclusion of land under roads as a further requirement of FRS-3 (see page 22);
- assessing the financial impact, if any, of the “leaky building” syndrome (see pages 23-24); and
- assessing the impact of the Privy Council decision on rating apportionments (see pages 25-28).

1.104 The last two matters arose after 30 June 2002 but required local authorities to consider the potential impact of both issues on 2001-02 financial statements.





## 1.2 Non-standard Audit Reports Issued

- 1.201 Last year, we resumed reporting on the non-standard audit reports issued on the annual financial reports. This year we have identified the public entities for which we issued a non-standard audit report.
- 1.202 This section covers non-standard audit reports issued during the year 1 April 2002 to 31 March 2003 and outlines the nature of those reports.

### Why Are We Reporting This Information?

- 1.203 An audit report is addressed to the readers of an entity's financial report. However, all public entities are in one sense or another creatures of statute and, therefore, also accountable to Parliament. We consider it important to draw Parliament's attention to the range of matters which give rise to non-standard audit reports.
- 1.204 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?

- 1.205 A non-standard audit report is one that contains:
- a **qualified audit opinion**; and/or
  - an **explanatory paragraph**.<sup>1</sup>
- 1.206 The auditor expresses a **qualified audit opinion** due to a disagreement or a limitation on scope. The type of opinion will be either an "adverse" opinion (explained in paragraph 1.209), or a "disclaimer of opinion" (paragraph 1.211), or an "except-for" opinion (paragraph 1.212).

---

<sup>1</sup> 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* (AS-702).





- 1.207 The auditor will include an **explanatory paragraph** (see paragraphs 1.213-1.214) in the audit report in order to draw attention to:
- a breach of law; or
  - a fundamental uncertainty.
- 1.208 An explanatory paragraph is included in the audit report in such a way that it cannot be mistaken for a qualification of the opinion.

ONE

### “Adverse” Opinion

- 1.209 An “adverse” opinion is expressed when there is disagreement between the auditor and the entity about the treatment or disclosure of a matter in the financial report and, in the auditor’s judgement, the treatment or disclosure is so material or pervasive that the report is seriously misleading.
- 1.210 Expression of an “adverse” opinion represents the most serious type of non-standard audit report.

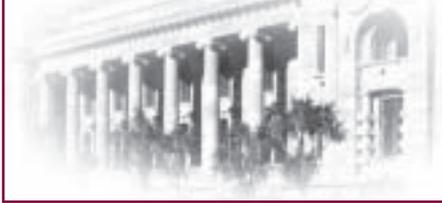
### “Disclaimer of Opinion”

- 1.211 A “disclaimer of opinion” is expressed when the possible effect of a limitation on the scope of the auditor’s examination is so material or pervasive that the auditor has not been able to obtain sufficient evidence to support, and accordingly is unable to express, an opinion on the financial report.

### “Except-for” Opinion

- 1.212 An “except-for” opinion is expressed when the auditor concludes that either:
- the possible effect of a limitation on the scope of the auditor’s examination is, or may be, material but is not so significant as to require a “disclaimer of opinion” – in which case 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; or





## NON-STANDARD AUDIT REPORTS ISSUED

### ONE

- the effect of the treatment or disclosure of a matter with which the auditor disagrees is, or may be, material but is not, in the auditor's judgement, so significant as to require an "adverse" opinion – in which case the opinion is qualified by using the words "except for the effects of" the matter giving rise to the disagreement.

### *Explanatory Paragraph*

- 1.213 In certain circumstances, it may be appropriate for the auditor to include in the audit report additional comment, by way of an explanatory paragraph, to draw attention to a matter that is regarded as relevant to a proper understanding of the financial report.
- 1.214 For example, it could be relevant to draw attention to the entity having breached its statutory obligations, or to a fundamental uncertainty which might make the going concern assumption inappropriate. Inclusion of an explanatory paragraph tends to constitute the most common type of non-standard audit report.

### **Summary of the Non-standard Audit Reports Issued**

- 1.215 The following table summarises the non-standard audit reports issued during the year 1 April 2002 to 31 March 2003. Appendix 1 on pages 95-102 provides the details of those reports.
- 1.216 No "disclaimers of opinion" were issued during the period.





**NON-STANDARD AUDIT REPORTS ISSUED**

**B.29[03b]**

<b>Name of Entity</b>	<b>Adverse Opinion</b>	<b>Except-for Opinion</b>	<b>Explanatory Paragraph</b>
Central Hawkes Bay District Council and Group			X
Chatham Islands Council	X		
Hurunui District Council and Group			X
Whakatane District Council			X
Rodney District Council Sinking Fund Commissioners			X
Patriotic and Canteen Funds Board	X		
<i>Racecourse Reserve Trustees –</i> Geraldine Oamaru Waimate Winton	X X X	X	
<i>Hall Board –</i> Haast Community Millerton	X X		
Whangarei Tourism Trust	X		
Wairarapa Cultural Trust	X		
<i>Museum Trust Board –</i> Canterbury Museum of Transport and Technology Otago Southland Museum and Art Gallery	X X X X		
<i>Licensing Trust/related entity –</i> Flaxmere (Charitable) Flaxmere Group Masterton (Charitable) Masterton Group Mount Wellington Trust Hotels Limited Mount Wellington and Group Porirua and Group Rimutaka (Charitable) Rimutaka Group Tararua Foundation Trust House (Charitable) Trust House Limited and Group		X X X X    X X X X X X	     X X X

**ONE**





## NON-STANDARD AUDIT REPORTS ISSUED

**ONE**

Name of Entity	Adverse Opinion	Except-for Opinion	Explanatory Paragraph
Village Pool Charitable Trust		X	
<i>Reserve Board –</i>			
Bledisloe Park Domain		X	
Lake Okataina Scenic		X	
Lake Rotoiti Scenic		X	
Mapiu Domain		X	
Matata Recreation		X	
Nelson Creek		X	
Ongarue Domain		X	
Ruakaka		X	
Tamaterau		X	
Waipu Cove		X	
Whatitiri		X	
Central South Island Fish and Game Council		X	
Waste Disposal Services		X	
Eastland Network Limited			X
America's Cup Village Limited and Group			X
Hawkes Bay Airport Authority			X
Opua Marine Management Limited			X
Tourism Services Limited			X
Tourism Facilities Limited and Group			X
Total Training Systems Limited			X
Nelmac Canterbury Limited			X
Nelmac Wellington Limited			X
Central Hawkes Bay Works Limited and Group			X
Tararua Roding Limited			X
Upper Hutt Economic Development Agency			X
Tauranga District Education Trust and Group			X
Mangere Cemetery Board			X
Infrastructure Auckland and Group			X





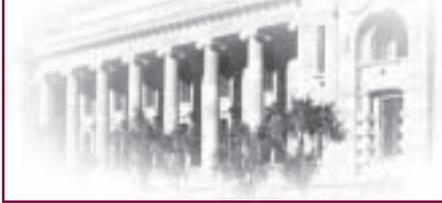
## 1.3 Timeliness of Annual Reporting

**ONE**

- 1.301 Each year we examine the timeliness of local authority annual reporting.
- 1.302 Under the Local Government Act 1974 (applicable for the 2001-02 annual reports), a local authority had until 30 November 2002 to adopt its audited annual report for the preceding financial year.
- 1.303 As there was no statutory time limit within which to publish the annual report, some councils did not report audited financial information to their ratepayers until six months after the end of the preceding financial year.
- 1.304 We considered the 30 November reporting deadline was too long after the end of the financial year.<sup>2</sup>
- 1.305 The Local Government Act 2002 will shorten the deadline by one month, requiring adoption by 31 October of audited annual reports for the preceding financial year, and publication (with a summary of the information to be published in the annual report) by 30 November. This change applies to all Councils with effect from the financial year ending 30 June 2005.
- 1.306 For 2001-02:
- the audits of 41 of the 86 local authorities were completed by 31 October 2002;
  - the audits of 43 local authorities were completed during November 2002 (while a number of local authorities had planned completion before November, a significant number were only completed in November because of “slippage”);
  - Wairoa District Council’s annual report was finalised on 29 November 2002 but could not be adopted by the Council until 3 December 2002; and
  - Waitomo District Council was unable to finalise its annual report until December 2002. The audit report was issued on 17 December 2002.

<sup>2</sup> *Local Government: Results of the 1999-2000 Audits*, parliamentary paper B.29[01a] 2001, pages 20-23.





## TIMELINESS OF ANNUAL REPORTING

- 1.307 Overall, these results were worse than in 2000-01.
- 1.308 With the replacement of the Local Government Act 1974 by the Local Government Act 2002, and, in particular, completion of the transitional period for infrastructure accounting, local authorities may be in a better position to improve reporting timeliness. It still represents a considerable challenge for some local authorities to bring their reporting processes forward by at least one month.

**ONE**





# 1.4 Accounting Issues

**ONE**

## Heritage Assets

- 1.401 Financial Reporting Standard No. 3 *Accounting for Property, Plant and Equipment* (FRS-3) requires the valuation and recognition of heritage assets in local authorities' financial statements. FRS-3 also requires heritage assets to be depreciated over their useful lives.
- 1.402 Many local authorities have heritage assets. Types of assets include:
- art galleries;
  - regional collections (such as early settler artefacts);
  - rare book collections; and
  - war memorials.
- 1.403 Often, these heritage assets are held within museums or other entities associated with a local authority, although a substantial number are held within local authority operating departments.
- 1.404 The valuation of such heritage assets is problematic because:
- apart from the valuation of art collections and other tradeable artefacts, there is no ready market generally available to assess the value of heritage assets; and
  - there may be no *generally accepted* methods of valuation for certain heritage assets where there is no evidence of a ready market.
- 1.405 Response to the FRS-3 requirements in respect of heritage assets has been variable. Some local authorities did obtain valuations but many were reluctant to do so, claiming that:
- valuations would cost local authorities or their associated entities a substantial amount for few discernible benefits; and
  - heritage collections generally have no or negligible depreciation because of their retention in controlled-environment locations which preserve their condition, or because of their exceptionally long life.





## ACCOUNTING ISSUES

### ONE

- 1.406 As the response from local authorities was not consistent, our audit teams were required to make judgements about whether non-inclusion of heritage assets in a local authority's financial statements was acceptable.
- 1.407 No local authorities' audit opinions were qualified in 2001-02 for non-inclusion of heritage assets, although the opinion on the financial statements of some entities associated with local authorities were (see section 1.2 on pages 12-16). However, the inconsistent approach among local authorities to valuation of heritage assets is an unsatisfactory situation.
- 1.408 The National Asset Management Steering Group (NAMS) has agreed to consider the issue and provide advice to local authorities as part of its broader concern with accounting and valuation of assets. A project team recently held its first meeting.
- 1.409 The NAMS advice will be important to establish a consistent approach to valuation of heritage assets that are generally of high cultural value to their local communities and have a place in the system for retention of New Zealand's history. We will work with NAMS in resolving the issue.

### Infrastructural Assets

- 1.410 Accounting for infrastructural assets is determined by FRS-3. This standard was effective for balance dates of 31 March 2002 and later. A transitional period, ending on 30 June 2004, was set to enable local authorities to bring their accounting practices into line with the standard's requirements.
- 1.411 Key features of accounting for infrastructural assets in FRS-3 are:
- retention of the practice of asset management by components<sup>3</sup>, which has become best practice in the local authority sector;
  - valuations moving from "fair value" on an "existing use" to a "fair value", "highest and best use" basis; and
  - retention of depreciated replacement cost (DRC) for valuing specialised assets – including infrastructural assets.

---

3 That is, identifying and allocating costs on the basis of components of an asset that have different useful lives or provide benefits in different patterns.





- 1.412 The impact of the standard was minimal in relation to valuing infrastructural assets, as FRS-3 continues the DRC valuation basis – although with some greater specificity. This contrasts with the potential impact on local authorities’ land and building assets. However, because of the dominance of infrastructural asset values, the effect of changes in land and building values on local authority statements of financial position was comparatively small.
- 1.413 For many local authorities, 2001-02 represented the first revaluation cycle of infrastructural assets under FRS-3. Given the continuation of valuation practice, we were surprised that local authorities had difficulty in completing revaluations. It was also disappointing that some valuation service providers contributed to these difficulties by both the quality of their work and its timeliness. Late completion of these revaluations appeared to be a prime contributor to “slippage” in completion of draft financial information and annual reports noted in section 1.3 on page 17.
- 1.414 We observed two matters in our auditing of revaluations:
- The importance of planning for revaluation. The valuation of infrastructural assets is important for planning, financial management and reporting purposes. While a revaluation may represent only an upgrade of existing valuation information, it is still a substantial exercise requiring careful consideration of the result. Planning for timely completion is important.
  - The importance of asset information. Revaluations (and valuations) are dependent on the quality of asset information available. While the sector has worked progressively on development of asset information and asset management plans, the quality of information available varies.<sup>4</sup> We are aware that substantial work was required by some individual authorities to enable 2001-02 revaluations to be completed.
- 1.415 Revaluations will continue to be part of each local authority’s financial planning and reporting framework. Timely completion of revaluations and the quality of asset information will continue to determine the ease with which the sector deals with this matter.

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<sup>4</sup> See our 2002 report *Local Government: Results of the 2000-01 Audits*, parliamentary paper B.29[02c], pages 12-13. Those comments are still applicable.





### Land Under Roads

#### ONE

- 1.416 Land under roading networks has been dealt with inconsistently within the sector over past years. While most Councils included land under roads in their financial statements, some did not. There was also, and remains, no generally accepted method of valuation. We encourage the sector to devise an acceptable method that all Councils can apply.
- 1.417 However, FRS-3 does not provide any basis to exclude such land from financial statements. Consequently, we expected local authorities to include these assets in 2001-02 on some reasonable valuation basis.
- 1.418 Local authorities employed a range of valuation techniques – from classification of land in accordance with its associated environs and attributing a value based on that neighbouring land, through to attributing an average land value across the authority's district. In some cases, the land value was subject to a discount factor recognising that the land under the road did not necessarily have the full value attributes of that neighbouring land.
- 1.419 Generally, the valuation has had a significant impact on total reported asset values. However, because land does not depreciate, its inclusion in a local authority's financial statements has no impact on the operating surplus or deficit.
- 1.420 There will continue to be a range of valuation bases applied until an accepted valuation methodology is determined. Further, we will not expect these assets to be revalued until an accepted methodology is determined. In all cases, we will expect full disclosure of the basis of valuations.
- 1.421 When a methodology is agreed, there is potential for revaluation adjustments to have a substantial effect on the reported results of many local authorities. This will happen where a revaluation results in a downward adjustment, because FRS-3 requires valuation decrements which exceed the amount of any net cumulative past revaluation increments to be recognised in the statement of financial performance.





## Environmental Obligations

- 1.422 We have reported previously on accounting for environmental obligations.<sup>5</sup> In the local authority context, this has been primarily applied to accounting for environmental obligations associated with local authority landfills – both those currently in operation and those now closed. We provided detailed comment on this aspect in a 1997 report.<sup>6</sup>
- 1.423 Consent obligations generally require landfill owners to undertake a post-closure care programme ensuring that there are no on-going detrimental effects to the environment from such actions as leachate.
- 1.424 Accounting for environmental obligations is covered by Financial Reporting Standard No. 15 *Provisions, Contingent Liabilities and Contingent Assets*. It requires recognition of the future obligations associated with landfill consents. In the case of currently operating landfills, there is also an associated asset with a local authority's ability to continue operating under the allowable consent. This asset reduces over time as landfill capacity is consumed.
- 1.425 The Society of Local Government Managers (SOLGM) has drawn up and promulgated an approach to accounting for environmental obligations. The sector has generally handled the accounting requirements effectively using the SOLGM model.
- 1.426 There has been a minor issue of whether some local authorities have identified all used and closed landfills. This is a problem particularly for rural-based local authorities. From our enquiries, it is unlikely that there are any substantial unrecognised liabilities associated with closed landfills.

**ONE**

## Leaky Buildings

- 1.427 After 30 June 2002, but prior to many local authorities completing their draft financial statements, the issue of leaky buildings (or “weather-tightness”) received national attention. Generally, it was a matter unrecognised by the sector to that point.

5 *Second Report for 2000*, parliamentary paper B.29[00b], pages 43-51 and *Local Government: Results of the 1999-2000 Audits*, parliamentary paper B.29[01a] 2001, pages 170-175.

6 *Second Report for 1997*, parliamentary paper B.29[97b], pages 53-60 and 113-121.





## ACCOUNTING ISSUES

### ONE

- 1.428 Despite the timing, it did cause local authorities to consider whether the matter should be recognised in their financial statements – either as:
- a liability, for either known liabilities or for a reasonable estimate of probable liability arising from a Council’s consent and compliance activity on monolithic-clad buildings; or
  - a contingent liability.
- 1.429 By the time of finalisation of annual reports, it was still unclear what the extent of the problem was and how it might be determined who, if any party, was liable – particularly where the builder had gone out of business. One local authority did make an accrual for a liability based on its specific circumstances through previous consideration of this matter.
- 1.430 The Weathertight Homes Resolution Services Act 2002 was enacted in November that year. The Resolution Service, established by the Act to hear claims by owners of leaky buildings, had received 740 applications covering 1,659 individual dwellings as at early-June 2003.
- 1.431 The Government is currently considering options for better regulation of the building industry.
- 1.432 The recognition in financial statements of any liability will need to be considered by each local authority on an on-going basis, determined from its own circumstances and experience.





## 1.5 Separate Properties and Rating Apportionments

**ONE**

- 1.501 For the past four years we have reported on the accounting and audit implications for local authorities of ongoing court proceedings between local authorities and the Valuer-General as to what is a “separate property” for the purposes of valuation and rating.
- 1.502 Under the Rating Powers Act 1988, local authorities could levy only certain charges – such as a uniform annual general charge – on each separate property. Some local authorities levied such charges on apportionments of a single separate property. The dispute concerned how a separate property is identified for rating and valuation purposes.
- 1.503 The legality of the historical rating apportionment practices is now clear, following a Privy Council decision on 7 October 2002.<sup>7</sup> The Privy Council favoured the approach of local authorities rather than the Valuer-General, but the decision did not address all rating practices.

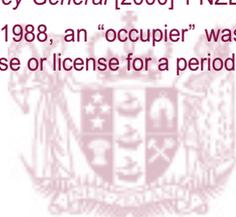
### Background

- 1.504 The Valuer-General argued that a “separate property” means a property as defined by a certificate of title, regardless of the number of occupiers. The local authorities argued that a property that is “separately occupied” should be entered as a “separate property” on the valuation roll. The High Court found in favour of the local authorities, but the Court of Appeal found in favour of the Valuer-General.
- 1.505 The Privy Council allowed the appeal of three councils and Local Government New Zealand (LGNZ) against the Court of Appeal’s decision, and restored the declarations made in the High Court.<sup>8</sup> The Privy Council agreed with the “occupation” approach of the New Zealand High Court – that where two or more people occupy land, the Valuer-General should enter each *separately occupied* part of the property as a separate property on the valuation roll, provided the property is *occupied* within the meaning of the Rating Powers Act.<sup>9</sup>

<sup>7</sup> *Rodney District Council & Others v Attorney-General* (Privy Council Appeal No. 29 of 2001).

<sup>8</sup> *Rodney District Council v Attorney-General* [2000] 1 NZLR 101.

<sup>9</sup> Under the Rating Powers Act 1988, an “occupier” was the owner of land or any person who had a right to occupy land under a lease or license for a period of a year or more.





## Financial Statements Disclosure

1.506 In 1998, when the rating apportionments issue was identified, we took the view that where authority for collection was in doubt local authorities should disclose the value of rates collected as a contingent liability in their financial statements for the year ended 30 June 1998. Because of the lack of resolution of the issue, we maintained that view for the years ended 30 June 1999, 2000 and 2001. In each of those years, some local authorities also recognised actual liabilities in relation to this issue.

## Impact of the Privy Council Decision

1.507 Following the Privy Council decision, LGNZ commissioned legal advice on its impact for affected local authorities that had recognised liabilities or disclosed contingent liabilities in their financial statements.

1.508 The advice identified three “categories” of liabilities:

- Definitely no longer liabilities.
- Probably no longer liabilities and not warranting disclosure unless actual claims are lodged.
- Still liabilities.

### Definitely No Longer Liabilities

1.509 The Privy Council decision established that a property shown in the valuation roll as an apportionment, but in respect of which a person had a right to occupy the property for a year or more, should have been shown as a separate property. Therefore, a local authority that has levied separate charges on such a property would have a strong defence to any claim for a refund. Accordingly, amounts disclosed in provisions or contingent liability notes for such properties could be eliminated.





### *Probably No Longer Liabilities*

- 1.510 The Privy Council did not explicitly address the Valuer-General's discretion under section 8(2) of the Valuation of Land Act 1951 to treat properties occupied for periods of less than one year as separate properties. This means that many properties that have been subject to separate charges, but which have been occupied under tenancies on a monthly basis, are not covered by the judgement.
- 1.511 However, the circumstances supporting a refund of any separate charges on such properties have not been established. Therefore, LGNZ has advised local authorities that a liability for such properties should continue to be disclosed only where proceedings have been brought for recovery of particular charges.
- 1.512 Amounts disclosed in provisions or contingent liability notes in this category could be eliminated, subject to there being no proceedings for recovery. We are not aware of any proceedings issued against local authorities for recovery, or any claims received.

ONE

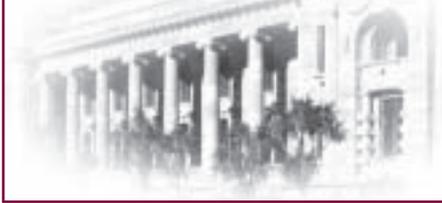
### *Still Liabilities*

- 1.513 The Privy Council decision also confirmed that separate charges levied against apportionments where there is no underlying separate occupation are unlawful. Amounts disclosed in provisions or contingent liability notes in this category of property that are not based on separate occupation should be disclosed as liabilities and local authorities should make refunds.

## **Subsequent Adjustment of Liabilities**

- 1.514 Following the Privy Council decision in October 2002, some affected local authorities amended or eliminated the contingent liability disclosures or provisions recognised in their financial statements for the year ended 30 June 2002. However, in other cases, local authorities were not able to address the matter prior to issue of the audit report for that year, and will need to do so in their 30 June 2003 financial statements.





## SEPARATE PROPERTIES AND RATING APPORTIONMENTS

### Local Government (Rating) Act 2002

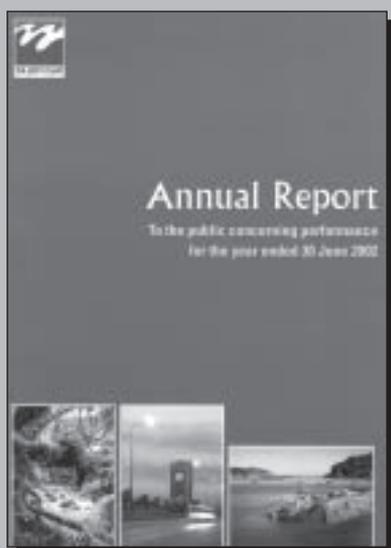
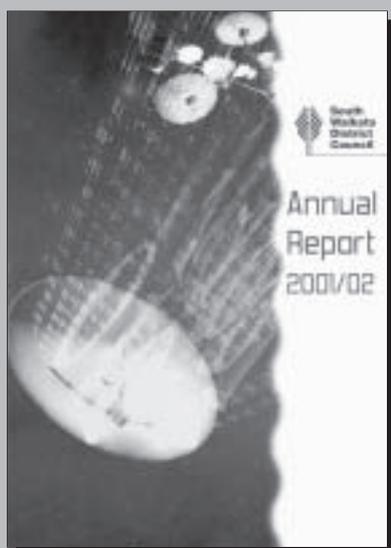
1.515 In March 2002, the Local Government (Rating) Act 2002 was passed with effect from the rating year starting on 1 July 2003. This Act has clarified the liability for, and basis of, rates for the future.

**ONE**



Two

# Other Issues Arising During 2001-02







## 2.1 Impact of the Public Audit Act 2001 – New Public Entities

TWO

- 2.101 In our 2002 report, we discussed the impact on the local government sector of the extended definition of “public entity” in section 5 of the Public Audit Act 2001 (the Act).<sup>1</sup>
- 2.102 The Act has extended the mandate of the Auditor-General in the sector by making the Auditor-General the auditor of any entity “controlled” by one or more public entities. The term “public entity” now includes any “council-controlled organisation” as well as core local authorities. This has increased the number of entities audited by the Auditor-General in the local government sector.
- 2.103 In this section, we discuss progress in identifying new public entities in the sector, and highlight some issues that have arisen in applying the “control” test.

### The “Control” Test

- 2.104 Under section 5(1)(f) of the Act, the Auditor-General is the auditor of every entity that is controlled by one or more local authorities or council-controlled organisations.
- 2.105 The Act uses both legal and accounting definitions of control. Section 5(2) says –

*For the purposes of subsection (1)(f), an entity is controlled by 1 or more other entities if –*

- (a) the entity is a subsidiary of any of those other entities; or*
- (b) the other entity or entities together control the entity within the meaning of any relevant approved financial reporting standard; or*
- (c) the other entity or entities can together control directly or indirectly the composition of the board of the entity within the meaning of sections 7 and 8 of the Companies Act 1993 (which, for the purposes of this paragraph, are to be read with all necessary modifications).*

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<sup>1</sup> *Local Government: Results of the 2000-01 Audits*, parliamentary paper B.29[02c] 2002, pages 65-67.





## IMPACT OF THE PUBLIC AUDIT ACT 2001 – NEW PUBLIC ENTITIES

### TWO

- 2.106 The “control” test is wider than that normally applied (under the Companies Act 1993, for example) to determine whether one entity unilaterally controls another. Under the Act, an entity is also a public entity where *two or more public entities together exercise control over it*.
- 2.107 The two legal limbs of the control test in paragraphs (a) and (c) of section 5(2) are reasonably straightforward. However, analysis of control under the accounting test in paragraph (b) is often more difficult.

### Control Under the Legal Tests

2.108 Issues to note under the legal tests include:

- *Indirect control* – A power exercised by a Mayor of a local authority in that capacity (for example, the appointment of trustees of a trust) is regarded as being exercised on behalf of the local authority – section 5(2)(c).
- *Ex officio appointees* – If members of a local authority are entitled to be represented on the board of a trust or other entity *ex officio*, – i.e. by right of being councillors – the council will control the other entity if the *ex officio* appointees are in a majority – section 5(2)(c), and section 7 of the Companies Act 1993.
- *Shared power of appointment* – A local authority may control another entity, even if it shares the power to appoint members of the governing body with a private sector organisation – section 5(2)(c), and section 7 of the Companies Act 1993.<sup>2</sup>
- *Fiduciaries* – A power exercised in a fiduciary capacity is to be disregarded for the purposes of control. For example, where a Mayor exercises a power under a trust deed as a trustee of the trust rather than as Mayor, the exercise of that power is not relevant to whether the local authority controls the trust – section 8 of the Companies Act 1993.

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2 The definition of “council-controlled organisation” in the Local Government Act 2002 also covers a shared power of appointment.





## Control Under the Accounting Test

**TWO**

**2.109** The relevant approved financial reporting standard, for the purpose of section 5(2)(b), is FRS-37: *Consolidating Investments in Subsidiaries*. FRS-37 is concerned with control of an ownership form, as opposed to control of a lending, purchase or regulatory form. Control is defined in paragraph 4.13 of FRS-37 as –

*“Control” by one entity over another entity exists in circumstances where the following parts (a) and (b) are both satisfied:*

*(a) the first entity has the capacity to determine the financing and operating policies that guide the activities of the second entity, except in the following circumstances where such capacity is not required:*

*(i) where such policies have been irreversibly predetermined by the first entity or its agent; or*

*(ii) where the determination of such policies is unable to materially impact the level of potential ownership benefits that arise from the activities of the second entity.*

*(b) the first entity has an entitlement to a significant level of current or future ownership benefits, including the reduction of ownership losses, which arise from the activities of the second entity.*

**2.110** Part (a) of paragraph 4.13 is referred to in FRS-37 as the “power” element, and part (b) is the “benefit” element. These elements are linked, as ownership benefits are derived from the determination of an entity’s financing and operating policies. Both elements must be present for control to exist, unless one of the exceptions to the power element in subparagraphs (i) or (ii) applies.

**2.111** FRS-37 sets out a number of rebuttable presumptions, which, in the absence of any evidence to the contrary, will indicate the existence of control (paragraph 5.10). Where a situation does not meet one of the rebuttable presumptions, FRS-37 lists a number of indicators of ownership powers and indicators of ownership benefits that may be sufficient to establish control (paragraph 5.11).





## **Power Element**

**2.112** Under FRS-37, an entity is presumed to control another entity if it appoints a majority of members of the second entity's governing body or controls a majority of voting rights at a meeting (i.e. a rebuttable presumption applies). FRS-37 overlaps with the legal limbs of the control test in this respect. However, FRS-37 goes further than the legal tests by setting out other indicators of power that are not solely related to appointment of the governing body or voting rights. The exemptions to the power element are also a significant extension to the legal tests of control.

## **Benefit Element**

**2.113** The benefit element requires the possible parent to have an entitlement to a significant or greater level of ownership benefits from the possible subsidiary's activities. Ownership benefits are benefits in the nature of a return on an investment. It is important to note that having an entitlement is sufficient – benefits do not have to be received.

**2.114** Types of ownership benefits include:

- benefits from distribution of earnings or net assets (for example, a right to a significant level of the net assets of an entity in liquidation); or
- other benefits from control over net assets (for example, synergistic benefits from a parent and subsidiary combining their activities); or
- benefits from an entity undertaking activities that are complementary to those of the parent (for example, a local authority establishing a trust to undertake an activity formerly provided by the authority, such as a library or a swimming pool).

**2.115** For benefits from complementary activities to apply, FRS-37 requires that all three of the following conditions apply:

- the supply of goods or services by the possible subsidiary is directly consistent with, and is likely to enhance, the operating objectives of the parent, and
- determination of the nature of the goods or services to be supplied is a direct consequence of the exercise of the parent's decision-making ability over the activities of the possible subsidiary, and





- the parent is relieved, as a result of the activity of the possible subsidiary, of an actual or constructive obligation to provide such supply; or the parent has a right to receive a future service delivery from the possible subsidiary that is not subject to additional funding to be provided by the parent.

### *Trusts Controlled by Local Authorities*

2.116 We have identified a number of charitable trusts in the local government sector as being controlled by a local authority in terms of FRS-37. The most common circumstances of control include:

- A local authority or local authorities have the right to appoint all or a majority of the trustees, in which case control under FRS-37 is presumed to exist in the absence of evidence to rebut that presumption.
- A charitable trust established by a local authority where the local authority does not appoint a majority of trustees but –
  - whose objects have been determined by the local authority and cannot be changed; and
  - whose complementary activities provide benefits to the local authority.

### *“Autopilots”*

2.117 In the case of a trust established for charitable purposes, it is reasonably common to find that the objects or purposes specified in the trust deed cannot be changed, or that substantive changes to the objects cannot be made. This is often in order to acquire or maintain status as a charity for income tax purposes.<sup>3</sup>

2.118 Such trust deeds can be an “irreversible pre-determined mechanism” or “autopilot”, in terms of the first exception to the power element in paragraph 4.13 of FRS-37. We have found that many trusts controlled by local authorities are in this category – that is, the significant policies of the trust have been irreversibly pre-determined by the local authority. Where the local authority is entitled to receive benefits from the trust, the local authority controls the trust under FRS-37.

3 A society or trust with charitable objects is exempt from paying income tax only if the Commissioner of Inland Revenue approves the objects as charitable.





### *Financing and Operating Policies*

2.119 The definition of “control” in paragraph 4.13 of FRS-37 refers to *the financing and operating policies that guide the activities of the second entity*. In the case of a charitable trust, we consider that the “policies” that guide the activities of the trust are the objects or purposes of the trust rather than day-to-day financing and operating matters such as the particular policies applying to the operational, borrowing or investment activities of the trust.

### *Benefits from Complementary Activities*

2.120 Due to the wide-ranging powers and functions of local authorities, it is common to find that the activities of a charitable trust are complementary to or consistent with the objectives of the local authority. However, in a small number of cases we have been puzzled by a local authority’s involvement in a charitable trust – for example, a charitable trust established by a local authority to perform health services in the district. In that case, it was not clear:

- that the objectives of the trust could be seen as enhancing the objectives of the local authority; and, consequently
- to what extent benefits may have been accruing to the local authority as a result of the activities of the trust.

## **Identification of New Public Entities**

2.121 To date, we have identified 110 trusts and other entities that are “controlled” by local authorities under the Act and which were not previously subject to our audit. We are still considering the status of a number of entities, and it is likely that several more will be identified as being public entities subject to our audit.

2.122 We have written to each new public entity that we have identified to explain that:

- it is a public entity; and
- as of 1 July 2001, the Auditor-General is its auditor.





2.123 We have observed that a number of local authorities do not have a clear idea of the entities that they have an interest in and may, in fact, control for the purposes of the Act. Our review of controlled entities under the Act has required them to give some attention to this. The Local Government Act 2002 requires them to undertake a further review of their associated entities to determine those that are “council-controlled organisations” and “council organisations”<sup>4</sup> under that Act.

TWO

## Council-controlled Organisations

- 2.124 As noted above, the term “public entity” includes a “council-controlled organisation” as defined in the Local Government Act 2002 (see paragraph 2.340 on page 49). The definition of “council-controlled organisation” in that Act is slightly wider than the definition of a controlled “public entity” under the Public Audit Act, as it uses a threshold of 50% for control.
- 2.125 The definition of “council-controlled organisation” is also wider than the definition of a local authority trading enterprise (LATE) under the Local Government Act 1974, as it includes both profit and non-profit entities.
- 2.126 This means that a small number of entities not currently audited by the Auditor-General have become public entities, by virtue of the definition of “council-controlled organisation”. The definition has applied from 25 December 2002. The accountability and reporting requirements for council-controlled organisations apply from 1 July 2003.

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4 A “council organisation” is a company or other organisation in which a local authority holds **any** voting rights or has the right to appoint **one or more** of the directors.





## 2.2 Collection of Money at Remote Sites

- 2.201 Last year, we said that our auditors would be reviewing councils' policies and procedures for cash collection at remote sites.<sup>5</sup>
- 2.202 As providers of a wide range of goods and services in different places, local authorities receive high volumes of small amounts of cash at sites away from the main council offices.
- 2.203 The establishment of strong internal controls for the collection of cash at these remote sites is necessary to prevent mishandling and safeguard against loss. The readily realisable nature of cash also makes it particularly prone to loss.
- 2.204 Where money is collected at a remote site, the potential for risk increases because:
- the ability to separate duties between people is usually limited; and
  - the distance of the site from the main council offices might mean that the local authority's standard internal controls are not capable of operating.

### The Work That Our Auditors Performed

- 2.205 Our auditors reviewed the written procedures that each local authority has for the collection of council money at remote council sites.
- 2.206 Our auditors then:
- selected one remote site to review cash collection procedures;
  - discussed the cash collection and banking procedures with the relevant council staff at the site;
  - performed a "walk-through" test of the procedures; and
  - considered whether the procedures being followed were consistent with the council's specified procedures.

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<sup>5</sup> *Local Government: Results of the 2000-01 Audits*, parliamentary paper B.29[02c] 2002, pages 73-75.





- 2.207 To assist our auditors in undertaking this work we provided best practice guidance on the procedures that councils should have in place for collection of cash at remote sites. The tenor of that guidance is given in Appendix 2 on pages 103-106.
- 2.208 We asked our auditors to raise any issues of concern arising out of this work with the local authority directly.

**TWO**

## What We Found

- 2.209 Our auditors selected a range of remote sites – including area offices, libraries, landfills, museums, swimming pools, and, in one case, the council-owned zoo.
- 2.210 On the whole, our auditors concluded that the controls were operating effectively for cash collection at remote sites.
- 2.211 Our auditors found that councils had documented procedures for cash collection for remote council sites (and the main council site), and that these policies and procedures were regularly reviewed and updated.
- 2.212 As expected, the ability to achieve adequate segregation of duties was an issue. Many remote sites have only one employee, or a small number of employees, and it is therefore not possible to have a number of employees involved in all the stages of the cash collection process.
- 2.213 Other issues identified by our auditors included:
- Daily bankings being prepared at the public counter – we recommend that the counting of cash is undertaken away from the view of the public.
  - Limited oversight of the cash collection process by the main council office – possible oversight controls that could be put in place include main council staff monitoring trends or consistent errors in cash (i.e. “overs and unders”), undertaking surprise cash counts of cash register floats, and undertaking regular reconciliations.
  - Variable implementation of the council’s procedures for cash collection at a remote site because the remote site did not have the systems, or the same number of staff, as the main council site.
  - Cash register tapes not being reviewed for voided or “no-sales” transactions.





## COLLECTION OF MONEY AT REMOTE SITES

2.214 The auditors used our best practice guidance to recommend improvements to councils' own written policies and procedures for cash collection at remote sites.

### TWO

2.215 Overall, we consider that the exercise was worthwhile for two reasons:

- to remind councils of the controls that are needed at remote sites; and
- to focus audit effort on an area where the potential for misappropriation can be high, even though the amounts involved are generally small.





## 2.3 Management of Separate Funds and Investments

**TWO**

- 2.301 This project revisited work undertaken in 1998<sup>6</sup> on councils' management practices for investments and separate funds.
- 2.302 In 1998, we considered whether councils were implementing long-term financial strategies, investment policies and annual plans based on consistent and credible information. We decided to re-examine these practices because of the greater emphasis on integrated financial planning with councils' overall planning and decision-making in the Local Government Bill that was before Parliament at the time this work was undertaken.
- 2.303 Our expectation is that councils, in managing their separate funds and reserves and investments, will have systems that promote:
- efficient use of funds;
  - good quality information for decision-making; and
  - adequate stewardship of and accounting for funds.

### Separate Funds

- 2.304 Separate funds can be created from a range of sources:
- separate rates, and rates by activity or area of benefit, under the Rating Powers Act 1988, and targeted rates under the Local Government (Rating) Act 2002;
  - user charges under specific Acts<sup>7</sup> and the general power under section 690A of the Local Government Act 1974;
  - developer/subdivider and reserve contributions under the Resource Management Act 1991;
  - sinking funds under the Local Authorities Loans Act 1956; and
  - funds held in trust, such as through private bequests.

<sup>6</sup> *Second Report for 1999*, parliamentary paper B.29(99b), pages 51-58.

<sup>7</sup> For example, under the Dog Control Act 1996.





## MANAGEMENT OF SEPARATE FUNDS AND INVESTMENTS

### TWO

2.305 Our findings in 1998 in relation to councils' separate funds and reserves were that, in many instances, councils:

- did not know why funds had been established;
- were unaware of whether there were any restrictions applying to the use of the separate funds;
- had not reviewed their separate funds and reserves since establishment to assess whether they were still required; and
- had set no funding level required for the fund.

2.306 We are pleased to note that councils' work to implement the financial management provisions of Part VIIA of the Local Government Act 1974 has clearly improved the management of reserves and other separate funds since our report raised these issues in 1999.

2.307 Councils hold a range of funds for which the balances and application should be separately accounted. In our review for this report, all councils had at least one such fund – with the most common type being for funds derived from separate rates, sinking funds, and then by rates by activity by area of benefit.

2.308 In addition to specific statutory requirements in some instances,<sup>8</sup> there has been a general duty to maintain such accounting records as is appropriate for accountability purposes. In the Local Government Act 1974 this was explicitly required by section 223F – *Financial systems* –

(1) *Every local authority shall adopt financial systems and reporting and record keeping procedures in accordance with this section and shall, in addition, establish and maintain a system of internal control designed to provide a reasonable assurance as to the integrity and reliability of the financial reporting of the local authority.*

(2) *The systems and procedures adopted shall –*

...

(f) *Show in a full and complete manner –*

...

(iii) *The application of all funds held or received for any particular purpose (such as special funds, rates, special rates, separate rates and charges, and trusts) and the amount and location of such funds while held by the local authority:*

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8 For instance, for Sinking Funds and separate rates.





2.309 While less explicitly required under the more empowering approach of the Local Government Act 2002, section 14(1) of this Act provides principles that local authorities must act in accordance with, which include that –

(a) a local authority should –

(i) conduct its business in an open, transparent, and democratically accountable manner; and

(ii) give effect to its identified priorities and desired outcomes in an efficient and effective manner:

...

(g) a local authority should ensure prudent stewardship and the efficient and effective use of its resources in the interests of its district or region.<sup>9</sup>

2.310 To meet principles such as these and others, local authorities will need to continue to consider whether revenue generated for particular purposes or from particular sources should be separately accounted for, for the purposes of financial systems and reporting.

### Management Information

2.311 Almost all Councils had identified the purpose for which separate funds were held. Likewise, while systems varied greatly, almost all local authorities had appropriate systems for ensuring that separate funds are spent according to any terms set for their use.

2.312 In our auditors' view, appropriate information was provided to councils (such as through regular reporting systems and during the Annual Plan process) to allow councillors to be aware in their financial decision-making of:

- the existence and purposes of separate funds;
- the balances of these separate fund accounts; and
- the council's overall liquidity position should it need to meet commitments from separate funds.

<sup>9</sup> See also section 101(1), which requires a local authority to manage its revenues, expenses, assets, liabilities, investments, and general financial dealings prudently and in a manner that promotes current and future interests of the community.





### *Effectiveness of Management Practices*

## TWO

- 2.313 Overall, we are satisfied that councils' management practices for separate funds are effective, and we believe that these practices have improved since our review in 1998.
- 2.314 About a quarter of councils held separate funds that were no longer used, or did not appear to have a reason for existing. In most instances, such unused funds had small balances and councils were proposing to review their purpose and use.
- 2.315 Just fewer than 40% of councils have separate fund accounts with overdrawn balances. However, in most instances the deficits were associated with infrastructure capital development or specific projects, with the overdrawn balances to be recovered over time by rates revenue.
- 2.316 There were very few instances in which funds were held in trust under terms that required the funds to be separately invested. However, where such terms exist, councils appear to be aware of and operating in accordance with them. In many instances, although councils did not believe there were explicit requirements to invest funds separately, they nonetheless did so.
- 2.317 All but six councils allocate interest to the balance of separate funds – with a wide range of practices being applied. The most common practice is to allocate interest on the basis of the average rate applying to the council for the average balance over a period. Other bases of calculating the interest rate to be applied include:
- the rate of inflation;
  - a fixed interest rate determined by the council – with some councils also making a charge for administrative costs;
  - the bank on-call rate; and
  - the 90-day bill rate.
- 2.318 The range of bases to establish the balance to which the interest rate is applied includes the:
- opening balance of the fund; and
  - closing balance of the fund.





2.319 In some instances, interest was being allocated only to those accounts nominated by the council, with other balances not attracting any interest. Practices for the management of calculating and crediting interest on separate balances vary from council to council and according to circumstances. In our view, proper accountability for funds means that councils should regularly review their separate funds and assess the rationale and reasonableness of their approach to managing them.

### *Internal Borrowing*

- 2.320 Many councils also apply an interest charge on internally borrowed funds. The lawfulness of this practice was confirmed by the Local Government (Rating) Act 2002, which amended the Local Government Act 1974 to permit a council to borrow internally.
- 2.321 Internal borrowing involves using cash reserves arising from one part of the council’s activities to resource other parts of the council’s activities. The question about the lawfulness of internal borrowing arose because Part VIIB of the Local Government Act 1974 authorised external borrowing only, and Part VIIA required the council to identify and fund “expenditure needs”.
- 2.322 In the case of internal funding, it was difficult to identify an “expenditure need” for funding purposes – there being no legal requirement to pay interest on internal borrowing. While an opportunity cost would be forgone through not investing externally, there was legal doubt about whether this opportunity cost amounted to an “expenditure need”.
- 2.323 About 65% of councils currently operate an internal borrowing regime. Our auditors report that almost all of these councils were appropriately recording transactions relating to these internal borrowings.
- 2.324 The definition of “borrowing” in the Local Government Act 2002 includes the incurring of debt through internal borrowing, regardless of whether the council decides that interest will be charged.





### *Surplus Funds from Separate Rates*

## TWO

- 2.325 A particular question that has been raised with us is the decision-making process that councils should follow where they propose to use surplus funds from separate rates for purposes other than those for which the separate rate was levied.
- 2.326 Section 61 of the Rating Powers Act 1988 required particular procedural steps to be undertaken where it was proposed to apply funds derived from a separate rate levy to another purpose. Where the surplus was \$50,000 or greater, the surplus could be expended for other purposes or works subject to the special order procedure under section 716B of the Local Government Act 1974.
- 2.327 Section 289 of the Local Government Act 2002 provides a saving provision for any special order procedure started before 1 July 2003. However, as the consultation principles under section 82 of the Local Government Act 2002 have been in effect since December 2002, councils considering using a separate rates surplus should also have regard to their responsibilities under these principles. In particular, where such a surplus was obtained from a specific community of interest and will not now be used for the intended purpose, we believe it would be appropriate for the consultation to include input from the affected community.
- 2.328 With the Local Government Act 2002 and Local Government (Rating) Act 2002 both in force, councils will need to consider the use of rating surpluses, including any surpluses from separate rates under the Rating Powers Act 1988, in accordance with the section 82 consultation principles (including considering whether a special consultative process may be required), the section 101 financial management considerations, and the section 77 decision-making requirements.

### **Investments**

- 2.329 Our major finding about councils' investments in 1998 was that a large number of investments were not making a commercial rate of return. This is not of itself a concern as councils hold investments for other than commercial reasons (see paragraphs 2.335-2.339). However, in some instances, councils did not:
- know or regularly review why they owned the investment; and
  - set or review the rate of return they expected from investments.





- 2.330 Councils are likely to have a range of investments – including:
- shares in council-controlled trading organisations and other companies such as port companies and energy companies;
  - investment funds; and
  - investment properties or forestry holdings.
- 2.331 Our review for this report showed that the most common form of investment was in property and investment funds rather than in Local Authority Trading Enterprises (LATEs) under the Local Government Act 1974<sup>10</sup>. Another form of investment that many councils held was loans and funds advanced to other entities.
- 2.332 In our 2002 review, we found that practices have improved since we reported in 1999. Most councils had a rationale for each of their investment holdings. Further, most councils now review their investments either annually or every three years as part of their Long Term Financial Strategy review. This is a beneficial result of the financial management framework established by Local Government Act amendments in 1996 that introduced a requirement for councils to adopt an Investment Management Policy. This requirement is continued in the Local Government Act 2002.

### Setting Expected Rates of Return

- 2.333 The area in which we are not confident there has been any significant improvement from the position in 1998 is the basis on which councils set rate of return expectations from investments.
- 2.334 We asked our auditors to review with councils the factors taken into account in setting expectations for rates of return on investments. We were told of a range of factors being taken into account – with the most common being the prevailing market conditions for the nature of the investment at the time. Other factors reported as considered included:
- the objectives of the council;
  - objectives in Statements of Corporate Intent;
  - valuation of the asset; and
  - significant operating strategies or decisions.

10 Under the Local Government Act 2002, LATEs became council-controlled trading organisations (see page 49).





## MANAGEMENT OF SEPARATE FUNDS AND INVESTMENTS

### TWO

2.335 However, many councils reported that, except for cash funds available for investment, or performance expectations of LATEs expressed in Statements of Intent, they did not set return rate expectations for their investments. In many instances, this was because they did not expect to make a commercial return from their investments.

2.336 Rather, these investments were held primarily to achieve social, economic or environmental gains for the community as a whole and, consequently, councils did not see these investments as being required to generate a rate of return. Examples are:

- investments in council-controlled trading organisations; and
- low-interest, or non-interest-bearing, loans to community and other organisations which are expected to produce other communal benefits.

2.337 Measuring the ‘return’ from these ‘non-commercial’ investments can be difficult. These ‘returns’ are the product of many different factors and influences, and it can be difficult to consider the extent to which:

- a gain in value of an asset should be expected by the local authority; and
- returns that may be generated for the wider community are the product of a particular local authority initiative.

2.338 However, both for effectiveness and accountability reasons, local authorities should actively consider the nature of the return they expect from an investment and how they will assess the achievement of that return.

2.339 Our report *Local Authority Involvement in Economic Development Initiatives*<sup>11</sup> provides guidance on matters that councils may find useful to consider in setting expectations for ‘non-commercial’ investments.

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2.340 The Local Government Act 2002 has broadened the concept of a “council-controlled organisation” from that of the Local Government Act 1974.<sup>12</sup> These changes:

- make non-profit council controlled organisations subject to the same accountability requirements as companies and profit organisations; and
- maintain the Local Government Act 1974 constraints aimed at preventing trading activities of council-controlled organisations from affecting competition (for better or worse) in councils’ districts.

2.341 Bringing non-profit council-controlled organisations into the same governance and accountability regimes as those that applied to LATEs – including the requirement for a statement of intent – should assist councils to clearly establish the purpose of their ownership interests in such organisations. In addition, the new requirement for councils to monitor the performance of their council-controlled organisations<sup>13</sup> provides a process for regular review of those interests and the council’s performance expectations.

2.342 The Act also contains requirements concerning a new type of organisation – the “council organisation” – which is any company or organisation in which a local authority has any ownership interest whatsoever or has the right to appoint one director (however described). The Act requires councils to monitor the performance of their council organisations, and their investments in such organisations would also be covered by the investment policy required by section 105.

12 The 2002 Act establishes two controlled forms:

**Council-controlled organisation (CCO):** is a company or organisation in which one or more local authorities directly or indirectly: – hold either 50% or more of the voting rights; or – can appoint 50% or more of the directors (however described). The main difference between the definition of CCO and LATE is that there is no requirement that a CCO operate a trading undertaking for the purpose of making a profit.

**Council-controlled trading organisation (CCTO):** is a council-controlled organisation that operates a trading organisation for the purpose of making a profit. While there is no requirement that a CCO intend to make a profit, the profit motive is significant for tax purposes. The Income Tax Act 1994 has been amended by the Local Government Act 2002 to provide that any CCO that is a company or is a CCO that trades for profit is not eligible to be granted charitable status for tax purposes. The Local Government Act 2002 also retains the competitive neutrality provisions from the Local Government Act 1974 for CCTOs:

- a council must not give any guarantee, indemnity, or security in respect of the performance of any obligation by a CCTO (section 62);
- a local authority cannot provide financial assistance to a CCTO on terms more favourable than it could borrow (section 63).

13 Section 65, Local Government Act 2002.





## 2.4 Local Authorities (Members' Interests) Act 1968 – Discussing and Voting When Interested

- 2.401 The rule of law known as the rule against bias exists to ensure that persons with the power to make decisions affecting the rights and obligations of others carry out their duties fairly and free from bias. It is summed up in the saying “no one should be a judge in their own cause.”
- 2.402 The Local Authorities (Members' Interests) Act 1968 (the Act) is a codification of part of this rule. It governs financial conflicts of interest by members of local authorities in two key ways. The Act:
- controls the making of contracts between members and their authority; and
  - prohibits members from participating in authority matters in which they have a pecuniary interest (other than an interest in common with the public).
- 2.403 The Audit Office is responsible for overseeing and enforcing the Act<sup>14</sup>, and we have taken an active role in recent years in raising awareness of the Act among local authority members. We encourage members to raise their queries with us before they cause problems. Accordingly, we now receive a large number of requests for advice about the Act, and requests for decisions about particular matters where the Act allows us to grant an approval of a contract or an exemption or declaration to enable a member to participate in a particular matter.
- 2.404 This section discusses:
- our role in investigating complaints under the Act;
  - a recent prosecution we took under the Act;

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14 Further information about the Act, and our role in relation to it, is available in our publication *Financial Conflicts of Members of Governing Bodies: A Guide to the Local Authorities (Members' Interests) Act 1968*, 3rd edition September 2001, ISBN 0-477-02885-3.





- our view that there is a need for a modern re-statement of the law; and
- the need for members to be alert to non-financial conflicts of interest.

**TWO**

## **Complaints**

- 2.405** We continue to receive a steady stream of complaints about alleged breaches of the Act. We have a role to investigate complaints under the Act and, if we consider that the circumstances warrant it, a duty to prosecute alleged offenders. A conviction of a member results in vacation of office, so we exercise our discretion to prosecute carefully.
- 2.406** In any particular situation it is open to us to form the view that, although an offence appears to have been committed, the circumstances do not warrant instituting legal action. We consider:
- the criteria usually considered by any prosecuting agency; and
  - the policy and objectives of the Act.
- 2.407** Many complaints can be resolved following preliminary enquiries. However, others require formal investigation – which is invariably costly, and extremely stressful for the member concerned, since his or her political reputation will often be at stake.

## **Prosecution and the Scope of Defences**

- 2.408** During the last year we prosecuted a local authority councillor for alleged offences of participating in meetings when he had a pecuniary interest. The decision to prosecute in this case was made after a thorough investigation, and after seeking independent legal advice.
- 2.409** The councillor was acquitted because the Court found that, although he had a pecuniary interest in the matter the subject of the charges, no offence had been committed because a statutory defence under section 6(3)(e) of the Act applied. It is the Court's role under the Act to decide on such questions.
- 2.410** That section provides a defence to an alleged breach of the Act if the matter in which the defendant participated was the "preparation, recommendation, approval, or review of" a district plan under the Resource Management Act 1991. The Judge held that the defence applied to a discrete matter relating to a Council policy that was being considered for possible future inclusion in part of a district plan.





## LOCAL AUTHORITIES (MEMBERS' INTERESTS) ACT 1968 – DISCUSSING AND VOTING WHEN INTERESTED

### TWO

2.411 The decision has two potential implications:

- Councils typically consider a wide range of matters that may ultimately be included in a district plan. Some councillors might now consider that they can participate in such matters even though they have a personal pecuniary interest. In our view, this would be inconsistent with the policy of the Act.
- It will be more difficult to apply the Act in individual situations, because it will not always be obvious to a councillor – or to those advising him or her – whether a particular matter is covered by the section.

2.412 In our view, the outcome of the prosecution:

- Reinforces the validity of the principles underlying the Act.
- Demonstrates a need for clarification of the scope of the section 6(3)(e) defence.
- Reinforces our long-held view that the Act needs redrafting. It is 35 years old, and in many areas its language is archaic, difficult to follow, and out of date.

2.413 The judgment also highlighted the problematic nature of prosecution as the only available remedy under the Act. It can be difficult to reconcile established civil law tests about pecuniary interest (based, as they are, on questions of what a reasonable bystander would think) with the criminal law standard of proof of an offence beyond reasonable doubt.

2.414 In addition, there may be a view that a criminal conviction is sometimes too blunt and heavy an instrument to comprise the only possible legal consequence for a breach of the Act. Nevertheless, prosecution remains the only sanction available under the Act and we will continue to fulfil our duty to bring charges before the courts in appropriate cases.

2.415 We intend to work with the relevant government agencies with the objective of obtaining a restatement of the law, to provide fresh and firm guidance for local authority members in today's environment.





## **Non-financial Conflicts of Interest**

- 2.416** The Act applies only to pecuniary interests. We do not have any formal decision-making role in relation to other types of conflict of interest, but can advise on or look into such matters in our role as auditor of local authorities.
- 2.417** Members of local authorities need to be aware of the potential for non-financial conflicts of interest. If a disaffected party challenges a decision of a local authority in the courts, the decision may be struck down if there exists a real likelihood or danger of bias by a member who was involved in the decision. This might arise, for example, if a member has a close relationship with an individual or organisation affected by the decision, or if a member expresses views which indicate that he or she has pre-determined the matter (that is, has a “closed” mind) before hearing all relevant information.
- 2.418** In these situations, as with pecuniary interests, members need to be alert to the risks of being challenged over a potential conflict. In the interests of openness and fairness, we encourage members to take a cautious approach to such matters and, if in doubt, to declare an interest and abstain from discussing or voting on the issue.
- 2.419** We intend to consider preparing, in the next year, some guidance for members on non-financial conflicts of interest.

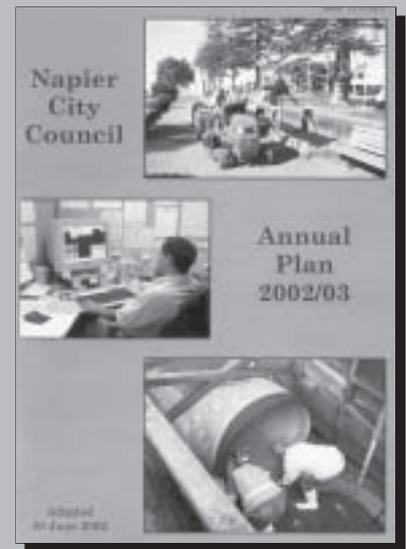
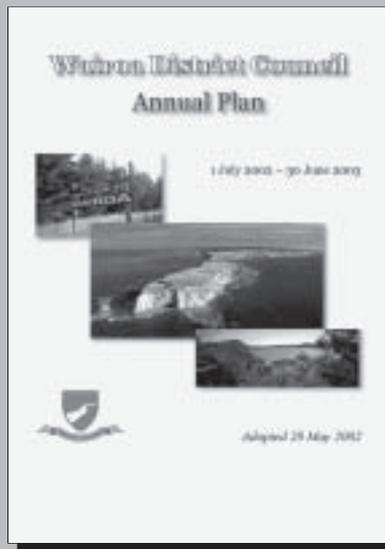
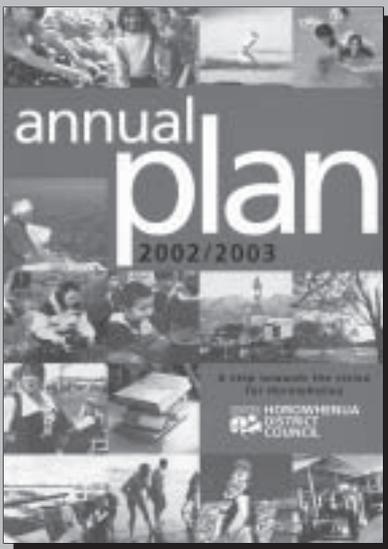
**TWO**





Three

# Areas of Focus for 2002-03







## 3.1 Implementation of the Local Government Act 2002 and the Local Government (Rating) Act 2002

THREE

- 3.101 Local authorities are dealing with large-scale change in their legislative framework as a result of a number of legislative amendments, in particular with the passing in 2002 of the new Local Government Act and the Local Government (Rating) Act.
- 3.102 The Local Government Act 2002 introduces a comprehensive planning and reporting regime. This regime builds on the provisions of the Local Government Act 1974 by introducing new elements that underscore the need for reliable and relevant information to support elected members and communities in decision-making. One new element – the long-term council community plan (LTCCP) – will require significant work by local authorities to develop the supporting policies and information by 2006 when the new Act comes fully into effect.
- 3.103 The Local Government Act 2002 also establishes new accountability and public consultation requirements for use of the rating mechanisms under the Local Government (Rating) Act 2002. The financial year 2003-04 will be the first in which local authorities will levy their rates under the new Rating Act. Many of these changes have required local authorities to undertake extensive preparation in anticipation of the Local Government (Rating) Act coming into force.
- 3.104 Because of the magnitude of the changes required as these two Acts come into effect, our audit focus during 2003-04 will be in three areas:
- specific new legislative compliance requirements;
  - the current state of councils' planning and reporting information; and
  - providing information where our auditors and the sector may require guidance in the future.





## IMPLEMENTATION OF THE LOCAL GOVERNMENT ACT 2002 AND THE LOCAL GOVERNMENT (RATING) ACT 2002

### THREE

3.105 We have selected three elements from the Local Government Act 2002 for particular focus:

- service levels;
- asset management information; and
- significance policies.

3.106 From the Local Government (Rating) Act 2002, we will be focusing on:

- the rating cap;
- new policy requirements; and
- the funding impact statement.

3.107 We will be formulating our expectations for the reporting of performance information by councils under the new Local Government Act. We will do this in part while determining our approach to the audit of LTCCPs – which we will audit with effect from 2006. We will also be formulating our own understanding of, and capability to audit, sustainable development reporting.

## Local Government Act 2002

### Service Levels

3.108 In recent reports to Parliament, we have expressed our concern that, in some cases, asset management plans were lacking service level information, or that expectations about service levels had not been established from a public consultation process.<sup>1</sup>

3.109 The Local Government Act 2002 requires local authorities in their LTCCPs to specify service levels, and performance measures and targets against which services can be assessed for groups of activities:

- in detail for the first three years; and
- in outline for subsequent years.

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<sup>1</sup> See, for example: *Local Government: Looking Back and Looking Forward*, parliamentary paper B.29[02a] 2002, page 30; and *Local Government: Results of the 1999-2000 Audits*, parliamentary paper B.29[01a] 2001, page 14.





- 3.110 Ideally, there should be a clear rationale for a local authority's choice to be involved in an activity or group of activities, and a link between this rationale and the service levels and performance measures.<sup>2</sup> This link will develop over the next 2-3 years as local authorities facilitate identification of community outcomes, as required of them on behalf of their communities by the Local Government Act 2002.

**THREE**

### *Asset Management Information*

- 3.111 A number of our reports to Parliament over the last decade have commented on asset management by local authorities, highlighting the importance of quality information for preparing reliable estimates.<sup>3</sup>
- 3.112 To enable communities to have confidence in the information and proposals contained in LTCCPs, the Act contains a number of requirements about asset information.
- 3.113 Based on feedback from our auditors, we believe that:
- many councils' asset management systems have not been significantly developed since their adoption (following the 1996 Local Government Act amendments); and
  - some councils may not be continuously maintaining and updating asset management information.
- 3.114 Our intention is to evaluate the current state of councils' asset management plans to ensure that reliable asset information supports the LTCCPs.

### *Significance Policy*

- 3.115 The Local Government Act 2002 provides local authorities with considerable scope for discretion about their activities within the statutory purposes and powers. This discretion is to be exercised through demanding planning, reporting, and accountability requirements. The concept of "significance" is central in these requirements and to the purpose of local government.

<sup>2</sup> For further suggestions about performance information, see our publication *Reporting Public Sector Performance*, ISBN 0-477-02877-2, 2002.

<sup>3</sup> *Local Government: Looking Back and Looking Forward*, parliamentary paper B.29[02a] 2002, page 28; and *Local Government: Results of the 1999-2000 Audits*, parliamentary paper B.29[01a] 2001, pages 11-17.





## IMPLEMENTATION OF THE LOCAL GOVERNMENT ACT 2002 AND THE LOCAL GOVERNMENT (RATING) ACT 2002

### THREE

- 3.116 We have previously reported on the approach of local authorities to the term “significant”, because the Local Government Act 1974 placed reliance on the exercise of judgement by decision-makers and therefore on the need to consider significance.<sup>4</sup> We were surprised to find that most local authorities had not formulated any guidance for the public, councillors, or staff about what might be regarded as significant.
- 3.117 The Local Government Act 2002 defines “significance” and “significant” (section 5), to help local authorities direct the appropriate level of consideration and public disclosure and consultation to matters based on their relative importance to the district or region.
- 3.118 Local authorities are also required to adopt a significance policy that sets out:
- their general approach to determining significance; and
  - any thresholds, criteria or procedures used in assessing the significance of any issue.
- 3.119 We will consider and report on the nature of local authorities’ significance policies.

## Local Government (Rating) Act 2002

### *The Cap on Targeted Rates and Uniform Annual General Charges*

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- 3.120 The Local Government (Rating) Act 2002 retains a 30 percent cap on the proportion that certain rates can comprise of a council’s total rates revenue. This cap applies to:
- targeted rates that are –
    - calculated as a fixed dollar amount per rating unit or separately used or inhabited portion of a rating unit (and which is not used solely for water supply or sewage disposal); and
    - uniform for all properties to which the rate applies; and
  - uniform annual general charges.

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4 *Local Government: Results of the 1999-2000 Audits*, parliamentary paper B.29[01a] 2001, pages 82-86.





- 3.121 While the cap is not new, the Local Government (Rating) Act 2002 introduces new, more flexible, rating tools. Calculation of the cap is, therefore, more complex. We will review local authorities' calculation of the rating cap, to assist them to avoid inadvertent breaches of the Act while they become familiar with the new requirements.

**THREE**

### *New Policy Requirements*

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- 3.122 The Act introduces several new policies that, by their adoption, allow councils to determine the circumstances under which they will forgo rating revenue or delay the receipt of this revenue. These policies are:
- rates relief for Maori freehold land;
  - remissions;
  - postponements; and
  - early payments.
- 3.123 We are particularly interested in the postponements policy, which allows local authorities to defer the receipt of rates revenue. Some local authorities have indicated that they will consider using this policy to provide ratepayers with services such as reverse mortgages. As such a use of this policy could raise financial reporting issues in future years, we will be assessing policies adopted in the first year of the Act to identify best practice and potential risks.

### *Funding Impact Statement, and Analysis of General and Targeted Rates Proposed*

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- 3.124 The Funding Impact Statement is a link between certain requirements under the Local Government Act 2002 and requirements under the Local Government (Rating) Act 2002. It must be included in a local authority's LTCCP and also in its Annual Plan. The purpose of the Funding Impact Statement is to set out the funding mechanisms that a local authority will use, their level, and the reason for their selection in terms of the principles of financial management.





## IMPLEMENTATION OF THE LOCAL GOVERNMENT ACT 2002 AND THE LOCAL GOVERNMENT (RATING) ACT 2002

### THREE

3.125 We will review each local authority's Funding Impact Statement to ensure that, for the rates proposed, the Statement contains the information from Schedule 2 and Schedule 3 of the Local Government (Rating) Act 2002. These schedules establish:

- the units of liability where a local authority is setting a general rate differentially under sections 13 and 14 of the Act; and
- factors for calculating the liability where a local authority is setting a targeted rate under sections 16-20 of the Act (targeted rates are similar to separate rates under the Rating Powers Act 1988).

3.126 We hope that, in future years, this information will allow us to assess the take-up and use of the more flexible rating powers provided through targeted rates.





## 3.2 Public-private Partnerships

### THREE

3.201 Well-designed and well-managed public-private partnerships offer a means of managing the risks and cash flow requirements of large capital-intensive projects. The concept of such partnerships has gained momentum over recent years, as reflected by the provisions of:

- the Local Government Act 2002 – which requires councils to adopt a policy on partnerships with the private sector and include this as part of their LTCCP; and
- the Land Transport Management Bill – which is currently before Parliament and proposes greater flexibility to enable new roads and roading improvements to be built.

3.202 Because public-private partnerships are likely to involve long-term capital-intensive projects, they can pose significant financial and non-financial risks. As a result, public concerns have arisen about public-private partnerships – particularly internationally, but also in New Zealand.

3.203 Consequently, a range of considerations needs to be identified and managed in any public-private partnership – including:

- risk distribution between the council(s) and the private entity(ies);
- responsibilities, particularly where statutory responsibilities are involved;
- performance expectations of each other; and
- public accountability expectations.

3.204 Public-private partnerships also raise accounting issues about how assets, liabilities, revenues and expenses should be recognised between the participating parties, and the disclosures required to ensure an accurate reflection in the financial statements.

3.205 Councils need specifically to consider their accountability duties to the public in entering into and managing any public-private partnerships. They will need to be open and informative to communities about:

- the nature of any partnership;
- how a partnership came into being and why; and
- how the benefits envisaged are being realised through the project.





## PUBLIC-PRIVATE PARTNERSHIPS

### THREE

- 3.206 There is a broad public interest in ensuring that councils considering public-private partnerships have access to guidance about:
- issues to consider in forming partnerships; and
  - management of the project and the relationship throughout the duration of the partnership.
- 3.207 We intend undertaking a project to identify and prepare best practice information. We will emphasise the New Zealand context both through local case studies and by drawing on international experience and best-practice lessons. We will also consider the treatment of public-private partnerships for accounting and reporting purposes.





## 3.3 The Balanced Budget Requirement

THREE

**3.301** Under the Local Government Act 2002, local authorities are required to set each year's operating revenue at a level sufficient to meet operating expenses. However, the Act allows local authorities that have an LTCCP the discretion to vary from this principle, having regard to –

- (a) the estimated expenses of achieving and maintaining the predicted levels of service provision set out in the long-term council community plan, including the estimated expenses associated with maintaining the service capacity and integrity of assets throughout their useful life; and*
- (b) the projected revenue available to fund the estimated expenses associated with maintaining the service capacity and integrity of assets throughout their useful life; and*
- (c) the equitable allocation of responsibility for funding the provision and maintenance of assets and facilities throughout their useful life; and*
- (d) the funding and financial policies adopted under section 102.<sup>5</sup>*

**3.302** This is a change from the Local Government Act 1974, which (since 1996) had contained a more prescriptive “balance the budget” requirement. We have reported on this more prescriptive requirement, particularly because of its effect that local authorities were required to cash fund the depreciation expense (subject to a few limited exceptions).

**3.303** “Depreciation” is the measure of the consumption of the economic benefits embodied in an asset whether arising from use, the passing of time or obsolescence.<sup>6</sup>

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<sup>5</sup> Section 100(2).

<sup>6</sup> Financial Reporting Standard No. 3 *Accounting for Property, Plant and Equipment* issued by the Institute of Chartered Accountants of New Zealand.





## THE BALANCED BUDGET REQUIREMENT

### THREE

3.304 Requiring councils, as a rule, to balance the budget by setting operating revenues to cover projected operating expenses is appropriate within the accepted framework of prudent financial management. However, both local government and we have raised concerns over recent years about whether depreciation is (of itself) an appropriate tool for determining the level of funding to maintain local authorities' assets over the long term.

3.305 We have previously noted that –

*Depreciation is not a proxy for the amount needed to fund local authorities' long-term asset requirements. Accounting for the past consumption of an economic benefit is not the same as providing for the full cost of services and assets in the future. These two purposes differ, and need to be considered separately.*

*In particular, revaluation of an asset and any reassessment of its remaining useful life result in recalculation of the depreciation charge (but do not necessarily indicate the funding needed for future service provision). The depreciation charge over the life of an asset will equal the renewal cost of the asset only by chance, especially if a revaluation or re-estimation of its useful life occurs.<sup>7</sup>*

3.306 We are not convinced that it would always be financially prudent to cash fund the difference between the depreciation charge and the asset replacement amount in cases where the depreciation charge is greater than the funding estimated as necessary to replace assets in the future. Equally, there may be circumstances where a council projects a surplus but is not collecting sufficient funds because, for example, its assets are valued at historic cost. Under the Local Government Act 1974 there was no scope for councils to adjust their level of funding to recognise such circumstances.

3.307 The change effected by the 2002 Act presents an opportunity to consider whether there are circumstances under which cash funding of depreciation may generate more funding than is required for asset replacement. We therefore propose to undertake financial analysis to test this proposition and identify any circumstances in which cash funding only the asset replacement amount would be financially prudent. If such circumstances are identified, we will prepare guidance to assist our auditors in giving advice to councils about how to work within the more flexible balanced budget requirements of the 2002 Act.

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<sup>7</sup> *Second Report for 2000, parliamentary paper B.29[00b], page 21.*





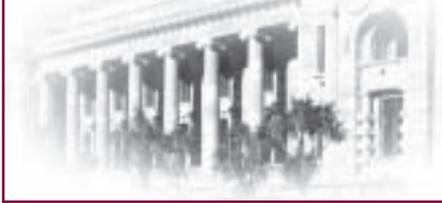
## THE BALANCED BUDGET REQUIREMENT

B.29[03b]

3.308 The depreciation expense is material for most territorial authorities. Therefore, our intention is that the guidance that will flow from our analysis will promote resource management improvements by councils, while giving communities assurance – through LTCCPs – that rates and other charges are appropriate and will be adequate to ensure that services and facilities are provided over the long term.

**THREE**





## 3.4 Sharing of Services Between Local Authorities

- 3.401 For some time now, we have observed a variety of initiatives in the local government sector that are designed to ensure that resources are more effectively and efficiently used between groupings of local authorities. One example of this is where two or more councils work together to deliver a service to the public – that is, a “shared service”.
- 3.402 Examples of shared services include:
- the pooling of regulatory staff between councils;
  - development of common IT systems to allow for co-ordinated purchasing, maintenance and user support, and (consequently) a common interface with the public; and
  - standardisation of processes – and the associated fees and charges – for common council services that are delivered in an area, such as dog licences and building inspection.
- 3.403 The Local Government Act 2002 recognises that local authorities may continue to engage in joint undertakings and co-operative activities.
- 3.404 We have decided to undertake a study of this topic to identify some of the potential benefits and lessons to be learned. Our preliminary view is that sharing services has the potential to bring about efficiency gains and to increase the effective use of resources by local authorities. Our study will also identify problems or difficulties associated with the concept and its application in practice.
- 3.405 While there is considerable debate on what constitutes a shared service, the focus of our study will be solely on public-to-public partnerships – i.e. between two, or a small group of, local authorities. We will not be examining public-private partnerships. (But see section 3.2 on pages 63-64.)





- 3.406 We have decided to undertake a case study approach to this work – similar to that adopted for our 2002 report, *Local Authority Involvement in Economic Development Initiatives – Choices for Successful Management*.<sup>8</sup> We intend to select a small number of shared service initiatives that are currently in operation for further study.
- 3.407 To provide background information for the study, we have written to all councils asking for details of any shared service initiatives that they have undertaken with other councils in their area. We said that we are interested in shared service initiatives that have been in operation for some period of time, as well as those that are at an early stage of implementation. We have also advised that we are interested where local authorities have undertaken no such initiatives – or have no initiatives planned – as this will give an indication of how widespread this type of activity is.
- 3.408 We intend to undertake the field work for this study later this year, with a proposed publication date of mid-2004.

**THREE**

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8 ISBN 0-478-02896-9.





Four

# Review of Licensing Trusts







## 4 Review of Licensing Trusts

### FOUR

### Financial Performance

4.001 We decided to have a further look at the financial performance of all licensing trusts. We have previously reported on their performance for the years 1991 to 1998 – most recently in our *Second Report for 1999*.<sup>1</sup> However, comparison of current financial performance with results from past years is problematic because:

- accounting practice for consolidation of licensing trusts and their subsidiary entities has changed; and
- the business activities of some licensing trusts have become both extensive and complex over the period.

4.002 For those reasons, in this review we looked only at the two financial years ended 31 March 2001 and 2002.

### *Overview of Financial Performance*

4.003 The information used in this overview is based on figures extracted from the 2002 annual report of each licensing trust. In some instances, licensing trusts have not included subsidiaries in their consolidated financial statements, as a result of which we have presented figures for the subsidiaries separately and performed manual consolidations, in the tables of detailed results on pages 89-92.

4.004 In aggregate, donations made from profits in 2001-02 averaged 3.4% of revenue (2000-01: 2.6%). The effect of consolidating charitable trusts that administer gaming machine income within a licensing trust group is significant. Charitable trusts with gaming machine income tend to distribute between 35% and 50% of their revenue.

4.005 Some trusts received a qualified audit opinion for the accounting treatment of certain expenses and assets. In the tables on pages 89-92, we have made adjustments to present these trusts' figures on a basis consistent with the requirements of generally accepted accounting practice.

<sup>1</sup> Parliamentary paper B.29[99b], pages 119-125.





## REVIEW OF LICENSING TRUSTS

### FOUR

- 4.006 Total revenue generated in 2001-02 was \$291 million (2000-01: \$271 million), and total assets at 31 March 2002 were \$220 million (2001: \$210 million).
- 4.007 Only four licensing trusts had significant term debt, which averaged just over 49% of total assets. The remaining trusts had little or no term debt.
- 4.008 Only seven out of the 24 licensing trusts generated a return on equity before donations of over 10% and, of those, two trusts' results include subsidiaries that hold gaming machine licences.
- 4.009 Seven licensing trusts have current ratios<sup>2</sup> of less than 1:1 – indicating current solvency issues – and only five have current ratios in excess of 2:1 – indicating a sound current position.
- 4.010 Several licensing trusts continue to show excellent financial results and are operating very successfully with high levels of community support.

### *Sources of Funds for Distribution*

- 4.011 In most instances, licensing trusts use two main means of raising funds for distribution to their communities:
- selling liquor; and
  - operating gaming machines at their premises.
- 4.012 However, some licensing trusts either do not operate gaming machines or do not directly hold the licences for the operation of gaming machines – the machines at their premises being operated under licence held by the Community Grants Foundation (the CGF) or a trust subsidiary.
- 4.013 For those licensing trusts that operate gaming machines under licence from the CGF, the Foundation acts as an umbrella in administering gaming machine operations and the distribution of proceeds. Grants from gaming machine proceeds are made by the CGF based on recommendations by the licensing trusts or their subsidiary charitable trusts. Therefore, information about these grants appears in the annual accounts of the CGF rather than being included in the public notices and financial statements of the licensing trusts.

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2 The “current ratio” is the relationship between current assets (such as cash and bank balances, stock, and receivables due within 12 months) and current liabilities (such as trade creditors and payables due within 12 months).





## Trusts Ceasing to Operate Since 1998

4.014 The Otumoetai South Licensing Trust ceased operating in 1998 as a result of financial difficulties, and several trusts in the Wellington region suffered significant and long-term impacts as a result of the collapse of a collectively owned company – Brand Hospitality Limited (BHL) – during 1999. As a result of the collapse:

**FOUR**

- Another collectively owned company, Capital Trusts Limited, went into liquidation.
- Wellington South Licensing Trust ceased operating.
- Wainuiomata Licensing Trust no longer operates any business under the Sale of Liquor Act, has yet to finalise financial accounts for the years 1999, 2000, and 2001, and appears likely to cease operating.
- The major shareholder in BHL, Porirua Licensing Trust (PLT), suffered significant financial loss both in terms of funds advanced to the company (\$500,000) and investment value in shares. However, following some difficulties in establishing its financial position, the PLT has continued to operate.

## Trusts Undertaking Activities Outside the Sale of Liquor Act

4.015 We have previously commented that some of the business arrangements being entered into by licensing trusts were never envisaged by the current legislation.<sup>3</sup> Where elected members do not have direct involvement (through holding licences) in the sale and supply of liquor and conduct of premises in their districts (as was the case in the BHL arrangement) there remains a need to ensure that members are accountable to their communities for the performance of their statutory objects.

4.016 In addition to Wainuiomata Licensing Trust, two other Licensing Trusts – Birkenhead and Parakai – continue to operate but are not currently engaged in activities associated with the sale of liquor as required by the Sale of Liquor Act. They operate only as a landlord.

<sup>3</sup> *Second Report for 1999, parliamentary paper B.29[99b], page 125.*





## REVIEW OF LICENSING TRUSTS

### FOUR

- 4.017 Amendments currently before Parliament in the Sale of Liquor Amendment Bill (No. 3) would provide a greater scope of activities for a licensing trust that reconstituted as a community trust. Any trust not currently engaged in activities associated with the sale of liquor could make its activities lawful by reconstituting. A greater scope of permitted activities could also assist those trusts experiencing operating difficulties.
- 4.018 However, the Amendment Bill has been before the House since 1999. Consideration may need to be given to some other legislative amendments if trusts are to be permitted to diversify their activities.

### Recognising the Community Support Given By Licensing Trusts

- 4.019 An issue that licensing trusts have raised with us in reporting on their financial performance is that accounting standards require them to treat donations as an expense rather than as a return to 'shareholders'. Trusts feel that this understates their profitability and their value to their community. For this review, therefore, we have used surplus or deficit before donations to report on trusts' profitability.
- 4.020 In our view, making donations to communities out of the proceeds of licensing trusts' activities is a key function and a matter of widespread community interest.
- 4.021 The Sale of Liquor Act requires licensing trusts to prepare annual accounts and to publish, at least annually in the newspapers circulating in their area, the audited accounts and a list of all the grants made during the year. These provisions should allow trusts to clearly identify the amount of community support financed from their sale of liquor operations.
- 4.022 We have suggested to licensing trusts that they consider the information they provide in the public notices and accounts in order to provide their communities with a fuller appreciation of the extent of community support that is derived from trust activities.
- 4.023 Where licensing trusts operate gaming machines under the auspices of the CGF, we have suggested that they provide information in notes to their financial statements about the:
- funds for distribution generated by the trust from gaming machine proceeds;





- grants recommended by the controlled charitable trust to, and approved by, the CGF; and
- funds available for distribution within the community.

## Extended Auditor-General Mandate in Licensing Trusts

4.024 Many licensing trusts have established subsidiary entities to perform aspects of their activities; for example:

- charitable trusts to facilitate the administration of gaming machine proceeds;
- management companies; and
- subsidiary businesses operating licensing trust trading arms.

4.025 Prior to the passing of the Public Audit Act 2001, these subsidiary entities were not within the mandate of the Auditor-General. Where any of these entities sought our assistance, we undertook their audit on the basis that they were managing the businesses of publicly owned bodies or were distributing the profits of those bodies.

4.026 The Public Audit Act 2001 has brought entities controlled by licensing trusts within the mandate of the Auditor-General. We believe that this will result in a significant improvement in the reporting arrangements for licensing trusts and in their public accountability.

## Remuneration of Licensing Trust Presidents

4.027 We have been asked about the basis for calculating the remuneration of the president of a licensing trust as to whether:

- In the case of a licensing trust group, for the purposes of the scale for presidents' honoraria, is "annual turnover" that of the parent licensing trust or the group?
- Should a president's remuneration each year be based on the annual turnover for that year or the previous financial year?





## REVIEW OF LICENSING TRUSTS

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4.028 Section 199(1) of the Sale of Liquor Act 1989 provides that –

*A licensing trust may pay to the president by way of remuneration a sum not exceeding in any year the amount for the time being fixed by the Minister of Finance after consultation with the Minister...*

### Remuneration Based On Parent or Group Figures?

4.029 The Ministers of Justice and Finance had fixed a scale of remuneration for chairmen of licensing trusts in December 1987, under section 8 of the Licensing Trusts Act 1949, based on “annual turnover”. However, in a group situation, a licensing trust may conduct all its trading activities through one or more subsidiaries and not engage in any direct trading itself. The licensing trust’s income is likely to be derived from sources such as interest and dividends rather than sales.

4.030 We reached the view that under the 1987 determination “turnover” should be that of the licensing trust parent rather than the ‘group’ because:

- there would clearly be a ‘double dipping’ issue if a licensing trust president were to receive both remuneration as president based on group turnover *and* fees as a director of a trading subsidiary; and
- when a licensing trust divests activities to a subsidiary the role of trust members as shareholders is different to when trust members are directly responsible for the business, and the president’s responsibilities are arguably less where others are being remunerated for running the trading activities.

4.031 However, we were conscious that it could also be appropriate to use the group turnover figure to calculate the president’s remuneration, as this would take account of the greater complexity associated with a group structure.

4.032 The Ministers fixed a new remuneration scale in December 2002 based on three factors – revenue, assets, and complexity. In our view, these factors should better allow the varying roles and business arrangements to be addressed.





### Remuneration Based On Which Year's Figures?

- 4.033 In our view, for the purposes of applying the scale, a president's remuneration must be based on the revenue and assets for, and liquor licenses operated by, each licensing trust in each year during the period of the presidency. That is, on the current financial year. It would be inappropriate to base an incoming president's remuneration on a trust's annual revenue, assets, and complexity figures under the previous president.
- 4.034 While annual figures can only be known with certainty at the end of a financial year, it should be possible to estimate the figures based on a trust's operating budget at any time during the financial year. The bands within the remuneration scale seem sufficiently wide for a licensing trust to determine with reasonable accuracy the band within which its figures are likely to fall.
- 4.035 Should actual results differ significantly from those budgeted, any necessary adjustments in remuneration could be made. Where a restructuring likely to affect a trust's operations is proposed, the President's remuneration would need to be adjusted accordingly.

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## Detailed Financial Review by Trust

### Ashburton, Cheviot, and Geraldine

- 4.036 Ashburton Licensing Trust provides management services by contract to Cheviot and Geraldine Licensing Trusts, but each maintains a separate Board of Trustees. In their respective districts, all three operate bars, restaurants, and cafes; sell alcohol both on and off premises and provide accommodation to the travelling public.
- 4.037 Each Trust also operates gaming machines from its premises. The Community Grants Foundation (CGF) is the licence holder for Cheviot and Geraldine, and the Ashburton Trust Charitable Foundation the licence holder for Ashburton.
- 4.038 Ashburton is the only Trust with a subsidiary – the Ashburton Trust Charitable Foundation – which distributes gaming machine proceeds to the community on behalf of the licensing trust. The Foundation Trust Board is comprised of three-quarters licensing trust members and one-quarter co-opted members.





## REVIEW OF LICENSING TRUSTS

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- 4.039 Ashburton and Geraldine are district trusts and have exclusive licence rights under the Sale of Liquor Act for the sale and supply of alcohol in each district. Cheviot is a local trust and (therefore) does not have exclusive licensing rights. Ashburton has been subject to two polls relating to its exclusive licence rights, both of which resulted in retention of those rights.<sup>4</sup>
- 4.040 In 2001-02, Ashburton's return on equity was 16.2% (2000-01: 14.4%), and it returned 3.1% (2000-01: 2.9%) of its revenue to the community by way of donations. About another 2% is returned to the community by way of sponsorships and advertising expenditure. With a good current ratio and low levels of term debt, Ashburton performs significantly better than average.
- 4.041 Geraldine and Cheviot returns are lower but consistent with the averages. Both are in a sound financial position, with good current ratios and no term debt.

### Birkenhead

- 4.042 Birkenhead Licensing Trust is currently not trading – having sold the off-licence business it held at 31 March 2002. It has recently entered into a sale and purchase agreement to buy the premises, but not the business, of a tavern in Birkenhead. The Trust operated gaming machines from its premises until sold, with the CGF as the licence holder.
- 4.043 Birkenhead is subject to full competition. Its proposed sole activity of landlord may mean that the trustees are not meeting their objects under the Sale of Liquor Act by having no direct involvement in the sale and supply of liquor.<sup>5</sup> In June 2002, the Trust formed the Birkenhead Charitable Trust, which is currently inactive.

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4 Under the Sale of Liquor Act 1989, District Licensing Trusts have exclusive rights to hold on-licences in respects of hotels and taverns and off-licences in respect of any premises other than certain club premises and premises on which wine is sold or any kind of liquor is made, within the trust district. Licensing trusts with such exclusive licensing rights are not able to operate or distribute their proceeds outside their district. These exclusive licence rights are subject to a poll of electors (see sections 214 and 215 of the Sale of Liquor Act). In many instances, electors have voted to remove these exclusive trading rights. As a result, trusts that face full competition are able to operate and distribute their proceeds outside their district.

5 Section 187(1)(a), Sale of Liquor Act 1989.





- 4.044 Birkenhead has performed well financially in the past and returned profits to the community at a level higher than average. As at 31 March 2002, it was in a sound financial position with a current ratio of 10:1 (2001: 7:1).

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Clutha

- 4.045 Clutha Licensing Trust operates seven licensed premises in South Otago – both directly and by management contract. Its only subsidiary – Southern Hotels Limited – does not trade. Forty-three gaming machines are operated from Trust premises, for which the CGF is the licence holder.
- 4.046 In 2001-02, \$349,000 was returned to the community from gaming machine profits. The Trust itself returned \$11,000 to the community by way of sponsorship, which is included in operating expenditure. The Trust is subject to full competition.
- 4.047 Clutha did not perform well in either 2000-01 or 2001-02, with return on equity at 7.9% and 5.5% respectively, and a current ratio of 0.8:1 and 0.6:1 respectively. The Trust has experienced ongoing solvency issues in recent years, but in 2001-02 achieved a surplus before interest, tax, and donations of \$444,000 (2000-01: \$350,000). It has returned money to the community from gaming machine profits through the CGF and sponsorships of \$360,000.

Masterton

- 4.048 Masterton Licensing Trust sold its operations to Trust House Limited in 1997, in exchange for 79% of the company's shares.
- 4.049 Trust House Limited is heavily diversified, with the following areas of operation:
- Hospitality – 100-room hotel, taverns, and bars.
  - Retail outlets – bottle stores and community stores.
  - Infrastructure – aged care hospital, and over 500 former State houses.
- 4.050 Trust House Charitable Trust owns and holds the licence for gaming machines operated at both Trust House Limited outlets and those managed for Flaxmere and Rimutaka Licensing Trusts.





## REVIEW OF LICENSING TRUSTS

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- 4.051 Masterton, Flaxmere, and Rimutaka Licensing Trusts are subject to full competition.
- 4.052 Masterton generates returns significantly higher than average, with return on equity in 2001-02 of 26.2% (2000-01: 17.4%). The Trust is more highly geared than most, with term debt to total assets at 31 March 2002 of 34.1% (2001: 38.1%), reflecting the different nature of its business, but compared to similar private sector businesses gearing is at a modest level and falling.
- 4.053 Donations of \$1.15 million from gaming machine profits were made in 2001-02 compared with \$283,000 in 2000-01. Those amounts were, respectively, 24% and 10.4% of the net surplus before donations.

### *Flaxmere*

- 4.054 Trust House Limited manages the operations of Flaxmere Licensing Trust under a management contract. These operations involve a tavern and a bottle store.
- 4.055 Trust House Charitable Trust owns the gaming machines at the tavern and is advised by the Licensing Trust on grant distributions in the Flaxmere area.
- 4.056 Flaxmere achieved a return on equity in 2001-02 of 8% (2000-01: 8.6%), which is about average. The Trust has a strong balance sheet with no term debt and assets at 31 March 2002 of \$1.77 million (2001: \$1.35 million).

### *Rimutaka*

- 4.057 Trust House Limited manages the operations of Rimutaka Licensing Trust under a management contract. These operations involve a tavern and a bottle store.
- 4.058 Trust House Charitable Trust owns the gaming machines at the tavern and is advised by the Licensing Trust on grant distributions in the Rimutaka area.
- 4.059 Rimutaka achieved a return on equity in 2001-02 of 28.9% (2000-01: 15.2%), which is better than average. The Trust has a strong balance sheet with no term debt and total assets at 31 March 2002 of \$1.1 million (2001: \$1.1 million).





### Hawarden

- 4.060 Hawarden Licensing Trust has no subsidiaries and does not operate gaming machines either directly or through the CGF. It is a local trust under the Sale of Liquor Act and (therefore) is subject to full competition.
- 4.061 Hawarden's only activity is ownership of a tavern property, so that its primary income is from rents. The trustees may, therefore, not be meeting their objects under the Sale of Liquor Act by having no direct involvement in the sale and supply of liquor.
- 4.062 The Trust has only a small annual income and provides a small contribution to the community by way of donation. It is in a sound financial position with no term debt and a current ratio at 31 March 2002 of 1.5:1 (2001: 4:1).

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### Invercargill

- 4.063 Invercargill Licensing Trust operates hotels, motels, taverns, cafes, bars, bottle stores, and catering businesses. It currently has exclusive licence rights under the Sale of Liquor Act for the sale and supply of alcohol in its district.
- 4.064 Subsidiary trusts hold the licences for approximately 187 gaming machines. In 2001-02, the Licensing Trust Group distributed \$5.2 million (2000-01: \$3.9 million) in donations to the local community, all but \$1.6 million (2000-01: \$1 million) of which was from gaming machine proceeds.
- 4.065 Invercargill is operating very successfully financially. It returns about 8.2% of its revenue to the community in donations and has consistently generated good profits. Its financial position is sound, with very high liquidity and low term debt.

### Johnsonville

- 4.066 Johnsonville Licensing Trust's involvement in the hospitality industry is subject to full competition. It has a subsidiary trust – Johnsonville Licensing (Charitable) Trust – that owns Johnsonville Property Trust Limited, which is the property investment vehicle for the group. The Licensing Trust also performs management services for its subsidiaries under contract.





## REVIEW OF LICENSING TRUSTS

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- 4.067 At the time we prepared this analysis, Johnsonville had 36 gaming machines at its premises, for which the CGF was the licence holder. Donations for 2001-02 totalled \$348,000 (2000-01: \$493,000). In July 2003, the Trust decided to sublease its two premises.
- 4.068 Johnsonville is only marginally profitable and in recent years has struggled to break even. However, it continues to be solvent, having had a current ratio at 31 March 2002 of 1.3:1 (2001: 1.2:1).

### Mataura

- 4.069 Mataura Licensing Trust faced a competition poll last year in which the community voted to retain the Trust's exclusive licence rights for the sale and supply of alcohol.
- 4.070 Mataura has no subsidiaries but has gaming machines on its premises, for which the CGF is the licence holder. In 2001-02, \$646,000 was distributed to the community through the CGF. The Trust itself gave out donations of \$100,000 and sponsorships of \$81,000.
- 4.071 For 2001-02, the Trust generated a return on equity before donations of 13.4% (2000-01: 7.9%). The Trust consistently maintains a current ratio of over 2:1, has no term debt, and is in a sound financial position.

### Mt Wellington, Otara, and Papatoetoe

- 4.072 Mt Wellington, Otara, and Papatoetoe Licensing Trusts are linked together by Northern Trusts Limited, which is jointly owned through the subsidiaries of each trust. The company provides management services to group entities on a break-even basis. Each licensing trust is subject to full competition in its local area.
- 4.073 Mt Wellington owns directly and indirectly through its other subsidiaries – Mt Wellington Charitable Trust and wholly owned Keri Corporation Limited – Mt Wellington Trust Hotels Limited. This company operates the Waipuna Hotel and Conference Centre and the Panmure Tavern. Keri Corporation also operates a bar.
- 4.074 Mt Wellington Charitable Trust holds the licence for gaming machines operated in Licensing Trust premises. The Licensing Trust appoints several trustees to the charitable trust.





- 4.075 Otara Licensing Trust appoints half the trustees of East Tamaki Charitable Trust. The Licensing Trust operates a bar and an off-licence store. The charitable trust holds licences for gaming machines on trust premises, and makes distributions to the community.
- 4.076 Papatoetoe Licensing Trust appoints half the trustees of St George Charitable Trust. The Licensing Trust also runs a tavern and off-licence store. The charitable trust receives distributions from the CGF, which holds the licences for gaming machines on Licensing Trust premises. The distributions are then redistributed back out to the community.
- 4.077 Mt Wellington Licensing Trust group is currently undergoing some restructuring and is concluding refinancing arrangements in an attempt to return the trading operations of Waipuna Hotel and Conference Centre and the Panmure Tavern to profitability. For 2001-02, the licensing trust had a deficit of \$431,000 (2000-01: \$570,000) and at 31 March 2002 had a high ratio (60.9%) of term debt to total assets.
- 4.078 Otara operated at a deficit in 2000-01 and 2001-02, while Papatoetoe produced a small surplus. Otara had a positive current ratio whereas Papatoetoe did not.

### Oamaru

- 4.079 Oamaru Licensing Trust operates bottle stores, a wholesale liquor outlet, several bars, hotel accommodation, and a restaurant. It is subject to full competition for the sale and supply of alcohol in the Oamaru area. It has three subsidiaries, one of which – Totara Hotels Limited – is used for name protection only and does not trade.
- 4.080 Oamaru Licensing Trust Charitable Foundation and Totara Hotels Sports Foundation administer gaming machine proceeds distributed from the CGF. The gaming machines are operated from licensing trust premises.
- 4.081 Oamaru has consistently operated at a deficit in recent years, although it has made some donations to the community. In 2002, \$534,000 was generated through gaming machines for which the CGF holds the licences. The Trust has an ongoing solvency problem resulting from the sale of a division in April 2001. At 31 March 2002, it had moderate debt levels that were reduced in 2002-03, a current ratio of 0.95:1 (2001: 1.2:1), and a ratio of term debt to total assets of 22.1% (2001: 24.6%).





## REVIEW OF LICENSING TRUSTS

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### *Parakai*

- 4.082 Parakai Licensing Trust owns a tavern, which it leases to an independent operator. Its only income is rent, it has no subsidiaries, and it is subject to full competition in its local area. The trustees may not be meeting their objects under the Sale of Liquor Act by having no direct involvement in the sale and supply of liquor.
- 4.083 The Trust's return on equity is low and it makes minimal donations to the community out of profits. In 2001-02 it distributed \$19,000 to the community from gaming machine proceeds administered by the CGF. The Trust has a good current ratio and no term debt, and so is in a sound financial position.

### *Porirua*

- 4.084 Porirua Licensing Trust – through its subsidiaries Mana Taverns Limited and Trust Porirua – owns property and operates cafes, bars, and gaming machines. The Trust is subject to full competition in its local district.
- 4.085 Mana Community Grants Foundation was formed in December 2002 to take over gaming machine licences held by the CGF. The Licensing Trust provides management services to its subsidiaries. All of the subsidiary entities are consolidated into the Trust's financial results.
- 4.086 In recent years, Porirua has incurred ongoing deficits. However, for 2001-02 it made a surplus of \$28,000 (2000-01: \$469,000 deficit), and improved its current ratio significantly from 0.8:1 at 31 March 2001 to 1.8:1 at 31 March 2002. The ratio of term debt to total assets also improved from 8.1% to 5.3% between 2001 and 2002.

### *Portage and Waitakere*

- 4.087 Portage and Waitakere Licensing Trusts each own 50% of West Auckland Trust Services Limited. The company supplies each Trust with managerial and secretarial services. It also buys liquor and distributes it at cost to the licensing trusts as well as undertaking some wholesale distribution. The company's results are not consolidated into either Trust's financial results. Therefore, for this analysis, we have manually prepared a consolidated position for the Portage and Waitakere "group" (including West Auckland Trust Services Limited).





- 4.088 Portage and Waitakere also each have subsidiary charitable foundations (which are currently dormant), and operate gaming machines for which the licences are held by the CGF. Both Trusts also have exclusive licence rights for the sale and supply of alcohol in their respective districts.
- 4.089 Both Portage and Waitakere produce a return on equity of approximately 7%, which is consistent with the industry average. They also have minimal term debt and adequate current ratios. As a “group”, in 2001-02 they distributed \$747,000 (2000-01: \$397,000) to the community out of profits and a further \$5.5 million from gaming machine proceeds administered by the CGF.

**FOUR**

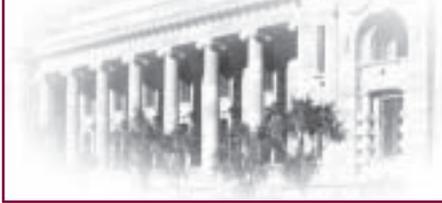
*Te Kauwhata*

- 4.090 Te Kauwhata Licensing Trust operates a tavern which has gaming machines on site licensed through the CGF. The Trust has no subsidiaries and has exclusive licence rights for the sale and supply of alcohol in its district. It has voluntarily allowed the local 4 Square Supermarket to sell liquor.
- 4.091 The Trust is very small and makes low returns to the community. It is in a reasonably sound financial position with a current ratio of 1.2:1 and low term debt.

*Terawhiti*

- 4.092 Terawhiti Licensing Trust has a subsidiary charitable trust that holds investments and distributes income by way of scholarships. It is in partnership with a company managing two bars, and is subject to full competition. Neither the charitable trust nor the partnership results are consolidated into the Trust’s financial results. The Trust’s income is 25% of the partnership income. The 2001-02 audit has not yet been completed because of issues related to obtaining information.
- 4.093 Terawhiti has a history of deficits, although in 2000-01 it broke even. In 2001-02 it incurred a \$35,000 deficit. However, at 31 March 2002 it had a positive current ratio of 19.2:1 (2001: 4.6:1) and no term debt.





## REVIEW OF LICENSING TRUSTS

### *Wainuiomata*

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4.094 Wainuiomata Licensing Trust has ceased operating and is in the process of winding up. Because audited financial statements for the period up to the winding up are not yet available, we have not included information relating to Wainuiomata in our analysis.

### *Wiri*

4.095 Wiri Licensing Trust operates a tavern in South Auckland, and also owns a commercial property in Manukau City (which it leases to four tenants). The Trust is subject to full competition and has no subsidiaries.

4.096 In 2001-02, the Trust produced a small return on equity of 5.3% (2001: 6.9%). At 31 March 2002, it had a current ratio of 0.3:1 (2001: 0.35:1), and a ratio of term debt to total assets of over 30%.





## REVIEW OF LICENSING TRUSTS

B.29[03b]

Trust or Subsidiary	Revenue		Surplus/(Deficit)		Surplus/(Deficit) before interest, tax, donations	
	2002 \$000	2001 \$000	2002 \$000	2001 \$000	2002 \$000	2001 \$000
Ashburton	16,239	14,668	988	758	1,970	1,540
Cheviot	857	891	36	27	64	53
Geraldine	1,775	2,038	78	59	117	90
Birkenhead	5,215	5,968	44	296	232	405
Clutha	8,579	7,755	251	161	444	350
Flaxmere (4)	2,111	1,871	118	93	178	136
Masterton (5)	36,295	29,175	3,650	2,427	5,882	3,943
Rimutaka	1,793	1,693	276	144	284	146
Hawarden	23	20	3	1	7	4
Invercargill	56,206	47,662	3,339	2,371	7,299	5,110
ILT Charitable Trust	3,066	2,419	283	173	1,492	1,159
ILT Sports Foundation	5,706	4,340	713	400	3,112	2,227
Invercargill (Consolidated) (6)	63,798	53,418	4,335	2,944	11,902	8,496
Johnsonville	2,907	3,615	94	(26)	122	18
Mataura	20,288	15,743	955	445	1,542	814
Mt Wellington (7)	13,895	21,877	(431)	(570)	1,173	1,296
Mt Wgtn Charitable Trust (Board)	25	31	5	20	5	20
Mt Wgtn Charitable Trust (Gaming)	2,296	2,868	160	181	1,087	1,363
Mt Wellington (Consolidated) (8)	16,216	24,777	(266)	(369)	2,266	2,679
Otara	2,497	3,290	(230)	(244)	(230)	(236)
East Tamaki Charitable Trust	1,012	874	(53)	67	464	361
Papatoetoe	7,205	4,653	121	41	147	73
St George Charitable Trust	462	433	(46)	97	462	431
Oamaru (9)	13,073	12,344	(255)	(152)	185	149
Parakai	70	69	22	28	39	42
Porirua	2,810	3,025	28	(469)	68	(443)
Portage	39,384	38,696	511	645	847	1,265
Portage Charitable Foundation	113	1,107	(393)	(157)	33	222
West Auckland Trust Services Ltd	25,705	25,159	(48)	40	(50)	47
Waitakere	53,868	51,464	930	1,154	1,663	1,750
Portage & Waitakere (Consolidated)	85,630	82,192	1,000	1,682	2,493	3,284
Te Kauwhata	630	594	11	(1)	15	1
Terawhiti (10)	32	191	(35)	-	(34)	-
Wiri	1,610	1,738	121	150	347	396

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## REVIEW OF LICENSING TRUSTS

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Trust or Subsidiary	Total Assets		Equity		Donations (1)		Other Com Conts
	2002 \$000	2001 \$000	2002 \$000	2001 \$000	2002 \$000	2001 \$000	2002 \$000
Ashburton	11,344	10,669	9,230	8,242	509	425	(3) 265
Cheviot	1,614	1,429	1,240	1,204	-	-	1
Geraldine	1,072	989	770	692	-	-	118
Birkenhead	2,823	2,895	2,564	2,520	155	24	40
Clutha	4,441	4,750	3,164	2,913	-	-	360
Flaxmere (4)	1,771	1,354	1,472	1,085	-	-	342
Masterton (5)	36,225	32,807	18,367	15,600	1,155	283	274
Rimutaka	1,123	1,148	956	950	-	-	671
Hawarden	344	325	334	315	1	1	4
Invercargill	49,843	45,464	42,612	39,274	1,618	1,048	-
ILT Charitable Trust	3,148	2,080	1,640	1,357	1,209	986	-
ILT Sports Foundation	2,881	2,010	2,238	1,525	2,399	1,827	-
Invercargill (Consolidated) (6)	55,824	49,472	46,491	42,156	5,226	3,861	-
Johnsonville	4,469	4,747	4,073	3,979	-	-	348
Mataura	10,537	8,672	7,897	6,942	100	100	728
Mt Wellington (7)	29,971	32,468	5,349	5,780	-	-	-
Mt Wgtn Charitable Trust (Board)	6,423	6,362	5,380	5,374	-	-	-
Mt Wgtn Charitable Trust (Gaming)	959	897	887	728	906	1,147	-
Mt Wellington (Consolidated) (8)	31,439	33,814	9,615	9,881	906	1,147	-
Otara	848	1,173	459	689	-	-	-
East Tamaki Charitable Trust	248	400	165	218	502	279	-
Papatoetoe	2,568	1,661	994	873	-	-	-
St George Charitable Trust	148	194	148	194	508	334	-
Oamaru (9)	7,285	7,306	3,301	3,387	92	68	534
Parakai	692	741	686	729	7	2	9
Porirua	4,489	4,600	3,853	3,801	-	-	589
Portage	12,418	12,350	9,770	9,259	76	3	2,777
Portage Charitable Foundation	92	698	84	477	426	379	-
West Auckland Trust Services Ltd	4,684	3,770	(269)	(221)	-	-	-
Waitakere	20,321	19,015	16,088	15,157	245	15	2,685
Portage and Waitakere (Consolidated)	35,515	33,833	25,673	24,672	747	397	5,462
Te Kauwhata	292	278	223	213	-	-	65
Terawhiti (10)	240	290	236	271	-	-	160
Wiri	3,909	4,038	2,295	2,174	-	-	19





## REVIEW OF LICENSING TRUSTS

B.29[03b]

Donations % of Revenue		Donations % of surplus/(deficit) before donations		Surplus/ (Deficit) % of Revenue (2)		Return on Equity		Current Ratio		Term Debt to Total Assets	
2002 %	2001 %	2002 %	2001 %	2002 %	2001 %	2002 %	2001 %	2002 %	2001 %	2002 %	2001 %
3.1	2.9	34.0	35.9	9.2	8.1	16.2	14.4	181.1	137.6	0.6	1.8
-	-	-	-	4.2	3.1	2.9	2.3	153.5	288.1	-	-
-	-	-	-	4.4	2.9	10.1	8.5	187.6	168.0	-	-
3.0	0.4	77.9	7.5	3.8	5.4	7.8	12.7	1,016.6	715.7	-	-
-	-	-	-	2.9	2.1	7.9	5.5	84.8	67.3	-	7.4
-	-	-	-	5.6	5.0	8.0	8.6	132.6	92.2	-	-
3.2	1.0	24.0	10.4	13.2	9.3	26.2	17.4	80.8	69.6	34.1	38.1
-	-	-	-	15.4	8.5	28.9	15.2	99.3	88.4	-	-
3.8	2.6	25.9	33.2	14.6	7.8	1.0	0.5	146.9	401.6	-	-
2.9	2.2	32.6	30.7	8.8	7.2	11.6	8.7	246.3	357.3	-	-
39.4	40.8	81.1	85.1	48.7	47.9	91.0	85.4	148.1	189.5	-	-
42.0	42.1	77.1	82.0	54.5	51.3	139.0	146.0	299.4	214.6	-	-
8.2	7.2	54.7	56.7	15.0	12.7	20.6	16.1	234.1	332.6	-	-
-	-	-	-	3.2	-0.7	2.3	-0.7	128.0	117.0	1.7	4.8
0.5	0.6	9.5	18.3	5.2	3.5	13.4	7.9	204.1	244.2	-	-
-	-	-	-	-3.1	-2.6	-8.1	-9.9	74.9	83.3	76.9	70.9
-	-	-	-	21.9	65.0	0.1	0.4	39.2	35.2	-	-
39.5	40.0	85.0	86.4	46.4	46.3	120.1	182.4	876.3	233.6	-	-
5.6	4.6	141.5	147.4	3.9	3.1	6.7	7.9	82.4	78.7	60.9	56.5
-	-	-	-	-9.2	-7.4	-50.1	-35.4	100.1	153.3	-	-
49.6	31.9	111.7	80.5	44.4	39.6	272.5	159.1	101.8	113.0	-	-
-	-	-	-	1.7	0.9	12.2	4.7	99.0	68.4	5.8	-
110.0	77.1	110.0	77.5	100.0	99.5	311.8	221.4	-	-	-	-
0.7	0.6	-56.4	-81.0	-1.2	-0.7	-4.9	-2.5	95.0	116.5	22.1	24.6
10.1	3.2	24.0	7.4	41.8	43.3	4.3	4.1	1,965.8	845.7	-	0.2
-	-	-	-	1.0	-15.5	0.7	-12.3	178.5	82.6	5.3	8.1
0.2	-	12.9	0.5	1.5	1.7	6.0	7.0	132.0	126.5	0.2	0.7
378.4	34.2	1,294.6	170.9	29.2	20.0	39.0	46.4	1,225.6	316.7	-	-
-	-	-	-	-0.2	0.2	17.8	-18.1	90.5	89.4	-	-
0.5	-	20.9	1.3	2.2	2.3	7.3	7.7	171.6	160.1	-	-
0.9	0.5	42.8	19.1	2.0	2.5	6.8	8.4	155.8	157.0	0.1	0.2
-	-	-	-	1.7	-0.1	4.7	-0.3	124.2	124.3	0.3	4.2
-	-	-	-	-108.6	0.0	-14.6	-	1,917.6	459.1	-	0.4
-	-	-	-	7.5	8.6	5.3	6.9	30.2	34.8	31.0	36.7

**FOUR**





## REVIEW OF LICENSING TRUSTS

### FOUR

#### Footnotes from the previous three pages

- 1 “Donations” is made up of only those items in the Trust’s Annual Report disclosed as donations or charitable distributions. “Other community contributions” includes distributions to the community by way of sponsorships or promotions and also grants made directly by the Community Grants Foundation and the like from gaming machine income.
- 2 Surplus/(Deficit) as a % of Revenue and Return on Equity calculations use surplus before donations.
- 3 Ashburton’s other community contributions are in the form of sponsorships, which are included in operating expenditure.
- 4 Flaxmere, Masterton, and Rimutaka results have been adjusted for incorrect accounting treatments in relation to disclosure of donations, and treatment of gaming machine revenue and expenditure for which the group entities act only as agent. The accounting treatment adopted by the Trust House group entities resulted in a qualified audit opinion. The effect of this treatment has been eliminated from the results so that the group results can be compared with other licensing trusts.
- 5 Masterton figures include the minority interests associated with ownership of Trust House Ltd.
- 6 Invercargill Licensing Trust “Consolidated” results have been manually calculated by adding individual entity results and eliminating inter-entity transactions disclosed as related party transactions in the Annual Report of each entity. From 2003, the results of the Trust Group will be consolidated in its Annual Report.
- 7 The Mt Wellington Licensing Trust result includes the minority interests of Mt Wellington Charitable Trusts.
- 8 The Mt Wellington Licensing Trust “Consolidated” results have been manually calculated by adding individual entity results and eliminating inter-entity transactions disclosed as related party transactions in the Annual Report of each entity.
- 9 The 2001 Oamaru Licensing Trust results are parent-only, as subsidiaries were not consolidated until 2002.
- 10 Terawhiti Licensing Trust 2002 financial statements have not been audited.



# Appendices





## Appendix 1

## Details of Non-standard Audit Reports Issued

### “Adverse” Opinions

Name of Entity	Financial Statements Period Ended	Reason for Opinion
Chatham Islands Council	30 June 2002	<p>We disagreed with the going concern basis being used to prepare the financial statements because the Council’s forecast revenue levels were insufficient to meet its forecast cash outflows, and the Council has often breached its legislative responsibilities because of the cost of compliance.</p> <p>Also, the Council did not recognise a provision for closure and post-closure costs associated with its operational landfills in accordance with Financial Reporting Standard No. 15: <i>Provisions, Contingent Liabilities and Contingent Assets</i> (FRS-15). Nor did it recognise an asset representing the unamortised portion of the landfill asset, which is a departure from Financial Reporting Standard No. 3: <i>Accounting for Property, Plant and Equipment</i> (FRS-3).</p> <p>The Council also departed from FRS-3 by not recognising the value of its museum collection assets in the Statement of Financial Position. FRS-3 requires museum collection assets to be recognised at fair value.</p> <p>We also reported that, had the going concern assumption been appropriate, and except for the departures from FRS-3 and FRS-15, the financial statements would have fairly reflected the financial position of the Council and the results of its operations.</p> <p>In addition, the audit report contained an explanatory paragraph reporting a breach of law in that the Council had not complied with the Local Government Act 1974, which requires Councils to set operating revenues at a level adequate to cover all projected operating expenses.</p>





## APPENDIX 1

Name of Entity	Financial Statements Period Ended	Reason for Opinion
Patriotic and Canteen Funds Board	30 September 2001 30 September 2002	We disagreed with use of the going concern basis to prepare the financial statements because the Board was intending to seek a change to legislation so that it could be disestablished.
Southland Museum and Art Gallery Trust Board	30 June 2002	The Board did not recognise the value of the museum collection assets purchased before 1991 in the Statement of Financial Position. This is a departure from Financial Reporting Standard No. 3: <i>Accounting for Property, Plant and Equipment</i> (FRS-3), which requires museum collection assets not previously recognised to be recognised at fair value. We also reported that, if it were not for the non-recognition of the museum collection assets, the financial position and operations of the Trust Board would have been fairly reflected.
Waimate Racecourse Reserve Trustees	30 June 2000	The Trustees breached the law by transferring their operations to another party, which was contrary to the Trustees' statutory obligation to be responsible for the Reserve. The financial report did not meet the statutory reporting requirements of the Trustees because they included the operations of the other party.
Oamaru Racecourse Reserve Trustees Winton Racecourse Reserve Trustees	30 June 2001  30 June 1993 30 June 1994 30 June 1995 30 June 1996 30 June 1997 30 June 1998	The Trustees breached the law by transferring their operations to another party, which was contrary to the Trustees' statutory obligation to be responsible for the Reserve. The financial reports did not meet the statutory reporting requirements of the Trustees because they did not contain all the assets and liabilities nor all the revenues and expenses that they otherwise would have, had the transfer not occurred.





APPENDIX 1

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Name of Entity	Financial Statements Period Ended	Reason for Opinion
Haast Community Hall Board Millerton Hall Board	30 June 2002 30 June 2002	These Boards did not prepare annual financial statements in accordance with the Public Finance Act 1989, and their financial statements do not comply with generally accepted accounting practice in New Zealand. However, the limited financial information presented did fairly reflect the assets, liabilities, receipts and payments of the Boards.
Whangarei Tourism Trust	30 June 2002	We disagreed with the Trust's financial statements being prepared on the basis of the going concern assumption. The Deed of Management between the Trust and the Whangarei City Council expired on 30 June 2002, and confirmed funding was only available to 30 June 2003.
Wairarapa Cultural Trust	30 June 2002	The Trustees recognised neither the value of their general collection assets nor the associated depreciation expense in the financial statements. This is a departure from Financial Reporting Standard No. 3: <i>Accounting for Property, Plant and Equipment</i> . In addition, the auditor was unable to verify income from exhibitions, concerts and donations due to limited control over those sources of income.
Canterbury Museum Trust Board	30 June 2002	The Board did not recognise the value of the heritage assets it owns. In addition, the amount of heritage assets donated during the year were not recognised as revenue, and heritage asset purchases were expensed rather than capitalised. These are departures from Financial Reporting Standard No. 3: <i>Accounting for Property, Plant and Equipment (FRS-3)</i> . We also reported that, if it were not for the departures from FRS-3, the financial statements would have fairly reflected the Board's financial position, results of operations and cash flows.
Museum of Transport and Technology Board	30 June 2002	The Board did not recognise the value of the heritage assets it owns. In addition, the Board did not recognise the cost or fair value of the heritage assets acquired or restored. These are departures from Financial Reporting Standard No. 3: <i>Accounting for Property, Plant and Equipment (FRS-3)</i> . We also reported that, if it were not for the departure from FRS-3, the financial statements would have fairly reflected the Board's financial position, results of operations and cash flows.





## APPENDIX 1

Name of Entity	Financial Statements Period Ended	Reason for Opinion
Otago Museum Trust Board	30 June 2002	The Board did not recognise the value of museum collection assets donated or subsidised prior to 30 June 2001 in the Statement of Financial Position. This is a departure from Financial Reporting Standard No. 3: <i>Accounting for Property, Plant and Equipment</i> (FRS-3) which requires museum collection assets not previously recognised to be recognised at fair value. We also reported that if it were not for the departure from FRS-3, the financial statements would have fairly reflected the Board's financial position and results of operations.

### *“Except-for” Opinions*

Name of Entity	Financial Statements Period Ended	Reason for Opinion
Geraldine Racecourse Reserve Trustees	30 June 1997 30 June 1998 30 June 1999 30 June 2000	We disagreed with the Trustees' accounting treatment in relation to revaluation of buildings. The Trustees revalued their buildings at insurance indemnity value rather than net current value and no depreciation was charged. The treatment resulted in departures from Statement of Standard Accounting Practice No. 3: <i>Accounting for Depreciation</i> (SSAP-3) and Statement of Standard Accounting Practice No. 28: <i>Accounting for Fixed Assets</i> (SSAP-28).
Flaxmere Licensing (Charitable) Trust	31 March 2002	We disagreed with the reporting of charitable distributions in the Statement of Movements in Equity because we believed that they did not represent distributions to the owners of the Trusts.  We also disagreed with the reporting in the financial statements of gaming machine transactions in which the Trusts had no direct interest.
Rimutaka Licensing (Charitable) Trust	31 March 2002	
Tararua Foundation	31 March 2002	
Masterton Licensing (Charitable) Trust	31 March 2002	
Flaxmere Licensing Trust Group	31 March 2002	
Masterton Licensing Trust Group	31 March 2002	
Rimutaka Licensing Trust Group	31 March 2002	
Trust House Limited and Group	31 March 2002	





Name of Entity	Financial Statements Period Ended	Reason for Opinion
Trust House Charitable Trust	31 March 2002	We disagreed with the accounting treatment of charitable distributions and the charitable distribution liability in the preparation of the financial statements.
Village Pool Charitable Trust	30 June 2002	We were unable to verify pool takings and shop sales due to limited control over these.
Ongarue Domain Board	30 June 2001	We were unable to verify some material revenues, due to limited control over those revenues. In addition, the financial reports did not include budgeted figures (breaching a requirement of the Public Finance Act 1989) and no statement of service performance was prepared.
Mapiu Domain Board	30 June 2001	
Bledisloe Park Domain Board	30 June 2001 30 June 2002	No budgeted figures were included in the statements of financial performance, financial position and cash flows (breaching a requirement of the Public Finance Act 1989). In addition, no statement of service performance was prepared.
Matata Recreation Reserve Board	30 June 2002	No budgeted figures were included in the statements of financial position and cash flows (breaching a requirement of the Public Finance Act 1989).
Waipu Cove Reserve Board	30 June 2000 30 June 2001	
Lake Okataina Scenic Reserve Board	30 June 2002	
Lake Rotoiti Scenic Reserve Board	30 June 2002	
Ruakaka Reserve Board	30 June 2000	No budgeted figures were included in the statements of financial performance, financial position and cash flows (breaching a requirement of the Public Finance Act 1989).
Whatitiri Domain Board	30 June 2001 30 June 2000	
Tamaterau Reserve Board	30 June 2001	
	30 June 1997	
	30 June 1998	
	30 June 1999	
	30 June 2000	
	30 June 2001	
	30 June 2002	





## APPENDIX 1

Name of Entity	Financial Statements Period Ended	Reason for Opinion
Nelson Creek Reserve Board	30 June 2001	We were unable to verify material payments due to the Board being unable to provide supporting documents.
Central South Island Fish and Game Council	31 August 2002	No budgeted figures were reported in the statement of financial position (breaching a requirement of the Public Finance Act 1989).
Waste Disposal Services	30 June 2002	We disagreed with the accounting treatment of the landfill improvements asset. The asset was overstated because capitalisation of the closure and post-closure costs in 2002 were not applied back over the periods to which they related, and (therefore) depreciation in those periods was not charged.

### *Explanatory Paragraphs*

Name of Entity	Financial Statements Period Ended	Subject Matter Covered
Eastland Network Limited	31 March 2002	We drew attention to the fact that the financial statements replaced previously issued financial statements, which had included a provision for the cost to settle a dispute. Attention was drawn to a note in the financial statements stating that the dispute had been settled and the provision revised to take account of the settlement.
America's Cup Village Limited and Group	30 June 2002	We drew attention to uncertainties surrounding the value attributed to properties intended for sale, the value of which depended on the outcome of the America's Cup and movements in the Auckland property market.
Mount Wellington Trust Hotels Limited Mount Wellington Licensing Trust and Group	31 March 2001 31 March 2002 31 March 2001 31 March 2002	We drew attention to uncertainties surrounding the going concern assumption. The validity of the going concern assumption was dependent on the outcome of the issue of debt securities (restructuring programme) and the continuing financial support of Westpac Bank.





Name of Entity	Financial Statements Period Ended	Subject Matter Covered
Hawkes Bay Airport Authority	30 June 2002	<p>We highlighted that:</p> <ul style="list-style-type: none"> <li>the Authority's joint venture partners planned to terminate the Authority and establish a company to undertake the airport activities, although no date had been set for termination; and</li> <li>notwithstanding the planned termination, the going concern assumption had been used in preparing the financial report.</li> </ul>
Opua Marina Management Limited	30 June 2002	<p>We drew attention in each case to the fact that the going concern basis had not been used in preparing the financial report. This was justified because the entity was ceasing to exist.</p>
Tourism Services Limited	30 June 2002	
Tourism Facilities Limited and Group	30 June 2002	
Total Training Systems Limited	30 June 2002	
Nelmac Canterbury Limited	30 June 2002	
Central Hawkes Bay Works Limited and Group	30 June 2002	
Taranua Roding Limited	30 June 2002	
Nelmac Wellington Limited	30 June 2002	
Rodney District Council Sinking Fund Commissioners	30 June 2002	
Upper Hutt Economic Development Agency	15 March 2002	
Tauranga District Education Trust and Group	30 June 2002	<p>The Council had not complied with the Local Government Act 1974 in setting operating revenues at a level adequate to cover all projected operating expenses. In particular, the Council, having consulted its community as part of the Annual Plan process, had resolved not to set operating revenue at a level adequate to cover the decline in service potential (depreciation) relating to its water and sewerage assets.</p>
Hurunui District Council and Group	30 June 2002	





## APPENDIX 1

Name of Entity	Financial Statements Period Ended	Subject Matter Covered
Central Hawkes Bay District Council and Group	30 June 2002	The Council had not complied with the Local Government Act 1974 in setting operating revenues at a level adequate to cover all projected operating expenses. In particular, the Council, having consulted its community as part of the Annual Plan process, had resolved not to set operating revenue at a level adequate to cover the decline in service potential (depreciation) relating to its bridges. The Annual Plan also omitted to fund a portion of the depreciation on its water, waste water and sewerage assets.
Whakatane District Council	30 June 2002	The Council had not complied with the Local Government Act 1974 in setting operating revenues at a level adequate to cover all projected operating expenses. In particular, the Council, having consulted its community as part of the Annual Plan process, had resolved not to set operating revenue at a level adequate to cover the decline in service potential (depreciation) relating to its sewage disposal, land drainage, and leisure and community service assets.
Mangere Cemetery Board	31 March 2001	We reported that the Trustees had breached the law by engaging in the business of retailing headstones, which is in contravention of sections 9 and 21 of the Burial and Cremation Act 1964.
Porirua Licensing Trust and Group	31 March 2001	The Trust breached the law by paying the former president remuneration that exceeded the amount fixed by the Minister of Finance over the past four years. This was a breach of section 199 of the Sale of Liquor Act 1989.
Infrastructure Auckland and Group	30 June 2002	In our opinion, the Board breached the law by making certain investments not permitted under the Local Government Act 1974. Infrastructure Auckland advised that it planned to remedy this position by 31 October 2002 (which it has done).





## Appendix 2

# Collection of Money at Remote Sites – Best Practice Procedures

## Background

The following is a list of best practice procedures to be followed for the collection of money at remote sites.

The controls are comprehensive, and local authorities should be conscious that it may not be cost effective to implement some of these procedures at all remote sites. Alternatively, limited opportunity to segregate duties at the remote site may mean it is not possible to do so.

## Written Policy and Procedures

Written policies and procedures are part of a local authority's overall control environment. They should be regularly revised to ensure that they remain current, and staff need to be trained in their application.

A local authority should have written policy and procedures regarding the collection of cash. Given that the number of staff, and the systems available, will vary at each cash collection point, it may not be possible to have a generic policy that covers *all* cash collection points.

For large local authorities with multiple cash collection points, at several remote locations, it may be appropriate for the policy to require a formal request and authorisation process for establishing new cash collection points.

A request to establish a new cash collection point could include the following:

- Reasons why a new cash collection point is needed.
- A list of all those persons involved with the cash collection point, and a description of their duties.
- The amount that will be maintained as a float.
- A description of the reconciliation process, including frequency of reconciliation.





## APPENDIX 2

- A description of the security for safeguarding cash until it is deposited in the bank.
- Information on how often deposits will be made.

Listed below are: the best practice procedures to be followed at each stage of the cash collection process; separate controls for safes and other cash storage facilities; and some possible oversight controls.

The controls assume that the main Council office is responsible for oversight of the cash collection process at the remote site.

### Cash Received in Person

- The cash received must be entered on a cash register, if one is available, and a copy of the receipt given to the customer. If a cash register is not available, pre-numbered receipts must be utilised and a copy of the receipt given to the customer.
- The cashier should not have access to the audit tape, the programming key, or the programming function of the cash register.
- All cheques must be stamped immediately with a restrictive endorsement payable to the Council.
- All voided or “no-sales” transactions should be initialled by an employee, other than the cashier, as evidence of review and approval. If possible, this should be undertaken at the time the voided or “no-sales” transaction is recorded. Otherwise, it should be undertaken at the time of balancing and reconciliation of the cash receipts.
- Only one cashier should be allowed access to a cash register or cash draw during a single shift.
- Cash must be stored in a safe, or other secure place, until it is deposited. Refer to page 106 for *Controls over Safes and other Cash Storage Facilities*.

### Cash Received through the Mail

Except possibly for camping grounds, it is unlikely that local authority money would be received through the mail at the remote site, as mail will generally go to the main Council office. Councils should not encourage the sending of cash through the mail, other than cheques.





- Where cash is received through the mail at the remote site, it is likely to be recorded in the same manner as cash received in person.
- In addition, mail should be opened by two people and generally recorded in some type of inwards register.

## Balancing and Reconciliation of Cash Receipts

- All cash collected must be balanced daily by comparing the total of the cash, cheques, and EFTPOS receipts to (as applicable) the cash register totals, the pre-numbered receipts totals, and the money received by mail totals.
- Where possible, the balancing and reconciliation of cash should be reviewed by someone not involved with collecting the cash or opening the mail. If voided or “no-sales” transactions have not been reviewed and approved at the time they are recorded, the reviewer of the reconciliation should also review these transactions.
- If, as a result of segregation of duties limitations, the balancing and reconciliation of cash cannot be reviewed by an employee independent of the cash receipting process, the reconciliation should be reviewed on a surprise basis by someone from the main Council office.

## Preparation of Banking

It is preferable that this function is undertaken out of sight of the public and in an area where staff cannot be disturbed.

- Where possible, the deposit for banking should be prepared by someone not involved with collecting the cash or opening the mail. This ensures an independent check over the balancing and reconciliation process described above.
- The deposit should be hand delivered directly to the bank, or the main Council office, preferably with the cash in a secure container. Alternatively, the Council could make use of a security firm for collecting the cash.
- If the deposit is made directly to the bank, the bank deposit slip and bank verification receipt along with the remote site’s record of money received should be delivered to the main Council office by a staff member from the remote site making the deposit. This is to avoid alteration to these documents by a third party.



## Controls Over Safes and Other Cash Storage Facilities

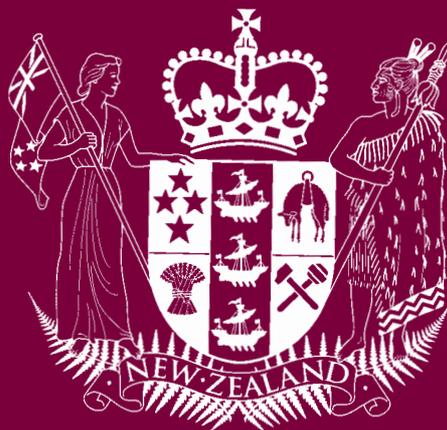
- Cash storage facilities should be locked when the person responsible for the storage facility leaves the area.
- Keys to the cash box, file cabinet, or desk that contains the cash should be restricted to the employee responsible for the funds.
- Extra keys should be secure. One option is to seal the extra keys in an envelope and have them retained by a supervisor for emergency use. Both the employee and the supervisor should sign over the seal on the envelope.
- If a file cabinet or desk is used and access cannot be restricted, a lockable box should be provided for use by the person responsible for the cash.
- If a safe is used, knowledge of its combination should be restricted to essential employees.
- The combination should be changed whenever a person with access leaves the remote site or changes jobs and no longer requires access to the safe.

## Possible Oversight Controls for Remote Sites

- The handling of money will normally generate some cash “overs and unders”. A record of them could be maintained for each person handling cash. The record could be reviewed by main Council office staff periodically, to detect any trends or consistent errors in either “overs” or “unders”.
- Main Council office staff should undertake surprise cash counts of all cash register floats from time to time. The count should be unannounced to prevent special preparation in anticipation of the count – such as temporarily replacing any missing funds.
- The main Council office should undertake regular reconciliations. These should be performed by an employee who has no cash handling responsibilities. It is likely to include comparison of bank verification receipts to bank statements.







**Controller and Auditor-General**  
*Tumuaki o te Mana Arotake*

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***Local Government:  
Results of the 2001-02 Audits***

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