

Local Government: Results of the 2002-03 Audits

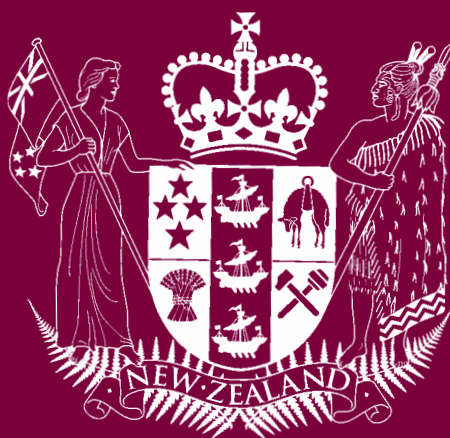


**Report of the
Controller and Auditor-General**

Tumuaki o te Mana Arotake

ISBN 0-478-18120-5

**Office of the Auditor-General
Private Box 3928, Wellington
Telephone: (04) 917 1500
e-mail: reports@oag.govt.nz
web site: www.oag.govt.nz**



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

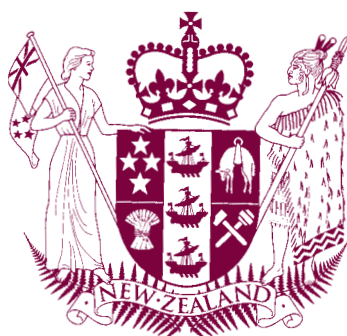
Tumuaki o te Mana Arotake

on

**Local Government:
Results of the
2002-03 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 over a horizontal line.

K B Brady
Controller and Auditor-General

Wellington
21 June 2004





Contents

	<i>Page</i>
Introduction	7
1 Issues from the 2002-03 Audits	9
1.1 Review of the 2002-03 Year	11
1.2 Non-standard Audit Reports Issued	12
1.3 Timeliness of Annual Reporting	16
1.4 Planning, Reporting, and Rate-setting Adoption Requirements	18
1.5 Accounting Issues	21
Subsidiaries and Associates	21
Heritage Assets	21
Valuation of Infrastructural Assets and Land Under Roads	22
1.6 Accounting Issues – Wellington Regional Stadium Trust	23
2 Other Issues Arising During 2002-03	27
2.1 Changes in Financial Reporting Standards	29
2.2 Learning in Local Government's New Statutory Environment	37
2.3 Significance Policies	42
2.4 Asset Management Plans	52
2.5 Service Levels	60
2.6 Implementation of the Local Government (Rating) Act 2002	67
2.7 Conflicts of Interest	80
2.8 Regional Councils – Management of Bovine Tuberculosis Vector Control Contracts	85
3 Areas of Focus for 2003-04	89
3.1 Issues for Attention in the 2003-04 Annual Audits	91
Review of Preparation for 2006 LTCCPs	91
Review of Contents of 2004 LTCCPs	91
Review of Summary of 2004 LTCCPs	92
Elected Members' Remuneration	93
3.2 Preparing to Audit Long-Term Council Community Plans	94
3.3 Auditing Amendments to Long-Term Council Community Plans	98
3.4 Auditing the Balanced Budget Requirement	100
Appendix	103
Details of Non-standard Audit Reports Issued	105





Introduction

This report is our “annual report” on the audits for 2002-03 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.

The new Local Government Act 2002 (the 2002 Act) has replaced the 1974 Act. The 2002 Act had a significant effect on the audits covered in this report and will have an even greater effect in following years.

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;
- describe examples of our expectations of “best practice” on various matters of financial management and reporting, governance, and administration; and
- describe work we are doing in preparation for our expanded role under the 2002 Act.

Contents of this Report

The contents of this report are grouped into three parts:

Part 1 (starting on page 9) reports on matters that arose during the course of the 2002-03 annual audits. We have again identified those entities on whose financial reports we have issued a non-standard audit report during the past year (see pages 12-15).

Part 2 (starting on page 27) deals with other issues that arose during 2002-03 and that have some longer-term consequences. We have commented on a number of areas we gave particular attention to during our audits last year, and have highlighted issues for local authorities to consider in the future. We have again provided some comment on conflicts of interest, including



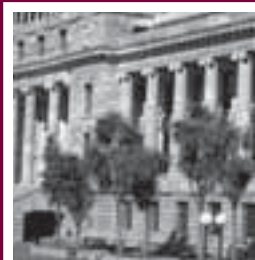


INTRODUCTION

our role under the Local Authorities (Members' Interests) Act 1968 (see pages 80-84), and have also commented on the management of Bovine Tuberculosis Vector Control contracts (see pages 85-88).

Part 3 (starting on page 89) describes some of the issues we have identified for attention during this year's 2003-04 annual audits. As in 2002-03, our focus is on local authorities' implementation of new legislation; in particular the 2002 Act. We also provide an update on work we are doing to ensure we are well prepared for our role under the new legislation.





Part One

Issues from the 2002-03 Audits

1



1.1 Review of the 2002-03 Year

ONE

1.101 Local authority annual reporting and audit engagements for 2002-03 were conducted against a background of significant change and some uncertainty:

- the Local Government (Rating) Act 2002 came fully into effect for the 2003-04 rating year;
- a number of the provisions of the Local Government Act 2002 came into effect during this period and, in particular, nine local authorities elected to prepare a long-term council community plan (LTCCP) for 2003-13; and
- the likely significant future effect of the transition to standards based on International Financial Reporting Standards (IFRS) began to emerge.

1.102 Against this backdrop, the overall timeliness of local authority reporting did not show any overall improvement from the previous year (see pages 16-17).

1.103 Other matters to affect the 2002-03 audit round were:

- new financial reporting standards dealing with subsidiaries and associates;
- continuing issues related to the requirements of Financial Reporting Standard No. 3: *Accounting for Property, Plant and Equipment* (FRS-3) that local authorities value and include heritage collections in their financial statements; and
- ongoing issues relating to valuation of property, plant and equipment, and the inclusion of land under roads as a requirement of FRS-3 (see page 22).





1.2 Non-standard Audit Reports Issued

1.201 This article covers non-standard audit reports issued during the year 1 April 2003 to 31 March 2004, and outlines the nature of those reports.

Why Are We Reporting This Information?

1.202 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 that give rise to non-standard audit reports.

1.203 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?

1.204 A non-standard audit report¹ is one that contains:

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

1.205 The auditor expresses a **qualified audit opinion** because of a disagreement or a limitation on scope. The type of opinion will be either an "adverse" opinion (explained in paragraphs 1.208-1.209), or a "disclaimer of opinion" (see paragraph 1.210), or an "except-for" opinion (see paragraph 1.211).

1.206 The auditor will include an **explanatory paragraph** (see paragraphs 1.212-1.213) in the audit report in order to draw attention to:

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

1 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 An explanatory paragraph is included in the audit report in such a way that it cannot be mistaken for a qualification of the opinion.

“Adverse” Opinion

ONE

- 1.208 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.
- 1.209 Expression of an “adverse” opinion represents the most serious type of non-standard audit report.

“Disclaimer of Opinion”

- 1.210 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

- 1.211 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
 - 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.





NON-STANDARD AUDIT REPORTS ISSUED

Explanatory Paragraph

ONE

- 1.212 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.
- 1.213 For example, it could be relevant to draw attention to the entity having breached its statutory obligations, or to a fundamental uncertainty that 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

- 1.214 The following table summarises the non-standard audit reports issued during the year 1 April 2003 to 31 March 2004. The Appendix on pages 103-110 provides the details of those reports.
- 1.215 No “disclaimers of opinion” were issued during the year.

Name of Entity	Adverse Opinion	Except-for Opinion	Explanatory Paragraph
Waitomo District Council and Group		X	
Chatham Islands Council			X
Central Hawke’s Bay District Council and Group			X
Tasman Bays Heritage Trust (Inc.) and Group	X		
Hawke’s Bay Cultural Trust	X		
Wairarapa Cultural Trust	X		
<i>Museum Trust Boards –</i> Canterbury	X		
Otago	X		
Museum of Transport and Technology	X		

... continued on the next page.



NON-STANDARD AUDIT REPORTS ISSUED

B.29[04b]

Name of Entity	Adverse Opinion	Except-for Opinion	Explanatory Paragraph
Patriotic and Canteen Funds Board	X		
<i>Hall Boards –</i> Okuru Public Bruce Bay Waitaha Haast Community Awakaponga Public	X X X X	X	
<i>Reserve Boards –</i> Nelson Creek Recreation Mapiu Domain Whatitiri Domain Ruakaka Matata Recreation	X	X X X X	
<i>Racecourse Reserve Trustees –</i> Oamaru	X		
Wellington Provincial Patriotic Council		X	
Carparking Joint Venture		X	
Inframax Construction Limited		X	
Waste Disposal Services Limited		X	
Marton Aquatic and Leisure Trust		X	
Village Pool Charitable Trust		X	
America's Cup Village Limited and Group			X
<i>Airport Authorities –</i> Nelson Regional Airport Authority Hawke's Bay Airport Authority			X X

ONE





1.3 Timeliness of Annual Reporting

ONE

- 1.301 Local authorities' annual reports provide information to assist communities to assess the performance of their local authority, and to hold it to account for that performance. Timely information is necessary for this to occur.
- 1.302 Each year we examine the timeliness of local authority annual reporting.
- 1.303 In regard to 2002-03, this was the final year local authorities reported under the Local Government Act 1974 (the 1974 Act). Local authorities had until 30 November 2003 (i.e. five months after their financial year-end) to adopt their annual reports.
- 1.304 For 2002-03 in respect of the 86 local authorities:
- the audits of 4 were completed by 31 August 2003;
 - the audits of 16 were completed by 30 September 2003;
 - the audits of 23 were completed by 31 October 2003; and
 - the audits of 43 (43 last year) were completed by 30 November 2003 – of these, 25 were completed in the fourth week of November.
- 1.305 Overall, the results are consistent with 2001-02. We were hoping for a general improvement.
- 1.306 Section 98 of the Local Government Act 2002 (the 2002 Act) sets new requirements for adoption and public release of a local authority's annual report. The annual report is to be adopted within four months of the end of the financial year (i.e. by 31 October). This brings forward the adoption date for the annual report by one month from the requirement that existed under the 1974 Act.
- 1.307 The 2002 Act also requires that the annual report, and a summary of the annual report, be made available to the public within one month of the adoption of the annual report. Under the 1974 Act, there was no specified time within which the annual report was to be made available to the public. We particularly welcome these changes. We see the annual report summary as an opportunity for local authorities to encourage greater communication with communities on their achievements and future directions.





TIMELINESS OF ANNUAL REPORTING

B.29[04b]

1.308 For 2002-03:

- 28 local authorities released their annual report within 5 working days of the date of their audit opinion;
- 15 local authorities released their annual report between 6 and 10 working days after the date of their audit opinion;
- 21 local authorities released their annual report between 11 and 20 working days after the date of their audit opinion; and
- the remaining 22 local authorities released their annual report 21 working days or more after the date of their audit opinion.

ONE

1.309 Six local authorities released a summary of their annual report. Of these, 3 were from the “early 9”². Of the 6 local authorities to release a summary:

- 5 of the 6 had a gap of 10 or greater days between their audit opinion and releasing their summary reports, while the other 1 issued the summary within 10 days.
- 3 of the 6 released their summary within one working day of releasing their annual report. The remaining 3 released their summary more than 10 working days later.

1.310 The new requirements for adoption and public release of annual reports take effect for the year in which a local authority adopts its first long-term council community plan (LTCCP). For all local authorities except the “early 9”, this will be the financial year ending 30 June 2005.

1.311 We continue to believe that the new dates for adoption and public release of annual reports will represent a considerable challenge for some local authorities.³ We will therefore continue to monitor adoption and public release dates as the 2002 Act provisions come fully into effect.

² “Early 9” refers to the nine councils that adopted their first long-term council community plan in 2002-03.

³ For example, *Local Government: Results of the 2001-02 Audits*, parliamentary paper B.29[03b], 2003, page 18.





1.4 Planning, Reporting, and Rate-setting Adoption Requirements

- 1.401 During the year – as a result of both our work in the local government sector and responding to ratepayer enquiries – we encountered a number of issues relating to formal adoption requirements in the Local Government Act 2002 (the 2002 Act) and its predecessor, and the Local Government (Rating) Act 2002 (the Rating Act).
- 1.402 These issues related to local authorities' resolutions to adopt their:
- long-term council community plan (LTCCP) or annual plan;
 - annual report; and
 - rates resolutions.
- 1.403 Councils cannot delegate responsibility for the adoption of these resolutions, and must adopt each of the three resolutions in a meeting of the Council that is called under the public notice requirements of the Local Government Official Information and Meetings Act 1987.
- 1.404 We are concerned to have encountered issues in such fundamental, but essentially straightforward and clear, requirements. Such adoptions are also important, as failure to adopt the LTCCP or annual plan or the rates resolution in the required manner could invalidate a local authority's annual revenue for rates.
- 1.405 A ratepayer who raised concerns about the adoption of their local authority's annual plan commented to us that errors in requirements such as adoption have caused them to feel doubt about the general conduct of the local authority's business – an understandable concern.

Adoption of the LTCCP or Annual Plan

- 1.406 Under section 93(3) and 95(3) of the 2002 Act, a local authority must adopt its LTCCP or annual plan before the start of the period to which it relates.





- 1.407 A recent ratepayer enquiry identified a potentially significant issue relating to a Council that might not be adopting its annual plan in the manner required. The 2002 Act requires either the LTCCP or annual plan to be adopted by resolution at either an ordinary or special meeting of the Council.
- 1.408 We requested all local authorities to send to us for review their minutes adopting either their LTCCP or annual plan. No local authorities were identified to have breached the adoption requirements. However, we did note that some local authorities chose to adopt their LTCCP or annual plan by sub-committee, and then ratified that adoption through either a Council meeting, or special Council meeting. This procedure appears reasonable, as long as local authorities ensure that public notice is given, that the ratification occurs before the statutory adoption date, and that clear records are kept.

Adoption of a Rates Resolution

- 1.409 Section 23 (1) of the Rating Act requires that:
- (1) *Rates must be set by a resolution of the local authority.*
 - (2) *Rates set by a local authority must –*
 - (a) *relate to a financial year or part of a financial year; and*
 - (b) *be set in accordance with the relevant provisions of the local authority's long-term council community plan and funding impact statement for that financial year.*
- 1.410 During the course of our review on rating (see pages 67-79), we noted that two local authorities did not adopt a rates resolution at the time of adopting their annual plan. This appears to have occurred as a result of confusion arising from some local authorities believing that the requirement to adopt a Funding Impact Statement as part of the LTCCP or annual plan had replaced the need to adopt a rates resolution.
- 1.411 As part of our analysis of rating this year, we are reviewing copies of rates resolutions from all local authorities to determine whether the failure to adopt a rates resolution under section 23(1) had occurred in other local authorities. We obtained the rates resolutions from the Department of Internal Affairs, where local authorities are required to send their resolutions under the Rating Act.





PLANNING, REPORTING, AND RATE-SETTING ADOPTION REQUIREMENTS

ONE

- 1.412 Both of the local authorities that we identified as omitting to adopt a rates resolution for 2003-04 at the time of adopting their annual plan have taken action to re-set the rates under section 119 of the Rating Act. We are aware that there is debate about whether the power to re-set the rates can be applied in a situation where rates were not properly set in the first instance. However, one of the local authorities involved sought legal advice, which has concluded that the provision is available. We have therefore accepted the actions taken by the local authorities to rectify the setting of the rates.
- 1.413 Our review of rates resolutions for the 2003-04 year disclosed a small number of resolutions that did not contain an appropriate level of detail. This is because many local authorities' rates resolutions refer to the information in their adopted annual plan, rather than setting out the intended rates fully in the rates resolution.
- 1.414 In our view, local authorities should ensure that their rates resolutions provide the level of information recommended as good practice, as set out in the *Local Government Knowhow Guide to the Local Government (Rating) Act 2002*.

Adoption of the Annual Report

- 1.415 Under section 98 of the 2002 Act, local authorities are required to adopt their audited annual report within four months of the end of the financial year to which the report relates.⁴
- 1.416 We have reported separately on the completion dates of our audits (see paragraph 1.304).
- 1.417 Completion of the audit and issuing of the audit opinion, and adoption of the annual report, requires co-ordination between the auditor and the local authority to ensure that the report on which an audit opinion is issued is the final report of the local authority that will be presented to the community.
- 1.418 In our article on the timeliness of annual reporting (see pages 16-17), we noted that timely information is necessary to assist communities to assess the performance of their local authority, and to hold it to account for that performance. We will be monitoring local authorities' adoption and issuing of their annual reports and summaries more closely in future, in particular their implementation of the 2002 Act's new adoption and public reporting responsibilities.

⁴ The Local Government Act 1974 provided that audited annual reports were to be adopted within five months of the end of the financial year to which the report related.





1.5 Accounting Issues

ONE

Subsidiaries and Associates

- 1.501 Financial Reporting Standard No. 37: *Consolidating Investments in Subsidiaries* (FRS-37) has introduced a new definition of control, and provides extensive guidance on the nature and identification of control. Control is the basis that determines if a local authority must consolidate another entity into its group financial statements. As a result of FRS-37, there have been changes to the entities included in the group financial statements of some local authorities.
- 1.502 Financial Reporting Standard No. 38: *Accounting for Investments in Associates* (FRS-38) has also introduced some changes into the determination of entities over which Councils have significant influence and are therefore “associates”. Associates are accounted for using the equity method of accounting. There have been some issues in applying this standard in its first year of application. A specific example of the difficulty is set out in this report (see pages 23-26) in relation to the interests of Wellington City Council and Wellington Regional Council in the Wellington Regional Stadium Trust.

Heritage Assets

- 1.503 Last year we reported on issues that had arisen in relation to accounting for heritage assets in accordance with Financial Reporting Standard No. 3: *Accounting for Property, Plant and Equipment* (FRS-3).⁵ The valuation of such assets is problematic because there is no ready market generally available to assess their value, and there may be no generally accepted methods of valuation for certain heritage assets.
- 1.504 There has been no further progress in relation to the heritage asset issues, although local authorities and other entities with significant collections of assets continue to raise their concerns.

⁵ *Local Government: Results of the 2001-02 Audits*, parliamentary paper B.29[03b], 2003, pages 19-20.





ACCOUNTING ISSUES

ONE

- 1.505 In 2002-03 no local authority audit opinions were qualified for non-inclusion of heritage assets, although the opinions on the financial statements of some entities associated with local authorities were qualified (see pages 105-107).
- 1.506 We expressed the view last year that the inconsistent approach among local authorities to valuation of heritage assets was unsatisfactory. We note that the National Asset Management Steering Group (NAMS) has recently completed work to provide guidance on the valuation of heritage assets. We will watch with interest to see whether this guidance enhances consistency in the valuation of heritage assets.
- 1.507 We are also mindful that the adoption of a new standard dealing with property, plant and equipment – to be based on International Accounting Standard 16: *Property, Plant and Equipment* – will have an effect on this matter. We will watch with interest the development of the new standard.

Valuation of Infrastructural Assets and Land Under Roads

- 1.508 Last year we reported on issues in relation to the valuation of infrastructural assets under FRS-3.⁶
- 1.509 Local authorities were given a transitional period, ending on 30 June 2004, within which to revalue all assets under FRS-3. During the 2002-03 year, many local authorities did revalue more assets. The comments that we made last year remain relevant, although we were pleased to observe some improvement in the process to obtain valuations.
- 1.510 Last year we also explained our approach to the valuation of land under roads.⁷ No progress has been made during the past year in reaching a consensus on the most appropriate valuation basis.
- 1.511 We will continue to encourage efforts to reach a consensus on the appropriate valuation basis. Pending such a consensus being reached, we will continue to expect these assets to be included in financial statements on some reasonable valuation basis. We will furthermore expect full disclosure of the basis of valuation.

6 *ibid*, pages 20-21.

7 *ibid*, page 22.





1.6 Accounting Issues – Wellington Regional Stadium Trust

ONE

- 1.601 Wellington Regional Council (Greater Wellington) and Wellington City Council jointly established the Wellington Regional Stadium Trust (the Trust) as settlors under a Trust Deed.
- 1.602 Greater Wellington and Wellington City Council have accounted differently for their respective interests in the Trust in their 2002-03 annual financial reports. Notwithstanding the difference, we issued both Councils with an audit report containing an unqualified opinion. We explain in the following paragraphs why we have accepted the different accounting treatments.

The Trust

- 1.603 An empowering Act was passed by Parliament in 1996 called the Wellington Regional Council (Stadium Empowering) Act 1996 (the Act). This Act required Greater Wellington in conjunction with Wellington City Council to establish the Trust as joint settlors, and enabled Greater Wellington to lend money to the Trust.
- 1.604 The Trust Deed was signed in 1997 and provides for certain decisions to be made jointly by both Greater Wellington and Wellington City Council in their capacity as settlors of the Trust. The decisions include appointment of the Trustees and amendments to the Trust Deed. Neither Council has greater influence than the other in the particular decisions for which they share joint responsibility.
- 1.605 Each Council provided the Trust with an interest-free loan (of different amounts), which was necessary for the financial viability of the stadium. Neither Council has a right to share in the net assets of the Trust, other than repayment of their respective loans, if the Trust is wound up.





ACCOUNTING ISSUES – WELLINGTON REGIONAL STADIUM TRUST

ONE

- 1.606 The two Councils and the Trust are currently in the process of seeking clarification from the High Court about the legal status of the Trust. The position of the Councils and Trust is that the Trust is not a council controlled trading organisation under the Local Government Act 2002. Instead, they claim that the Trust is an incorporated charitable trust, established in accordance with the provisions applicable to community trusts, and with its own governance code as required by Parliament in the Act and approved by the Minister of Local Government.

New Financial Reporting Standard

- 1.607 A new financial reporting standard – FRS-38: *Accounting for Investments in Associates*⁸ – became applicable to the 2002-03 financial reports of both Greater Wellington and Wellington City Council. Under FRS-38, an associate is an entity in which an investor has an ownership interest (not being a subsidiary of the investor or a joint venture entered into by the investor) and over which the investor has the capacity to exercise significant influence.
- 1.608 FRS-38 requires an entity's associates to be equity accounted into the entity's group financial statements. That is, an investor is required to account for the percentage of the equity of the associate attributable to the investor, whether the equity is attributable to the investor directly, or indirectly through its subsidiaries.

The Views of Both Councils

- 1.609 Both Greater Wellington and Wellington City Council agree that they have the capacity to exercise significant influence over the Trust and, therefore, that the Trust is an associate of both Councils. Nevertheless, Greater Wellington and Wellington City Council disagree about their respective levels of ownership interest. Greater Wellington is of the opinion that its ownership interest is nil, whereas Wellington City Council is of the opinion that it has a 50% ownership interest.

8 FRS-38 applies to financial statements covering periods ending on or after 31 December 2002.





ACCOUNTING ISSUES – WELLINGTON REGIONAL STADIUM TRUST

B.29[04b]

ONE

1.610 The reason for Greater Wellington’s view of nil ownership interest comes from its consideration of the substance of the arrangement in place. Greater Wellington’s view is that not accounting for a 50% interest:

- reflects the intention of Parliament through the Act, that the Trust be established and governed as an incorporated charitable trust, established in accordance with provisions applicable to community trusts with its own unique governance code;
- reflects the fact that the Council’s governance responsibilities, including the joint appointment of trustees with Wellington City Council, arise solely from Greater Wellington’s interest-free loan to the Trust;
- reflects the arms-length nature of the relationship including the financial relationship, and that Greater Wellington is legally prohibited from contributing any further funding to the Stadium Trust; and
- is appropriate given the complementary activities test within FRS-37: *Consolidating Investments in Subsidiaries*, which is used to determine ownership interest under FRS-38, is not met in respect of Greater Wellington.

1.611 Greater Wellington concludes that it does not have an equity interest in the Trust – rather, its only financial interest is an interest-free loan – and it would distort the economic reality of that interest to equity account 50% of the Trust.

1.612 The reason for Wellington City Council’s view that it has a 50% ownership interest comes from its consideration of the substance of the arrangement in place. Wellington City Council’s view is that accounting for a 50% interest:

- reflects Wellington City Council’s commitment to the Trust in a transparent manner for ratepayers;
- provides a complete representation within the group financial statements;
- is consistent with the principles behind Wellington City Council’s recognition of its interest in subsidiary trusts; and
- is appropriate given the complementary activities of the Trust – that is, the operating objectives of the Trust support the wider objectives of Wellington City Council.





ACCOUNTING ISSUES – WELLINGTON REGIONAL STADIUM TRUST

1.613 Wellington City Council therefore concludes that there is an ownership interest shared between it and Greater Wellington.

ONE

The Auditor-General's View

1.614 In our view, FRS-38 does not provide sufficient clarity about how to determine the ownership interest. FRS-38 is a new standard created in New Zealand (as opposed to being taken from another jurisdiction) and, therefore, has not been tested and refined in an international context.

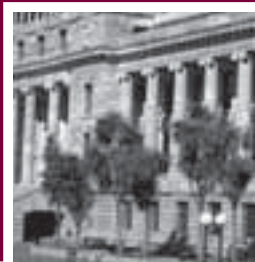
1.615 However, there is an international public sector accounting standard for accounting for associates – International Public Sector Accounting Standard Number 7: *Accounting for Investments in Associates*. This standard applies to associates for which an entity has a form of shareholding or other formal equity structure. The standard notes that where the equity structure is poorly defined it may not be possible to obtain a reliable measure of the ownership interest.

1.616 In the absence of clarity about determining ownership interest, we decided to accept both treatments. Our acceptance was based on both financial reports providing sufficient information to allow respective readers to work out the changes that would need to be made:

- in the case of Greater Wellington, to equity account 50% of the Trust; and
- in the case of Wellington City Council, to remove the amounts that had been equity accounted.

1.617 The current process of creating New Zealand standards based on International Financial Reporting Standards will also lead to change in the relevant New Zealand standards towards the end of 2004. We will give careful consideration to how the respective Councils' interests in the Trust should be accounted for under the emerging standards.





Part Two

Other Issues Arising During 2002-03

2



2.1 Changes In Financial Reporting Standards

TWO

- 2.101** For many years local authorities have been required to present their financial statements in accordance with generally accepted accounting practice (GAAP). GAAP means:
- approved financial reporting standards, so far as those standards apply to the local authority; and
 - in relation to matters for which no provision is made in approved financial reporting standards and that are not subject to any applicable rule of law, accounting policies that are appropriate in relation to the circumstances of the local authority and have authoritative support within the accounting profession in New Zealand.
- 2.102** The Accounting Standards Review Board (ASRB) has responsibility under the Financial Reporting Act 1993 to approve financial reporting standards. All existing financial reporting standards have been developed by the Financial Reporting Standards Board of the Institute of Chartered Accountants of New Zealand (FRSB) before being approved by the ASRB.
- 2.103** For the last decade, financial reporting standards in New Zealand have been sector-neutral. Sector-neutral standards are standards developed with regard to, and which establish standards and guidance for, the full range of entities to which they apply. The credibility of our public sector financial reporting has undoubtedly been enhanced by the fact that the same standards are applied by all entities.
- 2.104** In December 2002, the ASRB announced its decision that New Zealand entities would be required to apply new standards based on International Financial Reporting Standards (IFRS)¹ for reporting periods beginning on or after 1 January 2007. Entities would have the option to apply the new standards from periods starting on or after 1 January 2005. The timetable was driven by a desire to allow the corporate sector in New Zealand to make the transition, if desired, at the same time as Australia and Europe.

¹ The term IFRS is used to refer to International Accounting Standards Board (IASB) standards. The standards comprise:

- International Accounting Standards (IASs), inherited by the IASB from its predecessor body, the International Accounting Standards Committee (IASC), and the interpretations of those standards.
- International Financial Reporting Standards (IFRSs) – the new standards being issued by the IASB, and the interpretations of those standards.





CHANGES IN FINANCIAL REPORTING STANDARDS

TWO

- 2.105 IFRS apply only to profit-oriented entities. We understand that the new New Zealand standards to be based on IFRS will be called New Zealand International Financial Reporting Standards (NZ IFRS).² The format, language, and structure of IFRS will be preserved in NZ IFRS, but the ASRB has decided that a single set of standards should exist in New Zealand for application to all entities.
- 2.106 Retention of a single set of standards retains some of the benefits of sector-neutral standards, most notably efficiency in application of the standards (in that preparers and auditors will have a better understanding of a single set of standards) and efficiency in preparation of standards.
- 2.107 In order that the standards can be applied by what the ASRB calls public benefit entities³ (including almost all public sector entities), additional measurement and recognition requirements will be introduced, and additional or amended disclosure requirements may be established. It is possible that additional or amended disclosure requirements may apply to profit-oriented entities as well.
- 2.108 In June 2003, we raised concerns with the ASRB that inadequate consideration was being given to the effects of the changes to standards on public sector reporting in New Zealand. After discussion, the ASRB established the following guidelines to be used in adapting IFRS in New Zealand:
- The IFRS disclosure requirements cannot be reduced for profit-oriented entities.
 - Additional disclosure requirements can be introduced for all entities.
 - The IFRS recognition and measurement requirements for profit-oriented entities cannot be changed.
 - Recognition and measurement requirements can be amended for public benefit entities, with a rebuttable presumption that amendments will be made for differences between IFRS and the corresponding International Public Sector Accounting Standard (IPSAS)⁴ or existing New Zealand-developed Financial Reporting Standards (FRS), based on the IPSAS or FRS as applicable.

2 NZ IFRS will comprise:

- New Zealand International Accounting Standards (NZ IASs), and the interpretations of those standards.
- New Zealand International Financial Reporting Standards (NZ IFRSs), and the interpretations of those standards.

3 Public benefit entities are entities whose primary objective is to provide goods or services for a community or a social benefit, and where any risk capital has been provided with a view to supporting that primary objective rather than for the financial return to equity shareholders.

4 IPSAS are developed and issued by the Public Sector Committee of the International Federation of Accountants for application to public sector entities.



- Introduction of guidance materials for public benefit entities should be based on the same principles as apply to introduction of recognition and measurement requirements as outlined above.
 - Elimination of options in IFRS is permitted for all entities, on a case-by-case basis. Where an IFRS permits options that are not allowed in existing FRS, a strong argument would need to be made in order for the ASRB to agree to the retention of such options in the NZ IFRS. In reaching a view on this issue, the ASRB will be mindful of the approach adopted by the Australian Accounting Standards Board.⁵
- 2.109 During the past year, the FRSB has been developing the new standards to be based on IFRS. To date it has issued 37 exposure drafts of new standards, typically with each exposure draft being available for a two-month period for public comment.
- 2.110 It is unclear at present exactly what the new standards will mean for local authorities and other public sector entities. The full effect will become clearer towards the end of 2004. But, as further changes will be made in IFRS for application in 2006 and beyond, there may be further effects by the time local authorities and other public sector entities need to comply with the new standards for the first time.
- 2.111 We expect the majority of public sector entities to adopt the new standards for their first reporting period beginning on or after 1 January 2007. However, we expect local authorities will adopt these standards for their reporting period beginning 1 July 2006. This is because:
- councils are required to produce long-term council community plans (LTCCPs) by 30 June 2006 covering a minimum of 10 years starting 1 July 2006. Councils will subsequently be required to report against these plans.
 - councils will want to avoid having to present information under two different sets of standards in the one LTCCP. If Councils delay adoption until the latest possible date, then the first year of their 2006 LTCCP will be under the old standards, with the remaining nine years under the new standards.
- 2.112 Leaving adoption of the new standards until the year ending 30 June 2007 will still require local authorities to restate their opening statement of financial position as at 1 July 2005. This is necessary because the financial statements for the year ending 30 June 2007 must include comparative information for the 30 June 2006 year using the new standards.

⁵ One of the functions of the ASRB is to liaise with the Australian Accounting Standards Board with a view to harmonising New Zealand and Australian financial reporting standards (section 24, Financial Reporting Act 1993).





Our Concerns

TWO

2.113 We have a number of concerns about the transition to the new standards, including:

- the process being followed;
- the possible content of the standards; and
- the effect on the local government sector.

The Transition Process

2.114 In order to meet the same timetable as adopted in Australia and Europe, the new standards need to be in place in the very near future to enable entities to comply for periods starting on or after 1 January 2005 (necessitating an opening statement of financial position at 1 January 2004 for the earliest adopters). This has meant the complete set of standards is being changed in an 18-month period. This tight timetable has placed enormous pressure on the accounting standard setting boards (the ASRB and FRSB) but has, in our view, placed an impossible burden on those being asked to comment on the standards. As a result, the number of submissions has been very low.

2.115 For example, the Society of Local Government Managers' Financial Management Working Party has been able to comment on only one or two of the standards, because of the pressures generally being faced by the sector over recent months.

2.116 We have commented on almost all of the standards, but the breadth and depth of our consideration has been less than for previous new standards. We acknowledge and accept responsibility on behalf of the broader public sector to consider the effect of the proposed standards, but we have found it difficult to contribute at the level we would have liked. The end result of the speed of the process must inevitably be that the quality of the final standards is compromised.





Possible Content of the Standards

TWO

- 2.117 Notwithstanding the establishment of the ASRB Guidelines described in paragraph 2.108 (see pages 30-31), we still have concerns that the issues relevant to public sector entities are not being given sufficient consideration at the appropriate point in the process. In our view, lack of appropriate consideration could lead to standards being issued that contain inappropriate requirements for public sector entities or do not have sufficient guidance to ensure appropriate and consistent application of some requirements.
- 2.118 There have been exposure drafts issued with proposed requirements for public sector entities that simply do not make sense. A good example of such an exposure draft is ED NZ IAS 16: *Property, Plant and Equipment*. The exposure draft proposed that:
- where property, plant and equipment are revalued, there would be disclosure of the carrying amount that would have been recognised had the assets been carried under the cost method; and
 - revaluation movements would be accounted for on an individual basis rather than within classes (groups) of assets.
- 2.119 Many public sector entities do not have the records to enable them to disclose, for assets that are revalued, the carrying amount of those assets under the cost method. In any event, we see no value in that disclosure for users of financial reports. The expense of seeking to obtain the cost information, or some arbitrary alternative based on the carrying value when first adopting accrual accounting or NZ IFRS, cannot meet any cost/benefit test that might be applied.
- 2.120 Accounting for revaluation movements on an individual asset basis may not be able to be done by public sector entities because of a lack of information held in relation to individual asset movements in the past. There was no requirement for such information to be held.
- 2.121 We and others have argued strenuously against these proposals. We now understand that both of these proposed requirements will be changed in the final standard so that they are optional for public sector entities. Such changes are very welcome.





CHANGES IN FINANCIAL REPORTING STANDARDS

TWO

- 2.122 However, given that these two matters were considered in the development of the current New Zealand Financial Reporting Standard – FRS-3: *Accounting for Property, Plant and Equipment* – and the International Public Sector Accounting Standard – IPSAS 17: *Property, Plant and Equipment* – and were not requirements in either of those standards, we question the robustness of the process for development of the exposure drafts of NZ IFRS. It appears that the requirements applicable to profit-oriented entities were to be imposed on public benefit entities without regard to their different circumstances.
- 2.123 There have also been exposure drafts issued that do not retain the extensive and valuable guidance in current New Zealand financial reporting standards that are of relevance particularly to public sector entities. Again, a good example of such an exposure draft is ED NZ IAS 16. It is proposed that that exposure draft contain only some of the extensive valuation guidance currently in FRS-3. We are concerned that invaluable guidance, built up over a decade based on our experience as the first country to apply accrual accounting in the public sector, could disappear on approval of a new standard.
- 2.124 We are also concerned about the likely content of other standards, including, in particular, the standard dealing with consolidations. Our existing standards FRS-36: *Accounting for Acquisitions Resulting in Combinations of Entities or Operations*, and FRS-37: *Consolidating Investments in Subsidiaries* include extensive guidance that has been built up through the experience of applying consolidation principles in the public sector over the last decade. The nature of relationships and arrangements between entities frequently differs markedly between the public sector and the private sector, so this guidance can be and has proven very useful in seeking to apply the standards.
- 2.125 We are concerned at the risk that much of this guidance may be lost, and that there could be broader effects – for example, in regard to the Auditor-General’s mandate, which is determined by the definition of public entities in the Public Audit Act 2001. That definition relies in part on the requirements of any approved financial reporting standard (currently FRS-37). It is important that any such broader issues are properly considered in the development of the standards.





Effect on the Local Government Sector

TWO

- 2.126 We are also concerned about the effect of the change to NZ IFRS on local authorities and other public sector entities. The change has been driven by profit-oriented entities operating in international markets or which have subsidiaries in other jurisdictions or which are subsidiaries of companies in other jurisdictions. In our view, the change to NZ IFRS will not result in any immediate net benefits to the users of financial reports of public sector entities.
- 2.127 We acknowledge that the adoption of IFRS-based standards will fill some gaps in the existing financial reporting requirements. The most notable gaps filled include recognition and measurement of financial instruments, and accounting for revenue of an exchange nature. Standards on these matters are welcome.
- 2.128 However, important issues of relevance to the users of reports of public sector entities – such as how to properly account for non-exchange transactions and how to report broader (non-financial) measures of performance – have received no attention in the past few years. The latter has been a concern to us for many years and we are disappointed at the absence of any progress.
- 2.129 The change to NZ IFRS raises concerns because it will:
- force all public sector entities to focus once again on the core financial aspects of their reporting rather than the more complex and broader aspects of performance reporting;
 - demand additional training of entities and auditors to enable the change to be made in a reasonable fashion;
 - result in costs – costs which will arise without concomitant benefits for most public sector entities; and
 - require effort without any real improvement in the quality of information for users of the reports of public sector entities.





CHANGES IN FINANCIAL REPORTING STANDARDS

TWO

- 2.130 We are also concerned at the absence of guidance to local authorities in meeting some new reporting obligations under the Local Government Act 2002. For example, there is no guidance available on the preparation of summary LTCCPs and annual plans, and the guidance in FRS-29: *Prospective Financial Information*, which applies to LTCCPs, is deficient in a number of respects. It has been necessary for us recently to draw the issues in relation to FRS-29 to the attention of the FRSB (see paragraphs 3.213-3.214 on pages 95-96).
- 2.131 A significant concern in relation to local authorities is the capability of the sector to cope with extensive change in 2005 and 2006. The 2005 annual report of each council will be required to be completed by 31 October 2005, a month earlier than the reporting requirement has been in the past. In addition, all councils will be required to present a summary of their annual report in 2005.⁶ Furthermore, most councils will be starting extensive work during 2005 to enable them to prepare their first audited LTCCP in the early part of 2006. The need to establish an opening statement of financial performance under new standards at 1 July 2005 will further compound the issues and challenges.

Summary

- 2.132 We have made a major and ongoing commitment to the quality of financial reporting by public sector entities. We will continue to do so through representation on the FRSB⁷, by providing guidance to auditors on new requirements, and by making submissions on proposals which may affect public sector entities.
- 2.133 However, we are concerned that the speed of the process, and the limited consideration of the needs of the users of public sector reports, will adversely affect the quality of reporting over the coming years. We are also concerned about the capability of the local authority sector to respond to the extent of change expected of it in 2005 and 2006.
- 2.134 We will continue to monitor developments and work with the sector as best we are able. To this end, the Auditor-General has recently established a Project Steering Committee to lead our response to the change to NZ IFRS.
- 2.135 Notwithstanding the many challenges being faced, we encourage the local government sector to give appropriate attention to the change to NZ IFRS during the period ahead.

6 Nine councils, which were "early adopters" of new requirements in the Local Government Act 2002 in 2003, must meet this requirement in 2004.

7 As the Auditor-General is the auditor of the Accounting Standards Review Board, no member of the Auditor-General's staff is able to be a member of that Board, so our input is made through the FRSB.





2.2 Learning in Local Government's New Statutory Environment

TWO

2.201 Local authorities have been dealing with large-scale change in their legislative framework as a result of a number of legislative amendments, in particular with the introduction in 2002 of the new Local Government Act and the Local Government (Rating) Act.

2.202 The Local Government Act 2002 (the 2002 Act) sets out a comprehensive planning and reporting regime. This regime builds on the provisions of the Local Government Act 1974 (the 1974 Act), introducing new elements that underscore:

- provision of relevant and reliable information to support elected members and communities in decision-making; and
- the need for elected members and officers to make judgements about how best to achieve the 2002 Act's purposes for local government and local authorities.

2.203 Through our work to familiarise auditors with the 2002 Act, and in considering matters raised with us by local authorities since its introduction, we have dealt with a number of questions about local authorities' obligations under the Act. These questions generally relate to two types of issue:

1. How to prepare and undertake public planning and accountability processes and documents; for example:
 - when and who to consult;
 - the extent of analysis of an issue to undertake, and determining the period in which any effects should be assessed;
 - the extent of information to disclose in public plans and reports prepared under the Act; and
 - how to identify and make a significant change to either a Statement of Proposal or the adopted long-term council community plan (LTCCP).





LEARNING IN LOCAL GOVERNMENT'S NEW STATUTORY ENVIRONMENT

TWO

2. How to apply new provisions in the 2002 Act (for example, in respect of consultation and decision-making) to particular decisions under consideration; for example:

- the sale or purchase of land;
- the use of rates raised for a specific purpose that is no longer relevant; and
- tendering decisions, such as not to tender a contract.

2.204 Local authorities have told us that the central issues they are concerned to appropriately address are:

- The obligations regarding community views and consultation. Local authorities have frequently contacted us, asking if a particular decision requires them to consult.
- Addressing the requirements with respect to assessing 'significance'. This question has also been of considerable interest to us because, where a change is significant for the service levels or costs to a local authority projected in its LTCCP, an amendment is required on which an audit opinion must be issued (see pages 98-99).

2.205 We have generally found that such questions cannot be easily answered until a local authority has considered the issue or matter through the decision-making and consultation framework set out in the 2002 Act. While the Act introduces an approach based on what has commonly been called "the power of general competence", this does not mean that there are no constraints on the decisions and activities of local authorities.

2.206 Under the 1974 Act, processes were set out for specific decisions, but little guidance was otherwise given for general decision-making. The 2002 Act also sets out processes for specific decisions, such as adoption or amendment of the LTCCP, adoption of the annual plan, and changing the mode for delivery of a service. However, in addition to these specific requirements, Part 6 of the 2002 Act sets out general requirements for planning, decision-making, and accountability.





LEARNING IN LOCAL GOVERNMENT'S NEW STATUTORY ENVIRONMENT

B.29[04b]

TWO

2.207 The over-riding requirement for a local authority in making any decision is to satisfy itself that the proposal will meet the anticipated needs of the community at a reasonable cost, in a manner that accords with the purpose of local government as set out in section 10 of the 2002 Act:

The purpose of local government is –

- (a) to enable democratic local decision-making and action by, and on behalf of, communities; and*
- (b) to promote the social, economic, environmental, and cultural well-being of communities, in the present and for the future.*

2.208 Underlying this purpose, there are a number of principles or considerations that local authorities must consider and address as relevant in making decisions.⁸ As well as considering relevant principles and requirements, local authorities must also consider:

- the significance of the decision or matter – assessing the significance helps local authorities to decide the extent of analysis, disclosure, and consultation to undertake (see pages 42-51);
- the sections of the 2002 Act outlining the purpose of particular requirements which guide local authorities in analysing decisions and consulting for the statutory planning and reporting processes⁹; and
- the prescriptions that may apply to specific decisions, which in Part 6 of the 2002 Act relate primarily to inconsistent decisions or prohibited decisions¹⁰.

2.209 The principles or considerations specified by the 2002 Act are general. Therefore, in order to apply a principle, a local authority needs to identify and consider authoritative sources of good practice relevant to the specific situation.

2.210 For example, one question raised with us was whether a local authority would be acting in accordance with the 2002 Act if it entered into a contract that it had not tendered. Other local authorities in the region had jointly tendered the contract and the local authority approaching us wished to consider also becoming a party to the contract.

⁸ For example, sections 14, 39, 77, 78, 82 and 101.

⁹ For example, sections 10, 11, 91(2), 93(6), 95(5) and 98(2).

¹⁰ For example, sections 80 and 97, and Part 7.





LEARNING IN LOCAL GOVERNMENT'S NEW STATUTORY ENVIRONMENT

TWO

2.211 In the first instance, the local authority needed to satisfy itself that the contract would promote the social, economic, environmental, and cultural wellbeing of the district, in the present and the future. The following parts of the *Principles relating to local authorities* in section 14 of the 2002 Act appeared particularly relevant to us:

- (e) *a local authority should collaborate and co-operate with other local authorities and bodies as it considers appropriate to promote or achieve its priorities and desired outcomes, and make efficient use of resources;*
- (f) *a local authority should undertake any commercial transactions in accordance with sound business practices;*
- (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.*

2.212 However, the 2002 Act gives no further guidance on how to apply these considerations to a contracting decision. We therefore sought to point the local authority to good practice, as we were aware of it, in deciding whether there were indications that the service should be tendered. This might have seen the local authority considering matters such as:

- the background of the proposed contractor – the availability, capacity and performance of the proposed contractor to meet the local authority district's needs;
- whether the cost of a tendering process would be justified, including the cost to the local authority of running its own separate tender, and whether the proposed contract costs would be comparable to similar works or services tendered by the local authority;
- the competitive environment, including the robustness of the tender process that the other local authorities had run, and whether there might be contractors in the district that could perform the work but who had not had the opportunity to be considered during the other local authorities' tendering process; and
- the scope of services, and whether the contract could be easily altered or whether the nature of the service would need to be long-term.

2.213 The local authority, having satisfied itself on these matters, would consider next the various decision-making and consultation requirements in sections 76-90 of the 2002 Act and the financial management requirements of section 101.





LEARNING IN LOCAL GOVERNMENT'S NEW STATUTORY ENVIRONMENT

B.29[04b]

TWO

- 2.214 This example illustrates a key difference between the 2002 Act and the 1974 Act. Under the 1974 Act, a local authority was required to tender contracts over a financial value that it determined. However, it could resolve not to tender a contract over this amount, recording its reasons for not tendering.
- 2.215 Under the 2002 Act, there is no specific requirement for a local authority to tender works or services – but it is required to make commercial transactions in accordance with sound business practice. A local authority must decide not only when to tender but when and how to use any other approach that is consistent with sound business practice as it applies to that decision.
- 2.216 In making decisions under the 2002 Act, local authorities are to select an approach based on their considerations of the principles and considerations of the Act and the effect of the decision. This means that how a local authority determines its general approach to an issue is as important as its compliance with any specific procedural requirements.
- 2.217 As well as affecting local authorities, this changed approach of the 2002 Act affects our role as statutory auditor of local authorities. It requires us to consider the information a local authority relied on to support a decision, and the regard a local authority had to the relevant principles and considerations of the Act. We will need to do so in forming an opinion on any matter relevant to:
- the opinions we are required to issue on local authority annual reports and summaries (once an LTCCP has been adopted) and, from 2006, on their LTCCPs and any amendments thereto; and
 - our other audit duties under the Public Audit Act 2001 as they relate to local authorities, including performance audits and inquiries.
- 2.218 The planning, decision-making, and accountability requirements of the 2002 Act therefore represent a change in approach that we are working to respond to, with our auditors and through advice to the sector.





2.3 Significance Policies

TWO

2.301 A constant question for local authorities is when and on what issues communities expect to be consulted and receive information. In Part 6 of the Local Government Act 2002 (the 2002 Act) this question is a matter of judgement for local authorities, to be made having regard to the significance of issues.

What is Meant by ‘Significance’ and ‘Significant’?

2.302 The 2002 Act uses the terms ‘significance’ and ‘significant’ in relation to a range of decision-making responsibilities of local authorities. These terms also occurred in the Local Government Act 1974 (the 1974 Act), but were not defined. The 2002 Act, defines these terms to provide guidance and to help local authorities direct the appropriate level of attention, consideration, disclosure, and consultation to matters, based on their relative importance to the district or region.¹¹

2.303 ‘Significance’ can be thought of as a continuum ranging from insignificance to a high degree of significance. Certain specific decisions are identified as significant by the 2002 Act, and require a statement of proposal to be prepared and the special consultative procedure to be undertaken, in addition to the general decision-making requirements, before a decision can be made.¹²

2.304 Local authorities must ensure that their processes promote compliance with the decision-making provisions of the 2002 Act generally and, where a local authority regards a decision as significant, ensure that the decision-making procedures are appropriately observed.¹³

11 Section 5 of the Local Government Act 2002 defines ‘significance’ and ‘significant’ as:

– *significance, in relation to any issue, proposal, decision, or other matter that concerns or is before a local authority, means the degree of importance of the issue, proposal, decision, or matter, as assessed by the local authority, in terms of its likely impact on, and likely consequences for, –*

(a) *the current and future social, economic, environmental, or cultural well-being of the district or region:*

(b) *any persons who are likely to be particularly affected by, or interested in, the issue, proposal, decision or matter:*

(c) *the capacity of the local authority to perform its role, and the financial and other costs of doing so*

– *significant, in relation to any issue, proposal, decision, or other matter, means that the issue, proposal, decision, or other matter has a high degree of significance.*

12 For example, sections 88 and 97.

13 Section 76(3)(b).





2.305 Local authorities are also required, by section 90, to adopt a policy on significance (the policy) that sets out:

- (a) *that local authority's general approach to determining the significance of proposals and decisions in relation to issues, assets, or other matters; and*
- (b) *any thresholds, criteria, or procedures that are to be used by the local authority in assessing the extent to which issues, proposals, decisions, or other matters are significant.*

2.306 The policy must also list the assets considered by the local authority to be strategic assets, and must be adopted or amended using the special consultative procedure.

What Do the Requirements Mean for Local Authorities?

2.307 The extent, nature, and degree of compliance with the decision-making provisions are for each local authority to determine, given the significance of the matter. A local authority's assessment may affect:

- the extent of the analysis of options undertaken;
- the consultation with persons likely to be affected or interested in the decision or matter, where the local authority considers that it is not sufficient to rely on information already available; and
- the disclosure of the matter by the local authority – including in advice to the council, consultation information or a statement of proposal for the adoption or amendment of the long-term council community plan (LTCCP), adoption of the annual plan, or alteration in the mode by which a significant activity is undertaken.¹⁴

2.308 The development of a policy should not be seen as a substitute for a local authority considering the significance of a matter, as the 2002 Act requires. Rather, preparing a policy on significance should help each local authority to:

- form its own approach and build from precedents and decisions taken over time to help it consider any particular matter, and
- set out its understanding of the matters the public sees as sufficiently significant, such that information will be provided or consultation undertaken where decisions affect these matters.

14 Sections 77-80.





SIGNIFICANCE POLICIES

We have a broad concern that some local authorities may not have considered with their communities the approach and understandings they are applying in significance policies developed to date.

TWO

2.309 The use of the policy to record a local authority's understanding of its communities' expectations of what is significant makes it central to the purpose of local government –

*... to enable democratic local decision-making and action by, and on behalf of, communities.*¹⁵

2.310 The *Decision-Making Local Government KnowHow Guide*¹⁶, produced after the introduction of the 2002 Act, provided useful information to support local authorities in addressing the requirements of the Act in respect of 'significance' and 'significant'. However, we are aware from local authorities and enquiries from ratepayers that some local authorities are experiencing difficulty in applying their policy when assessing issues. We are also aware that local authorities are seeking to assess the effectiveness of their policies by discussing questions such as how frequently they might expect to identify issues as significant under their policies.

2.311 We reviewed how local authorities have approached the development of their policies in order for us to identify areas for future improvement.

Findings of Our Review of Policies on Significance

General Approach

2.312 Most local authorities state that assessments of significance will be made on a case-by-case basis using, in particular, considerations contained in the definition of 'significance' in section 5 of the 2002 Act of:

(a) *the current and future social, economic, environmental, or cultural well-being of the district or region:*

(b) *any persons who are likely to be particularly affected by, or interested in, the issue, proposal, decision or matter.*

¹⁵ Section 10(a).

¹⁶ Produced collaboratively by Local Government New Zealand, the Society of Local Government Managers, and the Department of Internal Affairs.





- 2.313 A third consideration of the section 5 definition is
- (c) *the capacity of the local authority to perform its role, and the financial and other costs of doing so.*

This consideration was less commonly referred to in local authorities' policies.

TWO

- 2.314 Other common features of general approaches in policies included that assessments would be based on the extent of effect or on the general public interest in the issue.
- 2.315 Some local authorities did not discuss their general approach, referring instead directly to specified thresholds and criteria.

Thresholds and Criteria

- 2.316 Many criteria for assessing significance refer to “effects that are substantial”, “not inconsequential” or “large”. This appears to be a circular approach that shifts the assessment required from the significance of the issue to the substantiality, consequence, or size of the issue. The reader is no better informed about how significance will be assessed and approached.
- 2.317 As with the general approach section of the policy, more than half of all local authorities indicated that thresholds and criteria were identified based on the provisions of the 2002 Act, with section 97 relied on the most.
- 2.318 About half of all local authorities used numeric, quantitative, or qualitative thresholds and criteria, with a fifth of all local authorities providing a mix of numeric, quantitative, and qualitative thresholds and criteria.
- 2.319 Examples of numeric thresholds and criteria included in local authority policies included a set dollar amount or percentage of operational or capital expenditure, or a set dollar or percentage of rates revenue.
- 2.320 While such thresholds are helpful because many decisions are specific to particular communities, services, expenses or sources of revenue, local authorities should consider the significance of a decision’s specific effects. The table below shows some possibilities.
- 2.321 Quantitative criteria did not contain a numeric threshold, but the consideration was to be made in numeric terms; for example, the extent of financial implications of the decision or that a large number of people would be affected by the decision.





SIGNIFICANCE POLICIES

TWO

Impact of decision	Nature of threshold or criteria
Change proposed to be funded by general rates.	An increase of x% of the general rate.
Change proposed to be funded by general/targeted rates.	An increase of x% of the targeted rate.
Change proposed to be funded by user fees.	An increase of x% of relevant fee.
Change proposed to the numbers of shares or other mechanisms of control of another entity.	The change alters the status of the other entity under the 2002 Act, e.g. the entity is no longer a council-controlled organisation.
Population threshold.	Change impacts on xx% or xx number of people in the affected area.

2.322 Qualitative criteria took into account considerations that could not easily be measured, and often included ideas such as:

- *Reversibility* – The more irreversible the effects of a decision, the more significance it has.
- *Inclusion of the matter in the local authority's LTCCP or annual plan* – If decisions are made within the prioritising and budgeting systems of a local authority, there is a greater ability to ensure that proposals are assessed against each other for value and benefit. This leads to a lower level of significance being necessary for any individual item than in a situation where decisions are made outside the budgeting process.
- *Consistency with decisions already consulted on* – Where there has been previous public consultation and a decision is consistent with the previous directions indicated by the local authority, an issue would be seen as having less significance than where there has not been consultation or the change is inconsistent with previous directions.
- *Practicality* – The intention of the policy is to assist local authorities to make decisions that are well informed, in an effective and efficient manner. The cost of consultation, the urgency of the matter, and whether there might be compassionate or commercial considerations would therefore also be taken into account.





- *Precautionary* – When the significance of a matter is unclear, the local authority will tend to treat the issue as having more significance rather than less.

2.323 In our view, the better-developed policies provided a mix of different types of criteria – numeric, quantitative, and qualitative – to assist the reader to understand how the local authority assesses significance. Thresholds and criteria merely provide a trigger for identifying whether a matter is likely to be significant – they are not the only determinants. Local authorities still need to weigh up the considerations set out in the section 5 definition, and the requirements of the 2002 Act as it relates to assessing significance in any particular instance.

TWO

2.324 Our expectation is that, where local authorities have not included thresholds and criteria as the 2002 Act suggests, they will maintain a “precedent” approach – for example, one local authority created a Register of Significant Decisions. Such an approach will allow local authorities to improve their understanding of what is significant for their districts or regions, and to ensure that like-issues are treated consistently over time.

Procedures

2.325 Making an assessment of the significance of an issue requires judgements to be made, and such judgements inevitably involve an element of subjectivity. One local authority’s policy acknowledged this subjectivity and committed the authority to providing guidelines and ongoing training to assist officers to identify and assess ‘significance’ and ‘significant’. The local authority that created the Register of Significant Decisions has included use of the register as a procedure in its policy, and intends the register to provide a future point of reference in assessing significance.

2.326 Many local authority policies did not set out procedures. We consider that the inclusion of procedures could be a useful enhancement, explaining to the public how issues are assessed and reported, and by whom. We also consider that policies on significance might in future be enhanced by inclusion of, or reference to, local authority delegations for decision-making authority, and consultation approaches or consultation policies.





SIGNIFICANCE POLICIES

Strategic Assets

TWO

- 2.327 A strategic asset under the 2002 Act is an asset or group of assets that a local authority needs to retain to maintain the local authority's capacity to achieve or promote any outcome that it considers important to the current or future well-being of the community.¹⁷ In addition to the categories set out in the definition in section 5 of the 2002 Act, the majority of local authority policies indicated that strategic assets were:
- infrastructural assets such as road, water, wastewater, and solid waste assets; and
 - social service assets such as libraries, parks, community centres, art galleries, convention centres, public pools, gardens, and zoos.
- 2.328 In general, Councils have taken a high-level “whole-of-asset” group approach, rather than identifying specific assets in their policies on significance. Typical of this type of approach are road networks, parks and reserves, and water and wastewater reticulation networks.
- 2.329 Many Councils state that, in respect of such assets, a significant decision is one that affects the whole of the asset, and that decisions affecting parts of the asset or network are not significant unless the ability of the Council to deliver the service as a whole is substantially affected.
- 2.330 We agree that local authorities need to identify strategic assets with care so as not to select too low a level of detail. Where local authorities have taken this approach, the effect of a decision about an individual asset should be assessed in terms of its effect on the operation of the network of which it forms part.
- 2.331 The need for consideration of the network effect was highlighted during 2004 by an enquiry we received about the consultation required under a policy, which included a “network” approach to parks and reserves. The local authority was considering sale or lease of a park for retail on which a range of athletics and recreational facilities were located. It was intended that these facilities would be relocated if the sale or lease proceeded although, at the time the decision was being considered, relocation proposals and the associated costs had not been prepared.

17 Section 5. The definition in this section also includes the following assets as strategic:

- any asset listed as a strategic asset in a local authority's policy on significance;
- any land or building owned by the local authority and required to maintain the local authority's capacity to provide affordable housing as part of its social policy; and
- any port company and airport company shares.





- 2.332 The question that was raised with us was whether the local authority was required to undertake the special consultative procedure in proposing to sell this particular park. Answering this question would in part have depended on whether the effect of the loss or relocation of these facilities – which were not available in other parks in the parks and reserves network – significantly affected the service provided within the network.
- 2.333 In this instance, the local authority chose to undertake a special consultative procedure. However, the broader message is that an individual asset may be significant enough to affect networks of assets and services as a whole.
- 2.334 We note the requirement of the 2002 Act in relation to asset information is:
- for LTCCPs to contain forecast information about assets and groups of assets required for groups of activities; and
 - for the rationale for groups of activities to include the community outcomes to which the activity contributes.
- 2.335 While there is no direct statutory relationship, there is an underlying logic that both strategic assets and information about assets required for activities or groups of activities are those that are needed to achieve a local authority’s outcomes. In our view, this suggests that strategic assets will also be the groups of assets required for groups of activities in LTCCPs.

Other Matters

- 2.336 Almost all local authority policies focus on Part 6 of the 2002 Act, referring to decision-making requirements and strategic assets. However, section 90 also refers to policies including “other matters”, and the Act uses ‘significance’, ‘significant’ and ‘significantly’ in a range of circumstances. A number of examples are provided as an endnote on page 51.ⁱ
- 2.337 Our review found that most policies are unlikely to provide useful guidance to officers, elected members, or the public to assist with assessing significance in the range of instances in which this is required by local authorities under the 2002 Act. For example, it is questionable whether many current policies would assist an officer preparing financial or other forecasts to identify a significant forecasting assumption¹⁸.

¹⁸ Schedule 10, clause 11.





SIGNIFICANCE POLICIES

TWO

2.338 In our view, local authorities should consider the various contexts in which ‘significant’ and ‘significance’ are used in the 2002 Act. They should then assess whether their current policies provide sufficient guidance to assist elected members and officers in making particular decisions.

Conclusions

2.339 In general, we conclude that policies on significance require improvement if they are to serve their purpose in enabling *democratic local decision-making and action by, and on behalf of, communities*.¹⁹ We expect such improvement will occur as local authorities become familiar with ‘significance’, ‘significant’, and the decision-making provisions of the 2002 Act, that require considering explicitly matters that have generally been considered implicitly in the past.

2.340 Areas that, in our view, would benefit from further development within policies are:

- the general approach taken to assessing the significance of matters;
- selection of, and guidance on the application of, thresholds and criteria; and
- inclusion of procedures used – both within the local authority, and in consulting with and informing the public.

2.341 While such development is occurring, our advice is that local authorities should not assume that the absence of specific criteria, thresholds, or procedures in their policy relating to a particular matter implies that the matter has low significance. The purpose of the policy is to assist with directing the appropriate level of attention, consideration, disclosure, and consultation to matters based on their relative importance to the district or region – rather than to exclude any matter from consideration.

2.342 In our view, local authorities should not, in general, find it onerous to meet the requirements for assessing significance where they are maintaining:

- decision-making procedures that address the requirements of sections 76-82 of the 2002 Act, and assess the effect of a decision before it is made; and
- active contact with their communities – consulting and providing information as changes occur and issues arise.

¹⁹ Section 10.





SIGNIFICANCE POLICIES

B.29[04b]

TWO

- i Instances where the term 'significant' occurs in the Local Government Act 2002 include:*
- “*significant decision*” (sections 76 and 77);
 - “*significant activity*” (sections 88 and 97);
 - “*significant new activity*” (section 16);
 - “*significant infrastructure*” (section 130);
 - “*significant assumptions*” (section 201);
 - “*significant assets*” (schedule 10, clause 11(b));
 - “*significant forecasting assumptions and risks*” (schedule 10, clause 11(a));
 - “*significant negative effects*” (schedule 10, clause 2(1)(c));
 - “*significant variation*” (schedule 10, clauses 3 and 15);
 - “*significant policies and objectives*” (schedule 10, clauses 4 and 16); and
 - “*significant part*” of its region (section 12(5)).
- Instances where the term 'significantly' occurs in the Local Government Act 2002 include:*
- “*significantly inconsistent with*” (section 80);
 - “*alter significantly*” (section 97);
 - “*significantly affect*” (section 97);
 - “*not being so significant*” (section 112); and
 - “*significant level of uncertainty*” (section 201).
- Instances where the term 'significance' occurs in the Local Government Act 2002 include:*
- “*significance of all relevant matters*” (section 79);
 - “*significance of the decision or matter*” (section 82(4)(c));
 - “*significance of proposals and decisions*” (section 90); and
 - “*determining significance*” (sections 90 and 281, and schedule 10, clause 7).

* Note that these lists are indicative rather than exhaustive.





2.4 Asset Management Plans

TWO

2.401 For more than a decade, the Auditor-General's reports to Parliament have raised issues about asset management by Councils.²⁰ These reports have particularly highlighted:

- the importance of quality underlying information to allow robust estimates to be prepared; and
- the need for asset management plans to be based on service levels established in consultation with ratepayers or users of services.

2.402 The 2002 report *Local Government: Looking Back and Looking Forward*²¹ commented:

... Almost all Councils have management plans and basic information for the assets that are delivering essential services. However, the plans and accompanying information are, in general, relatively unrefined. Quite rightly, effort has been concentrated on:

- *identifying and quantifying the assets;*
- *gathering information on their age and condition;*
- *developing information systems; and*
- *providing forecasts of cost elements – such as new capital investment (as well as renewals and operational expenditure).*

Few Councils have reached an advanced level of asset management. Advanced asset management is characterised by:

- *a much higher level of knowledge of the assets held (thereby allowing predictions to be made about performance);*
- *a greater understanding of the desired level of service that the community wants the assets to provide; and*
- *a focus on addressing the risks associated with managing the infrastructure.*

In my view, the benefits from asset management will only be fully realised by concerted effort on the advanced level.

²⁰ See, for example, *Review of Local Government Financial Asset Condition and Long-term Planning: Statistical Results*, ISBN 0-477-02845-4, 1994.

²¹ Parliamentary paper B.29[02a], page 28.





2.403 Various information requirements of the long-term council community plan (LTCCP) have reinforced the need for robust information so that communities can have confidence in the proposals and underlying information in these plans. In particular, clause 2(1)(d) of Schedule 10 of the Local Government Act 2002 (the 2002 Act) requires local authorities to:

... identify the assets or groups of assets required by the group of activities and identify, in relation to those assets or groups of assets,—

- (i) *how the local authority will assess and manage the asset management implications of changes to—*
 - (A) *demand for, or consumption of, relevant services; and*
 - (B) *service provision levels and standards:*
- (ii) *what additional asset capacity is estimated to be required in respect of changes to each of the matters described in subparagraph (i):*
- (iii) *how the provision of additional asset capacity will be undertaken:*
- (iv) *the estimated costs of the provision of additional asset capacity identified under subparagraph (ii), and the division of those costs between each of the matters in respect of which additional capacity is required:*
- (v) *how the costs of the provision of additional asset capacity will be met:*
- (vi) *how the maintenance, renewal, and replacement of assets will be undertaken:*
- (vii) *how the costs of the maintenance, renewal, and replacement of assets will be met.*

2.404 Other LTCCP content requirements to be drawn from asset management information include:

- **Clause 2(1)(e) of Schedule 10** – which requires the estimated expenses of achieving and maintaining the identified levels of service provision, including the estimated expenses associated with maintaining the service capacity and integrity of assets to be included in the LTCCP:
 - (i) in detail in relation to each of the first three financial years; and
 - (ii) in outline in relation to each of the subsequent financial years.
- **Clause 11 of Schedule 10** – which requires a local authority's LTCCP to identify all the significant forecasting assumptions and risks underlying the financial estimates, including the assumptions about:
 - (i) the useful life of significant assets; and
 - (ii) sources of funds for the future replacement of significant assets.





ASSET MANAGEMENT PLANS

TWO

2.405 With regard to local authorities' preparation to meet the new asset management information requirements of LTCCPs, we have been concerned that, for some local authorities, asset management information has:

- not significantly advanced since many local authorities prepared asset management plans as a result of the amendments to the Local Government Act 1974 (the 1974 Act) in 1996; and
- not been maintained or updated over time.

2.406 We also observed that, in the LTCCPs of local authorities that chose to adopt an LTCCP in 2003, little information was provided on assets and how these are to be managed and funded.

2.407 With new asset management content required to be included in LTCCPs from 2004, we felt it would be timely to review the robustness of current asset management planning to assess the state of information. We acknowledge that auditors do not have engineering expertise. Nonetheless, we consider that the criteria we used for our review were sufficiently clear, and that, for an issue of such importance, it would be useful for us to present a picture of the state of local authorities' asset management.

What We Did

2.408 We assessed local authority asset management plans (or information which has the function of such a plan), selecting the best and least developed plans of each Council for review. Because many Regional Councils are not extensively involved in asset-intensive activities, these Councils were included in the review only where they held significant assets.

2.409 The two selected plans for each local authority were ranked from 1 (low) to 5 (high) against 12 criteria. These criteria were based on the dimensions set out in the international infrastructure management manual *Creating Customer Value*, which, in our view, represent current best practice for the sector in asset management planning.





2.410 The dimensions used were:

1. **Description of assets** – that there is a description of the asset, both physically and in financial terms.
2. **Service Levels** – that service levels are specified:
 - based on consultation with the community or other relevant stakeholders; strategic objectives; legislative requirements and environmental standards; and the availability of resources; and
 - in terms relevant to customers, that are measurable and translate through to the operational plans.
3. **Timetable** – that the length of time is defined for the asset network to deliver the required service.
4. **Planning Assumptions and Confidence Levels** – that assumptions under which the asset management plan is prepared are identified, and that the reliability and accuracy of underpinning information is indicated.
5. **Outline Improvement Programmes** – that the asset management plan states what needs to be done to improve asset management processes and techniques, including outlining weak areas, how these will be improved, and the timetables and resources required for improvements.
6. **Integration** – that asset management planning information is linked with other relevant information in relation to effect.
7. **Financial Forecasts** – that asset management planning translates the physical aspects of planned operational, maintenance, renewal and new works into financial terms, specifically for at least the next 10 years and generally over the time the asset must deliver service, in a manner that is fair and consistent.
8. **Planning Preparation** – that the asset management plan was independently assessed or peer reviewed.
9. **Risk Management** – that asset management planning is integrated with other corporate risk management processes, and encompasses strategies for critical assets; provides for the effects of failure; and integrates with disaster recovery and business continuity plans, and optimised decision making.

TWO





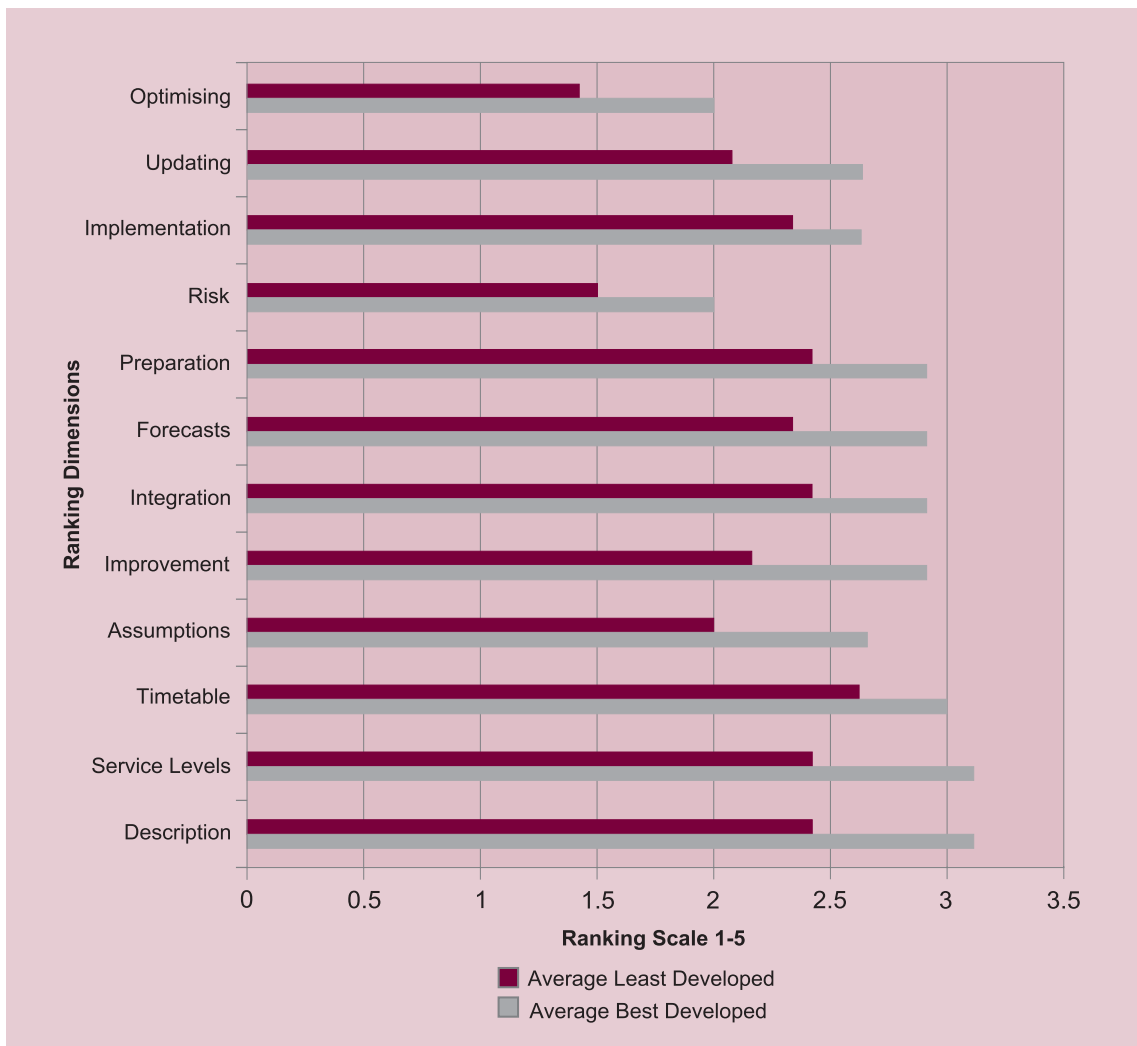
ASSET MANAGEMENT PLANS

TWO

10. **Implementation** – that asset management plan requirements are implemented and any discrepancies are formally reported.
11. **Updating** – that underlying systems are improved over time through regular formal revisions linked to the Council’s strategic planning cycles.
12. **Optimised Decision-Making** – that models and data are used to prepare options for asset treatments in order to achieve optimal costs.

Findings of Our Review of Asset Management Plans

2.411 The following graph shows the average rankings on each dimension for best and least developed asset management plans. This graph shows that most dimensions were ranked between 2 and 3.





Best Asset Management Plans

2.412 Of the best asset management plans:

- 4 cities and 2 districts scored 3 or above on every dimension ranked;
- 11 districts, 5 cities, and 1 region scored 3 or above for all but one or two of the dimensions ranked; and
- 4 districts scored 2 or less on every item ranked.

TWO

Least Developed Asset Management Plans

2.413 Of the least developed asset management plans:

- 3 districts, 2 cities, and 1 region scored 3 or above for all but one or two of the dimensions ranked;
- 23 districts and 8 cities scored 2 or below for all but one or two of the dimensions ranked; and
- 2 districts ranked no higher than 1 on all dimensions.

2.414 For both the best and least developed asset management plans, the two dimensions that were ranked lowest were risk management and optimised decision-making. This result is perhaps unsurprising – many local authorities initially drew up asset management plans to help establish whether their projected operating revenue was sufficient to cover operating expenses as required by amendments to the 1974 Act in 1996.²² Future uses of information, such as those of risk management and optimised decision-making, would not have been a primary focus.

2.415 Nonetheless, we had hoped that, when the benefits of asset management planning for managing and predicting the need for services were recognised by local authorities, they would have enhanced basic asset information to maximise the benefits that could be gained. These results suggest that such enhancement has not occurred to the degree we would have hoped – especially in view of the 2002 Act requirements.

²² Section 122C(1)(f) of the Local Government Act 1974.





ASSET MANAGEMENT PLANS

TWO

2.416 We considered whether there were any notable features in our rankings, such as:

- whether greater rates of population growth might be leading to a need for better asset management planning; and
- whether larger local authorities might be better equipped to plan (through greater resources and access to expertise) than smaller local authorities.

2.417 We saw no clear evidence suggesting that population growth has led to better asset management planning. There was some evidence that the size of a local authority can have an effect – but overall this was not marked, with a number of smaller districts with populations of less than 32,000 (including some of the smallest district populations in the country) being among the local authorities with the highest ranked asset management plans.

Range in Rankings

2.418 The average ranking range between best and least developed asset management plans for each local authority for all of the 12 dimensions was:

- 0.5 or less for 50% of local authorities; and
- 1 or less for just under 80% of local authorities.

2.419 A similar result was found by looking at the average ranges of ranking of all local authorities for each of the 12 dimensions. The average range between the best and least developed asset management plans was between 1 and 0.5 for 11 out of the 12 dimensions. The other dimension had an average range of 0.3.

2.420 This suggests that the variation in the quality of asset management plans between best and least developed plans is not great. While this result is heartening, we are aware that some local authorities may not have prepared asset management plans for non-infrastructure intensive assets – for example, parks and reserves. As our review was of assets for which information had been prepared, this could reflect a more positive state of asset management than actually exists for some types of assets.





Conclusions

2.421 Our review found that some local authorities need to improve their asset information to meet the new disclosure requirements of the 2002 Act. There is no statutory requirement for local authorities to follow a framework such as the *Creating Customer Value* criteria that we used to assess asset management plans for this review. Nonetheless, in our view, using such a framework should assist local authorities to prepare asset information that addresses most of the requirements of the 2002 Act.

TWO

2.422 The benefit of investing this effort to improve asset information to meet the new requirements of the 2002 Act should be to enhance local authorities' understanding of:

- how assets deliver service and the effect of asset decisions on service levels; and
- the cost of operating existing assets and the funding required for extra capacity.

2.423 Our review also suggests that, while most local authorities have a reasonable standard of base information, many need to invest further effort to apply the information to future-oriented uses such as risk management and optimised decision-making. It is through using robust asset information for these purposes that local authorities will be able to meet future needs effectively and efficiently, and protect the ability to deliver critical services to communities. The National Asset Management Steering Group has established a working party to draft guidance on optimised decision-making. We look forward to the outcome of this work.





2.5 Service Levels

TWO

- 2.501 In reports to Parliament in recent years, we have expressed concern that asset management plans have lacked information about service levels, or that such service levels had not been established through a public consultation process.²³
- 2.502 The international infrastructure management manual *Creating Customer Value* defines service levels as service parameters or requirements for a particular activity or service area against which service performance may be measured. Such service levels can relate to dimensions of, for example, quality, quantity, reliability, responsiveness, environmental acceptability, and cost.
- 2.503 In the Local Government Act 2002 (the 2002 Act), the concept of service levels is applied to all activities undertaken by local authorities rather than solely for asset management planning. Local authorities must specify in their long-term council community plans (LTCCPs):
- service levels for groups of activities;
 - performance targets and measures; and
 - the estimated expenses of achieving and maintaining these levels of service.
- 2.504 The LTCCP must specify this information in detail for the first three years, and in outline for subsequent years.
- 2.505 In the past, we have not always been convinced that costs of groups of activities in long-term financial strategies – the predecessor of LTCCPs – have been linked to, or driven by service level decisions. To meet the LTCCP content requirements of the 2002 Act, local authorities will need to more explicitly link levels of service with estimated expenses in underlying work programmes and budgets.
- 2.506 In our view, the LTCCP should clearly and logically state the relationship between the outcomes and the services undertaken, and the resulting service levels and performance expected for activities or groups of activities.

²³ See, for example, *Local Government Looking Back and Looking Forward 2002*, page 28, and *Local Government: Results of the 1999-2000 Audits*, page 14.





2.507 Information in LTCCPs about groups of activities is likely to improve in the next 2-3 years, as local authorities undertake the community outcome process under the 2002 Act, and improve the robustness and integration of underlying information.

2.508 We reviewed service levels for asset management-related activities in our review of asset management plans (see pages 52-59). Feedback from our auditors and local authorities has suggested that approaches to setting service levels for non-infrastructure-based services are proving more problematic. Therefore, for this review, we looked at service levels for two activities undertaken by each local authority that were not infrastructure-intensive. In most instances, the activities we reviewed were for services associated with:

- consent processing;
- animal control;
- arts, culture and recreation services; and
- community and democratic services.

TWO

Results of Our Review of Non-infrastructure-based Service Levels

Understanding Services

2.509 Our review found that there does not appear to be a strong understanding by many local authorities of the services that they are providing, or the contribution that these services make to outcomes. However, both the 2002 Act and the 1974 Act required local authorities to provide information in planning documents about the rationale for the delivery of services.²⁴

2.510 The myriad of terminology around concepts of performance reporting – such as outcomes, outputs, service levels, objectives, and deliverables – also appears to be creating confusion for both local authorities and the public.

2.511 In our view, a clear understanding of a local authority's reasons for providing a service, including how it contributes to outcomes being sought, is critical to creating a meaningful framework for determining service levels and assessing performance against these levels.

24 Clause 2(1)(b) in Schedule 10 of the 2002 Act, and section 122L(b) of the 1974 Act.





SERVICE LEVELS

TWO

2.512 When the nature and effect of a service is not well understood:

- like-services cannot be grouped well – which can make explanations in external planning and reporting documents difficult for readers to understand; and
- the selected service levels may not be the most appropriate or relevant, which can make it difficult for both local authorities and the public to assess the effectiveness of services and their value to the community.

Limited Consultation with Communities

2.513 The majority of local authorities that we reviewed had used their annual planning process to consult with their communities on service levels and performance.

2.514 Local authorities then drew the conclusion that, as the performance measures had remained unchanged in annual plans for some years, they established that the public had agreed to these service levels. However, we noticed that, in some instances – regardless of the extent of change or actual result achieved – performance measures did not change over a number of years in planning and reporting documents.

2.515 Local authorities frequently undertake consultation associated with specific activities or decisions – such as for the development of new policies, asset management plans, or redevelopment of facilities. However, such consultation often is:

- not focussed on service levels or changes to service levels that are likely to result from the activity or decision; or
- not resulting in consideration of the service levels to be specified in planning and reporting documents.

Legislative Requirements Dominate

2.516 Many local authorities set service levels based on legislative requirements (such as the resource consent processing timetables for the Resource Management Act 1991). Legislative requirements must be observed, and, in many instances, may be relevant and appropriate measures of service. However, the role of a local authority in delivering services is to promote the well-being of its district.²⁵

²⁵ Sections 10 and 11.





2.517 Local authorities should therefore consider, based on community feedback, whether other measures or indicators might be more relevant or important to the community than those set out in legislation.

TWO

Over-reliance on 'Satisfaction' Surveys

2.518 Ratepayer or user satisfaction can be a useful and relevant way of obtaining feedback on services. However, in our view, there tended to be an over-reliance by some local authorities on user satisfaction or ratepayer survey results for assessing the quality of services and service levels. Such feedback is useful where:

- the standard of performance being sought is clear, and feedback is relevant to the dimension of performance;
- respondents are asked questions that they could reasonably be expected to understand and hold a view on; and
- the survey allows feedback to be collected on elements of the service that respondents were not satisfied with, in order for this information to be used to improve service quality.

2.519 In noting the over-reliance on satisfaction surveys, we are not discounting the importance of public views and satisfaction. Rather, we are suggesting that performance against service levels is best evaluated through a range of indicators, such as ratepayer or user views, scientific data, quality control procedures, and numeric quantity or cost data.

Why Do Service Levels Matter to the Auditor-General?

2.520 Under the 2002 Act, we will be required to give an opinion on LTCCPs, including:

the extent to which the forecast information and performance measures provide an appropriate framework for the meaningful assessment of the actual levels of service provision.²⁶

²⁶ Sections 84(4)(c) and 94(c).





SERVICE LEVELS

TWO

2.521 Assessing the effect of change on service levels is also important to decision-making under the 2002 Act. If a proposed change has a significant effect on service level, a local authority may be required to, for example:

- undertake the special consultative procedure; and
- amend its LTCCP, including obtaining an audit opinion on the amendment.²⁷

2.522 We found that the specification of service levels was problematic in a small number of instances when issuing opinions on amendments to LTCCPs adopted in 2003. The major issue was that, as we did not have a mandate to audit the base document that was being amended, it was not possible to assess the extent to which the performance measures provided an appropriate framework for the meaningful assessment of service provision. In attempting to issue opinions on amendments that affected service levels, we also encountered many of the issues that arose in our review of service levels as discussed above.

What Does This Mean for Local Authorities?

2.523 The purpose of the LTCCP, according to the 2002 Act, is to:

- describe the activities of the local authority;*
- describe the community outcomes of the local authorities' district or region; and*
- provide integrated decision-making and co-ordination of the resources of the local authority; and*
- provide a long-term focus for the decisions and activities of the local authority; and*
- provide a basis for accountability of the local authority to the community; and*
- provide an opportunity for participation by the public in decision-making processes on activities to be undertaken by the local authority.*²⁸

²⁷ Section 97.

²⁸ Section 93(6), as required by section 84(4)(c).





2.524 The outcomes to which activities contribute, the service levels determined for those activities, and the measures and targets by which the achievement of these services levels is assessed are central to the purpose of the LTCCP. In our view, many local authorities will need to create a comprehensive performance model that takes account of the various information requirements of the 2002 Act so that communities are able to:

TWO

- understand the reasons for local authority services being undertaken, and the outcomes to which these services contribute;
- meaningfully assess the extent to which actual services have been achieved, based on comparison with forecast projections; and
- participate in debates about the services and levels of service sought, the value and cost of those services to communities, and how those services should be funded.

What Would a Comprehensive Performance Model Look Like?

2.525 The 2002 Act specifies considerations that a local authority is required to take account of, and contents to be included in the LTCCP. Within these statutory requirements, a local authority is able to determine the performance model that it will use.

2.526 In our view, a comprehensive performance model would:

- consider all elements of a comprehensive model of performance;
- incorporate a time dimension;
- choose useful reporting levels;
- select relevant information from each element of the model to an appropriate extent; and
- include commentary on uncertainties and strategy.²⁹

29 *Reporting Public Sector Performance*, 2nd edition, 2002, page 9.

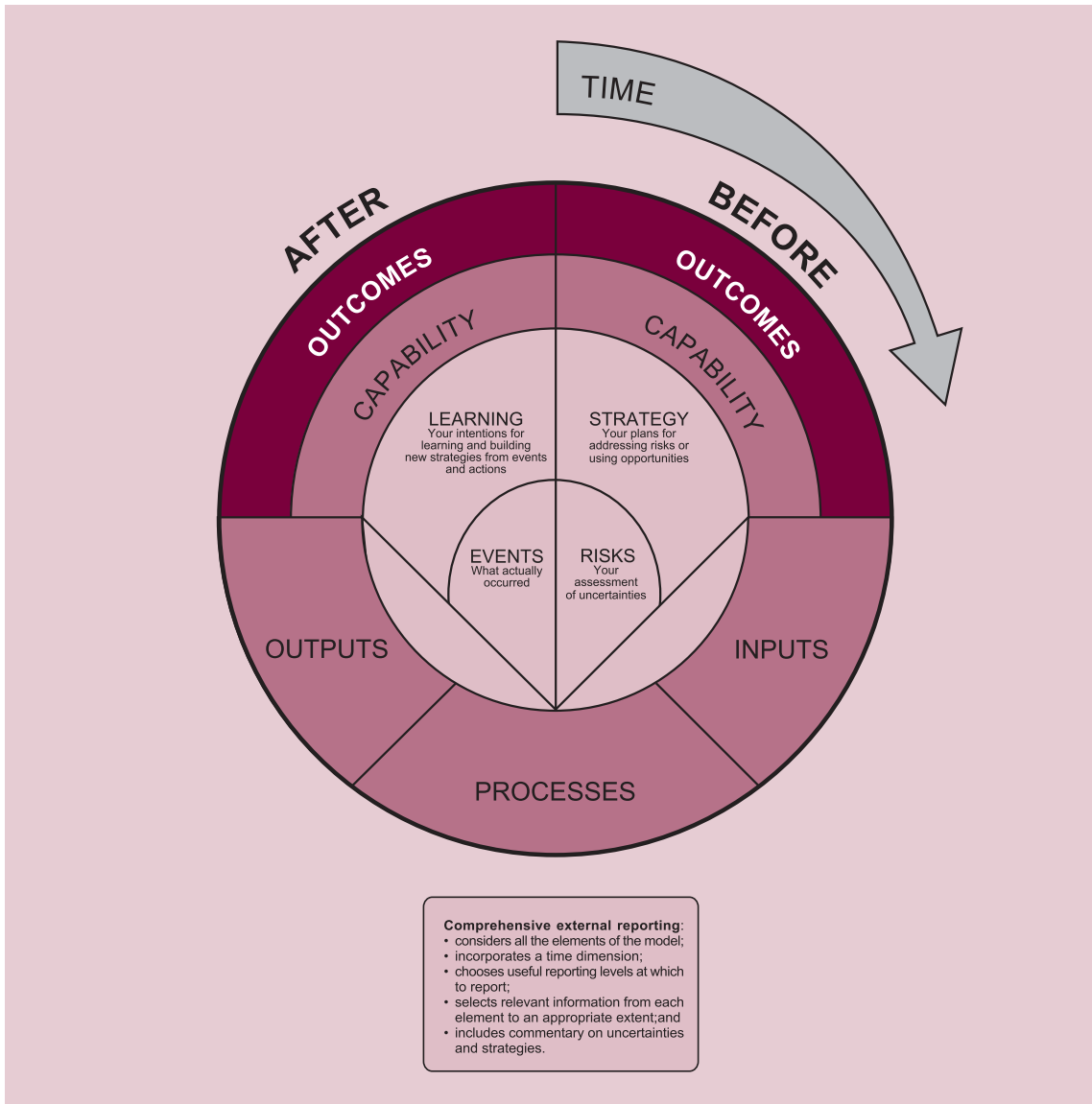




SERVICE LEVELS

2.527 The following diagram is drawn from our 2002 report *Reporting Public Sector Performance*, and illustrates the relationship of the elements that we see forming a comprehensive model of performance.

TWO



2.528 We will be building on our understanding and expectations of planning and reporting by local authorities so that communities can assess and understand the sustainability and effects of their local authorities' decisions. We are aware that the Society of Local Government Managers (SOLGM) is considering ways to support local authorities in regard to addressing the area of service levels, and we intend to work closely with SOLGM on these initiatives.





2.6 Implementation of the Local Government (Rating) Act 2002

TWO

Background

2.601 Local authorities collected rates under the Local Government (Rating) Act 2002 (the Rating Act) for the first time in 2003-04. When we reviewed how local authorities had implemented the Rating Act, we took into consideration that the local government sector was dealing with large-scale change in its overall legislative framework. Consequently, we focussed on:

- the new Rating Act policies through which local authorities can determine the circumstances under which they will forgo rating revenue, or delay the receipt of revenue;
- Funding Impact Statements³⁰ – to ensure that, for proposed general and targeted rates, the statements contained the information required by Schedules 2 and 3 of the Rating Act³¹; and
- procedures for calculating use of uniform annual general charges and uniform targeted rates, to ensure that the cap is not breached on revenue raised by uniform rates.

2.602 The Department of Internal Affairs provided us with the 2003-04 rates resolutions that had been forwarded to it as required by the Rating Act. Nineteen rates resolutions had not been provided to the Department at the time we conducted our review. We have directed our auditors to follow up this issue with the local authorities concerned.

30 Funding Impact Statements are required to be included in local authorities' long-term council community plans and Annual Plans, and to set out information that discloses the revenue and financing mechanisms to be used by a local authority. Under section 23, rates are required to be set in accordance with Funding Impact Statements.

31 Schedules 2 and 3 of the Rating Act 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 now-repealed Rating Powers Act 1988).





IMPLEMENTATION OF THE LOCAL GOVERNMENT (RATING) ACT 2002

New Policies

TWO

2.603 The Rating Act introduces several new policies that, by their adoption, allow local authorities to determine the circumstances under which they will forgo rating revenue, or delay the receipt of revenue. These new policies are:

- *Rates Relief for Māori Freehold Land Policy*: a few local authorities indicated either that they had not adopted such a policy or that they intended to adopt a policy that there would be no provision for rates on Māori Freehold Land to be remitted, although such rates might be remitted under other rates remission purposes. However, adoption of a Rates Relief for Māori Freehold Land Policy is required under the Local Government Act 2002 (the 2002 Act). Where a policy is to provide no such relief, that policy is to have been reached having regard to consideration of the criteria in Schedule 11 of the 2002 Act.
- *Remissions Policy*: to be adopted if a local authority is intending to grant remissions. All but a handful of local authorities had adopted a Remissions Policy.
- *Postponements Policy*: to be adopted if a local authority is intending to postpone receipt of rates that are owed to it. When such a policy is adopted, a local authority must grant any request for a postponement that falls within the policy. Nearly 70% of local authorities have adopted a Postponements Policy.
- *Early Payments Policy*: to be adopted if a local authority is intending to receive early payments of rates in a current or subsequent financial year. About 65% of local authorities have adopted an Early Payments Policy.

2.604 Local authorities need to be aware that they have power to remit or postpone rates or accept early payment of rates only in accordance with these policies. Therefore, local authorities need to be attentive to the provisions of these policies so that they remain relevant and appropriate.

Recording of Remissions and Postponement Costs

2.605 Sections 86 and 89 of the Rating Act deal with a local authority's recording obligations where it remits or postpones rates:





86. Recording remitted rates –

The local authority must record the remitted rates –

- (a) *on the rates record for the rating unit as paid on the due date; and*
- (b) *in accounting documents as paid by the local authority on behalf of the ratepayer in accordance with the relevant objective in the remission policy.*

TWO

89. Recording postponed rate –

(1) *Subsection (2) applies if –*

- (a) *a postponement fee is not added to the postponed rates; or*
- (b) *a postponement fee is added to the postponed rates that is less than the maximum set out in section 88(2).*

(2) *The local authority must record the net cost of a postponement in accounting documents as paid by the local authority on behalf of the ratepayer in accordance with the relevant objective in the postponement policy.*

2.606 The recording obligations also specify the information that can be provided to the public about the cost of a local authority's rates remissions and postponements, in terms of:

- the purposes for which rates are remitted; and
- the quantum of any remissions or postponement costs.

2.607 The local government sector asked for our views on how the recording obligations in the Rating Act should be reflected in a local authority's planning and reporting documents. In our view, disclosure of the costs and also the purposes of rates remissions and postponements in such documents is desirable, and best achieved by:

- a reconciliation of all rates remissions and postponements, and the purposes for which they were remitted or postponed, in the notes to the financial statements, referenced to the revenue figure in the Statement of Financial Performance; and
- disclosure of remissions within significant activity information and cost-of-service statements (where remissions are material or significant in terms of a local authority's policy objectives).





IMPLEMENTATION OF THE LOCAL GOVERNMENT (RATING) ACT 2002

Revenue and Financing Policy

TWO

- 2.608 The Revenue and Financing Policy is a requirement of the 2002 Act, not the Rating Act. However, several ratepayer enquiries during the year have led us to consider whether particular rates have been set lawfully, because full information is not provided in the Revenue and Financing Policy about the reasons for the selection of sources of funds for activities. The ratepayer enquiries referred in particular to the sources of funds in relation to section 103 of the 2002 Act, noting that a number of policies had not provided reasons for the selection of the basis for general rates and for the choice to set a uniform annual general charge.
- 2.609 We are not sure whether such omissions of information about rates have an effect, as there is no direct statutory link between the Revenue and Financing Policy and the rates set. However, we consider that, given the spirit and intent of the 2002 Act, it is reasonable to expect that Funding Impact Statements and rates resolutions would be consistent with the decisions reached in a local authority's Revenue and Financing Policy. Where this is not the case, section 80 of the 2002 Act requires that the reasons for any inconsistency, and any intentions the local authority has to rectify the situation, be stated at the time of the decision. We consider that this information should be noted in the relevant long-term council community plan (LTCCP) and annual plan.

Funding Impact Statements – Setting of General Rates and Uniform Annual General Charges

- 2.610 We reviewed local authorities' Funding Impact Statements to ensure that, for proposed general and targeted rates, the statements contained the information required by Schedule 2 and Schedule 3 of the Rating Act. Under sections 14, 17, and 18, a local authority can only set rates in accordance with these schedules.
- 2.611 Under Schedules 2 and 3, when setting rates, a local authority must take account of certain:
- “matters”; and
 - “factors”.





“Matters”

2.612 Under sections 14 and 17, the “matters” in Schedule 2 that may be used to define categories of rateable land are:

TWO

1. *The use to which the land is put.*
2. *The activities that are permitted, controlled, or discretionary for the area in which the land is situated, and the rules to which the land is subject under an operative district plan or regional plan under the Resource Management Act 1991.*
3. *The activities that are proposed to be permitted, controlled, or discretionary activities, and the proposed rules for the area in which the land is situated under a proposed district plan or proposed regional plan under the Resource Management Act 1991, but only if –*
 - (a) *no submissions in opposition have been made under clause 6 of Schedule 1 of that Act on those proposed activities or rules, and the time for making submissions has expired; or*
 - (b) *all submissions in opposition, and any appeals, have been determined, withdrawn, or dismissed.*
4. *The area of land within each rating unit.*
5. *The provision or availability to the land of a service provided by, or on behalf of, the local authority.*
6. *Where the land is situated.*
7. *The annual value of the land.*
8. *The capital value of the land.*
9. *The land value of the land.*





IMPLEMENTATION OF THE LOCAL GOVERNMENT (RATING) ACT 2002

“Factors”

TWO

2.613 Under section 18, the Schedule 3 “factors” that may be used in calculating liability for targeted rates are:

1. *The annual value of the rating unit.*
2. *The capital value of the rating unit.*
3. *The land value of the rating unit.*
4. *The value of improvements to the rating unit.*
5. *The area of land within the rating unit.*
6. *The area of land within the rating unit that is sealed, paved, or built on.*
7. *The number of separately used or inhabited parts of the rating unit.*
8. *The extent of provision of any service to the rating unit by the local authority, including any limits or conditions that apply to the provision of the service.*
9. *The number or nature of connections from the land within each rating unit to any local authority reticulation system.*
10. *The area of land within the rating unit that is protected by any amenity or facility that is provided by the local authority.*
11. *The area of floor space of buildings within the rating unit.*
12. *The number of water closets and urinals within the rating unit.*

Regional Councils

2.614 The Rating Act provides Regional Councils with power to set a uniform annual general charge. This power had not been available to Regional Councils under the Rating Powers Act 1988. One Regional Council took advantage of this new provision.

2.615 Another Regional Council did not set either a general rate or a uniform annual general charge. Instead, the Regional Council set a targeted annual charge, differentiated by location of properties within each territorial authority in its region.





2.616 Five Regional Councils set general rates as a rate in the dollar on an undifferentiated basis. Five set general rates as a rate in the dollar on a differential basis. These five differentiated on the basis of the land situation “matter” set out in Schedule 2 of the Rating Act, to take into account the different revaluation dates that apply to territorial authorities within their region.

TWO

Territorial Authorities

2.617 Eighteen territorial authorities used a general rate set as a uniform rate in the dollar. One City Council in this group also did not set any targeted rates except in respect of non-rateable properties (which would otherwise pay no rates for water supply, sewage disposal, waste collection, or services provided in relation to the land).

2.618 In general, the remainder of territorial authorities set differential general rates using the following “matters” under Schedule 2 of the Rating Act:

- the use to which the land is put (by far the most frequently used);
- where the land is situated (also frequently used); and
- the area of land within each rating unit.

2.619 Fourteen territorial authorities did not set a uniform annual general charge.

Funding Impact Statements – Setting of Targeted Rates

2.620 Targeted rates are similar to separate rates under the Rating Powers Act 1988, but provide a greater range of factors for setting differential targeted rates. Section 16 of the Rating Act provides that:

(1) *A local authority may set a targeted rate for 1 or more activities or groups of activities if those activities or groups of activities are identified in its funding impact statement as the activities or groups of activities for which the targeted rate is to be set.*

(3) *A targeted rate may be set in relation to –*

(a) all rateable land within the local authority’s district; or

(b) 1 or more categories of rateable land under section 17.





IMPLEMENTATION OF THE LOCAL GOVERNMENT (RATING) ACT 2002

TWO

(4) A targeted rate may be set –

(a) on a uniform basis for all rateable land in respect of which the rate is set; or

(b) differentially for different categories of rateable land under section 17.

2.621 Overall, local authorities appear to have had no difficulty in dealing with the requirement to select Schedule 2 “matters” and Schedule 3 “factors” in setting targeted rates. However, we have yet to see the more innovative approaches that were expected to emerge with flexible targeted rating powers, such as rating for particular services. At this stage, most local authorities are merely using the targeted rating power to continue rates formerly levied as separate rates under the Rating Powers Act 1988.

Regional Councils

2.622 All Regional Councils set one or a number of targeted rates. The most common activities for targeted rates are land transport, environment, and biosecurity.

2.623 For each of these activities, we considered the “matters” and “factors” used to set targeted rates. The most commonly used “matter” from Schedule 2 by which properties are identified as liable for a particular rate was where the land is situated. The provision or availability of a service provided by or on behalf of a local authority was also occasionally used. From Schedule 3, which provides the “factors” on which a property’s liability for a targeted rate is calculated (unless it is a uniform per property rate), the “factors” generally used were:

- capital value of the rating unit (the most commonly used);
- land value of the rating unit; and
- area of land within the rating unit.

Territorial Authorities

2.624 The wide range of targeted rates set by a number of territorial authorities and the extensive use of targeted rates made it difficult to prepare an analysis of trends in targeted rates used by territorial authorities. From our analysis, it appeared that all territorial authorities had set one or more targeted rates.





2.625 We looked at the Schedule 2 “matters” and Schedule 3 “factors” used by territorial authorities to set targeted rates over several common activities. The analysis of targeted rates for these activities showed fairly consistent patterns in the identification of “matters” and selection of “factors” for calculating rating liability across the country:

- *Water supply:* We identified more than 65 territorial authorities that set a targeted rate to fund some part of their water activity. For this activity the most frequently used “matters” were the availability of service, followed by where the land is situated. “Factors” commonly used were the extent of provision of service to the rating unit by the local authority, the number of separately used or inhabited parts of the rating unit, and the number or nature of connections for the land within each rating unit to any local authority reticulation system.
- *Sewerage and Wastewater:* We identified nearly 70 territorial authorities that set a targeted rate to fund some part of their sewerage and wastewater activity. For this activity, the provision or availability to the land of a service provided by or on behalf of the local authority was by far the most commonly used “matter”, followed by where the land is situated. A range of “factors” were used to a greater and lesser extent with:
 - the number of water closets and urinals within the rating unit being the most commonly used, followed by;
 - the number of separately used or inhabited parts of the rating unit, followed by;
 - the extent of provision of service to the rating unit by the local authority, and the number or nature of connections for the land within each rating unit to any local authority reticulation system.

A small number of local authorities also used the capital or land value of the rating unit.

- *Storm Water:* We identified more than 30 territorial authorities that set a targeted rate to fund some part of their storm water activity. The main “matter” used was where the land was situated, while the main “factors” used were:
 - the capital or land value of the rating unit;
 - the number of separately used or inhabited parts of the rating unit; and
 - the extent of provision of service to the rating unit by the local authority, and the number or nature of connections for the land within each rating unit to any local authority reticulation system.





IMPLEMENTATION OF THE LOCAL GOVERNMENT (RATING) ACT 2002

TWO

- *Refuse Collection:* We identified more than 50 territorial authorities that set a targeted rate to fund some part of their refuse collection activity. For this activity, where the land is situated was the most frequently used “matter”, followed closely by the provision or availability to the land of a service provided by or on behalf of the local authority. The main “factor” used was the number of separately used or inhabited parts of the rating unit, followed by the extent of provision of service to the rating unit by the local authority.
- *Roading:* We identified nearly 30 territorial authorities that set a targeted rate to fund some part of their roading activity. For this activity, where the land is situated was the most commonly used “matter”, followed by the use to which the land is put. The main “factors” used were the capital value or land value of the rating unit.
- *Community Board or Ward Rates:* We identified nearly 20 territorial authorities that set a targeted rate to fund community board or ward activities. Almost all community board and ward rates were set using the “matter” of where the land is situated. However, the “factors” on which liability was calculated were more evenly distributed, with the land value of the rating unit, and the number of separately used or inhabited parts, being most commonly used, followed by the extent of service provision to the rating unit by the local authority, and the capital value of the rating unit.

Compliance with the 30% Cap on Uniform Charges

2.626 The Rating Act retains a 30% 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.





- 2.627 While the cap is not new, the Rating Act introduced the new, more flexible, targeted rating powers. As a result, calculation of the cap under the Rating Act is more complex and creates a risk that local authorities could inadvertently breach the cap – especially until they became more familiar with the requirements of the Rating Act. We therefore decided to review how local authorities calculated the rating cap.
- 2.628 Overall, while we noted two breaches of the cap in our review of draft Funding Impact Statements, the local authorities concerned had taken steps to remedy these before adoption of their rates. Therefore, we did not observe any breaches of the cap in rates as finally adopted.
- 2.629 Of the two local authority draft plans that contained breaches, in one instance – as part of the public consultation process – a ratepayer submitted that the cap had been breached. In the other, the Council had adopted a rates resolution but had not sent out rates assessments. Therefore, the Council was able to revoke the resolution that breached the cap, and adopt a resolution that complied with the cap calculation.
- 2.630 We selected a sample of one-third of local authorities to look at the actual percentage of revenue generated by uniform general and targeted rates within the cap calculation. This analysis showed that the actual proportion of revenue raised by uniform general and targeted rates ranged from 6% to almost 29%, with the median being 21%.
- 2.631 We would caution local authorities that have chosen to generate revenue through uniform general and targeted rates that is close to the 30% cap, to ensure that, in the process of making changes in response to public consultation, adjustments to revenue do not result in the cap being inadvertently breached.
- 2.632 The potential for inadvertent breach and public confusion about what is set under targeted rating powers versus general rating powers is not helped where local authorities are not clear in their description of rates and do not provide a description of the activities for which the targeted rate is set, for example:
- a uniform annual general charge set using the targeted rating powers over both rural and urban land; and
 - a rate described as a targeted uniform general rate set on every rating unit, using the targeted rating powers over the four locations in the district.





IMPLEMENTATION OF THE LOCAL GOVERNMENT (RATING) ACT 2002

TWO

2.633 Section 16(1) of the Rating Act states:

A local authority may set a targeted rate for 1 or more activities or groups of activities if those activities or groups of activities are identified in its funding impact statement as the activities or groups of activities for which the targeted rate is to be set.

2.634 In our view, local authorities should take care in their Funding Impact Statements and rates resolutions to:

- accurately describe the type of the rate being set; and
- identify the activity or group of activities for which a targeted rate is set.

2.635 We also noted a number of instances where the Funding Impact Statement description of rates to be set did not match the presentation of categories of revenue in local authority financial forecasts. Consistent presentation of information is necessary if ratepayers are to be able to use LTCCPs and annual plans as a basis for assessing the proposals of local authorities, and the costs involved.

2.636 Finally, we note that the flexible powers available to set targeted rates could allow local authorities to set rates that, in substance, are uniform general rates, but which do not form part of the rating cap calculation – primarily through setting a targeted rate that varies by location but is flat in each location. For example, one local authority set a rate that purported to be a flat rate differentiated by location – however, the flat rate paid in each location was the same. This appears to make the differentiation by location irrelevant, as the same flat amount was paid by every property on which the rate was set.

2.637 We consider that this is a position likely to generate public confusion, and have suggested to the Department of Internal Affairs that it monitor the use of targeted rates to see whether the current rating cap is effective as a means of managing the extent of rates that are set on a uniform basis.





Setting a Rate for Unforeseen and Urgent Needs

2.638 We are aware that, during the year, one local authority used the power under section 23(3) to set a rate that was not provided for in its Funding Impact Statement. This is allowed if the local authority is satisfied that:

TWO

... the rate is required to meet an unforeseen and urgent need for revenue that cannot reasonably be met by any other means ...

2.639 We are concerned that the legislative tests were not met by this local authority's circumstances, and we are discussing this with the local authority. However, we emphasise that any local authority considering using this provision must, at the time of making the decision, be satisfied that:

- the rate is to meet an unforeseen need;
- the need for revenue is urgent; and
- the need cannot reasonably be met by any other means.





2.7 Conflicts of Interest

TWO

2.701 We continue to receive a large number of queries about conflicts of interest.

Local Authorities (Members' Interests) Act 1968

2.702 We have statutory functions in administering the Local Authorities (Members' Interests) Act 1968 (the Act). We encourage councillors – and Council staff who advise them – to contact us to discuss the application of the Act to particular matters before difficulties arise.

Other Conflicts of Interest

2.703 In previous years' reports, we have discussed various issues arising out of our role under the Act. However, the Act deals only with pecuniary interests. Many of the queries we receive relate to other types of conflict of interest. This is understandable, because the boundary between financial and non-financial conflicts of interest is often not clear. From a legal perspective, non-financial conflicts of interest are governed by the common (i.e. judge-made) law about bias in public body decision-making.

2.704 We discussed the relevant legal principles briefly in last year's report³², and the continuing level of interest in this area has persuaded us that there is a real need for practical guidance for members of local authorities. Accordingly, we have decided to expand the scope of our present Guide³³ to the Act, to include new material about non-financial conflicts of interest. A new edition of our Guide will be published ahead of the 2004 local authority elections.

³² *Local Government: Results of the 2001-02 Audits*, parliamentary paper B.29[03b], 2003.

³³ *Financial Conflicts of Interest of Members of Governing Bodies*, 2001, ISBN 0-477-02885-3.





Other Recent Issues

2.705 The remainder of this article discusses three particular issues that we have encountered frequently during the last year. They are:

- interests in common with the public (which relate to pecuniary interests under the Act);
- involvement or employment with other organisations (which can raise questions about both financial and non-financial conflicts of interest); and
- participation in public submissions processes (which are usually non-financial conflicts of interest).

TWO

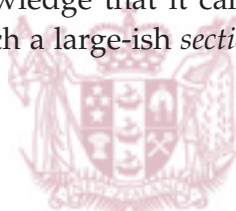
Interests in Common with the Public

2.706 The Act restrains discussing or voting on a matter in which a member has a pecuniary interest. However, that restriction does not apply to “an interest in common with the public”. If the member’s pecuniary interest can be said to be “in common with the public”, he or she is not prohibited from discussing and voting on the matter.

2.707 In considering whether an interest is in common with the public, we consider whether the interest is of a different *nature or kind* to that of other people, and whether it is significantly different in *size*. In other words, whether the matter affects the member in a different way or to a materially greater degree than most other people.

2.708 Some tolerance is necessary so as to apply the “interest in common with the public” exception in a realistic and practical way. In order to rely on the exception:

- We do not consider that the member needs to be affected to *exactly* the same extent as other members of the public. For instance, all ratepayers are affected slightly differently by the adoption of an overall rate. Nevertheless, we consider that this can safely be treated as an example of an interest which is in common with the public.
- We do not consider that the interest needs to be shared by *all* members of the public in the district – it is sufficient that the councillor is part of a large group of people affected in a similar way. The question of whether or not an interest is one in common with “the public” is often a matter of degree. We acknowledge that it can be difficult to draw a clear line as to the point at which a large-ish *section* of the public should be treated as “the public”.





CONFLICTS OF INTEREST

TWO

2.709 Members must always remain aware of the possibility of a pecuniary interest in cases where their particular interest is substantial and/or is shared by only a relatively small group of people. They need to consider whether or not many other members of the local community are likely to have a similar interest in the particular matter, or perhaps ask themselves whether the personal significance of any particular matter to them is greater than it is likely to be to the general public.

2.710 Two types of interest that we consider should be treated with particular care relate to:

- A member who is a property developer. The member may have an interest in town planning or development matters that is different in kind to that of most other residents or “ordinary” property owners.
- A member who is one of a small number of ratepayers affected by a targeted rate. The member’s interest may not be shared by a group large enough that it could be reasonably said to constitute “the public”.

Involvement or Employment with Other Organisations

2.711 We often receive queries about whether a member has a conflict of interest in a matter that concerns an organisation or club to which they belong, or a business of which they are an employee. Two different types of conflict might arise here. The member needs to consider whether he or she has:

- a pecuniary interest under the Act; and/or
- a conflict of interest more generally.

Pecuniary Interests under the Act

2.712 A pecuniary interest will usually not exist in these situations. But it depends on whether and how the particular matter could personally affect members or employees of that organisation.

2.713 A councillor who belongs to a community organisation such as a sporting, cultural or charitable group will not normally have a pecuniary interest in matters before the Council that concern the organisation (especially where it is, say, an incorporated society or charitable trust and members are not





entitled to derive personal profit from the organisation's activities). But a personal pecuniary interest might sometimes arise, if for instance the matter concerns a lease of Council land or clubrooms to the association where the rental could significantly affect subscriptions or other fees.

TWO

- 2.714 Similarly, we think a councillor who is employed by another organisation will not normally have a pecuniary interest in matters before the Council that concern the organisation. A Council decision relating to an operational matter of the organisation will not usually give rise to a personal financial interest of the member. Occasionally, however, a personal pecuniary interest might exist, if for instance the particular matter has the ability to affect the existence of the member's ongoing employment or salary at the organisation.

Non-financial Conflicts of Interest

- 2.715 In our view, these situations will more commonly raise a question of a potential non-financial conflict of interest. A conflict of interest might reasonably be said to exist if the member has a close relationship with an organisation involved in the matter before the Council. Such a connection might be seen as tainting the member's impartiality.
- 2.716 In our view, whether or not this is a real risk in any given case will depend on such things as:
- the strength of the member's personal links or involvement with the other organisation; and
 - the degree to which the matter under discussion directly affects the other organisation.
- 2.717 For example, in the case of a club, a conflict of interest claim might be stronger where the councillor is an officeholder or trustee or is otherwise strongly publicly identified with the club (as opposed to being merely a passive or ordinary member); and/or where the matter concerns a grant of money to the club or something else that specifically and significantly concerns the club (as opposed to a public policy issue which may indirectly affect the club or in which the club has chosen to take an interest).





CONFLICTS OF INTEREST

Participation in Public Submissions Processes

TWO

- 2.718 Bias (of a non-pecuniary sort) might reasonably also be alleged against a councillor who participates in a Council decision in two different ways, by both making a submission to the Council as a member of the public and then voting on the matter as a councillor.
- 2.719 A member who makes (or is party to) a formal submission might be inferred to have a fixed position and to have closed his or her mind to further persuasion. There could be a perception of a person acting as both an interested party and decision-maker on the same matter or, in other words, acting as a judge in their own cause.
- 2.720 The role of community consultation and submissions processes is to seek the views of the wider public who would not otherwise have the opportunity to speak on a particular matter. We think it should normally be unnecessary for elected members to participate in Council matters as submitters, because they have other opportunities to express their views, such as during Council debates and deliberations.
- 2.721 A councillor is of course free to lodge a formal submission with the Council, acting in their private capacity. But, if they do so, and then attempt to participate in Council decisions about that matter, we think there is a risk of the validity of the Council's decision being challenged on the ground of bias.
- 2.722 In addition, we also consider this would be ethically unacceptable as a matter of good practice.
- 2.723 While it is not for us to rule on questions of bias, we would strongly discourage members from acting in this way.





2.8 Regional Councils – Management of Bovine Tuberculosis Vector Control Contracts

TWO

Background

- 2.801 Nine Regional Councils, a unitary District Council (and some other entities) manage regional bovine tuberculosis (Tb) vector³⁴ control programmes under contract to Animal Health Board Incorporated (AHB)³⁵.
- 2.802 The Government makes the largest individual contribution to AHB's annual budget, to enable it to implement the National Bovine Tuberculosis Pest Management Strategy (NPMS). In the financial year 2002-03, the Ministry of Agriculture and Forestry paid out \$32.1 million against an appropriation of \$33.6 million in Vote Biosecurity.³⁶ The largest other source of AHB's annual revenue is the levy on all adult cattle killed – \$33.5 million in 2002-03.³⁷ In addition, the Councils contribute about \$4 million annually to AHB's budget.
- 2.803 An important part of implementing the NPMS is Regional Tb Vector Control Programmes. AHB has management contracts with the Councils to carry out the programmes by way of contracts for specific vector control activities.

34 A "vector" is a wildlife species infected with Tb that is involved with transmission of the disease to livestock. The most important two such species are the brush-tailed possum and (to a lesser extent, but significant in some parts of the country) the ferret.

35 AHB is a non-profit society incorporated under the Incorporated Societies Act 1908. Its members are Federated Farmers of NZ (Meat and Fibre Producers of NZ, Dairy Farmers of NZ), NZ Deer Farmers Association, NZ Game Industry Board, Dairy Insight, Meat New Zealand, and Local Government New Zealand. AHB is accountable to its members and has responsibilities to the Minister of Agriculture.

36 Source: MAF Annual Report 2002-2003, page 50.

37 Source: AHB's 2002-03 Financial Statements, Note 6.1.





REGIONAL COUNCILS – MANAGEMENT OF BOVINE TUBERCULOSIS VECTOR CONTROL CONTRACTS

TWO

Concerns About Contracts

- 2.804 In October 2002, we received representations from a large vector control contractor expressing concerns about the letting of vector control contracts by a Regional Council. Subsequently, we received a further series of complaints from other vector control contractors relating to the actions of two other Regional Councils and two Regional Council-owned businesses operating as vector control contractors.
- 2.805 The seriousness of the representations and the complaints was such that we decided that it would be appropriate to conduct three separate formal inquiries. These inquiries involved the three Regional Councils and the businesses that two of the Councils owned.
- 2.806 We completed the inquiries in early-March 2004, and the reports on them have now been made public.
- 2.807 Although these inquiries dealt in the main with specific local issues, we identified a number of national issues relating to the vector control activities that need action. We discuss these issues in the following paragraphs.

National Guidelines for Tendering Processes

- 2.808 It was apparent from the outset of our inquiries that, while recognised standards exist for tender processes in general, no commonly recognised industry standards existed against which we could audit the appropriateness of the tender criteria, such as evaluating a contractor's qualifications³⁸, and price/quality score weightings. These had been developed by each Council vector control managers independently.
- 2.809 After we discussed the matter with a number of Council chief executives and AHB, a project involving AHB in consultation with various Councils was launched to help draw up a set of national guidelines for the handling of vector control contract tenders.
- 2.810 Progress on the project has been slow, but we anticipate that the guidelines will be completed and introduced in time for the 2005 vector control contracts tendering round (expected to start from February 2005).

38 Such as holding a poisons licence, health and safety record, and past experience.





- 2.811 AHB has confirmed that the nine Regional Councils and the unitary District Council that act as appointed vector managers would be required to align their tender processes to the new national guidelines.
- 2.812 At a later date, we intend to review how well the Councils have responded to the new national guidelines and to see whether their tender processes have improved as a result.

TWO

Treatment of Council-owned Businesses

- 2.813 The two Regional Council businesses we inquired into compete directly against private contractors in their own and other regions. The existence of this competition requires that the tender processes treat all contractors competing for contracts equally. That is, a Council should show no favouritism towards its own business when competing for work in the Council's region.
- 2.814 In addition, both of the Council-owned businesses we inquired into shared buildings and resources with their owner while carrying on their business. As a result, we were also concerned to ensure that the Councils were not providing any inappropriate financial support by way of reduced amounts of fairly allocated Council overhead costs.
- 2.815 In both cases, the tender processes and the allocated share of Council overheads were appropriate and fair.

Preventing Conflicts of Interest

- 2.816 We also identified a need for the Councils we looked at to apply higher standards for preventing conflicts of interest during the tendering for and the management of vector control contracts. The improvements we suggested were to put in place written standards that:
- identify and handle conflict of interest situations involving Council employees or elected representatives (such as past business relationships with tenderers) throughout the tender process and in making decisions to award contracts; and
 - define acceptable business relationship standards for vector control managers (such as not accepting gifts) when dealing with tenders and managing day-to-day relationships with vector control contractors.





REGIONAL COUNCILS – MANAGEMENT OF BOVINE TUBERCULOSIS VECTOR CONTROL CONTRACTS

TWO

- 2.817 We noticed some differences in how two of the Councils audited the contractor's compliance with the contracts. These differences were in the vector manager's use of field audits to ensure that the contractors were complying with the work plan they submitted as part of their tender documentation. These work plans are important as they set out both how and where the poisons and traps will be used and controlled by the contractor.
- 2.818 The matters of both probity standards and the field auditing requirements are currently under action by AHB as part of the tender guidelines project mentioned in paragraphs 2.809-2.810 on page 86.





Part Three

Areas of Focus for 2003-04

3



3.1 Issues for Attention in the 2003-04 Annual Audits

THREE

Review of Preparation for 2006 LTCCPs

- 3.101 Other articles in this report have discussed the challenges that local authorities face in preparing long-term council community plans (LTCCPs) that address the full scope of the requirements of the Local Government Act 2002³⁹ (the 2002 Act).
- 3.102 Local authorities will need to plan carefully to prepare LTCCPs that are based on robust underlying information, integrate all relevant council policies, and communicate clearly to the public about intended services, issues, and choices.
- 3.103 Because 2006 is the first year in which we are required to give an opinion on LTCCPs under sections 84(4) and 94 of the 2002 Act, local authorities will also need to incorporate working with appointed auditors in their planning.
- 3.104 We intend to ask local authorities about their planning to prepare their 2006 LTCCP in order to:
- identify points at which auditor input would be appropriate;
 - manage the workload demands of undertaking the audit both for the sector and for our Office; and
 - identify any issues in advance that may otherwise affect our opinions.

Review of Contents of 2004 LTCCPs

- 3.105 In our view, preparation of LTCCPs by local authorities will be easier for those that previously had a long-term financial strategy (LTFS) based on sound information. While the LTCCP adds new dimensions to the content of the LTFS – its predecessor under the Local Government Act 1974 – the disciplines of LTFS preparation are transferable to the LTCCP.

39 *Learning in Local Government's New Statutory Environment*, pages 37-41.





ISSUES FOR ATTENTION IN THE 2003-04 ANNUAL AUDITS

THREE

- 3.106 Our observation of the nine local authorities that prepared LTCCPs for the period starting 2003 suggests that these documents and the processes for their preparation will develop by iteration over the next two to three triennial adoption cycles. In our view, this is why the Act provides a transition for auditing these documents, with our first opinions to be issued on the LTCCPs adopted in 2006.
- 3.107 While we have no mandate to audit LTCCPs in 2004, we have asked our appointed auditors to assess how local authorities have fared in presenting the content requirements of the 2002 Act in their 2004 LTCCPs. Our objective in undertaking this work is to identify common areas for improvement where there may be a need for good practice to be applied.
- 3.108 We have also asked appointed auditors of local authorities to note any areas where disclosures appear insufficient or errors are identified with the local authorities for consideration in adopting 2006 LTCCPs.

Review of Summary of 2004 LTCCPs

- 3.109 The 2002 Act has introduced requirements for summaries to be prepared of three key accountability documents – the Statements of Proposal for the LTCCP and the annual plan (sections 83(1)(a)(ii), 93(2), 95(2) and 89), and the annual report (section 98(4)(b)).
- 3.110 These summaries are required to give a fair presentation of the “major matters” covered in the document on which they are based (sections 89(a) and 98(5)) and are established by the 2002 Act as the primary bases for general consultation and accountability.
- 3.111 Financial Reporting Standard No. 39: *Summary Financial Reports* (FRS-39) applies to the annual report summary (section 111), but there is no generally accepted accounting practice that explicitly applies to the other two summary documents.
- 3.112 Nonetheless, in our view, when suitably adjusted to reflect the future-oriented nature of the information, FRS-39 provides sound and relevant guidance to local authorities in preparing summaries of the LTCCP and annual plan Statements of Proposal. Summary LTCCP Statements of Proposal should also be prepared with an understanding of what will be reported in the annual report summary for the corresponding period.





3.113 We have asked our appointed auditors to assess whether:

- the “major matters” in each local authority’s LTCCP Statements of Proposal have been covered in the summary; and
- the summary provides information that will give readers a good basis for consultation and subsequent accountability.

THREE

Elected Members’ Remuneration

3.114 The Remuneration Authority assumed responsibility for setting the remuneration of elected members in December 2001, with the enactment of the Local Government (Elected Member Remuneration and Trading Enterprises) Amendment Act 2001. The provisions in this Act relating to remuneration were carried through into the Local Government Act 2002 (the 2002 Act).

3.115 The Remuneration Authority now determines the remuneration, allowances, and expenses payable to any elected member of a local authority, and to any member of a community board. The Authority’s first determination on these matters is set out in The Local Government Elected Members Determination 2003⁴⁰, which took effect from 1 July 2003.

3.116 The Determination therefore applies to the 30 June 2004 reporting year. As this is the first year of this regime, we have asked our auditors to ensure that local authorities have complied with certain aspects of the Determination.

3.117 Specifically, we have asked our auditors to ensure that the Determination has been complied with in relation to:

- the aggregate amount that the Council is entitled to pay to all elected Council members in respect of salaries; and
- the annual salary amounts for Office holders (Mayor/Chair, Deputy Mayor/Deputy Chair, Chairs of Committees, and Councillors), where these amounts are specified in the Determination.

3.118 We expect that there should be no instances of non-compliance with the Determination. However, if any such instances are found, our auditors will report those instances to the local authority concerned and to this Office.

3.119 In next year’s report to Parliament, we will report on the results of this work.

40 SR 2003/146.





THREE

3.2 Preparing to Audit Long-Term Council Community Plans

- 3.201 The Local Government Act 2002 (the 2002 Act) introduced a new requirement that local authorities prepare a long-term council community plan (LTCCP).⁴¹ That plan must cover a period of not less than 10 years, and the first plan was required to be adopted in either 2003 or 2004.
- 3.202 Section 84(4) of the 2002 Act – in relation to a Statement of Proposal containing an LTCCP, and section 94 in relation to a final LTCCP – requires that the relevant document contain a report from the local authority’s auditor on:
- the extent to which the local authority has complied with the requirements of the 2002 Act in respect of the LTCCP;
 - the quality of the information and assumptions underlying the forecast information provided in the LTCCP; and
 - the extent to which the forecast information and performance measures provide an appropriate framework for meaningful assessment of the actual levels of service.
- 3.203 The auditor’s report must not comment on the merits of any policy content of the LTCCP.
- 3.204 The first audit of LTCCPs is required to be undertaken for those adopted in 2006.
- 3.205 Towards the end of 2003, we initiated a project (called Auditing the Future) to put in place the resources and know-how needed to successfully and credibly audit LTCCPs from 2006 onwards. The project also has an objective to share, promote, and communicate best practice in long-term planning within the local government sector up to 2006.
- 3.206 While the project is staffed from within our Office, we have established two reference groups to provide guidance and insight as we develop our capability to audit LTCCPs – an External Reference Group, and an Audit Service Provider Reference Group.

41 Section 93.





- 3.207 The External Reference Group comprises people selected from local government with expertise in planning, finance, and management, and who have an understanding of the policy drivers for our role under the legislation.
- 3.208 The Audit Service Provider Reference Group comprises a representative of each of the organisations carrying out audits of local authorities on behalf of the Auditor-General.
- 3.209 The project's early phase has focussed on the following matters:
- knowledge building;
 - technical standards and good practice development;
 - pilot studies; and
 - awareness raising and communication.

THREE

Knowledge Building

- 3.210 Exploratory meetings were held with a number of local government representatives about their views and experience of LTCCPs. Particular benefit was gained from workshop sessions with some Councils who had prepared an LTCCP in 2003.
- 3.211 We also sought information from other international audit organisations which have experience in auditing future-oriented information. There is relatively little experience worldwide, but we have gained some benefit from our exchanges.
- 3.212 We have also undertaken analysis of sustainable development assurance techniques and are assessing their relevance to our role in auditing LTCCPs.

Technical Standards and Good Practice Development

- 3.213 We have started work on the technical standards which Councils will need to follow in preparing their LTCCPs. In particular, we have reviewed the application of Financial Reporting Standard No. 29: *Prospective Financial Information* (FRS-29) to LTCCPs.





PREPARING TO AUDIT LONG-TERM COUNCIL COMMUNITY PLANS

THREE

- 3.214 We are satisfied that, in principle, FRS-29 provides a sound basis for the preparation of the financial aspects of the LTCCP. However, we have identified a range of matters that we think require re-consideration, and have brought these matters to the attention of the Financial Reporting Standards Board of the Institute of Chartered Accountants of New Zealand. The Board has advised that it will begin a review of FRS-29, and we have offered to assist with that review in whatever way we can.
- 3.215 We have identified that the quality of assumptions underpinning an LTCCP is a central issue, and have started some work to identify:
- the assumptions we would expect Councils to make;
 - the basis on which those assumptions should be made; and
 - the assumptions we would expect to see reported in an LTCCP.
- 3.216 When completed, this work will be discussed with the Society of Local Government Managers' (SOLGM) Financial Management Working Party, and we hope that a consensus will emerge on the appropriate assumptions and disclosure thereof.
- 3.217 We have identified a number of auditing policy and practice matters which we will need to address. These include the form of wording of our audit opinions on LTCCPs, and the approach to materiality in our audits of LTCCPs. We will report further progress on these matters in due course.

Pilot Studies

- 3.218 To gain a first-hand and real-life appreciation of the LTCCP process, we invited three Councils to allow us to undertake an audit of their 2004 LTCCP as pilot studies. These audits will not be "real time"; nor will we express any opinion on the LTCCP. However, we will pass on any issues that we identify to the Councils concerned, to ensure that they benefit from the process.
- 3.219 We have started the first two pilot studies (Auckland City Council and Marlborough District Council) and will begin the pilot study of Central Otago District Council in the near future.
- 3.220 We have already learned a great deal about the challenges faced by Councils in preparing LTCCPs – and the associated challenges for us in auditing these documents. Where necessary, we will also approach other Councils to assist us to test particular aspects of our proposed methodology.





Awareness Raising and Communication

- 3.221 The audit of LTCCPs is a significant new initiative in the Local Government sector. As a result, we are adopting an active communications strategy and will keep groups such as Local Government New Zealand, SOLGM, Ingenium, and others well informed.
- 3.222 We have also initiated a series of newsletters updating the sector on issues that we have identified, and the progress of our work. These newsletters and other relevant materials are available on our web site at www.oag.govt.nz.

THREE

Future Work

- 3.223 We will also address the matter of resource planning and management. This will assist us in the planning of LTCCP audits, particularly as they are undertaken only every three years. It will also assist us in ensuring that the appropriate resources are available to do the audits.
- 3.224 While the challenges of auditing comprehensive future-oriented documents, such as LTCCPs, are not insignificant, we remain confident that we will be ready to audit them in 2006, and that our audits will add significant value to both the communities which have an interest in those documents and the Councils that prepare them.





THREE

3.3 Auditing Amendments to Long-Term Council Community Plans

- 3.301 The Local Government Act 2002 (the 2002 Act) requires a local authority's long-term council community plan (LTCCP) to be audited. Similarly, it requires there to be an audit report on any amendment to an LTCCP.
- 3.302 The Act makes specific provision for amendments to LTCCPs because communities are reasonably entitled to expect that, when LTCCP changes are proposed, they will be dealt with in a manner that:
- makes the change, and the reasons for and effects of the change, clear;
 - enables community consultation and feedback on a basis similar to that by which the LTCCP was adopted; and
 - provides confidence that the integrity and robustness of the LTCCP remains, so that its proposals can be relied on.
- 3.303 Key sections of the Act relevant to amendments to LTCCPs include:
- Section 97, which sets out certain decisions that can be taken only if they are provided for in the LTCCP – including decisions to significantly alter service levels, to transfer ownership or control of a strategic asset, to construct, replace or abandon a strategic asset, and that will significantly affect the costs to or capacity of a Council;
 - Section 102, which says that changes to the funding and financial policies listed under that section are amendments to the LTCCP; and
 - Section 141, which makes it a condition of sale or exchange of endowment property that information about the intention to sell or exchange, and the use to which proceeds will be put, must be included in the LTCCP (section 97 may also apply).
- 3.304 We note that, while section 80 acknowledges that a Council may make a decision that is significantly inconsistent with any plan or policy (subject to disclosure), this does not over-ride the specific requirements of sections 97, 102, and 141.





AUDITING AMENDMENTS TO LONG-TERM COUNCIL COMMUNITY PLANS

B.29[04b]

THREE

- 3.305 We are currently working to establish how LTCCP amendments can be identified, and, where an amendment is proposed,
- the steps a local authority is required to take for public consultation on the proposed amendment; and
 - the audit work we are required to perform to issue an audit report on a proposed amendment.
- 3.306 In respect of a local authority's first LTCCP (for 2003 or 2004), the 2002 Act provides that an audit report is not required. The intention was that local authorities should be given time to become familiar with the new requirements associated with preparing an LTCCP, including improving the quality of information and assumptions underlying the forecast information provided in the LTCCP.
- 3.307 But there is no corresponding exception provided for in respect of amendments to 2003 or 2004 LTCCPs. It therefore appears that we are obliged to issue audit reports on any amendment to a 2003 or 2004 LTCCP, although we have not audited the LTCCP itself. We have in fact issued some reports accordingly.
- 3.308 It is difficult to prepare an audit report on an amendment without having audited the document being amended, unless the subject of the amendment is a discrete matter that does not affect the whole LTCCP (for example, the sale of endowment land).
- 3.309 The Local Government Law Reform Bill, as reported back to the House of Representatives in early-June 2004, proposes to amend the 2002 Act to clarify that amendments to 2003 or 2004 LTCCPs do not have to be audited. We welcome this proposal. However, regardless of whether the Bill removes the audit requirement for amendments to a local authority's first LTCCP, local authorities must comply with the requirements of section 84 of the Act for amendments. Therefore, Councils will still need to review changes proposed in 2005 annual plans to consider if any of these changes would constitute an amendment, and provide information accordingly.





3.4 Auditing the Balanced Budget Requirement

3.401 Section 100(1) of the Local Government Act 2002 (the 2002 Act) requires local authorities to set each year's operating revenue at a level sufficient to meet operating expenses, i.e. "balance the budget". However, section 100(2) of the 2002 Act allows a local authority to set projected operating revenues at a different level from that which would be necessary to meet operating expenses, provided that the local authority resolves that it is financially prudent to do so, 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.*

3.402 The intent of this provision is to ensure that local authorities make adequate and effective provision for the ongoing maintenance of service levels.

3.403 A variation of this provision was first introduced in 1996 with an amendment to the Local Government Act 1974 by the Local Government Amendment Act (No. 3) 1996. The wording of the earlier section was a more prescriptive balanced budget requirement. This earlier section had the effect of requiring local authorities to cash fund their depreciation expense (subject to a few limited exceptions) and became known as the funding of depreciation requirement.

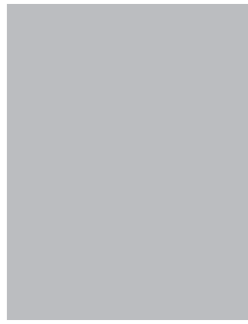
3.404 While the 2002 Act provides greater flexibility to allow local authorities not to balance the budget, it increases the complexity of the judgements that auditors need to make in assessing compliance.





- 3.405 We are therefore currently developing our expectations as to what work we will expect our auditors to undertake to assess compliance with section 100(1) for the financial year ending 30 June 2006 (the first year in which a local authority must have its long-term council community plan (LTCCP) audited).
- 3.406 For the financial year ending 30 June 2004 (and also the financial year ending 30 June 2005) we have advised our auditors that they need to ask local authorities how they have demonstrated compliance with section 100(1).
- 3.407 For those local authorities which indicate that they have not complied with section 100(1), we expect that they will have:
- made reasonable efforts to *assess the impact of their decision* not to set each year's projected operating revenues at a level sufficient to meet that year's projected operating expenses in terms of the considerations set out in section 100(2)(a), (b), (c) and (d);
 - *resolved* not to set projected operating revenues at a level sufficient to meet that year's projected operating expenses;
 - *included a statement* in the LTCCP that the budget does not balance, and the reasons for this decision; and
 - *identified any information deficiencies* – in terms of being able to demonstrate compliance with the considerations set out in section 100(2)(a), (b), (c) and (d) – and put in place an action programme for remedying these deficiencies before 2006.
- 3.408 If these steps are taken, and the decision to not comply with section 100(1) appears prudent, then we have advised our auditors that it will not be necessary to make any reference to the non-compliance in the audit opinions that are issued on a local authority's financial statements.
- 3.409 We have advised local authorities of these expectations in our newsletter titled *Auditing The Future: Project Update #2, December 2003*. The newsletter is available on our web site at www.oag.govt.nz.





Appendix



Appendix 1

Details of Non-standard Audit Reports Issued

“Adverse” Opinions

Name of Entity	Financial Statements Period Ended	Reason for Opinion
Tasman Bays Heritage Trust (Inc.) and Group	30 June 2002 and 30 June 2003	The Trust Board did not recognise the value of donated additions to the exhibits and collections it and Group owns, and has not provided depreciation on exhibits and collections. These are departures from Financial Reporting Standard No.3: <i>Accounting for Property, Plant and Equipment</i> (FRS-3). 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.
Hawke’s Bay Cultural Trust	30 June 2003	The Trust did not recognise the value of collection assets it owns in the Statement of Financial Position, and has not provided depreciation on collection assets. These are departures 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 and depreciated. 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, and results of operations.
Wairarapa Cultural Trust	30 June 2003	The Trust Board did not recognise the amount of donated additions to exhibits and collections during the year as revenue, and did not provide depreciation on those assets. These are departures from Financial Reporting Standard No. 3: <i>Accounting for Property, Plant and Equipment</i> (FRS-3). 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.

... continued on the next page.



APPENDIX

Name of Entity	Financial Statements Period Ended	Reason for Opinion
Canterbury Museum Trust Board	30 June 2003	The Board did not recognise the value of the heritage assets it owns in the Statement of Financial Position, and has not provided depreciation on the heritage assets. This is a departure from Financial Reporting Standard No.3: <i>Accounting for Property, Plant and Equipment</i> (FRS-3). 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.
Otago Museum Trust Board	30 June 2003	The Board did not recognise the value of the Trust museum collection assets it owns 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.
Museum of Transport and Technology Board	30 June 2003	The Board did not recognise the value of the heritage assets it owns in the Statement of Financial Position, and did not provide depreciation on heritage assets. This is a departure from Financial Reporting Standard No. 3: <i>Accounting for Property, Plant and Equipment</i> (FRS-3). 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.
Patriotic and Canteen Funds Board	30 September 2003	We disagreed with the use of the going concern basis to prepare the financial statements because the the Board was intending to seek a change to legislation so that it could be disestablished.
Okuru Public Hall Board	30 June 2002	The Board did not prepare annual financial statements in accordance with the Public Finance Act 1989, and their financial statements did not comply with generally accepted accounting practice in New Zealand. We were unable to form an opinion as to whether the limited financial information presented did fairly reflect the assets, liabilities, receipts and payments of the Board because there was no system of control over cash receipts and cash payments, which form a significant part of the Board's transactions.

**APPENDIX****B.29[04b]**

Name of Entity	Financial Statements Period Ended	Reason for Opinion
Bruce Bay Hall Board Waitaha Hall Board Haast Community Hall Board	30 June 2001 and 30 June 2002 30 June 2002 and 30 June 2003 30 June 2003	These Boards did not prepare annual financial statements in accordance with the Public Finance Act 1989, and their financial statements did 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.
Nelson Creek Recreation Reserve Board	30 June 2003	The Board did not prepare annual financial statements in accordance with the Public Finance Act 1989, and its financial statements did not comply with generally accepted accounting practice in New Zealand. In addition, the Board was unable to provide supporting documentation for some payments it made, and there are limited controls over the donations it has received. However, the limited financial information presented did fairly reflect the assets and liabilities of the Board.
Oamaru Racecourse Reserve Trustees	30 June 2002	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.

... continued on the next page.





APPENDIX

“Except-for” Opinions

Name of Entity	Financial Statements Period Ended	Reason for Opinion
Waitomo District Council and Group	30 June 2003	We disagreed with a subsidiary of the Council (Inframax Construction Limited) recognising a prior period adjustment resulting from a change in accounting estimate in the Council Group’s Statement of Movements in Equity. This is a departure from Financial Reporting Standard No. 7: <i>Extraordinary Items and Fundamental Errors (FRS-7)</i> , which allows for the recognition of a prior period adjustment only in the event of a fundamental error.
Awakaponga Public Hall Board	30 June 2000	The Board did not prepare annual financial statements in accordance with the Public Finance Act 1989, which requires inclusion of a statement of objectives and a statement of service performance.
Mapiu Domain Board	30 June 2001	We were unable to verify some material revenues, because of limited control over those revenues. In addition, the financial reports did not include budgeted figures, and no statement of service performance was prepared (breaching requirements of the Public Finance Act 1989).
Whatitiri Domain Board	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).
Ruakaka Reserve Board	30 June 2002	
Matata Recreation Reserve Board	30 June 2003	
Wellington Provincial Patriotic Council	30 September 2001 and 30 September 2002	We were unable to verify revenues from collections and donations because of limited control over these revenues.
Carparking Joint Venture ¹	30 June 2003	We were unable to verify car parking revenue because of limited control over these revenues prior to being recorded.

... continued on the next page.

¹ Carparking Joint Venture is a joint venture between Addington Raceway and the Christchurch City Council.



**APPENDIX****B.29[04b]**

Name of Entity	Financial Statements Period Ended	Reason for Opinion
Inframax Construction Limited	30 June 2003	We disagreed with the company's Board recognising in its Statement of Movements in Equity a prior period adjustment resulting from a change in accounting estimate. This is a departure from Financial Reporting Standard No.7: <i>Extraordinary Items and Fundamental Errors (FRS-7)</i> , which allows for the recognition of a prior period adjustment only in the event of a fundamental error.
Waste Disposal Services Limited	30 June 2003	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 2003 was not applied back over the periods to which they related, and therefore depreciation for previous periods was understated.
Marlon Aquatic and Leisure Trust	30 June 2002 and 30 June 2003	We were unable to verify revenues from pool admissions and confectionery sales because of limited control over these prior to being recorded.
Village Pool Charitable Trust	30 June 2003	We were unable to verify revenues from pool takings and shop sales because of limited control over these prior to being recorded.

... continued on the next page.



APPENDIX

Explanatory Paragraphs

Name of Entity	Financial Statements Period Ended	Subject matter covered
Chatham Islands Council	30 June 2003	We drew attention to uncertainties surrounding the going concern assumption. The validity of the going concern assumption was dependent on the successful conclusion of ongoing negotiations with the Government for additional funding.
Central Hawke's Bay District Council and Group	30 June 2003	We drew attention to the fact that 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 infrastructural assets.
America's Cup Village Limited and Group Nelson Regional Airport Authority	30 June 2003 31 March 2002	We drew attention to the fact that the going concern basis had not been used in preparing the financial report.* * Justified because the entity was ceasing to exist.
Hawke's Bay Airport Authority	30 June 2003	We highlighted that: <ul style="list-style-type: none"> 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 notwithstanding the planned termination, the going concern assumption had been used in preparing the financial report.



Recent Publications by the Auditor-General

Other publications issued by the Auditor-General in the past 12 months have been:

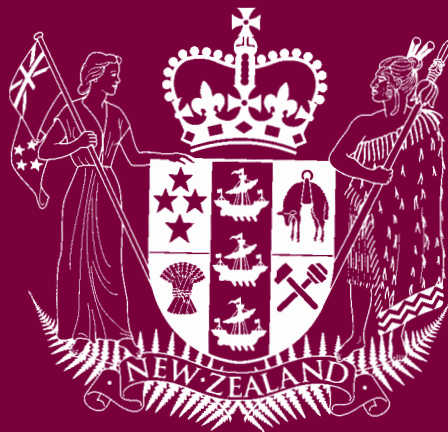
- Central Government: Results of the 2002-03 Audits – B.29[04a]
- Annual Plan 2004-05 – B.28AP(04)
- Accident Compensation Corporation: Case Management of Rehabilitation and Compensation
- Māori Land Administration: Client Service Performance of the Māori Land Court Unit and the Māori Trustee
- The State Services Commission: Capability to Recognise and Address Issues for Māori
- Inquiry into Expenses Incurred by Dr Ross Armstrong as Chairperson of Three Public Entities
- Social Security Benefits: Accuracy of Benefit Administration
- Ministry of Health: What Further Progress Has Been Made to Implement the Recommendations of the Cervical Screening Inquiry?
- Inquiry into Public Funding of Organisations Associated with Donna Awatere Huata MP
- Auckland Region Passenger Rail Service
- Managing Threats to Domestic Security
- Annual Report 2002-03 – B.28
- Key Success Factors for Effective Co-ordination and Collaboration Between Public Sector Agencies
- Co-ordination and Collaboration in the Criminal Justice Sector
- Inland Revenue Department: Performance of Taxpayer Audit
- Auckland Regional Council 2003-04 Rates
- Management of Hospital-acquired Infection

Web Site

All these reports are available in PDF form on our web site www.oag.govt.nz. They can also be obtained in hard copy on request – reports@oag.govt.nz. A cost may apply for hard copies.

Subscription for Notification of New Reports

We offer a subscription facility for people to be notified by e-mail when new Reports and Latest News are added to the web site. The link to this subscription service is on our Home Page and also in the Reports section of the web site.



The Controller and Auditor-General
Tumuaki o te Mana Arotake

**Local Government:
Results of the 2002-03 Audits**

ISBN 0-478-18120-5