Controller and Auditor-General
Tumuaki o te Mana Arotake

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Parliamentary paper

Local government: Results of the 2010/11 audits

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Local government: Results of the 2010/11 audits

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Auditor-General's overview

I am publishing this report in a context of potential change in the local government sector. The nature and amount of change has yet to be decided. Against this backdrop, local authorities – councillors and managers alike – must deal with two critical matters:

- preparing, consulting, and adopting the 2012-22 long-term plans (LTPs); and
- delivering levels of service that are not compromised by concerns about rate increases and debt.

This report shows that of the 78 local authorities, eight were unable to complete their 2010/11 annual reporting responsibilities by the statutory deadline of 31 October 2011. Of those eight, two had still not completed their obligations by 31 January 2012 – seven months after the balance date.

This report also shows that, as they strive to meet communities' expectations, local authorities face challenges balancing rates, other revenue, and debt with levels of service.

My Office has seen early drafts of LTPs that show that councils are working hard to maintain levels of service that their communities can afford.

Later this year, I will report fully on the outcomes of LTPs. Meanwhile, this report on the 2010/11 financial year and other matters that my Office has dealt with to 31 December 2011 points to some of the important matters that challenge local authorities as they prepare their LTPs for 2012-22.

I cannot report on local government in 2010/11 without noting the difficulties caused by the earthquakes that devastated Canterbury. Many of those communities have faced and continue to face substantial barriers to daily life. That they continue to strive to overcome these barriers is to their credit.

Local government staff in Canterbury have worked tirelessly to replace or return vital services. Our reliance on local government services and assets has never been more apparent.

Lyn Provost
Controller and Auditor-General

2 April 2012

Section A

Part 1
Introduction

1.1 In keeping with the approach we took last year, this report on the 2010/11 audits of the local government sector is in two sections:

- Section A reports on the full results of the 2010/11 annual reporting round of local authorities; and
- Section B contains short articles written in December 2011 to directly inform local authority chief executives and mayors of what the Office was working on during 2011, and that work's findings.

1.2 In this Part, we describe and summarise the content of Section A.

The timeliness of annual reporting

1.3 Local authorities' annual reports provide information that helps communities to assess how authorities have performed. This year's results show an unsatisfactory trend of local authorities not meeting their legislative obligations. In 2010/11, eight local authorities did not adopt their annual report by the statutory deadline. This compares with seven local authorities in 2009/10 and one local authority in 2008/09.

1.4 As at 31 January 2012, two local authorities had not yet completed their annual report – three months after the statutory deadline. In 2009/10, all annual reports were adopted by 30 November 2010.

1.5 Within one month of adopting its annual report, a local authority is required to:

- publicly release its annual report to the community; and
- make publicly available an audited summary annual report.

1.6 Excluding the two local authorities that have yet to finalise their annual reports, three local authorities missed the one-month timeframe for releasing their annual report to the community. Three local authorities missed the one-month timeframe for making available an audited summary annual report.

1.7 These reporting obligations are not new to local authorities. The trends that we see concern us. Local authorities that miss the statutory deadline fail to provide their stakeholders and community with the timely information that they are entitled to receive.

Our observations on reported financial performance

1.8 This is the second time we have reported our observations on the financial performance and position of local authorities, based on information in their audited financial statements.

1.9 Our comments are descriptive. We will continue to collect information from the audited financial statements of local authorities and report more fully over time.

1.10 Overall, trends are similar to those described in last year's report, *Local government: Results of the 2009/10 audits*.[1] Local authorities are collecting more revenue and spending more compared to last year and to their budget. Spending on capital is greater than last year, but less than the amount that local authorities budgeted.

1.11 Because the capital expenditure was less than budgeted, local authorities did not borrow as much as they had budgeted.

1.12 The financial information for two of the largest local authorities – Auckland Council and Christchurch City Council – has had a large effect on the consolidated financial information collected for 2010/11.

1.13 The Canterbury earthquakes' effect on Christchurch City Council's finances has been – and will continue to be – significant.

1.14 Auckland Council, established on 1 November 2010, prepared its first annual report for the eight months ending on 30 June 2011. Because the information disclosed is for only eight months, there is no comparative financial information for Auckland Council.

The financial reporting environment

1.15 In previous years, we have expressed concern about the New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) for many entities in the sector. Changes are under way, with amendments to the financial reporting standards that different types of entities should apply.

1.16 The proposed changes will not immediately resolve all our concerns. However, we do support the long-term strategy of separately considering the reporting requirements of public benefit entities and for-profit entities.[2]

1.17 Although the changes in the financial reporting environment are positive, there are still some challenges. Under NZ IFRS, financial statements have become longer and more complex, with increased disclosures. We continue to question the need for the volume of information disclosed, particularly for smaller entities in the local government sector.

1 Available at www.oag.govt.nz.

2 The Treasury defines public benefit entities as "reporting entities whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders". All local authorities are public benefit entities but some council-controlled organisations are not. See www.treasury.govt.nz for more information.

1.18 We consider it important that an appropriate standard be prepared for non-financial performance information. Non-financial performance information needs to be integrated with financial information to present a complete picture of an entity's performance for the financial year.

Reporting underlying profit

1.19 We have been uneasy about the practice of some entities that are associated with local authorities including alternative performance measures, such as "underlying profit", in their annual reports.

1.20 We reviewed the underlying profit disclosures made in the 2010/11 annual reports of electricity lines businesses and port companies. We found that the few of these companies that reported underlying profit in their annual reports did a reasonably good job of disclosing how they calculated underlying profit and how that profit related to the information in the financial statements.

1.21 However, in our view, the companies can report more clearly. We will continue our work to ensure that public sector practice is in line with private sector practice, given that public entities that make such disclosures have a commercial focus.

Relationships with chief executives

1.22 We have been following the recent debate about the hiring and pay of the chief executives of local authorities. Because the employer and employee – with the support of expert legal advice where necessary – best resolve individual employment matters, we rarely intervene in them.

1.23 The employment of chief executives must follow a proper process. The Local Government Act 2002 sets out the main requirements for appointing and reappointing chief executives. Local Government New Zealand (LGNZ) has produced useful guidance for the sector. Proper processes include making clear the roles and responsibilities of those involved in the recruitment process, keeping good records and confidentiality, and behaving professionally.

1.24 The pay of chief executives also needs to follow proper process. We encourage local authorities to take expert advice on the relevant employment market and salary movements but to consider that with the circumstances of the organisation. The governing body holds the final responsibility.

1.25 Something else that is being raised with us is the need for elected members and chief executives to understand clearly their roles and responsibilities – governance and management respectively. For an organisation to be run appropriately, it is critical that constructive working relationships are set up and maintained.

Reducing and managing greenhouse gas emissions

1.26 Last year, we reported that about 25% of local authorities were measuring, reducing, and offsetting their greenhouse gas emissions. In 2010/11, about 30% of the 78 local authorities were doing this.

1.27 Local authorities have different reasons for measuring and reporting their emissions, including to reduce corporate energy use and costs, to get or keep sustainability accreditation, or to lead their communities by example.

1.28 We expected that the New Zealand Emissions Trading Scheme (ETS) would encourage local authorities to begin measuring and reducing emissions, given increases in fuel and electricity prices. The ETS should encourage more focus on reducing waste when further costs (based on waste disposed of at landfills) are introduced.

1.29 The effect of the ETS on how local authorities measure and reduce greenhouse gas emissions is not yet apparent. However, some local authorities are taking part in the ETS through their forestry activities, and more local authorities will take part when the waste sector enters the ETS in 2013.

Managing leaky home liabilities

1.30 Providing for leaky home liabilities continues to be a major matter for local authorities. The collective liabilities of the four local authorities that leaky home liabilities affect the most increased from $477 million in 2009/10 to $510 million in 2010/11. This is an increase of $37 million, or 7.8%.

1.31 The increase happened because, having better historical information on which to base assumptions, local authorities were able to estimate their leaky home liabilities more reliably.

1.32 On 29 July 2011, the Government's Financial Assistance Package (FAP) became available to homeowners. Under the FAP, the Government and the local authority (if they are participating in the scheme) each pay 25% of the agreed repair costs. The homeowner pays the other half. As at 30 June 2011, the Crown provided $567 million for its obligation to contribute 25% of agreed repair costs to eligible owners of leaky homes.

1.33 As at January 2012, 29 local authorities had agreed to participate in the FAP.

Non-standard audit reports

1.34 We continue to use more “emphasis of matter” and “other matter” paragraphs in our audit reports. We see these paragraphs as helping to draw attention to significant matters relevant to understanding the financial and/or non-financial information about the entity.

1.35 This year, we wrote an emphasis of matter paragraph in the audit reports of the public entities that were dissolved as a result of Auckland Council’s creation. We drew readers’ attention to the fact that the financial statements were prepared on the basis that the entity was being wound up.

1.36 The large earthquakes of 2010 and 2011 affected the financial and non-financial performance of many Canterbury entities. We issued modified audit opinions for Christchurch City Council and those of the council’s group, Tuam Limited (a subsidiary of Christchurch City Council), and Waimakariri District Council and its group accounts.

Part 2
Timeliness in annual reporting

2.1 In this Part, we set out:

- the statutory requirements for adopting and publicly releasing an annual report; and
- when local authorities:
  - adopted their annual reports, and the reasons why some were late;
  - publicly released their annual reports; and
  - publicly released their summary annual reports.

Background

2.2 Annual reports provide information that helps communities to assess their local authorities' performance. For this process to be effective, the information must be comprehensive and timely.

2.3 Each year, we look at how timely local authorities' annual reports have been.

2.4 Under the Local Government Act 2002 (the Act), each local authority is required to:

- complete and adopt its annual report – containing audited financial statements and service performance information – within four months after the end of the financial year;[3]
- make its annual report publicly available within one month of adopting it; and
- make an audited summary of the annual report available within one month of adopting the annual report.

2.5 The local authority decides when the audited annual reports and summaries will be prepared and published, within the requirements of the Act.

Adopting annual reports

2.6 The Act allows local authorities four months after the end of the financial year to complete and adopt their annual reports. More local authorities did not meet this statutory deadline than in the previous two years, which concerns us.

2.7 Figure 1 shows the dates when our audits of local authorities were completed, which gives an indication of when local authorities were able to adopt their annual reports.

3 If the date that the audit of a public entity's financial statements must be completed by falls on a non-working day, then the Interpretation Act 1999 requires that the statutory deadline should be read as the next working day. In 2010/11, Marlborough Anniversary Day fell on Monday 31 October 2011. Therefore, 1 November 2011 was the last possible date for any affected local authorities to complete and adopt their annual report.

Figure 1
When local authority audits for 2008/09, 2009/10, and 2010/11 were completed

Period in which the audit was completed	Number completed during this period, 2008/09	Number completed during this period, 2009/10	Number completed during this period, 2010/11
Within 2 months after the end of the financial year	2	2	2
Between 2 and 3 months after the end of the financial year	11	22	12
Between 3 and 4 months after the end of the financial year	63	46	56
Subtotal: Number meeting statutory deadline	***76***	***70***	***70***
Between 4 and 5 months after the end of the financial year	1	4	2
More than 5 months after the end of the financial year	0	3	4
Not issued as at 31 January	0	0	2
Total	**77**	**77**	**78***

* We excluded the former Auckland local authorities in both the 2008/09 and 2009/10 financial year totals but included Auckland Council in 2010/11. Auckland Council prepared an eight-month "annual report" ended 30 June 2011 and was subject to the same statutory timeframe as other local authorities.

2.8 Eight local authorities (10%) failed to meet the statutory deadline for 2010/11, compared with seven for 2009/10. In addition, two local authorities' audits were still incomplete as at 31 January 2012 – that is, three months after their statutory deadline and seven months after their balance date.

2.9 Of the eight local authorities that failed to meet the statutory deadline in 2010/11, three (Central Hawkes Bay District Council, Ruapehu District Council, and Wairoa District Council) had failed to meet the deadline in 2009/10. In past years, the other five local authorities had been able to meet their deadlines.

2.10 The increase in the number of local authorities that failed to meet the statutory deadline and the delay in finalising annual reports as soon as possible are unsatisfactory. Local authorities know the statutory obligations and should have appropriate procedures to meet them. Those not meeting the deadline are failing to provide their community and stakeholders with the timely information that they are entitled to receive.

2.11 Two local authorities disclosed reasons for not meeting the statutory deadline in their annual report. Both stated that they had been waiting for information from a subsidiary entity. Where the audit of the subsidiary had been delayed and the subsidiary was significant to the local authority, this resulted in the delay in finalising the local authority's annual report.

2.12 The other local authorities that failed to meet the statutory deadline disclosed only that they were not able to adopt their annual report within four months after the end of the financial year and did not say why.

Releasing annual reports to the public

2.13 We looked at when local authorities released their annual report to the community. The Act allows up to one calendar month from when a local authority adopts its annual report to it releasing that report to the public. Figure 2 shows how well local authorities met this deadline.

Figure 2
When local authorities released their annual reports for 2008/09, 2009/10, and 2010/11

Time after adopting annual report	Number released 2008/09	Number released 2009/10	Number released 2010/11
0-5 days	32	23	25
6-10 days	10	6	8
11-20 days	10	21	10
21 days to one month	24	22	30
Subtotal: Number meeting statutory deadline	***76***	***72***	***73***
Number not meeting statutory deadline	1	5	5
Total	**77**	**77**	**78**

2.14 Five local authorities missed the one-month deadline for releasing their annual report to the community, and two of them have yet to finalise their annual reports.

2.15 Most local authorities make their annual report available to the public on their website. In our view, local authorities should be able to publish their annual reports on a website within a few days of adopting their reports. We expect the whole sector to be able to achieve this.

Releasing summary annual reports to the public

2.16 We reviewed the timing of the release of audited summaries of annual reports. The Act requires both the audited annual report and an audited summary to be released within one month of the annual report being adopted. Releasing an audited summary is important to keep local authorities accountable. The summary is the most accessible information for most readers, and the easiest document to circulate and make widely available.

2.17 As Figure 3 shows, in 2010/11, a similar number of local authorities made summaries of annual reports available within the statutory deadline as in 2009/10.

Figure 3
When local authorities released their audited summary annual report, for 2008/09, 2009/10, and 2010/11

Time after adopting annual report	Number released 2008/09	Number released 2009/10	Number released 2010/11
0-5 days	18	6	38
6-10 days	6	5	12
11-20 days	16	22	15
21 days to one month	26	38	7
Subtotal: Number meeting statutory deadline	***66***	***71***	***72***
One month to 40 days	10	3	2
41-50 days	0	0	0
51-60 days	0	1	0
Not yet issued at time of writing this report	1	2	4
Total	**77**	**77**	**78**

2.18 Four local authorities did not provide their communities with audited summaries of their annual reports within one month of adopting their annual report.[4]

2.19 Two local authorities have yet to adopt both their annual report and summary annual report. Until they do, we cannot comment on how they comply with the statutory timeframes for the public release dates of their summary annual report.

2.20 As with the annual report, local authorities know they must produce a summary annual report. We emphasise that local authorities need to project manage how they produce, audit, and publish their annual report summary.

4 One local authority had completed its annual report by 31 October 2011 but, as at 31 January 2012, had yet to release its audited summary annual report. Another local authority did not meet its statutory deadline for adopting its annual report by 31 October 2011 and had not yet issued its audited summary annual report as at 31 January 2012. These have been included in Figure 3 in the "Not yet issued at time of writing this report" row.

Part 3
Financial trends in the annual reports of local authorities

3.1 In this Part, we outline our observations on the financial trends arising out of local authorities' audited financial statements for the year ended 30 June 2011. We set out why we are reporting this information and the information that we considered, before discussing our analysis of:

- operating revenue;
- operating expenditure;
- cash flows;
- capital expenditure;
- debt;
- indicators of financial sustainability; and
- group financial information.

Why we are reporting this information

3.2 We first reported on the financial trends for the local government sector and our analysis of them in *Local Government: Results of the 2009/10 audits*. That information should provide readers with a financial overview of the local authority sector and the main trends in that sector.

3.3 We collected the information for our analysis from local authorities' annual reports, which are publicly available.

3.4 For this report, we have been able to report on financial information for the three years 2008/09 to 2010/11 and our observations of the emerging trends. We plan to continue to collect and fully report on local authorities' financial information.

The information that we considered

3.5 We collected all the information that we used in this analysis from the audited financial information in annual reports for the year ended 30 June 2011. There are 78 local authorities, but we have excluded the 2010/11 financial information of one local authority because the audit of the financial statements in that local authority's annual report was not complete when we wrote this report. We consider that excluding this local authority's result has little effect on the financial analysis in this Part.

3.6 We have included the draft financial information of one other local authority, even though its annual report had not been completed at the time we were writing. The draft figures were not significantly different from the financial information that has been adopted since then.

3.7 In our comparisons of year-on-year results, we have excluded the financial information of Auckland Council (which was formed on 1 November 2010) because it had prepared eight-month results for the 2010/11 financial year.[5]

3.8 Also, where we have compared year-on-year results, we have excluded the results of Christchurch City Council for all three financial years, 2008/09 to 2010/11. Christchurch City Council's 2010/11 operating revenue and expenditure and capital expenditure reflected the effect of the 2010 and 2011 Canterbury earthquakes. The changes in capital expenditure and operating revenue and expenditure were significant. Including them in the year-on-year analysis would not have provided a comparable picture of performance. We refer readers to Christchurch City Council's 2010/11 annual report for full commentary on the effect of the Canterbury earthquakes.[6]

3.9 We reviewed the effect of the Canterbury earthquakes on other nearby local authorities' financial statements (Environment Canterbury Regional Council, Hurunui District Council, Selwyn District Council, and Waimakariri District Council). We did not consider the combined effect on the operating revenue and expenditure of these local authorities to be significant in the overall local authority results, so we have not made any adjustments for their results.

3.10 Appendix 1 sets out a summary of the effects of the earthquake in these five Canterbury local authorities' annual reports.[7]

3.11 We have tried to be consistent in compiling and categorising the financial information. Because local authorities disclose information in different ways, consistency was not always possible. However, we do not consider any of these inconsistencies materially affect the information in this Part.

Operating revenue

3.12 Overall, in 2010/11, local authorities (excluding Auckland Council and Christchurch City Council) received operating revenue of $5.0 billion,[8] an increase of 2.0%, or $98 million, from 2009/10.

5 The four-month results of the previous eight Auckland local authorities for the period ended 31 October 2010 are excluded from the 2010/11 results, and their full-year results have been excluded from the 2008/09 and 2009/10 comparative results.

6 "Impact of the 2010 and 2011 Canterbury earthquakes", *Christchurch City Council 2010/11 Annual Report*, pages 138-143.

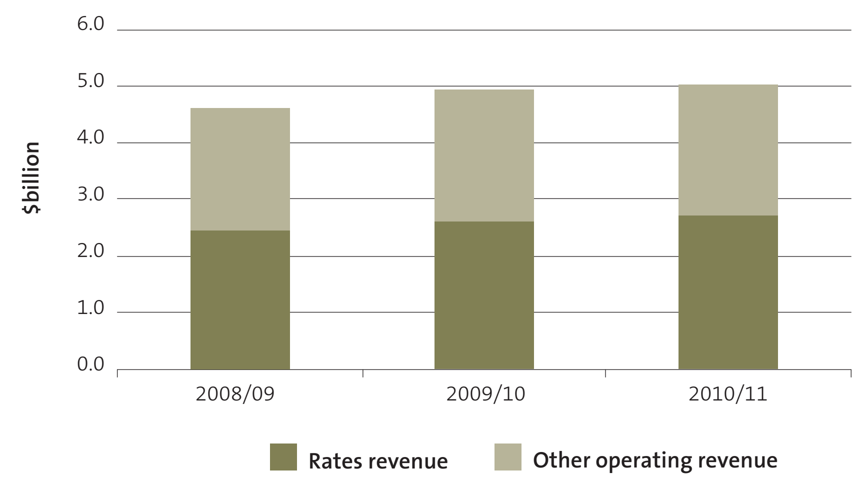
7 Christchurch City Council and the four other local authorities listed in paragraph 3.9.

8 Including Auckland Council and Christchurch City Council, the total operating revenue was $7.1 billion.

3.13 Rates revenue made up about 54% of operating revenue. In 2010/11, local authorities collected $2.7 billion in rates revenue,[9] an increase of 4%, or $104 million, from 2009/10.

3.14 Figure 4 shows (total) operating and rates revenue for the years 2008/09 to 2010/11.

Figure 4
Operating and rates revenue for 2008/09 to 2010/11



3.15 Year on year, operating and rates revenue increased in both 2009/10 and 2010/11. However, the percentage increases in 2010/11 were less those in 2009/10. In 2009/10, operating revenue increased 6.7%, while rates revenue increased by 6.2%. In 2010/11, operating revenue increased by 2%, while rates revenue increased by 4%.

3.16 Other than rates, the other major sources of revenue in 2010/11 include New Zealand Transport Agency subsidies of 14.6%, or $933 million, and development contributions and vested assets[10] of 3.8%, or $243 million.

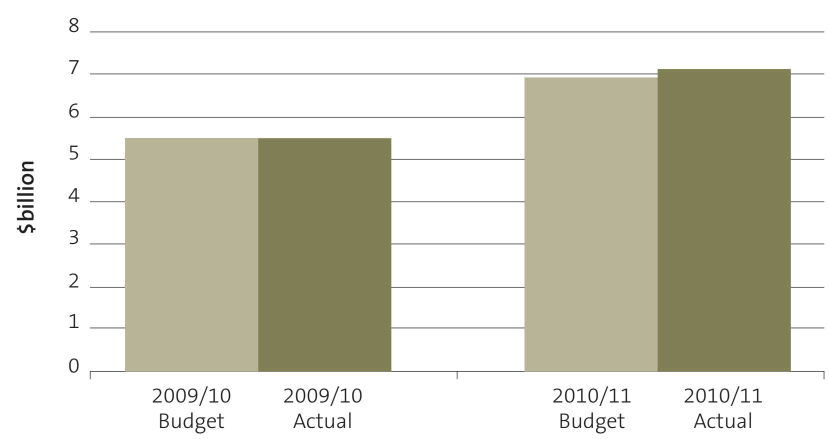
3.17 The proportion of operating revenue from development contributions and vested assets has fallen since 2009/10. This is what we expected to see, because the recession has slowed growth during the last few years.

9 Including Auckland Council and Christchurch City Council, the total rates revenue was $3.9 billion.

10 Vested assets are assets that are transferred to a local authority at nominal or zero cost. Typically, they might result from a situation where a developer has installed assets when developing a site and passes them to a local authority to manage, maintain, and deliver services through. The fair value of these assets has to be determined, because they are integrated into the local authority's asset information system so that they can be appropriately managed.

3.18 Figure 5 shows the local authorities' operating revenue compared to their budget (including Auckland Council and Christchurch City Council), for the last two years. The operating revenue in 2010/11 was 3.0% ($206 million) more than the amount that local authorities had budgeted.

Figure 5
Operating revenue – actual and budget in 2009/10 and 2010/11



Operating expenditure

3.19 In 2010/11, the total operating expenditure for local authorities (excluding Auckland Council and Christchurch City Council) was $4.8 billion.[11] This figure was $185 million greater than the equivalent figure in 2009/10.

3.20 Typically, we compare operating expenditure with two indices – the annual consumer price index (CPI) and the local government cost index (LGCI). The CPI to June 2011 increased by 5.3% (which included a 2.3% increase in the December 2010 quarter, when GST rose from 12.5% to 15%).[12] In their LTPs and annual plans, local authorities typically apply the LGCI to forecast their expenditure, rather than the CPI. The LGCI includes a general goods and services index, the transport capital expenditure index, and the "three waters" (wastewater, storm water, and freshwater) capital expenditure index. Therefore, the LGCI is a more accurate measure of costs local authorities face than is the CPI. The LGCI increased by 2.3%

11 Including Auckland Council and Christchurch City Council, the total operating expenditure was $6.8 billion.

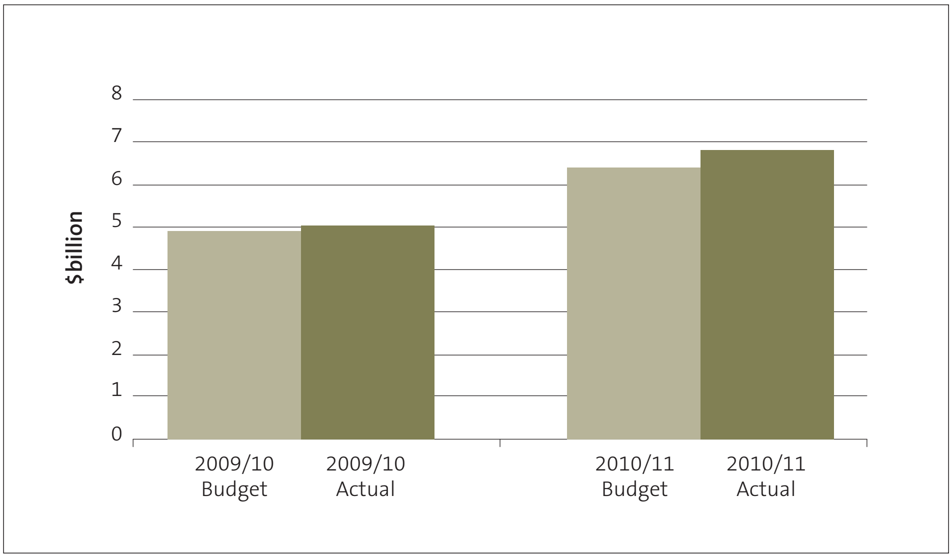
12 See www.stats.govt.nz.

in the year to June 2011, and is forecast to increase by 5.3% in the year to June 2012.[13]

3.21 Figure 6 compares local authorities' actual operating expenditure to budget (including Auckland Council and Christchurch City Council) for the last two years. The actual 2010/11 expenditure was 6.8% ($432 million) more than the amount that local authorities had budgeted.

3.22 In 2010/11, depreciation and amortisation expenses were about 14.6% or $1.1 billion, and interest expenses were $409 million, or 6.7% of operating expenditure.

Figure 6
Operating expenditure – actual and budget in 2009/10 and 2010/11



3.23 Of the $432 million increase on the amount that was budgeted for:

- $275 million was because of the effect of the earthquakes on Christchurch City Council's financial statements;[14]
- $98 million was from Auckland Council (where interest expenses and impairment of investments in subsidiaries were $90 million more than budget;[15] and
- $24 million was from an increase in Wellington City Council's leaky home liability provision.

13 Business and Economic Research Limited (2011), *Forecasts of price level change adjustors – 2011 update*, a note to Society of Local Government Managers and Local Government New Zealand, page 12.

14 "Impact of the 2010 and 2011 Canterbury earthquakes", *Christchurch City Council 2010/11 Annual Report*, page 143.

15 "Note 40 Explanation of major variances against budget", *Auckland Council 2010/11 Annual Report*, page 333.

Cash flows

3.24 The cash flow statement consists of three items – net cash flows from:

- operating activities, which reflect the usual day-to-day business activities;
- investing activities, which reflect the buying and disposing of long-term assets and other investments; and
- financing activities, which reflect changes in borrowings and equity.

3.25 Figure 7 shows net cash flows from operating, investing, and financing activities from 2008/09 to 2010/11 (excluding Auckland Council and Christchurch City Council). Net cash flows from operating and investing activities increased during the three years. The negative figures show that more money was going out, which was mainly because the local authorities were acquiring long-term assets.

Figure 7
Net cash flows from 2008/09 to 2010/11

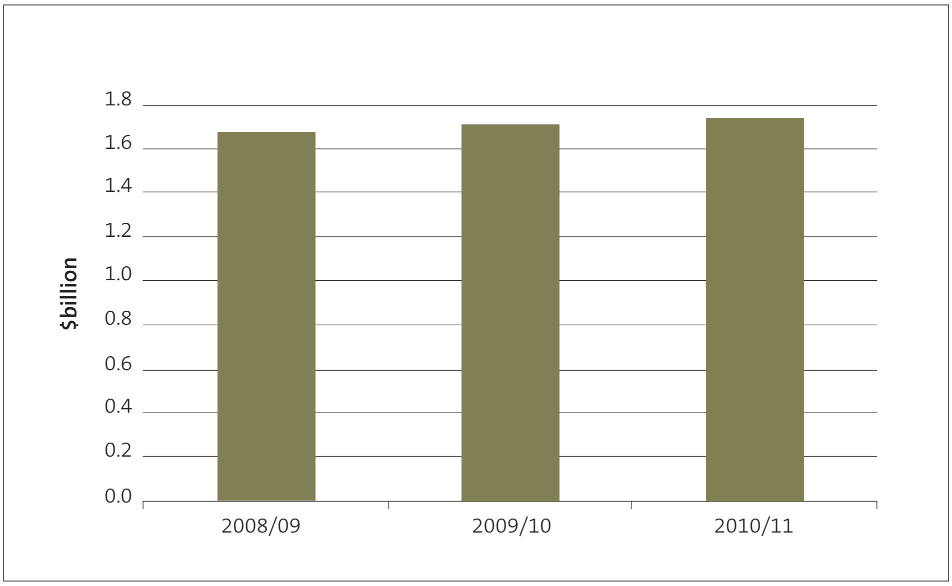
Net cash flow	2008/09 ($million)	2009/10 ($million)	2010/11 ($million)
From operating activities	1,024	1,095	1,218
From investing activities	(1,598)	(1,630)	(1,692)
From financing activities	547	546	511

Capital expenditure

3.26 Local authorities spent $1.7 billion[16] on capital work (excluding Auckland Council and Christchurch City Council) in 2010/11. This was an increase of 1.6%, or $27 million, on 2009/10 (see Figure 8).

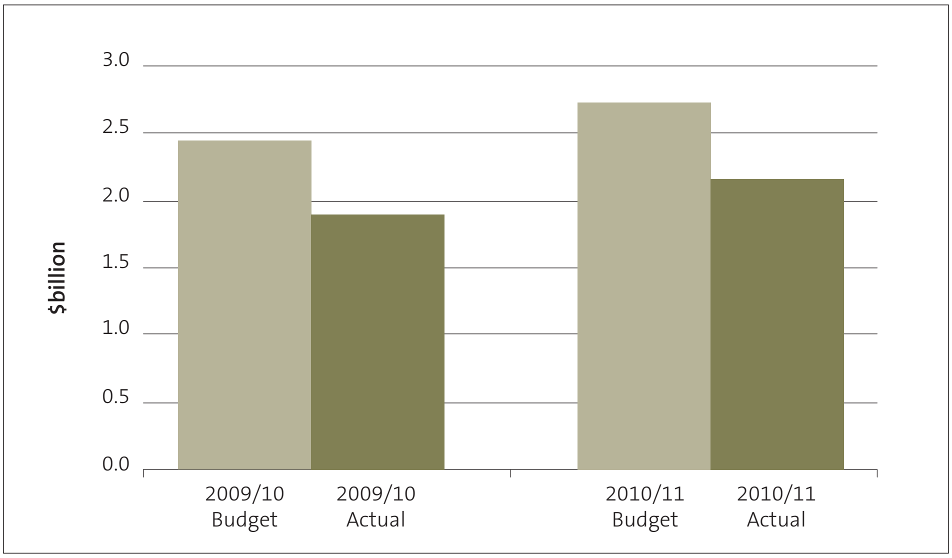
16 Including Auckland Council and Christchurch City Council, capital expenditure was $2.2 billion.

Figure 8
Capital expenditure from 2008/09 to 2010/11



3.27 Figure 9 compares local authorities' (including Auckland Council's and Christchurch City Council's) actual spending on capital to the amount that they had budgeted. In general, capital expenditure includes paying for new assets to meet additional demand or improve service, or replacing (or renewing) assets. In 2010/11, local authorities spent 20.8% ($568 million) less on capital than the amount they had budgeted. (For 2009/10, the figures were 22.3% or $545 million less than budget.)

Figure 9
Capital expenditure – actual and budget in 2009/10 and 2010/11



3.28 Many of the local authorities' annual reports do not effectively disclose why they spent less than budget. It could be that efficiencies were made on completed projects. However, it appears that many local authorities either deferred or reprioritised their planned capital expenditure. In our view, it is important that local authorities are transparent about their reasons for the difference between planned and actual capital expenditure.

3.29 We discuss the relationship between capital expenditure and depreciation in paragraphs 3.53-3.57.

Debt

3.30 Local authorities use debt mainly to pay for long-life assets. In general, this is considered to be fairer than alternatives because it shares the cost of the assets among different generations of ratepayers. In general, local authorities should not borrow money to fund their operations.

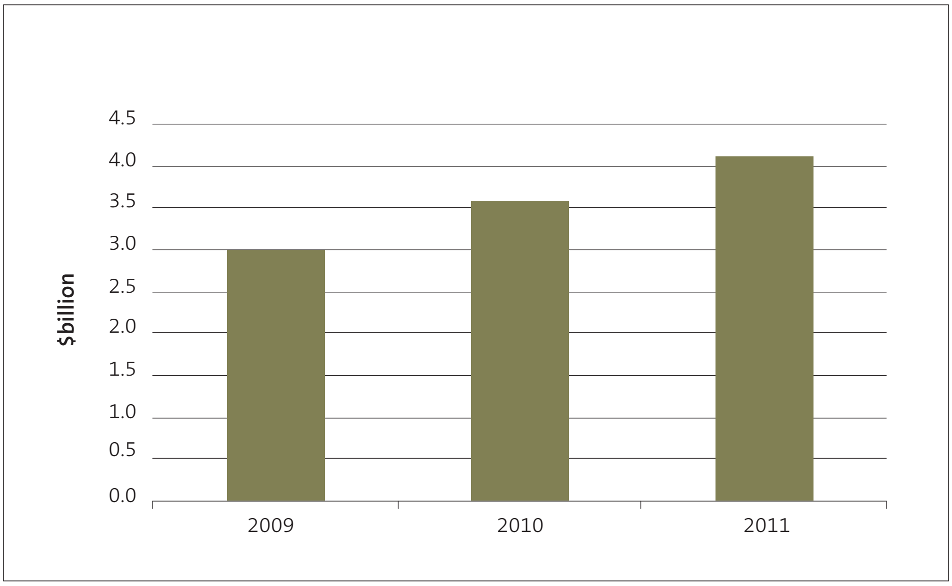
3.31 Local authorities (excluding Auckland Council and Christchurch City Council) had debt of $4.1 billion as at 30 June 2011.[17] Their total assets were $68 billion. Debt needs to be consistent with affordability considerations and what ratepayers expect to pay.

3.32 Figure 10 shows that local authorities continue to increase their debt – the total has increased by 14.7% since June 2010. The amount borrowed has been

17 Including Auckland Council and Christchurch City Council, the total borrowings were $7.6 billion and total assets were $106.5 billion.

increasing since 2009. The local authorities with the largest debt increases were those with high population growth.

Figure 10
Local authorities' debt 2009-2011

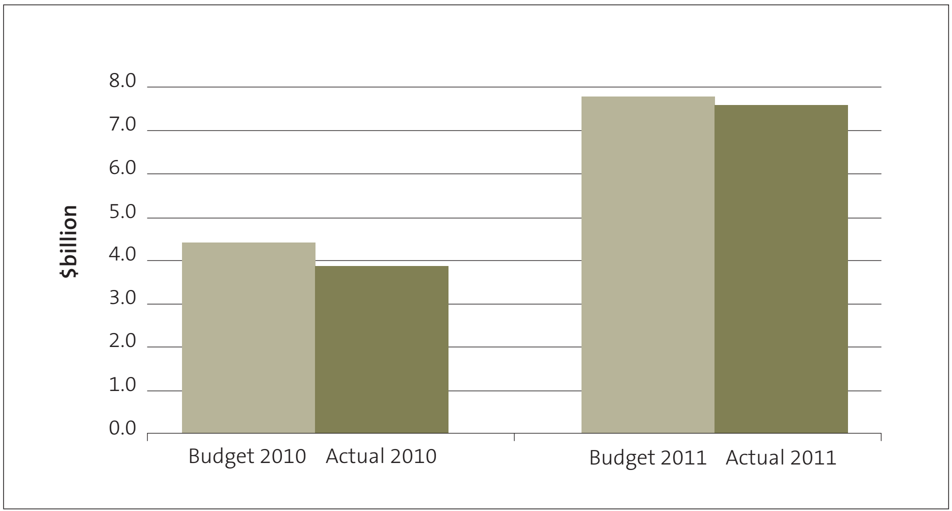


Note: As at 30 June each year. Excluding Auckland Council and Christchurch City Council.

3.33 In 2010/11, the average interest rate on debt was 5.7%.

3.34 Figure 11 shows local authorities' (including Auckland Council's and Christchurch City Council's) debt balance during the last two years compared to budget. As of 30 June 2011, local authorities had $202 million less debt than they expected to have. (On 30 June 2010, they had $526 million less debt than budget.) As at 30 June 2011, nine local authorities had no debt.

Figure 11
Debt – actual and budget in 2010 and 2011



3.35 In Figure 11, the 30 June 2011 amounts include Auckland Council, but the 30 June 2010 figures exclude the previous eight Auckland local authorities. Auckland Council's 30 June 2011 budgeted debt for the eight-month period was $2.7 billion compared to actual debt of $3.0 billion. The total debt for local authorities (excluding Auckland Council) for 30 June 2011 was $4.6 billion, which was less than the $5.1 billion budgeted.

3.36 In our 2009 report, *Matters arising from the 2009-19 long-term council community plans*, we noted that local authorities were planning to use debt more. This increasing use of debt has been evident since 2004. We have reported the amounts that were borrowed externally. Where a local authority has accumulated (cash) reserve funds, it will use those funds if, from a debt-servicing perspective, it is more advantageous than borrowing externally.

3.37 Debt continues to be an important tool in managing local authority finances and is an important means of achieving the statutory goal of inter-generational equity. Using debt to buy an asset is seen as a way to equitably apportion the capital cost of an asset to the generations of ratepayers who will use the asset.

3.38 Prudently using debt can help to avoid large increases in rates, which might result when an asset is paid for in the year of its construction.

3.39 The economic environment affects how councils seek to use debt. With the continuing effect of the global financial crisis, we are starting to see that some councils plan to rely less on debt. In general, this means revised, delayed and/or reduced capital expenditure. Other councils continue to rely on debt and, in some cases, have extensive capital programmes to fund.

3.40 It is clear from the strategies that we have seen in LTPs that local authorities know that they must be able to justify why they raise debt. Debt for capital projects is justifiable if it provides a benefit exceeding the cost.

3.41 We intend to analyse all 2012-22 LTPs and report later this year. We will specifically review the combined picture of rates, debt, development contributions and financial strategies.

3.42 At the time of writing, about 18 local authorities have joined New Zealand Local Government Funding Agency Limited (the LGFA).[18] In their 2012-22 LTPs, more local authorities indicate they may join the LGFA. These local authorities expect to pay lower interest rates than now and reduce their borrowing costs. The LGFA will also be able to borrow in foreign currency. Under the Local Government Act 2002, this option is not directly available to a local authority.[19] The local government sector and Parliament will be interested to see whether the participating local authorities reduce their borrowing costs. We intend to include this information in future reports to Parliament.

Indicators of financial sustainability

Local authorities' debt to total revenue (excluding Auckland Council and Christchurch City Council)

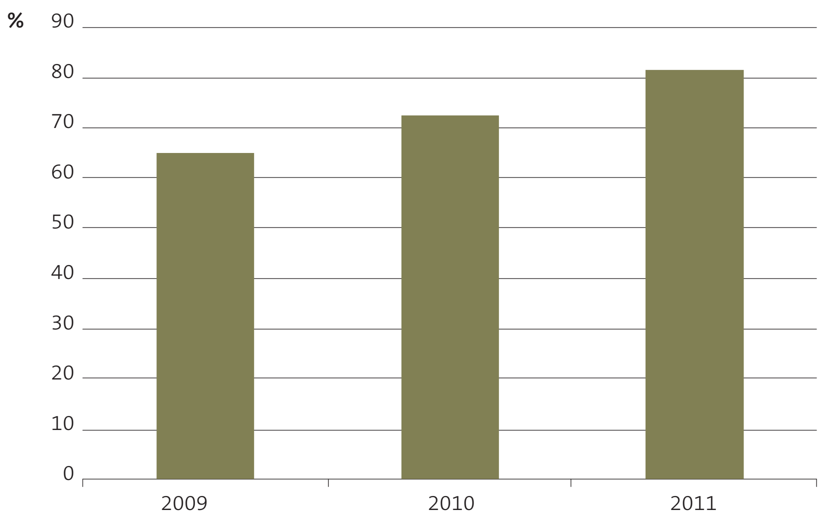
3.43 The percentage of debt to total revenue compares borrowings (current and non-current) at year-end to total annual operating revenue. The higher the percentage, the less able the local authority is to cover its borrowing from the revenue it generates.

3.44 Overall, local authorities' debt to total revenue increased from 72% in 2009/10 to 81% in 2010/11 (see Figure 12). The increase reflects the increase in debt that local authorities hold.

18 The LGFA was established under the Local Government Borrowing Act 2011.

19 This prohibition excludes Auckland Council, which is able to borrow in foreign currency.

Figure 12
Debt to total revenue, 2009-2011



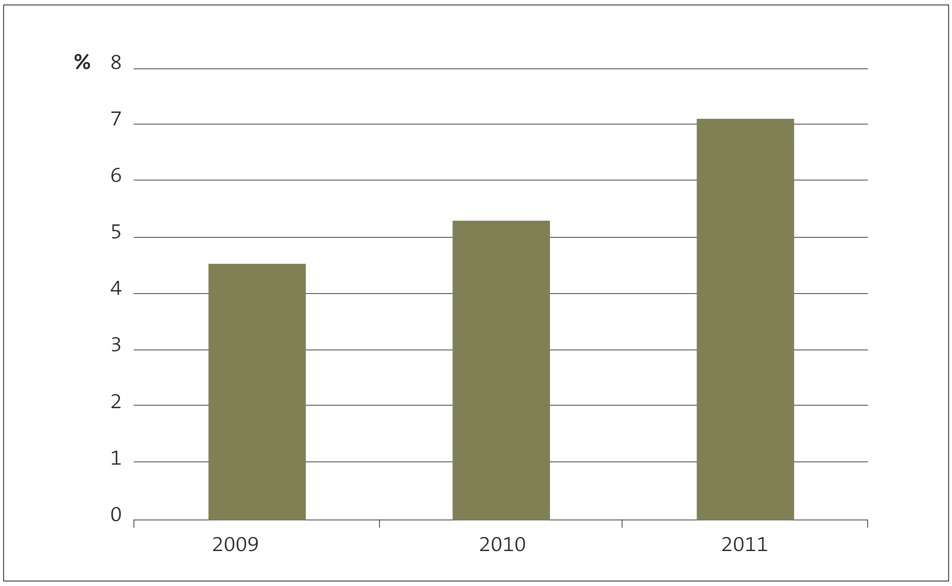
Note: Excluding Auckland Council and Christchurch City Council. Debt as at 30 June each year compared with revenue in the 12 months to that date. When Auckland Council and Christchurch City Council are included, the proportion of debt to revenue in 2011 was 194%. Auckland Council had a proportion of debt to revenue of 225%.

Debt to total assets (including Auckland Council and Christchurch City Council)

3.45 The proportion of debt relative to total assets indicates a local authority's debt-loading risk. A percentage of more than 100% means that a local authority has more debt than the value of its assets.

3.46 As at 30 June 2011, local authorities' proportion of debt to total assets was 7%. This was slightly higher than the 30 June 2010 figure of 5% (see Figure 13).

Figure 13
Debt to total assets, 2009 to 2011



Note: As at 30 June each year. Auckland Council and Christchurch City Council are included.

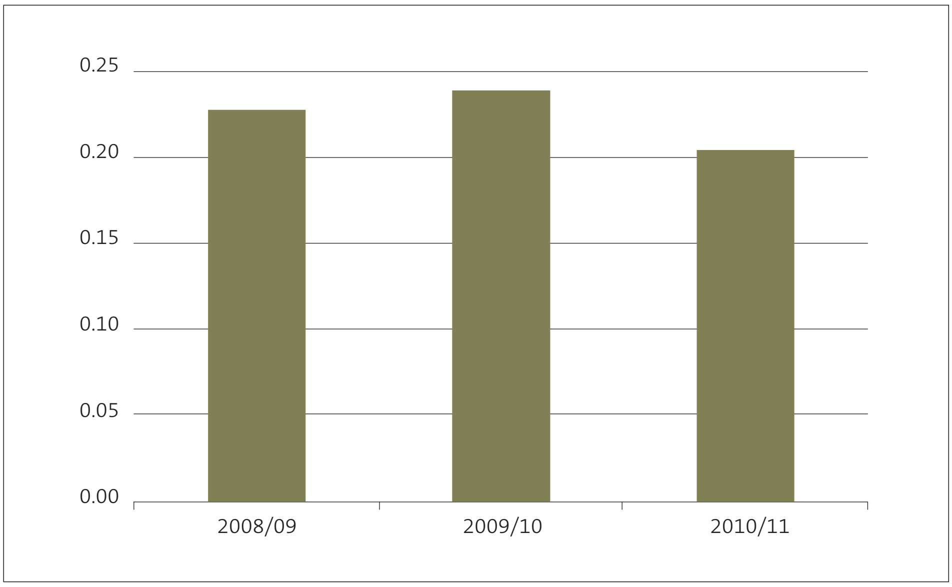
3.47 Local authorities typically have a large base of long-term assets, so we expect them to have a low proportion of debt to total assets. Nine local authorities had no debt as at 30 June 2011. The highest proportion of debt to total assets was 15%. It is worth noting that many local authority assets are not realisable because they are infrastructure, such as roads and water supply, wastewater, and storm water systems.

Self-financing (excluding Auckland Council and Christchurch City Council)

3.48 The self-financing ratio compares net cash flow from operating activities to total revenue. The higher the ratio, the higher the internally generated surplus a local authority has to fund investing activities, such as buying long-term assets.

3.49 Figure 14 shows local authorities' self-financing ratio from 2008/09 to 2010/11.

Figure 14
Self-financing ratio, 2008/09 to 2010/11



Note: The ratios shown in Figure 14 exclude Auckland Council and Christchurch City Council. Including those two local authorities, the 2010/11 self-financing ratio was 0.15:1. Christchurch City Council had a self-financing ratio of -0.7:1.

3.50 The highest ratio was 0.97:1 and the lowest was 0.02:1.

3.51 Christchurch City Council (not included in these results) was the only local authority with a negative self-financing ratio. A negative operating cash-flow result is rare for local authorities. Christchurch City Council reported in its annual report that:

> *After adjusting for non-cash items we have made a cash operating deficit for the year of $30.1 million compared to the planned surplus of $131.5 million. The difference between the planned surplus and actual deficit is essentially the result of earthquake-related payment to suppliers. This has been funded by reducing Council expenditure on the capital programme, the receipt of insurance proceeds, and through the use of funds Council previously had invested.*[20]

Capital expenditure relative to depreciation (excluding Auckland Council and Christchurch City Council)

3.52 The capital expenditure to depreciation ratio compares the rate of capital expenditure on assets to depreciation. A ratio higher than 1:1 shows that capital expenditure is higher than the depreciation rate, and suggests a level of

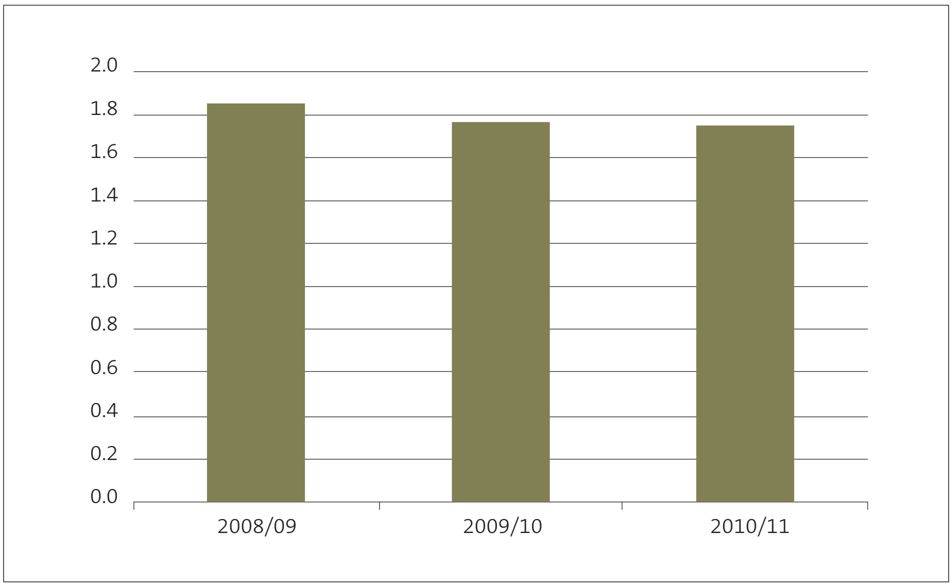
20 Christchurch City Council, *2010/11 Annual Report*, page 125.

reinvestment that is maintaining or improving the assets' performance capability, and improving the nature of the service that the assets provide.

3.53 This ratio is a long-term indicator, because capital expenditure can be deferred. Therefore, the indicator needs to be considered over several years as well as in any one year.

3.54 Figure 15 shows that the average capital expenditure to depreciation ratio for 2010/11 was 1.77:1 (2009/10: 1.78:1). We note that 16 local authorities had a ratio less than 1:1. In 2009/10, 11 local authorities had a ratio less than 1:1.

Figure 15
Capital expenditure relative to depreciation, 2008/09 to 2010/11



Note: The ratios exclude Auckland Council and Christchurch City Council. Including those two local authorities, the capital expenditure to depreciation ratio was 1.78:1.

3.55 We plan to collect information on how much local authorities invest in new capital projects compared with how much they spend on assets through renewal or replacement. We cannot easily extract this information from local authorities' audited financial statements.

3.56 The Local Government Act 2002, as amended in 2010, includes a requirement for local authorities to disclose in their LTP the capital that they have budgeted to meet additional demand, to improve the level of service, or to replace existing assets.[21] The Act requires a local authority to report its capital expenditure in its

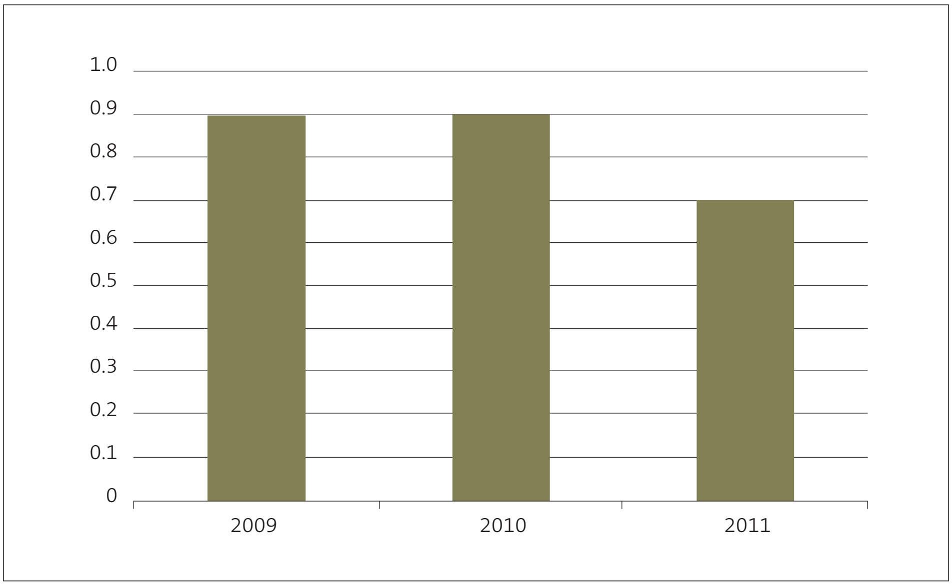
21 Schedule 10, clause 3 of the Act refers to a general requirement. The specific regulations that apply are the Local Government (Financial Reporting) Regulations 2011.

annual report. The annual report should also include reasons for variations of actual expenditure over or under budget.

Liquidity (including Auckland Council and Christchurch City Council)

3.57 Figure 16 shows that the overall liquidity ratio for the local authority sector was 0.70:1 at 30 June 2011. The liquidity ratio compares current assets to current liabilities. It measures whether a local authority has enough resources to pay what it owes during the next 12 months without having to borrow further.

Figure 16
Local authorities' liquidity ratio, 2009 to 2011



3.58 On 30 June 2011, the highest liquidity ratio for any local authority was 13.70:1 (at 30 June 2010, the equivalent ratio was 11.81:1) and the lowest was 0.10:1 (in 2010, the equivalent ratio was 0.16:1). In general, regional councils had a higher liquidity ratio than city and district councils.

3.59 The (often) low liquidity ratios for city and district councils reflect their debt profiles. Much debt is recorded as current because of how local authorities structure their loan renewals and their use of cash reserves (through internal borrowings) to fund capital expenditure before borrowing externally.

3.60 A ratio of less than 1:1 indicates that an organisation could have difficulty in meeting its liabilities, when they fall due, by using its current assets. The liquidity ratios achieved by local authorities are in line with those budgeted or anticipated in the local authorities' 2009-19 LTPs, reflecting that this is typical of how the local authority sector structures it debt. Most local authorities foresee few problems rolling over or renewing their loans.

Group financial information

3.61 We have considered the group financial information for city councils. Group financial information includes the financial information of the city council and of its council-controlled organisations (CCOs).

3.62 Each local authority structures its business differently. Some, such as Christchurch City Council and Auckland Council, have large group structures with several CCOs. Napier City Council and Porirua City Council have no CCOs. Some local authorities have CCOs that run core operations. For example, the statutory reorganisation of the Auckland Council group resulted in some of its CCOs running major activities and services – including water supply, wastewater, and transport. Other CCOs are held as local authority investments. A local authority must consult with its community before setting up or investing in a CCO.

3.63 The 13 parent city councils collected $3.7 billion in revenue. The CCOs collected a further $1.4 billion, of which the CCOs of Auckland Council and Christchurch City Council collected 86%, or $1.2 billion.

3.64 The parent city councils spent $3.5 billion, and the CCOs spent a further $1.4 billion. Of that $1.4 billion, the CCOs of Auckland Council and Christchurch City Council spent 86%, or $1.2 billion.

3.65 The 13 parent city councils' capital expenditure was $1.1 billion during 2010/11. CCOs spent a further $0.8 billion. The CCOs of Auckland Council and Christchurch City Council spent almost 92%, or $0.7 billion, of that $0.8 billion.

3.66 As at 30 June 2011, the city councils' CCOs had assets of $5.4 billion. Of this, 70%, or $4.1 billion, was held by the CCOs of Auckland Council and Christchurch City Council. The parent city councils had assets of $62.7 billion. The assets of Auckland Council and Christchurch City Council total $38.6 billion.

3.67 The city council CCOs had debt of $1.8 billion. The CCOs of Auckland Council and Christchurch City Council held 83% of this, or $1.5 billion. The parent city councils had debt of $5.3 billion, of which Auckland Council and Christchurch City Council held $3.5 billion.

Reporting financial information in the 2012/13 annual reports

3.68 In 2012/13, changes will have taken effect that should help us to better observe local authorities' financial performance and financial position.

3.69 Section 101A of the Local Government Act 2002, as amended in 2010, requires a local authority to adopt a financial strategy that informs and guides the assessment of funding and expenditure proposals. Local authorities are preparing their LTPs for 2012-22 and are required to include a financial strategy for all of the financial years covered in them. Section 101A specifies particular items that must be included:

- quantified limits on rates;
- rate increases; and
- borrowing.

3.70 Although local authorities are not required to report against their financial strategy until their pre-election report, we plan to analyse the annual report data against local authorities' LTPs every year.

3.71 At the time of writing, some local authorities had adopted their "statement of proposal" for their 2012-22 LTPs and were consulting the public about their plans. We have seen a trend towards more spending and debt, although there is an emphasis on keeping rate increases close to the forecast increases in the LGCI. We have also seen that many local authorities are looking at when and how much they spend on capital to try to minimise the effect on rates and debt. However, when local authorities are deciding about spending, they must consider the effect their decisions might have on the services that they provide.

3.72 The Local Government (Financial Reporting) Regulations 2011 specify the information that a local authority's financial statements in the LTP, annual plan, and annual report should disclose. A local authority must also prepare funding impact statements using the format prescribed in the regulations. Because all local authorities have to prepare the funding impact statements in the prescribed format, this should make it easier to compare the financial information of local authorities.

Part 4
The financial reporting environment

4.1 In this Part, we comment on:

- changes in the financial reporting environment; and
- some financial reporting challenges.

Changes in the financial reporting environment

4.2 We have expressed concerns in the past about the ongoing suitability of New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) for many entities in the local government sector. Our concerns were prompted, in part, by expected changes to NZ IFRS (because of proposed changes to the underlying International Financial Reporting Standards – IFRS) that would make it more difficult for many local government entities to apply them. Some of those changes are happening – although at a slower pace than we expected – and more changes are envisaged.

4.3 At the end of 2008, our concerns led to the then Auditor-General withdrawing staff from the standard-setting process, and, in June 2009, publishing a discussion paper entitled *The Auditor-General's views on setting financial reporting standards for the public sector*. Since that paper was published, we have seen meaningful debate about how financial reporting standards are set. Change is under way.

4.4 We hope that, by raising concerns, we have helped to influence changes to the Financial Reporting Act 1993 concerning the External Reporting Board (XRB), previously the Accounting Standards Review Board (ASRB). Since 1 July 2011, those changes have led to the XRB getting responsibility for preparing and issuing financial reporting standards, among other responsibilities. The XRB has set up two sub-boards. One of these, the New Zealand Accounting Standards Board (NZASB), is tasked with preparing and issuing financial reporting standards.

4.5 These changes are a positive step. They position the XRB to make changes to the financial reporting standards to be applied by different types of reporting entities, including all local government entities. As a result of these changes, the Auditor-General has made staff available to the new standard-setting process, and a staff member has been appointed to the NZASB.

4.6 The legislative changes require the XRB to draft a strategy for establishing different tiers of financial reporting for different classes of entities, and to submit the strategy for Ministerial approval by 31 March 2012. The purpose of this requirement is to ensure that the financial reporting requirements that apply to different classes of entities are appropriate.

4.7 The XRB began consulting on proposals for its draft strategy in September 2011, when it published three papers:[22]

- *Accounting Standards Framework: A Multi-Standards Approach*, a position paper;
- *Accounting Standards Framework for General Purpose Financial Reporting by Public Benefit Entities*, a consultation paper; and
- *Accounting Standards Framework for General Purpose Financial Reporting by For-Profit Entities*, a further consultation paper.

4.8 The position paper sets out the XRB's view that the country should adopt a multi-standards approach to financial reporting because such an approach is likely to best meet the information needs of those who use financial statements. We fully support an approach that focuses on users' information needs.

4.9 The position paper explains how the XRB formed the view that there should be a multi-standards approach. The view is based on feedback about a discussion document that the ASRB issued in September 2009 about a proposed new accounting and assurance standards framework for general purpose financial reporting.

4.10 The multi-standards approach sets a broad strategic shape to the new accounting standards framework. However, the NZASB needs to establish at a detailed level what that means to different categories of reporting entity, to ensure that all entities report appropriately. The XRB's two consultation papers set out proposals for different tiers of reporting entities and the broad proposals for the financial reporting requirements for those different tiers. We comment below on the proposals as they relate to local government entities.

Implications for entities in the local government sector

4.11 The consultation paper about accounting by public benefit entities proposes three tiers. Public benefit entities in the local government sector would be allocated to tiers depending on their operating expenditure and the nature of their accountability. The operating expenditure thresholds would be:

- for tier 1, more than $30 million;
- for tier 2, between $2 million and $30 million; and
- for tier 3, less than $2 million.

4.12 Tier 1 would include some public benefit entities based on the nature of their accountability, regardless of their operating expenditure. Those entities include leviers of coercive revenue (such as small local authorities) and issuers (which include a few local authorities).

22 See "Accounting Standards Framework Documents Released" on the XRB's website, www.xrb.govt.nz.

4.13 The financial reporting requirements for public benefit entities would depend on the tier to which an entity was allocated:

- tier 1 entities would be required to apply New Zealand public benefit entity (NZ PBE) standards based on International Public Sector Accounting Standards (IPSAS), together with relevant domestic standards where there is no equivalent IPSAS;
- tier 2 entities would apply the NZ PBE standards but with reduced disclosure requirements; and
- tier 3 entities would have a more simple form of reporting.

4.14 We expect that all three tiers should measure and recognise transactions consistently. However, there may be differences in how tier 3 entities measure and recognise transactions.

4.15 The proposed approach is likely to be more suitable than standards based on IFRS. However, IPSAS – comprehensive, complex standards with significant disclosure requirements – will significantly influence the proposed requirements. Therefore, although NZ PBE standards will be more appropriate – and some modifications can be made to IPSAS in creating those standards – they will not be a "silver bullet" that will immediately resolve all concerns that we have previously raised.

4.16 The consultation paper about accounting by for-profit entities proposes only two tiers. Large for-profit entities in the local government sector would be in tier 1 and all other for-profit entities in the local government sector would be in tier 2. To qualify as large, a for-profit entity in the local government sector would need to have revenue of more than $30 million or assets of more than $60 million.

4.17 The financial reporting requirements for those tier 1 entities would be NZ IFRS, which basically consists of IFRS supplemented by relevant domestic standards. Tier 2 entities would apply NZ IFRS but with reduced disclosure requirements.

4.18 We support the long-term strategy to separate the reporting requirements of public benefit entities and for-profit entities. Although IFRS and IPSAS are in line, they are likely to diverge. This is because IFRS focus more on the needs of a few users (mainly investors in international capital markets), whereas IPSAS focus on the needs of those who provide resources (such as ratepayers) and those who use public goods and services (such as water, sewerage, public parks, swimming pools, and libraries).

Financial reporting challenges

4.19 Although the changes in the financial reporting environment are a positive step, there are some significant financial reporting challenges facing the XRB and NZASB.

Reducing complexity

4.20 Since the introduction of NZ IFRS, most public sector entities' financial statements have become larger and more complex, with more disclosures. We continue to question whether the volume of information contained in financial statements properly meets the needs of those who typically read the financial statements. There remains a risk that readers are being presented with too much information, which makes it more difficult to "see the wood for the trees".

4.21 The tier structure will go some way to addressing the complexity of information, particularly for smaller entities, given the NZASB can determine the disclosure requirements for tiers 2 and 3. However, tier 1 entities will still have extensive disclosures, as required by IFRS and IPSAS.

4.22 In October 2010, the International Accounting Standards Board (IASB) invited the New Zealand Institute of Chartered Accountants and the Institute of Chartered Accountants of Scotland to carry out a project to review the levels of disclosure requirements in IFRS and to recommend changes to the disclosure requirements. Those institutes issued a report in July 2011 entitled *Losing the excess baggage – reducing the disclosures in financial statements to what's important*.[23] The report recommended deleting specific requirements and enhancing the use of materiality in financial reporting disclosures.

4.23 If disclosure requirements were reduced in line with the recommendations in the July 2011 report, financial statements prepared in keeping with IFRS could be reduced by up to 30% without losing important information for users. In our view, that would be a positive step. We consider that, if the disclosure requirements in IFRS were reduced, it would be difficult for the International Public Sector Accounting Standards Board (IPSASB) not to similarly reduce the disclosure requirements of IPSAS. Any changes to IFRS and IPSAS should, in time, be reflected in New Zealand standards.

Conceptual frameworks for financial reporting in the public sector

4.24 There are conceptual frameworks for both for-profit entities and public benefit entities. However, the framework that the IASB drew up for for-profit entities is more than 20 years old. The framework for public benefit entities is based on the

23 Available on the website of the New Zealand Institute of Chartered Accountants, www.nzica.com.

IASB private sector framework and includes only a few changes that focus on the public sector.

4.25 Conceptual frameworks are important because they provide a high-level "roadmap" to standard setters, and reference for preparers and auditors of financial statements for transactions that a particular standard does not address.

4.26 The IASB is working on changing its conceptual framework to one that is more narrowly focused on the needs of those people accessing international capital markets. This is a long-term project that has been under way for years.

4.27 During the last few years, the IPSASB has been working on its first conceptual framework for public benefit entities in the public sector. The IPSASB is considering the work that the IASB is doing but is not constrained by it. That work looks to be focused on the needs of both resource providers (such as ratepayers) and those who receive public goods and (community) services.

4.28 In our view, both of these conceptual framework projects are important. The NZASB has a role in appropriately influencing the work being done internationally. While changes are made to conceptual frameworks, it will be important to the public sector that the NZASB considers the interaction between the conceptual frameworks, given that the public sector includes for-profit and public benefit entities.

Standards for reporting non-financial performance information

4.29 Often, we have commented on how crucial non-financial performance information is to the accountability of many local government entities. We have noted that such information must work with financial information to provide a coherent and understandable picture about entities' performance.

4.30 Few paragraphs in NZ IFRS deal with statements of service performance – a particular form of reporting on non-financial performance information. Supplementing those paragraphs is a document entitled Technical Practice Aid No. 9: Service Performance Reporting (TPA-9). TPA-9 contains application guidance based on practice at the time the material was first published in 2002. However, arguably, it is too detailed and not focused enough on the main principles of what constitutes good reporting of non-financial performance information.

4.31 In our view, it is important that the NZASB create an appropriate standard for preparing non-financial performance information, because of the need for that information to integrate with financial information and present a complete performance picture.

Determining which entities combine to form a group

4.32 Which local government entities combine to form a group is important. Group financial statements affect the transparency of reporting and accountability, because they show the combined resources, and use of resources, by a "parent" entity.

4.33 "Control" is the accounting concept used to determine which entities are combined to form a group. Financial reporting standards provide a lot of guidance about what "control" is in a financial reporting sense. This guidance focuses on the substance of arrangements, not on the meaning of the word "control".

4.34 Even with the guidance provided in financial reporting standards, assessing whether or not an entity controls another in the local government sector can be difficult. This is particularly so for entities such as trusts, which have no formal ownership instruments. Working out whether entities such as trusts are "controlled" for financial reporting purposes remains challenging. The standards need to be clearer.

4.35 In our view, the NZASB needs to clarify what "control" means for entities with no formal ownership instruments. We consider that it is important that the entities that are combined to form a group keep focusing on the substance of arrangements and present useful information.

Part 5
Reporting alternative performance measures

5.1 Last year, we reported that we were uneasy with State-owned enterprises (SOEs) in the electricity sector disclosing alternative performance measures in their 2009/10 annual reports. In this Part, we report on the disclosures that entities associated with local authorities made. We:

- briefly explain why we were uneasy;
- set out our expectations for reporting "underlying profit";
- comment on underlying profit disclosures by electricity lines businesses and airport and port companies in 2011; and
- describe what we and others plan to do next.

Why we were uneasy

5.2 In our 2011 report to Parliament, *Local government: Results of the 2009/10 audits*, we noted that, in their annual reports, the electricity SOEs were disclosing an amount described as "underlying profit".

5.3 Underlying profit is an alternative performance measure to the profit figure determined using approved financial reporting standards and included in the financial statements. Sometimes different terms, such as "normalised profit", are used, but they are essentially the same type of measure. Underlying profit is not defined in financial reporting standards, but it typically excludes changes in the fair value of financial instruments and non-recurring transactions.

5.4 By disclosing their underlying profit, entities intend to provide information to users that can be used to assess ongoing financial performance, because it excludes certain items, such as changes in fair value and non-recurring transactions.

5.5 Usually, we encourage public entities to include information in their annual reports that is likely to be relevant to users. However, we were uneasy about the practice of disclosing underlying profit because:

- there is no guidance about what "underlying profit" is, or how it is arrived at, so inconsistent practices are likely;
- the underlying profit amount is often prominent in the annual report and could overshadow the financial information that was prepared in line with financial reporting standards; and
- the underlying profit amount is not always clearly labelled as supplementary information that is additional to the information required by financial reporting standards.

Our expectations for reporting underlying profit

5.6 In early 2011, we carried out research into underlying profit disclosures and established how we expect local government entities to disclose underlying profit. Our research included looking at how regulators address the reporting of underlying profit. In particular, we looked at work carried out by the:

- Securities Commission (which was disestablished and replaced by the Financial Markets Authority in May 2011);
- Committee of European Securities Regulators; and,
- Australian Securities and Investments Commission.

5.7 In March 2011, we gave our auditors guidance on what they should expect when entities disclose alternative performance measures such as underlying profit. We said that if entities in the local government sector disclose alternative performance measures in their annual reports, then we expect the disclosures to:

- be understandable;
- relate to information based on generally accepted accounting practice in New Zealand (NZ GAAP[24]), preferably by reconciling the amounts;
- be neutral and not used to remove "bad news";
- be consistently calculated over time;
- be less prominent than information based on NZ GAAP; and
- include comparative information.

5.8 We said that, for any alternative performance measure to be understandable, we expect the disclosures to contain enough contextual information for a reader to understand what the alternative performance measure is (that is, the principles supporting it) and why it has been included in the annual report.

5.9 In general, we expect the alternative performance measure to be disclosed outside the financial statements or in the notes to the financial statements, and for any commentary on the alternative performance measure to be balanced with commentary on information based on NZ GAAP.

Underlying profit disclosures in 2011

5.10 We chose to review the underlying profit disclosures made in the 2010/11 annual reports of electricity lines businesses, airport, and port companies. Underlying profit disclosures are usually reported by entities with a commercial focus, and electricity lines businesses and airport and port companies are the main entities in local government that have a commercial focus.

24 NZ GAAP includes applicable financial reporting standards issued by the New Zealand Accounting Standards Board, which is a sub-board of the External Reporting Board. NZ GAAP establishes requirements for preparing financial statements in New Zealand.

5.11 The purpose of our review was to gauge the level of reporting of underlying or normalised profit within the sector and assess how clear those disclosures were.

5.12 We did not identify any airport companies that were reporting underlying profit. A few electricity lines businesses and port companies reported underlying profit in their annual reports, using a range of reporting practices. Of the electricity lines businesses and port companies that reported underlying profit, some included it in their financial statements. Others included that information in commentary accompanying the financial statements. In our view, these electricity lines businesses and port companies were trying to provide readers with some insight into how the electricity lines businesses and port companies' performance should be judged.

5.13 These electricity lines businesses and port companies did a reasonably good job of disclosing how they calculated underlying profit and how that profit related to the information in the financial statements. However, in our view, their reporting could be clearer.

What next?

5.14 We will continue to work with electricity lines businesses, port companies, and our auditors, as appropriate, where we consider that improvements can be made to the disclosures about underlying profit (in keeping with the principles set out in paragraph 5.7).

5.15 We will watch the reporting of alternative performance measures (such as underlying profit) in the private sector, where the practice is more widespread. If needed, we will revise our expectations for for-profit entities in the public sector. We want to ensure that practice in the public sector is in line with practice in the private sector, given that public entities that make such disclosures have a commercial focus.

5.16 We will watch what is happening internationally, especially in Australia. We note that the Australian Securities and Investment Commission issued a regulatory guide (No. 230) in December 2011, entitled *Disclosing non-IFRS financial information*.

5.17 The Financial Markets Authority has said that it intends to seek input into a draft regulatory guide to disclosing alternative performance measures and other information prepared other than in keeping with approved financial reporting standards. We look forward to seeing the draft regulatory guide.

Part 6
The relationship between local authorities and their chief executives

6.1 A healthy and productive relationship between a local authority and its chief executive is an important factor in an authority's effectiveness. That relationship is the vital link between governance and management, and between decision-making by elected representatives and operational activity. If there are problems in that relationship, they can have a significant effect at all levels of the organisation.

6.2 The role of chief executives has been a significant topic of discussion in the local government sector during the last year. Contentious issues have included:

- the decision-making process for making appointments and reappointments;
- what might constitute pre-determination in those processes;
- how remuneration is set and disclosed; and
- the relative responsibilities of chief executives and elected members.

6.3 This Part provides brief comment on those issues.

Appointing and reappointing chief executives

6.4 The main legal requirements for employing chief executives are set out in schedule 7 of the Local Government Act 2002 (clauses 33-36). In summary:

- The local authority has to appoint a chief executive for a term of no more than five years.
- In the year before the contract expires, the local authority must review the chief executive's performance and their skill mix, and consider how the skill mix fits with the local authority's expected future needs.
- Based on that review, the local authority can then decide either to reappoint the incumbent for another two years, without advertising or any other process, or to advertise the pending vacancy and start afresh.
- The local authority is obliged to be a good employer, which specifically includes providing good and safe working conditions, and impartially choosing the best candidate based on merit.

6.5 As the employer, the local authority has a range of duties under general employment law, including the Employment Relations Act 2000 and common law.

6.6 Appointing a chief executive is an important decision for a local authority: it will shape how the organisation is led and managed for the term of the appointment.

Recognising how significant this decision is, the Local Government Act requires a Council to take this decision. It must not delegate the decision to a smaller group.

6.7 The appointment process can be reasonably straightforward if it is managed carefully and systematically and supported with appropriate external advice. The LGNZ publication, *Guide for Local Authorities on Hiring and Managing Relationships with the Chief Executive*, provides useful advice.

6.8 The process can become more complex if the local authority has decided to advertise the pending vacancy and the incumbent is applying. Experience has shown that there are several reasons why local authorities and/or chief executives might prefer to go through this full process rather than reappoint the incumbent for the additional shorter term. In practice, incumbents can and do apply.

6.9 In this situation, it is important that the local authority and the chief executive are clear that:

- as an employer, the local authority has to continue to manage and review the performance of the chief executive under their employment agreement; and
- as a recruiter, the local authority has to carry out the selection process in good faith and with a commitment to appointing the best candidate.

6.10 We know that there is sometimes concern about the risk of the first process contaminating the second and creating a risk of bias or predetermination in favour of the incumbent. We discuss in paragraphs 6.11-6.17 that this risk is likely to be manageable from a legal perspective. In particular, the recent High Court decision in *Howe v Keown* (2 September 2011) took a practical approach to what would constitute predetermination in an appointment decision. Against this backdrop, a positive performance review of an incumbent is unlikely to jeopardise an appointment process, if both processes are properly run. In an employment context, proper processes require all those involved to:

- be clear about the process they are in and their role and obligations;
- take legal and human resources advice as needed;
- keep proper records;
- behave professionally; and
- keep personal matters confidential.

What constitutes pre-determination?

6.11 The High Court decision in *Howe v Keown* arose out of Christchurch City Council's process for selecting a chief executive. The council had brought this process forward to avoid a possible change in leadership of the organisation part way through the recovery and rebuilding work needed after the Canterbury earthquakes. Mr Marryatt, the incumbent chief executive, was applying. Mr Howe, a concerned member of the public, sought an injunction to prevent Councillor Keown participating in the decision on who to appoint on the basis that he was not impartial.

6.12 The Judge concluded that Councillor Keown could participate and did not grant the injunction. The judgment contains some useful comment on how to think about bias and predetermination in the context of decision-making by elected councillors.

6.13 The judgment noted that the legal duty in the Act is to be impartial.

> *But partiality should not be confused with holding a strong and legitimate policy* [preference or point of view] *in favour of stability in a crisis, unless an outstanding candidate trumps that value. "Impartiality" is the word used in the Local Government Act and is clearly directed to preventing persons being favoured or disfavoured for inappropriate reasons.*

6.14 The Judge distinguished between a preference for stability, which he regarded as a legitimate policy that is consistent with the requirement to assess the merits of the candidates, and having a closed mind to the possibility of replacing the incumbent, which would amount to predetermination. The fact that the councillor had publicly expressed his satisfaction with the chief executive's performance did not mean that he had a closed mind on the possibility of replacing him.

6.15 The judgment acknowledged that requiring an elected council to make this decision "virtually guarantees that the decision-makers will have formed strong views before the hearing starts". The legislature has deliberately placed this decision in the hands of an elected and political body. "It means that Parliament intends full political accountability by the councillors to the ratepayers for the appointment of the Chief Executive Officer."

6.16 There are many cases where judges have cautioned against applying the law of bias rigorously to decision-making by elected persons. That body of law has developed to prevent corrupt decisions, influenced by fear or favour on the part of the decision-maker, not to limit the proper workings of the democratic process and political accountability.

6.17 This judgment is a useful reminder for the sector that it is not appropriate to automatically translate the general legal rules on bias and pre-determination to decisions being made by an elected body in a political context. It is always important to be careful to ensure that the actions of individual elected members do not undermine proper decision-making. However, the law does not require elected members to have no opinions.

6.18 We comment on these general issues in more detail in Part 5 of our good practice guide, *Guidance for members of local authorities about the Local Authorities (Members' Interests) Act 1968*, published in October 2010.

How chief executives' pay is set and disclosed

6.19 How much chief executives are paid has been a topic of public debate. In a time of concern about the performance of some local authorities, rates increases, and the general economic situation, many citizens have questioned some remuneration packages and pay increases.

6.20 The available guidance on how to set remuneration for a chief executive encourages local authorities to take expert advice on the relevant employment market and salary movements, and to consider longer term questions of retention of good staff, not just the short-term costs. This advice is sound.

6.21 However, it is important for a Council to ensure that it retains responsibility for these decisions, and treats expert advice as no more than an input to its final decision on what is appropriate. Like any employer, a Council will need to consider the organisation's financial situation and general questions of affordability and appropriateness, as well as market movements and performance. The Council has to decide on the right balance between its obligations as a good employer and its obligations to its ratepayers. It has to be ready to be politically accountable to its ratepayers for these decisions.

6.22 The Local Government Act 2002 helps this accountability by requiring the annual report to include information about the pay of each of the mayor or chairperson, the other members of the local authority, and the chief executive. Requests under the Local Government Official Information and Meetings Act 1987 can lead to more detailed information being released. All local authorities should expect that this information will be carefully scrutinised and be ready to justify the decisions made.

6.23 In our view, the focus in these situations should be on the accountability of the council members – acting collectively as the employer – rather than the employee. In the end, the employer decides on the appropriate pay package and should be ready to defend the decision and protect their employee from inappropriate personal criticism.

6.24 It is important for elected members to remember that they are employers with legal obligations to be a good employer and to provide good and safe working environment. It is unlikely to be appropriate to raise concerns about a chief executive's performance or the terms of their employment in public and to make it a matter of political debate. Doing so risks causing harm to the individual and to the local authority's legal position as employer. Concerns that relate to an individual's employment, even if that person is a chief executive, need to be handled carefully, respecting that person's privacy.

6.25 The LGNZ guide comments that:

> *Confidentiality is paramount. It is important to remember in both recruitment and performance management processes that the local authority is dealing with the personal and professional lives of individuals. At times there is a tension between the good employer and confidentiality requirements and the 'political' roles of councillors.*[25]

6.26 Occasionally, a local authority or a chief executive will approach the Auditor-General for advice or ask us to intervene in a difficult situation. We do not generally intervene in individual employment matters. These are best resolved by the employer and employee, supported by expert legal advice. We cannot substitute for that advice, for either party. There are specialist institutions dedicated to dealing with problems in employment relationships.

The relative responsibilities of chief executives and elected members

6.27 The other area of regular concern is the need for elected members and chief executives to have a clear and shared understanding of their different roles and responsibilities. In broad terms, the elected members have a governance role and the chief executive is responsible for managing the organisation. However, in practice it is not always easy to identify where the line falls.

6.28 Throughout the public sector, we see examples of governing bodies playing too limited a role and leaving too much to managers, and examples of governing bodies that get too involved in day-to-day managing. Both situations create risks.

6.29 In the local government sector, the more common risk is that elected members will defer too much to the organisation's professional staff. Particularly when members are new, it can be difficult to know what questions to ask or what reporting to require. Alternatively, the elected members may be so politically divided that they struggle to come together to exercise effective and collective governance.

25 Local Government New Zealand (2008) *Guide for Local Authorities on Hiring and Managing Relationships with the Chief Executive*, page 9.

6.30 In October 2011, Audit New Zealand presented a report to Hamilton City Council on the management of the V8 Supercars Event. Among other things, that report drew attention to the need for:

- important decisions to come to the full council, as early and with as much information as possible;
- councils to insist on full and regular reporting to them on important projects, from inception to completion, so that they are aware of emerging risks;
- councils to ensure that they have enough information to understand the risks and consequences of decisions before they take them, even if that involves "robust enquiry of management" at times;
- managers to operate on a "no surprises" basis with its governance group;
- managers to ensure that reports to council are written in clear and non-technical language so that they can be understood by elected members and the public; and
- councils to maintain a clear, up-to-date delegations policy so that decisions are taken at the right level and properly authorised.

6.31 Overall, the elected members and the chief executive have to establish a working relationship based on respect and trust. Keeping a constructive relationship requires regular communication and open discussion to address any emerging tensions as soon as they arise.

6.32 We encourage all local authorities and their chief executives to periodically consider whether this core relationship is operating well from each of their perspectives, and whether there are any aspects that could be improved.

Part 7
Activities to reduce and manage greenhouse gas emissions

7.1 This Part reports on the extent to which local authorities have:

- measured, reduced, and offset greenhouse gas emissions from their activities in the year ended 30 June 2011; and
- taken a broader approach to, and drawn up plans for, reducing greenhouse gas emissions in their territories, rather than just reducing their own emissions.

7.2 This Part also:

- refers local authorities to our guidance to public entities on the New Zealand Emissions Trading Scheme (ETS), issued in August 2011; and
- includes examples of local authorities' approaches to measuring, reducing, and offsetting greenhouse gas emissions.

7.3 Last year, we reported on these matters for the first time. This year, we have compared this year's results with last year's, where we can. We have been monitoring to see whether local authorities consider the environmental effects of what they do and whether the ETS is making a difference to this.

Background

7.4 The Local Government Act 2002 requires local authorities to promote environmental well-being. There is no explicit requirement for local authorities to measure or reduce the environmental effects of their activities. However, some local authorities have chosen to measure the greenhouse gas emissions for their activities, consider their waste management practices, and act to mitigate the environmental effects of those activities where it makes business sense to do so.

7.5 The three aspects to managing and mitigating greenhouse gas emissions are:

- measuring;
- reducing; and
- offsetting (for unavoidable emissions).

7.6 It is generally accepted that it is preferable to reduce emissions than to offset them.

7.7 Measuring emissions involves collecting information about matters such as fuel use, mileage, electricity/gas consumption, and use of raw materials. Data can then be converted into carbon dioxide equivalents using conversion and emission factors available from agencies such as Landcare Research New Zealand Limited or the Ministry for the Environment.

The New Zealand Emissions Trading Scheme

7.8 In August 2011, we published guidance information on the ETS. Our guidance, *The Emissions Trading Scheme – summary information for public entities and auditors*, provides background information on the scheme and gives public entities and auditors our views on how to account for and audit ETS matters.[26] We published this guidance to inform entities and their auditors about relevant ETS obligations and opportunities, particularly because there are critical deadlines that public entities might need to factor into their financial decision-making and planning in 2012.

7.9 The ETS is relevant to local authorities. As well as bearing price increases for fuel and energy, some local authorities and their CCOs will take part in the scheme because of forestry interests or because they operate landfills.[27]

Waste and the Emissions Trading Scheme

7.10 In 2013, when the waste sector enters the ETS, many local authorities will become participants through their operation of waste disposal facilities. (Under the Climate Change Response Act 2002, the operator of a waste disposal facility must take part in the ETS. We expect that most, if not all, solid waste disposal facilities that local authorities operate will meet this definition.) Operators of waste disposal facilities had to register as ETS participants by 31 January 2012 and will be required to pay a cost per tonne of methane emitted from January 2013.

7.11 Waste disposal operators already have to report their waste tonnage to the Ministry for the Environment to determine the waste disposal levy under the Waste Minimisation Act 2008. Therefore, additional compliance costs to meet the reporting requirements of the ETS should be minimal.

7.12 Local authorities will need to accurately forecast the ETS cost implications to determine any required increase in user charges. They will need to work out the best way to increase the charges. These financial implications should be included in the 2012-22 LTPs.

7.13 In 2011, an expert panel reviewed the ETS. In September 2011, the panel made recommendations to the Government. The panel recommended exempting some types of landfills from the ETS. The Government is considering its response to the panel's recommendations.

26 Section B of this report includes a summary of the content of the guidance information on the ETS.

27 Several local authorities with forests have registered as participants. They include Wellington City Council, Hawkes Bay Regional Council, Mackenzie District Council, Southland District Council, Ashburton District Council, Marlborough District Council, and Kaikoura District Council, and subsidiaries of Dunedin City Council, Invercargill City Council, and Gisborne District Council.

Measuring greenhouse gas emissions

7.14 Nineteen local authorities measure their greenhouse gas emissions. Another seven local authorities intend to start measuring their emissions in 2011/12.

7.15 Most of the local authorities that measure emissions focus on vehicles, air travel, electricity, and waste.

7.16 Some local authorities took part in the voluntary Communities for Climate Protection New Zealand (CCP-NZ) programme, which provided a structured approach for reducing emissions from a local authority's corporate activities (corporate emissions) and district-wide emissions (community emissions). This programme no longer operates, but some local authorities still use action plans introduced under it.

7.17 Some local authorities measure emissions from how employees commute to work, and from buildings and insulation.

7.18 Some local authorities use the greenhouse gas information in a sustainability report in their annual report and/or to get or keep sustainability certifications.

Monitoring and reporting on how local authorities generate and dispose of waste

7.19 Our auditors noted that 24 local authorities monitor and report on the production and disposal of waste that they or their communities generate. This was an increase from last year, when 19 local authorities did this. We set out some examples in paragraphs 7.20-7.23.

7.20 Christchurch City Council promotes information about community waste collected (kerbside organics, recycling, and rubbish) on its website.[28] The information shows the proportion of organics, recycling, and rubbish sent to the landfill over time. The Council also uses the information to show the effect the Council's kerbside wheelie bin service has had on waste.

7.21 For many years, Hamilton City Council has collected waste from its main council office building. The Council collects information on energy and natural gas consumption throughout council-owned and operated facilities to report against waste reduction targets. It reports the results in its annual report.

7.22 Nelson City Council has an agreement to sell landfill gas (methane) to Meridian Energy. Under the agreement, Meridian Energy measures the amount of landfill gas collected and reports the result to the Council. Nelson City Council also completes sustainability monitoring on its fuel, electricity, and water use and includes the results in its LTP and annual report.

28 See http://ccc.govt.nz/homeliving/rubbish/wastestatistics.aspx.

7.23 Northland Regional Council reports on waste sent to landfill and has active recycling programmes for organic and inorganic waste. The objective of these recycling programmes is to minimise waste going to landfill.

Plans to reduce greenhouse gas emissions

7.24 This year, 22 local authorities had a plan to reduce greenhouse gas emissions. This was fewer than last year, when 28 local authorities had a plan or a draft plan.

7.25 Local authorities that took part in the CCP-NZ programme plan to keep working on reducing emissions.

7.26 Paragraphs 7.27-7.32 include examples of what local authorities are doing or planning to reduce greenhouse gas emissions.

7.27 Several local authorities calculate their energy-related emissions using e-Bench, a full energy and utility software and environmental management database system. e-Bench models an organisation's core business (buildings and processes) and allows users to work out how efficiently they use energy and utilities, and how this relates to their core activities.[29]

7.28 Hamilton City Council's Local Action Plan focuses on reducing emissions from the Council's activities and those of the community. The Council's emission reduction activities are included in programmes such as introducing environmental systems at major facilities, trying out energy-efficient street lights, and an internal campaign to use water more wisely. The Council carries out regular audits to identify further opportunities to reduce emissions.

7.29 Nelson City Council has a sustainability co-ordinator, who is responsible for activities and initiatives that the Council has identified as part of its annual plan, and for ensuring that the Council talks with the community about sustainability and reducing waste. The Council's climate change action plan lists tasks for the Council and the community. The sustainability action plan includes involving Council managers, staff, and external partners (including other local authorities and Nelson City Council's CCOs).

7.30 Kapiti Coast District Council's energy policy focuses on reducing emissions from Council activities and within the district. For example, the Council plans to use what it saves from using a boiler fired by wood rather than diesel to dry sewage sludge to pay for energy-efficiency projects (25% on Council projects and 75% on community projects). The Council is preparing a Carbon and Energy Management Strategy that will focus on the Council's activities. Actions to reduce emissions in the wider community are included in the LTP and upcoming economic development strategy. The Council has signed up to be a certified organisation

29 See www.e-bench.com.

under Landcare Research New Zealand Limited's CarboNZero Programme,[30] which requires measuring the local authority's emissions to the ISO 14065 standard.

7.31 In June 2010, Wellington City Council agreed to a Climate Change Action Plan (CCAP). This is the Council's second climate change plan, with the first having been produced in 2007. The CCAP has seven action areas, six of which cover emissions reductions, while the seventh involves preparing for the effects of climate change. The six mitigation areas are buildings and energy, land transport, Council operations, forestry, aviation, and waste. The seven action areas cover emissions from both the wider community and the Council.

7.32 Greater Wellington Regional Council has a Climate Change Mitigation Corporate Action Plan, which includes:

- preparing a Regional Water Strategy with territorial authorities in the Greater Wellington region;
- carrying out regular summer water conservation campaigns; and
- formalising a corporate energy strategy.

7.33 The Council reports on its internal sustainability initiatives from time to time.

Targets for reducing emissions and how these are reported

7.34 A plan to reduce emissions needs targets and measures to assess and report progress. In 2010/11, we noted that 13 local authorities had targets for reducing emissions (in 2009/10, 18 had such targets) and that reporting practices vary. We set out some examples in paragraphs 7.35-7.38.

7.35 Although Waitomo District Council does not have targets for reducing emissions from its landfill, it has informal targets for reducing organic waste sent to the landfill. It reports to the Ministry for the Environment on the quantity of emissions generated from landfill waste.

7.36 Wellington City Council has targets for reducing emissions for the city and for the Council's operations. The emission results are reported internally and externally. For Council emissions, the information is reported internally, following international best-practice standards. Internal reporting for city-wide emissions began during 2010/11, with expert input from external agencies. The same information was reported externally in the statement of service performance in the annual report.

30 See www.carbonzero.co.nz. CarboNZero is the world's first internationally accredited greenhouse gas certification scheme under ISO 14065. CarboNZero-certified organisations have measured their organisation's greenhouse gas emissions so they understand what their effect is on the global climate. They then make a commitment to managing and reducing their greenhouse gas emissions by creating an emissions management and reduction plan. Any remaining emissions that the organisation cannot avoid are then offset by purchasing verified carbon credits.

7.37 Environment Canterbury Regional Council reports its emissions for its vehicle fleet, office electricity, and waste to the landfill in its annual plan and annual report.

7.38 Kaikoura District Council has Green Globe certification, which recognises its commitment to protecting the environment and working towards sustainability for its community.[31] The Council reports its achievement against targets in its annual report and in its Green Globe report. Australian-based Earthcheck Proprietary Limited independently audits the Green Globe benchmark report. Kaikoura District Council also applies the Earthcheck standard, and this is discussed in its annual report:

> *The Earthcheck standard is an international framework for tourism operators and destinations to measure and manage their environmental impact ... the Kaikoura community first measured its environmental impact, called benchmarking, and then adopted and implemented strategies to reduce its impact, called certification.*[32]

Offsetting emissions

7.39 Eleven local authorities are offsetting emissions or plan to, through their forests or plantations. Some local authorities are participating in the ETS through their forestry holdings, but see this as separate from offsetting activities. Others have decided not to offset, but to focus on reducing emissions.

Next steps

7.40 We intend to continue to monitor and report on the activities of local authorities in managing and reducing greenhouse gas emissions, using the year ended 30 June 2010 as a baseline, with a view to reporting to Parliament on:

- the nature and extent of commitment by local authorities to these activities; and
- the effects of the ETS on these activities.

31 See www.greenglobe.com.

32 Kaikoura District Council, *Annual Report 2010/11*, page 8.

Part 8
Managing leaky home liabilities

8.1 In this Part, we:

- provide an overview of leaky home liabilities;
- discuss the Government's Financial Assistance Package (FAP) for homeowners;
- describe the types of claims that local authorities face;
- discuss how leaky home liabilities need to be accounted for; and
- set out the findings of our review of four local authorities' leaky home liabilities.

Overview of leaky home liabilities

8.2 Providing for leaky home liabilities continues to be a major matter for local authorities. Auckland Council, Christchurch City Council, Tauranga City Council, and Wellington City Council are the four local authorities that are most significantly affected.

8.3 We note that, in the recently published *Auckland Council Long-term Plan* for the period 2012 to 2022, which is out for public consultation, Auckland Council has provided for $526 million to meet the estimated costs of leaky home claims during the next 10 years. These costs are to be funded by borrowing, with the repayments spread over 30 years. The repayments of this debt are spread so that the funding requirement does not fall on ratepayers in the year of settlement and so that current ratepayers do not bear the full cost of the settlements.

8.4 As at 30 November 2011, the Department of Building and Housing (DBH) had received 6677 claims lodged for 9262 properties and had completed assessments for 10,128 properties.[33] There were 1837 active claims, affecting a total of 4567 properties. The four local authorities were responsible for 96% of the properties with active claims and 87% of active claims.

8.5 Provision for leaky home liabilities for the four local authorities increased from $477 million[34] in 2009/10 to $510 million in 2010/11, an increase of $37 million or 7.8%. The movement in provisions reflected that the four local authorities are able to estimate their leaky home liabilities more reliably because they have more historical information on which to base their assumptions. As a result, the amount disclosed as contingent liabilities was less compared to 2009/10.

33 See www.dbh.govt.nz/ws-claims.

34 Of this, $454 million related to four of the former Auckland councils: Auckland City Council, North Shore City Council, Rodney District Council, and Waitakere City Council. The provision for all the former councils was $469 million as at 31 October 2010. See our June 2011 report, *Final audits of Auckland's dissolved councils, and managing leaky home liabilities,* page 15.

8.6 In 2011, the Government introduced the FAP to help homeowners repair their homes faster. The four local authorities take part in the FAP. They have tried to factor the FAP's effect into their leaky home liability calculations, even though the scheme was not effective before 30 June 2011.

The Government's Financial Assistance Package

8.7 From 29 July 2011, the FAP became available to homeowners to help to repair homes faster.

8.8 The FAP offers qualifying homeowners a share of the agreed actual cost of repairing leaky homes. The Government and the territorial authority (if the territorial authority is participating in the FAP scheme) each pay 25% of the agreed repair cost and the homeowner pays the remaining half. Under the FAP scheme, the homeowner agrees not to sue the contributing territorial authorities or the Government or any other contributing parties, although homeowners can still pursue other liable non-contributing parties such as builders, developers, and manufacturers of defective products.[35]

8.9 Eligible homeowners must lodge claims with DBH before 29 July 2016. The 10-year limit on lodging a weathertightness claim means that, over time, the number of forecast eligible claims will reduce.

8.10 The Crown has provided $567 million for the FAP. This represents the Government's obligation to contribute 25% of agreed repair costs to eligible owners of leaky homes.[36]

8.11 By late March 2012, 38 territorial authorities had chosen to take part in the FAP; 29 territorial authorities had chosen not to participate.[37]

The kinds of claims that local authorities face

8.12 We identified three categories of claims that local authorities must consider when assessing their current and future exposure to liability for leaky home claims:

- category 1 – claims that have been investigated and reviewed, where the total claim amount and the local authority's share have been confirmed;
- category 2 – claims still being investigated and confirmed, with work to assess whether other available parties will share the liability and work to assess the costs; and
- category 3 – claims that might be made against local authorities between now and the end of the statutory limitation period but that have not been lodged, including issues that homeowners might not yet have identified.

35 Department of Building and Housing, *Annual Report 2010/11*, page 84.

36 *Financial Statements of the Government of New Zealand for the year ended 30 June 2011*, page 121.

37 See www.dbh.govt.nz/fap.

8.13 Categories 2 and 3 continue to be of most concern to local authorities because of the associated uncertainty. However, local authorities now have more historical information from recent claims and are able to more reliably estimate their liabilities from future claims.

Accounting for leaky home liabilities

8.14 The accounting standard that applies to leaky home liabilities is New Zealand Equivalent to International Accounting Standard 37: *Provisions, Contingent Liabilities and Contingent Assets* (NZ IAS 37). This standard provides the definitions and criteria to identify whether a liability should be accounted for as a provision or disclosed as a contingency. The most relevant element of the criteria for leaky home liabilities is assessing whether a liability that needs to be estimated can be calculated reliably enough to meet the definition of a provision.

8.15 Our guidance to auditors on the appropriate accounting treatment of claims was:

- category 1 – a provision for the confirmed amount should be recorded in the financial statements;
- category 2 – a provision for the estimated amount should be recorded in the financial statements; and
- category 3 – a provision should be recorded in the financial statements if an actuarial assessment has been obtained and is reliable; otherwise it should be disclosed as a contingent liability.

8.16 Our monitoring of the sector up to 2009/10 found that identifying category 2 and category 3 claims was more difficult for local authorities than we had anticipated when we wrote our guidance. In our guidance, we assumed that an actuarial assessment, particularly if carried out by professional actuaries, would be enough to meet the requirements of NZ IAS 37 and allow accounting for the liability in the financial statements.

8.17 We found that, in many instances, the estimation processes used to assess liabilities for category 2 and 3 claims, whether done in-house or by a professional actuary, were not reliable enough to allow the resulting estimation to be accounted for as a provision in the financial statements. The argument to support this approach has been that the estimation processes were not reliable enough, because too many variables apply to each leaky home.

Our review of how four local authorities accounted for leaky home liabilities

8.18 The four local authorities collectively increased their provision by $37 million between 2009/10 and 2010/11. This was largely because Wellington City Council included $24.4 million for future claims for weathertightness issues that had not yet been identified or reported in its provision calculation. These claims were previously recognised as an unquantified contingent liability. Historical data on previous claims, homes that may experience weathertightness problems, and the percentage of homeowners likely to make a successful claim have allowed Wellington City Council to make a more accurate actuarial calculation of its leaky home liabilities.

8.19 Because of uncertainty about earthquakes, Christchurch City Council did not do an actuarial assessment of its leaky home liabilities at 30 June 2011. The Council calculated its provision based on the estimated cost of known claims outstanding and based on the average actual settlement costs. Its provision for leaky home liabilities increased by only $292,000 compared to the previous year to reach $3.5 million.

8.20 Auckland Council's total provision for 2010/11 was $456 million. Of this amount, $145 million related to claims that were being managed through a resolution process. (These were category 1 claims – that is, claims that are nearing resolution and whose claim amount is more certain.) The remaining $311 million reflected claims that have been reported to the Council or the Weathertight Homes Resolution Service (WHRS) and claims that are expected to be notified in the future. Auckland Council completed an actuarial valuation on its leaky home liabilities and included extensive disclosure of the assumptions applied in calculating its provision amount.

8.21 As outlined in paragraph 8.18, Wellington City Council changed its treatment of unreported claims from an unquantifiable contingent liability ($24 million) to a provision. Wellington City Council's total provision of $50 million reflected the potential net settlement of all known claims, including those Claims the council is managing and claims that have been lodged with the WHRS but are not yet being managed.

8.22 Tauranga City Council has a provision for claims under the WHRS of $0.5 million and a provision for claims under the FAP of $3.5 million. The $3.5 million provision reflected only higher-risk claims eligible under the FAP scheme due to the uncertainty surrounding this provision. The provision was based on an actuarial calculation.

8.23 Tauranga City Council was the only significantly affected local authority to record a quantified contingent liability of $1.1 million for less certain claims. Christchurch City Council and Wellington City Council disclosed unquantifiable contingent liabilities for unknown potential claims, as they could not be reliably estimated. In its contingent liability disclosures, Auckland Council did not include any disclosure on leaky home liabilities.

8.24 In terms of disclosure, Auckland Council[38] and Wellington City Council[39] were more extensive in their disclosures about the calculation of the leaky homes provision than Tauranga City Council. However, Tauranga City Council's disclosures did improve compared to 2009/10.[40] We continue to encourage local authorities to improve the way they disclose information about the calculation and assumptions surrounding leaky home liabilities, including the effect on calculations of changes to the assumptions – such as the information that was reflected in Auckland Council's and Christchurch City Council's 2010/11 annual reports.

38 Auckland Council, *Annual Report 2010/11*, pages 275 and 276.

39 Wellington City Council, *Annual Report 2010/11*, pages 52 and 53.

40 Tauranga City Council, *Annual Report 2010/11*, pages 178, 200, and 201.

Part 9

Non-standard audit reports

9.1 During the year ended 31 December 2011, we issued 642 audit reports for public entities in the local government sector.[41] Of these, 517 audit reports were standard. In this Part, we discuss the 125 non-standard audit reports that we issued on the financial and non-financial information of those entities.

Why we report this information

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

9.3 In each instance, the issues underlying a non-standard audit report are drawn to the attention of the entity and discussed with its governing body or chief executive.

What is a non-standard audit report?

9.4 A non-standard audit report[42] contains:

- a modified opinion; and/or
- an "emphasis of matter" or an "other matter" paragraph.

9.5 The auditors we appoint to audit public entities will express a **modified opinion** because of:

- a misstatement about the treatment or disclosure of a matter in the financial and/or non-financial information; or
- a limitation in scope because the appointed auditor has been unable to obtain enough appropriate evidence to support, and so is unable to express, an opinion on the financial and/or non-financial information or a part of the financial and/or non-financial information.

9.6 There are three types of modified opinion:

- an "adverse" opinion (see paragraphs 9.10-9.11);
- a "disclaimer of opinion" (see paragraphs 9.16-9.17); and
- a "qualified opinion" (see paragraphs 9.22-9.24).

41 We report separately on schools and tertiary education institutions, and non-education entities in the central government portfolio, in our yearly reports on the results of those audits.

42 A non-standard audit report is issued in keeping with International Standard on Auditing (New Zealand) 705: *Modifications to the Opinion in the Independent Auditor's Report* and/or International Standard on Auditing (New Zealand) 706: *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*.

9.7 The appointed auditor will include an "emphasis of matter" paragraph (see paragraph 9.34) or "other matter" paragraph (see paragraph 9.48) in the audit report to draw attention to matters such as:

- fundamental uncertainties;
- breaches of law; or
- concerns about probity or financial prudence.

9.8 The appointed auditor must include an "emphasis of matter" paragraph or an "other matter" paragraph in the audit report in such a way that readers cannot mistake it for a modified opinion.

9.9 Figure 17 outlines the decisions that an appointed auditor has to make when considering the appropriate form of the audit report.

Adverse opinions

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

9.11 An adverse opinion is expressed when the appointed auditor, having got enough appropriate audit evidence, concludes that misstatements, individually or in aggregate, are both material and pervasive to the financial and/or non-financial information.

9.12 During 2011, we expressed an adverse opinion on the financial or non-financial information of seven public entities.

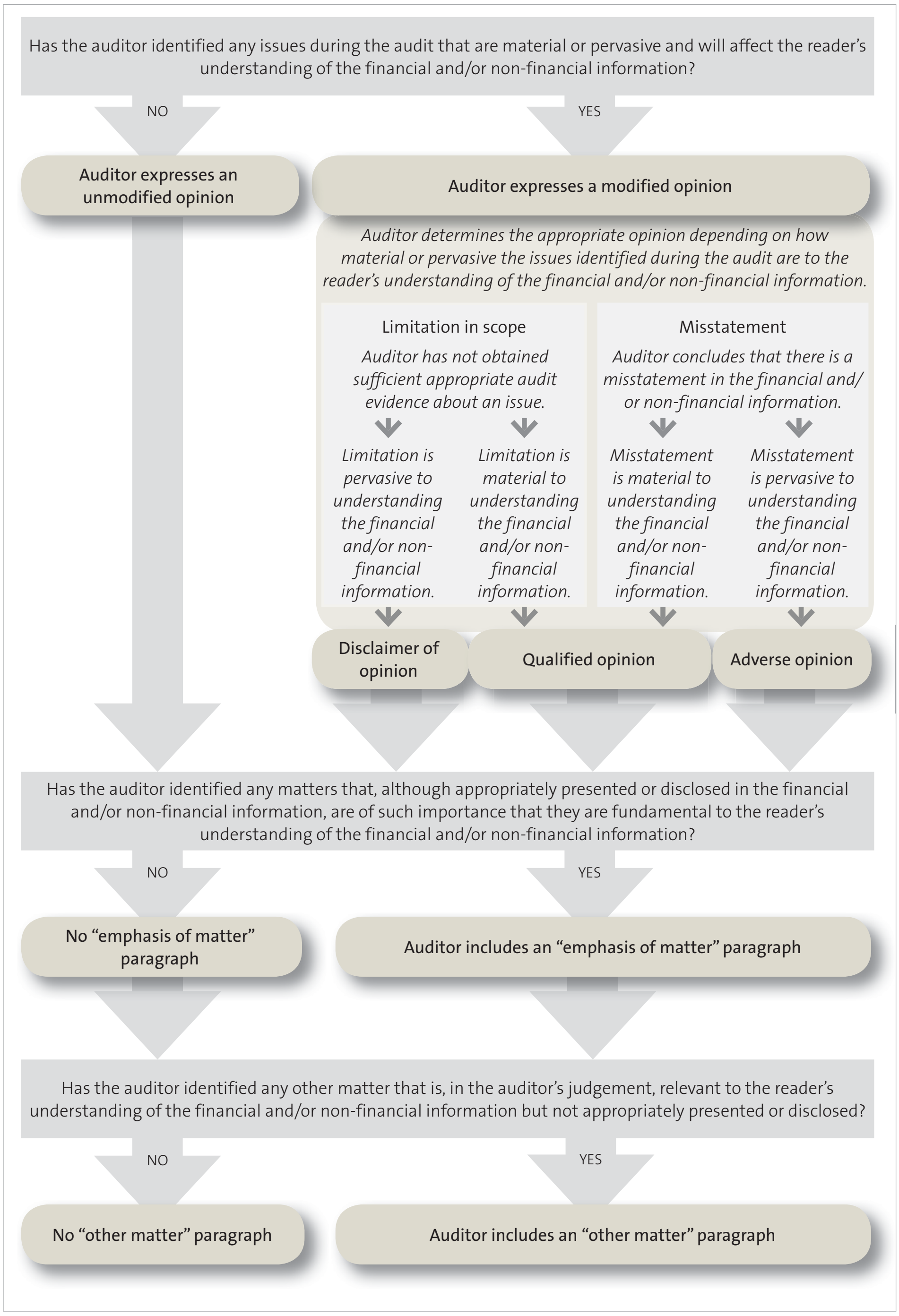
9.13 In a breach of the financial reporting standards, four entities did not recognise their collection assets or the associated depreciation expense from their financial statements:

- Southland Museum and Art Gallery Trust Board Incorporated (an entity associated with Gore District Council, Invercargill City Council, and Southland District Council);
- Far North Regional Museum Trust (a trust controlled by Far North District Council);
- Otago Museum Trust Board; and
- Pukaki Trust.

9.14 Three entities did not report performance information that reflected the entity's achievements measured against its performance targets, reporting that the Local Government Act 2002 requires:

- Crops for Southland Incorporated Society (an entity associated with Gore District Council, Invercargill City Council, and Southland District Council);

Figure 17
Deciding on the appropriate form of the audit report



Note: This flowchart is based on the requirements of New Zealand equivalents to the International Standards on Auditing: No. 700: *Forming an Opinion and Reporting on Financial Statements*; No. 705: *Modifications to the Opinion in the Independent Auditor's Report*; and No. 706: *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*.

- New Zealand Food Innovation (Manukau) Limited (a subsidiary of Auckland Council); and
- Dunedin (New Zealand) Masters Games Trust (a trust controlled by Dunedin City Council).

9.15 Appendix 2 sets out the details of these adverse opinions.

Disclaimers of opinion

9.16 A disclaimer of opinion is expressed when the appointed auditor cannot get enough appropriate audit evidence on which to base the opinion (a limitation in scope), and concludes that the possible effects on the financial and/or non-financial information of undetected misstatements, if any, could be material and pervasive.

9.17 A disclaimer of opinion is expressed when, in extremely rare circumstances involving multiple uncertainties, the appointed auditor concludes that, despite having obtained enough appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements and/or non-financial information because of the potential interaction of the uncertainties and their possible cumulative effect on the financial and/or non-financial information.

9.18 During 2011, we expressed disclaimers of opinion on the financial or non-financial information of eight public entities.

9.19 As a result of the Canterbury earthquakes, we could not form an opinion about the financial statements (other than the cash-flow statement) for the Christchurch City Council and group, and Tuam Limited (a subsidiary of Christchurch City Council).

9.20 We were unable to form an opinion on some or all of the balances in the financial statements of six entities because we could not get appropriate audit evidence to confirm those balances:

- Curries Proprietary Limited (a subsidiary of Christchurch City Council);
- Whatitiri Domain Board (year ended 30 June 2008);
- Ongarue Hall Society Incorporated (year ended 30 June 2006);
- Oakura Reserve Board (five years ended 30 June 2004, 30 June 2005, 30 June 2006, 30 June 2007, and 30 June 2008);
- Ohingaiti Cemetery (year ended 31 March 2010); and
- Hawea Cemetery Trust (four years ended 31 March 2007, 31 March 2008, 31 March 2009, and 31 March 2010).

9.21 Appendix 2 sets out the details of these disclaimers of opinion.

Qualified opinions

9.22 A qualified opinion is expressed when the appointed auditor, having enough appropriate audit evidence, concludes that misstatements, individually or in aggregate, are material, but not pervasive, to the financial and/or non-financial information.

9.23 A qualified opinion is expressed when the appointed auditor cannot get enough appropriate audit evidence on which to base the opinion, but concludes that the possible effects on the financial and/or non-financial information of undetected misstatements, if any, could be material but not pervasive.

9.24 In addition, a qualified opinion is expressed when the appointed auditor concludes that a breach of statutory obligations has happened and that the breach is material to the reader's understanding of the financial and/or non-financial information.

9.25 During 2011, we expressed qualified opinions on the financial or non-financial information of 27 public entities.

9.26 Tauranga Art Gallery Trust (a trust of Tauranga City Council) did not recognise its art works at fair value. This is a departure from NZ IAS 16: *Property, Plant and Equipment*.

9.27 Mt Wellington Licensing Trust and Group did not prepare group financial statements to consolidate the financial statements of its subsidiary. This is a departure from NZ IAS 27: *Consolidated and Separate Financial Statements*.

9.28 Our audit of Waimakariri District Council and group was limited because we could not get enough evidence to confirm certain balances and effects of the Canterbury earthquakes. Our "limitation of scope" opinion affected the service performance information reported in the annual report.

9.29 For Grey District Council, we could not get enough appropriate evidence to support reported performance of a particular performance measure.

9.30 The comparative information for Manukau Building Consultants Limited (a subsidiary of Manukau City Council) was limited because, for the year ended June 2009, we were unable to determine the effect of an adjustment made to regulatory fee income between 2008 and 2009.

9.31 We referred reader's attention to the disclosures of Manukau Buildings Consultants Limited and Auckland Regional Transport Network Limited and group (a subsidiary of Auckland City Council) that their financial statements were prepared on a dissolution basis.

9.32 In a departure from the Local Government Act 2002, the following three entities did not report performance information that reflected their achievements against performance targets:

- Auckland Regional Transport Network Limited and group (a subsidiary of Auckland City Council);
- Te Ahu Charitable Trust (a trust of Far North District Council); and
- Kaikoura Enhancement Trust and group (Kaikoura District Council).

9.33 For 19 entities, we could not get enough assurance about the completeness of revenue and/or expenditure (see Appendix 2).

"Emphasis of matter" paragraphs

9.34 In certain circumstances, it may be appropriate for the appointed auditor to include additional comments in the audit report to draw readers' attention to a matter that, in the appointed auditor's professional judgement, is fundamental to the reader's understanding of the financial and/or non-financial information. The additional comments will be included in the audit report in an "emphasis of matter" paragraph, provided the appointed auditor has enough appropriate audit evidence that the matter is not materially misstated in the financial and/or non-financial information.

9.35 During 2011, we used 11 main types of "emphasis of matter" paragraphs for the public entities that we cover in this report.

9.36 The first type of "emphasis of matter" paragraph drew attention to the dissolution basis being used appropriately when public entities were dissolved and their functions, duties, and powers were transferred to Auckland Council on 1 November 2010. The following public entities' audit reports included such "emphasis of matter" paragraphs:

- Auckland City Council and group;
- Auckland Regional Council and group;
- Manukau City Council and group;
- North Shore City Council and group;
- Papakura District Council and group;
- Rodney District Council and group;
- Waitakere City Council and group;
- Franklin District Council;
- Aotea Centre Board of Management (a subsidiary of Auckland City Council);
- ARTNL Britomart Limited (a subsidiary of Auckland City Council);

- Auckland Tourism and Visitors Trust (a trust of Auckland City Council);
- Metrowater Limited and group (a subsidiary of Auckland City Council);
- Sea + City Projects Limited (a subsidiary of Auckland City Council);
- Tomorrow's Manukau Properties (Flat Bush) Limited (a subsidiary of Auckland City Council);
- Tomorrow's Manukau Properties Limited and group (a subsidiary of Auckland City Council);
- Auckland Regional Holdings and group (a subsidiary of Auckland Regional Council);
- Auckland Regional Transport Authority (a subsidiary of Auckland Regional Council);
- Manukau Leisure Services Limited (a subsidiary of Manukau City Council);
- Manukau Water Limited (a subsidiary of Manukau City Council);
- Manukau Enterprise and Employment Trust (a trust of Manukau City Council);
- NSC Holdings Limited (a subsidiary of North Shore City Council);
- Enterprise North Shore Trust (a trust of North Shore City Council);
- Rodney Properties Limited (a subsidiary of Rodney District Council);
- Waitakere City Holdings Limited and group (a subsidiary of Waitakere City Council);
- Waitakere Enterprise Trust Board (a trust of Waitakere City Council);
- Waitakere Properties Limited (a subsidiary of Waitakere City Council); and
- Franklin Art, Culture and Library Trust (a trust of Franklin District Council).

9.37 The second type of "emphasis of matter" paragraph drew attention to the disclosures about the new local government structure for Auckland. The following public entities' audit reports included such "emphasis of matter" paragraphs:

- City of Manukau Education Trust (a trust of Manukau City Council);
- Manukau Beautification Charitable Trust (a trust of Manukau City Council); and
- Pakuranga Arts and Cultural Trust (a trust of Manukau City Council).

9.38 The third type of "emphasis of matter" paragraph drew attention to fundamental uncertainties about the validity of the "going concern" assumption. The following public entities' audit reports included such "emphasis of matter" paragraphs:

- Central Plains Water Trust (a trust established by Selwyn District Council and Christchurch City Council);
- Ruawhata Public Hall Board (three years ended 30 June 2008, 30 June 2009, and 30 June 2010;

- Grow Wellington Limited and group (a subsidiary of Greater Wellington Regional Council); and
- Creative HQ Limited (a subsidiary of Greater Wellington Regional Council).

9.39 The fourth type of “emphasis of matter” paragraph drew attention to uncertainties about outstanding claims provision and reinsurance, and the appropriateness of the going concern assumption. The audit report of New Zealand Mutual Liability Riskpool included such an “emphasis of matter” paragraph.

9.40 The fifth type of “emphasis of matter” paragraph drew attention to the financial difficulties of the local authority resulting from a material uncertainty on its subsidiary’s ability to continue as a going concern because of the downturn in the road-building industry. The audit reports of Waitomo District Council and its subsidiary, Inframax Construction Limited, included such “emphasis of matter” paragraphs.

9.41 The sixth type of “emphasis of matter” paragraph related to the “going concern” assumption being appropriately not used because public entities were disestablished or expected to be disestablished soon. The following public entities’ audit reports included such “emphasis of matter” paragraphs:

- Bay Broadband Limited;
- Cranberries New Zealand Limited;
- Dunedin Transport Limited (formerly Citibus Limited) (a subsidiary of Dunedin City Council);
- Forever Beech Limited;
- St James Theatre Charitable Trust and group (a trust of Wellington City Council);
- St James Theatre Limited (a subsidiary of Wellington City Council);
- Whangarei Tourism Trust (a trust of Whangarei District Council);
- Mana Taverns Limited;
- Local Government Industry Training Organisation;
- Southland Flood Relief Fund;
- The Trusts Charitable Foundation Incorporated; and
- Rangitikei Mayoral Relief Trust (a trust of Rangitikei District Council).

9.42 The seventh type of “emphasis of matter” paragraph drew attention to the effects of the Canterbury earthquakes on the financial and non-financial performance. The audit report for Orion New Zealand Limited and group (a subsidiary of Christchurch City Council) included such an “emphasis of matter” paragraph.

9.43 The eighth type of “emphasis of matter” paragraph drew attention to the enhanced performance measures and targets adopted by the entity. The audit report for Central Otago District Council included such an “emphasis of matter” paragraph.

9.44 The ninth type of “emphasis of matter” paragraph drew attention to the provision that a Board recognised for unseen repairs and maintenance that did not meet the definition of a liability but that was not material to the financial statements as whole. The audit report for South Port New Zealand Limited and group (a subsidiary of Environment Southland) included such an “emphasis of matter” paragraph.

9.45 The tenth type of “emphasis of matter” paragraph drew attention to the absence of a statement of performance because the entity is inactive. The following public entities’ audit reports included such “emphasis of matter” paragraphs:

- Dunedin Venues Limited (a subsidiary of Dunedin City Council – two years ended 30 June 2010 and 30 June 2011);
- Novus Contracting Limited (a subsidiary of South Taranaki District Council); and
- Waikato District Community Wellbeing Trust (a trust of Waikato District Council – one-month period ended 30 June 2010 and year ended 30 June 2011).

9.46 The eleventh type of “emphasis of matter” paragraph drew attention to a breach of statutory obligation that was disclosed by the entity in its financial statements. The audit report of North Shore Domain and North Harbour Stadium Trust Board (a trust of North Shore City Council) included such an “emphasis of matter” paragraph.

9.47 Appendix 2 contains more information about the “emphasis of matter” paragraphs that were included in audit reports.

“Other matter” paragraphs

9.48 In certain circumstances, it may be appropriate for the appointed auditor to communicate a matter that is not adequately presented or disclosed in the financial and/or non-financial information because, in the appointed auditor’s professional judgement, the matter is relevant to readers’ understanding of the financial and/or non-financial information. The additional comments will be included in the audit report in an “other matter” or similarly titled paragraph.

9.49 There were no “other matter” paragraphs in the audit reports of the public entities that we cover in this report.

Appendix 1
Reported effects of the Canterbury earthquakes

This Appendix summarises the effect on operating revenue and expenditure and capital expenditure of the Canterbury earthquakes on the five closest local authorities, as reported in their 2010/11 annual reports. The five local authorities closest to the largest earthquakes' epicentres were Christchurch City Council, Environment Canterbury Regional Council, Hurunui District Council, Selwyn District Council, and Waimakariri District Council.

For the five local authorities, we have not set out all of their disclosures about the effects of the earthquakes. The local authorities' annual reports should be read for the full account of the effects.

Christchurch City Council and group

Operating revenue ($million)	Operating expenditure ($million)	Capital expenditure ($million)
351.8	85.3	>12

Annual report commentary on damage to assets

Christchurch City Council states that the:

> *... 29 September estimate of the cost to replace or repair destroyed or damaged assets was $2.4 billion, plus 27 percent or minus 25 percent. To this needs to be added the $0.2 billion of damage to buildings, alongside with the as yet un-calculated cost of land remediation. When the cost of maintaining temporary services (the interim repair and maintenance of assets prior to the permanent rebuild) is excluded, the cost of the damage to Council assets is estimated to be $2.4 billion, plus 26 percent or minus 25 percent (more than $0.5 billion).*

See Christchurch City Council's disclosures on the effect of the earthquakes, specifically on pages 138-143 of its annual report and in the financial highlights section of the annual report (pages 124-129).

We issued a disclaimer of opinion on Christchurch City Council and group's financial statements, other than the statement of cash flows, because of the effect of the Christchurch earthquakes on property, plant, and equipment.

Christchurch City Council disclosed that $54 million has been recognised in the financial statements for the write-off and impairment of earthquake-damaged assets. The $2.4 billion estimated damage has not been recognised because it is not reliable enough, and as yet there is not enough information to appropriately account for the damage caused.

Environment Canterbury Regional Council

Operating revenue ($million)	Operating expenditure ($million)	Capital expenditure ($million)
4.2	14.8	>5.5

The estimated cost to Environment Canterbury Regional Council of the earthquakes has been about $4.5 million of direct operating costs, plus the damage to Environment Canterbury Regional Council's assets, which amounts to $12.6 million.

The Kilmore Street office complex was also badly damaged, with the Aoraki building to be demolished and the Pegasus and Waitaha buildings unable to be used. The state of the Pegasus building has not been determined, because only limited access has been allowed since February 2011.

We refer readers to Environment Canterbury Regional Council's disclosures on the effect of the earthquakes in its annual report and specifically on pages 39, 49-50, 54, and 59.

We issued an unmodified opinion on Environment Canterbury Regional Council's financial statements and service provision.

Hurunui District Council

Hurunui District Council provided no specific disclosure about the financial effect of the Canterbury earthquakes.

We issued an unmodified opinion on the Hurunui District Council and group's financial statements and service provision.

Selwyn District Council and group

Operating revenue ($million)	Operating expenditure ($million)	Capital expenditure ($million)
5.6	2.6	2.8

Selwyn District Council disclosed that:

> *By the end of the financial year the Council had incurred costs of $4.8 million on repairing damaged assets and it estimates that the total cost to repair its damaged assets is $7.2 million.*

We refer readers to Selwyn District Council and group's disclosures on the effect of the earthquakes in its annual report, specifically on pages 125-126.

We issued an unmodified opinion on the Selwyn District Council and group's financial statements and service provision.

Waimakariri District Council

Operating revenue ($million)	Operating expenditure ($million)	Capital expenditure ($million)
13.6	8.7	13.8

Waimakariri District Council disclosed that the damage its property, plant, and equipment, and infrastructural assets has been accounted for in the financial statements by recognising a $60.1 million impairment against these assets.

We refer readers to Waimakariri District Council's disclosures on the effect of the earthquakes in its annual report, specifically on pages 125 and 165.

We issued a qualified opinion on the Waimakariri District Council and group's financial statements and service provision information, other than the statement of cash flows, because of the effect of the Christchurch earthquakes on property, plant, equipment, and infrastructural assets.

Appendix 2
Details of the non-standard audit reports issued in 2011

Adverse opinions

These details relate to non-standard audit reports issued during the 2011 calendar year. Where an entity is directly controlled by, or associated with, one or more city, district, or regional councils, we have listed them in brackets.

Southland Museum and Art Gallery Trust Board (Gore District Council, Invercargill City Council, and Southland District Council)

Financial statements year ended: 30 June 2011

We disagreed with the Trustees not recognising the museum's collection, or the associated depreciation expense, in the Trust's financial statements. These are departures from New Zealand Equivalent to International Accounting Standard 16: *Property, Plant and Equipment* (NZ IAS 16). NZ IAS 16 requires museum collections to be recognised and depreciated as assets in the financial statements during their useful lives.

Far North Regional Museum Trust (Far North District Council)

Financial statements year ended: 30 June 2009

We disagreed with the Trustees not recognising the museum's collection, or the associated depreciation expense, in the Trust's financial statements. These are departures from Financial Reporting Standard No. 3: *Accounting for Property, Plant and Equipment* (FRS 3). FRS 3 requires museum collections to be recognised and depreciated as assets in the financial statements during their useful lives.

Otago Museum Trust Board

Financial statements year ended: 30 June 2011

We disagreed with the Trustees not recognising the museum's collection, or the associated depreciation expense, in the Trust's financial statements. These are departures from New Zealand Equivalent to International Accounting Standard 16: *Property, Plant and Equipment* (NZ IAS 16). NZ IAS 16 requires museum collections to be recognised and depreciated as assets in the financial statements during their useful lives.

Pukaki Trust

Financial statements year ended: 30 June 2010

We disagreed with the Trustees not recognising the artworks in the Trust's financial statements. This is a departure from New Zealand Equivalent to International Accounting Standard 16: *Property, Plant and Equipment* (NZ IAS 16). NZ IAS 16 requires the artworks to be recognised and depreciated as assets in the financial statements during their useful lives.

Crops for Southland Incorporated Society (Gore District Council, Invercargill City Council, and Southland District Council)

Financial statements year ended: 30 June 2011

We disagreed with the Society not reporting performance information that reflected the Society's achievements, measured against its performance targets. Doing so is required by the Local Government Act 2002.

New Zealand Food Innovation (Manukau) Limited (Auckland Council)

Financial statements and statements of service performance year ended: 30 June 2011

We disagreed with the company not reporting performance information that reflected the company's achievements, measured against its performance targets. Doing so is required by the Local Government Act 2002.

Dunedin (New Zealand) Masters Games Trust (Dunedin City Council)

Financial statements and statements of service performance year ended: 30 June 2011

We disagreed with the Trust not reporting performance information that reflected the Trust's achievements, measured against its performance targets. Doing so is required by the Local Government Act 2002. Our audit was limited because we were unable to obtain enough evidence to confirm the revenue for the previous year and use it as a comparator (the Trust had limited controls over the previous year's revenue).

Disclaimers of opinion

Christchurch City Council and group

Annual report year ended: 30 June 2011

We were unable to form an opinion on the Council and group's financial statements as a whole, other than the statement of cash flows, because of the significant damage to the Council's assets caused by the Canterbury earthquakes. The Council could not account for the impact of the earthquakes' on its assets because it could not estimate the effect with enough reliability when the audit was carried out. However, the Council did disclose that the earthquakes had affected its assets and why it could not reflect that effect in the financial statements.

Specifically, we could not get enough assurance:

- that the value of the property, plant, and equipment assets (valued at fair value) was correct, because there was no market evidence available to perform a revaluation in keeping with the requirements of New Zealand Equivalent to International Accounting Standard 16: ***Property, Plant and Equipment*** (NZ IAS 16);
- that there had not been a material movement in the replacement costs for infrastructure assets (valued using depreciated replacement cost) because no revaluations could be performed and appropriate replacement cost rates could not be determined with enough reliability; and
- to support the impairment losses and property, plant, and equipment values of the Council's subsidiary Vbase Limited (which is included in the group financial statements, and Vbase Limited's assets were substantially damaged by the earthquakes).

Our audit was also limited because we could not get enough audit evidence to support the "what did it cost" sections of the other information and the associated variance explanations.

We could issue an unmodified opinion on the Council and group's statement of cash flows.

Although we could not form an opinion on the Council and group's financial statements as a whole, other than the statement of cash flows, we provided assurance that we got enough appropriate audit evidence for the information included in the financial statements. The exceptions to this were the:

- carrying amount of property, plant, and equipment, asset revaluation reserves, and retained earnings in the balance sheet;
- related impairment losses, loss on disposals, and depreciation charged to the profit/loss in the statement of comprehensive income; and
- related property, plant, and equipment valuation gains/losses and the impairment losses charged to other comprehensive income in the statement of comprehensive income.

The audit report outlined that the Council and group reported non-financial performance information even though the Canterbury Earthquake (Local Government Act 2002) Order 2011 removed the requirement in the Local Government Act 2002 for that information to be reported. We did not audit the non-financial performance information, because it did not have to be reported.

Tuam Limited (Christchurch City Council)

Financial statements and statement of service performance year ended: 30 June 2011

We could not form an opinion on the financial statements and the statement of service performance, other than the cash flow statement, because we could not carry out adequate audit procedures to work out the effect of the Canterbury earthquakes on those statements. Specifically:

- the extent of earthquake damage suffered by the properties was unknown because of restrictions on access to properties;
- the investment properties could not be revalued as required by New Zealand Equivalent to International Accounting Standard 16: Property, Plant and Equipment (NZ IAS 16) because the independent valuer advised that there was no market evidence to support a reliable fair value for the properties as at 30 June 2011;
- any adjustment to the fair value of investment properties as a result of earthquake damage would affect the surplus/deficit for the year; and
- the tax treatment of investment properties depends on their future use and that use was unknown because of the uncertainties around the extent of earthquake damage. Therefore, current and deferred tax balances associated with the investment properties could not be determined easily.

Curries Proprietary Limited (Christchurch City Council)

Financial statements 15-month period ended: 30 June 2011

We were unable to form an opinion on the company's statement of comprehensive income and the statement of changes in equity because we were unable to obtain enough appropriate audit evidence to confirm the balances in the statement of financial position as at 31 March 2010. This limitation in scope occurred because the company had not been audited in the previous period, and we were unable to gain access to the accounting records for the previous period.

Whatitiri Domain Board

Financial statements year ended: 30 June 2008

We were unable to form an opinion on the financial statements of the Board because we were unable to obtain enough assurance about the completeness of revenue (because the Board had limited controls over that revenue). We were also unable to determine whether all payments recorded in the statement of financial performance had been properly incurred or correctly classified because there was inadequate supporting documentation for the Board's expenditure.

Ongarue Hall Society Incorporated

Statement of accounts year ended: 30 June 2006

We were unable to form an opinion on the financial statements of the Society because we were unable to obtain enough assurance about the completeness of revenue (because the Society had limited controls over that revenue). We were also unable to get enough appropriate audit evidence to support all expenditure and to confirm transactions that occurred during the period from July 2005 to 30 May 2006 because the bank statements for that period were lost.

Oakura Reserve Board

Financial statements year ended: 30 June 2004

We were unable to form an opinion on the financial statements of the Board because:

- we were unable to obtain representations about certain material matters that the Board is responsible for;
- we were unable to obtain enough assurance about the completeness of revenue (because the Board had limited controls over that revenue); and
- budgeted figures were not included in the statements of financial performance, financial position, and cash flows, even though including them is a requirement of the Public Finance Act 1989.

Oakura Reserve Board

Financial statements years ended: 30 June 2005, 30 June 2006, 30 June 2007, and 30 June 2008

We could not form an opinion on the financial statements of the Board because:

- we could not get representations about certain material matters that the Board is responsible for;
- we could not get enough assurance about the completeness of revenue (because the Board had limited controls over that revenue); and
- budgeted figures were not included in the statements of financial performance, financial position and cash flows, even though including them is a requirement of the Public Finance Act 1989.

We noted that our previous year's audits were limited because we could not provide assurance about the comparative information.

Ohingaiti Cemetery

Statement of accounts year ended: 31 March 2010

We could not form an opinion on the statement of accounts because we could not verify some revenue (because the Trustees had limited controls over that revenue). We could not work out whether all payments recorded in the statement of accounts had been incurred properly or classified correctly. We noted a breach of the Burial and Cremation Act 1964 because the Trustees failed to keep a register of burials.

Hawea Cemetery Trust

Statement of accounts years ended: 31 March 2007, 31 March 2008, 31 March 2009, and 31 March 2010

We could not form an opinion on the statement of accounts because we could not get enough appropriate audit evidence (because the Trustees did not retain all bank statements and other accounting records). We could not work out which receipts and payments happened during the year. We noted a breach of the Burial and Cremation Act 1964 because the Trustees failed to keep full accounts of all money received and spent.

Qualified opinions

Tauranga Art Gallery Trust (Tauranga City Council)

Financial statements and statement of service performance year ended: 30 June 2011

We disagreed with the Board not recognising the artworks of the Trust at fair value. This departs from New Zealand Equivalent to International Accounting Standard 16: *Property, Plant and Equipment* (NZ IAS 16), which requires entities to measure items of property, plant, and equipment at fair value and to carry out revaluations with enough regularity to ensure that revalued items are not included at a value that is materially different to their fair value.

Mt Wellington Licensing Trust and group

Financial statements year ended: 31 March 2008

We disagreed with the Trustees not preparing group financial statements to consolidate the financial statements of its subsidiary, Mt Wellington Charitable Trust. This departs from the New Zealand Equivalent to International Accounting Standard 27: *Consolidated and Separate Financial Statements* (NZ IAS 27). NZ IAS 27 requires an entity that has one or more subsidiaries at its reporting date to prepare consolidated financial statements for the group, including the parent and all of its subsidiaries.

Waimakariri District Council and group

Annual report year ended: 30 June 2011

Our audit was limited because we could not get enough audit evidence to confirm the:

- carrying value of property, plant, and equipment and infrastructural assets;
- impairment charged to the revaluation reserves and surplus/deficit; and
- associated effects of damage to the above from the Canterbury earthquakes.

This limitation in scope also affected the service provision information reported by the Council. We issued an unmodified opinion on the Council and group's statement of cash flows and other schedule 10 information.

Grey District Council

Annual report year ended: 30 June 2011

Our audit was limited because we could not get enough appropriate audit evidence to support the Council's estimates of the time it took to respond to various ratepayers' complaints and requests for service. The Council did not collect data for this performance measure.

Manukau Building Consultants Limited (Manukau City Council)

Financial statements and performance information 16-month period ended: 31 October 2010

Our audit of the comparative information was limited because, for the year ended 30 June 2009, we could not work out the effect of an adjustment made to regulatory fee income between 2008 and 2009. We drew attention to the disclosures in the financial statements that referred to the dissolution basis being used appropriately in preparing the financial statements because, on 1 November 2010, the Local Government (Tamaki Makaurau Reorganisation) Act 2009 dissolved Manukau Building Consultants Limited and vested its assets and liabilities in Auckland Council.

Auckland Regional Transport Network Limited and group (Auckland City Council)

Financial statements and performance information 16-month period ended: 31 October 2010

We disagreed with the company not reporting performance information that reflected the company's achievements, measured against its performance targets. Doing so is required by the Local Government Act 2002. We drew attention to the disclosures in the financial statements that referred to the dissolution basis being used appropriately to prepare the financial statements because, on 1 November 2010, the Local Government (Tamaki Makaurau Reorganisation) Act 2009 dissolved Auckland Regional Transport Network Limited and group and vested its assets and liabilities in Auckland Transport.

Te Ahu Charitable Trust (Far North District Council)

Financial statements year ended: 30 June 2010

We disagreed with the Trust not reporting performance information that reflected the Trust's achievements, measured against its performance targets. The Local Government Act 2002 requires this reporting.

Kaikoura Enhancement Trust and group (Kaikoura District Council)

Financial statements and performance information year ended: 30 June 2007

We disagreed with the Trust not reporting performance information that reflected the Trust's achievements, measured against its performance targets. The Local Government Act 2002 requires this reporting. We drew attention to the disclosures in the financial statements that the Trust did not prepare a statement of intent for the period beginning 1 July 2007.

Tauranga City Aquatics Limited (Tauranga City Council)

Financial statements and performance information year ended: 30 June 2011

Our audit was limited because we could not get enough assurance about the completeness of revenue (because the company had limited controls over that revenue).

Tauranga City Investments Limited and group (Tauranga City Council)

Financial statements and statement of service performance year ended: 30 June 2011

Our audit was limited because we could not get enough assurance about the completeness of revenue (because the company and group had limited controls over that revenue).

Tauranga City Venues Limited (Tauranga City Council)

Financial statements and performance information year ended: 30 June 2011

Our audit was limited because we could not get enough assurance about the completeness of revenue (because the company had limited controls over that revenue).

Te Kauwhata Licensing Trust

Financial statements year ended: 31 March 2009, 31 March 2010, and 31 March 2011

Our audit was limited because we could not get enough assurance about the completeness of revenue (because the Trust had limited controls over that revenue).

Awakaponga Public Hall Board

Financial statements years ended: 30 June 2008, 30 June 2009, and 30 June 2010

Our audit was limited because we could not get enough assurance about the completeness of revenue (because the Board had limited controls over that revenue).

Coates Memorial Church Board

Statement of accounts years ended: 30 June 2009 and 30 June 2010

Our audit was limited because we could not get enough assurance about the completeness of revenue (because the Board had limited controls over that revenue).

Mataroa Hall Board

Financial statements years ended: 30 June 2009 and 30 June 2010

Our audit was limited because we could not get enough assurance about the completeness of revenue (because the Board had limited controls over that revenue).

Millerton Hall Board

Statement of financial position and operating statement years ended: 30 June 2008, and 30 June 2009

Our audit was limited because we could not get enough assurance about the completeness of revenue (because the Board had limited controls over that revenue).

Ohau Hall Board

Financial statements years ended: 30 June 2003 and 30 June 2004

Our audit was limited because we could not get enough assurance about the completeness of revenue (because the Board had limited controls over that revenue).

Ohau Hall Board

Financial statements year ended: 30 June 2005

Our audit was limited because we could not get enough assurance about the completeness of revenue (because the Board had limited controls over that revenue). We could not substantiate the amount, nature, and use of petty cash.

Papanui Hall Board

Financial statements year ended: 30 June 2008

Our audit was limited because we could not get enough assurance about the completeness of revenue (because the Board had limited controls over that revenue).

Ongarue Hall Society Incorporated

Statement of accounts years ended: 30 June 2007, 30 June 2008, and 30 June 2009

Our audit was limited because we could not get enough assurance about the completeness of revenue (because the Board had limited controls over that revenue).

Taurikura Hall Board

Statement of accounts year ended: 30 June 2010

Our audit was limited because we could not get enough assurance about the completeness of revenue (because the Board had limited controls over that revenue).

Ruakaka Central Domain Board

Statement of accounts years ended: 30 September 2006, 30 September 2007, 30 September 2008, 30 September 2009, and 30 September 2010

Our audit was limited because we could not get enough assurance about the completeness of revenue (because the Board had limited controls over that revenue).

Whatitiri Domain Board

Financial statements year ended: 30 June 2009

Our audit was limited because we could not get enough assurance about the completeness of revenue (because the Board had limited controls over that revenue).

Our audit of the comparative information for the year ended 30 June 2008 was limited (because the Board had limited control over revenue and inadequate supporting documentation for its spending).

Ohingaiti Cemetery

Statement of accounts years ended: 30 June 2008, and 30 June 2009

Our audit was limited because we could not verify some revenue (because the Trustees had limited controls over that revenue) or work out whether some expenditure recorded in the statement of accounts had been incurred properly or classified correctly. We noted a breach of the Burial and Cremation Act 1964 because the Trustees failed to keep a register of burials.

Springfield Cemetery

Statement of accounts year ended: 31 March 2010

Our audit was limited because we could not get enough assurance about the completeness of revenue (because the Trustees had limited controls over that revenue).

Rai Valley Cemetery Trustees

Statement of accounts year ended: 31 March 2009

Our audit was limited because we could not get enough assurance about the completeness of revenue (because the Trustees had limited controls over that revenue). We could not get enough supporting documents for payments or work out whether some expenditure recorded in the statement of accounts had been incurred properly or classified correctly.

Lepperton Cemetery

Statement of accounts year ended: 31 March 2010

Our audit was limited because we could not get enough assurance about the completeness of payments (because the Trustees had inadequate documentation of payments).

Owaka Cemetery Trust

Statement of accounts year ended: 31 March 2010

Our audit was limited because we could not get appropriate audit evidence to support all of the Trustees' payments.

"Emphasis of matter" paragraphs

Auckland City Council and group

Financial statements and performance information 16-month period ended: 31 October 2010

We drew attention to the disclosures in the financial statements that referred to the dissolution basis being used appropriately to prepare the financial statements because, on 1 November 2010, the Local Government (Tamaki Makaurau Reorganisation) Act 2009 dissolved the Auckland City Council and group, and their functions, duties, and powers were transferred to Auckland Council. As a consequence of that reorganisation, all the assets and liabilities of the Auckland City Council and group were vested in Auckland Council and the entities it controls.

Auckland Regional Council and group

Financial statements and performance information 16-month period ended: 31 October 2010

We drew attention to the disclosures in the financial statements that referred to the dissolution basis being used appropriately to prepare the financial statements because on, 1 November 2010, the Local Government (Tamaki Makaurau Reorganisation) Act 2009 dissolved the Auckland Regional Council and group, and their functions, duties, and powers were transferred to Auckland Council and Environment Waikato. As a consequence of that reorganisation, all the assets and liabilities of the Auckland Regional Council and group were vested in Auckland Council, Environment Waikato, and Auckland Council's controlled entities.

Manukau City Council and group

Financial statements and performance information 16-month period ended: 31 October 2010

We drew attention to the disclosures in the financial statements that referred to the dissolution basis being used appropriately to prepare the financial statements because, on 1 November 2010, the Local Government (Tamaki Makaurau Reorganisation) Act 2009 dissolved Manukau City Council and group, and their functions, duties, and powers were transferred to Auckland Council. As a consequence of that reorganisation, all the assets and liabilities of the Manukau City Council and group were vested in Auckland Council and its controlled entities.

North Shore City Council and group

Financial statements and performance information 16-month period ended: 31 October 2010

We drew attention to the disclosures in the financial statements that referred to the dissolution basis being used appropriately to prepare the financial statements because, on 1 November 2010, the Local Government (Tamaki Makaurau Reorganisation) Act 2009 dissolved North Shore Council and group, and their functions, duties, and powers were transferred to Auckland Council. As a consequence of that reorganisation, all the assets and liabilities of the North Shore Council and group were vested in Auckland Council and its controlled entities.

Papakura District Council and group

Financial statements and service performance information 16-month period ended: 31 October 2010

We drew attention to the disclosures in the financial statements that referred to the dissolution basis being used appropriately to prepare the financial statements because, on 1 November 2010, the Local Government (Tamaki Makaurau Reorganisation) Act 2009 dissolved Papakura District Council and group, and their functions, duties, and powers were transferred to Auckland Council. As a consequence of that reorganisation, all the assets and liabilities of the Papakura District Council and group were vested in Auckland Council and its controlled entities.

Rodney District Council and group

Financial statements and performance information 16-month period ended: 31 October 2010

We drew attention to the disclosures in the financial statements that referred to the dissolution basis being used appropriately to prepare the financial statements because, on 1 November 2010, the Local Government (Tamaki Makaurau Reorganisation) Act 2009 dissolved Rodney District Council and group, and their functions, duties, and powers were transferred to Auckland Council. As a consequence of that reorganisation, all the assets and liabilities of Rodney District Council and group were vested in Auckland Council and its controlled entities.

Waitakere City Council and group

Financial statements and performance information 16-month period ended: 31 October 2010

We drew attention to the disclosures in the financial statements that referred to the dissolution basis being used appropriately to prepare the financial statements because, on 1 November 2010, the Local Government (Tamaki Makaurau Reorganisation) Act 2009 dissolved Waitakere City Council and group, and their functions, duties, and powers were transferred to Auckland Council. As a consequence of that reorganisation, all the assets and liabilities of the Waitakere City Council and group were vested in Auckland Council and its controlled entities.

Franklin District Council

Financial statements and performance information 16-month period ended: 31 October 2010

We drew attention to the disclosures in the financial statements that referred to the dissolution basis being used appropriately to prepare the financial statements because, on 1 November 2010, the Local Government (Tamaki Makaurau Reorganisation) Act 2009 dissolved the Council, and its functions, duties, and powers were transferred to Auckland City, Hauraki District Council, and Waikato District Council. As a consequence of that reorganisation, all the assets and liabilities of the Franklin District Council were vested in Auckland Council, Hauraki District Council, and Waikato District Council, and related controlled entities.

Aotea Centre Board of Management (Auckland City Council)

Financial statements and performance information 16-month period ended: 31 October 2010

We drew attention to the disclosures in the financial statements that referred to the dissolution basis being used appropriately to prepare the financial statements because, on 1 November 2010, the Local Government (Tamaki Makaurau Reorganisation) Act 2009 dissolved Aotea Centre Board of Management and vested its assets and liabilities in Regional Facilities Auckland Limited.

ARTNL Britomart Limited (Auckland City Council)

Financial statements and performance information 16-month period ended: 31 October 2010

We drew attention to the disclosures in the financial statements that referred to the dissolution basis being used appropriately to prepare the financial statements because, on 1 November 2010, the Local Government (Tamaki Makaurau Reorganisation) Act 2009 dissolved ARTNL Britomart Limited and vested its assets and liabilities in Auckland Transport.

Auckland Tourism and Visitors Trust (Auckland City Council)

Financial statements 16 month period ended: 31 October 2010

We drew attention to the disclosures in the financial statements that referred to the dissolution basis being used appropriately to prepare the financial statements because the Trust's assets, liabilities, contractual rights, and obligations were transferred to Auckland Tourism Events and Economic Development Limited on 1 November 2010.

Metrowater Limited and group (Auckland City Council)

Financial statements and performance information 16-month period ended: 31 October 2010

We drew attention to the disclosures in the financial statements that referred to the dissolution basis being used appropriately to prepare the financial statements because, on 1 November 2010, the Local Government (Tamaki Makaurau Reorganisation) Act 2009 dissolved Metrowater Limited and group and vested the assets and liabilities of the company and group in Watercare Services Limited.

Sea + City Projects Limited (Auckland City Council)

Financial statements and performance information 16-month period ended: 31 October 2010

We drew attention to the disclosures in the financial statements that referred to the dissolution basis being used appropriately to prepare the financial statements because, on 1 November 2010, the Local Government (Tamaki Makaurau Reorganisation) Act 2009 dissolved Sea + City Projects Limited and vested its assets and liabilities in Auckland Waterfront Development Agency Limited.

Tomorrow's Manukau Properties (Flat Bush) Limited (Auckland City Council)

Financial statements and performance information 16-month period ended: 31 October 2010

We drew attention to the disclosures in the financial statements that referred to the dissolution basis being used appropriately to prepare the financial statements because, on 1 November 2010, the Local Government (Tamaki Makaurau Reorganisation) Act 2009 dissolved TMPL (Flat Bush) Limited and vested its assets and liabilities in Auckland Council.

Tomorrow's Manukau Properties Limited and group (Auckland City Council)

Financial statements and performance information 16-month period ended: 31 October 2010

We drew attention to the disclosures in the financial statements that referred to the dissolution basis being used appropriately to prepare the financial statements because, on 1 November 2010, the Local Government (Tamaki Makaurau Reorganisation) Act 2009 dissolved Tomorrow Manukau Properties Limited and group and vested their assets and liabilities in Auckland Council.

Auckland Regional Holdings and group (Auckland Regional Council)

Financial statements and performance information 16-month period ended: 31 October 2010

We drew attention to the disclosures in the financial statements that referred to the dissolution basis being used appropriately to prepare the financial statements because, on 1 November 2010, the Local Government (Tamaki Makaurau Reorganisation) Act 2009 dissolved Auckland Holdings Limited and group and vested their assets and liabilities in Auckland Council.

Auckland Regional Transport Authority (Auckland Regional Council)

Financial statements and performance information 16-month period ended: 31 October 2010

We drew attention to the disclosures in the financial statements that referred to the dissolution basis being used appropriately to prepare the financial statements because, on 1 November 2010, the Local Government (Tamaki Makaurau Reorganisation) Act 2009 dissolved Auckland Regional Transport Authority and vested its assets and liabilities in Auckland Transport.

Manukau Leisure Services Limited (Manukau City Council)

Financial statements and performance information 16-month period ended: 31 October 2010

We drew attention to the disclosures in the financial statements that referred to the dissolution basis being used appropriately to prepare the financial statements because, on 1 November 2010, the Local Government (Tamaki Makaurau Reorganisation) Act 2009 dissolved Manukau Leisure Limited and vested its assets and liabilities in Auckland Council.

Manukau Water Limited (Manukau City Council)

Financial statements and performance information 16-month period ended: 31 October 2010

We drew attention to the disclosures in the financial statements that referred to the dissolution basis being used appropriately to prepare the financial statements because, on 1 November 2010, the Local Government (Tamaki Makaurau Reorganisation) Act 2009 dissolved Manukau Water Limited and vested its assets and liabilities in Watercare Services Limited.

Manukau Enterprise and Employment Trust (Manukau City Council)

Financial statements and performance information 16-month period ended: 31 October 2010

We drew attention to the disclosures in the financial statements that referred to the dissolution basis being used appropriately to prepare the financial statements because, on 1 November 2010, the Local Government (Tamaki Makaurau Reorganisation) Act 2009 dissolved Manukau Enterprise and Employment Trust and vested its assets and liabilities in Auckland Tourism, Events and Economic Development Limited.

NSC Holdings Limited (North Shore City Council)

Financial statements and performance information 16-month period ended: 31 October 2010

We drew attention to the disclosures in the financial statements that referred to the dissolution basis being used appropriately to prepare the financial statements because, on 1 November 2010, the Local Government (Tamaki Makaurau Reorganisation) Act 2009 dissolved NSC Holdings Limited and vested its assets and liabilities in Auckland Council.

Enterprise North Shore Trust (North Shore City Council)

Financial statements and performance information 16-month period ended: 31 October 2010

We drew attention to the disclosures in the financial statements that referred to the dissolution basis being used appropriately to prepare the financial statements because, on 1 November 2010, the Local Government (Tamaki Makaurau Reorganisation) Act 2009 dissolved Enterprise North Shore Trust and vested its assets and liabilities in Auckland Tourism, Events & Economic Development Limited.

Rodney Properties Limited (Rodney District Council)

Financial statements and performance information 16-month period ended: 31 October 2010

We drew attention to the disclosures in the financial statements that referred to the dissolution basis being used appropriately to prepare the financial statements because, on 1 November 2010, the Local Government (Tamaki Makaurau Reorganisation) Act 2009 dissolved Rodney Properties Limited and vested its assets and liabilities in Auckland Council.

Waitakere City Holdings Limited and group (Waitakere City Council)

Financial statements and performance information 16-month period ended: 31 October 2010

We drew attention to the disclosures in the financial statements that referred to the dissolution basis being used appropriately to prepare the financial statements because, on 1 November 2010, the Local Government (Tamaki Makaurau Reorganisation) Act 2009 dissolved Waitakere City Holdings Limited and group and vested their assets and liabilities in Auckland Council.

Waitakere Enterprise Trust Board (Waitakere City Council)

Financial statements and performance information 16-month period ended: 31 October 2010

We drew attention to the disclosures in the financial statements that referred to the dissolution basis being used appropriately to prepare the financial statements because, on 1 November 2010, the Local Government (Tamaki Makaurau Reorganisation) Act 2009 dissolved the Trust Board and vested its assets and liabilities in Auckland Tourism Events and Economic Development Limited.

Waitakere Properties Limited (Waitakere City Council)

Financial statements and performance information 16-month period ended: 31 October 2010

We drew attention to the disclosures in the financial statements that referred to the dissolution basis being used appropriately to prepare the financial statements because, on 1 November 2010, the Local Government (Tamaki Makaurau Reorganisation) Act 2009 dissolved Waitakere Properties Limited and vested its assets and liabilities in Auckland Council.

Franklin Art, Culture and Library Trust (Franklin District Council)

Financial statements year ended: 30 June 2010

We drew attention to that referred to the dissolution basis appropriately being used in preparing the financial statements because, on 1 July 2010, the Trust was dissolved and the Franklin libraries were transferred to Franklin District Council. The other arts and culture learning assets and liabilities were vested in a new trust, Franklin Arts, Culture and Learning Trust.

City of Manukau Education Trust (Manukau City Council)

Financial statements and performance information year ended: 30 June 2010

We drew attention the disclosures in the financial statements that refer to the new local government structure for the Auckland region. Decisions were yet to be made about Auckland Council's structure and operations, including how the Trust would be vested and integrated.

Manukau Beautification Charitable Trust (Manukau City Council)

Financial statements and performance information year ended: 30 June 2010

We drew attention the disclosures in the financial statements that refer to the new local government structure for the Auckland region. Decisions were yet to be made about Auckland Council's structure and operations, including how the Trust would be vested and integrated.

Pakuranga Arts and Cultural Trust (Manukau City Council)

Financial statements and performance information year ended: 30 June 2010

We drew attention the disclosures in the financial statements that refer to the new local government structure for the Auckland region. Decisions were yet to be made about Auckland Council's structure and operations, including how the Trust would be vested and integrated.

Central Plains Water Trust (Selwyn District Council and Christchurch City Council)

Financial statements year ended: 30 June 2011

We drew attention to the disclosures in the financial statements that referred to the uncertainties surrounding the going concern assumption. The validity of the going concern assumption depends on continued funding from Central Plains Water Limited or other sources.

Ruawhata Public Hall Board

Financial statements year ended: 30 June 2008, 30 June 2009, and 30 June 2010

We drew attention to the disclosures in the financial statements that referred to the uncertainties over the disestablishment of the Board and the transfer of its activities to the Department of Conservation. The Department was yet to decide whether it would approve the disestablishment of the Board.

Grow Wellington Limited and group (Greater Wellington Regional Council)

Financial statements and statement of service performance year ended: 30 June 2011

We drew attention the disclosures in the financial statements that referred to the uncertainties surrounding the continued existence of the company. The validity of the going concern assumption depended on the outcome of Greater Wellington Regional Council's 2012-22 LTP process.

Creative HQ Limited (Greater Wellington Regional Council)

Financial statements and statement of service performance year ended: 30 June 2011

We drew attention the disclosures in the financial statements that referred to the uncertainties surrounding the continued existence of the company. The validity of the going concern assumption depended on the outcome of Greater Wellington Regional Council's 2012-22 LTP process.

New Zealand Mutual Liability Riskpool

Financial statements year ended: 30 June 2011

We drew attention to the disclosures in the financial statements about the uncertainties involved in estimating how the Weathertightness Home Resolution Service might affect the outstanding claims provision and reinsurance receivables of the Scheme using actuarial assumptions. We drew attention to the fact that the going concern assumption had being used appropriately to prepare the financial statements because the Trustee of Riskpool is able to levy members to cover any shortfall in equity under the terms of the Trust Deed.

Waitomo District Council and group

Annual report year ended: 30 June 2011

We drew attention to the disclosures in the financial statements outlining the serious financial difficulties experienced by the Council and group's subsidiary, Inframax Construction Limited (the company). The Council had invested capital in the company to enable it to meet its short-term cash flow obligations. The disclosures outlined that, although the group financial statements had been prepared on a going concern basis, the going concern assumption of the company depended on:

- the continuing support of the company's lenders;
- continued support from the Council of the company's recovery plan; and
- the ability of the company to meet its forecast performance.

Inframax Construction Limited (Waitomo District Council)

Financial statements and statement of performance measures year ended: 30 June 2011

We drew attention to the disclosures in the financial statements outlining the serious financial difficulties experienced by the company, including the net loss incurred for the year ended 30 June 2011 and the resulting uncertainties about the use of the going concern assumption. The validity of the going concern assumption depended on:

- the continuing support of the company's lenders;
- continued support from Waitomo District Council for the company's recovery plan; and
- the ability of the company to meet its forecast performance.

Bay Broadband Limited

Financial statements year ended: 30 June 2011

We drew attention to the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements. The company ceased trading and the company is to be deregistered.

Cranberries New Zealand Limited

Financial statements year ended: 31 March 2011

We drew attention to the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements. The company ceased trading in May 2010.

Dunedin Transport Limited (formerly Citibus Limited) (Dunedin City Council)

Financial statements year ended: 30 June 2011

We drew attention to the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements. The company ceased trading after its assets were sold on 31 May 2011.

Forever Beech Limited

Financial statements year ended: 31 March 2011

We drew attention to the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements because the company ceased trading in July 2009.

St James Theatre Charitable Trust and group (Wellington City Council)

Financial statements year ended: 30 June 2011

We drew attention to the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements. The Trust and group was wound up after 30 June 2011 and the operations of the Trust and St James Theatre Limited were transferred to Wellington Venues Limited.

St James Theatre Limited (Wellington City Council)

Financial statements year ended: 30 June 2011

We drew attention to the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements. The company was wound up after 30 June 2011 and its operations were transferred to Wellington Venues Limited.

Whangarei Tourism Trust (Whangarei District Council)

Financial statements year ended: 30 June 2011

We drew attention to the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements. The Trustees intended to wind up the Trust within the next 12 months.

Mana Taverns Limited

Financial statements year ended: 31 March 2011

We drew attention to the disclosures in the financial statements that referred to the realisation basis appropriately being used in preparing the financial statements because the company is ceasing to operate.

Local Government Industry Training Organisation

Financial statements year ended: 31 December 2010

We drew attention to the disclosures in the financial statements that referred to the realisation basis appropriately being used in preparing the financial statements because the organisation is ceasing to operate.

Southland Flood Relief Fund

Financial statements year ended: 30 June 2011

We drew attention to the disclosures in the financial statements that referred to the dissolution basis appropriately being used in preparing the financial statements. Section 8 of Southland Flood Relief Committee Empowering Act 1992 requires the Trustees to wind up the fund on or by 23 March 2012.

The Trusts Charitable Foundation Incorporated

Financial statements year ended: 31 March 2011

We drew attention to the disclosures in the financial statements that referred to the dissolution basis appropriately being used in preparing the financial statements. The Trustees intended to wind up the Foundation within the next 12 months.

Rangitikei Mayoral Flood Relief Trust (Rangitikei District Council)

Financial statements year ended: 30 June 2010

We drew attention to the disclosures in the financial statements that referred to the going concern assumption appropriately not being used in preparing the financial statements. The Trust was to be wound up and its assets and operations transferred to the Wanganui-Manawatu Regional Disaster Relief Fund Trust.

Orion New Zealand Limited and group (Christchurch City Council)

Financial statements and performance statements year ended: 31 March 2011

We drew attention to the disclosures in the financial statements and performance statements that referred to:

- the effect of the Canterbury earthquakes on the company and group's financial performance; and
- the company's ability to report against forecast electricity network reliability targets, as set out in its statement of intent.

Central Otago District Council

Annual report year ended: 30 June 2011

We drew attention to the disclosures in the financial statements about the Council having inadequate and incomplete performance measures in the performance framework in the 2009/19 LTCCP, which contained a qualified audit opinion. Since then, the Council has improved its performance framework and made progress in explaining the relationship between community outcomes, service levels, performance measures, and targets. The revised performance measures provide an appropriate basis for a meaningful assessment of the Council's performance.

South Port New Zealand Limited and group (Environment Southland)

Financial statements year ended: 30 June 2011

We drew attention to the disclosures in the financial statements that referred to the provision for unforeseen repairs and maintenance. This provision did not meet the definition of a liability and should not be recognised as such. Even though it was not material to the financial statements as a whole, we felt it important to highlight it to the readers of the financial statements.

Dunedin Venues Limited (Dunedin City Council)

Financial statements years ended: 30 June 2010 and 30 June 2011

We drew attention to the disclosures in the financial statements about the company not having a statement of service performance. The company is inactive and did not have any performance to report for the period ended 30 June 2011.

Novus Contracting Limited (South Taranaki District Council)

Financial statements year ended: 30 June 2011

We drew attention to the disclosures in the financial statements about the company not having a statement of service performance. The company is inactive and did not have any performance to report for the period ended 30 June 2011.

Waikato District Community Wellbeing Trust (Waikato District Council)

Financial statements one-month period ended 30 June 2010

We drew attention to the disclosures in the financial statements outlining that the company did not prepare a statement of service performance. The Trust is inactive and did not have any performance to report for the period ended 30 June 2010.

Waikato District Community Wellbeing Trust (Waikato District Council)

Financial statements year ended: 30 June 2011

We drew attention to the disclosures in the financial statements outlining that the company did not prepare a statement of service performance. The Trust is inactive and did not have any performance to report. The Trust also failed to complete its statement of intent by 30 June 2011, for the period beginning 1 July 2011.

The North Shore Domain and North Harbour Stadium Trust Board (North Shore City Council)

Financial statements year ended: 28 February 2010

We drew attention to a breach of the Local Government Act 2002 because the Trust failed to have a June balance date. A June balance date is a requirement of the Act.

Section B

The Auditor-General's work and observations during 2011

This attachment contains short articles on our performance audits and other reports of interest to the local government sector that were published during 2011, namely:

- *Planning to meet the forecast demand for drinking water in Auckland*;
- *Government planning and support for housing on Māori land*;
- *Managing freshwater quality: Challenges for regional councils*;
- *The Emissions Trading Scheme – summary information for auditors and public entities*;
- *Local government: Improving the usefulness of annual reports*;
- *Managing the implications of public private partnerships*; and
- *Public Sector Fraud Awareness Survey – Cleanest public sector in the world: Keeping fraud at bay.*

The full reports are available on our website at www.oag.govt.nz.

We end this section with a brief update on local government inquiries during 2011, and our proposed work in 2012 on governance matters involving local authorities and CCOs and on biodiversity.

Performance audits in 2011

Planning to meet the forecast demand for drinking water in Auckland (progress report August 2011)

After the amalgamation of the former Auckland local authorities into the new Auckland Council, Watercare Services Limited (Watercare) became responsible for providing water and wastewater services to people throughout the Auckland region. Watercare became the owner of all the former Auckland local authorities' assets and liabilities for supplying water and removing wastewater.

We have begun a performance audit to determine how effectively Watercare is managing Auckland water services. The audit covers how well Watercare:

- serves its customers;
- plans to meet demand for water;
- manages its assets; and
- funds and prices water supply and wastewater services.

The audit also considers whether Auckland Council's governance arrangements for Watercare are efficient and fit for purpose.

In August 2011, because of changes happening in each of these areas, we reported our initial observations and suggestions for Watercare and Auckland Council to consider while work proceeds. We intend to review progress and report further in 2012.

Our interim report is in two parts – a letter to the Auckland Council and Watercare about governance matters, and a report on the other matters entitled *Planning to meet the forecast demand for drinking water in Auckland*.

Preliminary views

Below, we summarise our preliminary views on the transition to the new regime, and suggest matters for Watercare to consider when preparing its LTPs for managing assets and arranging funding.

Overall, Watercare has responded well to its new customer service role, improving customer services. Watercare seems to address problems promptly and make improvements when it finds out about problems with performance.

Watercare is well placed to create a more detailed strategic plan for water demand management in Auckland, building on work it did in 2008.[43]

Watercare recognises that asset management planning needs a long-term focus that brings together engineering, financial, economic, environmental, risk, and growth information. This helps it make the best decisions on matters such as replacing assets. Watercare is working on a longer-term asset management plan. Its experience leaves it well placed to do this. We will review this plan when it is completed.

Funding and pricing arrangements

Watercare is required to manage its operations efficiently to keep the cost of water supply and wastewater services to the minimum needed to effectively maintain the long-term integrity of its assets. Important decisions about Watercare's funding and pricing were made before Auckland's councils merged. These decisions included the new water price for the Auckland metropolitan area[44] and the regime for the infrastructure growth charge. Watercare is working on funding and pricing options for the longer term. Our report includes comments and suggestions. We hope to review Watercare's progress soon.

Reviewing arrangements for governance

The second part of our report is a letter to the chief executives of Watercare and Auckland Council setting out what we consider to be the two entities' emerging arrangements for governance, and what we expect from an effective governance framework.

43 The *Three waters final 2008 strategic plan* provides demand forecasts for water for the Auckland region. The individual network operators that contributed to the *Three waters* plan have been merged into Watercare.

44 $1.30 per cubic metre, effective on 1 July 2011.

In the letter, we state that the formal structure that Auckland Council has set up for governing and accounting for Watercare should meet our expectations. We identified two potential risks:

- a threat to Watercare's independence, particularly if ratepayers are widely dissatisfied about Watercare's performance on any matter and that leads to increased political concern; and
- creating a "compliance burden" by imposing informal requirements should Auckland Council's engagement with Watercare on its day-to-day business become mixed with the Council's governance of Watercare as a wholly owned subsidiary.

We believe that the governance arrangements are robust enough to avoid the first risk. With regard to the second risk, we consider it important that Auckland Council keep the "business partner" and governance roles separate to minimise the potential for additional reporting requirements that go beyond what councillors need to know to govern.

Government planning and support for housing on Māori land. Ngā whakatakotoranga kaupapa me te tautoko a te Kāwanatanga ki te hanga whare i runga i te whenua Māori (September 2011)

Many long-documented problems confront people who wish to build housing on Māori land, including lack of finance, planning restrictions, lack of infrastructure, and legislative constraints.

Our performance audit reviewed how effective and efficient the Government's support for, and regulation of, housing developments on Māori land was, with a view to getting a cross-sector perspective on how to be more effective. We carried out the audit in four regions:

- Te Tai Tokerau (Northland);
- Tāmaki Makaurau (Auckland);
- Tauranga Moana – Mataatua (Bay of Plenty); and
- Ōtautahi and Waimakariri (Canterbury).

In September 2011, we reported our findings to Parliament.

The audit process

We looked at the work of many public entities, including:

- the Housing New Zealand Corporation;
- Te Puni Kōkiri;
- the Department of Building and Housing;

- the Māori Land Court; and
- local authorities.

We assessed how the entities effectively inform and advise Māori, and identified the challenges facing Māori in securing approvals and funding. We met many other interested parties, including the Māori Trustee.

As part of our audit, we reviewed the initiatives set up to support Māori housing:

- Kāinga Whenua loans;
- the Māori Demonstration Partnership; and
- Special Housing Action Zones.

At the time of the audit, the Housing New Zealand Corporation administered Kāinga Whenua loans and the Māori Demonstration Partnership fund. The financial products available for building houses on Māori land are extensions of earlier programmes designed for different population groups and needs. For example, the Kāinga Whenua loans are an extension of the Welcome Home loan scheme, and the Māori Demonstration Partnership Fund is an extension of the Housing Innovation Fund.

Our findings

Owners of Māori land want to use their land to build high-quality, healthy houses and strengthen their communities. Most Māori who wish to build on Māori land do not fulfil those aspirations. Government help has produced mixed results, with support for Māori housing involving multiple agencies. Building a house on Māori land is challenging. Central and local government do not co-ordinate their work, and initiatives are ineffectively targeted and disconnected.

The quality and consistency of advice that agency staff provide varies. Many staff do not know and understand enough to be able to advise and guide adequately.

Banks are reluctant to accept Māori land as security for a loan, and state lending programmes are not tailored to the specific financial circumstances of Māori households and organisations. For example, most eligible applicants cannot afford Kāinga Whenua loans and, at the time we published our report, only one loan had been made.

We found that, although local authorities' planning for Māori land has been restrictive, they are increasingly acting to allow housing on Māori land that more than one person owns. Some local authorities have specific consulting arrangements and planning regulations that are meant to make it easier for Māori to build housing on their land. Some local authorities are taking on a leading role in bringing different agencies together to support in a more co-ordinated way those Māori who want to build houses on their land.

Our recommendations

Our report included six recommendations to the Department of Building and Housing and other agencies involved in supporting housing on Māori land. These include:

- co-ordinating better the work of agencies, with one organisation being a single point of contact for Māori;
- ensuring that staff are appropriately expert and knowledgeable to provide high-quality information and advice;
- making district plans more flexible to allow housing to be built on Māori land;
- getting local authorities to better support owners of suitable land who wish to build housing;
- targeting financial help better; and
- helping Māori organisations that wish to build houses.

Regional hui

After publishing our report, we organised hui in each of the four case-study regions included in our audit. The purpose of these hui was to present the findings of our report to agencies, whānau, hapū, and iwi interested in housing on Māori land. The hui was a forum for people to discuss the report's implications and to consider how our recommendations could be acted on locally.

Response from the sector

Local authorities in the case-study regions have responded positively.
The Department of Building and Housing is considering how to build our recommendations into the social housing reform programme. The Productivity Commission will include a section on housing on Māori land in its upcoming report on affordable housing.

Managing freshwater quality: Challenges for regional councils (September 2011)

In September 2011, we published the findings of our performance audit on how four regional councils manage freshwater quality.

This was a significant audit. The report has attracted much interest and the four regional councils – Waikato Regional Council, Taranaki Regional Council, Horizons Regional Council (which covers Manawatu-Whanganui), and Environment Southland – have been considering its recommendations.

When planning our audit, we were aware that there was a lot of work looking at freshwater quality, including the work of the Land and Water Forum. However, we thought that it would be useful to provide an independent view of how effectively the four regional councils manage freshwater quality.

Together, the four regions cover nearly one-third of the country's land area. The regions have different sizes, topography, landscapes, soils, and river gradients. We chose the four councils based on water quality trends and pressures in their regions and looked at all aspects of how they were managing freshwater quality.

To work out whether the four regional councils were maintaining and enhancing freshwater, we looked at whether they:

- understood well the state of, and trends in, freshwater quality in their regions;
- were responding appropriately and effectively to any deterioration in water quality; and
- were improving their plans and policies in good time.

We considered whether what the regional councils were doing was improving freshwater quality.

The National Institute of Water and Atmospheric Research Limited (NIWA) advised us on how suitable the regional councils' scientific monitoring networks are and on the state of, and trends in, freshwater quality.

During the audit, we gave each regional council individual reports. In September 2011, we presented an overview report to Parliament. In that overview report, we included a self-assessment tool for other regional councils to test their performance against our audit criteria. Our overview report focused on what has proved most difficult for regional councils to manage – non-point-source discharges from:

- surface runoff of nutrients, chemical pollutants, and bacteria from rural and urban land areas to waterways;
- farm animals in waterways; and
- contaminants from livestock farming and septic tanks leaching through soil into groundwater.

Our overall findings

We found that all four regional councils have areas of declining freshwater quality, and their responses to these areas of decline varied. All four understood well the state of freshwater in their regions. However, the two regional councils whose regions are seeing the most intensification of land use (Southland and Waikato) are not managing non-point-source discharges adequately. The regional councils are not doing enough to reduce known risks to freshwater quality. Both regional councils are trying to tackle the challenges of non-point-source discharges and their cumulative effects, but there is much work to be done.

The other two councils (Taranaki and Horizons) are doing better but also have areas where freshwater quality is at risk. Taranaki and Horizons regional councils are well placed to reduce risks to freshwater quality.

Regional councils cannot manage freshwater quality alone. Strong collaboration – from central government policy to regional councils and dairy sector representatives working together strategically and on the farm – encourages us.

All four regional councils are implementing programmes or policies to respond to areas of poor or declining freshwater quality. Although it can take many years to make changes to regional plans, some regional councils are introducing innovative, scientifically based policies to manage freshwater quality.

With regard to enforcing compliance, we were concerned that councillors in all the regional councils were involved either in deciding whether the regional council should prosecute or in investigating a case after a decision to prosecute had been made. There are strong and long-standing conventions against elected officials becoming involved in decisions to prosecute. We recommend that all decisions about investigating such matters and enforcing compliance be delegated to regional council staff.

The report's effect and results

In September 2011, we published the overview report with recommendations to all regional councils and the Ministry for the Environment. The four regional councils have responded to some of the recommendations in their individual reports that we gave them during the audit.

The report attracted considerable attention. Responses to the report have been generally favourable, although one notable exception (Federated Farmers) asked why we would look at this topic. The audit was challenging but worthwhile. Our use of NIWA and consulting extensively on our draft report helped us to understand the complexities of freshwater science. The part of the report about councillors being involved in prosecution decisions attracted much attention and comment. Regional councils have been reconsidering their approaches to this, and some are using the self-assessment tool.

We will follow up the recommendations to other regional councils and the Ministry for the Environment in about two years. It will be a good opportunity to consider the effect of the new National Policy Statement on how regional councils manage freshwater quality.

The Emissions Trading Scheme – summary information for public entities and auditors (August 2011)

In August 2011, we published guidance information on the ETS. Our guidance, *The Emissions Trading Scheme – summary information for public entities and auditors*, provides background information on the scheme and gives public entities and auditors our views about how to account for and audit ETS matters. We hope this document will inform entities and their auditors about relevant ETS obligations and opportunities, particularly as there are critical deadlines that public entities might need to factor into their financial decision-making and planning in 2012.

The ETS is relevant to local authorities. As well as price increases for fuel and energy, some local authorities and their CCOs will take part in the scheme because of forestry interests or operating landfills.[45]

Those who set accounting standards have given no guidance on accounting for ETS. We considered that we had to inform public entities about the accounting policy options for ETS transactions. Our report provides public entities with information about how the ETS works and how it affects accounting and auditing requirements.

Waste and the Emissions Trading Scheme

In 2013, when the waste sector enters the ETS, many local authorities will become participants through their operation of waste disposal facilities. (Under the Climate Change Response Act 2002, the operator of a waste disposal facility must take part in the ETS. We expect that most, if not all, solid waste disposal facilities that local authorities operate will meet this definition.)

In September 2010, the Climate Change (Waste) Regulations 2010 were finalised and these provide much of the detail about how the ETS will apply to waste disposal. The deadline for operators of waste disposal facilities to register as ETS participants was 31 January 2012.

The main implication for waste disposal operators will be the cost of emissions. The Emissions Trading Scheme Review Panel expects the ETS to cost landfill operators about $27.50 per tonne of waste, based on a carbon price of $25 per tonne and using the default emissions factor.[46]

Local authorities will need to accurately forecast the ETS cost implications to work out by how much they will have to increase user charges. They will need

45 Several local authorities with post-1989 forests have registered as participants. They include Wellington City Council, Hawkes Bay Regional Council, Mackenzie District Council, Southland District Council, Ashburton District Council, Marlborough District Council, and Kaikoura District Council, and subsidiaries of Dunedin City Council, Invercargill City Council, and Gisborne District Council.

46 Emissions Trading Scheme Review Panel, *Emissions Trading Scheme Review 2011: Issues statement and call for written submissions*, March 2011, Ministry for the Environment, Wellington.

to consider the appropriate mechanism to increase the charges. These financial implications should be included in the 2012-22 LTPs.

The ETS was reviewed in 2011 by an expert panel, which made recommendations to the Government in September 2011. The panel recommended exempting certain types of landfills from the ETS. The Government is considering its response to the panel's recommendations.

Implications for local authorities

The ETS is likely to affect financial statements in proportion to how significant the scheme is for each local authority. The effects on participants will include accounting for, and valuing, emissions units and, for participants and non-participants, valuing assets more generally.

When we audit LTPs, we will need to consider:

- a local authority's forecasts of the effect of the ETS on the waste sector, including the forecast costs of emissions and changes to user charges;
- for local authorities with forestry holdings, the local authority's forecasts of the effect of the ETS on the forest sector;
- a local authority's forecasts of the effect of the ETS on its input costs over the 10-year period of the LTP; and
- a local authority's consideration of how the ETS will affect its community over the 10-year period of the LTP.

In addition, local authorities will need to consider the cost implications of the ETS for their communities and whether this will affect the demand for, or affordability of, their services. The Emissions Trading Scheme Review Panel estimates that the ETS has increased national average household spending on fuel and electricity by $133 a year, with further increases to come after the end of the transitional phase.[47]

We are considering doing more work on the ETS in 2012, by looking at some case studies of public entities in the energy, waste, and forestry sectors that are participating in the ETS.

Local government: Improving the usefulness of annual reports (September 2011)

This year, we commissioned an analysis of how six local authorities publicly reported performance information during the last seven years. This analysis showed that the quality of reported performance information for the six local authorities improved, particularly for the 2009/10 annual report compared with

47 Emissions Trading Scheme Review Panel, *Emissions Trading Scheme Review 2011: Issues statement and call for written submissions*, March 2011, page 17.

earlier years. However, local authorities can make the content more meaningful for their communities.

The analysis informed our September 2011 discussion paper, *Local Government: Improving the usefulness of annual reports*. This paper sets out the legal requirements that local authorities must meet when they report their performance, provides examples of improved reporting, and includes recommendations for improvements.

Local authorities are required to report on how well they delivered services to their communities.

A local authority's annual report is a communication tool for providing wider information on what it has done and the services it has provided, and for comparing actual service delivery with forecast service delivery. The information in annual reports and summary annual reports should allow ratepayers, the community, and the wider public to assess how local authorities have managed community assets, and how efficient, effective, and cost-effective they have been.

Useful reporting on performance is always desirable, but it is even more critical in the current economic environment, with the local government sector under significant financial constraints. In addition, because of how diverse the services that local authorities provide are, it is important that they are transparent about costs, standards, effects, and outcomes. Comparing and communicating financial and non-financial performance over time is essential to show that performance has been efficient, effective, and cost-effective.

Our discussion paper recommends five steps to improve reporting of performance:

- identify services and results that would benefit from analysing longer-term trends and report that analysis, supported with commentary, in annual reports;
- analyse and evaluate service performance and cost, and effect and outcome results to assess and report on cost-effectiveness;
- include financial performance summaries for the financial year and longer periods, to reveal performance trends;
- use more graphs, diagrams, and other visual material, supported by narrative and commentary; and
- report against major financial performance indicators to benchmark and assess performance over time and against the financial strategy.

Better reporting of performance should help local authorities improve their decisions and how they manage. We hope that better reporting will help better inform people about what to expect from their local authorities.

The discussion paper is intended to help local authorities focus on what they are trying to achieve when they measure and report performance. Ultimately, what matters is being able to improve performance and what it achieves for the public.

Managing the implications of public private partnerships (November 2011)

As the Government and public entities look for more creative and innovative delivery of public services, public private partnerships (PPPs) are seen as offering the potential to help with these challenges. Recently, the Government has indicated that it wants to use PPPs as an option to help build infrastructure. The work of Treasury's National Infrastructure Unit to marshal expertise and necessary resources provides good support for these new central government PPP initiatives. Appropriately, the work, supported by two pilot PPP projects, has focused on working out specific policies, governance, and structures to help achieve the Government's strategic objectives and support the growth of the PPP market.

Our November 2011 discussion document, *Managing the implications of public private partnerships*, is intended to help readers understand the opportunities and challenges that a programme of PPPs brings to the public sector. We hope, too, that it will encourage discussion and informed debate about that programme.

PPPs bring together the public and private sectors in a mutually beneficial and dependent way. However, if more PPPs are entered into, careful attention is needed to encourage innovation and to fully understand and manage the challenges and opportunities that these partnerships present. For the public sector, this means broadening oversight and control of the PPP programme to effectively represent the public's interest.

The Local Government Act 2002 provides for local authorities to work with other institutions, including central government, other local authorities, the private sector, and communities. Until 2010, the Act required a PPP policy to be prepared and adopted as part of the long-term council community plan.[48] The Land Transport Management Act 2003 allowed public road controlling authorities to enter PPP-style concession agreements with third parties to build or operate roads.

Large infrastructure PPPs have been entered into during the last two decades. Most involve local authorities or transport projects. Apart from the transport

48 The requirement to have a policy on private partnerships, contained in section 107 of the Local Government Act 2002, was repealed by an amendment to the Act.

projects, there was little central government involvement and no centralised policy or guidance.

Although the use of PPPs is maturing, a sound platform for an ongoing programme of PPPs still needs to be built. There is:

- limited understanding among wider stakeholder and community groups;
- fragmented expertise and knowledge within the public sector;
- limited diversity in the capital markets and funding base; and
- only partial guidance and support available for local government.

Public entities are ultimately accountable for delivering public services. They cannot transfer this responsibility to the private sector. A public entity must have robust internal arrangements for deciding to choose to partner in a PPP. Broader oversight and control is needed to effectively represent and, ultimately, satisfy the public's interest. Also, it is essential that public entities involved in PPPs properly establish ongoing relationships and processes with stakeholder and community groups and give adequate opportunity for public scrutiny of performance under the contract.

The discussion document is intended to inform public sector leaders and decision-makers considering partnering with the private sector about the general features of public private partnerships and the factors that are seen as important in sustaining an appropriate "enabling" environment for all PPPs.

Public Sector Fraud Awareness Survey – Findings (November 2011)

The 2009 PricewaterhouseCoopers Global Economic Crime Survey showed that fraud is a fact of business life in New Zealand, with 42% of organisations suffering an economic crime in the previous 12 months, with an average loss of almost $492,000.[49]

To better understand how aware the public sector is of fraud risk factors, prevention, detection, and response mechanisms, we commissioned PricewaterhouseCoopers (PwC) to conduct an online survey of almost 1500 public sector employees. The survey, which was carried out between February and June 2011, focused on four main areas – fraud prevention, fraud detection, incidents of fraud, and fraud response. Schools accounted for about one-third (32.7%) of responses, local authorities about one-ninth (11.7%), and government departments or subsidiaries, one-tenth (10.2%).

49 The results of the 2009 PwC Global Economic Crime Survey were based on responses from more than 3000 companies in 54 countries. In New Zealand, 85 organisations from the private and public sectors took part in the survey and 21% of the New Zealand respondents were public sector organisations. Full results can be found on the PwC website, www.pwc.com.

Overall, our survey confirms a strong commitment within the public sector to protecting public resources. The incidence of fraud appears to be relatively low, with less than one-quarter of survey respondents aware of any fraud occurring in their organisation in the last two years. This finding supports New Zealand's consistently high rating on the Transparency International Corruption Perceptions Index.[50]

The results of our survey show that the incidence of fraud is lowest where:

- a public entity's culture is receptive to talking about and dealing openly with fraud;
- the entity communicates about fraud policies and risk; and
- incidents of fraud are reported.

The survey showed that effective controls play a major role in minimising fraud risk, with internal controls detecting 45% of all known incidents of fraud.

Despite the Government's drive for more efficient public sector operations (and potential job losses), 94.4% of respondents were confident of keeping their job, despite fewer resources.

Sharing our knowledge about fraud risks can protect the public purse

The survey results show that there are some simple steps that you can take to protect your organisation and the public sector from fraud. Three steps that will go a long way to minimising the incidence of fraud in your organisation are:

- regularly raising awareness of policies and procedures with employees;
- encouraging staff to report suspicious activity; and
- reporting suspected fraud to enforcement agencies.

Using the information we receive as part of our audit process, we will regularly update and, where appropriate, share high-level information we receive about fraud. You can support this by promptly informing your auditor if you suspect that fraud has occurred. By sharing information quickly, we can identify and minimise our risks, limiting possible losses, while working in ways that conform to our values and sense of community.

We are putting together results by sector to help you get more insight into the fraud risks within local government. We will send these results to you soon.

50 In 2010, New Zealand was rated first equal with Denmark and Singapore. In 2011, New Zealand was rated first.

Local government sector inquiries

Alongside the Auditor-General's primary function of carrying out annual audits for about 4000 public entities in the public sector, we are able to inquire in detail into matters of concern that people raise with us. As is usual, most of the inquiry requests we received this year concerned the local government sector, including requests made under the Local Authorities (Members' Interest) Act 1968. We received 215 inquiry requests about the local government sector in 2010/11, and have received a further 94 requests since 1 July 2011.

This year, we did not carry out any major inquiries into the local government sector, but have responded to many routine requests.

The global situation has brought financial matters to the fore of many people's thinking. We have noticed a growing focus in inquiry requests on local authorities' financial management, especially around budgets, plans, and infrastructure projects. These queries tie in closely with our general audit work and our work on LTPs in particular. We expect to see strong interest in the 2012-22 LTPs.

As noted in the Auditor-General's covering letter, the Canterbury earthquakes have affected the local government sector. Canterbury's local authorities must balance the spending, the speed of response required, and the rebuilding work's importance to Canterbury with the need for appropriately consulting the public and making decisions transparently.

We have streamlined our inquiries systems and focus. The information we publish makes it clear that our focus is on the way public entities use their financial, governance, managing, and organisational resources, not on individual complaints or concerns about how a public entity has handled a particular matter. This helps us respond to requests more quickly, although we realise that our refusal to look into individual complaints disappoints some who write to us.

Work ahead in 2012

Our focus in the first part of 2012 will be the audit of the 2012-22 LTPs. We are working on other projects of interest to the sector.

The governance of council-controlled organisations

We have an ongoing interest in how councils and CCOs arrange their governance and accountability. In 2011, the governance of councils and CCOs has been a high-profile concern, of considerable interest to ratepayers. Governance matters often raise questions of interest for the local government sector at large.

We are examining how local authorities and CCOs arrange governance and accountability. Our aim is to report to Parliament and the sector on how well CCOs' framework for governance and accountability is working, in particular on:

- strategic direction;
- appointing directors;
- monitoring performance;
- engagement and communication; and
- formal and informal accountability mechanisms.

We will look at case studies and then report on common themes that arise. As part of the project, we intend to consider the governance that Auckland Council and its CCOs are arranging.

Biodiversity

In early 2012, we will begin a performance audit of biodiversity management. The focus of the audit will be on how the Department of Conservation identifies biodiversity deterioration risks and whether it targets its resources effectively to achieve the Government's desired long-term outcomes. The audit will consider how DOC is working with other entities (including local authorities) to keep and restore biodiversity. As with the CCO project, we intend to use case studies to see which factors help bring success.

Publications by the Auditor-General

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

- Severance payments: A guide for the public sector
- Health sector: Results of the 2010/11 audits
- Central government: Results of the 2010/11 audits (Volume 2)
- New Zealand Blood Service: Managing the safety and supply of blood products
- Central government: Results of the 2010/11 audits (Volume 1)
- Education sector: Results of the 2010/11 audits
- Managing the implications of public private partnerships
- Cleanest public sector in the world: Keeping fraud at bay
- Annual Report 2010/11
- Transpower New Zealand Limited: Managing risks to transmission assets
- The Treasury: Implementing and managing the Crown Retail Deposit Guarantee Scheme
- Managing freshwater quality: Challenges for regional councils
- Local government: Improving the usefulness of annual reports
- New Zealand Transport Agency: Delivering maintenance and renewal work on the state highway network
- Government planning and support for housing on Māori land
- Inquiry into the use of parliamentary travel entitlements by Mr and Mrs Wong
- The Emissions Trading Scheme – summary information for public entities and auditors
- Planning to meet the forecast demand for drinking water in Auckland
- Appointing public sector auditors and setting audit fees
- Home-based support services for older people
- New Zealand Customs Service: Providing assurance about revenue

Website

All these reports, and many of our earlier reports, are available in HTML and PDF format on our website – www.oag.govt.nz. Most of them can also be obtained in hard copy on request – reports@oag.govt.nz.

Mailing list for notification of new reports

We offer a facility for people to be notified by email when new reports and public statements are added to our website. The link to this service is in the Publications section of the website.

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