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Challenges facing licensing trusts



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Auditor-General's overview

Licensing trusts have a responsibility to enhance the well-being of their communities. They raise funds to distribute to their communities, primarily through operating commercial businesses that sell alcohol and provide other hospitality-related services. Licensing trusts are public entities and come under my mandate.

Licensing trusts are one of the least known parts of the public sector. However, in my view, they have some of the highest risks. A high proportion of their transactions are in cash, and they trade in small but attractive items. These factors increase the risk of fraud and theft by customers and staff.

I have long been concerned that licensing trusts are one of the least scrutinised parts of the public sector. They have little or no visibility in Parliament. They hold assets on behalf of their communities, and it is important that they are accountable to those communities. Trustees elected from within the community govern licensing trusts. In most instances, these trustees perform their duties with integrity and to the best of their abilities. However, there is no comprehensive oversight of licensing trusts generally, other than by their elected trustees on behalf of their communities. Formal external oversight exists only from my audits and for the particular activity of operating gaming machines, where there are requirements monitored by the Department of Internal Affairs.

From our audit work, I have become aware that increasing numbers of licensing trusts are struggling with profitability and financial viability. Some have wound up during 2012/13, and others are considering winding up. I recognise that the challenges of the recent economic down-turn and the competitive nature of the hospitality industry are not unique to licensing trusts and have affected the whole hospitality industry.

Some licensing trusts are well managed and quite successful, despite current economic challenges. However, many licensing trusts are small, not well resourced, and struggling to comply with their accountability obligations. As a sector, licensing trusts are fragmented, and historically they have not provided much support to their smaller members.

I have also observed a lack of management and administrative capability in some licensing trusts that significantly affects the quality and timeliness of financial reporting and, consequently, the costs that my auditors incur, which are not fully recovered through audit fees charged to licensing trusts. Some licensing trusts also resist the costs of public sector external accountability.

I believe it is essential that licensing trusts are able to meet their accountability requirements to their communities. Given this context and the increasing level of challenge for all in the hospitality industry, I have decided that it is time to draw my broader observations and concerns to the attention of all those with an interest in this part of the public sector.

My staff shared these concerns and observations with the New Zealand Licensing Trusts Association while we were drafting this report. I commend the Association for accepting that, with the help of the stronger-performing licensing trusts, it has a role to play to lift the performance of all licensing trusts. By taking a group approach, they can help with one-off issues and might also be able to find ways for all trusts to operate more efficiently. I encourage the new working party of chief executives to support the licensing trusts that are facing challenges. We will monitor the progress of the working party and assist where appropriate.

A handwritten signature in black ink, appearing to read 'Lyn Provost', written in a cursive style.

Lyn Provost
Controller and Auditor-General

22 October 2014

Introduction

Purposes of this report

- 1.1 Licensing trusts are one of the least known parts of the public sector. However, we consider that they have some of the highest risks. There is no comprehensive oversight of licensing trusts, and increasing numbers of them are struggling with profitability and financial viability.
- 1.2 The purposes of this report are to:
 - increase Parliament’s awareness of this part of the public sector;
 - highlight the issues and risks that licensing trusts face; and
 - stimulate constructive dialogue among licensing trusts, and between licensing trusts and central government agencies that have oversight or monitoring responsibilities for licensing trusts, to explore options to provide better support to, and between, licensing trusts.

What are licensing trusts?

- 1.3 In the late 19th and early 20th centuries, the temperance movement arose in response to the hard-drinking culture of pioneer New Zealand. Many districts voted to prohibit the sale of alcohol.
- 1.4 Licensing trusts were first established in the 1940s as part of the relaxing of prohibition in New Zealand. They were a new way of licensing the sale and consumption of alcohol.¹ They were promoted as a more responsible and accountable alternative to the private licenced trade.
- 1.5 In 1943, Invercargill voted to restore the sale of alcohol after 38 years of prohibition. Most of the votes in favour were cast by soldiers serving overseas in World War II. However, the Invercargill community could not decide on a model for the sale and consumption of alcohol. To allay community concern, the Government decided on the licensing trust model. By the end the 1970s, 28 licensing trusts were operating throughout New Zealand. In 2012/13, there were 19 licensing trusts remaining, and 19 related entities (see the Appendix).
- 1.6 Licensing trusts have a primary responsibility to enhance the well-being of their community. They distribute surplus profits to their community and are accountable to that community through the election of their trustees.
- 1.7 When first established, each licensing trust had what was effectively a monopoly over the sale of alcohol in its district (see paragraphs 1.24-1.26). This is because, at that point in time, district licensing trusts operated most hotels, and legislation gave exclusive rights to sell alcohol from this type of venue. Today, only four licensing trusts continue to retain exclusive rights to operate hotels, taverns and

¹ The licensing trust model was influenced by a liquor licensing system in the United Kingdom known as the Carlisle Scheme.

off-licences² in their districts. These are the Invercargill, Maitāura, Portage, and Waitakere Licensing Trusts; alcohol can be sold with no restriction from other types of venues, such as privately operated clubs, restaurants and entertainment centres. The other 15 licensing trusts do not hold such exclusive rights and compete on the open market with other licence-holding premises in their districts, including those defined as hotels, taverns, and off-licences.

Licensing trusts today

- 1.8 Licensing trusts vary significantly. Some are landlords leasing their single premises to third-party licenced operators. Others are much larger entities, some retaining exclusive rights to operate hotels, taverns, and off-licences, and which operate multiple bars, cafes, conference centres, and, through associated charitable trusts, gaming machines.
- 1.9 The administrative capacity of individual licensing trusts ranges from contracting out all functions, to sole part-time administrative assistance, through to full specialised administrative functions. In general, licensing trusts have significant investments in land and buildings, either directly or through their related entities.
- 1.10 As noted earlier, only four licensing trusts continue to retain exclusive rights to operate hotels, taverns, and off-licences in their districts. The other licensing trusts operate in a fully competitive environment. The pressures of this environment have increased substantially since supermarkets started to sell wine and beer (off-licences). This competition has reduced profits for licensing trusts, particularly profits from off-licence/bottle store sales.
- 1.11 In recent years, social attitudes towards New Zealand's drinking culture have changed. There is now tougher legislation aimed at the safe and responsible sale, supply, and consumption of alcohol, and at minimising the harm caused by excessive or inappropriate drinking. Because hospitality industry products are essentially luxury goods, changes in economic circumstances during the past few years have significantly affected profits in many parts of the hospitality industry, including licensing trusts.
- 1.12 A high proportion of hospitality industry transactions are in cash, and they trade in small but attractive items. These factors increase the risk of fraud and theft by customers and staff for licensing trusts compared to other public sector entities.
- 1.13 Licensing trusts make significant contributions to their community through associations with charitable organisations that operate gaming machines (class 4 gambling – non-casino gaming machines) on licensing trust premises. Since 2005 legislation has not permitted persons engaged in the operation of a gaming venue

2 An off-licence (issued to, for example, bottle stores and supermarkets) allows the sale or supply of alcohol for consumption off the premises. It contrasts with an on-licence, which allows consumption on the premises where the alcohol is sold or supplied.

to be involved in the operation of the gaming machines. Some licensing trusts have set up trusts to ensure the required management separation in relation to gaming machines located on licensing trust premises. Others contract the services of charitable organisations for this purpose. The legislation specifically allows elected trustees of licensing trusts to sit on boards of charitable organisations operating gaming machines.

- 1.14 The profits that the charitable organisations make are distributed in the community in which the machines are located. There are specific requirements for transparency about the source of profits in all public announcements, so there is a clear distinction between profits of venue operators and those of the charitable organisations operating the gaming machines, particularly where there are common board members. These requirements are rigorously monitored by the Department of Internal Affairs.
- 1.15 Regulations administered by the Department of Internal Affairs require class 4 gambling organisations to return a minimum of 37.12% of gambling proceeds to the community. In general, class 4 gambling entities with links to licensing trusts return proceeds to the community at higher levels than private sector entities. For example, Mount Wellington Foundation Limited had a return level of 46.76% for 2012/13.
- 1.16 The New Zealand Licensing Trusts Association considers that the involvement of elected trustees in the boards of charitable organisations operating gaming machines significantly influences the equitable distribution of gaming profits within their communities. In its view, this is a positive element of the licensing trust sector, and influence over these distributions is even considered justification for the continuation of licensing trusts that are struggling financially in their other activities.
- 1.17 Currently, seven licensing trusts have set up charitable organisations that hold operator and venue licences. For the other licensing trusts, the most commonly used charitable organisation is The Trust Community Foundation Limited.³

³ The Trust Community Foundation Limited is a charitable trust providing services to support class 4 gambling (non-casino gaming machines).

An outline of the legal framework

- 1.18 The Sale and Supply of Alcohol Act 2012⁴ (the 2012 Act) sets out the statutory objectives of licensing trusts, which are to:
- sell and supply alcohol;
 - establish and operate premises to sell and supply alcohol, provide accommodation for travellers, and to sell and supply food and refreshments; and
 - conduct any other business that, in the licensing trust's opinion, can be carried on conveniently with any business associated with the above objectives.
- 1.19 Licensing trusts are public entities under the Public Audit Act 2001. They are statutory body corporates that are required by the 2012 Act to prepare annual financial statements, which must be audited by the Auditor-General.
- 1.20 Licensing trusts also have an inherent responsibility to operate commercial businesses efficiently and profitably.
- 1.21 Licensing trusts can spend or distribute their net profits as they see fit for all or any of the following purposes:
- promoting, advancing, or encouraging education, science, literature, art, physical welfare, and any other cultural, recreational, and philanthropic purposes; and
 - establishing, maintaining, and repairing any buildings or places to further any of the above purposes.
- 1.22 Licensing trusts pay income tax, rates, and other taxes and duties, as if they were a body corporate formed for private pecuniary profit.
- 1.23 In most instances, licensing trusts raise funds to distribute to their communities in two main ways:
- by selling alcohol and providing other hospitality-related services such as meals and accommodation; and
 - by hosting gaming machines at their premises under licence held by their related entities.⁵

4 The 2012 Act applies from 18 December 2013. It replaced the Sale of Liquor Act 1989. The 2012 Act made minimal changes to the accountability requirements of licensing trusts, and the changes made do not affect any of our comments, findings, or recommendations.

5 Site rentals received by licensing trusts for hosting gaming machines are controlled by the Department of Internal Affairs, and are based on cost recovery.

- 1.24 Licensing trusts own or have an interest in a wide range of related entities. These entities are involved in property investment and development, financial investments such as share and bond portfolios, a hydro-electricity scheme, and social housing.⁶
- 1.25 In 2004, the Sale of Liquor Act 1989 (the 1989 Act) was amended to allow local licensing trusts to operate outside their districts. The 2004 amendments also gave licensing trusts the option of restructuring as community trusts with charitable objectives that may or may not include selling alcohol. A community trust has a much wider scope for its activities than a licensing trust. The 2012 Act continued these changes.

Exclusive rights

- 1.26 Under section 350 of the 2012 Act, a licensing trust may hold exclusive rights in a district. This means that a licensing trust has the sole right to establish and operate hotels, taverns, and off-licences in their districts.
- 1.27 The 2012 Act provides that 15% of eligible voters who live in a licensing trust district can challenge that licensing trust's exclusive rights. When this occurs, the licensing trust must call a referendum.
- 1.28 Removing licensing trusts' exclusive rights has been considered on several occasions.⁷ We note that while there is a mechanism in legislation to remove exclusive rights there is no avenue for reinstating them, even if a community wished to.

Governance by election

- 1.29 Communities elect trustees of their licensing trust every three years on the same day as they elect local body councillors. Any person who is an eligible voter for an address in the defined licensing trust district may stand for election as a trustee. The Local Electoral Act 2001 applies to every election of trustees of a licensing trust. At the licensing trust's first meeting after the election, the trustees elect the president of the licensing trust.
- 1.30 Licensing trusts are accountable to their community through the election of trustees.
- 1.31 Remuneration of the president and trustees of licensing trusts must not be more than the amount fixed by the Minister of Finance after consulting with the Minister of Justice. In 2002, the then Minister of Finance determined that the Cabinet Fees Framework (the Fees Framework), used for setting fees for members

⁶ In this report, references to licensing trusts include a licensing trust's related entities.

⁷ For example, in 2010, by the New Zealand Law Commission in "Review of Regulatory Framework for the Sale and Supply of Liquor", New Zealand Law Commission R114, *Alcohol in our lives: Curbing Harm*.

of bodies in which the Crown has an interest, would be the mechanism used to determine the remuneration of presidents of licensing trusts. Under the Fees Framework, licensing trusts are classified as Group 3a Governance Boards. The State Services Commission provides guidance on the application of the Fees Framework.

Other relevant legislative obligations

- 1.32 Licensing trusts are considered to be local authorities for the purposes of Parts 1 to 7 of the Local Government Official Information and Meetings Act 1987. The provisions in that Act for access to official information and procedural requirements for meetings apply to licensing trusts.
- 1.33 Trustees of licensing trusts are subject to the Local Authorities (Members' Interests) Act 1968 (the Members' Interests Act) in the same way as councillors of local authorities. The Members' Interests Act helps to ensure that personal interests do not affect trustees when they participate in decision-making. It also helps to ensure that trustees cannot use their position to get preferential access to contracts. The two specific rules in the Members' Interests Act are that trustees cannot:
- enter into contracts worth more than \$25,000 in a financial year with the licensing trust they have been elected to govern; or
 - participate in matters before the licensing trust in which they have a pecuniary interest, other than an interest in common with the public.

Overview of licensing trusts' operations

2

2.1 In this Part, we discuss the financial health of licensing trusts and provide two examples of the contributions that licensing trusts make to their communities.

Licensing trusts' financial health

2.2 We have been monitoring the financial health of licensing trusts for several years. Fourteen of the 19 licensing trusts have incurred losses in one or more of the five years to 31 March 2013. Many licensing trusts have struggled to maintain profitability since the 1990s. Some licensing trusts have incurred losses for several years. For these trusts, ongoing losses will become unsustainable.

2.3 Licensing trusts are starting to deal with these challenges. Some have begun to diversify to help improve profitability. For example:

- Mount Wellington Trust Hotels Limited (the operating company of Mount Wellington Licensing Trust) has successfully operated the Waipuna Hotel and Conference Centre for many years. To enhance and protect this business, it has recently started operating a second conference site in Highbrook, Auckland, using its existing conferencing expertise.
- Trust House Limited is re-assessing its operational base. It has sold five non-performing businesses.

2.4 Licensing trusts are also under pressure to return more funding to their communities to support community activities and develop facilities. The downturn of the economy has reduced the ability of many private enterprises to support community ventures.

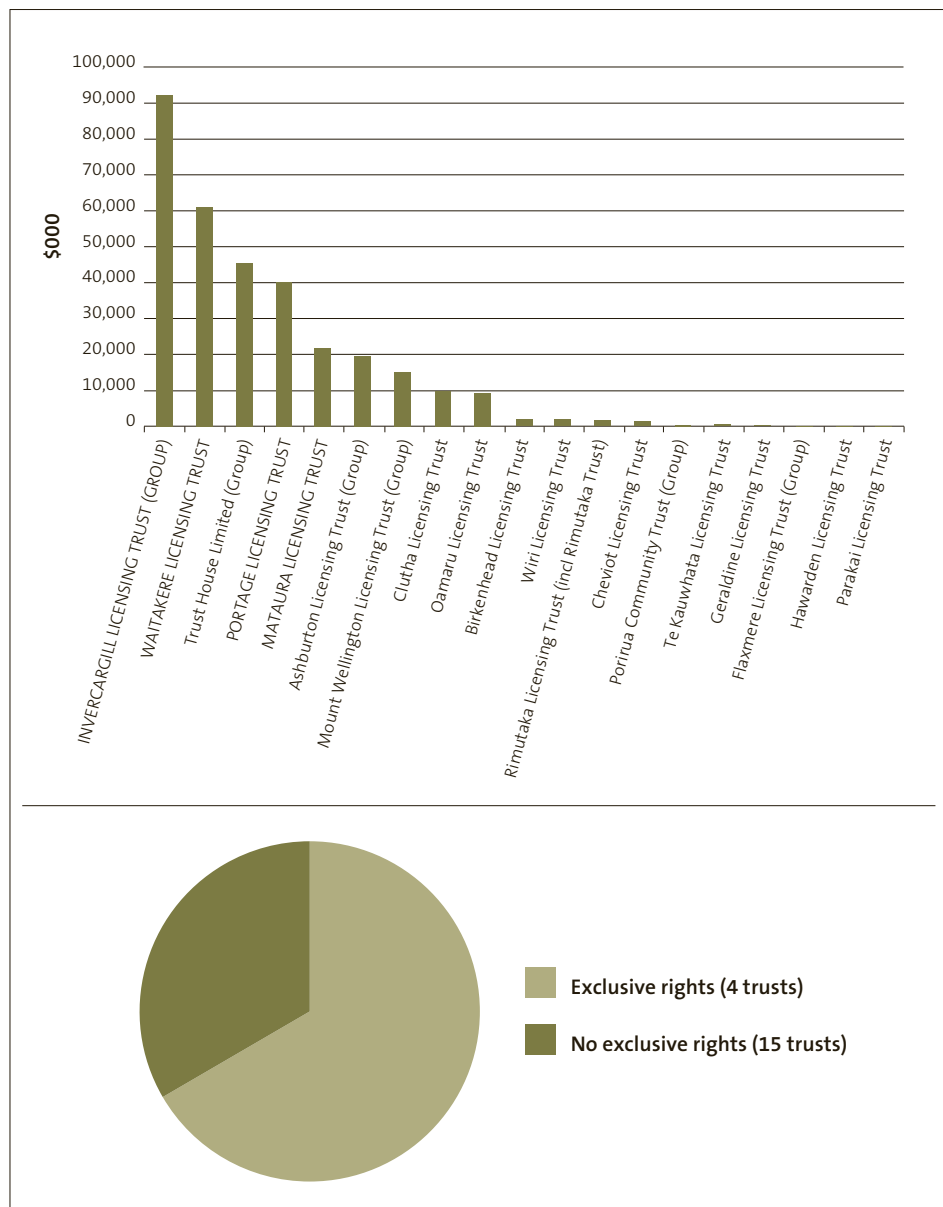
2.5 As well as seeking to implement operational efficiencies and remove unprofitable activities, some licensing trusts have pursued other more innovative diversification strategies to increase profitability. These have included investments in hydro-electricity, social housing, and property development. We recognise that trusts have undertaken their own due diligence into diversified investments. However, we note that undertaking activities that are so different to the core competencies of a licensing trust is arguably risky. Good governance and management of such ventures is essential to ensure good outcomes for communities.

- 2.6 Figures 1 and 2 set out total revenue and total comprehensive income⁸ for licensing trusts, as reported in their 2012/13 audited financial statements.⁹ Figure 3 sets out total assets for licensing trusts in each of the five years to 31 March 2013, drawn from the same source. Licensing trusts' total comprehensive income measures their profitability, and the combination of their total assets and total revenue indicates their relative size.
- 2.7 In Figures 1, 2, and 3, the licensing trusts that are shown with all capital letters are those that have exclusive rights to operate hotels, taverns, and off-licences in their district. Figures 2 and 3 are ordered from left to right based on highest to lowest revenue, as identified in Figure 1.

8 Generally accepted accounting practice defines total comprehensive income as the change in equity during a period resulting from transactions and other events, other than those changes resulting from transactions with owners in their capacity as owners.

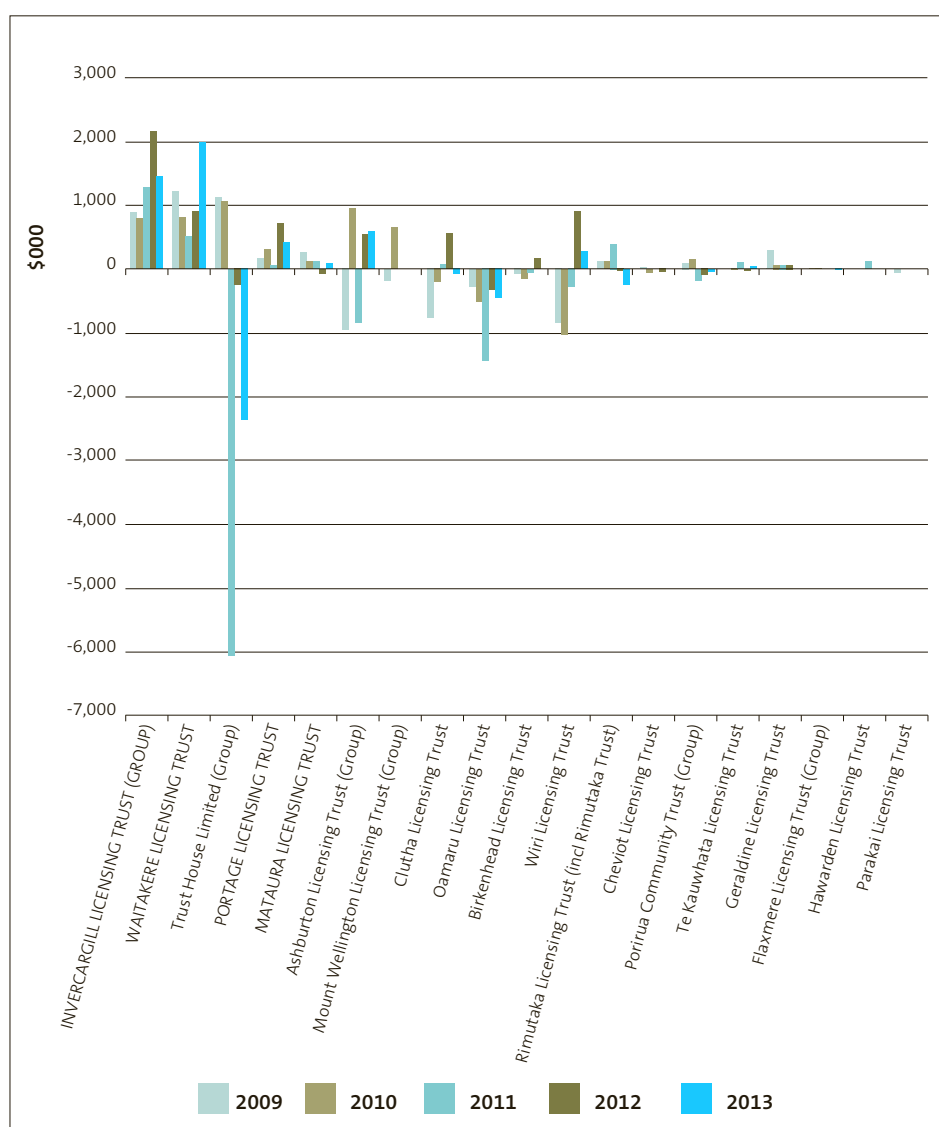
9 If a licensing trust's financial statements are not up to date (see Part 5 of this report), the information used in Figures 1 and 3 are from the most recently audited financial statements before 2012/13.

Figure 1
Licensing trusts' revenue for the year ended 31 March 2013



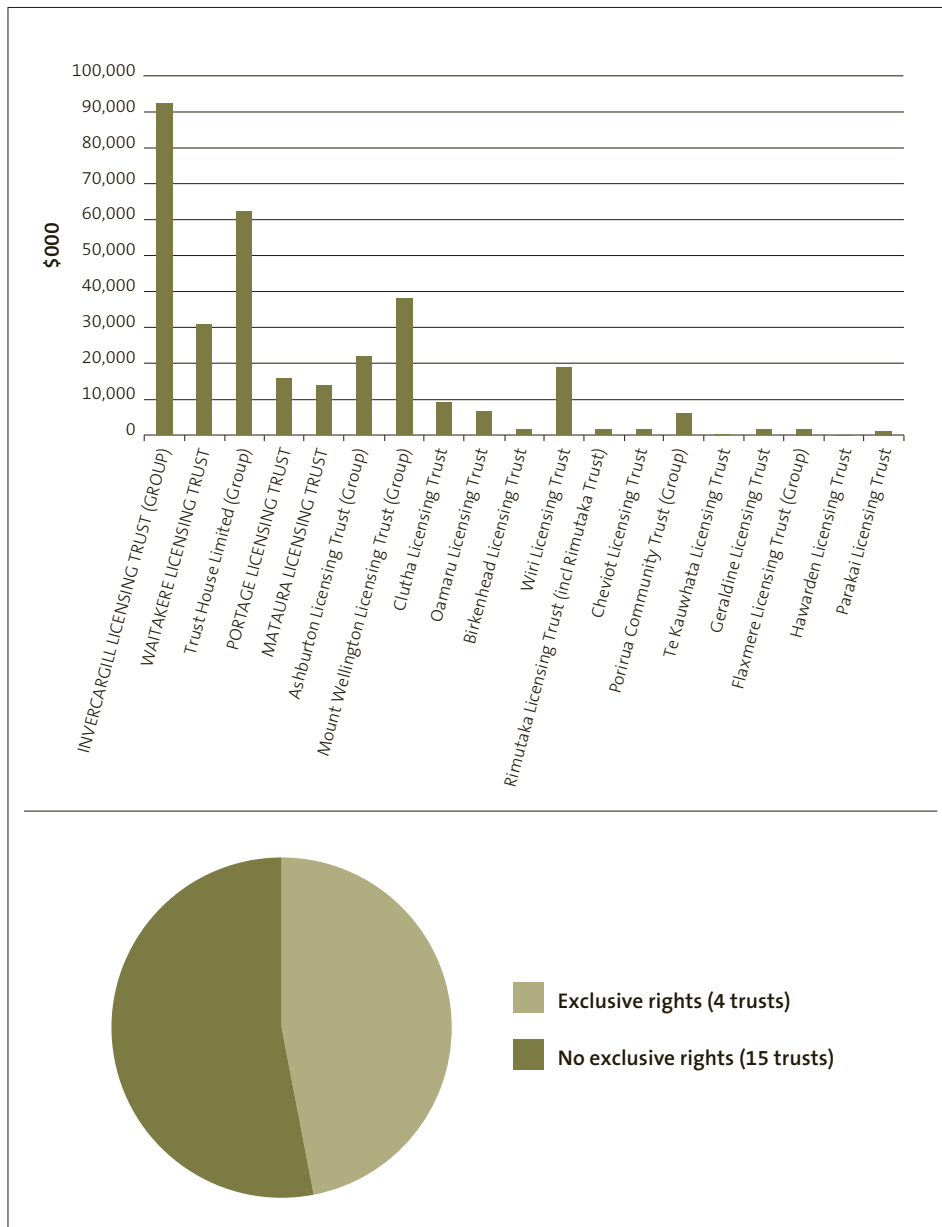
Notes: The 2012/13 audited revenue figures are presented because, in general, the minimal revenue fluctuations during the five years to 31 March 2013 do not show any identifiable trend.
In the case of groups where the group includes a charitable trust that operates class 4 gaming machines, the revenue will include income from gambling that has been conducted by gaming trusts associated with licensing trusts.

Figure 2
 Licensing trusts' total comprehensive income for the five years ended 31 March 2009, 2010, 2011, 2012, and 2013



Notes: In 2010, a change to tax legislation affected tax depreciation on commercial buildings. This resulted in deferred tax adjustments in 2010/11. These adjustments caused most of the negative total comprehensive income results in that year, and particularly affected Trust House Limited. This was a one-off adjustment and does not reflect a cash loss.

Figure 3
 Licensing trusts' total assets as at 31 March 2013



Licensing trusts' contributions to their communities

- 2.8 In the following paragraphs, we set out two examples of the positive contributions that licensing trusts make to their communities. These are not the only good examples available.

Invercargill Licensing Trust group

- 2.9 Invercargill Licensing Trust was the first licensing trust in New Zealand. It has operated in the Invercargill district since 1944. More recently, it has expanded into other parts of the South Island. This Trust retains exclusive rights to operate hotels, taverns, and off-licences in the district, and there is no overt challenge to this at present. Having exclusive rights makes achieving a profit and contributing to the community significantly easier than for those trusts without such rights. The Trust told us that it has made a profit for each of the 70 years it has operated.
- 2.10 For details of the Invercargill Licensing Trust group, see the Appendix.
- 2.11 Invercargill Licensing Trust has a long-standing policy of investing in its hospitality establishments. In its 2012/13 Annual Report, Invercargill Licensing Trust reported that it remains well positioned to produce reasonable profits to support the Invercargill community. Invercargill Licensing Trust noted that the hospitality industry is constantly evolving, with trends changing locally and globally. Invercargill Licensing Trust considers that reinvesting significant capital expenditure into its ventures is crucial to its future success.
- 2.12 During 2012/13, Invercargill Licensing Trust invested in several projects at its hospitality establishments. These included extensive refurbishment and redevelopment projects at Speight's Ale House, Kelvin Hotel, and Cable Court Motel. Invercargill Licensing Trust noted that, during 2014, it hopes to begin a complete rebuild of its Waikiwi Tavern and expand its Ashford Motor Lodge in Christchurch.¹⁰ Figure 4 summarises some of the Invercargill Licensing Trust's contributions to the community.

Figure 4
Summary of Invercargill Licensing Trust's contributions to the community

On average, Invercargill Licensing Trust has allocated total grants of \$3.66 million each year for the five years to 31 March 2013. The Invercargill Licensing Trust group has allocated total grants of \$49.57 million during the same five-year period, which is an average of \$9.92 million each year. The organisations and community projects that benefited from the grants allocated during 2012/13 include:

Tertiary Scholarships: More than 170 Invercargill students – both locally and abroad – currently receive an Invercargill Licensing Trust scholarship. Each student receives \$2,000 a year for three years. The total paid in 2012/13 was \$374,129.

Stadium Southland: Invercargill Licensing Trust has been the major funder of Stadium Southland and the adjacent velodrome since it conceived the project in the mid-1990s. Invercargill Licensing Trust formed a separate charitable trust to manage the project. Since the late 1990s, the Invercargill Licensing Trust group has contributed more than \$19 million to this facility. To assist the recovery from the stadium roof's collapse in the 2012 snowstorm, the Invercargill Licensing Trust group contributed \$1.05 million in 2012/13.

Rugby Southland: In 2012/13, Invercargill Licensing Trust donated \$405,000 and the Invercargill Licensing Trust Foundation \$350,000 to Rugby Southland to help ensure that local rugby remains viable and accessible to all.

Southland Basketball Association: In 2012/13, Invercargill Licensing Trust contributed \$205,000 to the Southland Basketball Association help develop basketball in the region.

Netball Southland (including Netball South Zone Incorporated): In 2012/13, Invercargill Licensing Trust donated \$310,000 to netball organisations in Southland.

Interactive whiteboard project: Since 2005, Invercargill Licensing Trust and the Invercargill Licensing Trust Foundation have contributed \$4,724,217 for interactive whiteboards in all Invercargill classrooms that require them and for ongoing professional development for teachers to maximise the whiteboards' use.

Trust House group

- 2.13 Trust House Limited was formed in 1998 to better co-ordinate and operate the diverse business enterprises of the Masterton Licensing Trust group. Masterton Licensing Trust owns 75% of Trust House. Masterton Licensing Trust became closely linked with Rimutaka and Flaxmere Licensing Trusts during the 1980s. Part of Trust House's role is to provide administrative and accountability services to all three licensing trusts and their related entities. Trust House has a separately appointed board of directors. Four are appointed by Masterton Licensing Trust, and three are independently appointed for their governance and business skills.
- 2.14 Trust House Foundation is responsible for the gaming machines operated in premises owned by the three trusts. Rimutaka Trust, Masterton Licensing (Charitable) Trust, and Flaxmere Licensing (Charitable) Trust recommend to Trust House Foundation how gaming profits should be distributed. The Foundation approves these recommendations.

- 2.15 During 2012/13, the Trust House group wound up or sold five businesses. Its Annual Report notes that it exited from these businesses because of their lack of profitability or because they required capital investment that did not fit within the group's required returns or strategic intent.¹¹
- 2.16 Trust House Limited owns a large portfolio of residential properties across the lower North Island, which it purchased from Housing New Zealand Corporation. It has invested in the capital improvement of these assets, resulting in the portfolio currently valued (14 years later) at more than four times the original purchase price. Trust House continues to be an active participant in the affordable housing market. Figure 5 summarises some of the Trust House group's contributions to the community.

Figure 5
Summary of the Trust House group's contributions to the community

In 2012/13, the Trust House group made charitable distributions of \$2.8 million. It distributed these funds based on the priorities established by each of the licensing trusts in the group, according to the needs and goals of each community. The organisations and community projects that benefited from the grants allocated during 2012/13 include:

Destination Wairarapa Incorporated: \$252,422 was provided to help run Destination Wairarapa, which provides tourist and event information to visitors to the Wairarapa. The local authorities in the region and Trust House jointly control Destination Wairarapa.

Flaxmere Schools Cluster: \$100,000 was provided to the Flaxmere Schools Cluster for interactive technology equipment and hand-held devices in classrooms. This grant adds to the \$100,000 provided in the previous year.

Masterton Motorplex Incorporated: \$200,000 was provided to Masterton Motorplex to help build a motorsport park facility of international standard. This grant adds to the \$120,000 provided in the previous year.

3

Challenges for licensing trusts

- 3.1 This Part examines several challenges that licensing trusts have faced in recent years.
- 3.2 Increasing numbers of licensing trusts are struggling with profitability and financial viability, particularly the smaller trusts. Apart from the strong performers, which are often largely those trusts that have retained exclusive rights, licensing trusts' profitability is generally declining rather than growing. For some, 2012/13 results were negative. If these results continue, these licensing trusts will become unsustainable and will make limited or nil distributions to their communities.
- 3.3 The licensing trusts that have retained exclusive rights and those with well-established operations have a scale that allows them to employ a management team, greater buying power, and the ability to provide cost-effective administration services to support trading operations.
- 3.4 In our 2012/13 audit reports, we highlighted that Oamaru Licensing Trust and Rimutaka Licensing Trust face "going concern" issues.¹² We considered it necessary to highlight to the readers of the financial statements of these two trusts that we had seriously considered whether applying the going-concern assumption was appropriate. This matter is unlikely to be easily resolved and there is a risk to other smaller licensing trusts in the future.
- 3.5 Larger trusts have more capability and capacity to consider continuity and plan for future changes than smaller trusts, which often find this difficult. It is not uncommon for smaller licensing trusts to have one member of senior management and one trustee actively involved in overseeing operations. When a trust's profits are diminishing, and it is under pressure to make contributions to meet needs in the community, it becomes very difficult and sometimes unpalatable for elected representatives to spend money on outside support or expertise. It can also be difficult to adequately provide internal management resource to lead the business in an increasingly competitive market. These circumstances make planning for the future very difficult.
- 3.6 It is important that licensing trusts are able to meet their accountability requirements to their communities, so that their elected trustees can be held to account. There is no other formal external scrutiny mechanism for licensing trusts, such as a select committee.

¹² See Figure 9 for further details.

Governance and accountability

- 3.7 Effective governance and accountability are important to any entity. For entities in the public sector, where the interests of the community must be taken into account, they are essential. We have observed that effective governance can be difficult for some licensing trusts. Accountability is influenced by the quality of management and by the support that those in governance roles provide to management. We found some instances of trustees not being prepared to address issues critical to the survival of their trust. Others, particularly the larger licensing trusts, have been more active in addressing strategic issues and making changes to prepare their businesses for the future.

Governance issues

- 3.8 We have also observed that it can be difficult to recruit high-calibre trustees – particularly in small communities. This is an issue for all public entities with elected governors and also affects the not-for-profit sector. It is a concern. We are also concerned about the costs for licensing trusts of holding by-elections. This can happen when the number of nominated candidates for an election is less than the number of vacant trustee positions or when a trustee resigns during their term. Licensing trusts meet the costs of by-elections from funds that would otherwise be distributed to communities or reinvested in the trust.
- 3.9 There will be a range of reasons why there are not enough nominations for any election, and it is inevitable that some resignations will occur in any three-year term. However, it is apparent that good calibre trustees can be hard to recruit – especially in small communities.
- 3.10 Te Kauwhata, Portage, Waitakere, and Clutha Licensing Trusts have faced varying levels of challenge. Portage and Waitakere Licencing Trusts incurred by-election costs because elected trustees stood for more than one public office and, following successful election to more than one role, were either required, or chose, to resign to avoid conflicts of interest. Although the specific circumstances differ, the outcome is the same for all: cost to the communities because reduced funds are available to distribute or reinvest.

Te Kauwhata Licensing Trust

- 3.11 Te Kauwhata Licensing Trust is one of the smallest. It makes low returns to the community. Its financial position has been deteriorating for some time, although it began efforts to address this in 2013. These efforts are continuing. The Trust is realistic about the challenges of operating in a small district with a low population. It is making efforts to market its business to a broader cross-section of the community and to reduce costs to boost profitability. The Trust sold a property

in 2011/12 and used some of the proceeds to address cash flow issues. It placed the remainder on term deposit. This has enabled continued use of the going-concern assumption in preparing its financial statements. However, the risks to the Trust's profitability are still very real.

- 3.12 Our auditors have identified a significant number of internal control issues in recent years, caused by limited management and governance capability. For the Trust's 2012/13 financial statements, our auditors expressed a qualified audit opinion because they could not get adequate assurance about the completeness of revenue.
- 3.13 A trust by-election was to be held because of a vacancy caused by a lack of nominations at the 2013 local elections. However, because of an incomplete enrolment process, the sole candidate's nomination was invalid. As a result, the Governor-General was invited, by public notice, to exercise his powers to appoint a suitably qualified person.

Portage Licensing Trust and Waitakere Licensing Trust

- 3.14 Portage Licensing Trust and Waitakere Licensing Trust each held a by-election on 11 February 2014 because of two resignations after the 2013 elections. We understand that the two elected trustees resigned because they also stood for, and were elected to, local boards of Auckland Council. They chose not to continue in both roles, although this is allowed.
- 3.15 In addition, the Waitakere Licensing Trust trustee resigned because he also stood for, and was appointed to, a District Licensing Committee. Because he could not legally hold both positions, he stood down as trustee. The Trusts each successfully appointed new trustees after holding by-elections. Voter turnout was low – about 12,000 people voted out of more than 70,000 eligible voters.

Clutha Licensing Trust

- 3.16 Clutha Licensing Trust does not have exclusive rights in its region, so it operates in a fully competitive environment.
- 3.17 During 2013, we investigated whether two elected trustees of Clutha Licensing Trust breached the rule in the Members' Interests Act that prevents elected members from entering into contracts that are worth more than \$25,000 with the entity they govern in any financial year. We confirmed that, towards the end of 2010, two trustees each exceeded the contracting threshold of \$25,000 each year. From that point, sections 3, 4, and 5 of the Members' Interests Act combined to mean that the trustees were no longer capable of holding office, their office was automatically vacated, and they each committed an offence by continuing to participate in Trust business for the rest of the three-year term.

- 3.18 The Trust was not aware that the Members' Interests Act applied to the Trust until new auditors identified this issue in 2013.
- 3.19 The Trust had been trading with the relevant companies for many years before the two trustees were elected. There is no suggestion that their position as trustees influenced the Trust's purchasing decisions.
- 3.20 The Trust asked us to consider giving retrospective approval under section 3(3) of the Members' Interests Act. This would mean that the two trustees would be deemed not to have been disqualified from office. We decided that we would likely have given approval if it had been sought at the time, which would have been done if the organisation had understood its statutory responsibilities properly. We were also aware that leaving the situation unresolved would expose the Trust to an undesirable level of legal risk as well as the cost of a by-election. We therefore gave the necessary approvals for the current and previous terms of office.
- 3.21 We also carefully considered whether we should bring a prosecution against the individuals for the offences they had committed. Even if the law is old and arguably out of date, it is still the law. Those holding public office or running public entities should be careful to comply with it. However, we decided that the public interest did not warrant a prosecution in this instance. We decided that recording the facts in this report to Parliament would provide enough transparency and accountability.

Accountability issues

- 3.22 Licensing trusts have a legal obligation to account to their communities for the assets that they hold and operate on their communities' behalf. The 2012 Act sets out the accountability obligations of licensing trusts. They must prepare financial statements in keeping with generally accepted accounting practice within five months after the end of each financial year, which must be audited by the Auditor-General. The audited financial statements must be publicly notified after the audit has been completed.¹³
- 3.23 We are concerned that several smaller licensing trusts are not complying with their statutory accountability and reporting obligations. This has particularly been an issue when a licensing trust winds up. However, some licensing trusts do not report in a timely manner on an ongoing basis. See Figure 7 for a list of licensing trusts that, after the five-month statutory deadline for the 2012/13 year, were behind with their accountability obligations.

¹³ The 1989 Act required licensing trusts to prepare a balance sheet and a profit and loss account annually and to publicly notify a summary of them.

3.24 We are concerned that our Office seems to be the only agency interested in endeavouring to hold licensing trusts to account to meet their financial reporting obligations or to help trusts meet their accountability obligations to their communities. No government department or select committee is responsible for monitoring licensing trusts or can assist trusts that are having difficulties meeting their financial accountability obligations. We note that the Department of Internal Affairs operates a rigorous audit process to ensure accountability of charitable organisations operating class 4 gaming machines, including those related to licensing trusts. This includes holding these organisations to account for publication requirements, to ensure that communities are informed, and monitoring minimum return rates.

3.25 Parakai Licensing Trust, Wainuiomata Licensing Trust, and Hawarden Licensing Trust have recently failed to meet their statutory accountability obligations to their communities.

Parakai Licensing Trust

3.26 Since 1972, Parakai Licensing Trust has owned one tavern, which it leased to independent operators. The Trust was effectively only a landlord, and its sole income was rent.

3.27 On 12 June 2013, the Trust was dissolved and became a community trust under the 2004 amendments to the 1989 Act (see paragraph 1.23). Although Parakai Licensing Trust completed all the necessary steps to become a community trust, including public notices, notification in the *New Zealand Gazette*, and an Order in Council, it had not provided appropriate financial statements and supporting information to complete the audit requirements for 2009/10 onwards.

3.28 On 10 July 2013, the assets of the Trust that had vested in the Parakai Community Trust were gifted to the Helensville District Health Trust. The Parakai Community Trust was dissolved at the same time. The outstanding annual financial statements for the Trust were not completed before both Trusts were dissolved and have not all been completed since then.

3.29 Despite the legal process of notifications about the dissolution that has occurred, the community has not received audited financial statements that set out what has been done with the assets that the Trust held on the community's behalf.¹⁴ A contributor to this delay has been the Trust's significant reliance on the auditors' help in preparing the financial statements. The Trust has needed this help because it lacked its own capability to address the accounting requirements associated

14 Since August 2013, we have been endeavouring to work with the Trust's representatives to help them meet the Trust's accountability requirements from an accounting perspective. The audit for 2009/10 was completed in April 2014. A process is now in place to complete the remaining outstanding reporting.

with dissolution. Our appointed auditor does not expect to be able to fully recover these costs (see Part 5). The auditor is currently working with the Helensville District Health Trust to resolve this.

Wainuiomata Licensing Trust and Wainuiomata Licensing (Charitable) Trust

3.30 Wainuiomata Licensing Trust ceased operating around 2003 and was wound up by court order in 2013. For several years before being wound up, the Trust operated only as a landlord of its premises, which it leased to a third party for a peppercorn rental. During this time, the Trust was not “engaged in activities associated with the sale of liquor”, as required by the 1989 Act. It also did not hold elections to maintain governance of the Trust. From 2002 until it was wound up in 2013, the Trust failed to complete its statutory accountability obligations in an appropriate time frame.

3.31 The financial statements for the group, which included the Wainuiomata Licensing (Charitable) Trust, a trust controlled by Wainuiomata Licensing Trust, for the nine years to 31 March 2011, and for 2011/12, were eventually prepared on a disestablishment basis for the Trust’s financial position as at 31 March 2012. Our appointed auditor drew attention to the Trust’s going-concern disclosures in the audit opinion dated 8 August 2012. This opinion confirmed that the Trust had appropriately not used the going-concern assumption because the Trust was about to be disestablished.

3.32 The assets of the Wainuiomata Licensing Trust group were subsequently vested in the Wainuiomata Bush Fire Force.

Hawarden Licensing Trust

3.33 Hawarden Licensing Trust owns one tavern, which it leases to independent operators. The Trust is effectively only a landlord, and its sole income is rent. Because the Trust is not directly involved in selling and supplying alcohol, it is unlikely that the Trust has been meeting its objectives under the 1989 Act or the 2012 Act.¹⁵ Our appointed auditor drew this to the Trust’s attention in 2007 and recommended that it consider reconstituting as a community trust. The Trust has not yet acted on this recommendation. Given the Trust’s limited income, the costs of reconstituting may be prohibitive.

3.34 The Trust receives a qualified audit opinion each year because it does not complete financial statements that comply with current accounting standards. The Trust argues that the standards are too complex for the simplicity of its operations and, therefore, that the expense involved is unwarranted, especially given its limited income.

¹⁵ It is likely that there are several other licensing trusts that are also operating in this position at the current time. To meet the objectives of the legislation this should be addressed.

- 3.35 Although we have some sympathy with this position, which we have previously expressed in various publications,¹⁶ this does not meet current accounting requirements.

Financial viability and performance

- 3.36 As noted earlier, licensing trusts are facing growing pressure through increased competition, declining revenue, changing social attitudes, and tougher legislation, combined with pressure to return more funding to their communities. These challenges have been prevalent for some years now. They have become more pronounced in recent years, with 14 licensing trust groups recording at least one loss within the five years to 31 March 2013. We recognise that the challenges of the recent economic down-turn and the competitive nature of the hospitality industry affect all those involved, not just licensing trusts. There has also been a reduction in class 4 gambling nationally since 2004, which has also affected licensing trust groups' profits.
- 3.37 We expressed doubt about the going-concern assumption for Oamaru Licensing Trust and Rimutaka Licensing Trust in their 2012/13 audit reports.

Oamaru Licensing Trust

- 3.38 Oamaru Licensing Trust does not have exclusive rights in its district, so it operates in a fully competitive environment. The Trust provides accommodation, conference facilities, and restaurant and bar services. The Trust has reported significant operating losses in recent years. Its operating cash flows, while positive, remain tight and have been deteriorating. Some structural and managerial changes implemented in October 2013 have improved its 2013/14 results.
- 3.39 The Trust's funding facilities are for 12 months. They are renewable in October each year, at the discretion of the Trust's bank. The short-term nature of these facilities has resulted in them being classified as current liabilities in the Trust's financial statements. This means that the Trust has a significant short-term liquidity risk. The Trust depends on the bank renewing the facilities in October each year. The cost of debt is a significant expenditure for the Trust, and renewing these banking facilities is crucial to the Trust's ongoing operations.
- 3.40 Our appointed auditors considered that the short-term nature of the loans and the significance of the Trust's dependence on the bank, coupled with financial pressures on the Trust, meant that there was a significant risk that the going-concern assumption would not be an appropriate basis for the preparation of the Trust's 2012/13 financial statements if the financial facilities provided by the bank are not renewed.

¹⁶ See, for example, *The Auditor-General's views on setting financial reporting standards for the public sector*, available at www.oag.govt.nz/2009/financial-reporting-standards.

- 3.41 For this reason, the auditor's report contained an emphasis-of-matter paragraph to draw the attention of readers to the situation set out in those financial statements. The emphasis-of-matter paragraph also referred to the Trust breaching one of its banking covenants on 31 March 2013 and its bank agreeing not to act on the breach.

Rimutaka Licensing Trust

- 3.42 Rimutaka Licensing Trust owns and operates a tavern in the Hutt Valley. Rimutaka Licensing Trust has a management contract with Trust House Limited to provide operational and administrative support.
- 3.43 For 2012/13, the Trust recorded an operating loss of \$89,499, and sustained a negative operational cash flow of \$50,980. The Trust had positive net current assets of only \$7,000 as at 31 March 2013.
- 3.44 Rimutaka Licensing Trust has a loan from Rimutaka Trust Limited for \$317,000. This loan is on commercial terms. It was due for repayment on 1 October 2013. However, the term of the loan has subsequently been extended to 1 October 2018.
- 3.45 For this reason, the auditor's report contained an emphasis-of-matter paragraph to draw the attention of readers to the situation set out in the financial statements. The emphasis-of-matter paragraph noted that the validity of application of the going-concern assumption in future years would be determined by the trustees' decisions about the Trust's future during 2013/14.
- 3.46 The Trust is currently considering its position and future options, and is taking community views into account.
- 3.47 It is pleasing to note that the trustees have committed to wind up the Trust promptly if a solution cannot be identified. The Trust's facilities are dated and need substantial renovation.

4

Oversight of licensing trusts

- 4.1 We consider that licensing trusts are probably the least scrutinised part of the public sector.
- 4.2 No central government agency or select committee has overall oversight or monitoring responsibility for licensing trusts. This is largely because those agencies' areas of responsibility are quite narrow and specific, which does not support broader engagement.
- 4.3 Local authorities have responsibility to operate District Licensing Committees under the 2012 Act¹⁷, but there is no requirement that they monitor or support licensing trusts.
- 4.4 The lack of coherent oversight, in combination with the significant number of challenges that licensing trusts face, is a cause for concern, particularly given the assets that licensing trusts manage on behalf of their communities.

Department of Internal Affairs

- 4.5 The Department of Internal Affairs (the Department) administers and enforces the Gambling Act 2003 (the Gambling Act) and all regulations made under the Gambling Act (gambling regulations). Licensing trusts are involved in providing class 4 gambling facilities (more commonly known as gaming or "pokie" machines). However, a licensing trust is unable to hold a class 4 operator's or venue licence under the Gambling Act. Entities set up by, or associated with, licensing trusts can hold operator and venue licences that allow them to operate gaming machines at licensing trust venues. These entities are usually constituted as charitable trusts.
- 4.6 The Department's role for licensing trusts is limited to regulating, auditing, and investigating class 4 gambling carried out by these charitable trusts at licensing trust properties.
- 4.7 Guidelines formed to outline the Department's view on assessing the financial viability of class 4 gambling operators has been under review for more than two years. Ongoing court action about the correct method of accounting for the costs of acquiring gambling equipment in calculating net proceeds under the Gambling Act has delayed the review's completion.

¹⁷ District Licensing Committees consider all matters associated with granting liquor licences, as required by sections 186-200 of the 2012 Act.

- 4.8 The guidelines currently include some accounting requirements that do not align with current accounting standards.¹⁸ When the review of the guidelines is finalised, we expect this matter to be corrected.

Ministry of Justice

- 4.9 The Ministry of Justice (the Ministry) administered the 1989 Act when it was in force and now administers the 2012 Act. The Ministry also advises on policy about alcohol-related offending, and crime and prevention.
- 4.10 The Ministry's only explicit responsibility for licensing trusts is the advisory role of the Minister of Justice in arranging Orders in Council by the Governor-General for constituting, varying, and amalgamating licensing trusts, and for vesting licensing trust assets in a newly constituted community trust. For example, the Ministry helped Parakai Licensing Trust to reconstitute as a community trust and to wind up that trust in 2013. However, it had no responsibility to ensure that the Trust had completed its accountability obligations before winding up.

State Services Commission

- 4.11 The 1989 Act, and subsequently the 2012 Act, provide for payment to the president of a licensing trust in keeping with the Fees Framework. The Fees Framework was established to enable Ministers and other individuals responsible for setting fees to set fees for members of bodies in which the Crown has an interest, within guidelines approved by Cabinet. The State Services Commission (the Commission) and the New Zealand Licensing Trusts Association Incorporated (the Association) prepared a step-by-step guide to determining the president's remuneration under the Fees Framework in 2002.¹⁹ The guide has not been updated since that time. The Commission's role relating to licensing trusts is limited to providing guidance on the application of the Fees Framework.

Controller and Auditor-General

- 4.12 The sole function of the Auditor-General in relation to licensing trusts is to audit and report on their financial statements under the Public Audit Act 2001. That function is supplemented by the general reporting powers of the Auditor-General under the Act, which have enabled the preparation of this report.

¹⁸ The guidelines currently require entities to account for any residual net proceeds not distributed at balance date as a liability because of the requirement to distribute during the financial year or within three months of the end of the year. Undistributed net proceeds do not technically meet the definition of a liability. As a result, this required treatment is incorrect and could affect the audit opinion. The Department of Internal Affairs has informally agreed that entities within the Auditor-General's mandate can disclose undistributed net proceeds in notes to the financial statements to avoid any effect on the audit opinion.

¹⁹ The current requirements are set out in Cabinet Office Circular CO (12) 6 dated 19 December 2012.

New Zealand Licensing Trusts Association Incorporated

- 4.13 The Association was established to provide support to licensing trusts and to act as an industry advocate. Apart from meeting for an annual conference and an annual general meeting, it appears to have had limited other activity in recent years. It has no staff. However, resources are provided by the licensing trust where the President of the Association is based, and Invercargill Licensing Trust provides financial support.²⁰ The Association has limited resources to provide support to individual licensing trusts that are facing challenges.
- 4.14 We acknowledge the work completed by senior management in licensing trusts during the 2012/13 year to establish a collective insurance scheme and self-insurance fund. This work has been completed in the name of the Association. However, it has been largely driven by those licensing trusts that will get the most value from the scheme. In general, smaller licensing trusts have not joined the scheme.
- 4.15 We also acknowledge the working party of chief executives formed by the Association at its 2014 annual conference and endorsed by trustees at the annual general meeting. The intention of the working party is to provide support to licensing trusts facing challenges. We will monitor the progress of the working party and assist where appropriate.

²⁰ In 2013, the Association received revenue of \$30,983, of which \$27,520 came from membership fees. Expenses totalled \$39,947. These were higher than normal because of additional costs incurred to obtain legal advice about proposed gambling legislation.

5

Auditing licensing trusts

- 5.1 In this Part, we discuss the audits of licensing trusts. We set out the factors that determine the audit fees for licensing trusts. We also discuss licensing trusts with late financial statements and those that have received non-standard audit reports.

Audit fees

- 5.2 Audit fees are currently a contentious matter for some licensing trusts. With many smaller licensing trusts struggling financially, facing pressure from the community, and operating in an increasingly competitive market where it is difficult to produce profits, there is often little willingness to pay audit fees. This is particularly so when private entities operating in the industry can avoid this cost by choosing not to appoint an auditor.
- 5.3 Audit costs are equally a challenge for the Auditor-General's audit service providers. Because of capability and capacity issues in licensing trusts, this challenge has escalated in recent years.
- 5.4 In this Part, we do not seek to establish any metric for calculating audit fees, because we continue to support the view that fees must take into account the individual circumstances of each entity.

Fee-setting background

- 5.5 Section 42 of the Public Audit Act 2001 authorises the Auditor-General to charge fees for auditing public entities. In practice, each public entity and its appointed auditor negotiate audit fees. The Auditor-General intervenes only if the parties fail to reach agreement.
- 5.6 Licensing trust audits are carried out in keeping with the *Auditor-General's Auditing Standards*. They include aspects that are not required in an audit of a private sector entity – in particular, consideration of effectiveness and efficiency, waste, and lack of probity or financial prudence.

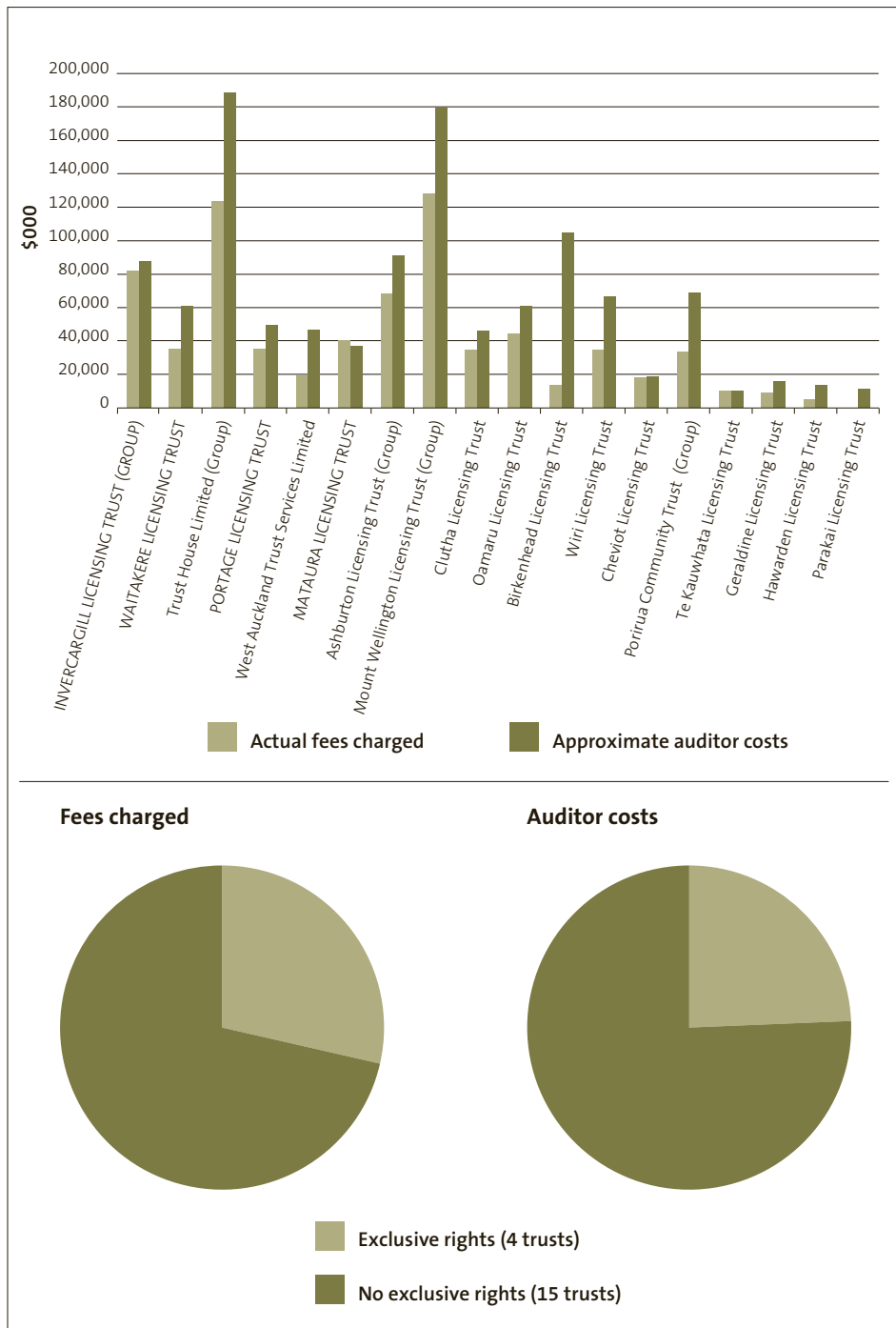
How licensing trusts' financial capability affects audit costs

- 5.7 Licensing trusts vary considerably in terms of their size and complexity of activities. In turn, the size and complexity of the business of each licensing trust affects the size and cost of its audit.
- 5.8 An equally significant determining factor of audit costs is the capability of the licensing trust to govern, operate, and control all aspects of its business and to provide the auditor with complete and accurate financial statements and supporting information for the audit.

- 5.9 The manner in which the auditor carries out the audit will also affect audit costs. Our audit service providers often do additional work to compensate for the lack of capability and capacity in public entities, particularly in smaller licensing trusts. Our auditors often work from incomplete and inaccurate initial draft financial statements to assist the entity's staff to meet statutory and accountability requirements during the audit process.
- 5.10 If a more hard-nosed "commercial" approach were adopted, it is likely for many (but not all) licensing trusts that the auditor would simply carry out an audit to the extent possible based on the information supplied and issue an appropriate audit opinion – which might well be a modified opinion.
- 5.11 Additional audit costs do not automatically translate into additional audit fees for entities. In the private sector, if audit fees are unacceptably low, or for other reasons such as excessive audit risk, the auditor can decide whether to continue as the auditor. The Auditor-General cannot do this because she is the statutory auditor. A consequence is that audit fees are affected not only by the above factors, but also by how prepared the auditor is to absorb costs "for the public good".
- 5.12 The Auditor-General's audit service providers often also absorb additional audit costs to avoid incurring further cost in trying to negotiate a higher fee. Our experience with some smaller licensing trusts is that trustees often view audit costs as a "grudge purchase". As a result, audit fees for licensing trusts vary widely and often do not reflect the apparent size or complexity of the activities of the trust or the actual audit costs.
- 5.13 We acknowledge that, for some of the smaller trusts, the audit fee can be a significant proportion of their often minimal profit, even if the audit goes smoothly. This can directly affect the funds available to distribute to the community.
- 5.14 In Figure 6, we set out the fees actually charged for the 2012/13 audit (or the most recently completed audit before 2012/13) for each licensing trust group and the actual costs the audit service provider incurred to complete that audit. Although cost overruns, which are often not on-charged to the entity, are not uncommon in the public sector, we consider that they are too common in licensing trust audits. In our view, this reflects the lack of capability and capacity in some licensing trusts.²¹ In the current environment, we consider that the situation faced by audit service providers is unlikely to improve.

21 We acknowledge that, in some instances, overruns are the result of poor performance by the audit service provider and cannot be wholly attributed to the performance of the audited entity.

Figure 6
Audit costs, audit fees, and resulting fee overruns for the year ended 31 March 2013*



* For the 2012/13 audit, the following licensing trusts had a change of auditor, which might have affected the costs incurred by the audit service provider – Oamaru Licensing Trust, Clutha Licensing Trust, the Porirua Community Trust group, Portage Licensing Trust, Waitakere Licensing Trust, West Auckland Trust Services Limited, and two of the subsidiaries in the Mount Wellington Licensing Trust group. West Auckland Trust Services Limited is included because it has an audit fee in its own right in addition to the audit fees for the trusts that it provides management services to. The audit fees for Flaxmere and Rimutaka Licensing Trusts are included in the Trust House group fees.

As with Figures 1, 2, and 3 earlier, the licensing trusts that are shown with all capital letters are those that have exclusive rights to operate hotels, taverns, and off-licences in their districts, and the trusts are ordered from left to right based on highest to lowest revenue, as identified in Figure 1.

Late financial statements

- 5.15 We issued 30 standard audit reports and six non-standard audit reports for licensing trusts and their subsidiaries for the period 1 January 2013 to 30 April 2014.
- 5.16 Ten sets of financial statements for licensing trusts for the year ended 31 March 2013 or earlier years had not been completed or audited by 30 April 2014. These are listed in Figure 7.

Figure 7
Licensing trust audits in arrears

Entity	Years in arrears	Number of years
Birkenhead Licensing Trust	2013	1
Birkenhead Charitable Trust	2013*	1
Hawarden Licensing Trust	2012, 2013	2
Parakai Licensing Trust	2011, 2012, 2013	4
Mount Wellington Licensing Trust	2011, 2012, 2013	3

* Subsequently completed prior to publication of this report.

Non-standard audit reports

- 5.17 In Figures 8 and 9, we set out details of the non-standard audit reports that we issued during the period 1 January 2013 to 30 April 2014.

Figure 8
Qualified opinions

Te Kauwhata Licensing Trust

Financial statements year ended: 31 March 2013

The Trust had limited controls over some of its revenue, which limited the assurance we could get about the completeness of its revenue.

Mount Wellington Licensing Trust and group

Financial statements year ended: 31 March 2009

The financial statements of the Trust's subsidiaries, Mount Wellington Charitable Trust and Mount Wellington Foundation Limited, were not consolidated in the group financial statements. This is a departure from New Zealand Equivalent to International Accounting Standard (NZ IAS 27): *Consolidated and Separate Financial Statements*, which requires an entity that has one or more subsidiaries to prepare consolidated financial statements for the group.*

Parakai Licensing Trust

Financial statements year ended: 31 March 2010

The Trust had limited control over some of its revenue, which limited the assurance we could get about completeness of its revenue.

We also drew attention, without modifying our opinion, to the fact that on 12 June 2013 the Parakai Licensing Trust was dissolved and its undertakings vested in the Parakai Community Trust. Further, on 16 July 2013 the Trustees gifted the operations, assets, and liabilities to the Helensville District Health Trust and disestablished the Community Trust.

* This was a complex technical issue that took time to resolve. We have a timetable in place to complete outstanding audits by March 2015.

Figure 9
Emphasis-of-matter paragraphs

Oamaru Licensing Trust

Financial statements year ended: 31 March 2013

We drew attention to the disclosures in the financial statements that referred to the going-concern assumption being appropriately used in preparing the financial statements. The validity of the going-concern basis depends on the Trust being able to obtain ongoing funding. It is required to renew its loans in October 2013 because it was in breach of one of its banking covenants at 31 March 2013.

Kauri Finance Limited (Porirua Community Trust)

Financial statements year ended: 31 March 2013

We drew attention to the fact that the financial statements for the year ended 31 March 2012 were not audited and the prior year comparative information in the current year's financial statements has not been audited.*

Rimutaka Licensing Trust and group

Financial statements year ended: 31 March 2013

We drew attention to the disclosures in the financial statements that referred to the uncertainties surrounding the going-concern assumption, which include continued pressure on the Trust's turnover and the options for the future of the Trust. The validity of the going-concern assumption depends on the decisions to be made by the Trustees on the future of the Trust by considering the various options that are available to them.

* Financial years ending March 2011 and 2012. Kauri Finance Limited was audited through the consolidated financial statements of the Porirua Community Trust. This approach did not comply with the accounting and auditing standards and, once identified, was corrected.

Appendix

Description of current licensing trusts

Ashburton Licensing Trust group

Ashburton Licensing Trust

Ashburton Licensing Trust operates two bottle stores, a café/deli, five bars, four restaurants, a hotel with 54 rooms and six conference rooms, and a 12 unit motel. It holds a 4.97% share in DB South Island Brewery Limited. Ashburton Licensing Trust has about 112 fulltime equivalent (FTE) staff.

Braided Rivers Trust

Braided Rivers Trust owns Ashburton Licensing Trust's subsidiaries. It is 100% owned by Ashburton Licensing Trust. Braided Rivers Trust has no staff.

Somerset Ashburton Limited

Somerset Ashburton Limited owns an investment property building with café/deli (the business is owned by Ashburton Licensing Trust), Ashburton Licensing Trust's headquarters, and rented office space. Somerset Ashburton Limited is 100% owned by Braided Rivers Trust. Somerset Ashburton Limited has no staff.

Braided Rivers Limited

Braided Rivers Limited was set up to subdivide and sell excess land associated with Ashburton Licensing Trust's conference facility – Hotel Ashburton. Braided Rivers Limited is 100% owned by Braided Rivers Trust. Braided Rivers Limited has no staff.

Birkenhead Licensing Trust group

Birkenhead Licensing Trust

Birkenhead Licensing Trust operates two bar-and-restaurant facilities. It has about five FTE staff. It contracts the services it needs for certain administration and accountability requirements from Birkenhead Charitable Trust and an external accountant. It also receives revenue from gaming site rentals operated on its premises by a privately owned charitable trust.

Birkenhead Charitable Trust

Birkenhead Charitable Trust owns one of the premises that Birkenhead Licensing Trust operates from. It provides small grants to the community using rent received from Birkenhead Licensing Trust. Birkenhead Charitable Trust and Birkenhead Licensing Trust have the same trustees.

Cheviot Licensing Trust

Cheviot Licensing Trust operates one small hotel, with two motel units, four hotel rooms, a camping ground, and a bar and restaurant facility. Cheviot Licensing Trust holds a 0.13% share in DB South Island Brewery Limited. It has about nine FTE staff.

Clutha Licensing Trust

Clutha Licensing Trust operates seven licenced premises in the Clutha region. All are directly managed by the Trust. The businesses include a hotel, a restaurant, five bar/bistros, a sports bar, six bottle stores, and one conference, function, and catering facility. Clutha Licensing Trust has about 53.5 FTE staff.

Flaxmere Licensing Trust group

Flaxmere Licensing Trust

Flaxmere Licensing Trust is non-trading and owns 3.2% of Trust House Limited. It has cash held in term deposit investments. Flaxmere Licensing Trust contracts the services it needs for administration and accountability requirements from Trust House Limited. Flaxmere Licensing Trust oversees Flaxmere Licensing (Charitable) Trust.

Flaxmere Licensing (Charitable) Trust

Flaxmere Licensing (Charitable) Trust was established by Flaxmere Licensing Trust for charitable purposes. Flaxmere Licensing (Charitable) Trust owns 1.4% of Trust House Limited. It recommends to the trustees of Trust House Foundation how gaming profits should be distributed to the community.

Geraldine Licensing Trust

Geraldine Licensing Trust owns three properties in Geraldine, which it leases to the Village Inn, Westpac Bank, and Bradley West Solicitors. Geraldine Licensing Trust holds a 0.39% share in DB South Island Brewery Limited. It has no staff.

Hawarden Licensing Trust

Hawarden Licensing Trust owns one tavern property and a residential property that are leased to independent operators. It holds a 0.0255% share in DB South Island Brewery Limited. Hawarden Licensing Trust does not directly employ any staff, but it does pay a secretary/treasurer on a time-required basis. The tavern operations are carried out by the independent licensee, who employs any staff required.

Invercargill Licensing Trust group

Invercargill Licensing Trust

Invercargill Licensing Trust operates a wide range of businesses in the hospitality industry in Invercargill. It also operates a motel in Dunedin and a motel in Christchurch. Invercargill Licensing Trust operates two hotels, four motels, 14 taverns and bars, six major liquor outlets, eight convenience bottle stores, and one conference and catering business. Invercargill Licensing Trust also provides alcohol wholesale to supermarkets throughout Otago and Southland. Invercargill Licensing Trust has exclusive rights to operate hotels, taverns, and off-licences in its district. It holds a 28.3% share in DB South Island Brewery Limited. Invercargill Licensing Trust has about 420 FTE staff.

Invercargill Licensing Trust Foundation

Invercargill Licensing Trust Foundation owns and operates all gaming machines in Invercargill Licensing Trust's establishments. It currently owns 181 gaming machines.

Masterton Licensing Trust group²²

Masterton Licensing Trust

Masterton Licensing Trust's principal activity is owning shares in Trust House Limited. It is non-trading. Masterton Licensing Trust owns a 75.2% share in Trust House Limited. Masterton Licensing Trust receives a royalty from Trust House Limited to finance its small operating costs. Masterton Licensing Trust contracts the services it needs for administration and accountability requirements from Trust House Limited. Masterton Licensing Trust oversees the performance of Trust House Limited, Trust House Foundation, Masterton Licensing (Charitable) Trust, and, to a certain extent, Tararua Foundation. Masterton Licensing Trust has no staff.

Masterton Licensing (Charitable) Trust

Masterton Licensing (Charitable) Trust was established by Masterton Licensing Trust for charitable purposes in the Masterton district. Masterton Licensing (Charitable) Trust has a 20.2% share in Trust House Limited. Masterton Licensing (Charitable) Trust recommends to the trustees of Trust House Foundation how gaming profits should be distributed to the community. Masterton Licensing (Charitable) Trust has no staff.

²² From a legal and technical accounting perspective, Trust House Limited is the group. We have listed Masterton Licensing Trust first to align with the rest of the Appendix.

Trust House Limited

Trust House Limited is the main trading entity in the Masterton Licensing Trust group and is controlled by Masterton Licensing Trust. Trust House Limited is primarily involved in the hospitality industry. Trust House Limited operates several bars, restaurants, bottle stores, a mid-range supermarket, and a major hotel in the Wairarapa, Wellington, and Flaxmere areas. Trust House Limited also operates a large rental residential housing portfolio. This portfolio comprises about 487 properties in the lower North Island. Trust House Limited provides management services for all of the entities in the Masterton Licensing Trust group in exchange for a management fee. Trust House Limited employs about 200 FTE staff.

Trust House Foundation

Trust House Foundation was established by Trust House Limited. It has responsibility for the licences for the class 4 gaming machines it operates in Trust House Limited and Rimutaka Licensing Trust premises. Trust House Foundation contracts Trust House Limited to perform administrative and management functions. By agreement, the trustees of Rimutaka Trust, Masterton Licensing (Charitable) Trust, and Flaxmere Licensing (Charitable) Trust recommend to the trustees of Trust House Foundation how gaming profits should be distributed to the community. Trust House Foundation approves these recommendations. Trust House Foundation has no staff.

Tararua Foundation Incorporated

Tararua Foundation Incorporated is controlled by Trust House Limited. The primary activity of Tararua Foundation is to own and operate the Kourarau Hydro Scheme. Tararua Foundation sells electricity to the spot market through its agent, Simply Energy Limited. Tararua Foundation is also potentially a vehicle for the development of a sports stadium in the Wairarapa and is currently holding some funds for this. Tararua Foundation has no staff.

Mataura Licensing Trust

Mataura Licensing Trust operates four hotels, one motel, four taverns, two restaurants, and two bottle stores. Mataura Licensing Trust holds a 4.83% share in DB South Island Brewery Limited. Mataura Licensing Trust has exclusive licence rights to operate hotels, taverns, and off-licences in its district. Mataura Licensing Trust has about 110 FTE staff.

Mount Wellington Licensing Trust group

Mount Wellington Licensing Trust

Mount Wellington Licensing Trust operates as an investment-holding entity. All of its activities are carried out through its subsidiaries. Mount Wellington Licensing Trust is effectively a governing entity with no staff.

Mount Wellington Trust Hotels Limited

Mount Wellington Trust Hotels Limited is 100% owned by Mount Wellington Licensing Trust. It operates a 148-room hotel with extensive conference facilities, a stand-alone conference centre and a community bar. All operations are managed centrally to maximise management expertise and purchasing power. Mount Wellington Trust Hotels Limited has about 165 FTE staff.

Mount Wellington Charitable Trust Board

Mount Wellington Charitable Trust Board is 100% owned by Mount Wellington Licensing Trust. The Trust Board includes the six trustees of Mount Wellington Licensing Trust and three independent trustees. The Trust Board makes donations to qualifying organisations in the local community. It has no staff. However, administration is undertaken by two contactors on a part-time basis.

Mount Wellington Foundation Limited

Mount Wellington Foundation Limited is a gaming society, which is 100% owned by Mount Wellington Charitable Trust Board. Mount Wellington Foundation Limited has a class 4 operator's licence and operates 36 machines in two venues. Mount Wellington Foundation Limited employs a part-time manager and two part-time staff.

Keri Corporation Limited

Keri Corporation Limited operates one bar. It has no FTE staff. All administration, including staff, are provided by Mount Wellington Trust Hotels Limited.

Oamaru Licensing Trust

Oamaru Licensing Trust owns and operates four establishments in Oamaru – one hotel with conference facilities and 49 rooms, one sports bar, one off-premise liquor franchise outlet, and one motel-restaurant-bar and bottle store with conference facilities and 16 motel rooms. Oamaru Licensing Trust holds a 5.66% share in DB South Island Brewery Limited. Oamaru Licensing Trust has about 84 FTE staff.

Parakai Licensing Trust

Parakai Licensing Trust owned one tavern that was leased out. Its sole revenue source was rent. During 2013, the lease was terminated and Parakai Licensing Trust became a community trust. Its assets were subsequently vested in a local health trust.

Porirua Community Trust group

Porirua Community Trust

Porirua Community Trust receives management fees from Trust Porirua. It has minimal transactions of its own. It consolidates the results of its wholly owned subsidiary, Trust Porirua. Porirua Community Trust was reconstituted under the Sale of Liquor Act 1989 after it ceased to have any interest in the alcohol industry after the sale of its trading operations by its then subsidiary, Mana Taverns Limited. Porirua Community Trust employs no staff.

Trust Porirua

Trust Porirua was established and is 100% owned by Porirua Community Trust. The principal activities of Trust Porirua are to promote charitable purposes in Porirua. Trust Porirua holds investment properties and other investments. Trust Porirua employs no staff.

Mana Community Grants Foundation

Mana Community Grants Foundation was established by Porirua Community Trust as a charitable trust. It operates gaming machines with the goal of maximising the returns from these machines for the benefit of the local community. Mana Community Grants Foundation owns 90 machines operating out of five separate and independently owned venues. Mana Community Grants Foundation's management and accounting requirements are provided by an independent contractor, under a management agreement. Kauri Finance Limited funds the purchase and maintenance of Mana Community Grants Foundation's gaming machines. Mana Community Grants Foundation employs no staff.

Kauri Finance Limited

Kauri Finance Limited is 100% owned by Trust Porirua. Its revenue consists of interest from loans to Mana Community Grants Foundation and to a company that operates a tavern in Petone. Kauri Finance Limited employs no staff.

Rimutaka Licensing Trust group

Rimutaka Licensing Trust

Rimutaka Licensing Trust owns and operates a wholesale liquor outlet and a public bar facility in Rimutaka. It also owns the land and building where the wholesale and public bar are situated. Rimutaka Licensing Trust currently contracts the services it needs for administration and accountability requirements from Trust House Limited. Rimutaka Licensing Trust has about 10 FTE staff.

Rimutaka Trust

Rimutaka Trust is a subsidiary of Rimutaka Licensing Trust. Its main function is to recommend to Trust House Foundation (controlled by Trust House Limited) how gaming machine profits should be distributed to the community. The trustees of Rimutaka Trust are the same as the trustees of Rimutaka Licensing Trust. Rimutaka Trust contracts the services it needs for administration and accountability requirements from Trust House Limited.

Te Kauwhata Licensing Trust

Te Kauwhata Licensing Trust is the owner of one tavern property, in which it operates two bars, and a wholesale bottle store. Te Kauwhata Licensing Trust has about five FTE staff.

West Auckland

Portage Licensing Trust

Portage Licensing Trust has exclusive rights to operate hotels, taverns and off-licences in its district. It operates six bars, one restaurant, and nine bottle stores. Management, administrative, and accounting services are provided to Portage Licensing Trust by the shared-services company, West Auckland Trust Services Limited. Portage Licensing Trust has about 127 FTE staff.

Waitakere Licensing Trust

Waitakere Licensing Trust has exclusive rights to operate hotels, taverns, and off-licences in its district. It operates seven bars, two restaurants, one hotel, and 14 bottle stores. Management, administrative, and accounting services are provided to Waitakere Licensing Trust by the shared-services company, West Auckland Trust Services Limited. Waitakere Licensing Trust has about 226 FTE staff.

West Auckland Trust Services Limited

West Auckland Trust Services Limited is a shared-services management company providing services to Portage Licensing Trust and Waitakere Licensing Trust. It is 50% owned by each of these trusts. It has a board comprising five independent directors (including the Chair) and two trustees from each shareholding trust. A board appointments panel appoints the independent directors on the basis of an agreed skills assessment process.

Wiri Licensing Trust

Wiri Licensing Trust owns some investment property that has several long-term tenants and some short-term tenants because Wiri Licensing Trust intends to redevelop some of its investment property in the near future. Wiri Licensing Trust owns two bars. One is operated under management contract, and the other is operated directly by Wiri Licensing Trust. The Trust also receives revenue from gaming site rentals operated on its premises by a privately owned charitable trust. Wiri Licensing Trust has about 13 FTE staff.

Publications by the Auditor-General

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

- Annual Report 2013/14
- Ashburton District Council: Allegations of conflicts of interest affecting decisions on a second bridge
- New Zealand Transport Agency: Maintaining and renewing the state highway network – follow-up report
- From auditor to soldier – stories of the men who served
- Accident Compensation Corporation: How it deals with complaints
- Ministry of Social Development: How it deals with complaints
- State-owned enterprises: Results of the 2012/13 audits
- Public entities' progress in implementing the Auditor-General's recommendations 2014
- The Auditor-General's strategic intentions 2014/15 to 2017/18
- Annual Plan 2014/15
- Setting up Central Agencies Shared Services
- Watercare Services Limited: Review of service performance
- Local government: Results of the 2012/13 audits
- Inquiry into the Plumbers, Gasfitters, and Drainlayers Board: Follow-up report
- Reflections from our audits: *Our future needs – is the public sector ready?*
- Health sector: Results of the 2012/13 audits

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.

Notification of new reports

We offer facilities on our website for people to be notified when new reports and public statements are added to the website. The home page has links to our RSS feed, Twitter account, Facebook page, and email subscribers service.

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