Controller and Auditor-General
Tumuaki o te Mana Arotake

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Local government: Results of the 2012/13 audits

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A sewerage maintenance worker with the former Auckland Regional Council, examines the new cables in place to prevent the Orakei Sewerage Hobson Bay crossing pipe from leaking. (Photo by Phil Walter)

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Last year, when I set out the results of the annual audits of entities in the local government sector, I reported that 2011/12 was demanding. This situation did not change in 2012/13. The year saw a focus on cost containment by local authorities, demands for constraint by their communities, proposed legislative amendments to the Local Government Act 2002, proposals for reorganisation of local authorities in some areas, the continuing effects of the 2010 and 2011 earthquakes on Canterbury local authorities, and the local body elections in October 2013.

Continued focus on good governance is necessary

In demanding environments, weaknesses in governance can often expose entities that are poorly equipped to manage uncertainties (or risk) or that are incapable of making well-founded investment decisions.

My staff contributed to the training by Local Government New Zealand of new and re-elected members by talking about the nature of risk and the extent to which external auditing contributes to managing that risk. We discussed our concern that elected members see an audit opinion as protecting them from all the risks they must manage and are responsible for.

Elected members are responsible for what the local authority does and how it does it – they are responsible for "getting it right". It is the elected members who the public hold accountable for those decisions and actions.

In December 2013, I released my report on an inquiry into the Mangawhai community wastewater scheme. This report detailed the woeful saga of the Kaipara District Council's poor management and governance oversight of the scheme, with failings at almost every stage of the project, as well as highlighting shortcomings and inadequacies by other parties. I encourage all public entities to read the report and take heed of the lessons learned, and consider the messages about the importance of having robust accountability, governance, and management controls in place.

Local Government New Zealand's partnership with the Institute of Directors and the development of training modules focusing on governance, leadership, and strategy skills for elected members are positive moves. And many local authorities are putting in place audit and risk committees as part of their framework for managing uncertainty and risk.

My Office's theme for work in 2014/15 is *Governance and accountability,* and we will maintain an interest in the developments in local government.

Near enough is not good enough

The 2012/13 year highlighted some poor practices within local government. Although I consider that communities are well served by their local authorities, my Office has observed practices – often practices that have evolved over time – that are out of step with statutory requirements. Many of the actions might, in themselves, seem minor, but their cumulative nature risks undermining the reputation of an individual local authority and the reputation of the sector.

Some local authorities justify their practices on the grounds of "being pragmatic", but their practices might mean that legal requirements are not met. This is a risk that, in my view, the sector should not take. In my view, near enough is not good enough.

Setting rates

During the year, it became apparent that there were several widespread problems with rating practices. Our audit work on rates revenue found that most local authorities had some level of compliance failure. Problems ranged from potentially serious legislative breaches, which created a significant financial risk to the local authority's revenue, through to low-risk legal breaches.

The problems we saw were related to all aspects of the rating legislation. Many of the problems seem to have arisen because of insufficient attention to legal requirements. The power to rate comes with obligations that need to be given the appropriate level of attention. It is important that local authorities use their legal powers to impose rates on their communities properly.

Local authorities need to lift their game and improve their processes and practices for setting rates.

I am encouraged by the positive response to the issues we have raised. Most local authorities sought legal advice and either took corrective action to rectify the errors or drew the errors to the attention of their communities. Local Government New Zealand and the Society of Local Government Managers have undertaken to work with local authorities to provide training and support to ensure that rating practices improve.

Reporting annually to communities

Six local authorities failed to meet the statutory deadline for adopting their annual reports. This compares with one failure in 2011/12. Of those six, one local authority's audit was still incomplete as at 31 March 2014.

Those not meeting the deadlines for adopting and releasing their annual reports are failing to provide their communities with the timely information they are entitled to receive. It is disappointing to see this increase in the number of statutory breaches.

Consistent financial trends in local authorities

My Office analysed the audited financial information in local authorities' annual reports. We found that local authorities sought to contain operating costs and work within their set budgets in 2012/13. This helped local authorities to limit rates increases for their communities.

Rates are a critical revenue stream for local authorities, which have few alternative revenue sources. There is limited ability for a local authority to reduce its reliance on rates revenue.

In my 2012 report, *Matters arising from the 2012-22 local authority long-term plans,* we identified that local authorities planned to spend $36.8 billion on capital works in the 10 years to 2021/22. Local authorities typically use debt to fund (at least in part) the construction of long-life assets.

The 2012/13 results continue the significant trend of local authorities carrying out substantially less capital work than budgeted. Local authorities' capital expenditure was $3.5 billion in 2012/13, $0.9 billion (20%) less than the $4.4 billion budgeted. In my view, there is a need to analyse this trend in detail, particularly to identify whether there is a growing backlog of renewal work or whether budgeting is too optimistic in comparison to contracting and administrative capacity.

Canterbury earthquakes and insurance recoveries

The Canterbury earthquakes highlighted the importance of good risk management for public entities, and the part insurance plays in that. There are two main local government insurance entities, Civic Assurance and the Local Authority Protection Programme Disaster Fund. They provide insurance cover to Christchurch City Council, and proceeds from insurance recoveries are expected to make a significant contribution to funding the rebuilding of infrastructure.

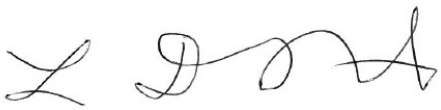
Some amounts have been paid to Canterbury local authorities by these insurance entities, but there are also some delays due to disputes with reinsurers. The time frame for resolving those disputes is uncertain.

Future focus

Local authorities are starting to prepare their 2015-25 long-term plans. These plans are an opportunity for local authorities to communicate and engage with their communities. The right debate with the community on what levels of service are affordable over time is critical.

Our focus will remain firmly on good asset management and the levels of service that local authorities are proposing to provide. Local authorities will also need to demonstrate to their communities that their funding path or financial strategy is prudent and fair.

My staff and I look forward to continuing our work with the local authority sector as it meets the challenges ahead.



Lyn Provost
Controller and Auditor-General

26 May 2014

Part 1
Our recent work on governance in local authorities

1.1 Several of our recent reports have considered the challenges of the governance role, particularly for those who are elected to govern local authorities. We drew on this work when we contributed to the training of new members of local authorities elected in October 2013. Our discussions with the sector, in that training and elsewhere, have focused on the tools available to help governance bodies manage their risks.

1.2 This Part sets out the main points from those discussions. We cover:

- the main role of an elected member;
- the sources of support available; and
- some lessons for elected members.

What is the role of an elected member?

1.3 Legislation does not spell out exactly what the governance role requires – for local authorities or any public entity. The responsibility is general and somewhat vague. It cannot be captured in a definitive list of tasks or functions.

1.4 The Local Government Act 2002 (the Act) requires each local authority, after an election, to work out how it is going to govern the organisation. Section 40 of the Act requires local authorities to prepare governance statements that set out, among other matters:

- their view of the responsibilities of the local authority;
- the electoral system and representation arrangements and how to change them;
- elected members' roles and expected conduct;
- governance structures and processes, including membership of the various committees that make up the governance structures and delegations of decision-making authority to those committees and to staff;
- the meeting processes that will be followed; and
- the management structure and the relationship between management and elected members.

1.5 In essence, elected members are responsible for what the local authority does and how it does it. This does not mean that all elected members must be actively involved in every part of the organisation's business. It is common to allocate large parts to management and staff, and to allocate different aspects of the governance responsibilities to specific parts of governance structures, such as local authority committees.

1.6 Generally, the roles are for:

- the governing body to set direction and policy, make important decisions, report to the public, and oversee the functioning and health of the organisation including its long-term capability and sustainability, and its compliance with the law; and
- management to focus on putting policies and decisions into effect, carrying out the organisation's functions, and providing information and advice to the governing body.

1.7 Elected members ensure that management is performing satisfactorily. The elected members are responsible for acting if problems emerge. Being able to identify risks early and manage them well is a vital skill for effective governance, helping to avoid pitfalls and keep an organisation on track.

1.8 In the end, elected members are responsible for "getting it right". To meet that responsibility, they need to receive high-quality information and advice from local authority officers and external professional advisors. Elected members need to know when to ask questions of their advisors, what questions to ask, and when to insist on expert advice to ensure that their questions are answered satisfactorily.

1.9 We encourage elected members to use common sense in their work. Common sense is a legitimate governance tool and a good way of testing technical and complex advice.

1.10 In November 2013, we noted in our report, *Inquiry into the Mangawhai community wastewater scheme* (our Kaipara District Council report) that the governance role is about maintaining the broad view. It involves:

- setting direction and policy;
- making significant decisions;
- testing and challenging advice to ensure that it is sound;
- monitoring the work of management to ensure that what is being done will achieve the local authority's objectives;
- keeping an eye on risks; and
- safeguarding the overall quality of the relationship between the local authority and its community.

1.11 When members of a governing body become too involved in operational matters, the risk is that nobody holds the broad view for the organisation and checks that the overall direction remains appropriate. Conversely, if elected members take too little interest in what the organisation is actually doing on the ground, they can become distant and disempowered. The art of effective governance is being able to find the right balance between these two extremes and understanding that the balance will change depending on the circumstances.

1.12 Fortunately, elected members do not carry out their responsibilities in isolation. Many sources of support are available. An elected member who understands when and how to use each source of support is more likely to be effective.

What sources of support are available?

1.13 Risks to local authorities come in several forms, including legal risk, financial risk, fraud risk, procurement risk, operational risk, and reputation risk. Newly elected members need to familiarise themselves with the main types of risk facing their organisation, how those risks are managed, and how they get information and assurance about them.

Local authority management

1.14 The chief executive is the link between governance and management. This means that it is vital that elected members have an effective relationship of trust with the chief executive. The chief executive is the conduit for access to the support of a team of senior managers and the organisation they lead.

1.15 The chief executive and staff are the main source of support for an elected member. That support must be accessed through appropriate channels, in keeping with the protocols agreed and recorded in the governance statement and elsewhere. Elected members need to respect that staff are impartial professionals, serving whomever the community elects to govern the organisation.

Legal advice

1.16 Managing legal risk is vital for public entities that exercise public power and spend public money. Legislative obligations affect all aspects of a local authority's work – how it operates, consults, runs meetings, makes decisions, and carries out what it actually does. Internal rules, such as organisational policies and delegations of authority, can also affect the lawfulness of individual decisions and actions.

1.17 Local authorities need to be meticulous about complying with the law and showing that they are acting within the law. The governors of the local authority should set that tone. In our Kaipara District Council report, we noted numerous inadequacies in the attention that the Council paid to legal issues when its Mangawhai wastewater project began, problems with the way it sought legal advice, and damage to its reputation within the community as a result.

1.18 If elected members are in doubt about their legal obligations, they should ask for professional legal advice. Some local authorities have internal capacity to provide legal advice. Many others rely on external legal advisers. The cost of obtaining such advice needs to be set against the importance of being seen to be careful to act within the law.

Audit committees

1.19 The governing body has to have an overview of all these risks. It also has to have systems or ways of getting advice to assure itself that the risks are appropriately managed. Many local authorities establish a dedicated audit (or audit and risk) committee. Such committees – usually a group of elected members and expert external appointees – are set up to give advice to the highest level of governance on matters of risk. Our 2008 guide, *Audit committees in the public sector*, commented that:

> *Audit committees have a valuable contribution to make in improving the governance, and so the performance and accountability, of public entities. They can play an important role in examining an organisation's policies, processes, systems, and controls. An effective audit committee shows that an organisation is committed to a culture of openness and continuous improvement.*
>
> *An audit committee does not displace or change proper accountability arrangements. Accountability for good governance rests with the public entity's governing body ...*
>
> *Effective audit committees can provide objective advice and insights into the public entity's strategic and organisational risk management framework. In doing so, they can identify potential improvements to governance, risk management, and control practices.*

1.20 There are four main assurance benefits from operating an effective audit committee – increased scrutiny, efficient use of resources, increased focus on internal assurance, and increased focus on accountability. The two main advisory benefits from operating an effective audit committee are a fresh perspective and a range of experience and expertise.

1.21 We noted in our Kaipara District Council report that audit committees are a particularly useful way for a governing body to manage any gaps in the skills and knowledge of its members. This is because of the ability to appoint independent members with particular expertise and experience.

1.22 We encourage those local authorities that have yet to set up an audit committee to consider doing so.

1.23 An effective audit committee plays an important role in improving governance, particularly because it can supplement the skills of the governing body with external appointees. However, an audit committee is only one part of protecting the local authority from risks. In the end, the governing body remains accountable for how well risks are managed, using the full range of tools available to it.

Internal audit

1.24 Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of risk management, control, and governance processes. The internal audit activity helps provide assurance to managers and governors that systems, processes, and controls are working effectively and in the way they were designed to.

1.25 An audit committee often oversees the programme of internal audit work.

External audit

1.26 Local authorities are required to have specific information in their annual reports and long-term plans audited. The purpose of the audit is to increase the confidence that readers can have in the information presented.

1.27 Local authorities need to understand the role of an auditor and their own responsibilities. The local authority is responsible for complying with legislative and accountability requirements. It must maintain financial and other records so that it can accurately meet its reporting obligations. Practical responsibility for maintaining good systems and producing the information rests with management. The local authority's governing body provides oversight and guidance, but it must also take formal responsibility for the information that is produced and reported.

1.28 The auditor's role is to provide an independent opinion on whether the information reported by the local authority can be relied on. The auditor does not provide an opinion (in a legal sense) on the local authority's legal compliance, other than the general assurance provided by the audit.

1.29 Local authorities often have a different impression of what an audit involves, which results in what we describe as an "expectation gap". For instance, local authorities with an unmodified audit opinion are often described as having "got the big tick" or similar. The implication is that an unmodified audit opinion means that everything has been checked and is fine.

1.30 In fact, an annual audit has a much narrower and more technical focus. The basic task of an auditor is to give an opinion on whether the information within the financial statements that the local authority has produced can be relied on. In local government, that task is broadened to cover information about service performance as well as the information in the financial statements. All of the auditor's work is directed towards being able to form this opinion.

1.31 Auditors do not check everything. They check the systems and processes that help produce the information that is subject to audit and check selected transactions within those systems. The auditor's work is based on the concept of "materiality". An auditor does not need to be concerned with transactions or aspects of the business that are too small to have a material effect on the information being reported. Auditors report on their work to the governing body of the local authority and to the public in the audit report that accompanies the local authority's annual report.

1.32 There is a popular misconception that auditors have checked that every transaction has been properly entered into and recorded. Auditors cannot and do not do this.

1.33 Although every audit report spells out what an audit involves and the limits of an audit opinion, we find that governors and managers often do not understand the audit function well. The risk is that they rely too much on the work of an auditor and do not take adequate steps to manage risks using the other tools available to them.

1.34 It is important that those governing or working in public entities take the time to ensure that they understand what assurance they can take from the work of the auditor.

Some lessons for elected members

Understand the governance role in the particular entity

1.35 No two public entities are the same. They organise themselves in a way that suits their needs, and tailor structures and systems to suit their circumstances. Local authorities' needs and circumstances change over time, particularly when an election results in changes to the elected members.

1.36 Therefore, it is important for new members of governing bodies to familiarise themselves with how the governance role works in that organisation at that time. Taking an active interest in the development of the governance statement required by section 40 of the Act after each election is a good way of becoming familiar with the main responsibilities, structures, delegations of authority, and systems for the flow of information and advice.

Use the various sources of support intelligently

1.37 This Part has outlined the main sources of support available to elected members when they carry out their governance role. Understanding these sources, their strengths and weaknesses, and how they can be used to provide a richer overall picture of an issue is an important skill. Relying too much on one source of assurance or for the wrong matters can create risks for the local authority.

Pay attention to indicators of organisational risk

1.38 Many organisations have a system for identifying, managing, and monitoring risks, both at project and organisational levels. Alongside these formal systems, elected members can draw on many other informal indicators to identify possible risks. These indicators include the number and nature of:

- complaints that the organisation receives (patterns or trends that might indicate a weak area or problem, how the number and range of complaints compares to those received by similar organisations, whether issues are resolved quickly or are persistent);
- matters that are raised with external scrutiny bodies, such as the Office of the Ombudsman, Office of the Auditor-General, and Privacy Commissioner;
- legal challenges that the organisation faces (including external challenges and internal corporate matters, such as personal grievances);
- media queries and comments; and
- concerns that are raised directly with elected members in their role as community representatives.

Do not be afraid to ask the dumb question

1.39 In paragraph 1.9, we mentioned the importance of common sense. When we inquire into matters that have gone wrong in a public entity, members of a governing body or senior managers will often tell us that they never really understood the advice they received. They accepted it because it was technical and others seemed happy. We strongly encourage elected members to have the courage to "ask the dumb question" and to demand that the information and advice they receive is clear and meaningful.

1.40 A good advisor should be able to explain advice in plain language. In the end, a public entity's governors are responsible for all its decisions and actions. Accountability means that you have to be able to explain publicly what you have decided and why, when asked.

1.41 That does not mean that a member of a governing body needs to become an instant expert in all relevant technical disciplines. It is appropriate to seek expert advice and rely on it. However, over time, an elected member should become familiar with the relevant tools and concepts. Developing a reasonable working knowledge helps an elected member understand when they need expert advice, to test that advice when it is received, and to understand its implications.

Use external scrutiny to make your local authority better

1.42 It is natural to resist external scrutiny – nobody enjoys being criticised. However, the strongest organisations are those that accept that there is always room to improve and that embrace every opportunity to get a fresh perspective on their work. The various complaints processes, external audits, and other reviews all provide opportunities for an organisation to see itself through the eyes of others. Sometimes this can reveal blind spots and weaknesses that other systems have not identified.

1.43 The governors of the organisation can set the tone that these opportunities are valuable rather than threatening, creating a culture that values transparency, accountability, and continuous improvement.

Part 2
Our work on rates in 2012/13

2.1 In this Part, we report on our audit work on rates revenue in 2012/13. We:

- explain the context for the work that auditors do on rates;
- set out our main findings from our analysis of this work;
- highlight the aspects of rating law that local authorities appear to be having the most difficulty with; and
- identify some lessons for local authorities.

Rates and the annual audit

Legal requirements for local authorities when setting rates

2.2 Local authorities' power to set rates is essentially a power to tax people to pay for the costs of delivering the services that local authorities provide. There are tightly prescribed legal rules about how that power must be used and what kinds of rates can be set. These rules are set out in the Act and in the Local Government (Rating) Act 2002 (the Rating Act).

2.3 The rules cover the:

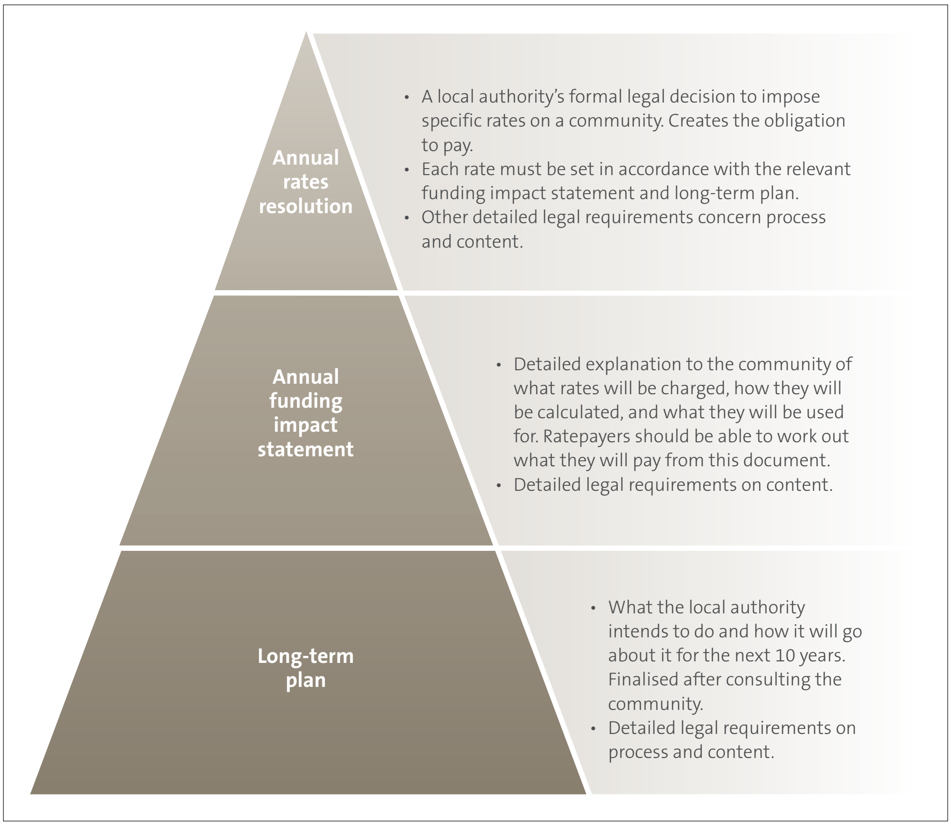
- process for, and content of, the long-term plan, which states what the local authority intends doing for the next 10 years and how it will fund its work;
- content of the local authority's funding impact statement, which informs the community about the rates for the coming year;
- annual process for setting rates; and
- content of rates resolutions.

2.4 The Rating Act gives local authorities wide powers to set, assess, and collect rates to fund their activities. To balance those powers, the law requires that local authorities:

- set rates in keeping with decisions that are made in a transparent and consultative manner; and
- have processes and information that allow ratepayers to identify and understand their liability for rates.

2.5 A local authority's rates resolution follows the directions and policies established by the long-term plan and the detailed information and explanations in the annual funding impact statement. It is vital that these formal documents (see Figure 1) are consistent with each other and meet the legal requirements.

Figure 1
The formal documents that allow a local authority to set and impose rates



2.6 For local authorities, failing to comply with rating law and the associated accountability requirements can create legal and financial risks, specifically to revenue from rates. The Rating Act gives some practical protection for a local authority's revenue base. It prescribes that the only defence a ratepayer has for not paying rates is that the local authority was not legally allowed to assess that rate. Ratepayers can use this defence only if they challenge the legality of the rate in the High Court. However, this requirement on ratepayers does not excuse local authorities from taking their legal obligations seriously. As public entities, local authorities need to be meticulous about their legal obligations and exercise their powers lawfully.

Why auditors look at rates

2.7 Understanding the work that auditors do on rates requires an understanding of the auditor's role and the balance between the responsibilities of the auditor and the public entity.

2.8 A public entity is responsible for ensuring that it complies with its legal and accountability obligations. For example, it must meet its detailed reporting obligations and must maintain financial and other records so that it can report accurately. In the context of setting rates, local authorities are responsible for ensuring that they comply with all aspects of the Rating Act when they set, assess, invoice, and collect rates.

2.9 The purpose of an audit is to increase the confidence that readers can have in the audited information. The local authority's financial statements for the relevant financial year and information about the local authority's performance (measures of service performance) must be audited.

2.10 In technical language, the auditor's objective is to obtain reasonable assurance that the audited information:

- is free from any material misstatement; and
- is presented in a way that is consistent with generally accepted accounting practice.

2.11 The auditor is responsible for planning and carrying out the audit to satisfy the audit's objectives. The auditor then gives an opinion on whether the information meets those objectives.

2.12 "Reasonable assurance" does not mean that the auditor has tested every transaction or disclosure. Nor does it mean that the auditor looked at every aspect of the local authority's operations, activities, and processes for setting rates and collecting rates revenue. Auditors assess whether particular activities, projects, or transactions have a direct material effect on the information being audited and plan their work accordingly.

2.13 The auditor's role is to provide an independent opinion on whether specific information that the public entity reports in the financial statements is reliable. An auditor can provide only reasonable assurance, rather than absolute assurance, that this is the case.

2.14 Rates are a significant component of the revenue of a local authority. This is reflected in the audited financial statements. An auditor seeks reasonable assurance that rates revenue has been properly calculated and that there is no major risk to collecting rates. This requires the auditor to consider whether the legal requirements for setting and charging the main rates appear to have been followed properly.

The assurance about rates that an audit provides

2.15 People sometimes assume that an auditor checks all of a local authority's decisions, contracts, and transactions and concludes whether a public entity is complying with all of its legal obligations. That is not correct.

2.16 Auditors always focus on matters that could materially affect the reliability of the information being audited. Three important aspects limit the assurance that an audit gives:

- Audits assess the reliability of **a particular set of information**, not a public entity's overall activities.
- An audit is designed to detect **material** misstatements, not all errors or problems regardless of their size or significance.
- An audit is designed to provide **reasonable assurance that the reported information is reliable**, not absolute assurance that the reported information is accurate and that the work underlying the information is sound in all respects.

2.17 An auditor's work on rates should give reasonable assurance that the rates revenue recorded in the financial statements materially reflects what the local authority could and has collected during the year. It cannot be taken as equivalent to a full legal review of how well the local authority complied with aspects of rating law for every rate and every ratepayer. If elected members or local authority managers want that kind of assurance, they need to get independent legal advice on their compliance and legal risk.

2.18 Sometimes, an audit will identify that a local authority is not complying with a legal requirement. However, that is an additional benefit of the auditor's work rather than the main purpose. It does not mean that an audit removes the need for a local authority to ensure that it complies with all legal obligations.

The audit work on rates revenue in 2012/13

Why we gathered information on rating practices

2.19 For 2012/13, we asked our appointed auditors to complete a questionnaire on rates. We did this because there were some indications of problems with rating practice among local authorities. Some local authorities identified legal breaches with their rates and took corrective legal action during the rating year. For example:

- Three local authorities (Kaipara District Council, Tasman District Council, and Christchurch City Council) identified problems that were significant enough to warrant validating legislation.
- Taupo District Council formally adopted its long-term plan retrospectively to remove any question about the validity of rates set for 2012/13.
- Ruapehu District Council and Waimate District Council reset their rates after they identified legal breaches in their setting of rates.
- A request was made to the Auditor-General to consider Clutha District Council's collection of a sewerage rate for properties that were not yet connected to the sewerage system in Benhar and Tokoiti. As a result of our inquiries, Clutha District Council arranged a refund or transfer to 2013/14 for all affected ratepayers because the Council concluded that the rate had been incorrectly charged.

2.20 In *Tacon v Hastings District Council* (2013), although the High Court did not rule in favour of the ratepayer, it did find deficiencies in the way the Council levied a targeted rate and that the Council had not fully complied with its legal obligations. This case illustrates that process deficiencies can and do occur, and that affected ratepayers will challenge local authority rating decisions if ratepayers think that the local authority got it wrong.

2.21 The problems with setting rates occurred regardless of the size of the local authority. Therefore, we decided to gather some information about rating practices and problems throughout the country.

The information we sought

2.22 We did not design or intend the questionnaire to identify all problems with the way local authorities set rates. Our questionnaire focused on rates problems that could affect the financial statements and, therefore, the audit. However, the exercise gave us good insight into overall practice and the kinds of legal problems that local authorities face when setting rates.

2.23 Particular aspects of focus included:

- whether the local authority's rates resolution was legally effective for setting rates;
- whether the local authority's funding impact statement and revenue and financing policy contained all the information required by the Rating Act for rates to be validly set;
- whether any particular rates that could create risk to the financial statements had been properly set;
- whether the local authority's rates resolution properly authorised penalties to be charged;
- whether the local authority's systems and controls for other aspects of the rating system were effective;
- whether the local authority dealt with goods and services tax (GST) correctly in the rates resolution and supporting documents; and
- whether local territorial authorities properly assessed and collected regional council rates on behalf of regional councils.

2.24 Our work identified some rating problems for 2012/13. Many local authorities had already identified some of the legal rating problems they faced for 2012/13 and, in some instances, for previous rating years and 2013/14 (see paragraph 2.19).

The process we followed

2.25 If, in completing the questionnaire, the auditor identified that the local authority was not, or might not be, complying with the legislative requirements, then the auditor drew that to the local authority's attention. The local authority then told the auditor whether it had considered the matter, including whether it had sought legal advice, and its views on whether it was complying with its legal obligations and the legal and financial risk that any potential problem created.

2.26 With support from our Office, the auditor then considered whether the local authority's view of its legal position and risk was reasonable, and the appropriate response to any confirmed legal breach. As with any audit matter, the range of possible responses by the auditor was:

- discussing the matter with relevant local authority staff during the audit work;
- including the matter in the formal letter to the local authority's managers at the end of the audit (the management letter) as part of the list of minor matters to follow up;
- including the matter in the management letter as a substantive discussion of a concern that needed to be addressed;

- the local authority disclosing the matter in its financial statements;
- a brief comment drawing attention to the matter in the formal audit report; or
- modifying (by qualifying) the audit opinion on the information that the local authority presented.

2.27 In deciding on the appropriate response, we considered how clear it was that there was a breach of a legal requirement, the legal risk (how likely it was that a court would invalidate the rate), and the financial risk (what kind of remedy a court might award and how much revenue was involved). We considered the nature of the legal breach and its significance in principle.

2.28 We found many instances of reasonably clear legal breaches where the amount involved was small and/or the chance of a court invalidating the rate and ordering repayment seemed low. In such instances, our general approach was to refer to the matter in the management letter to the local authority. However, we did not draw attention to the matter in our audit report. Our auditors will follow up these matters in future audits. Often, local authorities sought the views of their legal advisors on these matters.

2.29 However, we also found some examples of clear legal breaches that involved an important legal principle and/or for which we considered a court would be likely to order repayment. In those instances, we ensured that there was some disclosure of the problem – even if the amount was not material. In particular, we did this when we concluded that a local authority had invoiced for and collected money that, legally, it could not require ratepayers to pay. This arose when local authorities failed to include a particular rate in their formal resolution stating what rates to impose each year. If a rate was not included in that resolution, it had not been set and ratepayers could not be required to pay it. However, several local authorities had inappropriately proceeded to invoice and collect such rates revenue.

2.30 From our perspective, disclosing these problems is about more than reporting on legal risk. It is also about openness and transparency and our responsibility under section 20 of the Public Audit Act 2001 to report to Parliament on information arising out of the performance of our functions. In some instances, we considered that disclosing the problems we identified was important because, in effect, the local authority was invoicing ratepayers for rates that had not been lawfully imposed and for which there was no obligation to pay. We considered it important for that to be disclosed, even though the legal risk of a challenge by ratepayers was low and unlikely to warrant the local authority taking corrective action. We note that, in some instances, local authorities chose to repay ratepayers if it later became clear that a rate had not been lawfully imposed.

Our conclusions

2.31 Our appointed auditors noted several areas where there were issues with rating practice.

Compliance issues around the country

2.32 Our analysis of the completed questionnaires showed that most local authorities had some problems with rating compliance for 2012/13. All aspects of compliance with the rates legislation that we reviewed had problems. These ranged from potentially serious breaches of the requirements in the rates legislation (such as the local authority failing to adopt a long-term plan or to include all rates in its rates resolutions) to "technical" legal breaches (such as rating information not being included in the local authority's funding impact statement as required by the rating legislation, but included elsewhere in the local authority's long-term plan).

2.33 Some of the errors that we identified were important, either because they created a significant financial risk to the local authority's revenue (such as a problem with a significant, district-wide rate) or because they involved a major legal failing (such as charging a rate that the local authority had not set). We identified errors that, despite the local authority's poor compliance with rating law, have not become problematic, because ratepayers had not challenged their local authorities on these matters.

2.34 We understand that several local authorities are taking legal advice on the rating compliance issues that our appointed auditors raised with them, including whether they need to take remedial action.

Rates practices not meeting detailed legal requirements

2.35 We found that the rates practices of most local authorities did not meet statutory requirements.

2.36 Some aspects of rates legislation (such as the rates-related requirements for long-term plans, annual plans, funding impact statements, and revenue and financing policies in Part 6 and Schedule 10 of the Act) are detailed and highly prescriptive. Some of the rates requirements in the Rating Act and the Act are interrelated. This seems to have created considerable confusion for local authorities when interpreting and putting these requirements into practice. This confusion often results in local authorities failing to comply with the law. Some local authorities label and present information differently from what is explicitly required in the rates legislation. They often do this to make these documents easier to understand or to have the information in a more prominent place in the consultation documents. However, this can result in local authorities inadvertently breaching the rates legislation and being exposed to legal risk.

2.37 The Act requires local authorities to adopt a long-term plan every three years. This sets out the local authority's broad plans for what it intends to do and how it will go about it. The Act requires the long-term plan to include some basic policies and specific information in specific policies. Local authorities cannot take a different approach without going back to change the policy through the proper process set out in the Act. That process involves consulting their communities.

2.38 One of these required policies is a revenue and financing policy. To provide predictability and certainty about sources and levels of funding, this must state the different sources of funding the local authority will use to fund its operating and capital expenditure. The specific rates information that the Act requires to be included in the revenue and financing policy is part of the legal foundation for properly setting rates each year. If information is missing – and we found this to be a common problem – a rate might be at legal risk.

2.39 Local authorities need to ensure that each rate in the rates resolution fits within the local authority's revenue and financing policy, and that the revenue and financing policy properly supports the rates resolution.

Some poor understanding of legal process and responsibilities

2.40 Some local authorities had poor, deficient, or questionable rates practices, particularly with their processes for setting rates. A local authority formally authorises specific rates to be imposed on the community each year through a rates resolution. Some local authorities do not seem to appreciate that the rates resolution is a critical legal document, rather than just another step to implement policy decisions that were made during the planning process. We were especially concerned when we identified rates that were proposed in the local authority's funding impact statement, not included in the resolution, and then invoiced and collected from ratepayers.

2.41 We saw instances where rates documents had not been updated to show the local authority's actual intended rates. For example, the funding impact statement might have been updated to reflect the local authority's intentions but not the rates resolution, or the other way around. Because the rates-setting documents are so important, it is essential that local authorities have appropriate quality review processes to give assurance that rates are set in keeping with the law.

2.42 We were told that some local authority managers were not receiving – and elected members were not asking for – assurances from staff or the local authority's independent legal advisors that adequate work had been done to ensure compliance with rates legislation. Some local authorities relied on work carried out some years previously.

Poor practices

2.43 Many of the problems we identified seem to have arisen because not enough attention was paid to the detail of legal requirements and changes to those requirements. Some local authorities had many problems with rating compliance, which raises questions about their practices. The ability and power to rate comes with obligations that need to get appropriate attention.

2.44 Some local authorities:

- used out-of-date terms from pre-2002 rating law and confusing terminology that is not in past legislation or the Rating Act;
- used terms loosely when accurate and consistent terminology is important (for example, using many different descriptions of the statutory term "separately used or inhabited part of a rating unit");
- relied too much on old precedent documents (such as previous years' rates reports and rates resolutions) without updating them appropriately;
- relied too much on existing practices and procedures;
- relied too much on individual staff who were considered rating experts within the local authority but who might not have kept up to date with the Rating Act;
- had poor documentation practices and lacked quality reviews, particularly to ensure that rates information in long-term plans, rates policies, and rates resolutions was consistent; and
- made errors – such as decimal points in the wrong places in rates amounts and typographical errors – suggesting inadequate checking.

2.45 Some regional councils have territorial local authorities collect rates on their behalf but did not get assurance that rates were collected in keeping with the regional council's intentions. Sometimes, there was confusion about the responsibilities and roles of regional and territorial local authorities.

2.46 Many local authorities did not meet some of the main statutory purposes and objectives of the Rating Act, which are intended to allow ratepayers to easily identify and understand their liability for rates and to provide clarity, certainty, and stability in rating matters. Many local authorities did not clearly describe, explain, and include information about rates in their long-term plans and rates resolutions.

Our detailed findings

Procedural problems in rates-resolution processes and practices

2.47 A local authority's rates resolution is critical to setting rates. The rates resolution is how the local authority formally authorises specific rates imposed on the community each year. It is equivalent to a taxing statute. In general, courts strictly interpret coercive powers of this kind and their associated legal duties. The Rating Act sets out the procedure that local authorities must follow when setting annual rates. Complying with the detail of the Rating Act is vital. If the rate is not within the range of options and restrictions provided for in the Rating Act, it might not be valid. Therefore, local authorities need to be meticulous in ensuring that their processes for resolving to set rates comply with the procedural requirements and that their rates resolutions are legally effective.

2.48 Some local authorities had poor, deficient, and questionable rates-setting processes and practices, particularly for resolving to set rates. If continued, these practices could invalidate the rates.

2.49 Two local authorities are promoting rates validation bills after identifying serious legal breaches in their processes for setting rates. The local authorities identified these legal breaches before the auditors completed the questionnaire on rates.

2.50 Christchurch City Council failed to set a due date when it set its rates for all years from 2004/05 to 2013/14. The rates resolutions omitted the rates instalment dates and a provision for charging penalties. This meant that the rates never became legally due (and so were unenforceable) and that penalties could not be charged. After taking legal advice, the Council resolved on 19 September 2013 to reset the 2013/14 rates. It is promoting a bill to validate the rates and penalties it did not include in rates resolutions for previous years but collected from ratepayers. The Council disclosed these breaches in its financial statements for 2012/13, and our audit report drew the reader's attention to the Council's disclosures.

2.51 Taupo District Council identified a risk that it might not have properly adopted its 2012-22 long-term plan in line with the Act. Without a validly adopted long-term plan, the Council could not legally set its 2012/13 rates. After taking legal advice, the Council formally adopted its long-term plan on 24 September 2013. It is promoting a bill to validate rates and penalties collected from ratepayers for 2012/13. The Council disclosed these legal breaches in its financial statements for 2012/13, and our audit report drew the reader's attention to the Council's disclosures.

2.52 A further two local authorities decided to reset their rates during 2012/13 after they identified serious legal breaches in their setting of rates:

- Ruapehu District Council had to meet on three separate occasions to resolve to set rates for 2012/13 because of errors in funding impact statements and rates resolutions.
- Waimate District Council failed to resolve to set rates and penalties for 2012/13 and had to reset them in line with the Rating Act on 11 June 2013. The Council refunded or reversed all penalties charged for 2012/13.

2.53 Chatham Islands Council used wording in its annual rates resolution to set a water-targeted rate that differed from its intention to rate all properties connected to the Council's water supplies. The Council charged the rate to all water supply connections, but its rates resolution set the rate for water supply connections to properties in only one of the two main townships.

2.54 The auditors of at least six other local authorities questioned whether the resolution was clear enough to ratepayers. In one instance, the process for making the rates resolution was so unclear that external lawyers had to review the transcript of the Council's meetings about setting rates, not just the papers and minutes, to assess the Council's legal risk. In all of these instances, the local authorities' poor rates-setting practices were considered unlikely to invalidate rates. However, the local authorities needed to improve their practices to avoid the risk of invalidating future rates.

Procedural problems with funding impact statements

2.55 Each year, a local authority adopts a funding impact statement as a central part of its planning. The funding impact statement is contained in the local authority's annual plan or long-term plan (in a long-term plan year). The Act sets out the disclosures required in the funding impact statement. In effect, the funding impact statement tells the community what that year's rates will be, how they will be calculated, and what they will be used for.

2.56 Every rate in the annual rates resolution must be covered in the local authority's funding impact statement for that year. There must be enough background detail to allow ratepayers to work out what rates they will have to pay. Gaps in the funding impact statement information could put the rate at legal risk. Similarly, if the wording and specification of the rates in the rates resolution differs from the wording of the funding impact statement, that difference could raise questions about the legality of the rates.

2.57 Local authorities need to ensure that:

- their funding impact statement and rates resolution are consistent with each other; and
- the funding impact statement contains all the information that the Rating Act requires so that it properly supports the rates resolution and all rates are set validly and lawfully imposed.

2.58 Many local authorities had problems with the content of their funding impact statements, and some funding impact statements were not clearly identifiable in long-term plans. Many long-term plans included funding impact statements with names such as "Rating Policy", "Rating Charges", "How We Raise Rates", and "Funding and Financial Policies".

2.59 Many local authorities explained that they renamed their funding impact statements to make them easier for ratepayers to see in their long-term plans. However, "funding impact statement" is a statutory term that must be used consistently. Many local authorities were not aware that changing the name of their funding impact statements could breach the Rating Act.

2.60 Figure 2 lists the types of non-compliance we found with the Rating Act that could put the legality of the rates at risk.

Figure 2
Types of non-compliance that could put the legality of rates at risk

Inconsistencies between rates resolution and funding impact statement
Rates included in one but not the other
Different rates amounts
More than one valuation system
Rates described differently
Different dates for rates instalments
Inconsistent terminology for categories of targeted rates and charging basis of specific rates
Whether penalties apply for certain categories of rates
Different rounding practices for rates amounts
Other examples of non-compliance
Incorrect conversion of monetary amounts
Typographical errors in rates amounts to be charged

2.61 In some instances, auditors identified problems that, in our view, were likely to invalidate rates. Because of the significance of the problems, the local authorities disclosed the breaches of rates legislation in their financial statements. If they had not disclosed these breaches, the auditor would have had to consider whether to issue a non-standard audit report.

2.62 Grey District Council's rates resolution, which formally set the uniform annual general charge, applied a "per unique rating assessment". This term is not defined or used elsewhere. Under the Rating Act, a uniform annual general charge has to be set for every rating unit or for every separately used or inhabited part of a rating unit. The Council's funding impact statement states that the uniform annual general charge is to be calculated for every separately used or inhabited part of a rating unit. The rate had not been set in line with the funding impact statement as required by legislation.

2.63 Certain targeted Matamata-Piako District Council rates were not included in the rates resolution but were included in the funding impact statement and were charged.

2.64 Nelson City Council did not set the wastewater targeted rate and the separate general stormwater/flood protection targeted rate in keeping with its funding impact statement. The wording used for these rates in the Council's resolution differed from that used in its funding impact statement.

2.65 Waikato District Council charged some targeted rates that were included in the rates resolution but not in the funding impact statement.[1] There were also discrepancies between the rates resolution and the funding impact statement for some of Wairoa District Council's rates.

2.66 In two other situations where there were discrepancies between the rates information in the rates resolution and the funding impact statement, the local authorities refunded the amounts collected but did not disclose the legal breach in their financial statements.

Procedural problems with long-term plans and revenue and financing policies

2.67 Every three years, a local authority prepares a long-term plan, which sets out broad plans for what the local authority is intending to do and how it will go about it. The Act requires the long-term plan to include some basic policies. The Act requires particular information to be included in specific policies. When a local authority sets rates each year, the Rating Act requires them to be in line with

1 Auditors identified similar issues with Rangitikei District Council's rates, specifically its district-wide uniform annual general charge, as well as its libraries, stormwater, and water rates. This was considered at a different stage of the audit process and after the annual report had been completed.

the long-term plan. This requirement covers the activity and use of funds that fit within the long-term plan and the proposed source of funding and means of raising revenue signalled in the long-term plan.

2.68 A local authority's revenue and financing policy states the different sources of funding the local authority will use to fund operating expenses and capital expenditure. Local authorities cannot take a different approach without changing the policy through the proper process. The local authority's revenue and financing policy is likely to be a more general document designed to endure. However, the Act requires the revenue and financing policy to include specific information on rates. This information is part of the legal foundation for setting rates properly each year. If information is missing, the legality of a rate could be at risk.

2.69 The requirement for consistency between the rates resolution, the funding impact statement for the year, and the revenue and financing policy in the long-term plan is fundamental. This consistency links community consultation to the rates that ratepayers are required to pay.

2.70 As well as ensuring that the rates resolution is in line with the funding impact statement, local authorities need to ensure that the rates resolution is in line with the long-term plan, that each rate fits within the local authority's revenue and financial policy, and that the revenue and financing policy properly supports the rates resolution.

2.71 In one instance, a local authority identified a risk that it might not have properly adopted its final long-term plan, which could affect the validity of all rates in the district. In some instances, local authorities' long-term plans and/or revenue and financing policies did not contain everything needed for the rates in the resolution to be validly set. We found many discrepancies between, and conflicting descriptions of, the information contained in local authorities' revenue and financing policies and the information contained in other important rates documents, such as rates resolutions and/or funding impact statements.

Calculating uniform annual general charge

2.72 Another common example of poor practice – and, in some instances, non-compliance – involved the Rating Act's requirements about general rates. If the local authority's source of funding includes a general rate, the funding impact statement needs to state whether a uniform annual general charge is to be included and, if so, to set out the local authority's definition of a "separately used or inhabited part of a rating unit" if the charge is to be calculated on that basis.

2.73 We found confusing references to, and practices for, describing and applying the statutory term "separately used or inhabited part of a rating unit".

2.74 For example, we found widespread incorrect references to the statutory term "separately used or inhabited part of a rating unit" in many long-term plans and funding impact statements. We also found many conflicting, incorrect references in funding impact statements and rates resolutions (see Figure 3).

Figure 3
Examples of incorrect descriptions for the statutory term "separately used or inhabited part of a rating unit" in rates documents

- separately used or inhabited division of a rating unit
- unit of occupancy that can be separately let or permanently occupied
- separately used or inhabited part of a rating unit on every rating unit
- unit of occupancy
- used or inhabitable portion of a rating unit
- separately occupied portion of a rating unit
- separately used or inhabited residential parts of a rating unit
- rating unit on each separately used or inhabited part of a rating unit

2.75 Some local authorities' definitions of "separately used or inhabited part of a rating unit" differed between their rating documents. In some situations, local authorities collected their uniform annual general charge on the basis of a separately used or inhabited part of a rating unit, but it was not clear from their rating documents that the charge was to be calculated on this basis. For example, the resolution stated it was charged for each rating unit but the funding impact statement stated it was charged for each separately used or inhabited part of a rating unit, or the other way around. Some local authorities did not specify the basis on which some uniform annual general charges were calculated.

2.76 We were concerned about the extent of these incorrect descriptions, references, and practices for calculating and applying the uniform annual general charge. Some of them could invalidate the local authority's ability to collect the charge. The extent of the problems suggested poor work practices and a lack of rigour in setting rates.

2.77 During 2012/13, Environment Canterbury identified that it had set the uniform annual general charge on the basis of both a rating unit and a separately used or inhabited part of a rating unit, reasoning that individual local territorial authorities would choose one or the other basis. However, the legislation requires the charge to be calculated on only one of the two permitted bases. The method chosen must be consistent throughout the region. This resulted in a legal risk to Environment Canterbury, which it disclosed in its annual report.

Penalties

2.78 The Rating Act sets out specific legal requirements that local authorities must follow to be able to charge and collect penalties from ratepayers. Sometimes, the amount expected to be collected as penalties can be material to the financial statements. Local authorities need to ensure that they comply with these procedural requirements and that their penalties resolutions are legally effective.

2.79 Waitomo District Council incorrectly charged and collected rates penalties when, in our opinion, it had not explicitly set penalties as required by the Rating Act.[2] The Council disclosed this matter in its financial statements.

2.80 We found many examples in rates resolutions of poor observance of the explicit statutory requirements of the Rating Act authorising penalties to be added to rates. In some instances, these could invalidate imposing and collecting penalties. Some local authorities failed to explicitly specify in rates resolutions the dates that penalties would be added to rates, as required by the Rating Act. Local authorities need to strictly comply with these requirements to avoid legal challenge or risk to the validity of the local authority's ability to add and collect penalties on rates.

Water rates

2.81 We found complexity, confusion, and lack of clarity with how local authorities rated for water charges, especially water meter charges. Some local authorities seemed confused about the statutory requirements for setting targeted water rates, and provided inconsistent information in, or omitted information from, their main rates documents. For example, we found:

- discrepancies and inconsistencies in describing and applying specific water rates, including threshold details before charges apply; and
- not enough and inconsistent ratepayer information for calculating targeted water rates for water supply schemes and omitted information (such as water availability charges and water-by-meter charges).

Lump-sum contributions

2.82 Many local authorities did not pay enough attention to the legal requirements, and had poor and incomplete processes, for lump-sum contributions. For example, if a local authority intends to collect targeted rates through a lump-sum contribution, then certain disclosures must be made in rates documents. We found instances where this information was missing.

2 There were other instances where penalties were incorrectly charged and collected. Taupo District Council had no long-term plan, so it had no authority to charge and collect penalties. However, the Council did seek to set penalties in line with the Rating Act, and its penalties would not have been at risk if the Council had adopted the long-term plan. Christchurch City Council had no authority to charge and collect penalties because it omitted information about penalties from the rates resolution.

Goods and services tax

2.83 We found discrepancies with whether individual and total rates included or excluded GST. Some local authorities showed their rates amounts as including GST in one rating document and as excluding GST in another. Local authorities face a potential financial risk if the GST information and calculation is not disclosed accurately in their rates documents and calculated and charged consistently.

Other problems

2.84 Other problems we found included:

- confused practices and procedures because some local authorities were not sure whether a charge was a rate or an individual user charge;
- confusion, incorrect statements, and not enough information about the specific matters and factors that local authorities must consider when defining categories of rateable land and calculating liability for targeted rates; and
- not enough information in rates notices and invoices, conflicting rates information in funding impact statements and invoices, and not enough attention to the explicit legal requirements for local authorities' rates-invoicing practices.

Aspects for local authorities to improve

Consider how to combine community consultation with tightly prescribed taxing powers

2.85 Local authorities need to consider ways of ensuring proper compliance with technical legislative terms that have precise meanings, while communicating effectively with the community. In practice, this means carefully preparing consultation documents and processes to find a balance that complies with the legislation and that is easy to read and understand.

Near enough is not good enough

2.86 Local authorities are responsible for ensuring that they comply with the Rating Act. It is important that local authorities use their legal powers to impose rates properly. Many local authorities responded to our questions with "near enough is good enough". They also did not distinguish between the question of whether they had followed the law and the question of whether there was a substantial risk of legal challenge or granting of a remedy. In our view, near enough is not good enough.

2.87 In general, local authorities need to work harder to address and considerably improve how they set rates and document their rating practices. It is not acceptable for a public entity to work outside the law because the risk of someone taking it to court is low. Complying with legal obligations is not only about the risk of being challenged but also vital for maintaining and keeping the public's trust.

2.88 The Rating Act's purpose is to ensure that rates are set in a transparent and consultative manner. If local authorities get their rates-setting processes wrong, they need to consider disclosure to ensure that rates are set transparently and openly and to reduce their legal risk and the need for corrective action.

2.89 A clear process for setting rates should allow ratepayers to identify and understand how much rates they are liable to pay. The problems that we identified showed that consultation documents did not give ratepayers adequate information about their rates. Therefore, there is a risk that some ratepayers do not get an opportunity to express a view on the rates proposed.

Local authorities are responsible for getting it right

2.90 Local authorities need to be meticulous about regulatory compliance with all their statutory obligations. Local authorities are responsible for correctly meeting the statutory objectives and obligations under the Rating Act. The consequences and effects on ratepayers will vary. Ratepayers and the legal system will hold local authorities to account.

2.91 The greatest risk to local authorities in not addressing poor practice problems with how they comply with the Rating Act is that anyone can then challenge the validity of rates through the High Court. Local authorities should remove any uncertainty or ambiguity about the validity of rates and their processes for setting rates.

2.92 Every year, local authorities need to consider the common matters we have identified and, if needed, assess and rectify rates documents.

Part 3
Financial results and trends

3.1 In this Part, we summarise the financial results from the 2012/13 annual reports of local authorities, focusing on the audited information about operating revenue, rates revenue, operating expenditure, capital expenditure, and debt.

3.2 We also explore the financial trends in local authorities' annual reports using a set of indicators that we have developed. The indicators we use are outlined in Appendix 2.

3.3 The information excludes the results of Far North District Council and Hurunui District Council. The annual reports of those two local authorities were not publicly available when we prepared this Part (see paragraph 4.11).

What do the 2012/13 annual reports show?

Operating revenue and rates revenue

3.4 In 2012/13, local authorities recorded slightly less operating revenue ($8.14 billion) than in 2011/12 ($8.33 billion).

3.5 Local authorities levied rates of $4.53 billion, which was $36 million or 0.8% less than budgeted.

3.6 Local authorities have limited alternative revenue sources. In 2012/13, the other major sources of revenue were subsidies paid by the New Zealand Transport Agency, development contributions, and vested assets. Local authorities have limited ability to reduce their reliance on rates revenue.

Operating expenditure

3.7 In 2012/13, local authorities' total operating expenditure was $7.8 billion (down from $8.1 billion in 2011/12). Local authorities sought to contain their operating costs, and this helped them to constrain rates increases.

Capital expenditure

3.8 Local authorities' capital expenditure was $3.5 billion in 2012/13. This was $0.9 billion (20%) less than the $4.4 billion budgeted.[3]

3.9 Two local authorities accounted for $480 million of the $0.9 billion difference. Auckland Council spent $267 million less because some projects that were to be completed in 2013 will be completed in 2014 or later. Christchurch City Council

3 This information has been extracted from funding impact statements of local authorities. Because Auckland Council prepares a group funding impact statement, the figures include the capital expenditure of Auckland Council's subsidiaries.

had $213 million less capital spending because of delays rebuilding infrastructure and other capital projects.[4]

3.10 The accuracy of local authorities' forecasts of their capital expenditure was comparable to the prior year (see paragraph 3.27).

3.11 The 2012/13 results continue the significant trend of local authorities achieving substantially less capital work than budgeted. In our view, there is a need to analyse this in detail, particularly to identify whether there is a growing backlog of renewal work, whether budgeting is too optimistic for the local authority's contracting and administrative capacity, or whether some other factor is causing this shortfall.

3.12 We have collected and analysed the capital expenditure indicated in funding impact statements for 2012/13. Capital expenditure was disclosed in three categories:

- expenditure for new assets to meet additional demand;
- expenditure to improve service levels; and
- expenditure to replace or renew assets.

3.13 Local authorities spent less in dollar terms than budgeted. Their spending appeared to be more or less evenly spread between the three capital expenditure categories. Local authorities spent $245 million less on new assets to meet additional demand, $263 million less on assets to improve service levels, and $392 million less on renewals.

3.14 Although local authorities have invested in renewals up to the equivalent of 64% of depreciation, we are particularly concerned that local authorities are not spending their capital budgets for renewals. Only 64% of capital budgets were spent (see paragraph 3.79). If assets are not being maintained because of a backlog of renewal work, then levels of service are likely to be affected over time, if not immediately.

Debt

3.15 Debt and capital expenditure variances are generally closely aligned because local authorities typically use debt to fund the construction of long-life assets (at least in part).

3.16 Local authorities had debt of $10.1 billion as at 30 June 2013. This was $45 million less than budgeted, but $1.6 billion (13%) more than as at 30 June 2012. The $45 million actual-to-budget variance is made up of those local authorities with

4 Many of the capital projects are part of the infrastructure rebuild programme funded by insurance recoveries and Crown contributions. The wastewater activity has the largest share of infrastructure rebuild spending (see Christchurch City Council (2013), *Christchurch City Council Annual Report 2013*, page 133).

$584 million more debt than forecast, and offset by those local authorities with $539 million less debt than budgeted.

Detailed analysis using our set of financial indicators

3.17 We completed a more detailed analysis of the financial information using our set of financial indicators. We did this to analyse the historical financial information data and assess the aggregate effect it has on aspects of financial uncertainty. We also comment on the local authorities that appear outside the calculated sector norms (the outliers).

Indicators of ability to operate as planned

3.18 We looked at the actual versus budgeted results from 2006/07 to 2012/13. A result of 100% indicates that actual results are in line with the plans the local authority has made.

Actual to budgeted cash applied to operations

	2012/13
Average value	
Direction	
Variability	

3.19 The cash applied to operations reflects a local authority's expenditure on operations.[5]

3.20 The average actual to budgeted cash applied to operations has improved slightly, moving from an average of 103% in 2011/12 to 101% in 2012/13. The average for the last seven years was 103%. This is in line with our expectations, given the long-term nature of many local authority assets and related services.

3.21 There is moderate variability in how accurately local authorities set their budgets for operations. During the last three years, 38% of local authorities were outliers (that is, outside the calculated sector norms).

3.22 Overall, local authorities are becoming increasingly accurate in this aspect of budgeting. Compared with 2011/12, 27 local authorities had results that were further from the sector average but 40 had results that were closer to the average. Nine showed no change from the position of their results in 2011/12.

3.23 We saw three notable outliers. Bay of Plenty Regional Council achieved 86% of the operational cash flow budgeted. This is below the 94% achieved in 2011/12 but consistent with its seven-year trend. Operational cash flow has been below budget in each of the last five years – in the range of 85% to 94%. The Council

5 Note that in *Local government: Results of the 2011/12 audits*, we used net cash flows from operations for this indicator. We now consider that cash applied to operations is a better measure of stability than the net operating cash flow.

budgeted to receive revenue from central government and the Infrastructure fund to restore Rotorua Lakes,[6] but this did not occur.

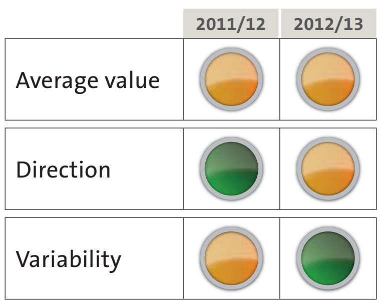
3.24 Whakatane District Council also achieved 86% of the operational cash flow budgeted. This was below the 99% achieved in 2011/12. For this local authority, we noted fluctuations ranging from 86% to 146% in the last seven years, with an average of 115%. The fluctuations appear largely related to emergency works that were required after floods in some years. In 2012/13, user fees and charges for waste, building inspections, resource consents, and trade waste were all less than budgeted.

3.25 Mackenzie District Council had significantly higher operational cash flows than budgeted, with a result of 140% against budget. This is substantially higher than its average for the last six years of 102% and higher than the results for the last two years, which were 90% and 95% respectively. The Council received more revenue from regulatory and consent fees and lease income in 2012/13 than budgeted.

3.26 It appears that the most significant challenge is budgeting for revenue that is not within the control of the local authority. By its nature, this type of revenue can be difficult to forecast. We consider that local authorities are, on average, managing operational cash flows accurately. However, at a more detailed level, there are often more significant inaccuracies in the actual to budgeted results. We encourage local authorities to focus on budget accuracy at a project level, where possible.

Actual to budgeted capital expenditure

3.27 In 2012/13, local authorities spent, on average, 78% of budgeted capital expenditure. This compares to an average of 79% for 2010/11, 2011/12, and 2012/13. There was low to moderate variability in the accuracy of the actual to budgeted capital expenditure. During the three years, 38% of the local authorities were outliers.



3.28 As well as the notable outliers discussed below, 14 local authorities spent less than 60% of budgeted capital expenditure and three local authorities spent more than 120% of budgeted capital expenditure.

3.29 Kaikoura District Council spent only 41% of its budget for capital expenditure. This was because construction of the new combined museum, library, and Council office facility was delayed. The lower spending was offset by a small unbudgeted

6 A sum of $6.8 million was budgeted to be received from the Ministry for the Environment – the Rotorua Lakes deed funding. If this had been received, it would have been disbursed to Rotorua District Council.

project to build three new pump stations (funded by reprioritising another project that was delayed the year before). In other words, Kaikoura District Council's modest capital spending was significantly affected by a large capital project that did not start as planned.

3.30 Auckland Council spent only 45% of budgeted capital expenditure, because a wide range of projects were revised and refined during the year. Examples include renewals work on the Council's administrative buildings that did not take place after the decision to buy a new building, and waterfront developments that were delayed while decisions about upgrades were finalised. Delays in getting approvals from Local Boards delayed some local projects. The Council is seeking to set more accurate budgets for capital expenditure.

3.31 West Coast Regional Council had significantly more capital expenditure than budgeted (spending was 156% of the budget). This was because of the unbudgeted purchase of land and construction of a building. Again, this shows how having one or two proportionally large projects affects a small local authority. In our view, this trend of spending less capital work than budgeted is of concern, particularly if it affects the level of service that communities expect to receive.

Actual-to-budgeted debt

	2011/12	2012/13
Average value		
Direction		
Variability		

3.32 The accuracy with which local authorities forecast their debt requirements remained steady at 88%, in line with the result achieved in 2011/12. This is highly aligned to the actual-to-budgeted capital expenditure result. The average actual-to-budgeted debt for 2010/11, 2011/12, and 2012/13 was 86%.

3.33 There was moderate variability in how accurately debt was budgeted. Few local authorities budget for debt needs accurately. During the three years, 31% of the results were outliers. This result is closely in line with the actual-to-budgeted capital expenditure (see paragraphs 3.27-3.28), which is to be expected.

3.34 Eight local authorities had no debt as at 30 June 2013. Another six local authorities had debt balances less than $1 million. Five of these 14 local authorities were regional councils.

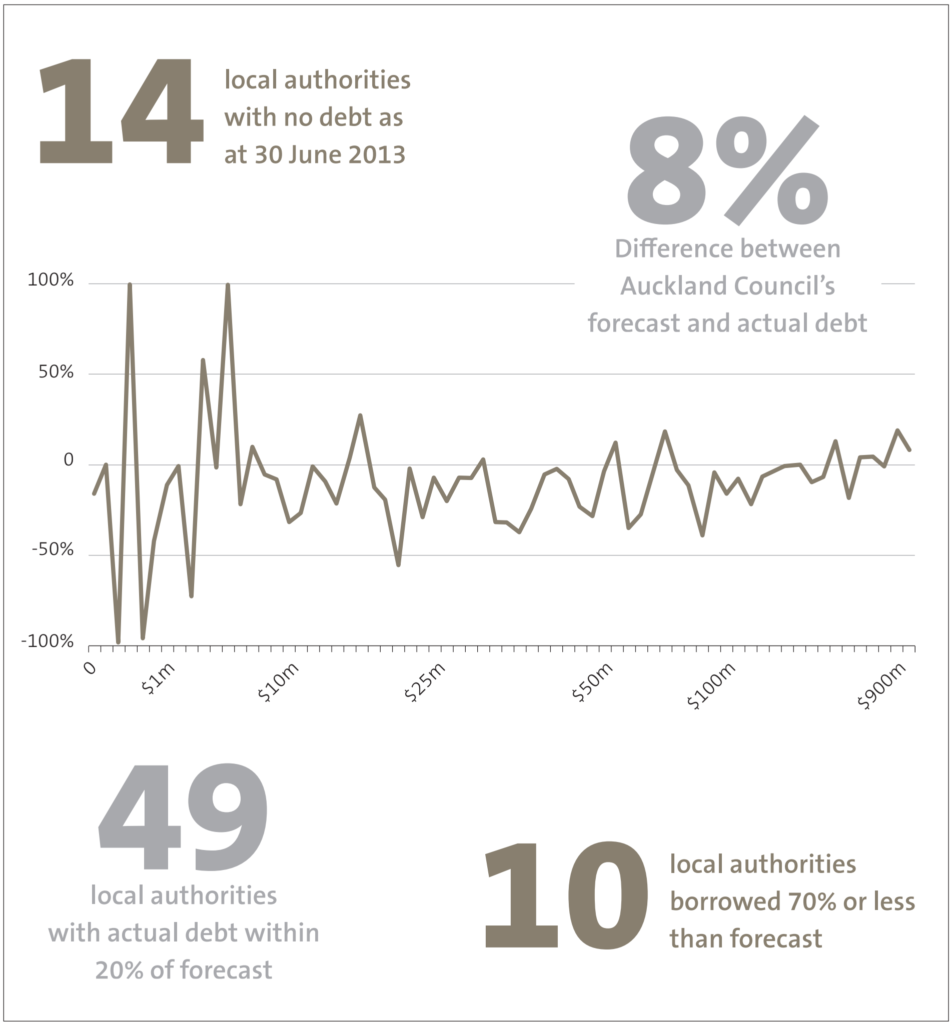
3.35 Marlborough and Westland District Councils were the only outliers, with debt balances greater than $10 million. These debt balances had a large effect on the average result. Marlborough District Council budgeted for $51 million of debt but finished the year with only $22.5 million. The reduced debt was because of delays in the forecast capital spending on water, wastewater, and solid waste projects. Some delays in buying properties delayed the roading capital programme, which, in turn, reduced the debt requirement.

3.36 In contrast, Westland District Council budgeted for $12 million debt and closed the year with a balance of $15.5 million. During 2012/13, some significant budget inaccuracies were identified, including the debt forecast.

3.37 We also noted several smaller local authorities that budgeted for debt below $10 million and did not borrow in line with their budget. These local authorities were Carterton District Council, Chatham Islands Council, Kaikoura District Council, Opotiki District Council, Rangitikei District Council, Stratford District Council, and Waimate District Council. West Coast Regional Council was the only local authority with a difference between budget and actual that was beyond one standard deviation from the norm. Although outside the norm, the amount involved was not large – West Coast Regional Council incurred less than $4 million debt. There is an ongoing aversion to using debt among smaller local authorities.

3.38 Figure 4 shows the spread of local authorities' debt balances as at 30 June 2013, and the percentage difference between their debt balances and their forecast debt.

Figure 4
Local authorities' debt as at 30 June 2013 and the percentage differences between forecast and actual debt



Note: Auckland Council is not included in the line graph because it operates on a much larger scale than other local authorities. Auckland Council's debt as at 30 June 2013 was $4.7 billion. It was 8% higher than forecast.

Summary observations about local authorities' ability to operate as planned

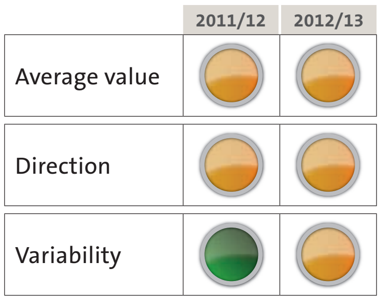
3.39 Overall, the average positions for local authorities against our indicators of ability to operate as planned have remained stable. The ability to budget for operational expenditure is sound at a high level, although there are more significant variances within categories of expenditure. The ability to forecast capital expenditure accurately has deteriorated slightly.

3.40 In our view, local authorities need to improve their forecasting for capital expenditure – results are consistently below the amounts forecast. The ability to forecast debt requirements accurately has slightly improved, but most local authorities are persistently over-estimating their debt requirements. This is highly aligned to under-delivery against capital expenditure budgets.

Local authorities' ability to manage uncertainty

3.41 We looked at three indicators that consider local authorities' ability to respond to short-term shocks.

Working capital



3.42 The working capital indicator compares current assets to current liabilities. It measures whether a local authority has enough resources to pay its debts when they fall due without having to borrow further or sell long-term investments and assets.

3.43 A result of 100% indicates a match between current assets and current liabilities. A result greater than 100% is preferable because it indicates that there are more resources available to respond to short-term unexpected events.

3.44 The average working capital ratio in 2012/13 was 161%. This was slightly higher than in 2011/12 and 2010/11. During the last three years, 26% of local authorities were outliers.

3.45 In general, regional councils have higher working capital percentages than territorial local authorities. For example, in 2012/13, the highest regional council result was 735%. This is because territorial local authorities typically have some debt reflected in current liabilities.

3.46 Debt is classified as a current liability if it is due for repayment in the next 12 months. Local authorities typically have arrangements where this debt is reissued under different borrowing terms and conditions. This can have a significant effect on this indicator. However, it might not reflect an immediate need for funding.

3.47 Bay of Plenty Regional Council, Central Otago District Council, Clutha District Council, Environment Southland, Hawke's Bay Regional Council, Kawerau District Council, Mackenzie District Council, Napier City Council, Otago Regional Council, and Wairoa District Council have been consistent outliers for the last seven years. Each has had working capital ratios greater than 200% each year.

3.48 The highest ratio in this period was for Wairoa District Council, with a working capital ratio of 1760% in 2006/07. On the other hand, 36 local authorities (47%) had working capital ratios of less than 100% for 2012/13.

3.49 Our analysis looked at working capital at a point in time. We acknowledge that some local authorities manage their working capital and cash requirements closely during the year to reflect when cash is required. For example, it is more cost-effective to draw on cash facilities when required because investment returns are always less than the cost of borrowing.

3.50 We also note that a very high working capital ratio does not always reflect good working capital management. A high working capital ratio could mean that a local authority is not managing its cash resources effectively by, for example, paying off debt rather than holding cash as an investment.

3.51 Compared to other local authorities, the 36 local authorities with a working capital ratio of less than 100% had less ability to manage uncertainty. We acknowledge that significant debt could be included in current liabilities that could be reissued subject to different credit terms and conditions.

Enduring operating expenses to total operating expenses

3.52 The enduring operating expenses to total operating expenses indicator compares the level of fixed costs as a proportion of total operating expenses.[7] In calculating this, we have defined employee benefits, interest, depreciation, and amortisation as enduring or fixed operating expenses. The greater the percentage, the less flexibility the local authority has to change its operations.

	2012/13
Average value	
Direction	
Variability	

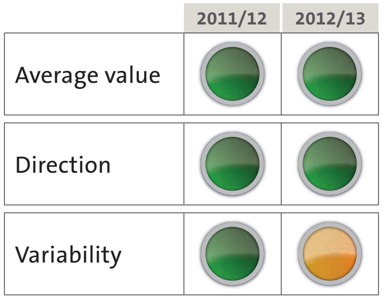
3.53 The average enduring operating expenses to total operating expenses result for 2012/13 was 49%. This is a slight increase from the 2011/12 result of 47%, and reflects a trend that has seen the average result steadily increase from 45% in 2006/07.

3.54 Variability throughout the sector is low. Although 37% of local authorities were outliers during the last three years, their results were tightly clustered around the sector average.

3.55 Overall, we did not identify any concerning trends for this indicator.

7 We did not use this indicator in previous years.

Interest expense to rates revenue



3.56 The comparison of interest expense to rates revenue looks at the proportion of rates revenue used to service debt.[8] A high percentage means less flexibility and fewer resources available to respond to unexpected events.

3.57 The average interest expense to rates revenue has decreased from last year to 7.3%. In *Matters arising from the 2012-22 local authority long-term plans* (our long-term plan report),[9] we reported that the average in the long-term plans was 9%.

3.58 Although there was moderate to high variability, the result is affected by some local authorities that did not incur any interest expense because they had no debt. Thirty-four percent of the results in the last three years were outliers. The 2012/13 result shows a decrease in the average and a small change in the number of outliers.

3.59 International practice suggests that interest costs to revenue can become challenging for a public entity to manage when they exceed 10%. However, we note that our comparison is to rates revenue, which is only part of a local authority's revenue stream. Overall, the local authorities had moved slightly away from this level in 2012/13.

3.60 Nineteen local authorities spent a higher proportion of rates revenue on financing costs in 2012/13 than in 2011/12. On the other hand, 28 local authorities spent less of their rates revenue on financing costs in 2012/13 than the previous year. This indicates that there is significant variability among local authorities.

3.61 As we noted last year, some local authorities had high debt balances and used a high proportion of rates revenue to cover the interest expense. Compared to other local authorities, these local authorities had an increased risk of not being able to respond to short-term events.

3.62 We saw three notable outliers. Tauranga City Council had interest expense to rates revenue of 25%. This was one percentage point lower than in both 2010/11 and 2011/12. The Council's debt had stabilised in 2012/13 after substantial increases in each of the previous three years. The Council had reduced the level of capital work carried out because of the slowed rate of population and economic growth. This resulted in a steadying of this indicator.

8 We have used uncapped data for this comparison because we consider that the sensitivity of this indicator means that the overall position on an uncapped basis is most relevant.

9 Controller and Auditor-General (2012), *Matters arising from the 2012-22 local authority long-term plans*, page 62.

3.63 Taupo District Council had interest expense to rates revenue of 20% in 2012/13. This was consistent with its position for the last two years. The Council's debt had also stabilised after several years of significant increases. Although the Council had significant infrastructure expenditure in recent years, it had sold surplus land and used the proceeds from forestry harvesting to manage the growth in debt. The Council signalled this approach in the financial strategy in its 2012-22 long-term plan.

3.64 Auckland Council also had interest expense to rates revenue of 20% in 2012/13. This was an increase from 16% in the previous year. This reflected the Council's growing debt balance to service a wide range of capital projects. Based on gross interest expense, this indicator was forecast to increase to 29% in the next three years. However, Auckland Council holds about $300 million of cash reserves and borrows on behalf of Watercare Services Limited (which sets water charges to pay for expenses, including interest expense – these charges are reflected in Auckland Council's group revenue).

Summary observations about local authorities' ability to manage uncertainty

3.65 Local authorities were generally in a reasonable position to manage uncertainties when they arose. The average results for these indicators did not indicate any significant changes in 2012/13 from prior years.

3.66 Although there was little variability in results for enduring expenses to total operating expenses, there was wider variability between local authorities for interest expenses to rates revenue and working capital indicators. This indicates the importance for each local authority to carefully monitor these indicators, particularly if the local authority had a result significantly different from the average. This could signal a reduced ability to respond to unexpected events.

Ability to invest for the future

3.67 We looked at three indicators that consider how durable a local authority is with longer-term uncertainties and in maintaining itself indefinitely by investing for the future.

Capital expenditure to depreciation

	2011/12	2012/13
Average value		
Direction		
Variability		

3.68 The capital expenditure to depreciation indicator reflects the reinvestment needed to maintain or improve the assets' performance capability and the nature of the service that the assets provide. We also analysed renewals expenditure to depreciation, because this provides a better picture of assets' ability to sustain services.

3.69 We were unable to look at renewals to depreciation last year because local authorities were not required to disclose the level of renewals in annual reports – now they are. The Transparency, Accountability and Financial Management amendments to the Act made disclosure of renewals, including comparative data from the previous year, compulsory from 2012/13 onwards.

3.70 The average capital expenditure to depreciation for 2012/13 was 154%. There was low to moderate variability between local authorities. Thirty-six percent of results were outliers.

3.71 We saw no clear trend because the average percentage for all local authorities continued to fluctuate.

3.72 In our long-term plan report, we reported that the average forecast was 135% for the 10 years to 2021/22. However, we noted that there was a downward movement, with the capital expenditure forecast to be 207% in 2012/13 and 111% in 2021/22. The actual capital expenditure during 2012/13 was considerably less than that forecast.

3.73 For 16 local authorities, capital expenditure was less than 100% of depreciation. The capital expenditure of these local authorities ranged from only 58% to 98% of depreciation. In contrast, Christchurch City Council had capital expenditure of 551% of depreciation because of the substantial earthquake recovery work. Otago Regional Council had 488% expenditure to depreciation because of significant flood protection work on the Leith river.

3.74 Northland Regional Council, which had capital expenditure of 441%, had also been investing significantly in flood protection work, and significant non-depreciable assets affected the results.

3.75 Local authorities with fast-growing communities typically had a higher proportion of capital expenditure to depreciation. However, we noted a reduction in the 2012/13 spending on capital by Auckland Council, Tauranga City Council, and Tasman District Council. In contrast, Kapiti Coast District Council and Selwyn District Council both had capital expenditure of more than 300% of depreciation.

3.76 The capital expenditure should reflect information set out in the asset management plans. As discussed in paragraphs 3.27-3.31, local authorities tended to carry out fewer capital works than budgeted.

3.77 Three local authorities consistently had capital expenditure to depreciation of less than 100%:

- Hutt City Council ranged from 71% to 90% from 2007/08 to 2012/13;
- Waimate District Council ranged from 63% to 98% from 2006/07 to 2012/13; and
- Kawerau District Council continued to show the least capital investment, with a range of 44% to 72% in the last seven years.

3.78 A consistently low percentage could call into question the local authority's ability to maintain assets in the long term. Kawerau District Council put its low reinvestment down to the relative newness of the town. However, the Council needs to carefully consider whether capital expenditure is enough to maintain desired levels of service in the long term and whether the relative age of the town remains a valid argument. Capital expenditure that is too low, even if it is in line with long-term plan forecasts, could lead to a sizeable need for renewal-related capital expenditure beyond the period of the long-term plan forecasts.

3.79 The average renewal expenditure to depreciation for 2012/13 was 64%. This was an increase on 2011/12, where the result was 60%. However, 28% of results were outliers during the two years, including 6% that were outside two standard deviations from the average.

3.80 In our long-term plan report, we reported that the average forecast was 75% during the 10 years to 2021/22. However, we noted that there was a downward trend, with the renewals forecast to be 92% in 2012/13, falling to 73% in 2021/22. Therefore, the renewals spending during 2012/13 was considerably below that forecast.

3.81 We could not identify any characteristics common to the five local authorities that had renewals spending to depreciation scores of less than 40%. Of the three local authorities with the lowest overall capital expenditure results, two had renewals results below the average for the local authorities and one was above the average. However, none of the three was one of the five local authorities with the lowest renewals spending.

3.82 Renewals are fundamental to the sustainability of a local authority. There is no definitive standard for the appropriate level of renewal. We consider it is reasonable to expect each local authority to have a different profile. However, many communities in New Zealand were established in the 1950s, and we expect renewal work on assets to be essential now to maintain levels of service.

3.83 We are concerned that, in the interests of holding down rates increases or because of the lack of available capacity to complete the work, renewal work has been deferred. It cannot be deferred too long. A more in-depth analysis of this matter is required.

Gross debt to total assets

	2011/12	2012/13
Average value		
Direction		
Variability		

3.84 For the gross debt to total assets indicator, a value of more than 100% indicates that a local authority has more debt than assets. This is highly unlikely in any organisation. For public entities, we expect the debt to assets indicator to be well below 50%.

3.85 For 2012/13, the average gross debt to total assets for local authorities was 5%. This was a slight increase on the average of 4.7% for 2011/12. There was moderate to high variability in this indicator, with 44% of local authorities being outliers for 2010/11, 2011/12, and 2012/13.

3.86 Most local authorities maintained a result similar to previous years, while others showed small increases. In our long-term plan report, we stated that the average gross debt to total assets forecast in the 10 years to 2022 was 6%. This means that the average for 2012/13 was comparable to that forecast for the coming years.

3.87 It is important to note that local authority assets, particularly infrastructure, are seldom sold. Therefore, they are not really available to repay debt. The important matter for local authorities is the ability to service and repay debt from operating revenue sources.

3.88 Seven local authorities – Central Otago District Council, Environment Southland, Mackenzie District Council, Northland Regional Council, Taranaki Regional Council, Waikato Regional Council, and Wairoa District Council – had no debt in any of the five financial years from 2008/09 to 2012/13.

Net cash flows from operations to capital expenditure

3.89 The comparison of net cash flows from operations to capital expenditure looks at the local authority's cash surplus (or deficit) from normal business-as-usual operations that has been or could be used towards capital expenditure requirements.

	2011/12	2012/13
Average value		
Direction		
Variability		

3.90 Apart from the cash surplus from normal operations, a local authority can fund capital expenditure by selling investments or assets, or by borrowing to fund the long-life assets.

3.91 A higher percentage indicates that the local authority is funding capital expenditure with internally generated funds rather than external funding (debt).

3.92 In 2010/11, 2011/12, and 2012/13, the average net cash flow from operations to capital expenditure was 82%. The average percentage in each of the three years was between 78% and 87%. For the three years, 40% of the local authorities were outliers.

3.93 No local authorities were consistently outliers. An average of about 80% is not a result that gives us cause for concern. If the percentage decreased over time, it would mean that local authorities were relying more on external funding.

Summary observations about local authorities' ability to invest for the future

3.94 We have not identified any significant movements in the indicators for 2012/13 compared to previous years. However, we are concerned by the extent of variability that we identified and caution local authorities to monitor their individual positions against these important long-term measures.

3.95 We particularly note that actual capital and renewals expenditure is below that forecast in the 2012-22 long-term plans. Local authorities need to clearly understand the implications of their asset renewal choices on their ability to deliver services to the community.

Part 4
Timeliness in annual reporting

4.1 In this Part, we describe:

- the importance of the statutory requirements for adopting and publicly releasing an annual report; and
- when local authorities:
  - adopted their annual reports – and why some authorities were late doing so;
  - publicly released their annual reports; and
  - publicly released their audited summary annual reports.

The importance of timely reporting

4.2 Annual reports provide information that helps communities to assess how well their local authorities perform. Ratepayers and communities are entitled to receive information on how their local authority has performed, both financially and operationally, against the local authority's intentions for the year.

4.3 For communities to effectively assess how well the local authority has performed, they need and deserve timely information. For this reason, local authorities need to ensure that their reports are on time.

4.4 The Act requires each local authority 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;
- make publicly available its annual report within one month of adopting it; and
- release an audited summary of the annual report within one month of adopting the annual report.

4.5 The local authority decides when to prepare and publish the audited annual reports and summaries, within the timing requirements of the Act.

4.6 Figure 5 shows how well local authorities met their statutory deadlines. Appendix 3 sets out more detail on when local authorities adopted and released their annual reports and summary annual reports.

Figure 5
Performance in meeting statutory deadlines for annual reports, 2008/09 to 2012/13

Statutory deadline for	Percentage of local authorities meeting statutory deadlines				
	2008/09	2009/10	2010/11	2011/12	2012/13
Adopting the annual report	99%	91%	90%	99%	92%
Releasing the annual report	99%	94%	94%	99%	96%
Releasing the summary annual report	86%	92%	92%	96%	95%

4.7 Since the introduction of the Act, there has not been a year in which every local authority has met all accountability requirements for the release of publicly available annual reports. This is not satisfactory.

4.8 Although we have not yet quantified the data, we are aware that some council-controlled organisations also failed to meet the statutory deadline. In one instance, a council-controlled organisation's failure to meet the statutory deadline affected the parent local authority's ability to meet its statutory deadline.

Adopting annual reports

4.9 The Act allows local authorities four months after the end of the financial year to complete and adopt their annual reports.

4.10 Six local authorities failed to meet the statutory deadline for 2012/13. This was worse than the year before, when one local authority failed to meet the statutory deadline.

4.11 Far North District Council and Hurunui District Council had not adopted their annual reports as at 31 January 2014 – that is, three months after their statutory deadline and seven months after their balance date. Hurunui District Council still had not adopted its annual report as at 31 March 2014.

4.12 Of the six local authorities that failed to meet the statutory deadline for the 2012/13 annual reports, Central Hawkes Bay District Council, Hurunui District Council, and Westland District Council had also failed to meet the deadline for 2010/11 and/or 2011/12. In past years, the other three local authorities met the deadline.

4.13 One local authority that believed it had adopted its annual report appears to have only conditionally adopted the annual report, “subject to final audit clearance”. The Act requires the annual report to include the audit report when the annual report is adopted. In our view, the local authority had yet to formally adopt its annual report. When we compiled our statistics, the local authority was seeking legal advice on this point. In this report, we have treated the local authority’s annual report as adopted.

4.14 We are disappointed that, despite the previous year’s improvement, six local authorities failed to meet the statutory deadline. Those not meeting the deadline are failing to provide their communities with the timely information they are entitled to receive.

4.15 Two local authorities disclosed reasons for not meeting the statutory deadline:

- In one instance, a quorum was not met at the meeting scheduled to adopt the annual report before the statutory deadline. The elected members met the following week and adopted the annual report on 8 November 2013.
- In the other instance, the audit of a subsidiary significant to the local authority was delayed. The local authority said that this delayed the local authority’s annual report. However, the local authority gave the same reason for missing the deadline in 2010/11. In our view, the local authority should have been aware of the recurring problem and taken appropriate steps to ensure that it met the statutory deadline.

4.16 The other local authorities that failed to meet the statutory deadline did not disclose why they were unable to adopt their annual report within four months of the end of the financial year.

Releasing annual reports to the public

4.17 We looked at when local authorities released their annual reports. The Act allows up to one calendar month between when a local authority adopts and releases the annual report.

4.18 One local authority missed the one-month deadline for releasing its annual report. Two local authorities had yet to complete their annual reports when we compiled the statistics for this Part.

4.19 Most local authorities publish their annual reports on their websites. In our view, local authorities should be able to publish annual reports on their websites within a few days of adopting them.

4.20 For 2012/13, fewer local authorities released their annual reports promptly after adopting them, compared to the year before. Only 49% of local authorities made their 2012/13 annual reports public within 10 days of adopting them, down from 58% for the 2011/12 annual reports. This is unsatisfactory and, as with adopting audited annual reports, we expect local authorities to focus on improving this.

Releasing summary annual reports to the public

4.21 Releasing an audited summary of the annual report is an important part of a local authority's accountability to its community. The summary is the most accessible and understandable information for most readers, and the easiest document to circulate and make widely available.

4.22 Two local authorities did not provide their communities with audited summaries of their annual reports within one month of adopting their annual reports.

4.23 When we compiled our statistics at 31 January 2014, two local authorities had not completed their annual reports and summary annual reports.

4.24 Local authorities know they must produce a summary annual report. We emphasise that local authorities need to effectively project manage the production and publication of their summary annual reports.

Part 5
Canterbury earthquakes and insurance recoveries

5.1 In this Part, we discuss:

- common insurance arrangements for local government;
- how the Canterbury earthquakes have affected New Zealand Local Government Insurance Corporation Limited, trading as Civic Assurance (Civic Assurance);
- how the earthquakes have affected the Local Authority Protection Programme Disaster Fund (LAPP); and
- the uncertainty about the amount of insurance recoveries payable to Christchurch City Council.

5.2 Insurance recoveries are just one part of the funding mix required to rebuild Christchurch and the surrounding region. Overall, there has been uncertainty about the amount of insurance recoveries arising from the Canterbury earthquakes. The uncertainty comes from several factors, including longer than normal claims development periods and the extent of damage.

5.3 Progress has been made towards settling the amounts paid or payable by the main local government insurers towards the costs of rebuilding and replacing buildings and infrastructure in Christchurch. There are two disputes with reinsurers that have affected progress, and the risk of these matters remaining unresolved falls on the insured – Christchurch City Council.

5.4 The amount of the final insurance contribution to the rebuild is still unknown and will take some time to resolve.

Background

5.5 The Canterbury earthquakes highlighted the importance of good risk management for public assets, and the part insurance plays in that. Insurance costs became one of the most significant cost pressures for many public entities after the earthquakes.

5.6 In 2012, to find out more about the extent of changes in insurance costs after the Canterbury earthquakes, we asked our auditors for information about post-earthquake insurance arrangements and costs for larger public entities.

5.7 We published the results of our work in June 2013.[10] That report summarised information about how more than 400 of the largest public entities insure their public assets and the main changes since 2010 after the Canterbury earthquakes.

10 Controller and Auditor-General (2013), *Insuring public assets*.

5.8 The report included our analysis of insurance for local government assets, and gave some information about the most commonly used insurance providers in local government – Civic Assurance and LAPP – and the effects of the Canterbury earthquakes on them.

5.9 Since our June 2013 report, the three entities most affected have completed their latest annual reports:

- Civic Assurance, for the year ended 31 December 2013;
- LAPP, for the year ended 30 June 2013; and
- Christchurch City Council, for the year ended 30 June 2013.

5.10 We have used the annual reports to provide information in this Part about the ongoing effects of the Canterbury earthquakes on those three entities.

Common insurance arrangements for local government

5.11 Before the Canterbury earthquakes, most local authorities:

- insured their "above-ground" property with Civic Assurance. Civic is owned by local authorities, and has a long history of providing insurance services to them;
- insured their "below-ground" water management infrastructure for fresh water, stormwater, and sewage (primarily the pipes), and flood protection assets (such as stopbanks and floodgates), through LAPP, a charitable trust formed and administered by Civic.[11]

5.12 In 2009, because of its substantial reserves and with a reinsurance programme managed by Civic Assurance, LAPP extended the cover offered to local authorities to both above- and below-ground assets.

5.13 Civic Assurance told us that 27 local authorities took up this offer, including Christchurch City Council,[12] which insured its below-ground and above-ground assets with LAPP for 2010/11 – the period of the Canterbury earthquakes. The other local authority most affected by the earthquakes, the Waimakariri District Council, was a LAPP member for its below-ground infrastructure and insured its above ground assets with Civic.

5.14 LAPP had insurance from Civic Assurance for Christchurch City Council's above-ground component, and Civic arranged reinsurance[13] cover for those properties.

11 Government policy since 1991 has been that the Crown will meet up to 60% of the cost of restoring water and sewage infrastructure services after a catastrophe and the local authority must meet the other 40%.

12 We summarised Christchurch City Council's insurance arrangements from 2007 to 2010, including the change to insuring above ground property with LAPP in 2010/11, in our 2012 report, *How Christchurch City Council managed conflicts of interest when it made decisions on insurance cover.*

13 Reinsurance is insurance purchased by an insurer that transfers a portion of the insurer's risk to other parties (the reinsurers). The reinsurers assume some of the risk in return for a share of the premium that the insurer receives.

5.15 LAPP provided Christchurch City Council with cover for the below-ground component, using a mixture of self-insurance from the LAPP fund and reinsurance.

5.16 Figure 6 shows Christchurch City Council's insurance arrangements for the period of the earthquakes – 1 July 2010 to 30 June 2011, and insurance recoveries received or projected.

Figure 6
Christchurch City Council's insurance arrangements for 2010/11 and recoveries received or projected

Insurance arrangements	Entities and roles for 2010/11 insurance	Insurance recovery
Above-ground	Above-ground reinsurers (which insure Civic Assurance)	$600 million (projected)
	Civic Assurance (which insures LAPP)	
	LAPP (which insures the Council)	
	Christchurch City Council	
Below-ground	LAPP (which insures the Council)	$201 million (paid)
	Below-ground reinsurers (which insure LAPP)	

5.17 We explain more about these arrangements below.

Civic Assurance

Reinsurance recoveries

5.18 As we noted in our June 2013 report, the Canterbury earthquakes had a significant effect on Civic Assurance. Civic has received claims on more than 900 properties as a result of the earthquakes. As Civic's above-ground property reinsurance programme for the period 30 June 2010 to 30 June 2011 was uncapped, most of the cost of the earthquake claims falls on Civic's reinsurers.

5.19 In contrast, the cost to Civic Assurance of the September 2010, February 2011, and June 2011 earthquakes was capped at $3.6 million for each event – a total of $10.8 million.[14]

5.20 As at 31 December 2013, Civic Assurance notes that:[15]

- The outstanding liability for Canterbury earthquake claims was $590 million (2012: $826 million).[16]

14 Civic Assurance (2012), *2011 Annual Report*, page 4.

15 Civic Assurance (2014), *2013 Annual Report*, notes 3d and 23 to the financial statements cover Canterbury earthquake claims and going concern.

16 The decrease in Civic's outstanding claims between the two financial years is mainly a result of updated information on costs of claims from Civic's loss adjusters.

- All but $5 million of the $590 million is covered by Civic's reinsurance arrangements, so Civic's net outstanding claims liability is $5.0 million. Of this amount, $2.9 million relates to Civic's remaining exposure to the Canterbury earthquake claims, and the remaining $2.1 million relates to Civic's other business-as-usual exposures.
- Not all of Civic's reinsurers have agreed to meet in full the claims made. Civic is attempting to resolve disputes with two of its reinsurers, AIG and R+V Versicherung AG (R+V), through arbitration.

5.21 The amounts in dispute that Civic Assurance considers that AIG and R+V are liable for total about $100 million. Civic believes that it will succeed in both disputes. Civic has included the disputed amounts in its overall reinsurance recoveries (that is, as an asset in its 31 December 2013 financial statements).[17] Civic also considers that it has other options to recover the shortfall if its claims against the two reinsurers do not succeed.

5.22 Civic Assurance's disputes with reinsurers also affect LAPP and, potentially, Christchurch City Council. The disputes concern the above-ground cover that LAPP provided to the Council in 2010/11, but not the below-ground cover. Civic is managing the disputes with the reinsurers on LAPP's behalf. LAPP disclosed information about the disputes with reinsurers in its 30 June 2013 financial statements, as noted in paragraph 5.54.

5.23 Until the disputes are resolved or other options for recovery pursued, there is some uncertainty about Christchurch City Council's insurance recoveries. The Council disclosed information about insurance recoveries in its 2013 annual report (page 146). We note these disclosures in paragraphs 5.71 to 5.75.

Civic Assurance's activities after the earthquake

5.24 For a period after the Canterbury earthquakes, from July 2011 to July 2012, Civic Assurance has been unable to renew its property reinsurance programme or secure suitable property reinsurance from any other source.

5.25 Although Civic Assurance has had access to property reinsurance from July 2012, it was unable to write any property insurance because its claims payable credit rating was reduced in 2011 to "B+, negative watch".

5.26 The Reserve Bank of New Zealand has issued Civic Assurance with a provisional licence to carry on insurance business under the Insurance (Prudential Supervision) Act 2010, and Civic intends to apply for a full licence. However, a condition of the provisional licence is that Civic does not offer any new business.

17 In 2013, Civic Assurance won a dispute on behalf of LAPP against another reinsurer, The New India Assurance Company Limited. The amount involved was just under $20 million.

5.27 Although Civic Assurance cannot accept any new insurance business for the time being, it continues to offer local authorities insurance products through Civic Property Pool, a charitable trust similar to LAPP. Civic also administers another mutual liability fund (called Riskpool), which is used by 58 local authorities for professional indemnity and public liability insurance.

5.28 The disputes with the two reinsurers need to be resolved before Civic Assurance can restore a claims payable credit rating of "A-" or better, which is needed before it can again offer material damage cover. The arbitration with AIG was completed in March 2014 but the outcome is not yet known. The arbitration with R+V was set for later in 2014, if settlement could not be reached beforehand.

Civic Assurance's financial position from 2010 to 2013

5.29 The Civic Assurance group made after-tax losses from the year ended 31 December 2010 to the year ended 31 December 2013. Most of these losses were because of the costs of dealing with the Canterbury earthquake claims. The biggest losses were in 2010 ($4.0 million) and 2011 ($5.4 million). Civic's equity decreased from $19.5 million to $10.1 million in that period.

5.30 Figure 7 below summarises key financial information for the Civic Assurance group from 2009 to 2013.

Figure 7
Civic Assurance group equity and profit (loss) from 2009 to 2013

	2009 $m	2010 $m	2011 $m	2012 $m	2013 $m
Equity	19.49	15.47	10.08	12.97*	12.35
Profit (loss)**	0.74	(4.01)	(5.39)	(1.28)	(0.62)

* Paragraph 5.31 explains the increase in equity between 2011 and 2012, despite the after-tax loss.
** Total comprehensive profit (loss) net of tax.

5.31 In early 2012, Civic Assurance offered shareholders the option of buying more shares in the company. It raised more than $4 million from 48 local authorities through this share offer. Civic carried out a second share offering later in 2012.[18] Although it made an after-tax loss in 2012, it also raised $4.17 million from the share issue. Overall, this resulted in an increase in Civic's equity from 2011 to 2012. The loss in Civic's most recent financial year was smaller.

18 The closing date for the capital raising has been extended several times and is currently extended until December 2014. This has been to allow time for further local authorities to take up the offer and to ensure that there was more certainty around the recovery of the disputed reinsurance receivables.

5.32 The directors of Civic Assurance have continued to regard the company as a going concern throughout the period of the after-tax losses.

5.33 Despite the losses in the last four years, Civic Assurance had equity of $12.35 million as at 31 December 2013.

Our audit reports for 2012 and 2013

5.34 In our audit report on Civic Assurance's 31 December 2012 financial statements, we drew attention to disclosures in the financial statements that referred to the going-concern assumption being appropriately used in preparing the financial statements, despite there being uncertainties about the outcome of reinsurance issues and when Civic will resume its normal business activities (see Appendix 4).

5.35 As the disputes with reinsurers remained unresolved at 31 December 2013, we included a similar comment in our audit report on Civic Assurance's 31 December 2013 financial statements. The comment noted the unresolved disputes were subject to arbitration, and that there was uncertainty about:

- when Civic would be able to resume its normal business activities; and
- whether Civic will make sufficient profits to allow all of its deferred tax asset[19] to be recovered.

5.36 We also noted that the validity of the going-concern assumption on which the financial statements were prepared depends on, among other matters, limiting Civic Assurance's net outstanding claims liability to $5.0 million.

5.37 Overall, we said that we considered Civic Assurance's disclosures about these matters in its financial statements to be adequate.

Local Authority Protection Programme Disaster Fund

How LAPP started

5.38 From 1991, Government policy has been to pay 60% of the costs of restoring water and sewage services after natural disasters, if the affected local authority can show that the damaged assets had been properly maintained and can meet the remaining 40% through other means (such as reserves, insurance, or mutual assistance schemes).[20]

19 Civic Assurance has a deferred tax asset of $3.88 million, but needs to return to profitability to realise the benefit of the tax asset. Civic has investment income and administration fees of more than $3 million a year, and can make a profit without writing insurance. Civic's loss in 2013 was because of the cost of administering the Canterbury earthquake claims and the legal costs of its disputes.

20 The 60/40 split between central and local government is set out in *The Guide to the National Civil Defence Emergency Management Plan* (revised in June 2009).

5.39 As a means for local authorities to cover their 40% share, Civic Assurance, along with Local Government New Zealand, established the LAPP mutual assistance scheme on 1 July 1993. It was set up as a charitable trust.

How LAPP works

5.40 Members make an annual contribution to LAPP in return for cover for the cost of restoring their infrastructure as a result of a damaging event. Contributions are set at a level that covers the expected risk, administration costs, and re-insurance premiums.

5.41 Members pay an annual contribution based on factors such as the risk or exposure of the member to a damaging event in its region, the value of the assets held by the member, and the state of repair, maintenance, and condition of the member's infrastructure.

5.42 In some years, the annual contribution includes a significant component for building the LAPP fund. This allows LAPP to cover some of the risk itself. LAPP's reinsurance arrangements are organised by Civic Assurance on LAPP's behalf.

5.43 LAPP meets insurance claims from a combination of assets in the mutual fund and reinsurance purchased from the global market.

5.44 Before the Canterbury earthquakes, member contributions and excesses had generally been falling, while values covered had more than doubled.

5.45 Members' contributions for below-ground cover increased significantly after the Canterbury earthquakes, to help rebuild the LAPP fund.

5.46 Figure 8 shows below- and above-ground contributions[21] to the LAPP fund from members in the period 30 June 2009 to 30 June 2013.

Figure 8
Contributions from LAPP fund members, 2008/09 to 2012/13

Members' contributions	2008/09 $m	2009/10 $m	2010/11 $m	2011/12 $m	2012/13 ($m
Below-ground	5.05*	3.17	11.43	14.12	9.0
Above-ground	0	0.038	2.38	0.036	0

* Includes "new entrant" contributions of $1.68 million. Local authorities that had joined the LAPP fund before September 2010 were required to pay an additional levy to the fund.

21 LAPP began separately recording above-ground and below-ground contributions from members in its 30 June 2011 annual report, but included comparative information for 30 June 2010.

Effects of the Canterbury earthquakes on LAPP

5.47 The Canterbury earthquakes have had a significant effect on LAPP. LAPP had one below-ground automatic reinstatement[22] so, although the September 2010 and February 2011 earthquakes were covered, the below-ground damage from the 13 June 2011 earthquake was not covered by LAPP's reinsurers.

5.48 LAPP had built up a total fund of $37.6 million by 30 June 2010. LAPP was then in its eighteenth year. In that time, there had been only a small number of claims and one medium-size claim after the February 2004 Manawatu floods. Because it had not had any large claims since being formed in 1993, LAPP had substantial reserves.

5.49 As noted in paragraph 5.12, in 2009 LAPP extended the cover offered to local authorities to include above-ground and below-ground assets. LAPP offered this cover for the three years from 2009/10 to 2011/12, and 27 members took it up. LAPP did not receive any above-ground contributions in 2012/13.

5.50 Figure 9 shows the size of the LAPP fund and LAPP's profit or loss from 2009 to 2013.

Figure 9
LAPP fund/equity and profit (loss) from 2008/09 to 2012/13

	2008/09 $m	2009/10 $m	2010/11 $m	2011/12 $m	2012/13 $m
Equity	36.9	37.6	(1.6)	2.6	8.8
Profit (loss)	3.44	0.68	(39.3)	4.3	6.2

5.51 In its annual report for the year ended 30 June 2013, LAPP noted that:

- Before the 4 September 2010 earthquake, LAPP's best estimate of Christchurch City Council's 40% exposure to a one-in-a-thousand-year earthquake for damage to its below-ground assets, using GNS Science models, was $17 million. However, because LAPP buys its reinsurance based on its whole membership, LAPP was able to pay the Council more than ten times this amount.
- It had settled its below-ground claims from the 2010 and 2011 Canterbury earthquakes. LAPP has paid about $15.4 million to Waimakariri District Council and about $201.5 million to Christchurch City Council.
- The cost of replacing Christchurch City Council's below-ground infrastructure will exceed $2 billion, so the cost to the Council for its 40% share will be more than $800 million.[23]

22 A provision in an insurance policy that results in insurance cover continuing to be provided after an event that results in a claim.

23 New Zealand Local Authority Protection Programme Disaster Fund (2013), *2013 Annual Report*, chairman's report, page 2.

5.52 As noted in paragraph 5.13, LAPP also provided above-ground cover for Christchurch City Council for 2010/11, for which it has insurance from Civic Assurance. This is why the two disputes with reinsurers affect LAPP and, potentially, Christchurch City Council. Like Civic, LAPP has not made any adjustments to estimated reinsurance recoveries in its 30 June 2013 financial statements. LAPP believes that the amounts in dispute are legally payable.[24] As noted above, the disputes are about the above-ground cover provided by LAPP, not the below-ground cover.

5.53 LAPP has made similar disclosures to those of Civic Assurance in its most recent financial statements about measuring gross claims liabilities and reinsurance recoveries. LAPP's June 2013 financial statements note the following:[25]

> *There are considerable uncertainties surrounding the measurement of gross claim liabilities and the related reinsurance recoveries arising from the Canterbury earthquakes. These arise from a number of factors including longer than normal claims development periods and the extent of damage.*
>
> *Gross outstanding claims liabilities total $649 million (2012: $880 million) of which the majority is the estimate of outstanding claims liabilities arising from the Canterbury earthquakes. This estimate represents loss assessors' estimates as at 30 June 2013 of what LAPP will ultimately pay, prior to receiving any reinsurance recoveries* [...]
>
> *Given the nature and number of uncertainties associated with the Canterbury earthquakes, the actual claims experience may deviate, perhaps substantially, from the gross outstanding claims liabilities as at 30 June 2013. Any changes to estimates will be recorded in the accounting period when they become known.*
>
> *After reinsurance and other recoveries, the net outstanding claims liabilities for the Canterbury earthquakes amounts to $7.0 million as at 30 June 2013 ($24.2 million as at 30 June 2012).*

5.54 For reinsurance recoveries receivable, LAPP's June 2013 financial statements note that Civic Assurance is in arbitration with two of the LAPP fund's reinsurers. This arbitration relates to the limits of the cover under the above-ground reinsurance programme. However, based on legal advice, LAPP believes that the amounts accounted for as receivable are legally payable. Accordingly, the financial statements do not include any adjustments to the reinsurance recoveries receivable.

24 New Zealand Local Authority Protection Programme Disaster Fund (2013), *2013 Annual Report*, note 5 to the financial statements, page 15.

25 New Zealand Local Authority Protection Programme Disaster Fund (2013), *2013 Annual Report*, note 4 to the financial statements, page 14.

LAPP's ongoing operations after the earthquakes

5.55 In its 30 June 2013 annual report, LAPP notes that most of the reinsurers on its 2010/11 reinsurance programme were not prepared to renew their arrangements after the earthquakes. LAPP also notes that, in the two years between June 2010 and June 2012, the cost of its reinsurance programme increased seven-fold. For LAPP's 2013/14 renewal, reinsurance rates halved, but are still 3.5 times more than they were in 2010/11. This means LAPP is not buying as much reinsurance protection now as it did in 2010/11, but it does have more cover than it was able to buy in 2012/13.

5.56 After consultation with its members, from 1 July 2012 the gap between what LAPP can afford to fund and the reinsurance deductible is covered through a mutual self-insurance arrangement between its members. For 2012/13, in the event of a major catastrophe, members were liable for five times their annual contribution as "mutual self-insurance".[26] This provided up to $45 million of cover, and was adopted as a means of speeding up the rebuild of the LAPP fund while keeping the LAPP contributions manageable for the members.

5.57 For 2013/14, members are liable for four times their annual contribution as mutual self-insurance. For 2014/15, members are expected to be liable for three times their annual contribution as mutual self-insurance should there be a major catastrophe.

LAPP membership

5.58 LAPP had 59 local authority members as at 30 June 2010 and 58 members at 30 June 2013. However, 12 members left the fund as of 1 July 2013, bringing the membership to 46 from a potential 78.[27] More local authorities have since given notice of leaving the fund.[28]

Going concern

5.59 LAPP's process of rebuilding the fund has resulted in equity of $8.8 million as of 30 June 2013 (2012: $2.6 million).[29]

5.60 Figure 10 shows how the size of the LAPP fund has changed since it was formed.

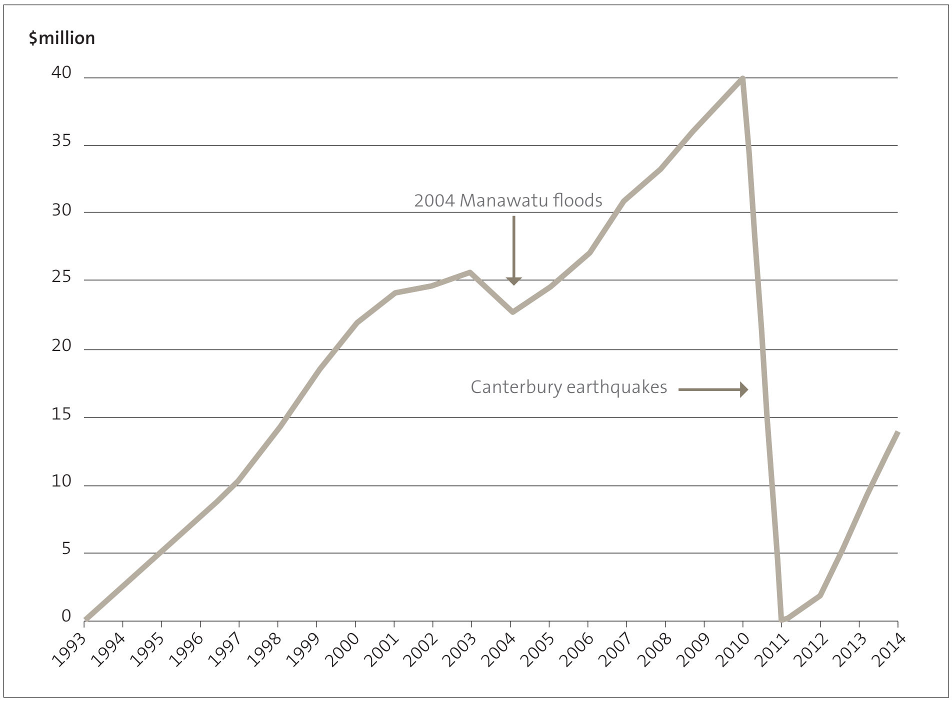
26 New Zealand Local Authority Protection Programme Disaster Fund (2013), *2013 Annual Report*, page 3.

27 New Zealand Local Authority Protection Programme Disaster Fund (2013), *2013 Annual Report*, page 4.

28 Members have to give one year's notice, but Civic Assurance believes that some will have done so merely to preserve their options and might yet remain members of the fund.

29 Civic Assurance has advised that LAPP's unaudited accounts to 28 February 2014 show equity of $14 million.

Figure 10
Size of the Local Authority Protection Programme fund, 1993-2014



5.61 LAPP's 2013 financial statements were prepared on a going-concern basis. Despite the fact that some members left the fund and others have given notice of their intention to leave (effective 1 July 2014), the trustees considered they had good reasons to believe the fund would continue as a going concern. There was strong support among remaining members, equity of $8.8 million (which is before receiving the 2013/14 contributions), and payments made from the fund are discretionary.

5.62 The chief executive of Civic Assurance told us that LAPP expects to retain or increase the number of members. He notes that, as members receive no payment when they leave, leaving means gifting the remaining LAPP fund to continuing members. This is a disincentive to leaving for some members.

Our audit report on LAPP's 30 June 2013 financial statements

5.63 In our audit report on LAPP's 30 June 2013 financial statements, we drew attention to disclosures in the financial statements that referred to the considerable uncertainty for measuring the gross claims liabilities and the related reinsurance recoveries arising from the Canterbury earthquakes. We considered the disclosures about these matters to be adequate. The audit reports in 2011 and 2012 also drew attention to those uncertainties.

5.64 In our 2013 audit report, we accepted that LAPP is a going concern and did not consider it necessary to draw attention to the trustees' going-concern statement.

The future of LAPP

5.65 Despite the loss in membership, the Chairman of LAPP is optimistic about LAPP's future. He has noted that, as the fund grows and reinsurance rates continue to normalize, the amount covered by mutual self-insurance can reduce. As shown in Figure 9, at 30 June 2013 the fund had increased to \$8.8 million from \$2.6 million the year before. It is projected to be \$14.8 million by 30 June 2014.

Christchurch City Council's position

5.66 Christchurch City Council's financial statements continue to be affected by the 2010 and 2011 Canterbury earthquakes (see paragraphs 6.20-6.23 and Appendix 4).

5.67 The proceeds from insurance recoveries are expected to make a significant contribution to the funding for Christchurch City Council to rebuild after the Canterbury earthquakes.

5.68 Christchurch City Council has estimated the total cost of the earthquake response and recovery to be \$4.4 billion. The Council has estimated that proceeds from its insurance claims will contribute around \$1.0 billion towards funding rebuild costs, with a further \$1.8 billion covered by the Crown's contributions. This results in an estimated Council contribution of \$1.6 billion.[30]

5.69 Both LAPP and Christchurch City Council's 2013 annual reports contain detailed information about rebuilding infrastructure and facilities and costs.[31] This information includes that:

- For buildings, facilities, and other assets, forecasts assume that the Council secures insurance settlements for rebuilding/repairing its assets on a like-for-like basis (less a 2.5% excess). Any betterment, such as improvement or strengthening, is to be funded through a \$225 million improvement allowance.
- For major buildings and facilities, such as the Town Hall, Art Gallery, Centennial Pool, and Lancaster Park (formerly AMI stadium), agreement is still to be reached between engineers acting for the Council and for the insurer on the extent of the damage, the method of repair (if any), and the expected cost.

30 Christchurch City Council (2013), *Annual Report 2013*, page 145.

31 New Zealand Local Authority Protection Programme Disaster Fund (2013), *2013 Annual Report*, page 2; Christchurch City Council (2013), *Annual Report 2013*, pages 145-146.

- LAPP contributed $201 million for below-ground assets, which was the maximum possible given its reinsurance programme.

5.70 LAPP's annual report for 2013 notes that the cost to the Council of meeting its 40% share of replacing below-ground infrastructure will exceed $800 million and is considerably more than the LAPP fund had been able to contribute.

Insurance and other recoveries

5.71 The Council's 30 June 2013 financial statements include "insurance/recovery" revenue of $373 million (2012: $575 million) and earthquake recoveries receivable of $345 million (2012: $345 million). These amounts reflect costs incurred and recoveries recognised for the Council[32] based on information available at 30 June 2013.

5.72 Of the insurance/recovery revenue, about $76 million is insurance proceeds; about $295 million is government grants or other assistance; and $2 million is other earthquake-related revenue. The insurance recoveries for the year reflect the value of claims for demolished and damaged buildings and facilities. The Council's financial statements note that no major insurance settlements were concluded in the year ended 30 June 2013.

5.73 The earthquake recoveries receivable of $345 million includes $176.2 million (2012: $140.5 million) for the Council from the proceeds of insurance recoveries. The Council has noted that a portion of the recoveries receivable due from insurers is dependent on settling claims with reinsurers.[33]

5.74 Accounting standards[34] require that insurance recoveries can be recognised in financial statements only when there is "virtual certainty" of receiving them. The Council noted that the virtual certainty threshold had been met and revenue recognised in some but not all instances. Where the virtual certainty threshold had not yet been met, the Council treated the recovery as a contingent asset.[35]

5.75 The Council noted that the ultimate outcome of future recoveries could not be reliably measured at 30 June 2013, and there will continue to be uncertainty about this matter for several years.[36]

32 These amounts are for the Council, not the Council group.

33 Christchurch City Council (2013), *Annual Report 2013*, page 197. The claims referred to here are the disputes between Civic Assurance and the two reinsurers.

34 NZ IAS 16: *Property, Plant and Equipment* and NZ IAS 37: *Provisions, Contingent Liabilities and Contingent Assets* (paragraphs 31-35 of NZ IAS 37 explain the "virtual certainty" threshold).

35 Christchurch City Council (2013), *Annual Report 2013*, page 146.

36 Christchurch City Council (2013), *Annual Report 2013*, note on contingent assets and liabilities, page 147.

5.76 We did not consider it necessary to draw attention to the potential effect of the dispute between Civic Assurance and two of its reinsurers in our audit report on the Council's 30 June 2013 financial statements. We considered the Council's disclosures about insurance and other recoveries to be adequate.

Part 6
About the audit reports issued in 2013

6.1 In this Part, we provide an overview of the audit results[37] for local authorities and other entities within local government.

6.2 Figure 11 shows that we issued 631 audit reports on local government entities during the year ended 31 December 2013.[38] Of the 631 reports, 543 were standard audit reports and 88 were non-standard audit reports.[39]

Figure 11
Audit reports issued on local government entities

	Number of audit reports issued	Number of standard audit reports issued	Number of non-standard audit reports issued			
			Unmodified opinion but including an "emphasis of matter" paragraph/s	Modified opinion (Qualified)	Modified opinion (Adverse)	Modified opinion (Disclaimer)
Local authorities	77§	73	3	-	-	1
Council-controlled organisations	181§§	142	22	5	12	-
Energy companies and subsidiaries	69	69	-	-	-	-
Airports and subsidiaries	23	23	-	-	-	-
Port companies and subsidiaries	30	29	1	-	-	-
Miscellaneous other local government entities	94*	81	6	2	5	-
Small entities	157**	126	2	25	-	4
Total	**631**	**543**	**34**	**32**	**17**	**5**

§ This number includes one audit report for the previous financial period.
§§ This number includes 15 audit reports for previous financial periods.
* This number includes eight audit reports for previous financial periods.
** This is made up of Administering Bodies and Boards, Cemeteries, Fish and Game Councils, and Local Authority Sinking Fund Commissioners. This number includes 28 audit reports for previous financial periods.

37 For a plain-English explanation of the types of audit reports, see "The Kiwi guide to audit reports", at blog.oag.govt.nz.

38 Local authorities, most council-controlled organisations, airports, port companies, other local government miscellaneous entities, administering bodies and boards, and local authority sinking fund commissioners have a 30 June balance date. Energy companies and cemeteries have a 31 March balance date. Fish and Game Councils have a 31 August balance date, and other entities, including some council-controlled organisations and other local government miscellaneous entities, have a balance date in March, August, October, or December.

39 The figures for the number of audit reports may include audit reports that relate to more than one financial period; for example, for the year ended 30 June 2012 and 30 June 2013. In most instances, we issue an audit report for each financial year.

6.3 We compared the results of our audit reports issued in 2013 with our audit reports issued in 2012 for any emerging trends or patterns. There was no significant difference in the number of standard and non-standard audit reports issued during 2012 and 2013 for the sector as a whole. Nor did we observe or identify any trends or significant changes between years.

Unmodified opinions with "emphasis of matter" paragraphs

6.4 We drew attention to disclosures in Kaipara District Council's financial statements for 2011/12 about:

- Kaipara District Council having going-concern issues and risks to financial viability because it depended on:
  - the continuing financial support of bankers and getting enough revenue from development contributions to help service debt;
  - addressing legal matters associated with past targeted rates;
  - adopting and putting into effect its 2012-22 long-term plan; and
  - being able to collect all rates levied, to manage cash flows;
- legal matters associated with targeted rates that lacked proper statutory authority, because of errors in setting them, and the contingent liability that would follow should any legal challenge result in the Council having to refund rates to ratepayers; and
- the Auditor-General agreeing to proceed with an inquiry into the Council's planning, development, implementation, and oversight of the Mangawhai community wastewater scheme.

6.5 We drew attention to disclosures in Kaipara District Council's financial statements for 2012/13 about:

- legal matters associated with targeted rates that lacked proper statutory authority because of errors setting them, and the contingent liability that would follow should any legal challenge result in the Council having to refund rates to ratepayers; and
- the Auditor-General agreeing to proceed with an inquiry into the Council's planning, development, implementation, and oversight of the Mangawhai community wastewater scheme.

6.6 We drew attention to disclosures in Taupo District Council and Group's financial statements for 2012/13 that referred to the breach of the Act because the Council failed to adopt its 2012-22 long-term plan by 1 July 2012.

6.7 A long-term plan is needed to provide for integrated decision-making, as a basis of accountability to the community and setting valid rates under the Rating Act. Because the Council did not adopt the long-term plan until 24 September 2013, the Council has applied to the Department of Internal Affairs for an Order in Council to validate the late adoption of the long-term plan as if had been adopted before 1 July 2012.

6.8 We drew attention to the serious financial difficulties and resulting uncertainties about the appropriateness of the use of the going-concern assumption in our audit report for 2012/13 on Inframax Construction Limited, which is a subsidiary of Waitomo District Council.

6.9 We drew attention to the disclosures in the financial statements for 2012/13 about the uncertainties in measuring the fair value of shares in incubator and accelerator companies because of the early-stage nature of the investments and the absence of quoted market prices for two subsidiaries of Greater Wellington Regional Council:

- Grow Wellington Limited and Group; and
- Creative HQ Limited.

6.10 We drew attention to disclosures that set out uncertainties about the validity of the going-concern assumption for five public entities for 2012/13:

- Infracon Limited, a subsidiary of Tararua District Council;
- Central Plains Water Trust, a trust set up by Selwyn District Council and Christchurch City Council;
- North Tugz Limited, a subsidiary of Ports of Auckland Limited and Northport Limited;
- New Zealand Local Government Insurance Corporation Limited and Group (trading as Civic Assurance); and
- Tamaki Redevelopment Company Limited.

6.11 We drew attention to the uncertainties associated with the outstanding claims provision and reinsurance receivables of the New Zealand Mutual Liability Riskpool Scheme and the appropriateness of the going-concern assumption for New Zealand Mutual Liability Riskpool for 2012/13.

6.12 We drew attention to disclosures about the New Zealand Local Authority Protection Programme Disaster Fund for 2012/13 preparing special-purpose financial statements and the uncertainty about the gross claim liabilities and the related reinsurance recoveries from the Canterbury earthquakes of 2010 and 2011.

6.13 We drew attention to disclosures about Athol Cemetery Trust preparing one statement of accounts covering 19 years (1993 to 2012).

6.14 We drew attention to eight disclosures about the going-concern assumption appropriately not being used because a public entity had been or was about to be disestablished. The public entities were:

- Christchurch Stadium Trust, a trust which had forecast financial difficulties and required additional support from external parties (for 2012);
- Selwyn Investment Holdings Limited and Group, a subsidiary of Selwyn District Council (for 2012/13);
- Lakes Environmental Limited, a subsidiary of Queenstown-Lakes District Council (for 2012/13);
- Lakes Leisure Limited, a subsidiary of Queenstown-Lakes District Council (for 2012/13);
- S C Aoraki Development Trust, a Trust controlled by Timaru District Council (for 2012/13);
- Timaru District Promotion Trust, a Trust controlled by Timaru District Council (for 2012/13);
- Taranaki Provincial Patriotic Council (for 2010/11); and
- Puhoi Cemetery Board, which was to be vested in Auckland Council on 25 September 2009 (for 2009/10).

6.15 In five instances, we drew attention to the disclosures that a statement of service performance had not been included in the annual report because the public entity was inactive:

- Tauwhareparae Forests Limited, a subsidiary of Gisborne District Council (for 2012/13);
- Westland Nature Trust, a trust controlled by Westland District Council (for 2012/13); and
- Kaikoura Community Charitable Trust, a trust controlled by Kaikoura District Council (for 2009/10, 2010/11, and 2011/12).[40]

6.16 We drew attention to the disclosures that Regional Software Holdings Limited, a company owned by six regional councils, had failed to issue a statement of intent for 2012/13 but reported performance information for that year.

6.17 We drew attention to the fact that six public entities failed to issue a statement of intent for the year after the reporting year:

- Luggate Nominee Limited, a council-controlled organisation in the Dunedin City Council group (for 2007/08);

40 Kaikoura Community Charitable Trust was previously known as Kaikoura Community Facilities Trust. Its balance date changed from 31 March to 30 June in 2012.

- West Coast Rural Fire Authority (for 2003/04);
- Canterbury Development Corporation Holdings Limited and Group, a subsidiary of Christchurch City Council (for 2012/13);
- Canterbury Development Corporation and Group, a subsidiary of Christchurch City Council (for 2012/13);
- New Zealand Food Innovation South Island Limited, a subsidiary of Christchurch City Council (for 2012/13); and
- CRIS Limited and Group, a subsidiary of Christchurch City Council (for 2012/13).

Modified opinions

Disclaimers of opinion

6.18 During 2013, we expressed disclaimers of opinion on the financial or service performance information of three public entities.

6.19 We expressed a disclaimer of opinion on the statement of financial position and the operation statement of Oakura Reserve Board (for 2008/09) because we could not get:

- signed representation letters and statements required by legislation from the Board; and
- enough assurance about the completeness of revenue and expenditure because of limited controls over that revenue and expenditure.

6.20 We expressed a disclaimer of opinion about the annual report of Christchurch City Council and Group (for 2012/13) because 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 earthquakes.

6.21 The Council could not account for the effect of the earthquakes on assets because it could not estimate the cost to repair the assets. However, the Council disclosed that the earthquakes had damaged its assets and made collating financial information more difficult. Specifically:

- We could not get enough assurance that the value of the property, plant, and equipment assets (valued at fair value) was correct, because no market evidence was 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).
- Although there was a material change in the replacement costs for infrastructure assets (valued using depreciated replacement cost), no revaluations could be carried out and appropriate replacement cost rates could not be worked out reliably enough.

- The surplus for the year for the Council and Group did not reflect the total losses from writing off irreparable assets and the other comprehensive income information did not reflect the total impairment of damaged, but reparable, assets and revaluations for assets that should be revalued.
- We could not rely on the comparative information in the 2012/13 financial statements.

6.22 Although we could not form an opinion on Christchurch City Council and Group's financial statements as a whole – other than the statement of cash flows – we were able to get enough audit evidence for the information in them except for:

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

6.23 Our audit of Christchurch City Council and Group was limited because we could not get enough audit evidence to support the "what did it cost" sections and the associated variance explanations for 2012/13 and related comparative information.

6.24 We also drew attention to the disclosure in the annual report regarding the Council becoming aware of deficiencies in its rates-setting resolutions since 2004/05. The Council has reset the rates for 2013/14 and is preparing a draft bill to correct deficiencies (that include the setting of payment dates and the charging of rates penalties) for 2004/05 to 2012/13.

6.25 We expressed disclaimers of opinion on the financial statements of Matata Recreation Reserve Board (for 2006/07, 2007/08, and 2008/09) because we could not get signed representation letters and statements of responsibility from the Board. The Board had limited controls over some revenue and inadequate supporting documents for payments. As a result, we could not get enough evidence to confirm the completeness of revenue or payments.

6.26 Because we did not offer an opinion on the financial statements for 2006/07 and 2007/08, we could not offer an opinion on the comparative information in the 2007/08 and 2008/09 financial statements.

6.27 We also drew attention to the disclosures in the Board's financial statements (for 2006/07, 2007/08, and 2008/09) that referred to the disestablishment and the transfer of operations, assets, and liabilities to the Department of Conservation on 24 August 2009. The decision of the Board not to adjust the financial statements was appropriate.

Adverse opinions

6.28 In 2013, we expressed adverse opinions on the financial or performance information of nine public entities.

6.29 Because they did not recognise their museum collection assets or the associated depreciation expense, which is a requirement of generally accepted accounting practice, we expressed adverse opinions for:

- Canterbury Museum Trust Board (for 2012/13);
- Otago Museum Trust Board (for 2012/13);
- Southland Museum and Art Gallery Trust Board Incorporated, a public entity associated with Gore District Council, Invercargill City Council, and Southland District Council (for 2012/13); and
- Pukaki ki Rotorua Charitable Trust (for 2010/11, 2011/12, and 2012/13).

6.30 We expressed an adverse opinion for Kaikoura Enhancement Trust (a trust controlled by Kaikoura District Council) for 2007/08 for not reporting against performance measures and targets in statements of service performance because it did not prepare a statement of intent.

6.31 We expressed adverse opinions for four public entities that had not reported against performance measures and targets in their statements of service performance because they did not prepare a statement of intent for the reporting year and failed to comply with the law for not preparing a statement of intent for the period following the reporting year. The adverse opinions were for:

- Mayoral Relief Fund Tasman/Nelson, a trust controlled by Tasman District Council (for 2011/12);
- Luggate Nominee Limited, a council-controlled organisation in the Dunedin City Council group (for 2008/09, 2009/10, 2010/11, 2011/12, and 2012/13);
- West Coast Rural Fire Authority (for 2004/05, 2005/06); and
- Mackenzie Tourism and Development Trust, a council-controlled organisation of Mackenzie District Council (for 2010/11 and 2011/12).[41]

41 This trust was disestablished in July 2012 and its 2012 financial statements were appropriately prepared on a disestablishment basis.

Qualified opinions

6.32 During 2013, we expressed qualified opinions on the financial or service performance information of 23 public entities. We express a qualified opinion when there is a disagreement with the treatment or disclosure of an issue in the financial statements or when we cannot get enough audit evidence about a matter.

6.33 We expressed a qualified opinion of the comparative information in the financial statements for 2012/13 of:

- Tuam Limited, a subsidiary of Christchurch City Council – we issued a disclaimer of opinion about Tuam Limited's 30 June 2012 financial statements, except the cash flow statement and statement of service performance; and
- Tauranga City Venues Limited, a subsidiary of Tauranga City Council – we did not get enough evidence about revenue for the year ended 30 June 2012.

6.34 We expressed a qualified opinion for Sarjeant Gallery Trust (for 2009/10 and 2010/11) because our audit of the property, plant, and equipment was limited. The equity was overstated as a result of the Trust recognising the transfer of its property, plant, and equipment to Wanganui District Council on 1 July 2009. These assets should have been recognised in the year ended 30 June 2011, the year the resolution was made. Our audit on the comparative information in the 2010 financial statements was limited. We could not rely on the opening balances because the 30 June 2008 financial statements were not audited.

6.35 Because we could not get enough assurance about the completeness of revenue and/or expenditure, we expressed qualified opinions for the following public entities:

- Tauranga City Aquatics Limited, a subsidiary of Tauranga City Council whose financial statements were appropriately prepared on a disestablishment basis (for 2012/13);
- Tauranga City Investments Limited and Group, a subsidiary of Tauranga City Council (for 2012/13);
- The World Buskers Festival Trust, a trust controlled by Christchurch City Council (for 2012/13);
- Nelson Creek Recreation Reserve Board (for 2008/09 and 2009/10);
- Mataroa Hall Board (for 2012/13);
- Oakura Reserve Board (for 2009/10 and 2010/11);
- Ruakaka Central Domain Board (for 2011/12 and 2012/13);
- Ongarue Hall Society Incorporated (for 2009/10);

- Waikiekie Domain Board (for 2010/11);
- Whatitiri Domain Board (for 2009/10 and 2010/11);
- Awakaponga Public Hall Board (for 2010/11 and 2011/12);
- Millerton Hall Board (for 2010/11 and 2011/12);
- Taurikura Hall Board (for 2011/12);
- Ruapuke Cemetery (for 2010/11 and 2011/12);
- Blacks Cemetery, whose financial statements were appropriately prepared on a disestablishment basis (for 2009/10);
- Calcium Cemetery (for 2007/08, 2008/09, 2009/10, and 2010/11); and
- Matata Cemetery Trustees (for 2011/12).

6.36 We expressed a qualified opinion for North Canterbury Fish and Game Council for 2012/13 because we could not get enough assurance about the quantity of inventory or biological assets as at balance date.

Part 7
Our current work in the local government sector

7.1 In this Part, we describe our current work in the local government sector. It includes:

- looking at the governance of council-controlled organisations;
- managing assets and service levels; and
- a review of Watercare Services Limited.

Governance of council-controlled organisations

7.2 The Auditor-General has an ongoing interest in the governance and accountability of council-controlled organisations and other subsidiaries of local authorities. The number of such public entities has increased steadily, but little research or analysis is available about either the reasons for this or how effective the public entities are. In some instances, high-profile governance matters have increased the interest in wider local government governance matters.

7.3 We have begun to review governance and accountability arrangements between local authorities and council-controlled organisations. Our review will contribute to our *Governance and accountability* theme in 2014/15.

7.4 We expect to report later this year on aspects of how well the statutory framework is working, including:

- accountability – how accountability works in practice for council-controlled organisations and other subsidiaries of local authorities;
- alignment of strategic direction – how council-controlled organisations and other subsidiaries fit within the local authority's overall strategy, and their awareness of that strategy and their role; and
- performance monitoring – including the value of the statement of intent framework and reporting, and oversight arrangements (such as council committees, holding companies, and Letters of Expectation).

7.5 We have already carried out interviews with people in some local authorities and council-controlled organisations. Our report will include any common themes, highlight what is working well, and identify any problems with the accountability and governance framework.

Asset and service-level management audits

7.6 Local authorities have been reporting on major infrastructure assets, an essential element of local government services, since the early 1990s. That reporting has coincided with the development of the discipline of asset management planning and cycle of substantial reinvestment in existing assets.

7.7 We have encouraged the good management of public assets since the introduction of accrual accounting in the late 1980s. We see that best results are achieved when asset management is integrated throughout an organisation. An integrated management approach involves robust information and systems that managers, engineers, valuers, planners, corporate finance staff, and the governing body use co-operatively to ensure that the right people contribute the right information at the right time.

7.8 In June 2013, we published *Managing public assets*. That report included a stocktake of how physical assets that deliver services to the public are managed. It summarised the high-level information that we received from more than 340 public entities about how they managed their physical assets.

7.9 Most public entities understood the importance of planning for assets, with plans in place for about 75% of assets. This indicated to us that most public assets were in a suitable condition to provide the services intended.

7.10 Our next piece of related work will be an audit of local government asset and service-level management. This audit will analyse and provide an overview of the life-cycle maturity of local government assets, where and when major investments are required, and whether asset management practice is keeping pace with the information needs of local authorities to manage service provision. Our audit seeks to answer the following questions:

- What is the state of asset management practice?
- Where is local government infrastructure in the asset management investment cycle?
- What is the effect of the current "deferrals" approach – is it likely to have long-term implications?

7.11 Managing assets using a life-cycle approach is important, because many assets are likely to have similar useful lives and maintenance and upgrade profiles. Assets must be maintained if they are to continue delivering the services intended from them. Deferring asset maintenance for a long time can result in more breakdowns and disruption of services, substandard services, and, in the end, failure of services.

7.12 The Local Government Act 2002 Amendment Bill (No 3) plans to introduce new requirements for infrastructure strategies and asset management planning:

> *The Bill provides for a new infrastructure strategy to be incorporated into long-term plans. The purpose of this strategy is to identify significant infrastructure issues, options, and implications for the council over a 30-year period. It will cover,*

as a minimum, those of the five core infrastructure categories provided by the council (water supplies, sewage treatment and disposal, storm water drainage, flood protection works, and roads and footpaths).[42]

7.13 The infrastructure strategy (for at least a 30-year period) is to be incorporated into local authorities' 2015-25 long-term plans. In principle, we support the inclusion of the proposed infrastructure strategy within long-term plans because it provides a more complete picture of how local authorities intend to manage their high-value long-life assets.

7.14 We plan to publish the results of our audit of local government asset and service-level management later in 2014.

Watercare Services Limited

7.15 The legislation that enabled the creation of Auckland Council requires the Auditor-General to review and report on the Council's service performance. The first such review we chose to do covers the service performance of Watercare Services Limited, which is the water and wastewater service provider in Auckland. We are publishing our report on that review at the same time as this report.

7.16 Our review focuses on an evaluation of the effectiveness and efficiency of the "customer interface", particularly focusing on the application of pricing policy, the billing system processes, and the complaints management system. Specifically, we have considered:

- tariffs;
- the operation of the contact centre;
- the introduction of monthly billing;
- meter reading; and
- customer debt management practices, including the operation of the Water Utility Consumer Assistance Trust.

7.17 The next review we choose is likely to be of Auckland Council's building consent service performance.

42 Local Government Act 2002 Amendment Bill (No 3), *Explanatory note.*

Appendix 1
Other work during 2012/13 relating to the local government sector

Report or letter	Brief description
Inquiry into the Mangawhai Community Wastewater Scheme	This report describes how Kaipara District Council managed the Mangawhai community wastewater scheme between 1996 and 2012, as well as the role played by other agencies, including the Office of the Auditor-General and Audit New Zealand.
Effectiveness and efficiency of arrangements to repair pipes and roads in Christchurch	This report looks at how effectively and efficiently the Canterbury Earthquake Recovery Authority, the New Zealand Transport Agency, and Christchurch City Council are reinstating horizontal infrastructure in Christchurch through an alliance called the Stronger Christchurch Infrastructure Rebuild Team.
Using development contributions and financial contributions to fund local authorities' growth-related assets	This discussion paper reviews how five local authorities use "growth charges", such as development contributions and financial contributions, to fund the assets that the communities will need for the growth they expect.
Inquiry into Mayor Aldo Miccio's management of his role as mayor and his private business interests (letter to the Mayor)	This inquiry arose after a request by Nelson City Council in the light of public concern about Mayor Aldo Miccio's trip to China in March 2012. We reviewed how the relationship between the Mayor's private business interests and his work in his official capacity had been managed.
Auckland Council: Transition and emerging challenges	The amalgamation of Auckland's local authorities and regional council into a single local authority was one of the most significant public sector reforms of recent years. This report reflects on the transition and Auckland Council's emerging governance challenges.
Matters arising from the 2012-22 local authority long-term plans	The 2012 round of 10-year plans coincided with the *Better Local Government* initiative, which seeks a local government sector that is leaner and more in keeping with national economic needs. This report represents our most significant contribution to our focus on the public sector's ability to meet the country's future needs.
How the Far North District Council has administered rates and charges due from Mayor Wayne Brown's company, Waahi Paraone Limited	Far North District Council and the then Mayor, Mr Wayne Brown, had been in dispute for some time about the rates and other charges owed by Mr Brown's company, Waahi Paraone Limited. The matters involved in the dispute were legally and factually complex, and the two parties were unable to resolve them through normal processes or direct discussion. In October 2011, Mr Brown and the Council each asked the Auditor-General to help resolve the matter.

Appendix 2
Our approach to better understanding financial trends

Our set of financial indicators

Comprehensively measuring and analysing a local authority's financial performance and position requires an understanding of a local authority's objectives, the risks to achieving those objectives, and the relationship between the two.

Financial statements are important in assessing financial performance and position. Although they say little about many of the operational objectives of public sector entities, they describe and summarise many of the factors that reflect the risk associated with achieving objectives (for example, through the underlying revenues, costs, liabilities, and assets).

An important part of the usefulness of financial statements is their ability to help a reader to understand financial uncertainty[43] in a standardised and comparable way. This is a fundamental part of a local authority's performance story.

The potential financial risks in delivering on objectives for local government

Risks in the local government sector arise from many sources, including economic, political, and structural changes within and outside the local authority. Our approach does not attempt to identify and understand the root cause of risk. Instead, we use the financial statements to help assess the overall effect on three aspects that relate to local authorities' financial ability to deliver on their objectives:

- The **stability** of a local authority's activities (operations, capital, investing, and financing) is about how reliably a public entity plans, budgets, and uses financial resources. This refers to the **ability to operate as planned**. To help understand this component, we focus on financial information that shows how consistent and accurate these activities are (for example, by comparing actual performance with budget/forecast).
- The **resilience** of a local authority to short-term anticipated events reflects how well it can "bounce back". This refers to the **ability to manage uncertainty**. To help understand this component, we consider financial information that shows how well a local authority can respond without major structural or organisational change. For example, we look at cash flow and income statement items such as interest expense and rates, and balance sheet items such as current assets and current liabilities.

43 The terms "risk" and "uncertainty" can have different meanings. For simplicity, we use the terms interchangeably to mean the potential for variation from what is expected or considered "normal". For instance, a public entity's large operating surplus can be as much an indicator of uncertainty (or risk) as if it had a large operating deficit.

- The **sustainability** of a local authority looks at how prepared the public entity is for long-term uncertainties and to maintain itself indefinitely. This refers to the ability to invest for the future. To help understand this component, we consider financial information that indicates how longer-term uncertainties are being managed. We focus, for example, on balance sheet items such as assets, liabilities, and debt, together with related items such as capital expenditure, renewal expenditure, and depreciation.

To assess the potential risk involved in delivering on sector objectives, we assess, over consecutive financial periods, the relative values, direction, and distribution of various indicators within the three aspects. In other words, we assess:

- whether the average values are within a reasonable range and how they change – this indicates the relative position of public entities to deliver services in a stable, resilient, and sustainable manner; and
- the distribution of public entities that lie outside what we consider "normal" for the local government sector.

Greater variability implies more uncertainty in the public entity's relative position and ability to manage services in a stable, resilient and sustainable manner. We have used a traffic light system to summarise the results of our assessments (see Figure 12).

Figure 12
Traffic-light system to summarise the result of our assessments

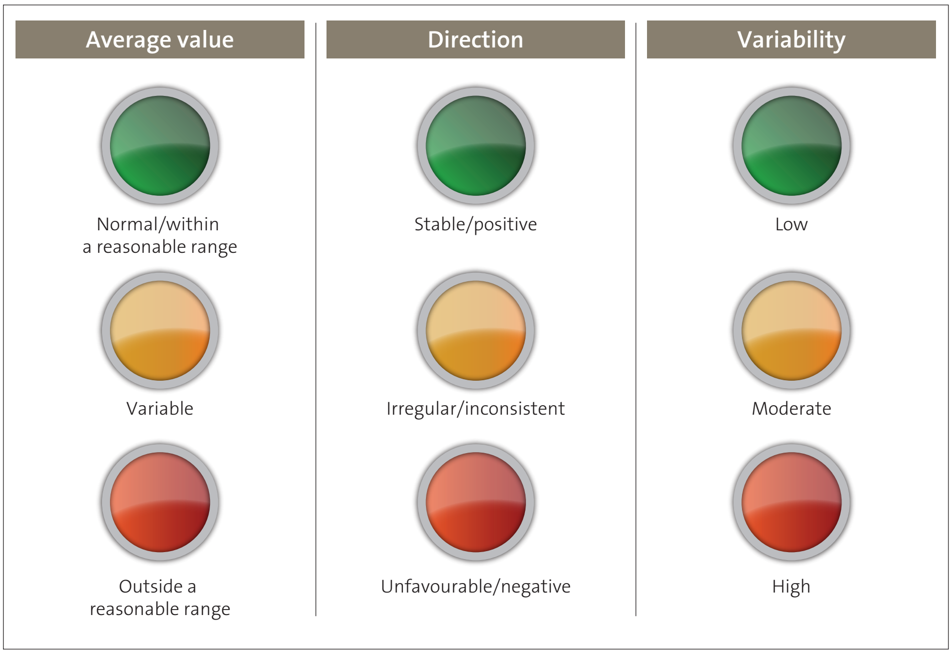
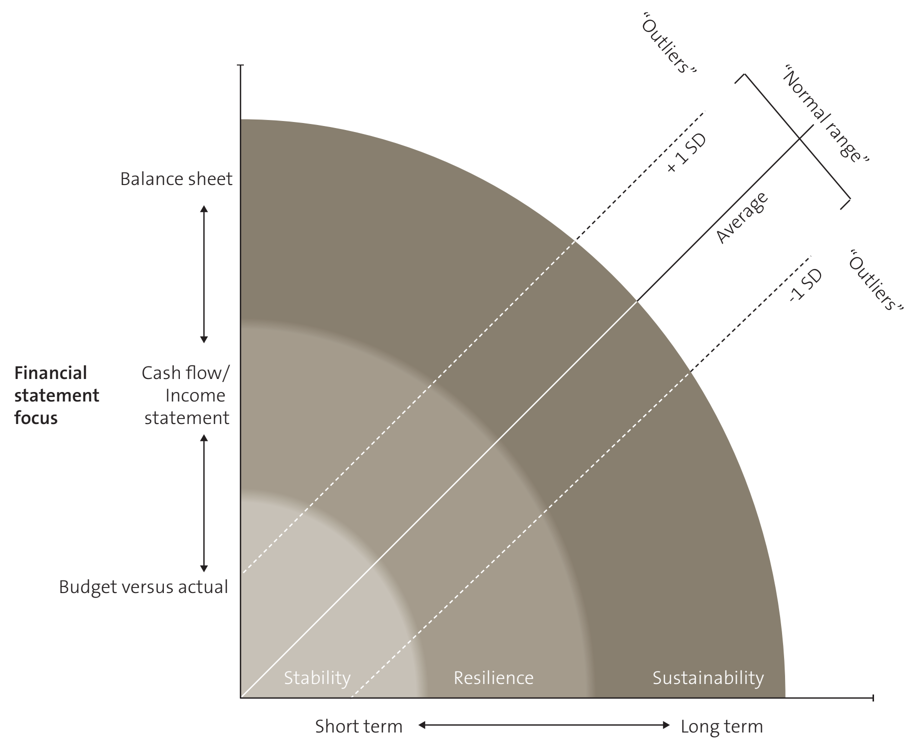


Figure 13 provides a visual presentation of our approach. It shows how sustainable services are built on the stable and resilient services of an organisation, and how we summarise and portray the "normal range" throughout local government by using a standardised measure of variation on either side of the average – in other words, plus or minus one standard deviation.[44]

Figure 13
Outliers outside standard deviation from average



We use the term "norm" to refer to this range of one standard deviation either way from the average for the measure concerned.

To measure the variability between indicators, we consider the standard deviation and differentiate outliers that lie close to one standard deviation from the average and outliers that are more than two standard deviations from the average. We then analyse these figures collectively.

As with all analysis of financial performance, there are limitations to what we can infer. Our approach focuses on the potential for uncertainty and does not

44 Standard deviation is a statistical measure of how far the data points are spread. A small standard deviation indicates that the data points tend to be close to the average. A larger standard deviation indicates that the data points tend to be further from the average.

comprehensively assess the performance of local authorities. We are not trying to rank local government entities and what is shown as the normal range assumes a regularity that may not always be there. The outliers are not necessarily less certain to deliver on their objectives – they may simply warrant further investigation.

In considering trends, we have taken a more consistent approach to managing extreme results that can influence or distort our measures over time.[45] Our approach is not to ignore or delete these very high or very low ratios but to transform (or cap) them at the 90th and 10th percentiles.

For most ratios, averages for local authorities do not change materially but, for all ratios, this capping process reduces variability and increases the number of outliers.

On balance, we consider the advantages of more consistency and comparability between ratios outweighs the disadvantages of standardising the data.

Figure 14 summarises the set of indicators that we have used.

Figure 14
Our indicators of financial performance

Ability to operate as planned (stable services)	Ability to manage uncertainty (resilient services)	Ability to invest for the future (sustainable services)
Actual to budgeted cash applied to operations*	Current assets to current liabilities – working capital	Capital expenditure to depreciation**
Actual to budgeted capital expenditure	Enduring operating expenses to total operating expenses***	Debt to total assets
Actual to budgeted debt	Interest expense to rates revenue	Net operating cash flows to capital expenditure****

* We have decided not to use the net operational cash flow variance but use instead an indicator that measures the difference in what was expected to be spent and what was actually spent on local authorities' operational needs.
** We have also considered renewal expenditure to depreciation.
*** Enduring operating expenses include employee benefits, interest, depreciation, and amortisation.
**** We have moved the indicator that considers how much capital investment is internally generated from the resilience analysis to the sustainability analysis. It has been replaced by an indicator that considers the flexibility of local authorities' cost structure – enduring operating expenses to total operating expenses. The indicator interest expense to debt, which shows the implied interest rate, has been removed from our set of indicators.

45 We also consider and discuss some individual entity ratios where, for example, they are notable outliers. In these instances, we show the entity ratios in their uncapped form.

Indicators of ability to operate as planned

To consider the ability to operate as planned, we compare local authorities' actual cash flow applied to operations, the capital expenditure, and the debt balance with what was originally budgeted.[46] A result of 100% indicates that planning was reliable and financial resources were used as intended.

Indicators of ability to manage uncertainty

The working capital indicator measures whether a local authority has enough resources to pay its debts as they fall due. A working capital percentage greater than 100% is generally considered preferable because that indicates that there are more resources available to respond to short-term unexpected events.

The enduring expenses to total expenses indicator measures the types of expenses that a local authority has little ability to influence while operations continue at current levels. Therefore, this measures the limitations to flexibility within which the local authority must operate.

The interest expense to rates revenue indicator shows the proportion of rates revenue that is required to service debt.[47] A higher percentage means less flexibility to respond to unexpected events.

Indicators of ability to invest for the future

The capital expenditure to depreciation indicator is used because depreciation is a reasonable estimate of the capital expenditure needed to maintain the asset base.[48] A better indicator is the replacement of assets to depreciation.

Local authorities typically call replacement of assets "renewals". An asset renewals ratio above 100% may indicate that the asset base is being managed in a sustainable way.

Before 2012/13, local authorities were not required to separately show renewals in their financial statements. Because this information, along with comparatives, is now available, we have also considered this indicator.

The proportion of gross debt to total assets indicates a local authority's capability to control and manage its longer-term financial uncertainties. For example, a

46 Capital expenditure is spending on property, plant, equipment, and intangible assets.

47 To calculate this indicator, we have used the interest expense as stated on the face of the statement of comprehensive income/income statement. The sector uses different terms to express this item, including finance cost, finance expense, or interest expense. In some instances, interest expense might include finance cost/expense items other than interest relating to borrowing, such as unrealised losses and gains on financial derivatives.

48 Depreciation reflects the depreciation expense for property, plant, and equipment and amortisation expense for intangible assets.

result of 10% means a local authority has debt equivalent to 10% of assets. This indicator considers debt as a source of funding assets and the influence that external funders may have on the public entity.

The indicator comparing net cash flows from operations to capital expenditure shows the cash surplus available for use for capital expenditure. A higher percentage indicates a local authority is better able to pay for capital expenditure using internally generated funds rather than relying on external sources.

Appendix 3
Adoption of annual reports and summary annual reports

When local authorities adopted their annual reports

When the annual report was adopted	Number adopted for financial year				
	2008/09	2009/10	2010/11	2011/12	2012/13
Within 2 months after the end of the financial year	2	2	2	1	2
Between 2 and 3 months after the end of the financial year	11	22	12	15	16*
Between 3 and 4 months after the end of the financial year	63	46	56	61	54
Subtotal: Number meeting statutory deadline	**76**	**70**	**70**	**77**	**72***
Percentage of local authorities meeting statutory deadline	99%	91%	90%	99%	92%
Between 4 and 5 months after the end of the financial year	1	4	2	1	4
More than 5 months after the end of the financial year	0	3	4	0	0
Not issued as at 31 January	0	0	2	0	2
Total	**77****	**77****	**78**	**78**	**78**

* In compiling data for this table, we questioned the process that one local authority followed in adopting its annual report. The local authority then sought legal advice on whether it needed to re-adopt its annual report. For the purposes of this report, we have treated the local authority's annual report as adopted.
** We excluded the former Auckland local authorities in the 2008/09 and 2009/10 totals but included Auckland Council in the 2010/11, 2011/12, and 2012/13 totals. Auckland Council prepared a report for the eight months to 30 June 2011 and had to meet the same statutory time frames as other local authorities.

When local authorities released their annual reports

Time after adopting annual report	Number released for financial year				
	2008/09	2009/10	2010/11	2011/12	2012/13
0-5 days	32	23	25	36	29
6-10 days	10	6	8	9	9
11-20 days	10	21	10	13	16
21 days to one month	24	22	30	19	21
Subtotal: Number meeting statutory deadline	**76**	**72**	**73**	**77**	**75**
Percentage of local authorities meeting statutory deadline	99%	94%	94%	99%	96%
Number not meeting statutory deadline	1	5	5	1	1
Not issued as at 31 January*	-	-	-	-	2
Total	**77**	**77**	**78**	**78**	**78**

*Data not collected before 2012/13.

When local authorities released their audited summary annual reports

Time after adopting annual report	Number released for financial year				
	2008/09	2009/10	2010/11	2011/12	2012/13
0-5 days	18	6	38	21	15
6-10 days	6	5	12	7	4
11-20 days	16	22	15	12	21
21 days to one month	26	38	7	35	34
Subtotal: Number meeting statutory deadline	**66**	**71**	**72**	**75**	**74**
Percentage of local authorities meeting statutory deadline	86%	92%	92%	96%	95%
One month to 40 days	10	3	2	1	2
41-50 days	0	0	0	1	0
51-60 days	0	1	0	1	0
More than 60 days	1	2	4	0	0
Not issued as at 31 January*	-	-	-	-	2
Total	**77**	**77**	**78**	**78**	**78**

*Data not collected before 2013.

Appendix 4
Non-standard audit reports issued in 2013

Adverse opinions

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

Financial statements and statement of service performance for the year ended 30 June 2013

The Trustees did not recognise the Trust Board's museum collection assets or associated depreciation expense in the financial statements. This is not in keeping with New Zealand Equivalent to International Accounting Standard 16 (NZ IAS 16): *Property, Plant and Equipment,* which requires public entities to recognise assets and depreciation in their financial statements.

Canterbury Museum Trust Board

Financial statements and statement of service performance for the year ended 30 June 2013

The Trustees did not recognise the Trust Board's museum collection assets or associated depreciation expense in the financial statements. This is not in keeping with New Zealand Equivalent to International Accounting Standard 16 (NZ IAS 16): *Property, Plant and Equipment,* which requires public entities to recognise assets and depreciation in their financial statements.

Otago Museum Trust Board

Financial statements and statement of service performance for the year ended 30 June 2013

The Trustees did not recognise the Trust Board's museum collection assets or associated depreciation expense in the financial statements. This is not in keeping with New Zealand Equivalent to International Accounting Standard 16 (NZ IAS 16): *Property, Plant and Equipment*, which requires public entities to recognise assets and depreciation in their financial statements.

Pukaki ki Rotorua Charitable Trust

Financial statements for the years ended 30 June 2011, 30 June 2012, and 30 June 2013

The Trustees did not recognise the Trust's artwork assets in the financial statements. This is not in keeping with the New Zealand Equivalent to International Accounting Standard No.16 (NZ IAS 16): *Property, Plant and Equipment,* which requires public entities to recognise assets and depreciation in their financial statements.

Kaikoura Enhancement Trust (Kaikoura District Council)

Financial statements and statement of service performance for the year ended 30 June 2008

The Trustees did not report performance information that reflected the Trust's achievements, measured against performance targets, and did not prepare a statement of intent for the year ended 30 June 2008. The Local Government Act 2002 requires a statement of intent and performance to be prepared.

Mayoral Relief Fund Tasman/Nelson (Tasman District Council)

Financial statements and statement of service performance for the year ended 30 June 2012

The Trustees did not report performance information that reflected the Trust's achievements, measured against performance targets, and did not prepare a statement of intent for the year ended 30 June 2012. The Local Government Act 2002 requires a statement of intent and performance information to be prepared. We drew attention to the disclosures in the financial statements outlining that the Trust failed to prepare a statement of intent for the year beginning on 1 July 2012.

Luggate Nominee Limited (Dunedin City Council)

Financial statements and statement of service performance for the years ended 30 June 2009, 30 June 2010, 30 June 2011, 30 June 2012, and 30 June 2013

The company did not report performance information that reflected the company's achievements, measured against performance targets, and failed to prepare a statement of intent for each reporting period. The Local Government Act 2002 requires having a statement of intent and reporting performance information. We drew attention to the disclosures in the financial statements outlining that the company failed to prepare a statement of intent for the years beginning 1 July 2009, 1 July 2010, 1 July 2011, 1 July 2012, and 1 July 2013.

West Coast Rural Fire Authority

Financial statements and statement of service performance for the years ended 30 June 2005 and 30 June 2006

The Authority did not report performance information that reflected the Authority's achievements, measured against performance targets, and failed to prepare a statement of intent for 2004/05 and 2005/06. The Local Government Act 2002 requires a statement of intent and performance information to be reported. We drew attention to the disclosures in the financial statements outlining that the Authority failed to prepare a statement of intent for the years beginning on 1 July 2005 and 1 July 2006.

Mackenzie Tourism and Development Trust (Mackenzie District Council)

Financial statements and statement of service performance for the years ended 30 June 2011 and 30 June 2012

The Trust did not report performance information that reflected the Trust's achievements, measured against performance targets, and failed to prepare a statement of intent for 2010/11 and 2011/12. The Local Government Act 2002 requires a statement of intent and performance information to be reported. We drew attention to the disclosures in the financial statements outlining that the Trust failed to prepare a statement of intent for the 2011/12 and 2012/13. We noted the disclosures in the financial statements that referred to the disestablishment basis appropriately being used in preparing the financial statements because the Trust ceased active trading in July 2012 and is being disestablished.

Disclaimers of opinion

Christchurch City Council and Group

Annual report for the year ended 30 June 2013

We were unable to form an opinion on Christchurch City 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 a series of Canterbury earthquakes. The Council could not account for the effect of the earthquakes on its assets because it could not estimate the costs to repair these assets. However, the Council disclosed that the earthquakes had affected its assets and gave information about the financial effects of the damage.

Oakura Reserve Board

Statement of financial position and operating statement for the year ended 30 June 2009

We were unable to form an opinion on the Reserve Board's statement of financial position and operating statement for the year ended 30 June 2009 because we were unable to get a statement of responsibility from the Board that the law requires and a signed representation letter and because we could not gain enough assurance about the completeness of revenue and expenditure information due to limited controls over revenue and expenditure.

Matata Recreation Reserve Board

Financial statements for the year ended 30 June 2007

We were unable to form an opinion on the Reserve Board's financial statements for the year ended 30 June 2007 because we were unable to get a signed representation letter from the Board or enough assurance about the completeness of revenue because of limited controls over that revenue. We were unable to verify expenditure because of inadequate supporting documents for payments. We drew attention to the disclosures in the financial statements that referred to the disestablishment of the Reserve Board and the transfer of its operations, assets, and liabilities to the Department of Conservation on 24 August 2009. The Board's decision not to adjust the financial statements was appropriate.

Matata Recreation Reserve Board

Financial statements for the years ended 30 June 2008 and 30 June 2009

We were unable to form an opinion on the Reserve Board's financial statements for the years ended 30 June 2008 and 30 June 2009 because we were unable to obtain a signed representation letter and a signed statement of responsibility from the Board, enough assurance about the completeness of revenue because of limited controls over that revenue and enough assurance about comparative information. We drew attention to the disclosures in the financial statements that referred to the disestablishment of the Reserve Board and the transfer of its operations, assets, and liabilities to the Department of Conservation on 24 August 2009. The Board's decision not to adjust the financial statements was appropriate.

Qualified opinions

Tuam Limited (Christchurch City Council)

Financial statements and statement of service performance for the year ended 30 June 2013

Our audit was limited on the comparative information presented for the year ended 30 June 2013 because we issued a disclaimer of opinion on the company's 30 June 2012 financial statements, other than the cash flow statement and statement of service performance because of the company not being able to reliably work out the fair value of the investment properties as at 30 June 2012 and the related current and deferred tax balances at that date.

Tauranga City Venues Limited (Tauranga City Council)

Financial statements and statement of service performance for the year ended 30 June 2013

Our audit of comparative information was limited because we were unable to get assurance about the completeness of revenue for the year ended 30 June 2012.

Sarjeant Gallery Trust

Financial statements for the year ended 30 June 2010

Our audit was limited because property, plant, and equipment were understated and equity was overstated as a result of the Trust recognising the transfer of its property, plant, and equipment to Wanganui District Council on 1 July 2009, which should have been recognised in the financial year ended 30 June 2011, the year the resolution was made. Our audit on the comparative information was limited because the Trust's financial statements for the year ended 30 June 2009 was affected by opening balances being not audited in that year.

Sarjeant Gallery Trust

Financial statements for the year ended 30 June 2011

Our audit of the comparative information in the 2011 financial statements was limited because the property, plant and equipment was understated and the equity was overstated as a result of the Trust recognising the transfer of its property, plant, and equipment to Wanganui District Council in the year ended 30 June 2010, instead of the year ended 30 June 2011, the year the resolution was made.

Tauranga City Aquatics Limited (Tauranga City Council)

Financial statements and statement of service performance for the year ended 30 June 2013

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). We drew attention to the disclosures in the financial statements that referred to the disestablishment basis appropriately being used in preparing the financial statements because the company's assets and liabilities were transferred to Bay Leisure and Events Limited on 1 July 2013.

Tauranga City Investments Limited and Group (Tauranga City Council)

Financial statements and statement of service performance for the year ended 30 June 2013

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

The World Buskers Festival Trust (Christchurch City Council)

Financial statements and statement of objectives and performance for the year ended 30 June 2013

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

Nelson Creek Recreation Reserve Board

Statements of accounts for the years ended 30 June 2009 and 30 June 2010

The Board had limited controls over some revenue and hall hire bonds, which limited the assurance we could get about the completeness of the information.

Mataroa Hall Board

Financial statements for the year ended 30 June 2013

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

Oakura Reserve Board

Financial statements for the years ended 30 June 2010 and 30 June 2011

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

Ruakaka Central Domain Board

Statement of accounts for the years ended 30 June 2012 and 30 June 2013

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

Ongarue Hall Society Incorporated

Statement of accounts for the year ended 30 June 2010

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

Waikiekie Domain Board

Statement of accounts for the year ended 30 June 2011

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

Whatitiri Domain Board *Statement of accounts for the years ended 30 June 2010 and 30 June 2011* The Board had limited controls over some revenue, which limited the assurance we could get about the completeness of the revenue information.
Awakaponga Public Hall Board *Financial statements for the years ended 30 June 2011 and 30 June 2012* The Board had limited controls over some revenue, which limited the assurance we could get about the completeness of the revenue information.
Millerton Hall Board *Statement of accounts for the years ended 30 June 2011 and 30 June 2012* The Board had limited controls over some revenue, which limited the assurance we could get about the completeness of the revenue information.
Taurikura Hall Board *Statement of accounts for the year ended 30 June 2012* The Board had limited controls over some revenue, which limited the assurance we could get about the completeness of the revenue information.
Ruapuke Cemetery *Statement of accounts for the years ended 31 March 2011 and 31 March 2012* The Board had limited controls over some revenue and stock, which limited the assurance we could get about the completeness of the revenue information and carrying value of the remaining stock on hand.
Blacks Cemetery *Statement of accounts for the year ended 31 March 2010* Our audit was limited because we were unable to get appropriate and enough audit evidence to support all payments. We drew attention to the disclosures in the financial statements that referred to the disestablishment basis appropriately being used in preparing the financial statements because Central Otago District Council took over the Cemetery's functions in December 2012.
Calcium Cemetery *Statement of accounts for the years ended 31 March 2008, 31 March 2009, 31 March 2010, and 31 March 2011* Our audit was limited because we were unable to get appropriate and enough audit evidence to support all payments.
Matata Cemetery Trustees *Statement of accounts for the year ended 31 March 2012* Our audit was limited because we were unable to get appropriate and enough audit evidence to support all payments.
North Canterbury Fish and Game Council *Financial statements and statement of service performance for the year ended 31 August 2013* Our audit was limited because we were unable to get appropriate and enough audit evidence to verify the quantity of inventories or biological assets as at balance date.

Emphasis of matter paragraphs

Kaipara District Council

Financial statements for the year ended 30 June 2012

We drew attention to disclosures in the financial statements about:

- Kaipara District Council having going-concern issues and risks to financial viability because it depended on:
  - the continuing financial support of bankers and getting enough revenue from development contributions to help service debt;
  - addressing legal matters associated with past targeted rates;
  - adopting and putting into effect its 2012-22 long-term plan; and
  - being able to collect all rates levied, to manage cash flows;
- legal matters associated with targeted rates that lacked proper statutory authority, because of errors in setting them, and the contingent liability that would follow should any legal challenge result in the Council having to refund rates to ratepayers; and
- the Auditor-General agreeing to proceed with an inquiry into the Council's planning, development, implementation, and oversight of the Mangawhai community wastewater scheme.

Kaipara District Council

Financial statements for the year ended 30 June 2013

We drew attention to the disclosures in the financial statements about:

- legal matters associated with targeted rates that lacked proper statutory authority because of errors setting them, and the contingent liability that would follow should any legal challenge result in the Council having to refund rates to ratepayers; and
- the Auditor-General agreeing to proceed with an inquiry into the Council's planning, development, implementation, and oversight of the Mangawhai community wastewater scheme.

Taupo District Council and Group

Financial statements for the year ended 30 June 2013

We drew attention to the disclosures in the financial statements that referred to the breach of the Local Government Act 2002 because the Council failed to adopt its 2012-22 long-term plan by 1 July 2012, which is needed for accountability reasons and for setting valid rates under the Local Government (Rating) Act 2002. Because the long-term plan was not adopted until 24 September 2013, the Council applied to the Department of Internal Affairs for an Order in Council to validate the late adoption of the long-term plan as if it had been adopted before 1 July 2012.

Inframax Construction Limited (Waitomo District Council)

Financial statements and statement of performance measures for the year ended 30 June 2013

We drew attention to the disclosures in the financial statements outlining the serious financial difficulties experienced by the company, including the net loss for the year ended 30 June 2013 and resulting uncertainties about using the going-concern assumption. The validity of the going-concern assumption depended on the continuing financial support of the company's lenders and Waitomo District Council.

Grow Wellington Limited and Group (Greater Wellington Regional Council)

Financial statements and statement of service performance for the year ended 30 June 2013

We drew attention to the disclosures in the financial statements about the uncertainties in measuring the fair value of shares in incubator and accelerator companies because of the early nature of the investments and the absence of quoted market prices.

Creative HQ Limited (Greater Wellington Regional Council)

Financial statements and report on performance for the year ended 30 June 2013

We drew attention to the disclosures in the financial statements about the uncertainties in measuring the fair value of shares in incubator and accelerator companies because of the early nature of the investments and the absence of quoted market prices.

Infracon Limited (Tararua District Council)

Financial statements and statement of service performance for the year ended 30 June 2013

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 Infracon Limited's bank continuing support and the company's ability to put its turnaround plan into effect.

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

Financial statements and performance information for the year ended 30 June 2013

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 and other sources.

New Zealand Mutual Liability Riskpool

Financial statements for the year ended 30 June 2013

We drew attention to the disclosures in the financial statements that referred to the uncertainties associated with the outstanding claims liability and reinsurance receivables of New Zealand Mutual Liability Riskpool and the inherent uncertainties involved in estimating those amounts using actuarial assumptions. We also drew attention to the disclosures in the financial statements that referred to the going-concern assumption appropriately being used in preparing the financial statements of the Scheme as a whole and Funds No.7 and No.15, and Funds No.10 to No.13 (where the total liabilities exceed total assets because the Trustee is able to levy the members of the Funds to cover any shortfall in equity in any Fund under the terms of the Deed of Trust).

Athol Cemetery Trust

Statement of accounts for the 19 years ended 31 December 2012

We drew attention to the disclosures in the financial statements that referred to the fact that the Trustees had prepared one statement of accounts covering 19 years from 1 April 1993 to 31 March 2012. This is a departure from the requirements of section 29(2) of the Burial and Cremation Act 1964, which requires that Trustees in April prepare for audit a statement of accounts showing full particulars of all money received and paid during the year to the 31 March just past, together with a statement of assets and liabilities as at the close of that year.

Tauwhareparae Forests Limited (Gisborne District Council)

Financial statements for the year ended 30 June 2013

We drew attention to the disclosure in the financial statements about the company not having a statement of service performance because it is inactive and did not have any performance to report. The company did not comply with the law by failing to complete by 30 June 2013 the statement of intent for the year beginning 1 July 2014.

Westland Nature Trust (Westland District Council)

Financial statements for the year ended 30 June 2013

We drew attention to the disclosure in the financial statements about the Trust not having a statement of service performance because it is inactive and did not have any performance to report. The Trust failed to comply with the law by not completing by 30 June 2013 the statement of intent for the year beginning 1 July 2013.

Luggate Nominee Limited (Dunedin City Council)

Financial statements and statement of service performance for the year ended 30 June 2008

We drew attention to the disclosure in the financial statements outlining that the company failed to comply with the law by not completing a statement of intent for the year beginning 1 July 2008.

West Coast Rural Fire Authority

Financial statements and statement of service performance for the year ended 30 June 2004

We drew attention to the disclosure in the financial statements outlining that the Authority failed to comply with the law by not completing a statement of intent for the year beginning 1 July 2004.

Kaikoura Community Facilities Trust (Kaikoura District Council)

Financial statements and statement of service performance for the years ended 31 March 2010 and 31 March 2011

We drew attention to the disclosure in the financial statements about the Trust not having a statement of service performance because it is inactive and did not have any performance to report. The Trust failed to comply with the law by not completing the statement of intent for the year beginning 1 April by 31 March of that year.

Kaikoura Community Charitable Trust (Kaikoura District Council)

Financial statements and statement of service performance for the year ended 30 June 2012

We drew attention to the disclosure in the financial statements outlining that the Trust failed to comply with the law by not completing a statement of intent for the year ended 30 June 2012.

Regional Software Holdings Limited

Financial statements and statement of service performance for the year ended 30 June 2013

We drew attention to the disclosure in the financial statements outlining that the company failed to comply with the law by not completing a statement of intent for the year ended 30 June 2013. We drew attention to the disclosure that outlines how the company reported performance information in the statement of service performance without having a statement of intent.

Canterbury Development Corporation Holdings Limited and Group (Christchurch City Council)

Financial statements for the year ended 30 June 2013

We drew attention to the disclosure in the financial statements outlining that the company failed to comply with the law by not completing a statement of intent for the year beginning 1 July 2012.

Canterbury Development Corporation and Group (Christchurch City Council)

Financial statements and statement of service performance for the year ended 30 June 2013

We drew attention to the disclosure in the financial statements outlining that the company failed to comply with the law by not completing a statement of intent for the year beginning 1 July 2012.

New Zealand Food Innovation South Island Limited (Christchurch City Council)

Financial statements and statement of service performance for the year ended 30 June 2013

We drew attention to the disclosure in the financial statements outlining that the company failed to comply with the law by not completing a statement of intent for the year beginning 1 July 2012.

CRIS Limited and Group (Christchurch City Council)

Financial statements and statement of service performance for the year ended 30 June 2013

We drew attention to the disclosure in the financial statements outlining that the company failed to comply with the law by not completing a statement of intent for the year beginning 1 July 2012.

North Tugz Limited (Ports of Auckland Limited and Northport Limited)

Financial statements for the year ended 30 June 2013

We drew attention to the disclosure in the financial statements about the negotiations of the company for a new long-term service agreement with a key customer and a renewed or replacement bank facility whose outcome was uncertain.

New Zealand Local Government Insurance Corporation Limited and Group – Trading as Civic Assurance

Financial statements for the year ended 31 December 2012

We drew attention to the disclosure in the financial statements that referred to the going-concern assumption being appropriately used in preparing the financial statements, despite uncertainties about the outcome of reinsurance issues and when the company will resume its normal business activities.

Tamaki Redevelopment Company Limited

Financial statements for the 11 months ended 30 June 2013

We drew attention to the disclosure in the financial statements about the company's financial statements being prepared under the going-concern assumption because it relies on its shareholders to fund operating expenses and liabilities. Funding until 30 June 2014 is secure. Further funding depends on shareholders approving a business case in the second quarter of 2014.

New Zealand Local Authority Protection Programme Disaster Fund

Special purpose financial statements for the year ended 30 June 2013

We drew attention to the disclosure in the special purpose financial statements that referred to the fact that the Trustees had prepared special purpose financial statements. We also drew attention to the disclosure in the financial statements that referred to the uncertainties about gross claim liabilities and related reinsurance recoveries arising from the 2010 and 2011 Canterbury earthquakes.

Christchurch Stadium Trust

Financial statements for the year ended 31 December 2012

We drew attention to the disclosure in the financial statements that referred to the going-concern basis appropriately not being used in preparing the financial statements because the Trust had a limited life and had an obligation to decommission the stadium and wind up when Christchurch has a new permanent stadium. We drew attention to the expected financial difficulties, which the Trust will not be able to address without further support from other parties.

Selwyn Investment Holdings Limited and Group (Selwyn District Council)

Financial statements and statement of service performance for the year ended 30 June 2013

We drew attention to the disclosure in the financial statements that referred to the realisation basis appropriately being used in preparing the financial statements because the shareholders in the company decided to liquidate the company on 4 September 2013.

Lakes Environmental Limited (Queenstown-Lakes District Council)

Financial statements and statement of service performance for the year ended 30 June 2013

We drew attention to the disclosure in the financial statements that referred to the disestablishment basis appropriately being used in preparing the financial statements because the shareholder decided to re-integrate the operations of the company into Queenstown-Lakes District Council and to disestablish the company.

Lakes Leisure Limited (Queenstown-Lakes District Council)

Financial statements and statement of service performance for the year ended 30 June 2013

We drew attention to the disclosure in the financial statements that referred to the disestablishment basis appropriately being used in preparing the financial statements because the shareholder decided to re-integrate the operations of the company into Queenstown-Lakes District Council and to disestablish the company.

S C Aoraki Development Trust (Timaru District Council)

Financial statements for the year ended 30 June 2013

We drew attention to the disclosure in the financial statements that referred to the disestablishment basis appropriately being used in preparing the financial statements because the Trust was officially dissolved on 20 August 2013.

Timaru District Promotion Trust (Timaru District Council)

Financial statements and statement of service performance for the year ended 30 June 2013

We drew attention to the disclosure in the financial statements that referred to the disestablishment basis appropriately being used in preparing the financial statements because the Trust was officially dissolved on 20 August 2013.

Taranaki Provincial Patriotic Council

Financial statements for the year ended 30 September 2011

We drew attention to the disclosure in the financial statements that referred to the disestablishment basis appropriately being used in preparing the financial statements because the Council (the governing body) approved in principle the formation of a Trust to assume ownership of the assets of the Council and to supersede the functioning of the ownership of the Council.

Puhoi Cemetery Board

Statement of accounts for the year ended 31 March 2010

We drew attention to the disclosure in the financial statements that referred to the disestablishment basis appropriately being used in preparing the financial statements because the Cemetery Trustees began the process of having the cemetery vested in Auckland Council.

Publications by the Auditor-General

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

- Watercare Services Limited: Review of service performance
- Inquiry into the Plumbers, Gasfitters, and Drainlayers Board: Follow-up report
- Reflections from our audits: *Our future needs – is the public sector ready?*
- Central government: Results of the 2012/13 audits (Volume 2)
- Inquiry into property investments by Delta Utility Services Limited at Luggate and Jacks Point
- The Auditor-General's Auditing Standards 2014
- Maintaining a future focus in governing Crown-owned companies
- Delivering scheduled services to patients
- Continuing to improve how you report on your TEI's service performance
- Department of Corrections: Managing offenders to reduce reoffending
- Public entities in the social sector: Our audit work
- Immigration New Zealand: Supporting new migrants to settle and work
- Summary: Inquiry into the Mangawhai community wastewater scheme
- Inquiry into the Mangawhai community wastewater scheme
- Regional services planning in the health sector
- Effectiveness and efficiency of arrangements to repair pipes and roads in Christchurch
- Earthquake Commission: Managing the Canterbury Home Repair Programme
- Using the United Nations' Madrid indicators to better understand our ageing population

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.

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