Controller and Auditor-General
Tumuaki o te Mana Arotake

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Insights into local government: 2020

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Insights into local government: 2020

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June 2021

Contents

Auditor-General's overview

E ngā mana, e ngā reo, e ngā karangarangatanga maha o te motu, tēnā koutou.

Last year was extraordinary. Covid-19 caused significant disruption for most public organisations, including councils and the organisations they own. Despite this, councils continued to deliver essential services to their communities, as well as leading the local response when a state of national emergency was declared due to Covid-19.

It can be easy to overlook the wide range of services councils provide to their communities. However, there are many proposed changes on the horizon to the traditional roles and functions of local government. New regulatory requirements are being put in place or proposed (for example, new and updated national policy statements). Other areas for change are also being proposed, including the three waters and resource management reforms. The reform processes, and the information and engagement requirements these involve, have added to the stresses already evident in local government.

The proposed reforms have the potential to reshape New Zealand's system of local government. This has led to the recent announcement of a review into the future for local government. It is a difficult time for the local government sector, which needs to continue to deliver and develop core services at the same time as its future role is considered.

Providing affordable and sustainable services to communities has always been a challenge for councils, but it is becoming even harder. Previous Auditors-General and I have noted concerns that councils have not been adequately reinvesting in their assets. This trend continued in 2019/20. However, many councils have identified this matter in their 2021-31 long-term plan consultation documents. Within these documents, we saw some councils confront the infrastructure issues they are facing and propose to raise rates to provide sustainable services over the long term. My view is that well-planned, funded, and well-managed asset renewal programmes are critical to sustainable service delivery. Without this, communities can end up paying more for asset renewals and suffering unexpected disruptions to services because of asset failure.

Councils also need skilled staff. I acknowledge the difficulty many councils have in attracting and retaining qualified staff. The proposed changes for local government are likely exacerbating this. In the current environment, procurement strategies that acknowledge the tight contractor and consulting market are also critical.

Effective governance of councils is important. I am pleased to see that there has been a concerted effort across the sector to enhance the performance and function of audit and risk committees, including:

- establishing a committee when there was not one in place already;
- appointing one or more independent members with the required skills to consider and advise on risks, to support the council; and
- reviewing the committee's terms of reference to ensure that they are fit for purpose.

My Office will continue to support audit and risk committees by regularly sharing our insights and observations and updating our good practice guidance.

Governing bodies also have a role in assessing the design and effectiveness of councils' internal systems and controls. We recently released our revised good practice guides on conflicts of interest and sensitive expenditure. In a rapidly changing environment, it is important that councils' policies are reviewed regularly to ensure that they remain appropriate and that they continue to be followed. Effective governance also extends to oversight of organisations that councils have ownership interests in. The review of Auckland Council's council-controlled organisations by an independent panel includes information that should be useful for the wider sector.

This report explores in some detail the challenges faced by regional councils in managing conflicts of interest. This includes discussions about some of the conflict of interest issues and challenges we considered during the year, along with two examples from regional councils that we have considered previously to illustrate the points we discuss. Many regional councils have elected members from agricultural backgrounds, and the management of conflicting interests can be complicated as councils seek to make regulatory and planning decisions. This is further complicated by the fact that the Local Authorities (Members' Interests) Act 1968 is dated and is out of step with the approach other sectors take to managing conflicts of interest – it is timely for this legislation to be reviewed.

The preparation of councils' 2019/20 annual reports and our audits were severely disrupted by Covid-19. Our auditors needed considerably more time to complete the audits of the 2019/20 annual reports compared with a normal year. This has resulted in auditors seeking to recover additional audit fees from councils at a level that is unusual.

In response to Covid-19, Parliament extended the statutory reporting time frames for councils (among other public entities) by two months. This was an important step to ensure that the quality of reporting was not compromised at a time when robust financial and performance reporting was even more critical than usual.

Having said this, my auditors issued more qualified audit opinions on councils' annual reports than they have previously. Most qualifications were because the auditor was not able to obtain sufficient evidence to support non-financial performance reported by councils. The performance that a council reports should tell a story about the services it delivers, why it delivers them, and what difference it intends to make to its community. Councils need robust systems to collect and report performance, not only for their financial performance but for their non-financial performance as well. Ratepayers should know the levels of service they are receiving for the rates and charges they pay.

The delay in preparing councils' 2019/20 annual reports and the uncertainty and complexity caused by Covid-19 have proved challenging for both council staff and my auditors, especially as they moved immediately into the preparation and audit of 2021-31 long-term plans and the associated consultation documents. I expect that the 2020/21 financial year-end will also be a challenge as the impact of Covid-19, together with challenges of resourcing, affect both councils and my auditors.

Councils provide services that are important to all New Zealanders. In a challenging environment, council staff have continued to work tirelessly for the benefit of their communities.

Nāku noa, nā,

John Ryan
Controller and Auditor-General

22 June 2021

1 Councils' performance in 2019/20

1.1 In this Part, we consider the main financial performance trends of councils for 2019/20.[1] We comment on the revenue recorded by councils, the operating expenditure incurred by councils, whether councils are processing building consent applications within the statutory time frames, and whether aspects of councils' non-financial performance for 2019/20 were affected by Covid-19.

1.2 To carry out our analysis, we compared 2019/20 actual reported figures with what councils planned and included in their budgets.[2]

1.3 Overall, the revenue received by councils in 2019/20 from core revenue sources (such as rates, subsidies, and grants) was as expected and in line with what had been budgeted for.

1.4 Councils did incur higher than forecast operating expenditure. From our analysis, there were no consistent reasons for this. However, we have noted that liabilities from leaky home claims is a long-standing issue that continues to have significant expenditure implications for at least two councils.

1.5 Covid-19 directly affected council services that were required to close during Alert Levels 3 and 4. However, based on the information included in councils' annual reports, other council operations were not as affected by Covid-19.

Revenue recorded by councils

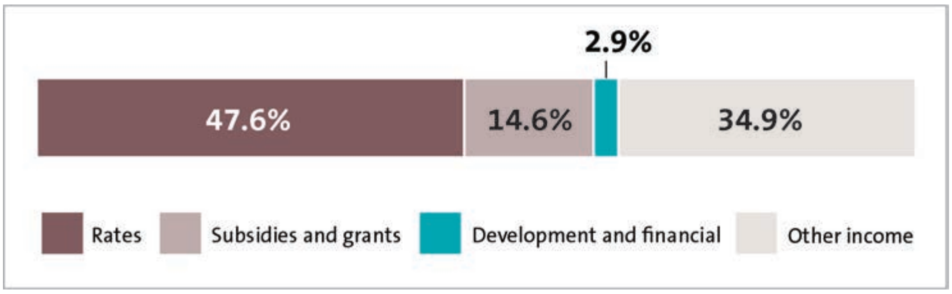
1.6 Councils recorded total revenue of $13.9 billion for the 2019/20 year (2.8% higher than the $13.6 billion budgeted). Excluding Auckland Council, councils recorded total revenue of $8.8 billion, which was 4% higher than councils had forecast ($8.4 billion).

1.7 Figure 1 shows the categories of revenue for councils for the 2019/20 year.

1 For 2019/20, draft financial information for five local authorities was included in our analysis because the audited financial information was not available at the time we undertook our analysis. Five councils missed the revised deadline to complete and adopt their audited annual report by 31 December 2020. Paragraphs 3.4-3.9 of this report provide more information.

2 We looked at individual council figures, except for Auckland Council where group level figures were used, because the council-controlled organisations of Auckland Council provide core services such as public transport, roading, and water services. Budget information is as reported in councils' 2019/20 annual reports.

Figure 1
2019/20 actual revenue, by sub-category



Source: Analysed from information collected from councils' annual reports.

1.8 The proportion of revenue recognised by councils was similar to the previous financial year.

1.9 Of the total revenue in 2019/20, $6.6 billion was from rates. This was largely consistent with the amount councils planned to collect and equates to 47.6% of the councils' total revenue. In 2018/19, rates were 46.7% of the councils' total revenue.

1.10 The revenue received by councils was not significantly affected by the nationwide lockdown in response to Covid-19, although we note that individual councils would have been affected in different ways. For example, Hurunui District Council had a decrease in revenue because the Hanmer Springs Thermal Pools and Spa could not operate during Alert Levels 3 and 4.

1.11 We note that councils faced public pressure to keep rates increases down in the 2020/21 financial year to assist ratepayers facing financial hardship because of the disruptions of Covid-19.[3] As a result, many councils reconsidered planned rates rises and consulted with their communities on options to keep rates down. Councils also considered other options to provide targeted assistance to ratepayers that needed it, including revised rates remission, postponement policies, and lower rate penalties.

1.12 We found that revenue other than rates was largely as planned. Subsidies and grants received by councils was $75 million (3.8%) higher than budgeted.

1.13 In previous years, most subsidy income has been received from Waka Kotahi New Zealand Transport Agency. More recently, councils have had access to other grants, such as the Provincial Growth Fund, some tourism funds, and the Government's "shovel-ready" funding.

3 Local Government Covid-19 Response Unit (August 2020), *Local government sector COVID-19 financial implications, Report 3 – Comparison of 2020 annual plan budgets against long-term plans*, page 10.

1.14 Christchurch City Council had a significant increase (85%) compared with budget in subsidies and grants, largely because it received $81 million of grants from the Crown's Christchurch Regeneration Accelerator Fund to accelerate Canterbury's earthquake recovery. This was not budgeted for.

Operating expenditure of councils

1.15 Councils incurred higher than forecast operating expenditure. The total operating expenditure for all councils was $12.5 billion, which was a $626 million (5.3%) increase compared with planned expenditure of $11.9 billion. When Auckland Council is excluded from these results, councils incurred total operating expenditure of $8.1 billion compared with a budget of $7.6 billion.

1.16 Figure 2 shows the main categories of councils' operating expenditure.

Figure 2
2019/20 budget and actual operating expenditure, by sub-category

Operating expenditure	2019/20 Actual $million	2019/20 Budget $million	Expense as a proportion of total actual operating expenditure (%)
Depreciation and amortisation	2,661.9	2,638.4	21.3
Employee costs	2,765.9	2,679.0	22.2
Finance costs	806.7	867.6	6.5
Other operating expenditure	6,247.2	5,670.4	50.0
Total	**12,481.7**	**11,855.4**	**100.0**

Source: Analysed from information collected from councils' annual reports.

1.17 Employee costs for all councils increased by 3.2% to $2.8 billion compared with a budget of $2.7 billion. In our work, we often hear about the challenges councils face in recruiting and retaining skilled staff, particularly regulatory and engineering staff. We will continue to monitor and report on this.

1.18 Other operating expenditure was 10% higher than budgeted. From our analysis, there were no consistent reasons for this.

1.19 Two councils, Auckland Council and Tauranga City Council, had higher operating expenditure compared to budget due to increased operating expenses for the remediation of weathertightness and associated building defects.

1.20 Liabilities from leaky home claims is a long-standing issue that continues to have significant implications for Auckland Council in particular. This issue is complex due to uncertainty and the various stages of legal proceedings. As a result, it is difficult for councils to budget for. We first reported on council's exposure to liabilities from leaky home claims in our report *Local government: Results of the 2006/07 audits*.[4]

1.21 Tauranga City Council reported $30.6 million in weathertightness settlements in 2019/20. This was a significant increase for the Council as no settlement had occurred in the previous year. Because of the complexity of the settlements, these have a high degree of uncertainty when setting the budget. Tauranga City Council also reported other losses of $35.7 million. This included asset impairments for the Harington Street carpark building, which did not meet the required standard of seismic resistance ($19.8 million), and the Bella Vista site remediation ($9 million).

1.22 Auckland Council notes in its annual report that the costs of weathertightness settlements are not budgeted for because of the uncertainty of a provision for the remediation of weathertightness and associated building defect claims (as well as the remediation for the management of contaminated land and closed landfills). Auckland Council's provision for remediation of weathertightness claims increased by $86 million as a result of the high costs associated with multi-unit claims. The contaminated land and closed landfills provision mainly increased by $17 million due to an increase in climate change coastal adaptation costs associated with closed landfills.[5]

1.23 Another reason for Auckland Council's increased operating expenditure was an unbudgeted $10 million that the Auckland Emergency Management Team spent on Covid-19 relief, including the delivery of food parcels and household goods during the nationwide lockdown period.[6] Additional expenditure for Covid-19 relief might also have been incurred by other councils, but this level of detail was not in their annual reports.

Building consents

1.24 Councils have a statutory requirement to process most building consent applications within 20 working days (this applies to 67 out of the 78 councils as the 11 regional councils do not process building consents). As part of the audit of councils' non-financial performance, our auditors often look at how councils meet this requirement. This timeliness requirement can also be used as an indicator of councils' effectiveness in responding to growth.

1.25 In 2018/19, we reported that most councils did not meet the statutory time frames for processing building consent applications.[7]

4 Office of the Auditor-General (2008), *Local government: Results of the 2006/07 audits*, Part 10, page 69.

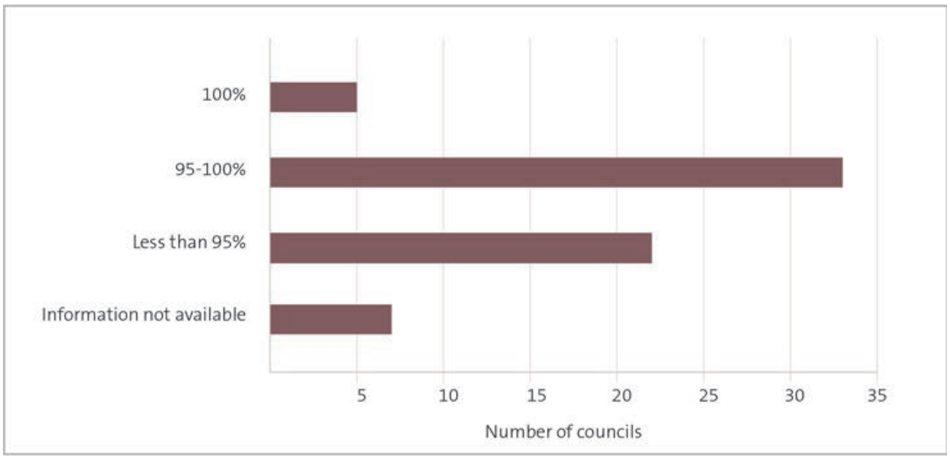
5 Auckland Council (2020), *Auckland Council Annual Report 2019/20*, Volume 3, page 31.

6 Auckland Council (2020), *Auckland Council Annual Report 2019/20*, Volume 3, page 31.

7 Office of the Auditor-General (2020), *Insights into local government: 2019*, Part 3.

1.26 In 2019/20, building consent performance data was available for 60 councils (2018/19: 60). Of the 60 councils, five reported that they had processed 100% of building consent applications within 20 working days (Figure 3),[8] which is the statutory requirement (in 2018/19, eight councils reported that they had processed 100% of building consent applications in that time frame). Thirty-three councils reported they had processed between 95% and 100% of building consent applications within the time frame (2018/19: 34), and 22 councils reported that they processed fewer than 95% (2018/19: 18). We did not find usable information about building consent timeliness in seven councils' annual reports.

Figure 3
Councils' processing of building consent applications within 20 working days in 2019/20



Source: Collated from 60 councils' annual reports.

1.27 This indicates a decline in performance in 2019/20 compared with 2018/19, with fewer councils processing all building consent applications within 20 working days and more councils processing fewer than 95% of these applications within the statutory time frame.

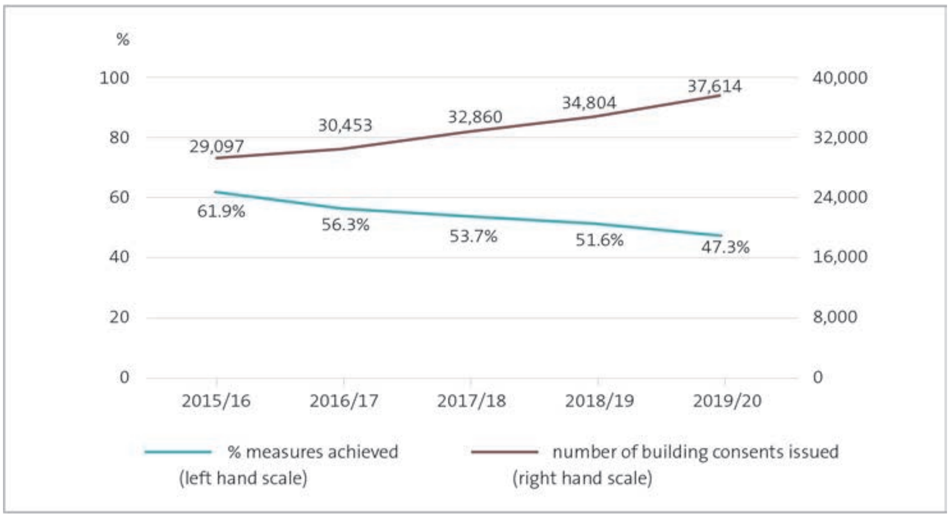
1.28 We could reasonably expect fewer building consent applications to have been processed during the latter half of the 2019/20 financial year as a result of Covid-19 and the economic slowdown. This might have presented an opportunity for those fewer applications to have been processed more quickly. However, this does not take account of the nature or complexity of the applications, or whether councils' other activities took priority over building consent processing post-lockdown.

8 These councils were Horowhenua District Council, Ruapehu District Council, Stratford District Council, Waimakariri District Council, and Waitomo District Council.

1.29 Of the five councils that processed 100% of building consent applications within the statutory time frame, only one (Waimakariri District Council) is classified as a high-growth council under the National Policy Statement on Urban Development Capacity 2016 (see Appendix 1).[9] This means that most high-growth councils are not meeting the statutory time frame for processing building consent applications.

1.30 Timeliness is one of the measures used to assess councils' performance in relation to building consents. These measures are generally shown as either "achieved" or "not achieved" in councils' annual reports. Trend analysis of councils' performance across all building consent measures shows a steady decline from 61.9% achieved in 2015/16 to 47.3% achieved in 2019/20 (Figure 4). The decrease of 4.3% from 2018/19 to 2019/20 is larger than the 3.4% average decrease per year from 2015/16 through to 2018/19. Given that performance has been declining since 2015/16, Covid-19 cannot be the principal reason for this, in the years up to and including 2018/19.

Figure 4
Percentage of all building consent performance measures achieved and the total number of building consents issued for new dwellings, 2015/16 to 2019/20



Source: From information collected from councils' annual reports and Statistics New Zealand.

1.31 Figure 4 shows that the total number of building consents issued has increased steadily from 29,097 in 2015/16 to 37,614 in 2019/20. Overall, the percentage of performance measures achieved has decreased over the same period. However, this might not represent a direct causal relationship and there could be other factors contributing to fewer building consent performance measures being achieved over time.

9 Two provincial and three rural councils met the statutory time frame.

1.32 We encourage all councils to investigate their performance. In our view, high-growth councils in particular need to consider what effect this could have on their ability to support growth in their communities.

Levels of service were not significantly affected in 2019/20 as a result of Covid-19

1.33 Because of the disruption caused by Covid-19, we looked at whether the performance information reported indicated a decline in the levels of service provided by councils in 2019/20.

1.34 Our analysis did not indicate any consistent decline in the levels of service provided by councils. This was because many of the services provided by councils are essential services that continued despite New Zealand moving into a nationwide lockdown during the financial year.

1.35 However, some services were affected. For example, there was a drop in the percentage of performance measures achieved in respect of libraries in 2019/20. Between 2015/16 and 2018/19, the percentage of performance measures achieved in respect of libraries were relatively stable, dropping from 74.6% in 2015/16 to 70.2% in 2018/19. In 2019/20, this dropped to 54.0%. This is not unexpected, given that libraries were closed for part of the 2019/20 financial year during Alert Levels 3 and 4.

Councils' investment in infrastructure

2

2.1 In this Part, we consider how well councils reinvested in their assets, reported on their three waters assets performance measures, delivered on their 2019/20 capital expenditure budgets, and built assets needed for growth.[10] Because councils generally use debt to fund capital expenditure, we have also considered the debt owed by the sector as at 30 June 2020.

2.2 In our analysis, we considered the local government sector as a whole and, in some cases, as five sub-sectors. The sub-sectors were:

- metropolitan councils;
- Auckland Council (considered separately from other metropolitan councils because of its size);
- provincial councils;
- regional councils; and
- rural councils.

2.3 The most significant result continues to be the level of asset reinvestment. Councils' renewal capital expenditure in 2019/20 was 74% of depreciation for the year. This continues a trend that we have been reporting since 2012/13, which indicates that councils are not adequately reinvesting in their assets. Further, councils spent $1.38 billion (21%) less than they planned to on their assets.

2.4 An increasing number of councils have acknowledged in their 2021-31 long-term plan (LTP) consultation documents that they have been underinvesting in their assets.

Reinvestment in councils' assets during 2019/20

2.5 To consider how well councils are reinvesting in their assets, we compared capital expenditure on renewals with the annual depreciation charge. We consider depreciation to be the best estimate of the portion of the asset that was "used up" during the financial year. Assets have long life-cycles, so this is only one indicator of whether councils are adequately reinvesting in their assets.

2.6 Overall, based on our analysis, we remain concerned that councils might not be adequately reinvesting in critical assets. If councils continue to underinvest in their assets, there is a heightened risk of asset failure and resultant reduction in service levels, which will negatively affect community well-being.

2.7 In 2019/20, all councils' renewal capital expenditure was 74% of depreciation (this was 79% in 2018/19). This means that, for every $1 of assets used up, councils were reinvesting 74 cents. For 22 councils, renewal capital expenditure was more

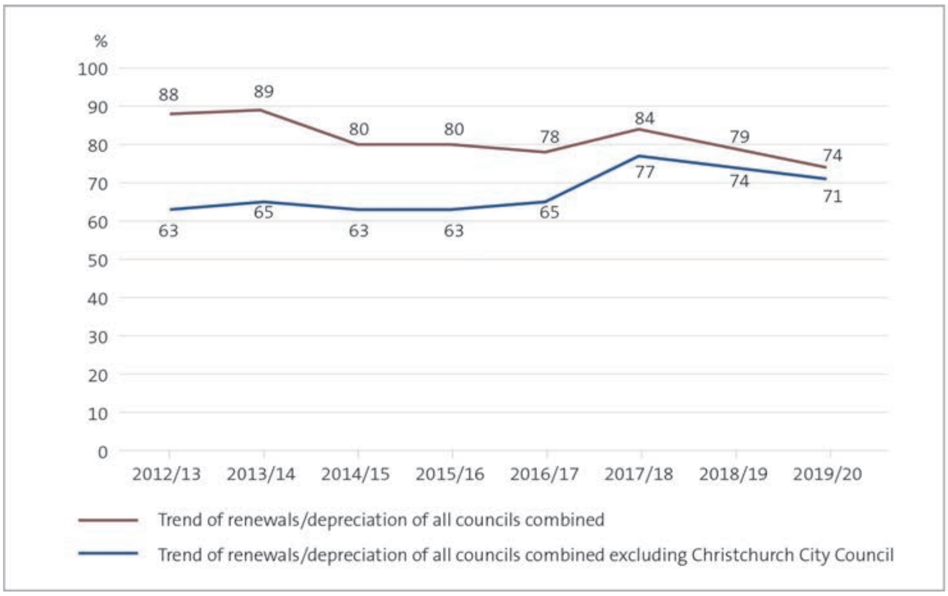
10 For 2019/20, draft financial information for five local authorities was included in our analysis because the audited financial information was not adopted at the time we carried out our analysis. Five councils missed the revised deadline to complete and adopt their audited annual report by 31 December 2020. Paragraphs 3.4-3.9 of this report provide more information.

than 100% of depreciation. This is slightly fewer than the 29 councils for which this was the case in 2018/19.

2.8 Figure 5 compares renewal capital expenditure with depreciation for all councils, from 2012/13 to 2019/20. There are two lines on the graph. One line includes all councils, and the other excludes Christchurch City Council.

2.9 Christchurch City Council's renewal capital expenditure is proportionately higher than other councils because of the rebuilding work it has done since the 2011 Canterbury earthquakes.

Figure 5
Renewal capital expenditure compared with depreciation for all councils, 2012/13 to 2019/20



Source: Analysed from information collected from councils' annual reports.

2.10 During the past eight years, renewals ranged between 74% and 89% of depreciation for all councils. However, the effect of Christchurch City Council's rebuild after the Canterbury earthquakes did not give an accurate picture of how much all councils were investing in renewals, mainly from 2012/13 to 2016/17. Overall, there was a change between 2016/17 and 2017/18 where councils' renewal investment significantly increased, but this has declined since 2017/18.

2.11 In 2019, we reported that councils were forecasting, in their 2018-28 LTPs, an increase in what they were proposing to spend to renew their assets.[11] All councils,

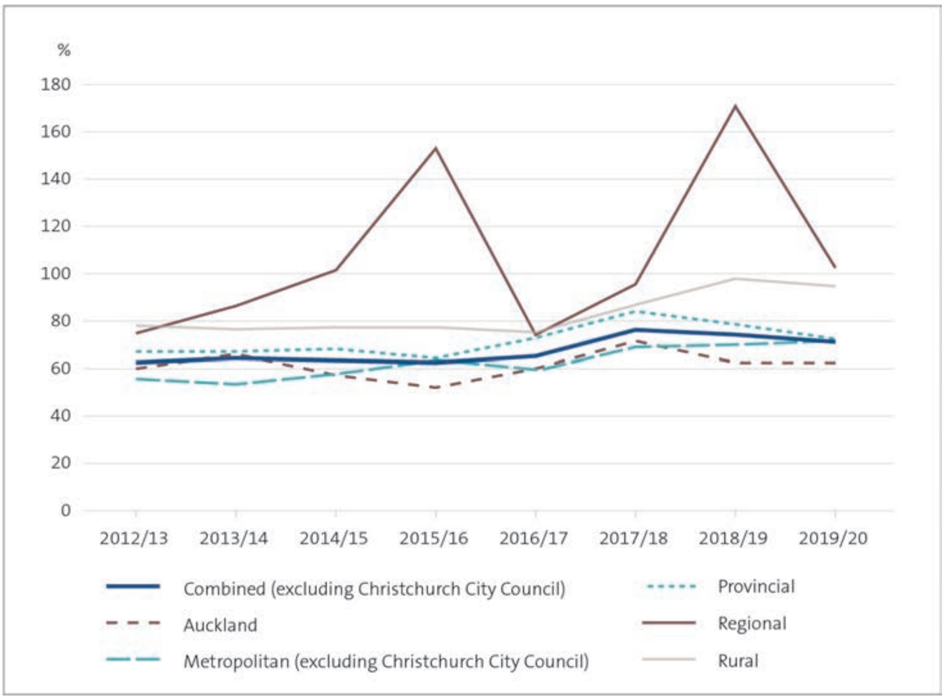
11 For example, Office of the Auditor-General (2019), *Our 2018 work on local government*, Figure 2.

excluding Christchurch City Council, had planned renewing assets at over 80% of the depreciation expense for the 2018/19 and 2019/20 financial years. Figure 5 shows that this has not occurred.

2.12 Councils are currently preparing their 2021-31 LTPs. We intend to analyse these plans to see how councils are planning to catch up on any previous underinvestment in their assets and will report on our analysis.

2.13 When considering council sub-sectors (see Figure 6), and excluding Christchurch City Council, two sub-sectors have a different trend to that shown for all councils.

Figure 6
Renewal capital expenditure compared with depreciation for all council sub-sectors (excluding Christchurch City Council), 2012/13 to 2019/20



Source: Analysed from information collected from councils' annual reports.

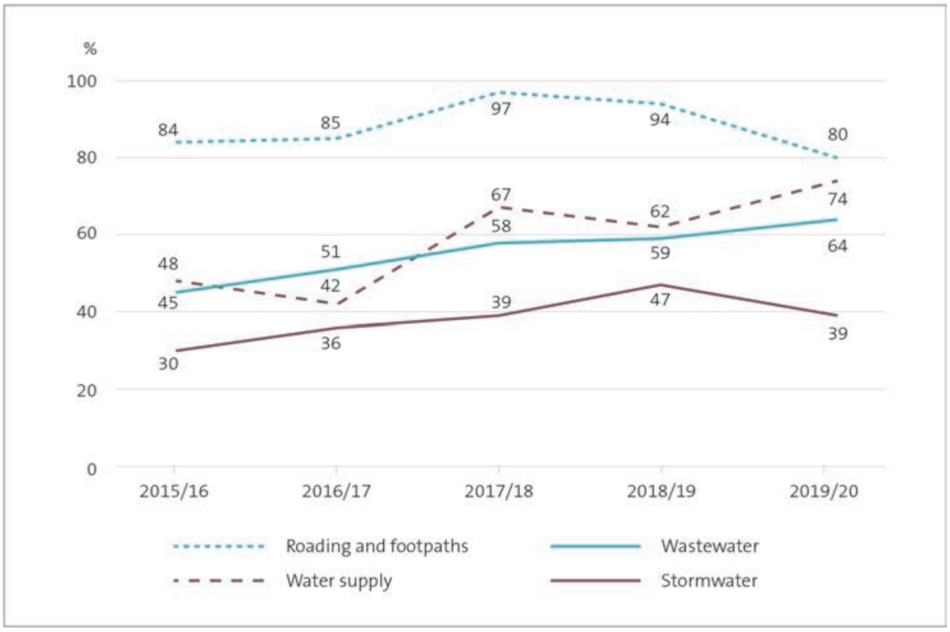
2.14 Regional councils' renewals as a percentage of depreciation ranged from 74% (in 2012/13) to 170% (in 2018/19), then dropped to 103% in 2019/20. Greater Wellington Regional Council replacing a significant number of public passenger vehicles during 2018/19 affected that year's figure. Environment Canterbury's replacement of its head office building was the main factor for the peak in 2015/16.

2.15 Rural councils' renewals as a percentage of depreciation ranged from 75% (in 2016/17) to 98% (in 2018/19), with a small drop to 95% in 2019/20. Roading assets are rural councils' largest asset category. As noted in paragraph 1.13, councils receive a subsidy from Waka Kotahi New Zealand Transport Agency, which is an incentive to replace their roading assets. This funding relationship, along with rural councils' asset mix, might explain why they have a different trend to other council sub-sectors.

2.16 We have also considered 2019/20 renewals expenditure (excluding Christchurch City Council) by infrastructure asset category. Other infrastructure asset classes have the following percentages of renewals spend as a proportion of depreciation in 2019/20 (see Figure 7):

- Roading and Footpaths – renewals spending was 80% of depreciation.
- Water supply – renewals spending was 74% of depreciation.
- Wastewater – renewals spending was 64% of depreciation.
- Stormwater – renewals spending was 39% of depreciation.

Figure 7
Renewal capital expenditure compared with depreciation for all councils combined (excluding Christchurch City Council) by infrastructure asset category, 2015/16 to 2019/20



Source: Analysed from information collected from councils' annual reports.

2.17 It is evident that the level of reinvestment is lower for all three waters assets (drinking water supply, wastewater, and stormwater), compared to roading and footpaths. Over the last two years, the amount reinvested into the three waters assets has also been significantly less than what councils budgeted for in their 2018-28 LTPs. Given the age of some of these networks, we are concerned that councils are more likely to defer reinvestment in their three waters assets than in roading and footpaths. We will continue to look into this as we review councils' 2021-31 LTPs.

2.18 The data also demonstrates that the level of reinvestment is significantly lower for stormwater than for other water assets. This is consistent with the findings of our December 2018 report *Managing stormwater systems to reduce the risk of flooding*, where we reported that councils were spending less than depreciation on renewing stormwater assets, which might indicate underinvestment. These lower levels of investment could be because there is a tendency for councils to prioritise water supply and wastewater over stormwater, particularly as there are other options to manage stormwater depending on local geography (for example, through discharge to land).

2.19 Although spending on renewals is less than the annual depreciation charge, overall councils have increased capital expenditure on their three waters assets.

2.20 In 2019/20, councils spent $1.7 billion on three waters assets (see Figure 8), which represents 54% of total council spending on infrastructure assets for the year. This is an increase of $385.6 million (29%) from 2018/19. We expect this level of spending to increase in the coming years.

Figure 8
2019/20 spending on three waters assets as a proportion of spending on total infrastructure assets, by capital expenditure type

Capital expenditure	Three waters assets $million	Total infrastructure assets $million	Percentage of total infrastructure spending on three waters assets
Meet additional demand	614.0	838.7	73.2
Improve the level of service	500.5	1,045.4	47.9
Renew existing assets	591.7	1,270.1	46.6
Total	**1,706.2**	**3,154.2**	**54.1**

Source: Analysed from information collected from councils' annual reports.

Three waters performance measures and trends

2.21 Under the Non-Financial Performance Measures Rules 2013 made by the Secretary for Local Government, councils are required to report their performance against specific performance measures for the three waters (drinking water supply, wastewater, and stormwater). These measures are shown as either "achieved" or "not achieved" in councils' annual reports.

2.22 Figure 9 shows that performance for all three waters measures was relatively consistent between 2015/16 and 2018/19. Water supply performance remained consistent into 2019/20. However, the percentage of wastewater measures that were achieved declined from 83.3% in 2018/19 to 76.6% in 2019/20, and the percentage of stormwater measures that were achieved increased from 77.3% in 2018/19 to 83.6% in 2019/20.

Figure 9
Percentage of water supply, wastewater, and stormwater performance measures achieved, 2015/16 to 2019/20

Source: Analysed from information collected from councils' annual reports.

2.23 The consistent performance against the three waters performance measures show that, at this point, the underinvestment in assets is not significantly affecting the levels of service being provided to communities for the sector as a whole. However, these results will be different for individual councils.

We also note that assets have long lives and can often sustain a period of underinvestment before levels of service start to decline.

Delivery of capital expenditure budgets

2.24 Most councils did not deliver on their total capital expenditure budgets in 2019/20. This means that some capital projects are either delayed or not being delivered at all, which could affect the levels of service received by communities.

2.25 Councils' total capital expenditure in 2019/20 was $5.14 billion, which was the highest amount councils spent on their assets in the last eight years. However, the amount spent was only about 79% of the $6.52 billion budgeted.[12] This is a smaller percentage than in 2018/19, when councils spent 82% of their capital expenditure budgets. The lockdowns in response to Covid-19 are likely to have affected the delivery of some projects.

2.26 On average, all council sub-sectors spent less than 100% of their capital expenditure budgets. The regional council sub-sector was the lowest, spending $142 million or, on average, 56% of their budget. By comparison, Auckland Council spent $2.30 billion or 93% of its budget.

2.27 Looking at individual councils, 52 councils spent less than 80% of their capital expenditure budgets. This continues a pattern we have observed over time (see Figure 10). There were 12 more councils spending less than 80% of budget than in 2018/19. This is the highest number in the last eight years. Covid-19 would have affected the delivery of some projects, but there are also constraints in the availability of contractors, specialists, and associated resources in New Zealand.

Figure 10
Number of councils spending either less than 80%, between 80% and 100%, or over 100% of their budgeted capital expenditure, 2012/13 to 2019/20

	Spent less than 80% of budget	Spent 80% to 100% of budget	Spent over 100% of budget
2012/13	46	22	10
2013/14	44	21	13
2014/15	46	21	11
2015/16	45	20	13
2016/17	47	19	12
2017/18	35	23	20
2018/19	40	20	18
2019/20	52	13	13

Source: Analysed from information collected from councils' annual reports.

12 This information is from the statements of cash flows of councils. It includes only the cash that councils spent on purchasing property, plant, and equipment and intangible assets.

2.28 Councils are currently preparing their 2021-31 LTPs. From our review of the LTP consultation documents, we observed that most councils are aware of delivery issues and have put plans in place to support the timing of their investments. However, there are risks that councils will not be able to deliver on their capital expenditure budgets because they will not be able to secure the necessary contractors, specialists, and associated resources.

2.29 This situation is likely compounded by border closures, which restricts the entry of people into New Zealand, and an increase in proposed capital projects, meaning that councils are competing with other entities (and each other) to secure limited resources. We intend to comment further on this issue when we report on the 2021-31 LTPs.

Building assets needed for growth

2.30 Some councils are experiencing significant population growth. For the purposes of our analysis, we have considered "high-growth councils" to be those categorised as such in the National Policy Statement on Urban Development Capacity 2016 (see Appendix 1).[13]

2.31 In their 2018-28 LTPs, high-growth councils forecast making significant investments to meet the additional demands on their infrastructure.

2.32 This is the second year we have examined how well high-growth councils have achieved their growth-related capital budgets. In 2019/20, we found that most of these councils did not build all the assets they had budgeted for. This was also the case in 2018/19. We encourage these councils to reassess their future planned budgets to accommodate what has not been achieved to date.

2.33 In 2019/20, high-growth councils spent approximately $1.04 billion (2018/19: $0.93 billion) on capital expenditure intended to meet additional demand. This was nearly 70% of the $1.49 billion budgeted in 2019/20 for this purpose. Three councils spent more than their growth-related capital expenditure budgets. In contrast, four councils spent less than 45% of their budgets.

2.34 High-growth councils received capital subsidies or grant revenue of $1.15 billion – 6.4% more than the $1.08 billion budgeted for the year. It is therefore unlikely that funding is the primary reason for the delay in capital expenditure. High-growth councils might not have been able to complete their capital programmes for the same reasons as other councils (see paragraphs 2.28-2.29).

13 The National Policy Statement on Urban Development 2020 came into effect on 20 August 2020. It replaced the National Policy Statement on Urban Development Capacity 2016. The new policy statement might mean that different councils are defined as high growth from 2020/21 onwards. However, the old policy statement still applied for the 2019/20 year we are looking at in this report.

2.35 As noted in paragraph 2.30, we have considered high-growth councils to be those categorised as such in the National Policy Statement on Urban Development Capacity 2016. However, from our review of the 2021-31 LTP consultation documents, we note that many councils that previously indicated they had negative or static growth are now having to deal with growth and the associated provision of infrastructure. Therefore, the definition and impacts of "high-growth" could apply to more councils in the future.

Council debt trends

2.36 The total amount of budgeted debt for all councils for the year ended 30 June 2020 was $19.52 billion. The actual total debt was $19.65 billion. This was $136 million, or 1%, more than budget. Councils generally use debt to fund capital expenditure.

2.37 We considered Auckland Council's debt separately from other councils because of its size. Auckland Council had borrowing of $10.2 billion as at 30 June 2020, which was $494 million more than they anticipated borrowing. Auckland Council reported in its annual report that the increase in borrowings was higher than budget due to the reduced revenues and pressures on working capital arising from Covid-19.[14]

2.38 The total amount of debt as at 30 June 2020 for all other councils was $9.44 billion, compared with a budget of $9.80 billion.

2.39 From our review of the 2021-31 LTP consultation documents, we are aware that several councils are planning to borrow to fund increased capital expenditure. In some cases, councils are planning to borrow to help fund operating costs in the short term, particularly where they have been affected by lower than anticipated revenue streams.

2.40 As a general principle, debt should not be used to fund operations. It has been described as "borrowing to pay for the groceries". Any councils borrowing to fund operating expenditure should consider their rationale for using this approach.

14 Auckland Council (2020), *Auckland Council Annual Report 2019/20*, Volume 3, page 65.

3 The audit reports we issued

3.1 Each year, auditors give an independent report on each council's financial statements and performance information (statements of service performance). This information is an important part of the council's annual report and its accountability to its community.

3.2 The auditor's report lets a reader know whether they can rely on the audited information in the council's annual report.

3.3 In this Part, we discuss when councils adopted their 30 June 2020 annual reports and whether they met the deadline for doing so, the types of audit reports we issued, and the effect of Covid-19 on our audits.

When the audit reports were issued

3.4 The Local Government Act 2002 requires councils to:

- complete and adopt an annual report that contains audited financial statements and service performance information within four months after the end of the financial year;
- make the audited annual report publicly available within one month of adopting it; and
- make an audited summary of the annual report publicly available within one month of adopting the annual report.

3.5 In response to Covid-19, Parliament passed legislation on 5 August 2020 to extend the statutory reporting time frames for councils (amongst other public entities) by two months. For councils, this moved the statutory deadline from 31 October to 31 December 2020. The statutory time frames were extended so that council staff and auditors could ensure that there was no reduction in the quality of financial and performance reporting because of the impact of Covid-19.

3.6 Five councils missed the revised deadline to complete and adopt their audited annual report.

3.7 There has been a 10% decline to 86% in the number of councils making their annual report publicly available within a month of adoption and a 10% decline to 82% in the number of councils releasing their summary annual reports within a month of adopting their annual report.

3.8 We consider that this is likely because the statutory deadline was extended until the end of December 2020. This meant that the deadlines for making the summary and the annual reports available often occurred during the holiday period.

3.9 Appendix 2 provides more detail on when councils adopted and publicly released their annual reports and summary annual reports.

The types of audit report we issued

3.10 At the end of December 2020 (the revised statutory deadline), audit reports had been issued on 73 councils' financial statements and performance information for the financial year ended 30 June 2020. All of the council audit reports issued included an emphasis of matter paragraph. We explain this in more detail in paragraph 3.14.

3.11 If a material aspect of a council's financial statements or performance information does not comply with accounting standards or the organisation cannot provide us with the evidence needed to support that information, we issue a "qualified audit opinion".[15]

3.12 We issued 21 qualified audit opinions on councils' financial statements and performance information. Many of the qualified audit opinions related to issues arising in the performance information reported by councils. We explain this in more detail in paragraphs 3.15-3.27.

Emphasis of matter paragraphs – impact of Covid-19

3.13 The World Health Organisation declared Covid-19 a pandemic on 11 March 2020. In response, we considered what effects the pandemic, including the potential economic impact and possible effects of the nationwide lockdown,[16] would have on public entities and their accountability documents. We determined that it would be prudent to refer to this in the audit reports that we issued for all public entities for the year ended 30 June 2020.

3.14 As a result, we included emphasis of matter paragraphs in all council audit reports[17] to draw attention to the relevant disclosures about the impact of Covid-19 that each entity made in its financial statements and performance information.

Qualified opinions – statement of service performance information

3.15 The statement of service performance contains important information about what a council achieved during the year. The performance that a council reports should tell a story about the services it delivers, why it delivers them, what standards it is looking to meet in delivering those services, and what difference it intends to make for the community it delivers services to.

15 For definitions of audit reports, see Office of the Auditor-General (2014), *The Kiwi guide to audit reports*.

16 On 21 March 2020, the New Zealand Government introduced a four-tiered alert-level system in response to Covid-19. On the 25 March, New Zealand moved into Alert Level 4 and a nationwide lockdown. A state of emergency was declared. More information on this timeline is available at www.covid19.govt.nz.

17 The Auckland Council audit report did not include an emphasis of matter paragraph in their audit report, as they are issued with a key audit matters opinion. However, the Auckland Council audit report still refers to the effects of Covid-19 and makes reference to the relevant disclosures where they are relevant to our key audit matters.

3.16 Good quality reporting, of both non-financial and financial information, allows informed consideration by readers – particularly those from the communities affected – about what is happening and what could be done better. Of the audit opinions we issued for the year ended 30 June 2020, 20 (27%) included qualifications on the council's non-financial information. For the 30 June 2019 financial year, we issued seven qualified opinions on non-financial information repeated in the statement of service performance.

3.17 Ten of the performance information qualifications were related to the measures that councils are required to report as set out in the Non-Financial Performance Measure Rules 2013 (the Rules) made by the Secretary for Local Government. This included measures that include the number of complaints (per 1,000 properties connected) received about:

- drinking water clarity, taste, odour, pressure or flow, continuity of supply, and the council's response to any of these issues;
- sewage odour, sewerage system faults and blockages, and the council's response to issues with the sewerage system; and
- the performance of the stormwater system.

3.18 The Department of Internal Affairs has issued guidance to help councils apply the Rules. This includes guidance on how to count complaints.

3.19 Our audits found that the 10 councils had not counted complaints in keeping with the Department of Internal Affairs' guidance. We also found that the method of counting these councils used was likely to have understated the actual number of complaints received in the current year and in comparative years.

3.20 In some cases, complete records were not available and auditors were unable to determine whether the councils' reported results for these performance measures were materially correct.

3.21 These measures are important because the number of complaints are indicative of the quality of services received by ratepayers as well as the scale of the issues that are the subject of the complaints.

3.22 Further, we also identified that four of those councils had deficient systems for classifying complaints against each of the three measures of water performance listed in paragraph 3.17.

3.23 Four of the qualifications on performance information related to councils who used information provided by Wellington Water Limited.[18] Auditors identified issues with the following performance measures:

- fault response times for water supply, wastewater, and stormwater; [19]
- number of dry weather sewerage overflows;[20]
- maintenance of the reticulation network – water supply;[21] and
- total number of complaints received.[22]

3.24 Wellington Water Limited was unable to provide reliable information for these performance measures for the following reasons:

- inaccurate inputs – for example, attendance and resolution times for fault service requests were not always recorded at the point in time that they occurred;
- system faults – for example, the system used to record dry weather sewerage overflows incorrectly included other events; and
- limited input information – for example, there were a limited number of water meters across the reticulation network to reliably report the water loss percentage for each shareholding council and the information was reported at a regional level.

3.25 For four statement of service performance qualifications, auditors found that the supporting evidence for the performance measures being reported was unreliable. The reasons for this varied, for example:

- For one council, the performance measures for its water supply and wastewater services were considered unreliable as a result of implementing a new customer service request system. The system was successfully implemented but this was six months after it was introduced, so the council was unable to provide accurate supporting evidence for the first six months of the financial year.
- One council received a qualification on its performance information for fault resolution times for water-related call outs. The data used to generate the results contained several irregularities, such as negative response and resolution times, and requests dated before the current year. The way the data was recorded meant that there was not sufficient evidence to support the measures.

18 Wellington Water Limited manages the water assets and services of six councils and provides performance information in respect of those services to all six councils, which are then required to report that information in their respective statements of service. The limitations in scope affecting the four council's that received qualifications were not considered significant in the other two council's because they did not report the same performance information because of how they deliver water services.

19 All four councils that received a qualification had an issue with this measure.

20 All four councils that received a qualification had an issue with this measure.

21 Three of the councils that received a qualification had an issue with this measure.

22 Three of the councils that received a qualification had an issue with this measure.

- One council received a qualification on its performance information for resource consent processing times in 2018/19. In this case, it was because auditors were unable to determine whether the council's comparative year information was materially correct for this performance measure. The council had resolved the issues with recorded consent processing times for the 2019/20 audit, but the limitation for comparative year data could not be resolved.
- One qualification on performance information was directly related to Covid-19. The measure was of customer satisfaction for public transport services. This is an important aspect of transport and urban development performance because it indicates the quality of the service provided. In this instance, a customer survey to determine passenger satisfaction levels could not be completed because of the nationwide lockdown. As a result, the council could not report on customer satisfaction.

3.26 The increase in the number of qualifications on council's non-financial information indicates that, increasingly, councils' performance systems are not robust or, in some cases, not fit for purpose, resulting in poor performance reporting. Communities want to know that the levels of service they are receiving for the rates they pay. This is a critical part of ensuring that the community can have trust and confidence in their council.

3.27 To produce reliable data, councils need robust performance management systems. Otherwise, it is difficult for a council to clearly understand its performance and where it needs to focus its finite resources to maintain the appropriate levels of service for its communities.

Other qualified opinions

Kaikōura District Council

3.28 Kaikōura District Council received a qualified opinion on both its financial and performance information.

3.29 Complexities created by the earthquake in November 2016 mean that Kaikōura District Council has continued to receive qualified audit opinions because of limitations and uncertainties supporting the value of certain assets reported in its financial statements.

3.30 In 2019, Kaikōura District Council was able to revalue its infrastructure assets and buildings. We were satisfied that the revalued carrying amount was fairly reflected at 30 June 2019 in the financial statements. However, we still issued a qualification on the financial information because there was a limitation relating to impairment and revaluation movements in the figures for the previous year. We were satisfied that property, plant, and equipment was appropriately accounted for in the year ended 30 June 2020.

3.31 We also issued a qualification on Kaikōura District Council's performance information because the Council does not have sufficiently reliable systems and processes to accurately report a number of performance measures. For just under half of the performance measures, the Council either was not able to report on any performance for the year or had reported performance as incomplete.

Taranaki Regional Council

3.32 We issued a qualification on Taranaki Regional Council's financial information because there were limited audit procedures that our auditor could adopt to independently confirm the reasonableness of the carrying value of earthquake-prone stands at Yarrow Stadium.

The effect of Covid-19 on our audits

3.33 Covid-19 significantly affected the way auditors completed their 2019/20 audits. There were also additional uncertainties and complexities that auditors needed to consider in carrying out their audit work. In many cases, this resulted in extra audit work and additional audit fees.

3.34 Our priority was to maintain the health and well-being of our staff while responding to Covid-19 and during the lockdowns in Alert Levels 3 and 4.

3.35 There were logistical impacts. For example, audit teams were required to work remotely in many cases and often at late notice, particularly as parts of the country moved in and out of alert levels. At times, this meant the audit work was not carried out as efficiently as it could have been and took longer to complete than would normally be the case.

3.36 Covid-19 also added uncertainty and complexity to our audit work, which increased the risk of material misstatement in financial statements. For example, the assumptions used in asset valuations, including investment properties, were more uncertain with a wider range of possible outcomes than in previous years.

3.37 Councils with investments in airports and other council-controlled organisations significantly affected by the disruption created by Covid-19 required additional audit work to gain assurance that the value of the investment was accounted for correctly and councils were making the appropriate level of disclosures in their annual reports.

4 Our work to support good governance and accountability in councils

4.1 For public organisations to operate effectively and achieve outcomes for their communities, it is essential that they have the public's trust and confidence. Factors that significantly influence the public's trust and confidence in councils include how well the councils carry out their governance and management responsibilities, how transparently they make their decisions, and the reliability of the information they use to make those decisions.

4.2 Elected members are responsible for what their council does and how it does it. They are obliged to make decisions on behalf of their communities in a robust and transparent way. Good governance also requires elected members to manage uncertainties and gain assurance that the council is identifying and appropriately managing organisational risks.

4.3 In this Part, we discuss the work we carried out during 2019/20 to support councils in achieving good governance, accountability, and transparency by:

- sharing insights about what "good" looks like;
- understanding how councils manage risk; and
- supporting councils' long-term plans (LTPs) for 2021-31.

4.4 We also discuss local government procurement and the Local Authorities (Members' Interests) Act 1968.

Sharing insights about what "good" looks like

Good practice guidance

4.5 We are in a unique position to identify and share examples of good practice to help public organisations to improve. One way we do this is by issuing good practice guidance.

4.6 We have recently updated our good practice guides about managing conflicts of interest and the Local Authorities (Members' Interest) Act 1968 (the Act). We have also updated our sensitive expenditure guidance.

4.7 We will next update our good practice guides on:

- charging fees for public sector goods and services; and
- audit and risk committees.

Workshops with elected members

4.8 We wrote to all council chief executives in July 2019 – and to all council mayors and chairs in October 2019, after the local authority elections – offering to run workshops with elected members. As of 31 January 2021, we had run 26 workshops, which have been attended by members of 35 councils.

4.9 Our sessions focused on:

- our work and the role of the Auditor-General;
- what conflicts of interest are and why they must be managed well;
- the foundations for maintaining trust and confidence – competence (getting things right), reliability (being consistent and timely), and integrity (doing the right things in the right way); and
- the benefit of having an effective audit and risk committee.

4.10 Alongside the workshops, we prepared a booklet: *Councillors' guide to the Auditor-General*. We also prepared three short videos about managing conflicts of interest, effective audit and risk committees, and maintaining trust and confidence.

Supporting effective council audit and risk committees

4.11 During 2019/20, we re-emphasised that we expect all local authorities to have an effective audit and risk committee. We also stressed that, in our view, committees having an independent member, ideally being the chairperson, supports such effectiveness.

4.12 We conveyed this message to all council chief executives, mayors, and chairpersons in our letters and to elected members at our workshops.

4.13 We are pleased to see that all councils now have an audit and risk committee. As of December 2020, 48 committees had an independent chairperson.

4.14 The focus of our work is now on supporting councils in improving the effectiveness of their committees. To do this, we are placing greater emphasis on our relationship with the chairpersons of committees.

4.15 We have run a series of workshops for committee chairpersons. We have covered Auckland Council's approach to considering the risks posed by Covid-19, how councils' audit and risk committees can support the process of preparing LTPs, and areas of audit focus for the 2021-31 LTPs.

4.16 We expect committees to provide assurance to elected members (and council management) that risk is being well-managed. We also expect committees to support the council in thinking longer term, beyond the issues and risks at hand.

This will help councils to maintain the trust and confidence of their communities while managing the uncharted risks that Covid-19 and other challenges, such as climate change, has exposed them to.

4.17 We plan on updating our good practice guides for audit and risk committees in 2021/22. We are also looking at the risk-management practices of councils and expect to report on these in 2021/22.

Understanding how councils manage risk

4.18 Identifying, understanding, and managing risk is a fundamental part of effective governance. We have been familiarising ourselves with councils' understanding of, and approaches to managing, risk.

4.19 We wanted to identify what would support councils to improve how they manage risk, including strengthening how audit and risk committees operate, where this is needed. This work will include us publishing case studies of four councils to share their good practice with other councils.

4.20 Because of the challenges faced by councils, the need for effective risk-management policies and practices is now more vital than ever.

Supporting councils' long-term plans for 2021-31

4.21 Councils' LTPs are a key mechanism for communities to hold their councils to account for what the councils say they will do.

4.22 The costs, risks, and other effects of Covid-19 have been important for councils to consider as they have prepared their 2021-31 LTPs.

4.23 Councils are also turning their mind to regulatory change – most significantly, the effects of proposed three waters and resource management reforms.

4.24 We worked with Taituarā – Local Government Professionals Aotearoa (formerly known as the Society of Local Government Managers) as it prepared good practice guidance on preparing LTPs. We also worked together on the following bulletins to help elected members engage in the LTP process:

- *Preparing for long-term plans;*
- *Financial and infrastructure strategies: The building blocks of your long-term plan;*
- *Good asset management (including information) to underpin your long-term plan;*
- *Assumptions underpinning your long-term plan;*
- *Covid-19 assumptions in your long-term plan;* and
- *What the audit report on your long-term plan consultation document means.*

Local government procurement

4.25 In May 2020, we wrote to all council chief executives about an article we had written about local government procurement. The article asked a series of questions to help councils think about whether their procurement processes and procedures are working effectively and whether they can be improved.

4.26 The questions cover:

- good governance for procurement;
- planning for significant capital projects;
- conflicts of interest;
- emergency procurement;
- procurement capability and capacity;
- procurement policies and training;
- contract management; and
- achieving broader outcomes through procurement.

Local Authorities (Members' Interests) Act 1968

4.27 The Act was designed to help protect the integrity of local government by ensuring that local authority members cannot take advantage of their official position for personal financial gain.

4.28 The Act has the following two main rules:

- Section 3 states that members cannot benefit from contracts with the local authority if more than $25,000 of payments are made under those contracts in any financial year. We refer to this as the contracting rule.
- Section 6 states that members cannot participate in matters before their local authority that they have a financial interest in, other than an interest in common with the public. We refer to this as the non-participation rule.

4.29 Although the principles underlying the Act are relatively simple, the detail of these rules and the various exemptions are complex. The Act is also out of date and the rules are not always easy to apply in a modern local government context.

4.30 However, local authorities and their members need to understand the Act, because breaching its rules can lead to a criminal conviction or disqualification from office. We have produced a plain English guide to help local authorities and elected members understand their responsibilities.[23]

4.31 An earlier edition of this guide covered non-financial interests and predetermination. However, the Act covers only the financial interests of

23 Office of the Auditor-General (2020), *Local Authorities (Members' Interests) Act 1968: A guide for members of local authorities on managing financial conflicts of interest.*

members. Because of this, our guidance about non-financial interests and predetermination is now in a separate guide: *Managing conflicts of interest: A guide for the public sector*.

4.32 That guide is intended for all public sector organisations, including local authorities. It covers other types of interests that might affect a member's ability to participate in their local authority's decision-making.

4.33 The Auditor-General has a special role under the Act. The Auditor-General can give prior approval and, in limited cases, retrospective approval for contracts that would otherwise disqualify the elected member. The Auditor-General can also give approval to a member to participate in local authority decision-making. We have a strong focus on providing guidance and assistance to help councillors and staff do the right thing rather than investigating potential breaches after the event.

4.34 During 2019/20, we considered six requests for approval to participate in local authority decision-making (section 6 of the Act). Four of these requests were from councillors at one council (see Part 5).

Managing conflicts of interest in regional councils

5

5.1 In this Part, we discuss the conflict of interest rules that apply to regional councils and some of the issues and challenges with managing conflicts of interest in regional councils.

5.2 Because regional councils have a regulatory role and many have elected members from the agricultural sector, managing conflicts of interest can be complicated. Some regional council members will be particularly affected by their council's regulatory and planning decisions.

5.3 We discussed these issues with several regional councils after the 2019 local government elections.[24] We also considered the following two specific situations where regional councils had to manage conflicts of interest:

- The first was about potential financial conflicts of interest. Four Otago regional councillors asked us for exemptions or declarations under the Local Authorities (Members' Interests) Act 1968 (the Act) so they could participate in significant water-related planning decisions in the region.
- The second was a request from a regional council for guidance on how to manage a potential conflict of roles for councillors appointed as directors of council-controlled organisations (CCOs).

5.4 Our responses to these requests could be of interest not just to regional councils but to all councils. We outline them below, as well as two examples from regional councils that we have considered previously and material from our existing guidance to illustrate and explain the main points. First, we briefly set out the rules on managing conflicts of interest that apply to regional councils.[25]

Conflict of interest rules that apply to regional councils

5.5 Effectively, two different legal regimes govern how regional councils manage conflicts of interest. Which regime applies to a particular conflict depends on whether the councillor's interest is financial or non-financial.

Financial interests

5.6 The Act regulates financial interests, and its rules are strict. They are based on the common law view that a person with a financial interest is presumed to be biased because of that interest.[26]

24 These discussions were at the post-election workshops discussed in Part 4.

25 For a more detailed explanation of these rules, which apply to all councils, see our two June 2020 publications *Local Authorities (Members' Interests) Act 1968: A guide for members of local authorities on managing financial conflicts of interest* and *Managing conflicts of interest: A guide for public entities.*

26 The Act does not define "financial interest". The test we use is whether, if the matter were dealt with in a particular way, discussing or voting on that matter could reasonably give rise to an expectation of a gain or loss of money for the councillor concerned.

5.7 The Act prohibits members of regional councils or committees of regional councils from discussing or voting on any matter that they have a financial interest in unless their interest is "in common with the public". (We discuss the meaning of "in common with the public" in paragraphs 5.11-5.18.)

5.8 A councillor can apply to the Auditor-General for an exemption from this rule or for a declaration that the rule does not apply in a particular instance. The Auditor-General may grant the exemption or declaration if they are satisfied that:

- the councillor's financial interest is so remote or insignificant that it would not reasonably be regarded as likely to influence their participation in the matter;[27]
- the council's business would be impeded if the councillor could not take part;[28] or
- it is in the public interest[29] for the councillor to participate despite their financial interest.[30]

Non-financial interests

5.9 Councillors' non-financial conflicts of interest, such as those created by a personal relationship or a role in another organisation, are governed by common law. There are no particular statutory rules, and the Auditor-General has no role in determining whether councillors can or cannot participate in matters that they have a non-financial interest in.

5.10 The test for whether a non-financial conflict of interest exists is whether an objective observer who knows the relevant facts would perceive the person to be biased because of that interest.

Financial interests – meaning of "interest in common with the public"

5.11 Councillors will often have financial interests in matters that council and committee meetings discuss and vote on. Councillors are members of the community who will be affected by some council decisions, such as those involving planning matters or rates.

5.12 As mentioned in paragraph 5.7, a councillor whose financial interest in a matter is "in common with the public" is not prohibited from discussing and voting on that matter.

27 Section 6(3)(f) of the Act, which applies to a request for an exemption.

28 Section 6(4) of the Act, which applies to a request for a declaration.

29 The Act expresses the public interest as "in the interests of the electors or inhabitants of the district of the local authority or of the area under its jurisdiction".

30 Section 6(4) of the Act.

5.13 We discuss how to determine whether a councillor's interest is "in common with the public" in Part 4 of our guide on the Act for elected members.[31] In summary, it depends on the following three components:

- the nature of the interest (such as the kind and extent of the interest);
- the size of the group who are also affected and whether that group is big enough to constitute "the public"; and
- whether the councillor's and the group's interests are affected in a similar way.

Environment Canterbury example

5.14 We considered the meaning of interest "in common with the public" in regional council decisions in our 2009 investigation into possible conflicts of interest by Environment Canterbury (ECAN) councillors. We considered whether the financial interests of four ECAN councillors in proposed changes to the way the Council charged for water related resource consents were "in common with the public". The proposed changes involved ECAN recovering more of its water-management costs from a group of resource consent holders, rather than from general rates.

5.15 The four councillors were potentially affected by the proposal because they or their spouse held relevant consents. They therefore had a financial interest in the decision to implement a new charging regime that had more emphasis on "user charges".

5.16 We considered whether the councillors' financial interests could be regarded as interests in common with the public. Many decisions about rating and charging, including targeted rates, are broad enough to be regarded as affecting the public generally, provided sufficient numbers of people are affected in the same way.

5.17 About 2.7% of ECAN ratepayers held consents that would be subject to the proposed water charges. We concluded that the interests of those consent holders were different in kind and extent from the interests of the general public (whose rates would slightly decrease because of the greater user charges), and that they formed a small and clearly identified subset of the rate-paying population.

5.18 We therefore found that the interests of the four councillors were not interests that could be regarded as interests "in common with the public", and they had breached the Act. We released a full report explaining our decision in December 2009.[32]

31 Office of the Auditor-General (2020), *Local Authorities (Members' Interests) Act 1968: A guide for members of local authorities on managing financial conflicts of interest*, paragraphs 4.35-4.44.

32 Office of the Auditor-General (2009), *Investigation into conflicts of interest of four councillors at Environment Canterbury.*

Application by Otago Regional Council for exemptions and declarations

Background

5.19 In February 2020, Otago Regional Council applied to us for exemptions and declarations under the Act. These would enable several councillors to take part in decisions about whether to notify two plan changes under the Resource Management Act 1991.

5.20 The plan changes were about freshwater management. They could have been financially significant to people who held certain historic permits to take water. The plan changes also included measures to improve water quality that would affect farmers and others in the agricultural sector. These measures included requirements to fence waterways (to exclude animals) and to obtain resource consents for intensive winter grazing.

5.21 Four of the regional councillors had possible financial interests in the proposed changes and applied to us for exemptions or declarations. They considered that, because the changes were significant planning decisions that were of high public interest in the region, all councillors should be able to participate in the process.

Criteria for granting an exemption or declaration

5.22 Our guidance sets out the criteria we use to determine whether to grant an exemption or declaration.[33] (Paragraph 5.8 sets out the statutory grounds for granting an exemption or declaration.)

5.23 For an exemption, we consider the nature and size of the financial interest and the relationship of the interest to the matter being decided. We need to assess whether the financial interest would influence the elected member when they discuss or vote on the matter. The test is an objective one. Ultimately, we must assess how significant the interest looks to an outside observer.

5.24 For a declaration on the "public interest" ground, we consider information from the councillor and the council on why the councillor's participation is important. Relevant factors could include:

- the matter being so significant to the community as a whole that it justifies the involvement of all members; or
- the member having particular expertise in the matter or an important link with people in a particular area, organisation, or community group whose views would not be adequately represented if the member could not take part.[34]

33 Office of the Auditor-General (2020), *Local Authorities (Members' Interests) Act 1968: A guide for elected members of local authorities on managing financial conflicts of interest*, paragraphs 4.45-4.65.

34 This can also be relevant to the "business impeded" ground.

5.25 For a declaration on the "business impeded" ground, we consider whether the quality of the council's decision-making would be affected if one or more members could not take part – for example, because there would be only a few members left to participate or a member has particular expertise that is not otherwise available.

How the criteria applied to the Otago regional councillors[35]

5.26 Based on the information provided by the councillors about their circumstances and financial interests, we:

- granted an exemption for one councillor to participate. We considered that his indirect financial interest in the plan changes was so remote and insignificant that it could not reasonably be regarded as likely to influence him in making decisions about them.
- declined to give declarations to enable two councillors to participate in the plan change matter related to entitlements to use water. Both councillors had a direct financial interest in the matter, and we did not consider that the criteria for the "public interest" ground had been met.

5.27 However, we found that those two councillors did not have a financial interest in the other plan change (related to water quality), so they did not need a declaration to participate in that matter.

5.28 We found that one councillor had no financial interest in either plan change and did not need an exemption or declaration.

The issue of representation

5.29 Two of the councillors argued that their background or involvement with communities that would be affected by the plan changes meant that they brought special skills and expertise to the debate.

5.30 They argued that they should be able to participate to contribute that expertise. They also argued that their respective constituents would not be adequately represented if they could not participate. Declaration requests often raise similar arguments about the need for a member to represent particular groups. In these situations, we consider whether the council can access the views of the people the member wishes to represent in other ways, such as in the submissions process or by receiving advice from council staff. It is important that we hear the council's views, not just those of the member concerned.

5.31 Members are required to act impartially in the interests of their whole district or region. They are not there to represent a particular group only, even if they are strongly associated with that group.

35 Office of the Auditor-General (2020), *Otago Regional Council: Applications for exemptions and declarations.*

Hawke's Bay Regional Council example

5.32 That said, representation can be a valid argument in some circumstances. In 2016, we gave a declaration to enable a councillor on the Hawke's Bay Regional Council to take part in decision-making on a proposed water storage and irrigation scheme. The councillor owned land that could benefit from the scheme in the future.

5.33 The councillor also had extensive expertise in the matter and represented the constituency that contained most affected landowners.[36] We considered that it was important that the councillor could represent her constituency in the matter.

5.34 We gave the declaration on the grounds that:

- the benefits of allowing the councillor to participate outweighed the risk that their financial interest could be seen to unduly influence the outcome; and
- the decision was especially significant for the local authority and region, warranting all members being involved.

Exemptions and declarations are only for financial interests

5.35 It is important to understand that, in some instances, the financial interest regulated by the Act might be only part of the issue. It might not even be the major risk.

5.36 The Act regulates only financial interests. It does not regulate more general conflicts of interest, such as those that arise from other roles that a councillor has or from their personal associations.

5.37 Under the Act, we can give exemptions and declarations only for financial interests. We are not empowered to give them for non-financial conflicts of interest or for predetermination – where a councillor has made strong statements that indicate that they have already made their mind up about a matter.

5.38 This means that an exemption or declaration to allow a member or members to participate despite a financial interest has no effect on their non-financial interests or predetermination. A council decision could still be challenged on those grounds.

Request for guidance on managing a conflict of roles

Background

5.39 We received a request from a regional council for guidance on how to manage potential conflicts for councillors who are appointed as directors of CCOs.

5.40 The council had appointed two councillors and the chief executive as directors of a council-controlled holding company that manages the council's investments. The

36 Office of the Auditor-General (2016), *Application for an exemption or a declaration by Cr Hewitt*.

council's policy was to have an equal number of councillors appointed as directors (including the chief executive, as appropriate) and independent directors on the Board of the holding company, assuming there were enough suitable candidates.

5.41 The councillors appointed as directors asked us to clarify their roles, including the balance between a director's responsibilities under the Companies Act 1993 and a councillor's duties under the Local Government Act 2002. The council asked us whether a declaration under the Act would be a way to manage any future conflicts for the councillors appointed as directors.

5.42 We told the council that we considered it more likely that any conflict of interest would come from a conflict of roles than from any financial interest in the matters under discussion. We said that, because we can make declarations under the Act only for financial interests (see paragraph 5.9), we could not make one in this situation.

5.43 We referred the council to relevant parts of our good practice guidance on managing non-financial conflicts of interest – in particular, those on how to manage a conflict of roles.[37]

When roles conflict

5.44 A conflict of roles or conflict of duties can happen when an official performs duties for two or more entities who have competing or incompatible interests or objectives. The issue with a conflict of roles is generally not that they have a personal conflict but that the interests of the entities they work for or represent conflict.

5.45 The conflict might exist in a general sense (for example, if one entity is responsible for regulating the activities of the other), or it might relate to a particular matter or transaction that both entities are involved in.

5.46 Officials who are responsible for making decisions on behalf of an entity are obliged to act fairly and impartially when making those decisions. They will generally also have other obligations to the entity, such as to protect and advance its interests and to not use or disclose confidential information.

5.47 If a person owes duties to more than one entity, and the interests of those entities coincide in some way, the risks are that the person:

- will not be able to make fair and impartial decisions in the interests of both entities at the same time; or
- in acting for one entity, will breach one or more of their obligations to the other entity, such as the obligation to hold certain information in confidence.

5.48 Conflicts are less likely to arise when the interests of the two entities are clearly "complementary" – for example, where one entity has been set up for the

37 Office of the Auditor-General (2020), *Managing conflicts of interest: A guide for the public sector.*

purposes of advancing the interests of the other. However, a person might still have conflicts in that situation, such as when one entity is making decisions about funding the other, its continued existence, or on a formal submission it has made.

5.49 Depending on the severity of the conflict, the person might have to withdraw from one or both sides of the transaction or take some other form of mitigating action to manage the conflict.

Our 2015 report on governance and accountability of council-controlled organisations

5.50 We also referred the council to our discussion of the pros and cons of appointing councillors as directors of CCOs in our 2015 report on governance and accountability of CCOs.[38] That report states our view that councillors should be appointed as directors only in exceptional circumstances. However, when they are appointed, an open and transparent process that uses the same appointment criteria as for independent directors should be followed.

5.51 The report also said:

> *We acknowledge the argument that elected members can make a contribution to CCO governance. We also recognise that councillor-directors may add value to a board by being a Council voice, by ensuring that the CCO's objectives are aligned to those of the local authority, and by providing a community perspective. However, a councillor-director must have the necessary skills and experience to contribute fully to the governance of the CCO.*
>
> *If a local authority appoints councillors to the boards of its subsidiaries to ensure that the CCO remains mindful of its shareholder's expectations, the councillor's presence on the board should not be a substitute for a formal system for monitoring and accountability. There are other, more transparent methods for the parent local authority to influence a CCO, such as the statement of intent process, a letter of expectations, the dividend policy, and approval of major transactions.*
>
> *In our view, effective monitoring and oversight, including setting clear expectations about the CCO's purpose and strategic alignment, should obviate any need for councillor-directors to provide an additional layer of oversight.*

38 Office of the Auditor-General (2015), *Governance and accountability of council-controlled organisations*, paragraphs 5.15-5.28.

Balancing duties as a councillor and a director of a council-controlled organisation

5.52 The council asked us about the balance between a councillor's duties as an elected member and a company director's duties under the Companies Act 1993. The following discussion summarises our response.

5.53 The main points from our guidance on managing conflicts of interest are that people with potentially conflicting roles as a councillor and a director of a CCO need to be:

- clear what their obligations to each role or organisation are;
- confident that both organisations have clear expectations about how to manage any conflicts and, if necessary, have a protocol that explains those expectations; and
- alert for situations where the interests of the two organisations might conflict, even if they generally do not.

5.54 We told the council that, under the Act, councillors:

- are required by their Oath of Office to act impartially in the best interests of their region;
- are bound by the Act for any conflict involving a financial interest (and by common law for any conflict involving a non-financial interest, including any conflict of roles); and
- must comply with any relevant requirements in the council's code of conduct, including any rules regulating how they may use or disclose information obtained during their work as an elected member.

5.55 Under the Companies Act, directors:

- are bound to act in the best interests of the company, unless there is a specific provision in the company's constitution that permits them to act in the interests of their holding company or appointing shareholder;
- must comply with the requirements for managing and disclosing conflicts of interest in sections 139 to 144 of the Companies Act; and
- must comply with the requirements for using or disclosing company information in section 145 of the Companies Act.

5.56 We told the council that, in their role as directors of the CCO, the councillors and the chief executive should not have any difficulty complying with these requirements, provided that the constitution of the CCO permits them to act in the interests of their holding company or parent entity (in this instance, the council).

5.57 Managing conflicts of interest under the Companies Act is based on transparency and disclosure. Directors disclose their interests in an interests register. This register focuses on financially beneficial transactions with other entities that the director is involved with.

5.58 Any conflict of those interests is discussed and managed at board level. It is not necessarily a barrier to the director participating in decisions about matters involving those interests.

5.59 Therefore, a director's "other role" as an elected member of the council would not generally prevent them participating in CCO decisions about matters that the council has an interest in.

5.60 However, it is more complicated for councillors in their role as elected members for two reasons. The first is that they are required to act impartially in the best interests of their region. The second is that common law governs how their non-financial conflicts of interest are managed, not the Companies Act.

5.61 The common law test for non-financial conflicts is whether an objective observer would perceive the councillor to be biased and not acting impartially because they are a director of the CCO.

5.62 In some instances, the councillors' participation in council decisions on regulatory matters could adversely affect the CCO. Their role as directors of the CCO could call into question their ability to participate in those decisions impartially.

5.63 In other instances, the councillors' conflict could be about particular transactions (such as when the CCO submits on, or appeals, a planning matter). The chief executive could also be conflicted for particular situations, such as when they need to advise the council on matters that the CCO has submitted on.

5.64 Our general advice was to remind the council that the councillors who are also directors need to consider on a case-by-case basis how their involvement in matters concerning the CCO would be perceived. They also need to consider whether their involvement in council decision-making could create a legal or reputational risk to the council.

5.65 Part of managing conflicts well is being open and transparent. If a council decision could adversely affect the CCO, the councillors who are also directors should declare that conflict and decide whether it precludes them from being involved in the council's decision.

General comments on the legislation governing conflicts of interest in local government

5.66 We are aware that our decisions about the Otago regional councillors in 2020 caused some concern in the sector. We received a preliminary request for guidance from another regional council that was involved in water-related plan changes and also had farmers on the council.

5.67 That council was keen to understand our approach to the representation issue (which we discussed in paragraphs 5.29-5.31). It also wanted clarification about when a financial interest in a matter might materialise.[39]

5.68 We have previously said that the rules for managing conflicts of interest in the local government sector are generally out of step with the approach other sectors take – for example, under the Crown Entities Act 2004.[40]

5.69 The legislation governing conflicts of interest for other sectors generally covers both financial and non-financial conflicts of interest. Under these regimes, an assessment of whether the interest is "material" is made.

5.70 The legislation might set out requirements for declaring interests. Sometimes, it will even specify rules on whether a person can participate in decisions they have an interest in. However, these rules are left to the entity to manage and administer. It is very unusual for an independent third party such as the Auditor-General to make final decisions on who can and cannot participate.

5.71 Finally, under these regimes, failure to follow the requirements might result in breaches of duty to the organisation or political accountability of some kind. However, unlike the Act, they do not involve a possible criminal sanction.

5.72 We will continue to advocate for a review of the Act and the rules governing how the local government sector manages conflicts of interest. We will encourage that review to consider whether:

- the regime for managing conflicts of interest for members of local authorities should cover both financial and non-financial conflicts;
- it remains appropriate for breaches of the Act to have a criminal sanction; and
- there is a need for an independent decision-maker to determine whether someone with a conflict can or cannot participate in council decisions and, if so, who that party should be.

5.73 This reconsideration could fit within a review of the governance provisions in the Local Government Act 2002 or of the role of the Local Government Commission.

39 Office of the Auditor-General (2020), *Local Authorities (Members' Interests) Act 1968: A guide for elected members of local authorities on managing financial conflicts of interest*, paragraphs 4.28-4.34.

40 Our most detailed report was in 2005, *The Local Authorities (Members' Interests) Act 1968: Issues and options for reform*.

Appendix 1
Sub-sectors and the high-growth councils

Sub-sectors

Local Government New Zealand defines four types of sub-sector:[41]

- metropolitan;
- provincial;
- rural; and
- regional (comprising regional councils and unitary authorities).

We followed these definitions but considered Auckland Council as its own sub-sector separate to the other metropolitan councils because of its size. For the purposes of our analysis, we have grouped the unitary authorities in their respective provincial or rural sub-sectors. The councils that make up each sub-sector are listed below.

Auckland sub-sector
Auckland Council

Metropolitan sub-sector		
Christchurch City Council	Dunedin City Council	Hamilton City Council
Hutt City Council	Queenstown Lakes District Council	Palmerston North City Council
Porirua City Council	Tauranga City Council	Upper Hutt City Council
Wellington City Council	Whangārei District Council	

Provincial sub-sector		
Ashburton District Council	Central Otago District Council	Far North District Council
Gisborne District Council	Hastings District Council	Horowhenua District Council
Invercargill City Council	Kaipara District Council	Kāpiti Coast District Council
Manawatu District Council	Marlborough District Council	Masterton District Council
Matamata-Piako District Council	Napier City Council	Nelson City Council
New Plymouth District Council	Rotorua Lakes Council	Selwyn District Council
South Taranaki District Council	South Waikato District Council	Southland District Council
Tasman District Council	Taupō District Council	Thames-Coromandel District Council
Timaru District Council	Waikato District Council	Waimakariri District Council
Waipa District Council	Waitaki District Council	Western Bay of Plenty District Council
Whanganui District Council	Whakatāne District Council	

41 For more on the sector groups, see www.lgnz.nz.

Rural sub-sector		
Buller District Council	Carterton District Council	Central Hawke's Bay District Council
Chatham Islands Council	Clutha District Council	Gore District Council
Grey District Council	Hauraki District Council	Hurunui District Council
Kaikōura District Council	Kawerau District Council	Mackenzie District Council
Ōpōtiki District Council	Ōtorohanga District Council	Rangitikei District Council
Ruapehu District Council	South Wairarapa District Council	Stratford District Council
Tararua District Council	Waimate District Council	Wairoa District Council
Waitomo District Council	Westland District Council	

Regional sub-sector		
Bay of Plenty Regional Council	Environment Canterbury	Environment Southland
Greater Wellington Regional Council	Hawke's Bay Regional Council	Horizons Regional Council
Northland Regional Council	Otago Regional Council	Taranaki Regional Council
Waikato Regional Council	West Coast Regional Council	

High-growth councils

High-growth councils are those councils categorised as such under the National Policy Statement on Urban Development Capacity 2016.[42] We note that the National Policy Statement on Urban Development 2020 came into effect on 20 August 2020. It replaced the National Policy Statement on Urban Development Capacity 2016. The new policy statement might mean that different councils are defined as high growth from 2020/21 onwards. However, the old policy statement still applied for the 2019/20 year we are looking at in this report.

We did not include regional councils because none had high growth throughout their entire region. Councils categorised as high-growth when we prepared this report were:

- Auckland Council;
- Christchurch City Council;
- Hamilton City Council;
- New Plymouth District Council;
- Queenstown Lakes District Council;
- Selwyn District Council;
- Tauranga City Council;
- Waikato District Council;
- Waimakariri District Council;
- Waipa District Council;
- Western Bay of Plenty District Council; and
- Whangārei District Council.

42 For more on the National Policy Statement on Urban Development Capacity 2016, see www.hud.govt.nz.

Appendix 2
When councils adopted their annual reports and released their annual reports and summary annual reports

When councils adopted their annual reports

When the annual report was adopted	Number adopted for financial year				
	2015/16	2016/17	2017/18	2018/19	2019/20
Within two months after the end of the financial year	0	0	0	0	0
Between two and three months after the end of the financial year	27	15	15	20	6
Between three and four months after the end of the financial year	49	60	56	54	16
Between four and five months after the end of the financial year*	-	-	-	-	13
More than five months after the end of the financial year*	-	-	-	-	38
Subtotal: Number meeting statutory deadline	**76**	**75**	**71**	**74**	**73**
Percentage of councils meeting statutory deadline	*97%*	*96%*	*91%*	*95%*	*94%*
Between four and five months after the end of the financial year	0	2	3	3	0
More than five months after the end of the financial year	1	1	2	1	0
Not issued as at the date of compilation	1	0	2	0	5
Total	**78**	**78**	**78**	**78**	**78**

* Because of Covid-19, Parliament passed legislation on 5 August 2020 to extend the statutory reporting time frames for local authorities (among other public entities) by two months. For local authorities, their statutory deadlines moved from 31 October to 31 December 2020. The statutory time frames were extended to ensure that there was no reduction in the quality of financial and performance reporting because of the impact of Covid-19. In 2019/20, five councils missed the revised deadline to complete and adopt their audited annual report by 31 December 2020.

When councils released their annual reports

Time after adopting annual report	Number released for financial year				
	2015/16	2016/17	2017/18	2018/19	2019/20
0-5 days	28	23	27	34	31
6-10 days	15	19	11	13	9
11-20 days	14	8	16	11	12
21 days to one month	17	22	22	17	16
Subtotal: Number meeting statutory deadline	**74**	**72**	**76**	**75**	**68**
Percentage of councils meeting statutory deadline	*95%*	*92%*	*97%*	*96%*	*86%*
Number not meeting the deadline	3	6	0	3	5
Not issued as at the date of compilation	1	0	2	0	5
Total	**78**	**78**	**78**	**78**	**78**

When councils released their summary annual reports

Time after adopting annual report	Number released for financial year				
	2015/16	2016/17	2017/18	2018/19	2019/20
0-5 days	16	7	15	14	16
6-10 days	14	15	11	8	11
11-20 days	11	11	10	14	9
21 days to one month	29	32	37	36	28
Subtotal: Number meeting statutory deadline	**70**	**65**	**73**	**72**	**64**
Percentage of councils meeting statutory deadline	*90%*	*83%*	*94%*	*92%*	*82%*
One month to 40 days	6	9	2	6	7
41-60 days	1	4	1	0	2
More than 60 days	0	0	0	0	0
Not issued as at the date of compilation	1	0	2	0	5
Total	**78**	**78**	**78**	**78**	**78**

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