

Joint Treasury/Office of the Controller and Auditor-General Report to FEC: Application of the Public Audit Bill to Community and Energy Trusts

Introduction

The Committee has sought information about how the Public Audit Bill applies to various types of community trusts.

This paper shows how the Bill brings trusts (in general) under the Auditor-General's mandate, and then discusses:

- community trusts which hold ex-trustee bank funds ("trustee bank community trusts"); and
- trusts which hold shares in energy companies ("energy trusts").

How Do Trusts Come Under The Auditor-General's Mandate?

Trusts can come under the Auditor-General's mandate in one of three ways:

(a) As a class of public entity included in Schedule 1

Schedule 1 of the Bill sets out *classes* of entity that are "public entities" for the purposes of the Auditor-General's mandate.

The schedule contains several classes of trust. Examples are:

- licensing trusts;
- Maori Trust Boards; and
- community trusts established under section 225D of the Local Government Act 1974 ("section 225D trusts").

Neither trustee bank community trusts nor energy trusts are included: see further discussion below.

Section 225D trusts are the only ones that need explanation here. They are trusts which local authorities can establish to receive any part of the proceeds of sale of their shares in a port company or a LATE (local authority trading enterprise).

The trust deed of a section 225D trust is prepared by the local authority, and approved by the Minister of Local Government. Its property is held in trust to be applied for purposes beneficial to the community.

Currently there is only one section 225D trust: the Northland Regional Community Trust.

(b) As a public entity listed in Schedule 2

Schedule 2 is a list of public entities that do not fall into any of the classes listed in Schedule 1. Examples of trusts listed in Schedule 2 are:

- Canterbury Museum Trust Board;
- Maori Soldiers Trust;
- Queen Elizabeth II National Trust; and the
- Winston Churchill Memorial Trust.

Newly formed trusts can be added to the schedule either by their establishing legislation (if there is any) or by Order in Council (see clause 44(a) of the Bill).

(c) Through the “control” test in clause 5

Clause 5(1)(f) of the Bill makes an entity subject to the Auditor-General’s mandate if it is “controlled” by one or more of:

- the Crown;
- an Office of Parliament;
- an entity of a class listed in Schedule 1;
- an entity listed in Schedule 2; or
- an entity in respect of which the Auditor-General is the auditor under an enactment.

The “control” test is in clause 5(2). In practice, it will cover three broad types of trusts:

- non-statutory trusts established by the Crown;
- trusts established by statutory bodies, in exercise of their statutory powers; and
- trusts established by local authorities.

The coverage of these trusts under existing law is very uneven. Under the Bill, most will be caught by the “control” test and therefore be “public entities”.

Trustee Bank Community Trusts

These trusts were set up by the Crown under the Trustee Banks Restructuring Act 1988. Their purpose was to:

- hold shares in the reconstituted trustee banks; and
- apply property vested in them for purposes beneficial to their communities.

The Minister of Finance appointed the first trustees of each trust. Thereafter, trustees were appointed in the manner set out in each trust deed. Trustee bank community trusts are now covered by the Community Trusts Act 1999. The appointment of trustees is still covered by each trust deed. However, under section 6 of the Act the Governor-General has power to remove a trustee in certain circumstances (e.g., disability, or acting in a manner prejudicial to the trust).

The Community Trusts Act is silent on the audit arrangements for the trusts. However, the “control” test in the Public Audit Bill will make the Auditor-General the auditor if the trust deed enables the Crown to control the composition of the trust board: see clause 5(2)(c). If the Committee wanted to ensure that all Trustee Bank Community Trusts were subject to the Auditor-General’s mandate this could be done by including them into Schedule 1 as a class of public entity.

Energy Trusts

Energy trusts are entities that were formed to hold shares in energy companies, on behalf of the public, under the Energy Companies Act 1992. The Act required each energy authority to prepare an establishment plan for approval by the Minister of Energy. Each plan had to identify any “person” to whom voting equity securities in an energy company would be allocated.

Several plans provided for the creation of a community trust for this purpose. These trusts have become known as energy trusts.

The Audit Office is not currently the auditor of energy trusts. The Bill as introduced does not change this.

The origin of the Bill’s policy is the 1998 FEC report, *Inquiry into Audit Office Legislation* (I. 3E, pages 7-8). The report adopted the principle that, as a general rule, Parliament should appoint the auditor of non-Crown public sector organisations where:

- no practicable alternative exists for the community and other stakeholders of these entities to appoint an independent auditor; or
- the entities exercise some form of coercive or other significant power conferred by Parliament.

The Auditor-General had expressed the view to the FEC that energy trusts fitted these principles.¹ However, the FEC disagreed, and said in its report that “it is not Parliament’s business to set up the accountability arrangements for these trusts, as they are no different from any other trust in which a geographic community has an interest”. In its response to FEC’s report the then Government noted that “community trusts holding shares in energy companies fall outside the scope of parliamentary responsibility, and hence outside the proper scope of the Auditor-General’s mandate”.

The recent *Report of the Ministerial Inquiry into the Electricity Industry* has taken a different position. The inquiry considered that there was a need to strengthen the accountability arrangements relating to the trusts and recommended that:

the government legislate to require distribution companies that are majority owned by trusts to be subject to:

- the Local Government Official Information and Meetings Act [1987];
- the Public Finance Act [1977]²; and
- the Ombudsman [sic] Act [1975].³

The Officials’ report responding to the Ministerial Inquiry recommended that Ministers:

- rescind the prior Cabinet decision and agree that electricity trusts and trust-like entities should be included in the classes of the entity of which the Auditor-General is the auditor;
- agree to promote an amendment to the Public Audit Bill to require electricity distribution and retail/generation trusts and trust-like entities to produce annual financial statements that are to be publicly available, to be included in the Audit Bill, and to be audited by the Audit Office.

The primary argument for including the energy trusts within the Auditor-General’s mandate was recognition that exposing the Trusts to public audit offered a pragmatic solution to the perceived problem that the accountability arrangements supporting the Trusts were deficient.

Expanding the mandate to cover such trusts increases the Crown’s risks of legal liability to parties that might act on reliance upon an audit report. The risk, however does not appear large in comparison to the benefits of brining the Trusts within the mandate.

¹ See also the First Report of the Controller and Auditor-General for 1998 (B.29 98a), page 133.

² Reference to the Public Finance Act 1977 connotes the inquiry’s preference that ‘energy’ trusts be subject to public audit.

³ See Main Recommendations, recommendation m; chapter 7. It appears, from the context of the report, that the Committee intended to refer at this point to energy trusts themselves, rather than the companies which they own.

Treasury advises that the committee consider including 'energy-trusts' in the appropriate Schedule of the Bill.