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Dear Mayor

Report: Review of the processes followed by Hamilton City Council in relation to the V8 Supercars Event

1 Introduction

Further to our proposal to you dated 26 January 2011 and your acceptance dated 25 February 2011, Audit New Zealand was engaged to undertake a review of the processes followed by Hamilton City Council (HCC) in bringing the V8 Supercar event to Hamilton. We now submit our report for this review.

Some concern had been expressed within Council about whether the processes that had been followed and the information that had been made available to Council with respect to the V8 race event had been appropriate. A range of difficulties has arisen with the event. In particular there has been a significant overall increase in cost to the Council for hosting the event. As a consequence of its concerns Council sought an independent review of these matters.

We wish to note that Council commissioned this review itself. In doing so the Council wished to understand what had occurred with the V8 event and to take from that understanding any lessons that could be learned and applied to future projects. We commend the Council for being prepared to commission this review.

2 Background

HCC entered into a contract with Caleta Streetrace Management Limited (CSM) to promote and support an annual V8 Supercar street race event for a period of seven years. Track infrastructure was constructed during 2007 and the first race event occurred in April 2008. The first event was not financially successful resulting in losses for the Promoter (CSM). HCC incurred additional costs in constructing the track and received lower than expected revenue. The subsequent race events in 2009 and 2010 also incurred losses for the Promoter and generated no revenues for HCC. By early 2010 CSM was experiencing severe financial difficulties. Through negotiations between the parties in April 2010 it was agreed the event contract would be novated to an Australian company, V8 Supercars Australia Pty Limited (V8SC) which runs many of the other V8 Supercar Championship events in other locations. V8SC is the principal promoter of the V8 event. It had contracted CSM to run the New Zealand event. When novating the event contract to V8SC in April/May 2010 the

Council also agreed a conditional commitment to the event until 2017. A further race event has taken place in April 2011 with V8SC as the Promoter.

At the time of our review the V8 event had already had a seven year history in terms of HCC's interest and involvement in it. HCC's initial interest in the event occurred in 2004 although the first race did not occur until 2008. This long history has presented some challenges for the review because of the need to locate relevant documentation produced over a long period of time and the difficulties in achieving accurate recall of matters by those we interviewed. We also had to take into account the changes in staffing and elected membership that have occurred which have resulted in some loss of knowledge of the matters we have considered. We cannot be entirely confident that we have located all the information that may be relevant to this review. However, we believe we have obtained sufficient information to reach the findings and conclusions set out in this report.

3 Scope of the review

Council sought a review of the decision making processes for the V8 Supercar event so as to determine:

- Whether sound and prudent governance and management processes, have been applied to the decisions made; and
- In terms of timeliness and appropriateness of information, how well Council was advised and kept informed on the matters it had to make decisions on including the original decision and subsequent variations.

In undertaking the review we considered:

- Whether the accountability, governance and management processes that have been followed are consistent with expectations and recognised good practice in the public sector.
- Whether applicable Council policies have been complied with.
- Whether the reporting to Council was adequate.
- What lessons could be learned from the Council's experience with this event.
- What recommendations should be made arising from this review.

The agreed scope of this review also included the following matters which we comment on in italics below:

- Any other scope that may be agreed with the Council for this review.
We did not agree any change to the scope of the review.
- To what extent this report should remain confidential to the Council.
We prepared this report on the presumption that it will be available for public release.

4 The work that has been undertaken

In the course of this engagement:

- We reviewed a large amount of documentation sourced from HCC's records system, both hard copy and electronic, and from staff files. We made multiple requests for information as we became aware of its likely existence. Council staff made strenuous efforts to find the documentation that we were seeking. We are satisfied that the documentation that we became aware of has been made available.
- We interviewed 12 current elected members and the current Mayor, two former elected members, a former Mayor, five current staff members and a former staff member and a former Chief Executive, Tony Marryatt. Some staff were interviewed on several occasions. We have listed the interviews that were undertaken in **Appendix 1** to this report.
- We were initially unable to arrange an interview with another former Chief Executive, Michael Redman as a consequence of some disagreement between HCC and Mr Redman over his access to confidential documentation. However, we eventually met with Mr Redman on 8 September 2011 to discuss our draft report. Mr Redman also provided a written response to our draft report. Mr Redman was provided with a further draft of the report for review on 14 October 2011 but he did not provide any further comments on the substance of the draft report.
- Initially we provided the current Mayor with reports on the progress of the review work. However, when Mr Harris commenced his appointment as Chief Executive we provided our progress reports to him. Neither the Mayor nor the current Chief Executive provided any direction on the findings of our review work.
- We prepared a draft report.
- In accordance with our normal clearance process for reviews of this nature we provided several parties potentially affected by the report with an opportunity to comment on it. Former Mayor Bob Simcock, former Chief Executives Michael Redman (as noted above) and Tony Marryatt, and the Deputy Chief Executive, Blair Bowcott were provided with a copy of the draft report and invited to provide comments. They all did so.
- HCC's legal advisors viewed the draft report immediately prior to its finalisation and provided some limited feedback principally in respect of some commercial in confidence matters arising from the contracts between HCC and the Promoters of the race event.
- We finalised our report and presented it to Council on 27 October 2011.

5 Basis on which our assurance is provided

During this engagement, our work has been undertaken on the basis that HCC:

- Ensured that we received all information that we requested or that was available and relevant to our engagement where it was under the control of HCC.

- Advised us of any circumstances that arose prior to or during the course of our work that may have been material to and significant in relation to our work.

Audit New Zealand is a business unit of the Controller and Auditor-General. Our assurance service was provided in accordance with Section 17 of the Public Audit Act 2001 and the standard terms attached to our letter of engagement.

6 What the review has not included

In reporting on this review we believe it is important to record from the outset that our work has not involved a review of the appropriateness of the decision to host the V8 race event. Our report should not be taken to imply that the V8 race event should or should not have occurred. Our work has been focussed on a review of management and governance processes related to the event.

The success or otherwise of the event depends on a number of factors such as economic benefit to the region, the costs of hosting it, support from the community and elected members and environmental effects. We understand that several economic benefit assessments over the last five years have identified significant benefit to the region from each race event. The decision on whether the event should have been hosted or any decision as to whether it should continue to be hosted in the future are matters that rightfully lie with the Council.

We undertook some work to review the financial position for the event. However, our work was not a full financial audit or review. We undertook sufficient work to gain an understanding of the cost position and to determine whether the reporting of costs to Council had been adequate. There were also some processes attached to matters of cost that we needed to clarify.

7 Public sector expectations

There was a range of authoritative and good practice guidance available to us for this review. This information provided a benchmark for the expectations of a public sector organisation in managing an event such as the V8 Supercar event. Some of the published guidance that we used included:

- “Public sector purchases, grants and gifts: Managing funding arrangements with external parties” produced by the Office of the Auditor-General.
- “Procurement guidance for public entities” produced by the Office of the Auditor-General.
- “Turning principles into action: A guide for local authorities on decision making and consultation” produced by the Office of the Auditor-General.
- The Local Government Act 2002.
- The Council’s own policies and procedures.

We have also developed an extensive knowledge and experience base from our audit and review work across the local government sector.

8 Terms used in the report

In this report we have referred to a number of people, organisations, and inter-related companies. For the sake of clarity we explain these references as follows:

- Where we have referred to “Council” this is a reference to the body of elected representatives. On occasions we have also referred to “Councillors”. The V8 race event has occurred through three terms of “Council” (2006 to 2011). The present Council includes elected members who were not part of the earlier Councils. Consequently our references in this report to Council need to be interpreted with some care.
- Where we refer to “Hamilton City Council” or “HCC” we are referring to the entity or organisation consisting of elected representatives and staff.
- HCC contracted with Caleta Streetrace Management Ltd (CSM) as Promoter for the event and Caleta Asset Management Ltd (CAM) which held a lease for the pit lane structure and initially owned some track infrastructure. Unless otherwise indicated, CSM and CAM have been referred to collectively as CSM. The principal shareholders for both CSM and CAM were the same – Dean Calvert and Stephen Vuleta. Both companies are now in liquidation.
- HCC also contracted with Elephant Management Company Ltd (EMC) on 4 January 2007 for design services for the track infrastructure. Stephen Vuleta was the principal of EMC. EMC received payment of approximately \$150,000 for services provided during 2007.
- Following the demise of CSM as Promoter, HCC entered into agreements with V8 Supercars Events Pty Ltd (V8SE) to promote the event and with V8 Supercars Australia Pty Ltd (V8SA) in respect of some compensation arrangements associated with the event. V8SE and V8SA are related companies. Unless otherwise indicated, V8SE and V8SA have been referred to collectively as V8 Supercars (V8SC).
- Three Mayors have been elected to Council during the term of the V8 race event. Michael Redman was Mayor from 2004 until May 2007 when he resigned to become Chief Executive. Bob Simcock who had been Deputy Mayor then became Mayor from May 2007 until October 2010. Julie Hardaker was elected as Mayor in October 2010. Each reference in this report to “Mayor” is specific as to who we are referring to.
- Five Chief Executives have been appointed by the Council through the term of the V8 race event. Tony Marryatt was Chief Executive during the period that HCC committed to hosting the V8 race event. He left Council’s employment in May 2007 before the contract with CSM was approved by Council (October 2007) and well before the first race event in April 2008. Graeme Fleming was appointed as Acting Chief Executive for two months from the time of Tony Marryatt’s departure until Michael Redman became Chief Executive. Michael Redman stood down as Mayor of HCC in May 2007 and became Chief Executive in July 2007. He resigned in October 2010. Blair Bowcott, Deputy Chief Executive was appointed as Acting Chief Executive during the period from October 2010 until April 2011. Barry Harris commenced as Chief Executive in April 2011 and is the current Chief Executive. Unless it is quite obvious each reference in this report to “Chief Executive” is specific as to who we are referring to.

9 Executive summary

Audit New Zealand was engaged to undertake a review of the processes followed by Hamilton City Council (HCC) in bringing the V8 Supercar event to Hamilton. In reporting on this review we believe it is important to record from the outset that our work has not involved a review of the appropriateness of the decision to host the race event. Our report should not be taken to imply that the V8 race event should or should not have occurred. Our work has been focussed on a review of management and governance processes related to the event.

HCC entered into a contract with Caleta Stretrace Management Limited (CSM) to promote and support an annual V8 Supercar street race event for a period of seven years. The first race event occurred in April 2008. In early 2010 CSM experienced severe financial difficulties. Through negotiations between the parties in April 2010 it was agreed the event contract would be novated to V8 Supercars Australia Pty Limited (V8SC).

We summarise our review findings as follows:

- 1 The earliest communication we could identify concerning the potential for HCC to host the V8 Supercar event was an e mail dated 24 November 2004 between a HCC staff member and the Mayor at that time.
- 2 On or about 7 February 2006 a one page high level agreement was entered into by HCC and Capital Stretrace Management (later known as Caleta Stretrace Management) with each party committing to the race event. The high level commitment was not in itself the contract for the promotion of the event – that came later. Council confirmed its commitment to the race as part of the 2006 – 16 LTCCP.
- 3 The opportunity to host the event had been known to a select group within HCC over a period of 15 months leading up to a surprise announcement to Councillors on 8 February 2006. The competing interests of Auckland and Wellington were no doubt a factor in the need for confidentiality. We believe that there was a need for greater transparency with the governance group about this event opportunity as it was developing particularly through late 2005 and early 2006 when the opportunity for Hamilton to host the event was becoming more likely. The approach taken with respect to the announcement being a surprise to most Councillors does not sit well with the general principles and expectations of the Local Government Act 2002.
- 4 We have not located any proper business case assessment for the V8 event opportunity neither before Council’s informal commitment in February 2006 nor before its commitment through the June 2006 LTCCP nor since. We believe that making a commitment to a major event and significant expenditure without undertaking a full business case assessment was a serious oversight by HCC.
- 5 Full due diligence of the proposed Promoter was not undertaken as part of HCC’s consideration of a contract with CSM. In our view this was a further serious oversight by HCC. We found that there was some evidence that CSM had financial difficulties before the contract was signed but HCC does not appear to have recognised this. Mr Redman advised us that HCC had negotiated “step in” rights with V8SC and therefore the absence of full due diligence was not critical. However, we did not find evidence of any agreement between HCC and V8SC with respect to “step in” rights.
- 6 While the task to construct the track infrastructure was recognised within Council as a project, the event itself over its seven year duration was not recognised as a project. In our view this was a mistake. The application of project management disciplines to

the full event project would have seen a much more robust approach being taken to defining responsibilities and managing matters such as cost estimating, expenditure, funding, risk management, monitoring and reporting.

- 7 The V8 race event in its entirety was a significant project for Council. However the decision on the award of a contract to CSM to promote the event was made by a small Subcommittee of Council. We suggest that for all significant matters (significance being assessed in terms of value, risk, time, public interest etc) it may be more appropriate for the key decisions and related monitoring and reporting to be referred to the whole of Council or a substantial committee of Council.
- 8 When the Contracts Subcommittee made its decision in October 2007 to enter into a contract with CSM for the race event it did so without reference to either the proposed contract or the terms of that contract. The Subcommittee's decision was not "in principle" nor was it qualified in any way nor did the Subcommittee require any reference back to it on the final terms of the contract. Management provided advice that the proposed contract had received a legal review but the contract was further changed over the following six months up to the time at which it was signed. It is not clear to us how the Subcommittee assured itself that the contract that was eventually signed was acceptable.
- 9 The Contracts Subcommittee membership included the Chief Executive. As Chief Executive, Mr Redman participated in the decision to award the contract to CSM in October 2007. There is a need for management to be objective and to be perceived to be so in the advice it provides to Council. Mr Redman's earlier role with Council as Mayor and his strong advocacy for the race event raises questions about whether he should have been involved in making the decision in this instance if for no other reason than the perceptions that can exist.
- 10 A common outcome of the democratic process is that a Council or one of its committees may not have all the specialist skills or sufficient people with those skills that may be necessary to consider some of the technical matters put in front of it. Obviously the elected representatives place some reliance on the Chief Executive and his/her management team to assist on those matters. That is appropriate. However, another option Council has is to consider engaging an expert advisor to assist the Council or its committees with independent advice.
- 11 The sub project that was established to build the track infrastructure and the work that was undertaken to obtain a resource consent for the event appears to have been well managed by HCC.
- 12 The total cost to develop the track infrastructure was about \$18 million which was well in excess of the \$7 million estimate provided by CSM and upon which Council committed to the event in June 2006. Well before the first race event and well before the formal contract was signed with CSM it was evident to management that costs would significantly exceed the original estimates.
- 13 At the heart of the request for this review was concern by the current Council about the costs of the V8 event. The time and effort required by us and by HCC to respond to our information requests about costs was a clear indicator to us that the financial management and reporting of the event had not been adequate.
- 14 We found that HCC expenditure on the V8 event to December 2010 was in excess of \$37 million. This \$37 million cost is greater than the overall cost reported to Council

confidentially at its meeting on 13 December 2010. \$2.15 million of the additional cost relates to the CSM and CAM debt which is made up of lease payments and other revenue that was not received. Some of this debt was not properly reported to Council at the time it arose and some has not been reported at all.

- 15 Revenue received by HCC from CSM for the 2008 and 2009 events was \$1.525 million which reduces the overall total cost of the event as at December 2010 and in respect of the 2008, 2009 and 2010 race events to **\$35,935,700**.
- 16 Some of this cost (\$2.294 million) was expenditure incurred for lighting, fencing and park upgrade work as a consequence of the effect of the race event on the Waikato Stadium No 2 ground. We have not attempted to resolve the differing views with current and former Councillors and staff about what proportion of this expenditure rightfully belongs to the V8 event. We simply say that expenditure that is a direct consequence of the event should be included in the project cost. However, expenditure that would have been incurred at a later date regardless of the event, does not need to be included.
- 17 HCC funding for the V8 event has been drawn from a number of sources including the CBD Upgrade budget, the Events Sponsorship Fund and through the use of a reserve (the V8 Reserve). Revenues received by HCC from the 2008 and 2009 race events totalling \$1,525,000 were applied to the V8 reserve to reduce its debit balance. This reserve had a significant debit balance of \$14.322 million as at 30 June 2011.
- 18 In our view the multiple sources of funding for this event diminished the transparency of the funding arrangements. The arrangements also increased the complexity of reporting on the overall funding requirements for the event. A single budget or source for the funding would have been more appropriate for a project of this nature.
- 19 Given the Council's decision in October 2011 not to continue with the V8 race event after 2012 it is now apparent that the reserve is unlikely to receive revenues sufficient to offset the debit balance. HCC should review this reserve with a view to determining what future revenues could reasonably be expected to accrue to the reserve. HCC should then either make appropriate accounting adjustments to recognise this and/or should append notes to its accounts explaining the rationale for the reserve and its current status and what the likely future recovery may be.
- 20 HCC spent \$18 million on the provision of track infrastructure and further monies on the payment of Host City fees before the formal contract was signed with CSM in April 2008. We discussed this matter with Mr Redman. He advised us that *"it is common practice for local and central government to commit significant expenditure to event delivery prior to contract signing"*. Mr Redman further advised that the *"risk is deemed acceptable where there is a clear commitment for the event to proceed"*. We do not agree. This was a significant business risk for HCC to take that in our view was unacceptable for a public sector organisation.
- 21 It is apparent that CSM was under-capitalised and was experiencing cash flow problems well before the first race event. We were advised by former Mayor Mr Simcock and Mr Redman and by other HCC staff we interviewed that they had not been aware of CSM's cash flow difficulties at this time. We believe they ought to have been aware given the advice from CSM in September 2007 that it didn't have *"the money to cash flow the concerts"* and given CSM's proposal to HCC that HCC purchase the pit lane structure. Unfortunately, HCC missed an opportunity to

reconsider the wisdom of entering into a contract with CSM given the apparent cash flow issues.

- 22 On 29 February 2008 HCC purchased the pit lane structure and associated fittings for a price of \$2.25 million. The purchase involved a lease back arrangement with CAM. CAM made the first two lease payments but CAM then defaulted on all further lease payments totalling \$720,000 until insolvency was declared in April 2010.
- 23 During 2007 HCC made several early payments of Host City fees. Then during 2009 HCC agreed to make advance payments of Host City fees to assist CSM with its cash flow problems. We have not identified evidence that Council was aware of these early and advance payments. Making advance payments for goods and services can be a significant business risk. In our view HCC was unwise in making advance payments of the Host City fees to CSM. \$837,500 of the Host City fees that was paid in advance was not recovered when CSM became insolvent.
- 24 The total debt that CSM/CAM has with HCC is \$2.987 million. This debt includes lease payments of \$874,167, revenue not received for the 2009 event of \$603,403, revenue not received for the 2010 event of \$570,000, other reimbursement owed for the 2009 and 2010 events of \$101,326 and the overpayment of Host City fees that was not recovered of \$837,500. It is unlikely that any of this debt will be recovered.
- 25 We are aware that CSM and CAM are in liquidation at the time of writing this report. We were concerned to find that HCC had not advised the Liquidator of the full debt owed by these companies to HCC.
- 26 At its meeting on 21 April 2010 Council agreed to novate the Promoter contract from CSM to V8SC. However, this decision was made without knowledge of the total costs of the race event. No business case was prepared for the novation proposal. Mr Simcock advised us that he did not consider that information on total costs was necessary for Council to make its decision. We disagree. Council should have insisted on management providing all this information.
- 27 From our review of the information related to the 21 April 2010 meeting of Council we were left with the impression that because of the urgency for a decision Council felt it had only two choices – support the novation of the contract or abandon the event. Council concluded that it had no option other than to agree to the novation of the CSM contract to V8SC.
- 28 At the 21 April 2010 meeting Council agreed with management a set of principles to be applied to the new Promoter contract with V8SC. Management put in place a suite of agreements that should have been consistent with these principles but they were not.
- 29 Included amongst these agreements was a Compensation Agreement through which HCC was obliged to pay CSM's creditors in the sum of \$3.025 million. HCC had no legal obligation to meet CSM's debts through the original contract with CSM. In our view this agreement was inconsistent with the principles that had been agreed by Council and it was inconsistent with the advice that management had provided to Council. We did not locate any proper authorisation by Council for this payment. The payment does not fit within management delegations.
- 30 There were several other aspects of the various novation agreements that appeared to be inconsistent with the Council decision and direction at its 21 April 2010 meeting.

We note in this regard the agreement for HCC to meet a share of the costs for the freight of cars and the inclusion of a claw back provision with respect to the recovery of losses from the profits of future events.

- 31 The claw back provision is a significant issue for HCC given that the likelihood of ever receiving a share of any future profits is significantly diminished by this claw back provision. From our interviews of Councillors we found very little awareness of this “claw back” provision until our interviews. Many Councillors had understood that V8SC would meet all event losses. We are particularly concerned that management was not transparent with Council about this matter.
- 32 There has been significant use of confidentiality provisions and public excluded Council meetings in the conduct of business for this race event. This has left both Council and the public with poorer knowledge than it should have had. Mr Redman commented to us that the decision to operate in public excluded is made by Council not by management. We observed that there appeared to be a lack of trust by management that Councillors would hold information confidential.
- 33 During this review we became aware of considerable dissatisfaction by some Councillors about reporting of the V8 event by HCC management and questions about whether it had been adequate. We noted that some informal reporting was occurring but concluded that the formal reporting had not been adequate. We also concluded that there was a lack of understanding between management and governance about what the reporting expectations were for this Project.
- 34 The costs of the track infrastructure rapidly increased through 2007 and early 2008 and quickly exceeded the original \$7 million estimate. Management’s response to this was to adopt a practice of reporting net cost for the event. As the costs increased management reassessed the forecasts for the likely revenues that it might receive for the event and concluded that increased revenues would match the increased costs. HCC was then able to continue to report a net cost of \$7 to \$8 million for the event despite the fact that costs had risen significantly. This change to reporting net cost lacked transparency with respect to the total cost of the infrastructure. The reporting of net cost did not disclose the actual costs that were arising nor the assumptions that were being made by management about projected revenues.
- 35 The total cost of the V8 event was not reported to Council for a period of more than two years. As noted previously the decision made by Council in April 2010 to novate the Promoter contract to V8SC was made without information on the total costs of the event. In our view this was a very unsatisfactory situation. We discussed this matter with Mr Redman. He advised that Council had been happy with the arrangement for reporting and could have requested additional reporting but did not.
- 36 We understand that major projects being undertaken by the HCC have generally not been included in the annual internal audit programme. The project for the V8 event has not been reviewed previously through the internal audit programme nor has it been the subject of any other formal review. It is possible that some of the issues with this event such as the adequacy of reporting and the awareness of risks and costs may have been identified earlier if the V8 event had been the subject of independent review or included in the internal audit programme. We suggest that all major projects be reviewed periodically by HCC.
- 37 Concurrently with this review Council and HCC management have introduced a number of organisational changes to improve governance and management aspects

of HCC's operations. We have not specifically reviewed these changes but they appear consistent with a number of recommendations we have made. We commend HCC for taking these actions which are noted towards the end of this report.

We have included a number of recommendations in this report that if actioned by Council would result in significant improvement in the management of future events or projects.

Summary of Recommendations

1	Management should ensure that it operates on a “no surprises” basis with its governance group. The provision of early information to Council on significant opportunities, risks, activities or business changes is desirable.
2	All major projects and major decisions should be supported with a well developed business case and supporting information.
3	Consideration should be given to undertaking full due diligence of the other party for all significant commercial transactions such as major contracts.
4	High value, high risk, long timeframe and unique commitments may need to be recognised as projects and managed in accordance with project disciplines and principles.
5	Consideration should be given to referring major decisions and approvals and reporting thereof (particularly when the activity cuts across several HCC functions) directly to full Council or a Committee of the whole of Council.
6	Council should seek appropriate assurances from management as to the acceptability of the terms of a contract and should require reference back to Council should there be any significant changes to terms, scope, risk or cost.
7	Management needs to ensure it is objective and perceived to be objective in its advice to Council.
8	HCC should ensure that it has robust assessments of costs before making commitments to any major spends.
9	As far as possible for major projects and activities a single dedicated budget or a single source of funding is desirable to simplify accounting and to ensure transparency through the reporting.
10	HCC should review the use of the V8 reserve. HCC should determine what future revenues could reasonably be expected to accrue to the reserve and what accounting adjustments should be made to reflect this or HCC should append explanatory notes to its accounts.
11	All significant funding to external parties should be supported by comprehensive and properly executed agreements so as to protect HCC’s accountability obligations as a public sector organisation and its commercial and reputational interests and risks.
12	Improved monitoring and reporting for projects from inception to completion is essential to ensure that Council is fully aware of any emerging risks.
13	It is important that all significant financial risks with HCC commitments be fully investigated and properly reported to Council so that early action can be taken to mitigate the risk.
14	There is a need for HCC to significantly strengthen the management of its debtors and fully report significant arrears to Council.

15	Business risk should be specifically considered when making any significant advance payments for goods and services. Review by Council may need to be considered.
16	HCC should ensure that all legitimate debts are invoiced and that proper steps are then taken to recover that debt.
17	HCC should ensure that all debt is fully reported in any liquidation process.
18	When a change is proposed to a significant term of contract such as guarantees, indemnities, insurances and payments then this change should be referred for approval to the approving authority for the contract (for the V8 event this was Council).
19	Council should review its delegations policy to incorporate specific requirements in respect of contracts and to clarify what constitutes a variation that requires approving authority approval and in particular Council approval.
20	All Council committees, subcommittees, officers and others holding delegated authority should be reminded of their responsibilities and obligations under the Council's Delegation Policy.
21	For major projects and activities Council and management should agree the specific requirements for reporting.
22	For major projects and activities management should consider providing a regular consolidated report to Council on all aspects of the project.
23	Management should ensure that reports to Council are written in clear non-technical language to ensure for both Council and the public that there is clarity of understanding.
24	Council should make robust enquiry of management to be satisfied it has sufficient and clear information and understanding to make its decisions.
25	Management should ensure that robust mechanisms are in place to keep Council informed about serious contractual risks that could have significant financial implications for HCC.
26	Periodic review of major projects should be incorporated into the annual internal audit programme.

10 Findings

We have set out below our findings in relation to the matters we have reviewed.

In **Appendix 2** of this report we provide a summary chronology of some of the key decisions and events that occurred during the course of the V8 race event between 2004 and 2011.

10.1 The genesis of the event

The earliest communication we could identify concerning the potential for HCC to host the V8 Supercar event was an e mail dated 24 November 2004 between a staff member and Mayor Redman. A range of further communications between potential promoters and HCC and other internal communications about the V8 event occurred through to late 2005 when HCC confirmed with a Promoter (later known as CSM) its interest in hosting the event. On 10 January 2006 a Principal of CSM wrote to HCC acknowledging HCC's interest in the event. The letter requested confidentiality about the opportunity and provided an assessment of costs to build the track infrastructure and host the event. The Promoter also proposed a separate engagement by HCC with EMC to provide consultancy work for the track design. HCC's response to this was to seek from the Promoter a firm and urgent commitment to the event so that HCC could include the event in its 2006-16 draft LTCCP document that was being prepared at that time for public consultation.

10.1.1 Letter of intent

On or about 7 February 2006, a one page agreement was entered into by HCC and Capital Streetrace Management (later known as Caleta Streetrace Management) with each party committing to the race event. The Principal of Capital Streetrace Management described this agreement as a "Letter of Intent". It is important to note that this letter of intent was a high level commitment to the event. It was not in itself the contract for the promotion of the event – that came later. The letter of intent was undated.

10.1.2 Announcement of the event to Councillors

On 8 February 2006 the opportunity to host the event was announced by Mayor Redman to Councillors at an informal workshop. We understand from interviews that the announcement was received with acclaim and wide support from the elected members. It was recognised by the Councillors that the event fitted well with HCC's vision to position Hamilton as a vibrant and distinctive metropolitan city. Council had been looking for a signature event to promote the city and now it had found one.

10.1.3 Authorisation of the event through the LTCCP

Following the workshop announcement of the opportunity to host the race event it was included in HCC's draft LTCCP that was released for public consultation. The LTCCP referred to the event as follows:

"The event is highly sought after and has the unanimous support of Council", and

"Council's initial financial commitment is \$7M which will provide key infrastructural improvements such as roading upgrades and crash barriers for the proposed circuit..... Ongoing costs for Council, which include the fee paid to the

promoters to run the event, will be funded annually out of its increased Events Sponsorship Fund. The promoter's fee is currently under negotiation."

There were very few LTCCP submissions received about the V8 event opportunity. The Council concluded that a commitment to the event could be confirmed and in June 2006 the LTCCP was adopted by Council with the inclusion of the V8 race event.

We make the following observations about the circumstances leading up to the Council's commitment to the race event in June 2006:

10.1.4 No surprises approach

The opportunity to host the event had been known to a select group within HCC over a period of 15 months leading up to the surprise announcement to Councillors on 8 February 2006. We understand that Councillors informally confirmed their support on that day. The event opportunity had been discussed and developed on a confidential basis over a prolonged period. The competing interests of Auckland and Wellington were no doubt a factor in the need for confidentiality. Commercial negotiations of this kind usually need confidentiality. In late 2005 and early 2006 the opportunity became more promising for Hamilton. However, confidentiality continued to apply within HCC. The result was that news of the opportunity was a surprise to most Councillors when it was announced on 8 February 2006 as was the request for an immediate indication of support.

We appreciate that it can be difficult to manage the need for confidentiality around commercial negotiations in the context of transparent decision-making processes of elected councils. However, the closed approach taken here resulted in the governance group (the elected members) being asked to make an initial, albeit informal, commitment to the race event in February 2006 with little time or information for a properly considered position. This approach does not sit well with the general principles and expectations of the Local Government Act 2002.

Mr Simcock commented to us about this matter. He advised that as a Councillor at that time he *"was surprised to learn what staff and the Mayor had been working toward, (but) did not feel remotely disadvantaged by that and did not feel pressured to make any particular decision"*.

We believe that there was a need for greater transparency with the governance group about this event opportunity as it was developing through late 2005 and early 2006 rather than it being presented as a surprise. Earlier, better information may have resulted in a better decision making environment.

Recommendation 1: *Management should ensure that it operates on a "no surprises" basis with its governance group. The provision of early information to Council on significant opportunities, risks, activities or business changes is desirable.*

10.1.5 The business case

We would have expected the V8 opportunity to have been the subject of a full assessment by HCC in terms of options, costs, funding, risks, timelines and the fit with the organisational vision and business objectives – often referred to as the development of a business case. Commitments to all major projects or events should involve consideration of the business case to ensure good decision making.

We have not located any properly constructed business case assessment for the V8 event opportunity neither before Council's informal commitment in February 2006 nor before its commitment through the June 2006 LTCCP nor since. We believe that making a commitment to a major event without a full business case assessment was a serious oversight by HCC given the expected whole of life cost of the event – costs in excess of \$20 million were known in 2006. Some elements of the business case information for the V8 event such as cost were put in front of Council but it later became evident that this was rudimentary and unreliable information. No detailed cost estimate was prepared nor was there any initial consideration of risks and effects. There is a responsibility on both management and governance to ensure that the business case is prepared.

Recommendation 2: *All major projects and major decisions should be supported with a well developed business case and supporting information.*

10.1.6 Due diligence

Neither at the time the initial commitment was made to the event in early 2006 nor at any time later up to the signing of a contract with CSM was full due diligence undertaken in respect of the proposed Promoter. We consider the absence of a full due diligence check to be a serious oversight in the planning for and commitment to this event.

Some of HCC's early communications were with Capital Streetrace Management Ltd. The Companies Office does not appear to have a record of this company. The communications from about April 2006 were with Caleta Streetrace Management Ltd (CSM). As a company CSM appears to have had a single interest only – the V8 race event in Hamilton. It does not appear to have had any significant trading history prior to the Hamilton event. It appears to have had minimal assets. Due diligence would have identified this early in the process and possibly raised questions with HCC as to the wisdom of contracting with a company that had limited trading history and marginal liquidity.

As part of our review we discussed this matter with Mr Redman who was Mayor at this time. He advised us that HCC did satisfy itself that the principals of CSM had experience in the running of race events at Pukekohe. However, he acknowledged that no financial due diligence was undertaken. He further advised that "HCC negotiated step in rights with V8SC in the event that CSM was unable to deliver the event for any reason. This provided HCC with protection that the street race would still be hosted in the City if CSM reneged". For that reason he did not believe that there was an essential need for HCC to undertake full due diligence of CSM.

We further investigated the advice provided by Mr Redman. We reviewed the contract between CSM and V8SC. That contract does not contain any obligation on V8SC to "step in" and ensure the continuing performance of the race event should CSM default. We concluded that Mr Redman was mistaken with his recollection of this matter. We reconfirmed our position that full due diligence of CSM was not undertaken by HCC and should have been.

Recommendation 3: *Consideration should be given to undertaking full due diligence of the other party for all significant commercial transactions such as major contracts.*

10.1.7 The Australian Capital Territory Auditor-General's report

During the course of document research for this review we came across a late submission that was made in relation to HCC's 2006-16 LTCCP process. The submission included a copy of a July 2002 report prepared by the Auditor-General for the Australian Capital Territories (ACT). The report presented the results of a performance audit that examined the costs and benefits of the V8 race event in Canberra. The performance audit found that the costs of running race events in Canberra in 2000 and 2001 were significantly greater than had been expected. Canberra withdrew from hosting the race event following the 2002 race.

This late submission was forwarded by e mail to all Councillors and to management on 9 June 2006. The submitter indicated his intention to make his submission available to the public as well. What surprised us was that we were unable to locate any record that Council or management or any other member of the public had actively considered this quite negative ACT report.

We discussed this matter with Mr Redman. He advised us that HCC had considered the economic benefit assessments for two other events – in Wellington and Adelaide. He also advised that the ACT report was discussed with V8SC and "*in particular the finding that the (Canberra) event did not deliver the predicted economic benefits*". We accept this advice from Mr Redman, but we note that the report also referred to considerably greater costs for Canberra to host the event than had been expected. This aspect of the report does not appear to have received much attention by HCC as it continued with its commitment to the event and discovered later that, in common with Canberra, the costs to HCC were considerably greater than had been expected. We also note that this ACT report was provided to HCC four months before Council approved its contract for the V8 race event and nine months before the contract was actually signed. There was ample opportunity for HCC to review its commitment to the race event if it had wished to.

The ACT report did not appear to raise all the "red flags" for Council or for HCC management that it should have.

10.1.8 Recognition of the race event as a Project

The task to construct the track infrastructure was recognised within Council as a project and a planned approach involving both staff and Councillors was taken to each race. However, the event itself as a full seven year commitment was not recognised as a project. In particular, the arrangements for cost estimating, funding, monitoring and reporting appear disjointed and inadequate. In our view the failure to apply project management disciplines and principles to the full event as a commitment was a mistake. The application of project management disciplines and principles over the entire seven years of the event would have seen a much more robust approach being taken to defining responsibilities and managing matters such as cost estimating, expenditure, funding, risk management, monitoring and reporting. We further discuss these matters and other aspects of the project management later in this report.

Recommendation 4: *High value, high risk, long timeframe and unique commitments may need to be recognised as projects and managed in accordance with project disciplines and principles.*

10.1.9 Early information on costs

We were advised by several current and former Councillors during interviews for this review that when the Council committed to the V8 event in 2006 the costs to HCC had been indicated as being \$7 million.

However, in reviewing this claim we found that the 2006-16 LTCCP referred to the race event as having an infrastructure cost of \$7 million together with “the fee to be paid to promoters to run the event”.

Consequently, Council had clear information at the time it finalised the LTCCP (June 2006) that the total cost for the race event over seven years would be in excess of \$20 million. We do not accept that the race event could ever have been understood to be only a \$7 million financial commitment to HCC. The passage of time may have led to some misunderstanding about this.

10.2 Significant decision made by a Council subcommittee

We made a number of observations about the circumstances related to the approval of the contract with CSM and the approval of other contracts related to the V8 event.

During the Council terms pertinent to this event (2006 to 2010) major contracts were referred for approval to a Contracts Subcommittee (of the Finance and Audit Committee (F & A)). The Contracts Subcommittee consisted of four members, three of whom were elected members. The other formal member was the Chief Executive. The Contracts Subcommittee approved many of the construction contracts related to the track build for the race event. It also approved the major contract with CSM as Promoter of the event. This approval was given on 3 October 2007.

10.2.1 Referring major decisions to full Council

The V8 race event in its entirety was a significant project for Council. This may not have been fully recognised until perhaps 2010. However, for all significant matters (significance being assessed in terms of value, risk, time, public interest etc) it may be more appropriate for the key decisions and related monitoring and reporting to be referred to Council or a substantial committee of Council. Council inevitably notes or endorses decisions made by its committees and subcommittees. However, the noting and endorsement often occurs with less information being available to the Council than may have been available to the committee. Hence our suggestion of immediate reference to the full Council for major decisions and reporting on significant projects.

We are aware that the present Council has disbanded the Contracts Subcommittee in favour of a Finance and Monitoring (F & M) Committee now dealing with all these matters. The F & M Committee is now a committee of the whole of Council. Arguably, these changes to committee structure obviate the need for us to make recommendations on this aspect of the review. However, we have included a recommendation for the sake of completeness of the review report.

Recommendation 5: *Consideration should be given to referring major decisions and approvals and reporting thereof (particularly when the activity cuts across several HCC functions) directly to full Council or a Committee of the whole of Council.*

10.2.2 Decision on contract made without knowledge of the contract terms

When the Contracts Subcommittee made its decision 3 October 2007 to enter into a contract with CSM for the race event it did so without reference to either the proposed contract or the terms of that contract. The Subcommittee's decision was not "in principle" nor was it qualified in any way nor did the Subcommittee require any reference back to it on the final terms of the contract.

It took another six months until April 2008 for the contract to be signed by the parties. Further negotiation and legal work was necessary over the six month period to finalise the contract document. We understand that the negotiations provided a more favourable outcome for HCC. However, it is not clear to us how the Subcommittee assured itself that the contract that was eventually signed would be acceptable. It appears that the Subcommittee simply relied on management to ensure that the final contract terms were acceptable.

We did not consider this situation to be entirely appropriate, neither in terms of the time that elapsed between the Council's approval of the contract and the signing of the contract, nor in terms of the unqualified nature of the Subcommittee's approval.

In terms of its governance function Council needs to take reasonable steps to ensure that the contract will be suitable. It can do this by seeking information from management on the proposed scope and terms of the contract. It can qualify its approval and require reference back to Council should there be any significant change in such things as scope, terms and costs. It can also seek from management assurances that appropriate legal and other reviews of the proposed contract have been undertaken. Management provided advice to the Subcommittee on 3 October 2007 that a legal review had been undertaken but further changes were then made to the draft contract over the following six months before it was signed.

In some instances Council may itself wish to view the proposed contract documents although in practice this is often not realistic and the documents may not be particularly easy to understand or interpret. Obviously it is also necessary to maintain confidentiality in respect of the commercial terms of the contracts. We noted a practice at HCC of not making copies of contract documents available to Councillors. Some Councillors expressed concern to us about this practice. We were advised by present and former staff that this practice had been agreed between management and Council. We are not persuaded that this is always an appropriate arrangement but suggest it be further discussed between management and Council.

Recommendation 6: *Council should seek appropriate assurances from management as to the acceptability of the terms of a contract and should require reference back to Council should there be any significant changes to terms, scope, risk or cost.*

10.2.3 Management obligation to be objective in giving advice and in participating in decision making

The Contracts Subcommittee membership included the Chief Executive, Mr Redman. At its meeting on 3 October 2007 the Contracts Subcommittee approved the contract with CSM. Mr Redman participated in this decision. In his earlier role as Mayor he brought this event to Council for consideration and advocated strongly for it.

There is a need for management to be objective and to be perceived to be so in the advice it provides to Council. Mr Redman's earlier role with Council as Mayor and his

support for the race event raises questions about whether he should have been involved in making the decision on the race event contract if for no other reason than the perception that his contribution to the decision may have lacked objectivity.

All those contributing to decisions must be very mindful of the need to be objective and open minded in their consideration of the decision to be made. The risks related to fairness and independence are heightened with a committee of only four members.

Recommendation 7: *Management needs to ensure it is objective and perceived to be objective in its advice to Council.*

10.2.4 Governance capability

During the course of this review we discussed with Councillors the challenges they face when considering the many complex and technical matters that are put in front of them. For example, the F & A Committee for HCC had oversight of much of the regular financial reporting that had been put in front of Council including reporting on the V8 race event.

When reporting is not adequate the performance of governance can be seriously compromised. Consequently it is important that the governance group recognises any inadequacies in the reporting. Later in this report we comment on the adequacy of the reporting on the V8 event. At this point we note that the F & A Committee may not have had all the skills that it needed to understand the reporting that it did receive on the V8 event and to address some deficiencies in that reporting (we refer later amongst other matters to the practice of reporting net cost).

A common outcome of the democratic process is that a Council or one of its committees may not have all the specialist skills or sufficient numbers of people with those skills that may be necessary to consider the technical matters put in front of it. Obviously the elected representatives place some reliance on the Chief Executive and his/her management team to assist on those matters. That is appropriate. However, another option Council has is to consider engaging an expert advisor to assist the Council or its committees with independent advice. We are aware of a number of Boards that adopt this practice. We have not made any recommendation on this matter but note it for Council's information.

10.3 Resource consent and track infrastructure build

During the period 2006 to April 2008 HCC obtained a resource consent for the race event, built the track infrastructure and provided other facilitation and logistical support to allow the first race to take place. We reviewed the approach that HCC took to this work. We make observations in the following sections of our report on the circumstances related to preparation for the first race.

10.3.1 Resource consent for the V8 event

HCC applied for and obtained a resource consent for the race event. This was a significant task in itself. This appears to have been a well managed exercise given that the consent was obtained in December 2006 well ahead of the first race and ahead of the major commitments to the infrastructure build. We also note that there were no appeals of the consent and the consent conditions were manageable from HCC's point of view. This was a very successful outcome for HCC management.

Agreements were entered into between the Promoter and some businesses and residents in the vicinity of the track to eliminate possible objections to the resource consent. We noted a media report of 27 November 2006 that specifically referred to a “*stream of potential objectors have since been met with, placated and deals cut to obtain their backing*”. We concluded that the existence of these agreements was well known at the time.

However, we learned that these agreements with objectors have caused some recent consternation for some Councillors. Following the demise of CSM, HCC found itself liable in respect of at least one of these agreements – with Pet Practice. We did not enquire into the full extent of these agreements. However, we note that it is not uncommon for agreements to be made with objectors as part of consent processes. We do not take any position on this.

We understand that HCC has obtained advice on its liability in relation to the Pet Practice agreement. We understand that some liability arose because HCC had undertaken to ensure that should CSM end its role as Promoter then any future new promoter would honour the agreement. It transpired that the new Promoter (V8SC) did not honour the agreement and consequently HCC found itself with some liability. In our view this was an unfortunate outcome for HCC and not necessarily something management could have expected. In any event it is a minor cost issue for HCC.

In recently discussing this matter with Mr Redman who was Mayor at the time of the resource consent process he advised us that he was surprised that V8SC had not honoured the agreement with Pet Practice. He pointed out that during negotiations with V8SC in April 2010 which he was involved in as Chief Executive he had understood that the new Promoter (V8SC) would honour the commitments made by CSM in 2006 with objectors.

We have reported on this matter because of the concerns held by some Councillors about this issue. There is no recommendation that we can make.

10.3.2 Sub project to build the track

The sub project established by HCC to build the track infrastructure appears to have been well planned and managed. The infrastructure project had many elements and required considerable coordination. HCC applied a project approach to this work. It established a Race Planning Management team (RPM) to manage the preparation. The RPM had a diverse membership including persons outside Council. The RPM had terms of reference and it held regular meetings, it identified a budget and monitored the costs.

The RPM built the infrastructure in the latter part of 2007 and early 2008 and delivered the infrastructure in time for the first race event in April 2008. This was a commendable effort. Unfortunately the costs were considerably greater than had been originally expected when the Council committed to the event in June 2006. However, the responsibility for this does not in our view lie with this sub project team.

10.3.3 Cost of the infrastructure build

One of the early disappointments to HCC was the cost to develop the track infrastructure. The total cost was about \$18 million which was well in excess of that envisaged at the time the event was committed in June 2006 (\$7 million). This cost

was incurred before the first race event took place. We considered the reasons for the higher than expected cost.

Much but not all of the infrastructure was purchased through competitive processes. Competitive processes are the preferred means by which value for money can be ensured. We did not identify any particular concerns about the approaches to purchasing. What was most evident to us as an issue was that the original estimate of cost provided by CSM in January 2006 for track infrastructure was quite inadequate. HCC's subsequent pricing of the work and its cost record confirms this. We note again that HCC did not prepare a robust business case including a detailed estimate for this project. HCC relied on a superficial costing by CSM as the basis for its commitment to the project and its funding requirements.

Recommendation 8: *HCC should ensure that it has robust assessments of costs before making commitments to any major spends.*

10.4 Reviews post the 2008 event

Following the first race event in April 2008 the Council commissioned two independent reviews. In August 2008 an Economic Impact Report prepared by Horwarth was made public. This report indicated that the first race event had an economic benefit to the region of \$28 million. The August 2008 Economic Impact report was a follow up on an economic benefit assessment undertaken for the resource consent process in 2006.

In May 2008 Council engaged Peter Stubbs of Simpson Grierson to undertake a review of the first race event. The review was a requirement of the resource consent that was granted for the event in late 2006. The review involved consideration of ways of improving the event, identifying ways to reduce or eliminate detrimental impacts of the event on Frankton and identifying ways to enhance the positive impacts of the event.

The report from Peter Stubbs was received by HCC in August 2008 and considered by Council the following month. The review report identified 121 recommendations related to operational and consent matters. The actions identified from the report were completed by HCC over the following months. This appears to have been well managed.

These reviews were prudent. Both reports provided quite positive results or outcomes for HCC and the race event.

10.5 Financial decisions and actions

At the heart of the request for this review was concern by the current Council about the costs of the V8 event. It quickly became obvious to us that the financial situation was quite complex. We also found that considerable work was going to be required of us to properly understand what had brought about the current financial position with the event. It took us several months to obtain from HCC all the information that we required. The time and effort required by us and by HCC to respond to our information requests was a clear indicator to us that the financial management and reporting of the event had not been adequate.

We have prepared our own assessment of the financial position for the event. However, we did not undertake a full financial audit. Our work was necessary to gain

an understanding of the financial provisions and contractual arrangements for the event and the financial reporting to Council. We consider good practice, especially where major projects are involved, requires decision-makers to be particularly vigilant around costs of and risks to the project. We assessed HCC's practices with these principles in mind.

The following parts of this report identify matters arising from HCC's financial management of the event and the decisions that were made. We have also referred to issues with the delegated authority held by decision-makers under existing Council policies.

10.5.1 Overall cost of the event

From our review of HCC's financial records, the HCC expenditure to December 2010 in respect of the 2008, 2009 and 2010 race events was in excess of \$37 million, comprising:

• Infrastructure assets	\$17,979,000
• Operating costs	\$XXXXXXXX*
• Novation transition costs	\$3,506,000
• Interest on borrowing	\$XXXXXXXX*
• Related costs	\$2,294,000
• CSM & CAM debt to HCC (not recovered)	\$1,580,000
• 2010 Revenue guaranteed to HCC (not paid)	\$570,000
	\$37,460,700

* These \$ sums have been removed to ensure the commercial confidentiality of the "Operating Costs" (substantially Host City fees) as required by the Promoter's contract.

Revenue received by HCC from CSM for the 2008 and 2009 events was \$1.525 million which reduces the overall total cost of the 2008, 2009 and 2010 race events as at December 2010 to **\$35,935,700**.

We make the following comments on the above items of cost:

- The Operating costs noted above includes an overpayment of \$837,500 for Host City Fees that was never recovered from CSM – we further comment on this later in our report.
- The Novation transition costs include a share of freight costs for the 2010 event that HCC agreed to fund.
- The Related costs includes expenditure incurred for lighting, fencing and park upgrade work as a consequence of the effect of the race event on the Waikato Stadium No 2 ground – the inclusion of some of this cost is questioned by some present and former Councillors and by former Chief Executives Tony Marryatt and Michael Redman – we further comment on this below.

- The CSM and CAM debt referred to includes unpaid lease rentals for the pit lane structure and Empire Street building of \$874,167 together with other debt – we record this unpaid rentals and other revenue as an expense so as to portray a clearer picture of the overall cost to HCC. HCC has now written off \$1.58 million of the debt.
- The 2010 guaranteed revenue was a further debt that CSM had that was neither invoiced by HCC nor paid by CSM – we record this unpaid revenue as an expense so as to portray a clearer picture of the overall cost to HCC.

This \$37 million cost (before revenues) is greater than the overall cost reported to Council confidentially at its meeting on 13 December 2010. \$2.15 million of the additional cost relates to the CSM and CAM debt not paid and the guaranteed revenue not received (nor invoiced).

Related costs debate

We have not attempted to resolve the differing views that exist with current and former Councillors and staff about what proportion of the \$2.294 million in related costs rightfully belongs to the V8 event. We would simply say that expenditure that is a direct consequence of the event should be included in the project cost. However, expenditure that has been simply brought forward i.e would have been incurred at a later date regardless of the event does not need to be included in the project cost. Mr Redman is firmly of the view that costs related to the Waikato Stadium No 2 ground should not have been included in the V8 event costs.

It is our understanding that a proportion of the \$2.294 million does not rightfully belong to the V8 event. In any case, the related costs that may be in dispute constitute only a small proportion of the total event costs.

10.5.2 Funding of the event

Funding for the V8 event has been drawn from several sources:

- The track infrastructure which was constructed in 2007 and early 2008 before the first race event occurred was funded initially from the CBD Upgrade Budget. However, as costs increased above the initial estimate of \$7 million (advised in the 2006-16 LTCCP) the additional funding was sourced from a reserve. This reserve (V8 reserve) was established with a nil balance. It had a significant debit balance of approximately \$14.322 million as at 30 June 2011. The purchase of the pit lane structure was also “funded” from this reserve as was a property purchase. The Compensation payment referred to later in this report appears to have been funded from this V8 reserve.
- The Host City fees, with the exception of those paid in advance, have been paid from the Events Sponsorship Fund which was rates funded. The Host City fees have represented a very significant draw on the Events Sponsorship Fund which was increased in 2006 to accommodate these fees. The Host City fees that were paid in advance (much of which was not recovered) were funded from the V8 reserve. The Promoter contracts require confidentiality in respect of the actual cost of the Host City fees.

- Revenues received by HCC from the 2008 and 2009 race events totalling \$1.525 million including lease payments were applied to the V8 reserve to reduce its debit balance.

In general terms the track infrastructure was funded by debt and the Host City fees were funded by rates. Mr Marryatt advised us that for this reason he believed two sources of funding for the V8 event was appropriate. However, there was also other funding such as the guaranteed revenue share, ticketing revenue and lease payments. In our view the multiple sources of funding for this event diminished the transparency of the funding arrangements. The arrangements also increased the complexity of reporting on the overall funding requirements for the event. A single dedicated budget or a single source for the funding would have simplified the management of the various revenues and expenses. This approach may have been more appropriate for a project of this nature.

Recommendation 9: *As far as possible for major projects and activities a single dedicated budget or a single source of funding is desirable to simplify accounting and to ensure transparency through the reporting.*

Use of the V8 reserve

We have several concerns about HCC's use of the V8 reserve:

- The existence of a reserve with a substantial debit balance is in itself very unusual. We understand that the original rationale for reserve funding for some of the event costs was that HCC wished to ring fence the additional infrastructure costs that arose and was then expecting revenues to be accrued to this reserve over time that would eventually offset the additional costs. The revenues were expected to include revenue guaranteed under the Promoter contract, some profit share, a share of revenue from ticket sales and catering and lease rental income for the pit lane structure and Empire Street buildings. Unfortunately much of this revenue didn't eventuate, costs were much greater than expected and consequently the V8 reserve had a substantial \$14.322 million debit balance as at 30 June 2011.
- Given the Council's decision in October 2011 not to continue with the V8 race event after 2012 it is now apparent that the reserve is unlikely to receive revenues sufficient to offset the debit balance. HCC should review this reserve. HCC should then either make appropriate accounting adjustments to recognise this and/or should append notes to its accounts explaining the rationale for the reserve and its current status and what the likely future recovery may be.

Recommendation 10: *HCC should review the use of the V8 reserve. HCC should determine what future revenues could reasonably be expected to accrue to the reserve and what accounting adjustments should be made to reflect this or HCC should append explanatory notes to its accounts.*

10.5.3 Spending in advance of a formal agreement with CSM

The development of the documentation for the original contract between HCC and CSM occurred over an extended period between early 2007 and April 2008. Advanced drafts of the contract document were in existence in mid 2007 at the time former Chief Executive, Mr Marryatt left Council's employment. On 3 October 2007

the Contracts Subcommittee approved a seven year contract with CSM for the race event. However, the formal agreement between HCC and CSM was not signed until 14 April 2008 more than six months after Council had given its approval. The signing occurred a few days before the first race event. However, by the time the formal contract was executed in April 2008 HCC had spent about \$18 million on track infrastructure together with the Host City fees paid to the Promoter.

We make the following observations about the circumstances related to the execution of the contract with CSM and the expenditure incurred up to April 2008:

Expenditure prior to contract signing

HCC spent in excess of \$18 million during 2007 and early 2008 in advance of the signing of the formal contract with the CSM. Much of this expenditure was on track infrastructure but there was further expenditure related to Host City fee payments to CSM. We consider it unacceptable to incur significant expenditure in advance of the signing of a formal contract. We do not view this as an authorisation issue because the June 2006 LTCCP and July 2007 Annual Plan effectively authorised expenditure for the event. Instead we regard this expenditure as being a significant business risk.

Until contract signing there was a risk that CSM could walk away from formalising the contract. There would have been few remedies available to HCC if it had done so because the "Letter of Intent" entered into in February 2006 was inadequate to protect the HCC's interests. CSM's delicate financial position was already evident by April 2008 and an unsigned contract increased the risk that CSM might not confirm the contract. If CSM had defaulted on its intent to promote the race event then HCC would have been left embarrassed. HCC would have been left owning infrastructure for which it had no use. There would have been limited ability to sell it.

We were particularly concerned to find that substantial Host City fees had been paid to CSM in advance of contract signing. These fees were paid in accordance with a schedule attached to a draft version of the contract document. In our view these fees should not have been paid without at least a substantial heads of agreement having been properly executed, if not the formal contract.

We have not been able to ascertain why significant expenditure was allowed to occur in advance of a formal contract. It is possible that management placed some reliance on the one page but undated Letter of Intent that was executed in February 2006 between HCC and CSM. Clearly there was a need to start building the track infrastructure well in advance of the first race. However, the Letter of Intent and the urgency of the track build were a poor basis on which to incur in excess of \$18 million in expenditure. The Letter of Intent did not identify the event management responsibilities of each party, did not contain any provisions related to performance, dispute, breach or remedy and it contained no payment schedule. The Letter of Intent was not a sound basis on which to spend in excess of \$18 million. It was certainly not a sound basis on which to pay the Host City fees.

We discussed this matter with Mr Redman. He advised us that "*it is common practice for local and central government to commit significant expenditure to event delivery prior to contract signing*". Mr Redman further advised that the "*risk is deemed acceptable where there is a clear commitment for the event to proceed*". We do not agree. We repeat again that HCC took a significant business risk that we consider unacceptable for a public sector entity. A considerable sum of money was spent in advance of a formal contract – this was inappropriate.

Recommendation 11: *All significant funding to external parties should be supported by comprehensive and properly executed agreements so as to protect HCC's accountability obligations as a public sector organisation and its commercial and reputational interests and risks.*

Councillors unaware of contract signing

We understand from interviews that many Councillors were not aware that six months elapsed from the time of the Contracts Subcommittee approval of a contract with CSM (October 2007) until it was actually signed (April 2008). We discussed this matter with Mr Redman who was Chief Executive at this time. He advised us that Councillors were advised at a workshop in February 2008 that the contract had not been signed at that time. We assume that Councillors may not have recalled this workshop advice.

However, for a period of about five months from October 2007 to February 2008 many Councillors do not appear to have been aware that the contract with CSM had not been signed. We believe management should have made Council more aware of progress with the execution of the contract with CSM. Significant expenditure was being incurred by HCC throughout this time and particularly during the period from October 2007 to February 2008. As noted earlier in this report there was a significant risk with this expenditure.

However, Council had some knowledge that expenditure had occurred in the absence of a signed contract with CSM. For example, the expenditure that occurred prior to the Subcommittee's approval of the contract in October 2007. Council does not appear to have expressed any concern about this and in our view it should have.

Recommendation 12: *Improved monitoring and reporting for projects from inception to completion is essential to ensure that Council is fully aware of any emerging risks.*

10.6 CSM's cash flow difficulties

From our study of HCC's records it is apparent that CSM was under-capitalised and was experiencing cash flow problems well before the first race event. We were concerned to find evidence of this before HCC signed the event contract with CSM in April 2008. The following sections of this report outline our findings around CSM's financial difficulties before the first event in April 2008, its continuing financial problems after that first event, and the financial implications for HCC that stemmed from the decisions that were subsequently made.

10.6.1 CSM's cash flow difficulties pre the first V8 race event in April 2008

From our review of documents and agreements we found evidence that CSM had cash flow issues before the first race event in April 2008. We discuss below some of the indications of this.

Pit lane structure

In August 2007, CSM approached HCC with a suggestion that HCC purchase the pit lane and race control structure being constructed by its associated company CAM. Under the yet to be executed event promotion contract, CSM was responsible for providing this structure. CSM's purchase proposal was raised with Council in a report of 27 February 2008 from the Chief Executive, Mr Redman. The report presented the

purchase as an “*opportunity*” for HCC to own the entire track infrastructure which would then be leased back to CSM (in fact CAM) with a positive cashflow for HCC. The purchase effectively set aside the Promoter’s contractual obligation under the proposed contract. The Council agreed to the purchase.

A Sale and Purchase Agreement was then entered into with CAM on 29 February 2008 to purchase the pit lane structure and associated fittings for a price of \$2.25 million. We observe that this purchase was clearly beneficial to CSM and CAM as it avoided the need for the capital commitment associated with the structure build. The first payment by HCC to CAM/CSM for this structure was made on the day the purchase was agreed (29 February 2008) in an amount of \$1,986,208. A subsequent payment of the balance of \$263,810 was made on 8 September 2008.

CAM made the first two lease payments of \$600,000 on 6 May 2008 and \$120,000 on 29 September 2008 (almost two months late). CAM then defaulted on all further lease payments totalling \$720,000 until insolvency was declared in April 2010. We further refer to this matter later in our report.

Concert event

CSM was obliged as part of its Promoter contract to run a free concert in Seddon Park in conjunction with the annual race event. We noted from email exchanges between the Promoter and HCC staff in September and October 2007 that CSM was advising that it didn’t have “*the money to cash flow the concerts*”.

Host City fees

The Agreement between HCC and CSM obliged HCC to pay CSM a Host City fee commencing 1 May 2007 and ending on 1 February 2014. Instalments of the Host City fees up to and including 1 May 2009, were made generally in accordance with the payment schedule. However, two payments were made early – these were respectively paid three weeks and one month early when reviewed against the then unsigned event Agreement. We were unable to identify the reasons for the early payments. However, making early payments is an unusual business practice and implies cash flow issues.

Our conclusions

We concluded from the above that there were clear early indications of CSM’s cash flow difficulties before the contract was signed with CSM and before the first race event. We were advised by former Mayor Mr Simcock and by Mr Redman and other HCC staff we interviewed that they had not been aware of CSM’s cash flow difficulties at this time. We believe they ought to have been aware given the circumstances noted above and particularly the issue with the concert and the early payment of some Host City fees.

We did not identify any reporting to Council that would have suggested that Council was aware of any cash flow concerns with CSM. The knowledge of this risk, to the extent that it may have existed, could have only resided with management.

Unfortunately, HCC missed an opportunity to reconsider the wisdom of entering into a contract with CSM given the apparent cash flow issues. We have previously pointed out that HCC had not undertaken any due diligence of its proposed Promoter.

Recommendation 13: *It is important that all significant financial risks with HCC commitments be fully investigated and properly reported to Council so that early action can be taken to mitigate the risk.*

10.6.2 CSM's cash flow difficulties after the first V8 race event in April 2008

There is evidence that CSM's cash flow difficulties continued after the first event in April 2008, and up to its eventual financial failure two years later, in April 2010. Several difficulties were indicated during this period and we describe them below.

CSM and CAM debt to HCC

A memorandum from the Deputy Chief Executive to Mayor Simcock and the Chief Executive, Mr Redman dated 19 February 2009 states:

"The major issue for the promoters is currently securing revenue and maintaining cashflow (as the majority of revenue is received after the event while costs are front-loaded) and they acknowledge they are under-capitalised and may need new investors".

The memo also refers to difficulties that the Promoter had in fully determining the 2008 event loss. The memo also refers to the Promoters net shortfall of \$1.7- \$1.8 million from sponsorships and higher than anticipated operational costs. The memo outlines a request from CSM to HCC to:

"Help cash flow the event prior to April by deferring payment date for HCC debts until 90 days (will be made current after the event)".

The deferment of payment shifted the due date until after the second race in April 2009 which assisted in ensuring that the Promoter could proceed with the 2009 event.

The memo did not include details of CSM's and CAM's overdue debt to HCC at that time (February 2009). We found that the total debt at that time was \$255,416, being;

- CAM – two quarterly pit lane structure lease payments of \$120,000 each (1 November 2008 and 1 February 2009); and
- CSM – the first monthly lease payment of \$15,416.67 (1 February 2009) for the Empire Street building and yard (this was a sublease arrangement and although scheduled payments were due to commence from 1 February 2009, the sublease document was not signed until June 2009).

We would have expected HCC to have robust measures in place to manage these debts. However, in our view the focus appeared to be on the need to proceed with the next race event rather than managing the debt.

Recommendation 14: *There is a need for HCC to significantly strengthen the management of its debtors and fully report significant arrears to Council.*

Host City fees variation June 2009

Scheduled quarterly instalments of Host City fees were being paid regularly by HCC to CSM in accordance with the contract between the parties. However, on 22 May 2009 CSM requested an amendment to the payment schedule to bring forward payments of the fees. The request was made because of CSM's ongoing cash flow difficulties. HCC agreed to this request. In agreeing HCC effectively varied the contract and set aside the payment obligations under the contract with the Promoter. HCC's agreement to the request resulted in HCC making a significant advance payment of future Host City fees. This advance was made by 1 July 2009. Part of these advance payments covered a period post the 2010 event but the advances were made to assist CSM in meeting its financial obligations arising from the 2009 event. These advance payments represented another considerable financial risk to HCC. Unfortunately the risk was realised later.

We have determined that a proportion (\$837,500) of the Host City fees that were paid to CSM in advance of original contractual obligations has not been recovered from CSM. It is now clear there is no hope of recovery of this sum as the company is now in liquidation.

Host City fees variation April 2010

A further variation to the Host City Fee payments was agreed to by HCC on 14 April 2010. This variation provided for 2011 host city fees to be paid in advance to allow the 2010 event to proceed. The one page agreement was signed by the Chief Executive, Mr Redman. The variation effectively became redundant with the novation the Promoter contract to V8SC. Consequently no further Host City fees were paid to CSM. As noted previously, by this time HCC had overpaid \$837,500 in Host City fees which was never recovered.

Our discussion with Mr Redman about these advance payments

Mr Redman advised us during this review that he believed HCC management had taken prudent steps to seek assurance from CSM that the event was sustainable long term and that all parties were taking "reasonable steps to support the viability of the event". Mr Redman advised that he received the assurances from CSM that he had requested and on that basis he approved the June 2009 advance payments. He also advised that he had obtained internal advice that he had the delegated authority to approve the June 2009 and April 2010 contract variations that provided for the advance payments. We discuss the delegations matter later in this report.

Our conclusions

Although the Deputy Chief Executive's memo of 19 February 2009 was addressed to the Mayor and the Chief Executive, we found no evidence to indicate that Councillors generally were informed of the issues raised in the memo. Similarly, no evidence was found to show that Councillors were advised of changes to the Host City fee obligations and in particular the proposal to make advance payments. We are concerned that these matters were known by the HCC management team and in part by the Mayor, but were not reported formally to Council as a whole. We comment further on this matter later in this report.

Making advance payments for goods and services can be a significant business risk. In our view HCC was unwise in making advance payments of the Host City fees to CSM.

Recommendation 15: *Business risk should be specifically considered when making any significant advance payments for goods and services. Review by Council may need to be considered.*

10.6.3 Financial implications to HCC of CSM's failure

We have identified a number of matters of concern in relation to CSM's financial failure in April 2010:

CSM and CAM debt

By the time CSM's financial difficulties came to a head in April 2010, CSM was in debt to HCC by an amount of **\$2.987 million**. This total debt was made up as follows:

\$1.58 million (excl GST) in respect of:

- the first five months of lease payments by CSM for the Empire Street building was paid in March 2010 being 9 to 14 months overdue. However, no further lease rental payments by either CAM or CSM were made for the pit lane and Empire St buildings and a debt of \$874,167 had accumulated by April 2010, part dating from 1 November 2008;
- contracted shared revenue and ticketing revenue from the 2009 event of \$603,403 which had been invoiced;
- reimbursements relating to the 2009 and 2010 events of \$101,326 which had been invoiced. These reimbursements related to accommodation commissions and other support that HCC had provided; and
- other minor revenue amounts of \$1,220.

\$570,000 in revenue sharing:

Under the revenue sharing terms of the contract, HCC was entitled to expect a guaranteed revenue share from each event. HCC's entitlement from the 2010 event, due to be paid by 31 August 2010, was \$570,000. This debt was not invoiced nor received by HCC.

Similarly, ticket and catering revenue from the 2010 event was not invoiced; we understand no attempt was made to determine the amounts that may have been due to HCC from these sources.

\$837,500 for overpayment of Host City fees

\$837,500 had been paid to CSM by way of Host City fees paid in advance of original contractual obligations. This overpayment was never recovered.

Our conclusion

We do not believe that HCC has properly managed the debt situation with CSM and CAM. All debt should have been invoiced. We were unable to identify why some debt appears to have been ignored by HCC management.

Recommendation 16: *HCC should ensure that all legitimate debts are invoiced and that proper steps are then taken to recover that debt.*

10.7 Management's reporting of CSM debt to Council

At an Extraordinary meeting (public excluded) held on 21 April 2010 (a few days after the 2010 event), Council received and considered a report of the same date from the Chief Executive and the Deputy Chief Executive. The report advised Council that:

- CSM was no longer in a financial position to continue staging the event.
- Negotiations with V8 Supercars Australia Pty Ltd were underway to secure the event for the future.
- Debt due from CSM to HCC was \$1.58 million (excl GST). The report recommended that the debt be transferred to “...to the V8 Event Reserve” and suggested “...future profit share ... presents the best opportunity for Council to recover the money”.

However, the report did not refer to the Host City fees that had been paid in advance at that time (\$837,500). Nor did the report refer to the fact that HCC was unlikely to receive the “guaranteed” revenue of at least \$570,000 from the 2010 event. In our view the report should have disclosed the overall financial situation relating to the V8 event so that Council could properly consider these matters while also considering the novation of the event to V8SC.

We discussed this matter with Mr Redman as part of our review. He advised that he relied on reporting by the Finance team at HCC and that he was entitled to rely “on the completeness of that advice when signing the report” of 21 April 2010. We interpreted Mr Redman’s advice to mean that the failure to report the full level of CSM debt was a mistake by the Finance team.

Our conclusion

We regard the failure to report to Council on 21 April 2010 the further debt of \$1.4 million for the advances of Host City fees and guaranteed revenue as a serious oversight by management. We have already included in this report recommendations for better management and reporting of debt.

10.7.1 Liquidation of CSM and CAM

We are aware that Caleta Streerace Management Ltd and Caleta Asset Management Ltd are in liquidation at the time of writing this report. We were concerned to find that HCC had not advised the Liquidator of the full debt owed by these companies to HCC. HCC has only advised the Liquidator of a debt of \$1.58 million plus GST – this was the amount that had been invoiced to CSM.

It is clear from records filed with the Companies Office that HCC cannot expect any debt recovery. However, in our view the total debt, including the unrecovered Host City fees paid in advance and the “guaranteed” revenue from the 2010 event that was not invoiced should have been filed with the Liquidator.

Recommendation 17: *HCC should ensure that all debt is fully reported in any liquidation process.*

10.7.2 Release of CSM Directors from Personal Guarantees

Later in this report we refer to agreements to novate CSM’s original contract to V8 Supercars Australia Pty Ltd. One of the agreements – the Enabling Agreement – signed in May 2010 included provisions whereby CSM’s Directors were discharged from the personal guarantee obligations they entered into in respect of the pit lane lease arrangements.

The Enabling Agreement indicates that in the interests of being able to proceed with the 2010 event HCC wanted to secure support from CSM’s Directors for the novation to V8SC and waiving the personal guarantees ensured that support.

In discussing this matter with Mr Redman he has pointed out that the waiving of the personal guarantees was discussed with Council at its meeting on 21 April 2010. Mr Redman says that in his view he obtained a clear understanding with Council that if Council agreed the novation of the promotion contract then the personal guarantees would not be pursued.

We note from the transcript of this Council meeting that there was discussion amongst Councillors to the effect that it was unlikely that the Principals of CSM would have any money left to honour any personal guarantees to the Council. This was speculation on the Council’s part and was not necessarily a sound basis on which to conclude that there was little value in the personal guarantees being pursued.

Our conclusion

Discharging personal guarantees is a significant business risk. This removed a further opportunity for HCC to recover debts owed to it by CSM and in particular the \$874,167 owed in respect of rentals for the pit lane structure.

Council was aware of the proposal by management not to pursue the personal guarantees. However, in our view there should have been a formal resolution by Council that the personal guarantees would not be pursued if the novation proceeded.

Recommendation 18: *When a change is proposed to a significant term of contract such as guarantees, indemnities, insurances and payments then this change should be referred for approval to the approving authority for the contract (for the V8 event this was Council).*

10.8 Novation of the event from CSM to V8SC

The Chief Executive and Deputy Chief Executive’s report to the Extraordinary Council meeting of 21 April 2010 outlined “... proposed changes to the 2011 and future Hamilton ITM400 event in Hamilton and to gain Council approval for proposed contractual and financial changes”.

High level principles and approval for novation

The Officers' report detailed "*high level principles of the draft agreement between Council and V8SC*". The report arose from discussions Mayor Simcock and senior staff held with representatives of V8SC over the 2010 race weekend to secure the future of the event in Hamilton following CSM's financial failure. In general terms the report recommended the existing contract between HCC and CSM be novated to V8SC, and be amended to recognise the "high level principles" summarised in the report. The report made eight recommendations to effect the novation and contract amendments.

Council agreed the eight recommendations put forward by management, but also agreed an additional ninth resolution relating to co-ordination of a joint public announcement once agreement (with V8SC) had been reached.

From our review of the information related to the 21 April 2010 meeting of Council and in particular the transcript of that meeting we were left with the impression that because of the urgency for a decision Council felt it had only two choices – support the novation of the contract or abandon the event. Council concluded that it had no option other than to agree to the novation of CSM's contract to V8SC. Council was clearly concerned about what had occurred and sought clarification from management about a number of matters. The discussion at this meeting made reference to the need to protect the ratepayer investment in the race event. However, the novation was a decision that had to be made under urgency and unfortunately in our view it was made with inadequate or incorrect information.

Cost report not provided by management

We noted that the 21 April 2010 Officers' report advised that "*Due to very recent circumstances this report overtakes ...*" a commitment "*...to bring to Council a report on the status of the event following the 2010 Hamilton ITM400*". This was a reference to an earlier commitment by management to provide Council with a full cost report for the V8 race event. This cost report was not provided for the 21 April 2010 meeting. It was not until December 2010, a further eight months later, that Council received this cost report.

As part of our review we discussed with Mr Redman the absence of this cost report for the 21 April meeting of Council. He advised that the April 2010 race meeting had taken place immediately prior to the meeting of Council and that it was too early for the financial outcome of that event to be determined. Consequently, he did not believe that management could have provided a full cost report to this meeting of Council.

Our conclusion

We agree with Mr Redman that management was not able to provide to Council at its 21 April 2010 meeting a cost report that included full up to date information. However, it had been two years since a full cost report had been provided by management. A full report to Council was well overdue. We believe that management should have provided a cost report based on the best information it had available. If necessary the report could have made assumptions about costs and revenues for the 2010 event or could have been a report of costs up to a date immediately preceding the event.

We are concerned that Council did not have information on the total costs of the V8 event at the time it was making a decision on the event's future. Mr Simcock advised us that in his view *"those costs were not material to the decision that needed to be made"*. We disagree with this proposition. In our view management should have provided a cost report as it had earlier promised to do and Council should have insisted on receiving the report. That would have allowed Council to have a full appreciation of the relative risks of the choices before it. The novation of the promotion contract was a critical decision made in the absence of good cost information.

Assumptions made on future profits when considering the case for novation

The Officers' report to the 21 April 2010 meeting of Council set out the basis on which the contract for the promotion of the V8 event could be novated from CSM to V8SC. This report to Council referred to an enhanced ability with V8SC to run a financially successful race event:

"V8SC are firmly of the view that the 2011 and future events can be significantly enhanced and that these events can be profitable",

"V8SC are a large organisation, with the financial strength, track record and expertise to provide Council with a high level of comfort that they can deliver a successful and financially secure event".

The report also referred to a profit sharing arrangement between V8SC and Council.

The comments and recommendations in the 21 April 2010 Officers' report appear to be predicated on the assumption that profits would flow in the future, and that the financial problems would disappear.

We discussed this matter with Mr Redman. He advised that Councillors were aware at the 21 April 2010 meeting that there was no guarantee of future profits. There was specific reference to this at the meeting. However, he also believed there was increased confidence by both Councillors and management that V8SC could operate a profitable event.

It appears to us that there was a presumption by management and Councillors that there would be profits with future events. We do not believe that presumption was wise given the history of the event to that time. We note again that no further business case or economic assessment or cost reporting was provided to this meeting. This information would have given a fuller picture of the history and risks.

The novation agreements

Following the 21 April 2010 meeting, HCC and V8SC entered into a Heads of Agreement on 27 April 2010 (six days later) to ensure the continuation of the V8 event. This agreement was signed by Chief Executive Redman on behalf of HCC. Subsequently, specific agreements were entered into to give effect to matters in the Heads of Agreement. Descriptions of the primary agreements are:

- **Deed of Novation** signed on 24 September 2010 - the parties to this agreement were CSM, V8 Supercar Events Pty Ltd (V8SE) and HCC. This agreement was signed under common seal by the Deputy Chief Executive and a Councillor on behalf of HCC.

This Deed novated CSM's Agreement with HCC of 14 April 2008 to V8SE. The Deed of Novation released and discharged CSM from the original Agreement, and entitled V8SE to assume the rights, benefits, and obligations of CSM arising from the original Agreement.

- **Deed of Variation** signed on 24 September 2010 – the parties to this agreement were HCC and V8SE. This agreement was signed under common seal by the Deputy Chief Executive and a Councillor on behalf of HCC.

The Deed of Variation refers to the Deed of Novation, and sets out variations to the original 14 April 2008 CSM Agreement.

- **Hire Agreement** for the Pit Lane Structure (race infrastructure) dated 24 September 2010 – the parties to this agreement were HCC and V8SE.
- **Deed of Sublease** for the Empire Street Building facilities dated 24 September 2010 – the parties to this agreement were HCC and V8SE.

10.8.1 Management actions that were inconsistent with the Council's decision and directions on 21 April 2010

We have reviewed the Officers' report to Council dated 21 April 2010, Council's decision in respect of that report's recommendations, and the content of the various Agreements put in place to effect the transfer of the Promoter's responsibilities from CSM to V8SC. We also reviewed a verbatim transcript of the Council's public excluded meeting held on 21 April 2010. From these records we identified some inconsistencies between Council decisions and the subsequent actions taken by management. The inconsistencies are described as follows:

CSM and CAM debt

CSM and CAM accumulated significant debt arising from their purchases of supplies and services leading up to the running of the 2010 race event. CSM's financial situation created a serious risk that its suppliers would not be paid. This situation was of great concern to HCC because it created financial risk for the suppliers and placed at risk the continuing support from these suppliers for the 2010 event and for any future race event.

The Officers' report of 21 April 2010 advised that V8SC proposed to step in and take over the running of the event from 2011, subject to approval by the Council and the board of V8SC, and subject to V8SC settling CSM's debts with its suppliers. As part of V8SC's proposal all creditors of CSM (with the exception of HCC) would be settled and existing suppliers would have the first opportunity to continue providing services and products to the event.

The concern about CSM's debts was discussed at the Council's meeting on 21 April 2010 and at informal meetings held before and after the meeting of the 21 April. We did not locate any written records of the informal meetings. We have been told that there was some acknowledgement by Council at these meetings that if necessary HCC should assist with the settling of CSM's debts. The nature of this assistance is described below. HCC had no legal obligation to provide any assistance.

In the formal discussion of this matter at the Council's 21 April 2010 meeting there were repeated verbal assurances provided by management that V8SC would pay

CSM's creditors. The Officers' report presented to this meeting asserts that "*all creditors from the 2010 event will be settled by V8SC ...*".

However, for reasons we refer to below we do not consider the discussions at the Council meeting nor the Officers' report were reflected in the actions then taken by management in the settling of those debts.

Indemnity by HCC and the Compensation Agreement

We found that the Heads of Agreement referred to above placed an obligation on HCC to indemnify V8SC against any liabilities of CSM/CAM or from the event arising prior to V8SC taking over responsibility for the event. HCC provided this indemnity via a Heads of Agreement obligation which was subsequently translated into a Compensation Agreement.

The Compensation Agreement was signed by the Chief Executive, Mr Redman and V8SC on 19 May 2010 i.e about three weeks after the Council meeting. The payment vouchers related to this agreement were signed by the Deputy Chief Executive. The detailed terms of this agreement are confidential.

We have concluded that the overall effect of the arrangements set out in the Compensation Agreement was to obligate HCC to pay V8SC a sum of \$3.025 million. The Agreement then required V8SC to pay CSM \$3.025 million so that CSM could settle with its creditors. The Agreement also included an undertaking by HCC to V8SC that CSM had been obligated by HCC to pay the \$3.025 million (the actual payment was \$2.99 million) to its creditors.

A separate Enabling Agreement was entered into between HCC, CSM, and CSM's Directors on 6 May 2010. This Agreement included a requirement for CSM to use the payment it received from V8SC to pay its creditors.

Neither the Officer's report of 21 April 2010 nor the discussions with Council at its meeting made any explicit reference to a "Compensation Agreement". There was discussion at the Council meeting about "transition costs". Mr Redman advised us that he considered the Compensation Agreement to be part of those transition costs. We sought in our review to understand what had actually occurred with the settling of the CSM/CAM debts.

Our concerns about the compensation arrangements

Our particular concerns were:

- whether the Compensation payment that was made to V8SC was a new additional cost to HCC or an advance against other monies that would have been due and paid at a later time;
- whether the payment was properly authorised; and
- how the payment was funded.

We discussed these matters with Mr Redman and HCC staff. In Mr Redman's submission to us of 8 September 2011 he advised:

- *“It is my understanding from the finance staff that an advance from the Events Sponsorship Fund funded the Compensation payment”.*
- *“In approving the Deed of Novation, Deed of Variation, Compensation Agreement and any associated agreement I sought and received advice from the DCEO (Deputy Chief Executive) that at the time of approval they were within management’s delegation based on his analysis of the Council resolutions from April 2010. A major principle being the financial delegation provided in Recommendation 4 from the April 2010 meeting.....I was entitled to accept this advice and did so in good faith”.*

Recommendation 4 stated: *“That the event sponsorship fund will have a probable timing increase in the reverse carryover of future budgets to fund the transition and set up costs of V8SC”.* Later in our report we comment on the lack of clarity of this recommendation.

Our review of this compensation matter has confirmed that:

- The Officers’ report to the 21 April 2010 meeting refers to HCC assisting with “transition and set up costs of V8SC” and links this to the events sponsorship fund. The transcript of discussions at this meeting refers to the intention to “bring forward some of the next year’s payment to assist with some of these transitional costs” i.e an arrangement to make advances or prepayments of the Host City fees.
- However, the Compensation Agreement that was put in place to effect this assistance from HCC makes no reference to the payment of \$2.99 million being an advance or prepayment of any monies due in the future. Specifically, the Agreement makes no reference to it being an advance against the Host City fees which are funded from the events sponsorship fund. It is clear from the Agreement that the compensation payment is non refundable so accordingly it was not an unsecured loan and nor was it a prepayment of monies due in the future.
- No other formal agreement with V8SC appears to exist that secured and confirmed the Compensation payment as an “advance” or prepayment of monies due in the future.
- Neither the Officers’ report to Council on 21 April 2010 nor the transcript of the discussions at that meeting record any explicit reference or intention for HCC to make an additional payment of \$2.99 million to V8SC at HCC cost for use in settling CSM’s creditors.
- There was no specific budget provision made by HCC for the total of \$2.99 million paid to V8SC and the \$41,000 paid to another CSM creditor.
- Host City fees for 2011 were paid from the Events Sponsorship fund. The first instalment of these fees was paid late and following the signing of the Deed of Variation on 24 September 2010.
- In a letter from Mr Redman to us dated 3 October 2011 he provided us with a further explanation of his understanding of the basis for the funding of the Compensation payments. His explanation relies in part on a saving he made

in negotiating Host City fees with V8SC and the use of that saving to offset part of the cost of the Compensation payments. Mr Redman also referred to an expectation that the race event may be shifted from April 2011 to November 2011 which could have given rise to a further saving. We consider this expectation of a shift in the race timing to have been an unreliable funding assumption. It would have required a new consent process that would have given rise to further cost and risk to HCC without any certainty that the shift in race timing would have been approved. No aspect of the arrangement described by Mr Redman for the funding of the Compensation payment appears to us to be genuinely an advance or prepayment of Host City fees as also asserted by Mr Redman. The explanation appears to be that savings made in one area of expense for the V8 event and savings assumed in another area were reallocated to fund other V8 related expenses (the Compensation payments). We found no evidence to suggest that any of this had been properly discussed or agreed with Council.

- We were advised by the Deputy Chief Executive that the proposition that the Compensation payment would be in the form of an “advance” was not discussed or agreed with V8SC. The Deputy Chief Executive also told us that he believed the Chief Executive, Mr Redman did not have the delegated authority to sign the Compensation Agreement in the form drafted.
- Mr Simcock advised us that the Compensation payment was discussed with Council informally at a meeting on or about 20 April 2010 i.e the day prior to Council’s formal meeting on 21 April. However, he commented that the resolutions agreed by Council at its 21 April meeting did not reflect Council’s understanding from the preceding day.

However, we have reviewed the extensive records that exist for the 21 April 2010 meeting and there is no indication to us that Council agreed recommendations that it knew to be incorrect in terms of the discussions the previous day.

Our conclusion

- We believe the only understanding that Councillors could have derived from their meeting on 21 April 2010, from the Officers’ report and recommendations presented to that meeting and from the discussions at that meeting was that the assistance that HCC may provide in respect of CSM’s creditors was an advance or prepayment of Host City fees to V8SC to assist it in paying off the CSM creditors. However, that did not occur.
- Council was advised by the Chief Executive at the meeting that V8SC “*have asked us to bring forward some of the next year’s payment to assist with some of these transitional costs*” and that a proportion of this may be used to pay off CSM’s debts. This was a clear reference to an advance or prepayment. However, no advance or prepayments were actually made.
- The Compensation payment of \$2.99 million made by HCC to V8SC was not an advance or prepayment of any monies due to V8SC in the future. No such arrangement was secured in the formal agreements with V8SC. It was a new and additional cost for HCC for which there was no specific budget.

- The Compensation agreement with V8SC was signed by the Chief Executive, Mr Redman on behalf of the Council. The Compensation Agreement as a document is quite straightforward with respect to its provisions. The absence of any reference to the “advance” nature of the Compensation payments should have been quite obvious to Mr Redman when he signed that document
- Host City fees were separately paid in full for 2011. Clearly there was no administrative understanding that the Compensation payments were to be an advance against these fees.
- We have not been able to determine the extent to which Mr Redman relied on advice at the time he signed the Compensation Agreement. However, the Chief Executive is ultimately accountable for the agreement.
- Council was not formally made aware nor did it specifically approve an additional cost to the V8 event of \$2.99 million to compensate V8SC for the settlement of CSM’s creditors. At the time the compensation payments were made most Councillors had not been aware that HCC had met the cost of CSM’s debts.
- The Compensation payment was a new additional cost to HCC. It was not referred to and was not consistent with the principles agreed with Council as set out in Paragraph 2.5 of the Officers’ report to Council of 21 April 2010.
- The transcript of the 21 April 2010 meeting records Mayor Simcock’s advice that “*there is no room in this resolution for staff to negotiate another deal as far as I am concerned*”. However, we did not find any formal reference back to Council about the Compensation payment.
- For the above reasons we concluded that the Compensation payment of \$2.99 million made by HCC to V8SC was not properly authorised by Council.
- There is one further matter we raise. A circuitous arrangement was put in place to pay CSM’s creditors. Payments were made by HCC to V8SC in Australia who in turn passed those monies on to CSM in New Zealand. Those monies were then used by CSM to pay its creditors. The services provided by those creditors would have been subject to GST. The GST would have been approximately \$330,000. We suggest HCC clarify who obtained the credit for this GST.

Event losses and the claw back provision

The 21 April 2010 Officers’ report indicates that one of the principles of the draft agreement between the Council and V8SC was that “*V8SC underwrite all operating losses*”. Commentary in the report includes “*V8SC will promote and run the event, with Council having no exposure to any operating losses, and sharing any event profits 50/50 with V8SC*”. Similarly, the transcript of the 21 April 2010 Council meeting records repeated clear advice by management that V8 event losses from and including 2011 would be met by V8 Supercars, and that profits from events would be shared 50:50.

However, the Heads of Agreement dated 27 April 2010 and the Deed of Variation dated 24 September 2010 departed from the principle that HCC would have “no

exposure” to any operating losses. These agreements allowed V8SC to “claw back” all losses (from the 2011 event) out of profits from future race events. The actual terms of these agreements are confidential. However, we have concluded that the effect of the claw back arrangement is to significantly diminish the likelihood of HCC ever receiving a share of any future profits.

Again, from our interviews with Councillors we found that many were not aware of this “claw back” provision. Until our review many had understood that V8SC would meet all event losses. However, Councillors were aware that event profits would be shared 50:50. Similar advice was given to the media.

We discussed this matter with Mr Redman. He confirmed that the inclusion of the claw back provision “*was agreed by management as part of the negotiations with V8SC*”.

Mr Redman also pointed out that a reciprocal claw back agreement was negotiated in HCC’s favour that could have increased the profit share available to HCC over the term of the contract by a further \$990,000 over and above the agreed 50:50 profit share. However, this claw back arrangement which was in HCC’s favour only applied after the claw back provision in V8SC’s favour had been applied.

We are particularly concerned that management was not transparent with Council or with the public about these claw back arrangements. These arrangements were not consistent with the understanding and approval given by Council at its meeting on 21 April 2010. The financial impacts of these arrangements are a matter to be determined in the future.

2010 event freight costs

The 21 April 2010 Officers’ report to Council makes no reference to the difficulties that were being experienced by CSM in meeting the cost of freight for the cars for the 2010 event. Management was aware of this issue at the time of their report to Council.

The Heads of Agreement and Deed of Variation both provided for HCC to pay a share of the 2010 freight cost by 30 December 2010. Of particular note is the fact that the Heads of Agreement refers to a previous agreement in respect of this matter. That prior agreement stemmed from an exchange of emails between V8SC and HCC’s Chief Executive on 6 and 8 April 2010 that required payment by 1 July 2010. The Heads of Agreement amended and extended the time for payment until 30 December 2010. This exchange of emails occurred two weeks before the 21 April 2010 meeting. However, the Chief Executive, Mr Redman did not specifically mention the freight issue either in his report or at the meeting on 21 April 2010. HCC paid its share of the freight costs (\$474,717.31) on 22 December 2010. HCC had no contractual obligation to make this payment under its original agreement with CSM.

We discussed this matter with Mr Redman. He acknowledged that the 21 April 2010 report to Council should have referred to this freight cost but that management had viewed it as just one of the transition costs that were anticipated at that time. Mr Redman also stated that the freight cost was not a new or additional cost to HCC as it was “*deemed an advance on sponsorship monies HCC would pay to stage the 2011 event*” and he refers to an agreement with CSM of 14 April 2010 in this regard. However, this was an agreement between HCC and CSM and not between HCC and V8SC. Shortly after this agreement was signed the contract was novated to V8SC. The sharing of the freight costs that was then agreed with V8SC was not secured on

the basis of HCC's share being an "advance". This became a new additional cost to HCC that was not specifically discussed or agreed with Council.

Freight costs from 2011

The 21 April 2010 report makes no reference to the fact that V8SC expected to recover a share of the total freight costs of each race from any profits (after the claw back of losses from previous years). The subsequent Heads of Agreement and Deed of Variation entitle V8SC to recover a significant share of freight costs from profits.

Our overall conclusions

We did not find evidence that the settling of CSM's debt, the compensation arrangements, the inclusion of the claw back provisions nor the cost sharing arrangement for freight costs were raised with Council formally for approval. These arrangements were at odds with the principles agreed with Council at the meeting on 21 April 2010 to be used as a basis for the novation of the Promoter contract and the continuation of the event.

We again note from the transcript of the Extraordinary Council meeting of 21 April 2010 that a Councillor referred to the "...*Agreement in Principle in front of us...*" and asked "...*if there is any sort of a large degree of difference from here, have we got an assurance that this is going to come back...*".

In response, Mayor Simcock advised "*There is no room in this resolution for staff to negotiate another deal...*".

It appears to us that staff did negotiate a substantially different deal. In terms of the direction provided by Council at the 21 April meeting HCC management should have referred these matters back to Council for its approval but did not do so.

10.9 Decision-making - delegated authorities

Council Subcommittee

We noted that the Contracts Subcommittee of the F&A Committee, when approving the V8 Supercars contract with CSM in 2007, was acting under delegated authority from the Council in terms of the Council's Delegations Policy relevant at that time. We have commented earlier in this report that in our view major decisions and approvals particularly those that cut across several functions of Council should be referred to full Council, or a committee of the whole of Council.

Delegations policy

Council's Delegation Policy Manual authorises the Chief Executive "*to spend or contract up to 100% of the specified sum on any item within the Council's work plan and budget (LTCCP and Annual Plan)...*". The Policy sets the "*specified sum*" at \$500,000 (GST excluded). The Policy also requires the Chief Executive to report on any contract entered into over 50% of the specified sum. The Policy also places an obligation on any delegate to report decisions to Council where the decision "*is one of which the delegator for any reason should be aware*"; or where the "*...matter determined is one which the delegator or the Council has in any way whatsoever indicated that a decision of that kind should be reported in a particular way*".

Staff delegations

We have noted previously in this report that a number of variations were instructed by management in respect of the contract with CSM. We have also noted that a number of decisions were made by management that appear to be at variance with Council decisions. From our review of HCC records we have concluded that some decisions were made and some variations were authorised by management that should have been referred to Council. We believe these management actions were outside the delegated authority for the staff concerned.

The particular decisions made under authority of the Chief Executive or Deputy Chief Executive that we believe are outside their authority are set out below.

10.9.1 Agreement to vary the Host City fee schedule – May/June 2009.

Following a request from CSM on 22 May 2009 the Deputy Chief Executive wrote to CSM on 2 June 2009 and agreed to make advance Host City fee payments. In doing so HCC effectively varied Schedule 2 of the original 14 April 2008 contract with CSM. The Deputy Chief Executive's actions constituted an instruction to vary the contract with CSM. The Deputy Chief Executive has advised us that in issuing this variation he was acting under directions from the Chief Executive, Mr Redman.

Host City fees were advanced from 2010 entitlements in order to assist CSM to meet its financial obligations arising from the 2009 event. As we have noted previously in our report the advancement of these payments resulted in HCC paying \$837,500 of Host City fees that were never recovered when CSM failed financially in April 2010.

The approval of this variation should have been referred to the approving authority for the original contract i.e to Council. While the Delegations Policy may not explicitly cover this matter we believe prudent and experienced managers should have recognised the need to seek the Council's approval for this action.

10.9.2 Variation Agreement 14 April 2010.

The Chief Executive, Mr Redman signed this formal variation agreement on 14 April 2010. The variation provided for the payment of further Host City fees. This agreement involved 2011 Host City fees being paid in advance to allow the 2010 event to proceed. No advance payments were actually made under this agreement because CSM's financial failure overtook events.

10.9.3 Management's rationale for its actions in instructing contract variations

We have described the June 2009 and 14 April 2010 proposals for advance payments to be made as "variations" because they amended the terms of Schedule 2 of the contract with CSM (the payment schedule). The fact that the June 2009 variation was somewhat informal in its execution does not in our view alter the fact that it was a variation. The April 2010 variation was formally instructed.

We sought to understand in this review why HCC management believed it could instruct a variation to a contract without reference to the approving authority for that contract (the Council in this instance). We were advised by management that provided the change to the contract did not involve additional cost to HCC then it was not a variation that required Council approval. We disagree with this proposition.

We also discussed this matter with Mr Redman. He advised us that:

- *“in all decisions made by management there was thoughtful consideration of whether officers had delegated authority to enter into agreements”.*
- *“when approving advance payments or variations to the contract (he) sought and received advice on delegations from the DCEO” (Deputy Chief Executive Officer).*
- *“in approving the Deed of Novation, Deed of Variation, Compensation Agreement and any associated agreement (he) sought and received advice from the DCEO that at the time of the approval they were within management’s delegation based on his (DCEO’s) analysis of the Council resolutions from April 2010.”*

We discussed Mr Redman’s position with the Deputy Chief Executive. He agreed that he discussed the delegations issue with the Chief Executive but he says that the Chief Executive’s interpretation differed from his. He advised that the concept of a “fiscal envelope” was the Chief Executive’s way of interpreting delegations as was the concept of reporting “net cost” rather than gross cost. He advised us that he did not agree with these interpretations and communicated his view to the Chief Executive. The Deputy Chief Executive acknowledged that he had worked on the various agreements that were drafted for the novation. He also stated that the terms of those novation agreements were agreed with the Chief Executive, Mr Redman.

We have not attempted to reconcile the views of Redman and the Deputy Chief Executive noted above.

The making of advance payments of Host City fees that occurred in 2009 may not have resulted of itself in additional cost except that part of this was never recovered. However, the making of advance payments was a significant alteration to an agreed payment schedule. This constituted a variation that strikes at the heart of a contract. The change in this instance also carried significant risk. Any change to the terms of a contract is a variation. Unless a contract sets out an alternative delegation for the approval of variations then we would expect the approving authority for a contract to approve any variations. In this instance Council was not asked to approve the variations and we believe it should have been. This would also have ensured that Council was more aware of a significant emerging issue.

10.9.4 Compensation Agreement 19 May 2010

We have reported above on the Compensation Agreement that was agreed with V8SC on 19 May 2010 and an associated Enabling Agreement with CSM’s Directors that was signed on 6 May 2010. The Compensation Agreement had no relationship to the original contract with CSM. It related to a set of new contracts with V8SC for which principles had been agreed with Council.

Management did not raise with Council the necessity for compensation arrangements as a new additional cost to HCC. The payments that were made (\$2.99 million + \$41,000 = \$3.031 million) were well in excess of the Chief Executive’s financial delegation. There was no certain prospect that this would ever be recovered and therefore it represented a significant increase in cost for the V8 race event.

We raised this matter with Mr Redman. He explained that he was able to negotiate savings in one area of expenditure for the V8 event (Host City fees) that in terms of his delegations he believed he was then able to use to fund the Compensation payments. In applying management's "fiscal envelope" interpretation of delegations he believed he did not require any further approval by Council for the Compensation payments. We do not accept the validity of this position. In any event the savings made or assumed only accounted for part of the costs of the compensation payments.

Furthermore, we were particularly concerned that the Officers' report to Council of 21 April 2010 referred to V8SC being responsible for settling CSM's debt. Indeed, the Council's resolution of 21 April 2010 specifically noted that the agreement with V8SC was subject to the approval of V8SC's Board settling the creditors from the 2010 event. No specific mention was made in the Officer's report or in the resolution that HCC would be reimbursing V8SC and HCC would be carrying the cost.

We have concluded that the Compensation payment was not properly authorised by Council and nor was it within the delegations applying to the Chief Executive.

Our overall conclusion on the delegations matter

We found that in respect of all the matters referred to immediately above staff exceeded their delegated authority and took actions that were not properly authorised. These matters were not referred to Council for approval nor were they reported to Council at the time the matters arose.

Recommendation 19: Council should review its delegations policy to incorporate specific requirements in respect of contracts and to clarify what constitutes a variation that requires approving authority approval and in particular Council approval.

Recommendation 20: All Council committees, subcommittees, officers and others holding delegated authority should be reminded of their responsibilities and obligations under the Council's Delegation Policy.

10.10 Confidentiality used as justification for not informing Council or the public

Some decisions and activities undertaken by councils may require a need for confidentiality particularly when commercial issues are concerned. During this review we made a number of observations about the approach HCC took to the V8 event:

- The early discussions between HCC and CSM in 2005 were conducted with a high level of confidentiality. We understood that this approach was taken because of the competing interests of other cities in hosting the event but principally because of demands by the proposed Promoter. It is apparent that most Councillors were unaware of the race event opportunity until the surprise announcement by Mayor Redman in February 2006. The knowledge of the event opportunity was known to a small group consisting of the Mayor and several senior staff.
- The Council or its Committee made decisions on a number of contracts or agreements that were entered into for the hosting of the event, for the novation of the Promoter's contract in 2010 and for construction contracts awarded for the building of the track infrastructure. We did not identify any instance where the agreement documents were placed in front of Council for

its information. Commercial confidentiality appeared to have been used to withhold this information from Council.

- Many of the meetings at which Council made its decisions on the V8 event and the contracts related to it were conducted in public excluded sessions of Council.
- The Council's consideration through its Committee of the Events Sponsorship Fund in relation to the payment of the Host City fee was conducted in a public excluded session of Council.
- Much of the Council's reporting on the above and the minutes of meetings was kept confidential and the information was not available to the public.
- It was clear from documents that we reviewed that the Promoter wished to maintain confidentiality around the commercial arrangements for the event. It appeared to us that the Promoter's sensitivity was more about protecting its commercial position rather than HCC's.
- We discussed this matter with Mr Redman. He commented that the decision to operate in public excluded is made by Council not by management. He also pointed out that a Councillor was on the Project Control Group set up to manage each race and that Councillor had an obligation to report back to other Councillors.

The consequences of the approach taken were:

- Despite being the governance group Councillors were often not as well informed as they should have been about issues, risks, costs, funding assumptions and various management decisions on the event. We have commented on this earlier in our report, for example the failure to report CSM's debt to Council in 2009.
- Over a significant period of time total costs of the V8 event were not reported to Council. In particular, Council was unaware of the total cost of the event when it made its decision in April 2010 to novate the contract for the promotion of the event. This had significant consequences.
- Information provided by HCC to the media in March 2010 appears to have been constrained by a need for confidentiality. As a consequence it was incomplete and potentially misleading. Within several weeks of the media enquiry CSM withdrew from its contract with HCC.

Ideally management and Councillors should be operating in a "no surprises" and transparent environment with the Council's business. There will be some constraints in relation to detailed and commercially sensitive information. However, HCC should be proactively working towards and regularly reviewing its approach to an open operating culture. There is clearly a need for a better and more open relationship between management and elected representatives. However, that requires trust on both sides and a confidence by both management and Council that what needs to be kept confidential is kept confidential.

10.11 Reporting

Regular and appropriate reporting of projects and major activities is a critical component of good management and governance. The reporting requirements should be agreed between management and governance. The reporting needs to focus on those matters that are important to accountability and good performance such as costs, risks and progress.

During this review we became aware of considerable dissatisfaction by some current Councillors about reporting of the V8 event by HCC management and concerns about whether it had been adequate. In reviewing our draft report Mr Simcock commented to us that he believed the concern about reporting only arose during the 2010 election campaign and that the concern was not evident earlier. He commented that the Chief Executive, Mr Redman had been complimented by Councillors on his ready availability to respond to questions from Councillors. It was apparent to us from Mr Simcock's comments that a distinction was being drawn between informal reporting and formal reporting by management. We accept that there may have been a range of informal reporting occurring that provided information to Council or some Councillors but there are no records of that and it is very difficult to understand the adequacy of it. However, there is clearly also a need for good formal reporting by management to Council and in this review we sought to understand that.

We found the following features with the formal reporting on the V8 event.

10.11.1 Reporting of costs

We considered the way in which costs were monitored by HCC and reported to Council:

Reporting of net cost

The June 2006 -16 LTCCP reported a cost of \$7 million for the track infrastructure plus Host City fees. The contract that was eventually agreed with the Promoter and signed in April 2008 provided for some revenue sharing and some guaranteed revenue for HCC from each race event.

However, the costs of the track infrastructure rapidly increased through 2007 and early 2008 and quickly exceeded the original \$7 million estimate. Management's response to this was to adopt a practice of reporting net cost for the event. As the costs increased management reassessed the forecasts for the likely revenues that it might receive for the event and concluded that increased revenues would match the increased costs. HCC was then able to continue to report a net cost of \$7 to \$8 million for the event despite the fact that costs had risen significantly above the original \$7 million cost. This change to reporting net cost lacked transparency with respect to the total cost of the infrastructure. The reporting of net cost did not properly disclose to Council the actual costs that were arising nor the assumptions that were being made by management about projected revenues. In our view the revenue assumptions were optimistic. The approach taken by management to the reporting of costs appears to have reinforced in some Councillor's minds an understanding that the total overall cost would be approximately \$7 million.

Reporting of total cost

Total costs of the event were reported to Council in February 2008 just prior to the first race and then again in September 2008. A further report did not occur until December 2010. Management had undertaken to report total costs to Council in April 2010. However, this did not occur because management believed that with the demise of CSM a sensible cost position could not be presented. Consequently, a period of more than two years elapsed between September 2008 and December 2010 with Council not receiving a full update on costs of the event. We discussed this matter with Mr Redman and he advised that he believed Council had been happy with the arrangement for reporting and could have requested additional reporting but did not.

We found that reporting was occurring for discrete parts of the V8 event project and to discrete parts of Council. For example, the Event Sponsorship Subcommittee was receiving regular but confidential reports on events sponsorship which included the Host City fees that were being paid. The Contracts Subcommittee in public excluded sessions was approving a range of contracts to build infrastructure for the event. The Finance & Audit Committee was receiving reporting on the V8 reserve and other aspects of cost for the V8 event. Some reporting was occurring as part of the Council's statutory annual reporting. All this reporting appeared somewhat disparate in nature.

Although we have concluded that the reporting to Council has not been adequate, we found that Council had better knowledge of costs than some former and current Councillors may be recalling now. We noted that Councillors received agenda reports and minutes whether they were a member of a committee or not. Some aspects of cost were well reported such as the Host City fee and various individual contracts for the track building. The V8 Reserve was clearly identified in Council reports. The difficulty for Councillors was that they had to try to bring all the costs together themselves rather than being presented with a properly constructed report that clearly set out the total costs. Council also had limited knowledge of the revenues that were or were not being received. Council had no knowledge of the revenue assumptions that its management team was relying on and some areas of cost and some debts were not disclosed to Council at all.

Notwithstanding the limited reporting to Council, management was maintaining for itself a detailed record of total costs until late 2008. This reporting was maintained initially to support the needs of the infrastructure development project for the event. We reviewed some of this information. We found that it contained a good picture of the emerging costs and likely total cost outcome. It was unfortunate that Council did not receive the benefit of this cost information through regular reports. It is also unfortunate that the detailed cost record being produced by management does not appear to have continued beyond late 2008. Mr Redman advised us that he had not been aware of these management reports.

10.11.2 Omissions in the formal reporting

We found some significant omissions in the reporting by HCC management to Council. We have noted many of these matters earlier in our report but summarise them as follows:

- Management did not report to Council (more specifically the Finance and Audit Committee) on the outstanding debts that CSM and CAM had with HCC

during the latter part of 2009 and leading up to the 2010 novation. Unpaid rentals for the pit lane structure and Empire Street building totalling \$874,167 is an example of this.

- At the time of the April 2010 novation management did not clearly and specifically advise Council of the intention to enter into a Compensation Agreement requiring HCC to pay off CSM's debts to others.
- Again at the time of novation HCC management did not advise Council of the arrangements it was making with V8SC for HCC to meet a share of costs for the freight of cars for the 2010 race event and subsequent events.
- HCC management did not inform Council about the variations it was agreeing and the advance payments of the Host City fees it was making or proposing to make during 2009 and 2010.
- HCC management generally did not provide Council with good information on the terms and conditions of contracts it was entering into for any aspect of the V8 event – including the original contract with CSM, the contracts to build the track and the agreements entered at the time of novation of the promoter contract.

10.11.3 Ambiguous reporting

We also found instances when the reporting by management was ambiguous, unclear or too technical to be easily understood. Two examples of this were:

- The Summary of V8 Financials November 2010 prepared by management refers to *“borrowed from HCC's internal cash reserve (V8 reserve debt) to be repaid from V8s profit”*. In fact the reserve had a debit balance and there was no “cash”. The reference to a cash reserve is difficult to understand and potentially misleading. We note that this information was released publicly. We regard it as a poor statement whether technically accurate or not.
- The 21 April 2010 Officers' report contained a recommendation *“that the event sponsorship fund will have a probable timing increase in the reverse carry over of future budgets to fund the transition and set up costs of V8SC”*. Council agreed this recommendation apparently without comment. However, in our view its meaning is almost incomprehensible. It concerns us that management has relied on its interpretation of this recommendation to justify a series of actions it took that we regard as inappropriate. We refer to the Compensation payments and share of freight costs in this regard.

10.11.4 Our conclusion on the quality of the reporting to Council

In our view the formal reporting by HCC management to Council about the V8 event was not adequate. There appears to have been a lack of understanding between management and governance about what the reporting expectations were for this Project. The failure by HCC to recognise this event as a seven year project compounded the issue. Consequently, reporting on the V8 event was inconsistent and incomplete. There is a need for a significant improvement in the reporting of future projects. For a major project or activity (including situations like the V8 event where the activity is periodic) we suggest that Council consider putting the approvals, reporting and monitoring in the hands of Council as a whole, or a Committee of the

whole of Council to ensure that Council as a whole has awareness of all matters related to the project.

While undertaking this review we noted the reporting being currently provided for the Claudelands Development. We found that it was of a much higher standard than had been evident for the V8 event. A continuation of this approach by HCC for future projects would clearly be beneficial.

Recommendation 21: *For major projects and activities Council and management should agree the specific requirements for reporting.*

Recommendation 22: *For major projects and activities management should consider providing a regular consolidated report to Council on all aspects of the project.*

Recommendation 23: *Management should ensure that reports to Council are written in clear non-technical language to ensure for both Council and the public that there is clarity of understanding.*

Recommendation 24: *Council should make robust enquiry of management to be satisfied it has sufficient and clear information and understanding to make its decisions.*

Recommendation 25: *Management should ensure that robust mechanisms are in place to keep Council informed about serious contractual risks that could have significant financial implications for HCC.*

10.12 Internal Audit programme

We understand that major projects being undertaken by the HCC have generally not been included in the annual internal audit programme. Some projects have been the subject of separate and from time to time independent reviews. However there has been no consistent approach to formally and periodically reviewing major projects.

The V8 event consisting of races over seven years each with costs and revenues for HCC was not recognised by HCC as a project. Consequently, there has been little formal review of it over the last three years. It is possible that some of the issues with this event such as the adequacy of reporting and the awareness of risks and costs may have been identified earlier if the V8 event had been the subject of independent review or included in the internal audit programme.

We believe that major projects should be incorporated into the internal audit programme. The delivery of audit against the agreed programme could involve the use of internal staff or could require the engagement of external specialists. The external specialists may be engaged by the project managers. However, the review or audit should be coordinated as part of an overall programme of work.

Recommendation 26: *Periodic review of major projects should be incorporated into the annual internal audit programme.*

10.13 Improvement actions taken by the Council

We commenced this review in March this year. Concurrently with our review Council and its management have introduced a number of organisational changes to improve governance and management aspects of HCC's operations. We have not reviewed any of these changes but they appear to be consistent with the actions we may have

expected HCC to take arising from this review. We commend HCC for taking these steps. We note the changes made by HCC as follows:

- A new governance structure has been introduced with fewer committees and subcommittees and with full representation by all elected members on all standing committees.
- A new delegations policy has been introduced.
- A new management structure has been introduced.
- A new risk management policy has been implemented.
- An improved reporting framework has been developed particularly with respect to projects.
- Business cases are now required for all new projects.
- Reporting of overdue debts has been enhanced.
- A new document management system has been being introduced.

10.14 Our overall conclusions

The V8 Supercar race is a significant event for HCC, for Hamilton City and for its community. The four races held to date have no doubt been a success as an annual high profile occasion for the City. Two assessments that have been undertaken indicate that there has been significant economic benefit to the City and its environs. However, these successes have come at a cost to HCC that is significantly greater than had been expected. This has led HCC to question its support for the event.

At HCC's request we have completed a review of the V8 Supercar event. We have considered the approach and processes that HCC has followed in supporting and hosting the race events. This report has set out our findings and recommendations from the review.

We summarise our key findings as follows:

- There was a lack of caution by both management and Council in committing to the V8 race event in 2006. There was no objective assessment of the event opportunity. No business case was prepared. No due diligence of the proposed Promoter was undertaken. Financial difficulties with CSM were apparent before the contract with CSM was signed.
- The V8 event was not recognised by HCC as a seven year project. The application of project management principles would have seen a much more robust approach being taken to defining responsibilities and managing matters such as cost, funding, risks and reporting over the full duration of the event.
- The sub project that was established to build the track infrastructure and the work that was undertaken to obtain a resource consent for the event appears to have been well managed by HCC.

- The initial January 2006 cost estimate prepared by CSM for the track development and upon which the Council's commitment to the event was made was quite inadequate. Well before the first race event and well before the formal contract was signed with CSM it was evident to management that costs would significantly exceed the original estimates.
- HCC spent in excess of \$18 million on the provision of track infrastructure as well as the payment of some Host City fees before the formal contract was signed with CSM in April 2008. This was a significant business risk for HCC that in our view was unacceptable for a public sector organisation to take.
- Management did not share total cost information nor information about CSM's financial difficulties with Council as well as it should have. For a period of two years Council did not receive a report on the total costs of the event.
- Management took steps to assist CSM with its financial difficulties. Advance payments of Host City fees were made and the payment by CSM of some debt to HCC was deferred. Council was not properly advised of these matters at the time they occurred.
- As at December 2010 the total cost to HCC of hosting the 2008, 2009 and 2010 race events was \$37.4 million. Revenue of \$1.5 million obtained from the first two races has reduced the net cost of the V8 event to approximately \$36 million. This cost is a little higher than advised to Council in December 2010. This cost is significantly greater than the cost signalled in the 2006-16 LTCCP of \$7 million plus the Host City fees. The cost of the Host City fees was not disclosed in the LTCCP for commercial confidentiality reasons.
- The total debt that CSM has with HCC is \$2.987 million. It is unlikely that this debt will ever be recovered. \$837,500 of the debt related to a proportion of the Host City fees that was paid in advance and never recovered when CSM failed. Management agreed the advance payments without reference to Council.
- The decision made by Council to novate the Promoter contract from CSM to V8SC was made without knowledge of the total costs of the race event. No business case was prepared for the novation proposal. Council should have insisted on management providing this information.
- However, from our review of the information related to the 21 April 2010 meeting of Council we were left with the impression that because of the urgency for a decision Council felt it had limited choice but to agree to the novation of CSM's contract to V8SC.
- At the 21 April 2010 meeting Council agreed with management a set of principles to be applied to the new Promoter contract with V8SC. Management put in place a suite of agreements that should have been consistent with these principles.
- Included amongst these agreements was a Compensation Agreement through which HCC paid off CSM's creditors in the sum of \$2.99 million. In our view this agreement was inconsistent with the principles that had been formally

agreed by Council and inconsistent with the advice that management had provided to Council. We did not locate any proper authorisation by Council for this payment. The payment does not appear to fit within management delegations.

- There were several other aspects of the agreements that appeared to be inconsistent with the Council decision and direction at its 21 April 2010 meeting. We note in this regard the inclusion of a claw back provision with respect to losses and the agreement by HCC to pay a share of the freight costs.
- Reporting by management to Council on this V8 event has not been satisfactory. In particular, we note that the reporting of the total cost of the V8 event was not satisfactory.
- There has been significant use of confidentiality provisions and public excluded Council meetings in the conduct of business for this race event. This has left both Council and the public with poorer knowledge than it should have had.
- The V8 event project has not been the subject of any previous review. It should have been. Major projects and activities should be included in the internal audit programme.

We have included a number of recommendations in this report that if actioned by HCC would result in significant improvement in the management of future projects.

This review has been difficult for some of those involved in it. Seven years has now elapsed since the race event was first considered by HCC. Consequently document and memory retention has been tested by the review. There has also been a high level of public interest in the review. However, we have appreciated the assistance provided to us by the Council and its staff and by the former staff and former elected members who we have interviewed.

Next steps

Please feel free to contact us if there are any issues on which you would like further clarification, or if we can be of further assistance.

Yours sincerely



Peter Davies
Director
Specialist Assurance Services



Rod Titcombe
Consultant

Appendix 1: Persons interviewed as part of this review

Current elected members

Mayor Julie Hardaker
Marijke Westphal
Peter Bos
Pippa Mahood
Roger Hennebry
Daphne Bell
Gordon Chesterman (Deputy Mayor)
John Gower
Dave MacPherson
Angela O'Leary
Margaret Forsyth
Martin Gallagher
Ewan Wilson

Former elected members

Bob Simcock (Former Mayor)
Joe Di Maio
Glenda Saunders

Current staff

Blair Bowcott (Deputy Chief Executive)
Barry Easton (PMO Manager) *
Les Geurts (Internal Audit Manager)
Carol Serra (Senior Project Manager)
Philip Burton (GM Public Affairs) *
(* Resigned during the review)

Former staff

Tony Marryatt (former Chief Executive)
Graeme Fleming (former Group Manager)
Michael Redman (former Chief Executive)

Appendix 2: Timeline Summary

Date	What occurred
Nov 2004	E mail correspondence discussing an opportunity for HCC to host the V8 event.
10 Jan 2006	Letter from Promoter providing an assessment of costs to host the V8 event.
7 Feb 2006	Letter of Intent from the Promoter committing to staging the V8 event.
8 Feb 2006	Presentation by Mayor to Council on V8 event opportunity.
30 Jun 2006	Council meeting adopts 2006-16 LTCCP including provision for V8 event.
Jul 2006	Economic Impact Assessment prepared for resource consent process.
20 Nov 2006	Resource consent granted for the V8 event.
6 Dec 2006	First meeting of HCC's project group for the track infrastructure development.
30 Mar 2007	First invoice from promoter for Host City fee (due 1 May 2007, paid 15 May 2007).
27 Apr 2007	Internal cost report indicates track cost of \$14.3 million against original estimate of \$8.5 million.
11 May 2007	CEO Tony Marryatt leaves Council's employment.
22 May 2007	Michael Redman resigns as Mayor. Bob Simcock becomes Mayor.
21 Jun 2007	Second invoice from Promoter for Host City fee (due 1 Aug 2007, paid on 10 Jul 2007).
2 Jul 2007	Michael Redman takes over as CEO.
17 Aug 2007	Council's Contracts Subcommittee approves contract for pit lane construction.
18 Sept 2007	E mail discussion indicating promoter does not have ability to cash flow the event concert.
20 Sept 2007	Third invoice from Promoter for Host City fee (due 1 Nov 2007, paid on 2 Oct 2007).
3 Oct 2007	Council Contracts Subcommittee approves seven year contract with Caleta Streetrace Management Ltd (CSM) for promotion of V8 event.
19 Nov 2007	Council notes the 3 Oct 2007 Contracts Subcommittee decision to award a contract to CSM.
7 Jan 2008	Fourth invoice from Promoter for Host City fee (due 1 Feb 2008, paid 29 Jan 2008).
5 Feb 2008	Council workshop on V8 event. Council advised of \$14.19 million track build costs.
27 Feb 2008	Council agrees to purchase the pit lane structure from the promoter for \$2.25 million and lease it back to the Promoter.
29 Feb 2008	Sale and Purchase Agreement signed with CAM for HCC to purchase the pit lane structure.
14 Apr 2008	Contract between HCC and Promoter (CSM) signed.
18 Apr 2008	First V8 race event takes place.
15 Aug 2008	Second Economic Impact Report – identifies \$28.3 million benefit to Hamilton from first race.

25 Aug 2008	Independent Review report on first event.
31 Oct 2008	Internal HCC e mail recording "bad news" with losses from the first race event.
19 Feb 2009	Internal memo from Deputy CEO to Mayor and CEO reporting on 2008 event loss and setting out the CSM's request to HCC for help with its cash flow problems.
6 May 2009	Correspondence from V8SC recording concern about the CSM's financial situation.
19 May 2009	Letter from HCC to Promoter proposing advance payment of Host City Fees to assist Promoter's with its financial obligations from the 2009 event.
22 May 2009	CSM formally seeks advance payments of Host City fees against the 2010 event to assist financing of the 2009 event.
2 Jun 2009	Letter from HCC to CSM agreeing to the advance payment of Host City fees by 1 July 2009.
2 Jun 2009	First advance payment of Host City fees paid.
1 Jul 2009	Second advance payment of Host City fees paid.
9 Oct 2009	Correspondence recording loss on the 2009 event and the insolvency of event. Notes that it is up to HCC to resolve.
2 Mar 2010	Advice to media and Council of the 2009 event costs to HCC and that the net overall cost of the V8 event is \$7.95 million after allowing for guaranteed revenue.
24 Mar 2010	Internal HCC e mail reporting that Promoter is technically insolvent.
April 2010	Various correspondence discussing the Promoter's financial situation and options to address that and allow the April 2010 race event to proceed.
21 Apr 2010	Extraordinary Council meeting to discuss novation of Promoter contract to V8 Supercars.
27 Apr 2010	Heads of Agreement signed with V8SC for it to assume responsibility for the race event. Agreement contains a claw back provision whereby future profits can be used to offset any losses incurred in running a previous event, commits HCC to indemnify V8SC for CSM's creditors and commits HCC to pay half the 2010 event freight costs.
6 May 2010	E-mail from HCC to media and media release advising that HCC has no exposure to any operating losses only an opportunity for profit share.
6 May 2010	Enabling Agreement entered into between HCC, CSM and CSM's Directors obligating CSM to pay its creditors from monies refunded to CSM from V8SC (from funds paid by HCC to V8SC).
19 May 2010	Compensation agreement signed between HCC and V8SC. \$2.2 million paid by HCC to V8SC.
1 July 2010	Further \$790,000 paid to V8SC under the Compensation Agreement.
24 Sept 2010	Deeds of Novation and Variation signed with new Promoter.
14 Oct 2010	New Council elected.
29 Oct 2010	CEO Michael Redman resigns.
13 Dec 2010	Extraordinary meeting of Council to discuss the V8 event. Information on total costs for the event was released following this meeting.
25 Feb 2011	Audit NZ engaged to undertake a review of the V8 event.