Local government financial management framework – is it fit for purpose

Department of Internal Affairs – Central/Local Government Partnerships Group

June 2019
## Document status

<table>
<thead>
<tr>
<th>Ref</th>
<th>Approving Director</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indicative Report</td>
<td>Bruce Robertson, RBRL (with Stu Cross, ML)</td>
<td>18 June 2019</td>
</tr>
<tr>
<td>Final</td>
<td>Bruce Robertson, RBRL (with Stu Cross, ML)</td>
<td>27 June 2019</td>
</tr>
</tbody>
</table>

© Morrison Low

Except for all client data and factual information contained herein, this document is the copyright of Morrison Low. All or any part of it may only be used, copied or reproduced for the purpose for which it was originally intended, except where the prior permission to do otherwise has been sought from and granted by Morrison Low. Prospective users are invited to make enquiries of Morrison Low concerning using all or part of this copyright document for purposes other than that for which it was intended.
Contents

Executive summary 1
Background and introduction 4
Recommendations 6
  Immediate impact changes 6
  Longer term detailed work programme 8
The financial management framework 14
  The planning framework as it currently stands 15
  The decision making framework as it currently stands 21
  The reporting framework as it currently stands 25
  The monitoring framework as it currently stands 29
Ability to respond to major future issues 32
Key themes 34
  Strategy versus business plan 34
  Audit role 35
  Balanced budget 37
  Standardisation, size, scale, capability and capacity 40
  Benchmarking 42
  Communication and engagement 43
Workshop feedback - Planning 46
  What is working? 46
  What could be improved? 46
  Matters raised in workshops that may have direct policy implications 47
Workshop feedback - Decision making 48
  What is working? 48
  What could be improved? 48
  General observations 49
Workshop feedback – Reporting 50
  What is working? 50
  What could be improved? 50
Workshop feedback - Monitoring 52
  What is working? 52
  What could be improved? 52
Appendix A Table of recommendations 53
Appendix B List of councils attending workshops 55
Appendix C Relevant legislation 56
Appendix D Workshop scoping paper 57
Executive summary

1. DIA commissioned Morrison Low and RBruce Robertson Ltd to facilitate a series of workshops with local government, and to provide an opinion on the current financial management framework.

2. We completed a review of the local government financial management framework (the framework) by facilitating conversations with the local government sector and applying our professional judgement and opinion on good financial management principles to the framework.

3. In carrying out this work, workshops were held in Dunedin, Christchurch, Wellington, Palmerston North and Hamilton. A sixth workshop was also held in Wellington, comprising a number of local government professionals, to obtain an additional perspective. Workshops were run as facilitated table top discussions, where participants were asked to turn their minds to how the framework enables, constrains or encourages good financial management practice.

4. The framework is the product of legislation, regulation and good practice. Common features are the Local Government Act 2002 (the Act), regulations and Generally Accepted Accounting Practice (GAAP). Key players include elected members and staff of local authorities and their communities, the Auditor-General as the independent auditor, external agencies such as the Local Government Funding Agency (LGFA) and credit rating agencies, standard setters such as Chartered Accountants Australia New Zealand (CAANZ) and Institute of Public Works Engineers Australasia (IPWEA) and developers of good practice, the Society of Local Government Management (SOLGM).

5. Through its previous work, DIA has identified a number of significant issues facing local government, including population growth and decline, the impacts of climate change and raising sea levels, and increasing regulatory standards to name a few. This review of the framework seeks to answer the question of whether the current framework enables councils to deal with those looming, significant issues, and indeed the issues of the present.

6. Overall our review found that, while there is nothing in the framework to prevent councils from responding to these significant issues, the current framework could go further in encouraging councils to address these issues proactively.

7. Importantly, we think the challenges with the framework lie with how effectively it encourages, or incentivizes councils to address those issues, and whether the framework could better encourage those issues to be addressed. While this report does raise several matters and makes some recommendations, we do not recommend wholesale reform of the current framework. Our recommendations focus on areas where opportunities exist for further gains or relate to current practice. In fact, participants strongly spoke of needing improved practice.

8. Key findings can be arranged into six key themes:
   - **The purpose of LTPs** needs to be considered in terms of its dual function as a business plan and a strategic document. It is recognised that balancing these differing needs is challenging, however the current tension between the dual roles creates a risk that neither role is being served as effectively as it could.
• **There is a need to consider the role of audit**, particularly in relation to the audit of Long Term Plans (LTPs). Consideration should be given to the role that audit plays in the strength of the current system, and the value it creates. There was strong affirmation for the role of the auditor. However, it is also necessary to review the balance between auditing strategy and financial information, and the level and nature of assurance that is provided through the process.

• **The balanced budget and prudence** provisions have driven some positive changes to financial management within the sector. It is now time to consider whether those provisions remain appropriate to meet the challenges of the future, and whether they are comprehensive enough. It is worth considering whether the current measures are actively encouraging good decision making, and whether there are opportunities for these provisions to further drive councils to demonstrate that they are prudent and sustainable.

• There is a call for some level of **standardisation and recognition of size and scale within the current framework**. The needs to minimise the compliance burden on smaller councils must however be balanced against the competing needs of ensuring the principles of prudent financial management and sound accountability are maintained. Further work is needed to identify the core information requirements common to all communities, and the opportunities for standardisation or reduction in requirements.

• **The current suite of mandatory reporting benchmarks** is not fit for the future requirements of the sector. There is a firm recognition that benchmarking is not inherently bad, and there is a high level of encouragement for continued benchmarking. However, in our view, this must be:
  - measurable
  - clear on whether they are short term or able to be monitored and reported over a long term
  - accompanied with relevant context (which may be prescribed)
  - useful for ratepayers.

• **Communication** of key financial and strategic information, and engagement with communities needs to be further improved. Effective communication and engagement is currently inhibited through the format, length and technical nature of the major documents relating to the framework. DIA should investigate opportunities to improve communication through simplification and digitisation of key documents. Other opportunities exist around the centralisation of some key local government data.

9. The challenge of how to make the framework more effective is an area that we consider requires more investigation, and we consider that this would best occur in collaboration with the sector. We recognise that DIA intends to do so. While our report identifies specific areas where there is room for improvement, we are strongly of the view that any change must first be tested with local government and other affected parties, and DIA should consider whether pilot trials of suggested improvement are required to refine recommendations.

10. While there are a number of opportunities to improve the framework from a legislative or regulatory point of view, it is important to recognise that many of the matters raised in this report relate to the sector’s current practice. Improvements to current practice, which may be achieved through working closer with the sector to identify and promote examples of best practice will also go a long way towards addressing these issues. In some cases, legislative change may also be required to encourage or enable better practice.
11. Our findings focus on how we can ensure that councils are having the right debate with their communities and gets their engagement. We consider that the framework currently risks encouraging a compliance focus, which often fails to address the big strategic issues and seldom elicits active engagement from communities.

12. Changes to the framework to reduce the compliance burden, or the compliance heavy focus, will go a long way to enabling councils to draw attention to the long-term strategic issues that must be addressed within a sustainable model of local government. However, this reduction in compliance must be carefully balanced to ensure that the strengths of our current system are maintained.

13. As a way forward we recommend that:
   - DIA adopts the work programme set out in this report to further investigate possible opportunities for improvement in relation to each of the six key themes above, including both legislative and practice improvements
   - DIA continues to collaborate and engage with the local government sector in order to respond to the findings of the Productivity Commission review, and any changes arising from this review
   - further consideration is given to the role of auditors in relation to the LTP, and that any such consideration is undertaken in conjunction with the Office of the Auditor General
   - where opportunities for improvement are identified, DIA works with the sector to identify opportunities to pilot proposed changes prior to formalising changes. This would likely require DIA to assist with resourcing or funding any such work.
Background and introduction


15. The Department of Internal Affairs (DIA) is the Government’s lead advisor on local government policy and will be offering advice to Government on its response to the inquiry. The Department has started provisional work to prepare its thinking on local government finances, now and into the future. Their initial analysis has identified that local authorities are wrestling with a range of significant challenges which are driving cost increases, including:
   - changing populations and demographics
   - tourism
   - climate change
   - seismic strengthening
   - roads in rural areas.

16. This initial analysis has also illustrated:
   - growing affordability issues
   - rates revenue increasing faster than council LTPs predict
   - depreciation and asset service requirements are significant factors in councils’ costs.

17. We understand that through 2019, DIA will fully prepare its thinking and advice on the issues facing the sector and the appropriate response from Government. DIA sought to be well placed in its thinking by November 2019 so that it can fully support the Government’s response to the Productivity Commission’s findings. At a broader level, the Government is committed to ensuring that all New Zealanders have a safe and sustainable water supply and that local government’s focus on community wellbeing is strengthened and furthered. Both of these elements pose challenges for the current funding and financing framework operating across local government.

18. DIA has indicated that it wishes to further its understanding of the utility and performance of the Local Government Financial Management Framework. More specifically, DIA wishes to better understand the effectiveness and efficiency of the current controls, obligations and powers conferred on local authorities, and the sector’s views on any required changes and improvements.

19. DIA commissioned Morrison Low and RBruce Robertson Ltd to facilitate a series of workshops with local government, and to provide an opinion on the current financial management framework.

20. Workshops were held in Dunedin, Christchurch, Wellington, Palmerston North and Hamilton. A sixth workshop was also held in Wellington, comprising a number of local government professionals, to obtain a further perspective.

21. Workshops were run as facilitated table top discussions, where participants were asked to turn their minds to how the current financial management framework enables, constrains or encourages good financial management practice.

22. Prior to attending the workshops, participants were provided a scoping paper setting out some of the key questions that were to be asked and defining the parameters of the financial management framework. The content of that scoping paper is largely replicated within this report and is attached as Appendix D for further reference.
23. Following the workshops, a voluntary survey was sent to participants to seek specific example information regarding costs, resources and time required to complete many of the core functions of the financial management system. Responses to this survey were limited, with only eight of the 55 councils responding.

24. The results of that survey are presented within this report, as examples for each stage of the financial management framework.
Recommendations

25. Our review identified six key areas where improvements to either the framework itself or improvements to current practice have the potential to create meaningful gains in the framework’s ability to facilitate the right debate.

26. Our recommendations fall into two categories, those that can be achieved without significant levels of engagement or further investigation, and those that will require detailed engagement with key parties. Except for the changes that are effectively remedial in nature, we recommend that the Department develops a work programme that aims to have the majority of changes in place before the 2024/34 Long Term Plan process commences (the next LTP is the 2021/31 LTP, for which some councils will have already commenced early preparation).

27. Importantly, we heard feedback from the sector that one of the many inhibitors to the sector improving its financial management practices in recent times is constant legislative change. In this regard, change should not be considered lightly and before implementing any changes to the current system, which is generally considered to be sound, DIA should assure itself that the changes will be positive and meaningful.

28. We set out the details of our recommendations below, including a proposed work programme for changes requiring further investigation and engagement.

29. In carrying out the below programme of work, we recommend that DIA establishes a programme reference group comprising sector leaders and professionals alongside key DIA staff. This will enable ideas to be tested throughout the programme.

Immediate impact changes

30. Immediate impact changes are those changes that can be achieved with minimal levels of engagement or investigation with the sector (or for which the “solution” is clear), but which may have some immediate beneficial impact on the effectiveness of the framework.

Alignment of Central Government and Local Government processes

31. The current timing of certain central government and local government processes is mis-aligned. This means that, particularly where those processes relate to local government funding or capital works programmes (for example NZTA funding allocations), councils are having to make significant assumptions in their LTPs which they could be required to change at a later date. Using the NZTA example, we understand the NZTA funding allocations are finalised in August, while LTPs must be finalised by the end of the preceding June – this timing difference creates a risk that councils may have to make a LTP amendment in subsequent years.

32. DIA should facilitate discussions between key central and local government entities to seek better alignment of these processes. We consider that this should have a large positive impact on financial management within local government.
Changes to the Rating Act as recommended by the courts

33. In the High Court Case, Mangawhai Ratepayers’ & Residents’ Association Inc V Northland Regional Council & Kaipara District Council, Duffy J noted that the drafting of the Rating Act, as it currently stands, is problematic and creates opportunity for councils to make unintentional error. While Duffy J did not go so far as to state that the legislation should be amended, this is clearly inferred. As demonstrated by the case itself, the current legislation exposes regional councils to unnecessary risk and litigation costs, which could be avoided in the future by implementing this legislative change.

34. Similarly, DIA should undertake a further review of the Rating Act and Local Government Act with the objective of identifying any other potential areas that create risk for litigation. Another issue that was bought to our attention is the risk of litigation that currently exist for councils that seek to amend rating resolutions that contain simple or obvious errors.

Funding impact statements

35. The Act and the associated regulations currently prescribe two different statements that are both called “funding impact statements”, being the funding impact statement for groups of activities, and the funding impact statement for the whole of council which must provide additional detail on rating proposals. This is confusing and should be addressed by amending the name of the later statement (or at least the rating component of that statement) to “rating impact statement”, or another similarly descriptive name.

Balanced budget

36. The definitions of a balanced budget in the Act, and in the Local Government (Financial Reporting and Prudence) Regulations 2014 are currently different. This inconsistency means that while a council may meet the balanced budget test under section 100 of the Act, they may fail to meet the corresponding benchmark, and may make it difficult to communicate performance accurately. DIA should make remedial changes to either the Act or the Regulations to align these definitions.

37. In undertaking the above, DIA should consider whether it is also appropriate to further alter the definition of a balanced budget to remove certain ringfenced capital income and expenditure, although this may require further policy work.

Combined infrastructure and financial strategy

38. While the Act currently allows a combined infrastructure and financial strategy to be produced, there are a number of issues which make this challenging. For example, the time frame requirements for an infrastructure strategy are 30 years (or more) while a financial strategy is only required to consider a period of ten years. Similarly, an infrastructure strategy is only required to cover certain types of assets, while a financial strategy must cover all asset classes.

39. We have heard that a number of councils would consider developing a combined infrastructure and financial strategy, which in our view is likely to better be able to meet the strategic objectives of those documents, if the barriers to doing so were reduced.

1 [2016] NZHC 2192 [15 September 2016]
2 For example, subsections 3, 4, 5, and 6 of section 15 of schedule 10 of the Act.
40. Although work to identify and resolve the potential barriers to developing a combined strategy may not be straightforward, we consider the potential and immediate gains that may arise from this work justify its consideration as an action to commence early.

41. DIA should undertake work to minimise the barriers for developing a combined strategy and should consider engaging with those councils that have successfully produced a combined strategy (Wellington and Rangitikei) to identify what changes may need to be made.

Electronic rates invoices

42. During the workshops we were advised that one council sought legal advice on the option of emailing rates invoices to ratepayers. We understand that the advice indicated that the council required a physically signed notification from the ratepayer to allow email invoices to be sent, among other potential barriers.

43. Consideration should be given to simplifying the legislation to better enable emailing of rates invoices.

Longer term detailed work programme

44. The detailed work programme outlined below focuses on the six key areas for potential improvement identified within this report. While we do not specifically address the issue of communication and engagement as a separate focus area in the recommendations below, we consider that improvements to the way councils communicate and engage with communities are critical, and all of the matters raised below seek to make improvements in that area.

45. In fact, through the facilitation of the work programme outlined below, DIA should ensure that the impacts of any proposed change on effective communication and engagement are well considered, with a focus on improvement.

46. The recommendations listed below follow the structure of the key themes identified as arising from the workshops. A tabulated work programme, outlining each specific recommendation is attached at Appendix A.

The mixed purpose of the long term plan

47. The LTP currently serves both a strategic and an operational purpose. While it is clear that both of these purposes are critical for good financial management, the challenges of encapsulating these mixed, and at times conflicting, purposes in a single document are clear and reflected within current LTPs.

48. In their current form, LTPs are typically long (300 pages on average), compliance focussed (on average 87% is statutorily prescribed) and have relatively low levels of engagement from communities. In attempting to serve both purposes these documents are at risk of being viewed as compliance documents, and in some cases prevent the strategic decision making that they are trying to incentivize.

49. A work programme should be developed to seek opportunities to:
   - Reduce unnecessary prescription
   - Consider the separation of components of the LTP to reflect its differing purposes; or
   - Identify opportunities for industry best practice to be developed, promoted, and adopted
This work should involve feedback from industry professionals (from within and outside local government) and industry bodies such as SOLGM and LGNZ. As appropriate, DIA should also seek feedback from the Office of the Auditor General and look to overseas jurisdictions to understand what has been tried elsewhere (and to what effect). For example, we are aware that the financial plan, and strategic plan are separated in New South Wales, and that there are differing opinions about the effectiveness of this.

Improvements in this area are likely to have a large impact on communications and engagement with communities and should help to enable councils to have a greater focus on strategy in developing their LTPs.

It is likely that any policy changes resulting from this workstream will take a significant amount of time to develop and should not be rushed. On the other hand, through this work programme we anticipate that there will be several opportunities identified for the development of industry best practice. These opportunities should be pursued as they arise and may have a more immediate impact on the effectiveness of the system.

**The role of the auditor**

Through our workshops we identified that the current role of the auditor in reviewing LTPs is likely to be driving a compliance focus within those documents and may not be delivering the best value for the opportunity that is presented.

While we have indicated that there may be additional value to be obtained by refocussing the role of the auditor, and perhaps considering the type or level of assurance provided, we are conscious that there are a range of views both within the sector, and likely held by the Office of the Auditor General, about what an effective review of LTPs may look like.

While we consider that there may be significant gains to be had through redefining the role of the auditor in reviewing LTPs, any changes in this area are likely to only be possible through significant engagement with local government and the Office of the Auditor General. Further, to the extent that the recommended changes represent a fundamental change in the way reviews are carried out, any change will need to be accompanied with capability building, process development, and pilot programmes for auditors.

The assurance given to the public and to external users of the financial management framework documents through the current “audit” of the LTP is such that any changes in this area must be carefully managed so as to retain the integrity of one of the strengths of our framework.

Finally, any changes to the structure (or mixed nature) of LTPs may have a bearing on what can and cannot be audited. Because of this, and the relative complexities of addressing this issue properly, we recommend that this workstream is carried out subsequently to those recommendations relating to the mixed role of the LTP.

There may also be value in considering whether the Office of the Auditor General could be more explicit in identifying what it considers to be best practice examples of LTPs, financial strategies, infrastructure strategies, and other key components of the financial management framework. This would help the sector with its continuous improvement and may be easily achieved without any change in policy.
**Balanced budget**

59. This report presents a number of issues with the current requirement for councils to maintain a balanced budget. Some of the recommendations relating to this provision have been highlighted above as “immediate impact changes” - specifically, alignment of the definition of a balanced budget, and the removal of certain ringfenced capital items.

60. We have also raised issues regarding the financial prudence provisions which may require further work and consideration.

61. Specifically, we note that the requirement to maintain a balanced budget would appear to be subservient to the stronger principal in the act of financial prudence. However, the short-term nature of the balanced budget provision (which does not require a council to consider the long term funding and financing implications of its decisions) can lead to perverse outcomes, which may not be considered “financially prudent”. Equally, the ability for a council to “opt out” of maintaining a balanced budget on the grounds that it is financially prudent to do so has been used by some councils to opt out on affordability grounds alone.

62. Further work needs to be undertaken to consider the interaction of sections 100, 101, 101A, and 101B of the Act within the context of the need for councils to be financially prudent and to ensure long term, sustainable delivery of services in an affordable way. In particular, policy areas to consider further may include:

- Whether the balanced budget provisions could be strengthened to require some consideration (whether quantitative or qualitative) of potential future liabilities and how the council is ensuring that it will be able to afford to address them when they arise.
- Whether the balanced budget provision is actually necessary.
- Whether section 100(2) should require councils to detail its justification for why it considers that it is financially prudent to not maintain a balanced budget.
- Whether the balanced budget provision should be a minimum threshold, thereby more explicitly allowing a council to maintain an operating surplus without risking non-compliance with the balanced budget provisions (and without having to make a resolution that it is financially prudent to collect more revenue than it requires to meet its operating costs in a year).

63. While we consider that all policy matters affecting local government should involve the sector, we believe that this particular area of policy consideration may be carried out internally by DIA before engaging with the sector with more developed potential policy options.

64. While we consider that changes to the balanced budget provisions will assist with the long-term financial sustainability of the sector, these changes are unlikely to have an immediate impact. Further, these changes are unlikely to be impacted by other recommendations within this report.

**Asset management reporting**

65. Our report notes that current asset management reporting, and in particular the benchmarks used for reporting, are not sufficient for a reader to form an informed view about whether a council is adequately investing in, or provisioning for investment in, its core infrastructure.

66. While the balanced budget provisions have the effect of requiring a council to fund the depreciation of its assets, there are no provisions that require that council spend the revenue it collects on the renewal or replacement of those same assets.
With the majority of a council’s expenditure being related to the management and maintenance of assets that are used to deliver core services to the public, good asset management reporting is critical.

DIA should facilitate a specific work programme to develop more comprehensive and useful asset management reporting guidelines. Such guidelines should include:

- A measurement of a council’s investment in the renewal or replacement of its core infrastructure.
- A way of providing contextual information regarding the specific situations it faces (such as the council being a high or low growth council).
- A way of providing context regarding the relative age of an asset base, or information about the stage of the asset management lifecycle the council is in.
- Reporting on the average condition of assets, by class, and of the methods used to assess condition.
- Some level of standardisation of classification of expenditure between capital and maintenance, as well as between renewals, upgrades, and growth assets. This may be able to be achieved through best practice guidance developed by the sector rather than legislative reform.

Consideration should also be given to whether the required reporting is also accompanied with a benchmark, and if so, whether that benchmark varies depending on the circumstances of a council.

Further, while we note that it is already mandatory for councils to disclose the replacement cost for their core infrastructure, we recommend that further work is undertaken to ensure that this is actually done and that the true replacement cost is disclosed.

DIA should consider whether this work should be undertaken internally or in conjunction with sector groups and professional bodies such as SOLGM and IPWEA. Any benefits arising from improvements in this area are likely to take some time to transpire.

**Financial and non-financial performance measures**

This report identifies that the current set of financial and non-financial performance measures are ineffective, difficult to measure and particularly in relation to the quantified limits on rates and borrowing, lack consequence.

We recommend that further work is undertaken with sector and community groups to develop a set of benchmarks or performance measures that are:

- measurable
- clear on whether they are short term or able to be monitored and reported over a long term
- accompanied with relevant context (which may be prescribed)
- useful for ratepayers.

Consideration should also be given to how performance against these benchmarks is measured and communicated, including:

- Whether there should be any requirement for councils to calculate, or measure performance against the benchmark itself, or whether this should be done by an external agency relying on standardised information reporting; this may need to be considered on a case by case basis.
- Whether performance against the benchmarks should be disclosed within existing documents, separately, or through a centralised portal.
- Whether certain information disclosures, measurement methods, and other key underlying assumptions relevant to the benchmarks should be standardised.
75. Because performance measures can be reviewed and amended/added individually, there may be opportunities for this work stream to be staged to allow the communication and engagement benefits to be realised as quickly as possible. A staged programme would be particularly easy to implement for performance benchmarks which are able to be measured and disclosed centrally, such a programme would involve:

- Consideration of the key benchmarks that would be useful to be disclosed, and the requisite information requirements.
- Consideration of the method of measurement for those benchmarks, and development of a centralised reporting process.
- Identification of any standardisation required.
- Centralised measurement and reporting against benchmarks.
- Identification of benchmarks which must be measured by councils, or of additional information requirements.
- Continuous review/addition of benchmarks.

76. Where performance against benchmarks is measured and disclosed centrally, and existing information is well disclosed, there may be no need for legislative reform.

Size, scale, capability and capacity

77. We consider that most of the issues that we have raised regarding the size, scale, capability, and capacity of local government can be addressed through changes in practice and guidance, rather than through legislative amendment.

78. In particular we note that:

- Standardisation of key documents, or indeed cost classification (such as the way in which overheads are accounted for and allocated) can be achieved through sector bodies and the publication of best practice guidance. In our view, standardisation should not be legislated or mandatory. Any such attempts at standardisation should ideally involve input from multiple parties, including SOLGM, LGNZ, DIA, and the Office of the Auditor General to ensure all needs are being met.
- At its most simple, issues regarding capability and potential opportunities for standardisation, may be able to be achieved through the recognition of best practice documents, which will inform the sector of what good looks like. This should help drive continuous improvement.
- Matters regarding capability and capacity are challenging to address, and skills shortages are noted in most industries across New Zealand. Addressing these challenges may require innovative thinking, and changes to current practice. Examples such as the Manawatu-Rangitikei arrangement, and RATA in the Waikato, are a good starting point, however for real gains to be made the scale of such arrangements may need to be larger (potentially at a regional, cross-regional, or national level). Work should be carried out with the sector to identify opportunities to encourage such arrangements, and remove existing barriers, as well as further consideration given to larger scale solutions.
- There may be some legislative barriers that exist in attempting to address issues of scale, and there is a necessary balance that must be achieved to ensure that the framework remains fit for purpose and continues to provide the relevant levels of transparency and accountability. While it may still be beneficial to consider opportunities for scaled back or tiered reporting requirements, this should be undertaken with caution.
Our recommendations regarding size, scale, capability, and capacity range from complex to more straightforward. However, we consider work with the sector to identify best practice and develop optional standardised documents may be an easy-to-achieve outcome that should be commenced early. Engagement with the sector to understand the current barriers to greater resource and knowledge sharing arrangements should also commence early, as opportunities to address capability and capacity issues within the sector may take a considerable amount of time to address.
The financial management framework

80. For the purposes of this report, the financial management framework is the framework, as imposed through legislation, regulations and industry best practice, within which a council must make strategic and operational decisions regarding its planned revenue raising, expenditure and investment activities.

81. The framework follows a natural cycle, illustrated below, that progresses from planning to decision making (or ‘doing’), reporting and finally to monitoring, with various legislative and best practice requirements at each stage.

82. Importantly, the framework serves many roles, and attempts to serve the competing needs of several different groups, including:

- providing information and guidelines to assist elected members with decision making
- communicating information regarding a council’s planned and actual financial and non-financial performance, strategic direction and rates impacts to ratepayers
- providing assurance to credit agencies and lenders that a council is prudently managing its finances
- functioning as an operational plan and accountability tool for council officers
- signalling future investment requirements to central government, in part to support applications for grant funding.
84. When considering the effectiveness of the framework, it is important to be cognisant of these competing needs and any potential hierarchy that could or should be taken into account. That is, if an aspect of the financial management framework is fulfilling the needs of its primary purpose but only partially fulfilling the needs of a secondary purpose, it may still be, at least partly, effective.

85. Within the current financial management framework, councils are required to undertake the following activities.

- Produce an LTP every three years. This plan covers a period of ten years and is finalised half-way through the election cycle.
- Produce an annual plan in the remaining years
- Prepare a financial strategy as part of the LTP process
- Prepare an infrastructure strategy, covering a minimum period of 30 years, as part of the LTP process
- Develop a number of policies including a revenue and financing policy, a significance and engagement policy, which should be included in the LTP documentation
- Prepare an annual report, using GAAP, in each financial year, this must also include a second set of financial statements (funding impact statements) which are prepared using different principles
- Report against a number of mandatory financial and non-financial benchmarks
- Prepare a pre-election report, to be published no later than two weeks prior to the nomination day for an election
- Prepare internal reports
- Maintain asset management plans for key strategic asset classes and core infrastructure
- Have annual reports and LTPs audited by auditors that are appointed by the Office of the Auditor General
- Make a rates resolution
- Consultation with communities about key decisions

The legislative provisions, where relevant, that impose the above requirements, are set out in Appendix C.

86. In carrying out this review, we sought the views of council officers (through a series of workshops) on the effectiveness of the framework, including all the elements described above, and its ability to respond to future issues.

87. This report summarises the findings from those workshops and follows the various stages of the framework. It also provides commentary regarding our view of the framework and the feedback received and sets out a number of recommendations for potential improvement or further investigation.

88. The full requirements faced by councils in each stage of framework are set out below.

The planning framework as it currently stands

89. The planning framework is the first step in our definition of the financial management framework/cycle. It is within this stage that the council sets and articulates its strategy and objectives for the future delivery of services and communicates that plan to its community.

90. The planning framework incorporates the following:

---

3 The full list of councils that attended workshops is set out in Appendix B.
**Long term plans**

91. An LTP is a document (or set of documents) that sets out the strategic direction of a council for the next ten years. In addition to provided projected budgets for the next ten years, and setting out the associated impact on rates, the LTP also contains:
   - the financial strategy
   - the infrastructure strategy
   - activity statements, including financial and non-financial performance measures, levels of service and funding impact statements
   - details regarding underlying assumptions
   - financial prudence benchmark disclosures
   - revenue and financing policy
   - significance and engagement policy
   - rating base information.

92. The preparation of an LTP is clearly a large undertaking that involves the review and revision of a number of core strategic documents, and the consideration of community views through a formal consultation process.

93. The requirement for councils to prepare an LTP was introduced as part of the rewriting of the Act in 2002.

94. The requirement was introduced at the same time as the introduction of the four well beings and the consequential increase in flexibility provided to councils. The LTP was seen as a mechanism to increase the accountability and rigour in councils planning processes, as noted by the select committee who stated:

   “The Bill empowers communities as well as councils and requires local authorities to be more accountable to their electors. Councils are allowed greater flexibility in their activities but must ensure that their decision-making processes are open to the influence and scrutiny of their communities”.

95. LTPs were introduced for the purpose of informing communities and enabling their participation in long term planning. This is reiterated in legislation.

**Financial strategies**

96. Councils are required to prepare a financial strategy as part of their LTP. The strategy must cover, at a minimum, the same ten-year period as set out in the LTP, and must:
   - include a statement of significant assumptions, including changes in population and land use, and the associated capital and operating costs
   - include the factors that may impact the expected amount of capital expenditure that must be spent on network infrastructure and flood protection works in order to maintain existing levels of service
   - include any other factors that may impact on a council’s ability to respond to growth, demands for increasing levels of service, or maintaining existing service levels
   - set out the councils quantified limits on rates and borrowing, and its assessment of its ability to provide existing and future levels of service within those limits
   - set out the council’s investment policies (i.e. its target returns and objectives for holding investments)
   - set out the council’s policies regarding the giving of securities on borrowings.

97. The requirement to prepare a financial strategy was introduced in 2010, with affect from the 2012 LTPs.
The purpose of the strategy, as stated in the Act, is to act as a guiding document for financial decision making and provide context for consultation. In doing so, the financial strategy is intended to promote financial prudence and transparency of the impact of funding and financing proposals on rates, debt and investments.

In the third reading of the bill that introduced the requirement to prepare a financial strategy, a great deal was made that the financial strategy would empower ratepayers to question council decisions and discuss trade-offs. Evidently, the financial strategy’s primary audience was intended to be the ratepayer.

**Infrastructure strategies**

An infrastructure strategy must be prepared and adopted by a council as part of its LTP. The strategy must cover a period of at least 30 years, and should include:

- estimates of the projected capital and operating expenditure associated with the management of the council’s infrastructure assets, annually for the first ten years of the strategy, and in five yearly blocks in subsequent periods
- identification of the significant investment decisions that the council must make for the management of its assets, including the likely timing of those decisions and the options and potential costs for each decision
- a statement regarding the significant underlying assumptions, including the asset lifecycles, levels of growth and levels of service
- a statement regarding the level of uncertainty associated with the underlying assumptions, and the impacts of that uncertainty.

An infrastructure strategy is intended to clearly demonstrate how a local authority intends to manage its assets over a long period of time. The strategy is also intended to set out the key strategic options available to council in the management of its assets, and the potential implications of those options.

The strategy, in outlining the proposed approach that it will take to managing its infrastructure assets, must consider the need to:

- replace existing assets
- respond to external growth or population decline pressures
- allow for changes in levels of service
- consider public health outcomes, and plan to maintain or improve those outcomes
- consider the environmental outcomes, and plan to maintain, improve or mitigate the effect on them
- provide for resilience to natural hazards.

The strategic nature, and its role of the infrastructure strategy in providing key information to the public, and decision makers, to enable informed decision making was highlighted in Hon Sam Lotu-Iiga’s (then Associate Minister of Local Government) closing remarks in the final reading of the empowering bill, in which he noted:

> “that is why this bill introduces a requirement for a 30-year infrastructure strategy to provide for the prudent management of those assets. There is a need for decision makers and the public to have a good overview of the key infrastructure issues and options to make informed decisions.”

---

4 Local Government Act Amendment Act 2010
5 Local Government Act 2002 Amendment Act 2014
The select committee took on board councils’ suggestions to improve the proposed infrastructure strategy. The amended provisions in the bill anticipate that the 30-year infrastructure strategy will focus on each of the first ten years and then the remaining 20 years in five-year blocks. This will allow councils to think ahead, to game-plan for likely scenarios. It does this without imposing an unnecessary administration burden on councils by requiring detailed year-by-year financial and circumstantial estimates. The increased focus on long-term planning means decisions about local infrastructure will be timely, considered, and will lead to better short, medium, and long-term outcomes.”

Annual plans

104. A local authority must prepare and adopt an annual plan for each financial year, however the first year of projected results of an LTP is considered to be an annual plan, such that annual plans must only be prepared in the years between LTPs.

105. The purpose of an annual plan, as provided for in legislation, is to set out the annual operating and capital budget for the council, and support and provide for integrated decision making. The annual plan also identifies variations from the LTP and acts as an accountability document for the local authority.

106. Importantly the legislation provides provisions that acknowledge there may be duplication of effort between the preparation of the LTP and the annual plan and seeks to minimise the compliance burden associated with that duplication. In particular, councils are able to opt out of the consultation requirements for an annual plan if it “does not include significant or material differences from the content of the LTP”. Further, councils should make reference to the LTP in meeting certain disclosure requirements, rather than duplicating the LTP.

107. The contents of an annual plan are heavily prescribed, and include (but are not limited to):

- forecast financial statements
- the forecast financial statements for the previous year, presented in a way which enables comparison by the public
- a funding impact statement in the prescribed form, including specific details regarding the calculation and application of general rates, uniform annual general charges, and the calculation and application of targeted rates
- examples of the impact of rating proposals on different categories of rateable properties, with a range of different values
- financial prudence benchmark disclosures
- rating base information including the number of assessable properties and the total projected capital and land value of the rating units within the region
- outline the details of reserve funds held by the council including the purpose of each fund and the balances and movements of the fund.

Policies

108. The Act sets out several policies that must be prepared, adopted and disclosed by local authorities. These include both financial and non-financial policies, such as:

- a significance and engagement policy
- processes to provide opportunities for Māori to contribute to decision making
- a revenue and financing policy
- a liability management policy

6 As defined in the Act
• an investment policy
• a development contributions policy
• a policy on the remission of rates on Māori free hold land
• a local boards funding policy (where applicable)
• optionally a rates postponement and/or rates remission policy.

109. A council must consult on the formation or amendment of any of its policies other than the liability management and investment policies.

**Asset management plans**

110. An asset management plan is a document that summarises all key asset information in one place. It provides the information required to enable better decision making regarding the day to day management of assets and the financial implications of those decisions. It differs from an infrastructure strategy in its increased level of detail and more operational focus.

111. A typical asset management plan includes information regarding:

• the importance of the asset in delivering specific services, including information about criticality of the assets
• an assessment of the condition of the assets
• an outline of the current assets used to deliver services, and an assessment of the future asset requirements to deliver agreed levels of service
• the planned approach towards the investment in assets and, in particular, the renewal or replacement of assets
• the required operational and capital spend on asset classes and the amount that has been committed by the organisation
• the potential approaches that may be used to address current level of service shortfalls.

112. The preparation and use of asset management plans has long been accepted by the local government sector, although it is worth noting that while there is a practical requirement to prepare an asset management plan, there is no specific legislative requirement. Despite the lack of legislative requirement, most councils maintain asset management plans for their critical and core infrastructure.

113. Due to the lack of legislative requirements around the development of asset management plans, there is significant variation within the sector on:

• the actual content of an asset management plan
• the public availability of the plan
• the suite of assets that have asset management plans
• the length, complexity, and focus of asset management plans.
The average Long Term Plan is 300 pages long

87% of the average Long Term Plan is legislatively prescribed content, including around 70 pages of financial data and 50 pages of policies.

Councils typically begin preparation of a Long Term Plan two years before it is published

Two councils delivered the Long Term Plan late in 2018

Councils in our survey reported an average of 30% of total FTEs are involved in a typical council’s Long Term Plan process

Councils in our survey also reported that an average of 23% of FTEs are involved in the preparation of the Annual Plan

In our survey less than 1 in every 357 residents downloaded their council’s annual plan*

Less than 1 in every 260 ratepayers downloaded their council’s consultation document*

One council reported that their annual plan cost $750,000 to prepare (including staff time) – that equates to 1.2% of that council’s rates income

*Total downloads divided by total population (2018). Downloads include out of region and may not be unique.
The decision making framework as it currently stands

115. The decision making stage in the framework is the stage of the framework where local government turns plans into actions. The key components of this stage in the framework relate to consultation process, balanced budget, and financial prudence requirements.

116. The decision making framework incorporates the following:

**Significance and engagement**

117. Throughout the decision making process councils are required to determine whether, and to what extent, they must engage with their communities. In order to guide this determination and provide communities with certainty about where and when they will be consulted, local authorities are required to adopt a significance and engagement policy.

118. The policy sets out the local authority’s:

- general approach to determining whether a proposal or decision is significant
- the criteria or procedures that are used to make the assessment of significance
- the format and level of consultation that may be desirable for decisions about specific issues, assets or other matters
- the method of engagement with the community for any other matters
- strategic assets.

119. A local authority must consult with its community when developing or amending a significance and engagement policy.

120. When consulting on issues, the local authority must follow the processes outlined within its significance and engagement policy, along with section 76 – 82 of the Act.

**Balanced budget**

121. The balanced budget provisions, set out in section 100 of the Act, require a council to set its projected operating revenue at an amount that is equal to, or greater than, its projected operating expenditure for the same year. This provision impacts on all stages of the framework, however it is a key component of the decision making process because it constrains the way in which funding and expenditure decisions are made.

122. The requirement effectively ensures that councils collect enough operating revenue to enable the repayment of borrowings and to provide for the future replacement of assets. In doing so, councils are constrained in their ability to increase expenditure on day to day costs, without a consequential increase in rates.

123. Councils may however elect to opt out of the requirement to maintain a balanced budget if they believe it to be financially prudent to do so. In making such a decision, councils are required to have regard to:

- the projected whole of life costs required to maintain predicted levels of service
- the projected revenue that will be available to fund the whole of life costs to maintain levels of service
- the balance of funding between debt and rates, and the equity issues associated with that mix.
124. The Act contemplates that these issues are considered together, such that a council should ensure that it is able to sufficiently meet the future cost pressures for the delivery of its services using an alternative funding approach if it so wishes to opt out of the provisions.

**Financial prudence**

125. In addition to the balanced budget provisions, councils must report on their performance against, and therefore must make decisions within the context of, the financial prudence benchmarks that are set out in regulations. Specifically, these include the following:

- The rates affordability benchmark which compares actual rates increases to the quantified limit on rates increase as set by the local authority. Note that there is no prescribed method for determining the quantified limit on rates.
- The debt affordability benchmark which compares a council’s borrowings to its quantified limit on borrowings. As with the quantified limit on rates, the limits on borrowings are determined independently by each local authority, with no prescription regarding the method of determination.
- The balanced budget benchmark, which effectively ensures that a council is not running an operating deficit and is complying with the balanced budget provisions of the Act.
- The essential services benchmark which compares capital expenditure on core infrastructure with the depreciation on those same assets. A council will pass this benchmark if expenditure on core infrastructure (including growth, level of service and renewals expenditure) is equal to or exceeds depreciation.
- The debt servicing benchmark which compares borrowing costs to its revenue. A high growth council will meet this benchmark if its borrowing costs are less than 15% of its revenue, while the threshold for other councils is 10%.
- The debt control benchmark which measures whether a council has borrowed more or less than it had budgeted to. A council will meet this benchmark if its borrowings for the year are less than or equal to budgeted.
- The operations control benchmark which compares actual and budgeted net cash flows. A council will meet this benchmark if its actual net cash flows are equal to, or exceed, its budgeted cash flows (which may be achieved through having higher revenue, lower costs, or some combination of the two).

126. There are no specific sanctions or penalties for failing to meet any of the above-mentioned benchmarks. However, performance against the benchmarks is required to be disclosed in public documents.

127. The way performance against the financial prudence benchmarks is reported is heavily, prescribed. The regulations include specific formats and colouring for graphs, as well as prescribed wording for disclosure statements.

**Borrowing restrictions**

128. In addition to the debt servicing benchmark, which sets an effective limit on the amount that a local authority can borrow, and the Local Government Funding Agency’s covenants, there are certain other restrictions that relate to the ways in which councils can borrow, including:

- restriction on the ability to borrow in foreign currencies
- constraints over the way assets can be used as security for a loan
- restrictions on the provision of guarantees to council controlled trading organisations
- restrictions on the rates, terms and conditions which can apply to money that is lent to council controlled trading organisations.
**Rating provisions**

129. Rates are the predominant source of income for all local authorities in New Zealand. They are a charge levied on properties within the local authority’s boundary, and can take the form of a general rate (charged to all properties in the district), a general charge (charge at a fixed amount for all properties), or a targeted rate (which may be fixed or value based).

130. In addition to being empowered to charge rates, local authorities are provided with the power to collect unpaid rates through the sale of property. However, given the wide reach of a local authority’s powers to charge, collect and enforce the payment of rates, there are several rules and regulations that are imposed on councils to ensure their powers are exercised responsibly and transparently.

131. The Local Government (Rating) Act 2002 sets out the rules and regulations regarding rates including:

- the types of rates that may be charged, and the methods for calculations
- restrictions on the proportion of rates that may come from uniform Annual General Charges
- the process for setting rates, including the requirement for a rates resolution and the content of a rates assessment
- the record keeping requirements
- provisions relating to the collection of rates, and the ability to impose penalties or undertake legal proceedings to collect rates
- the processes relating to rating sales and the sale of abandoned land
- provisions relating to the rating of Māori freehold land
- provisions allowing for the charging of lump sum capital contributions.

132. The process for setting and assessing rates is heavily prescribed and has been subject to a number of legal challenges in recent times.
Councillors in our survey reported undertaking an average of six consultations, outside of the LTP, per year.

A number of councils reported receiving no submissions for some consultations.

54,000 people “follow” Wellington City Council’s Facebook page – that’s 25% of the resident population.

One in every 97 residents made a submission on their council’s long term plan according to our survey.

The cost of consulting outside of the long term plan process depends on the decision being made but ranged from $600 to $265,000 in our survey (excluding staff time).

In our survey, the consultation process for LTPs ranged in cost from $17,000 to $1.5 million.
The reporting framework as it currently stands

133. The reporting stage of the framework involves formal and informal requirements for reporting. Councils are required to prepare external, formally legislated reports, in addition to facing specific disclosure requirements. Furthermore, to enable effective decision making, councils have regular internal reporting requirements.

134. The key aspects of the reporting requirements faced by councils are set out below.

**Annual reports**

135. Councils are required to publish an annual report every financial year, that compares its actual activities and performance with its intended activities and performance for the same year. The report’s primary purpose is to promote the council’s accountability to the community.

136. The financial information presented in a council’s annual report must comply with GAAP, and specifically the New Zealand Not for Profit Standards (typically PBE IPSAS) for tier one and tier two entities. While some smaller councils can take advantage of the tier two concessions, most councils in New Zealand must comply with the full suite of tier one not for profit accounting standards.

137. In addition to the mandatory financial information that is prepared under GAAP, annual reports must also contain the following:

- Groups of activity statements which identify the activities within each group, the community outcomes that the group of activities seeks to achieve, and the results of any measurement undertaken on the progress towards achieving those outcomes.
- The capital expenditure incurred for each group of activities, including a breakdown of that expenditure by purpose (noting that mixed purpose expenditure can be classified solely under the primary purpose). This must also compare actual and budgeted information.
- An audited statement of service provision that compares the level of service achieved for each group of activities to the performance target, and specifies whether intended changes have been achieved and the reasons for any significant variation with the intended level of service.
- An audited funding impact statement for each group of activities.
- For each group of activities, a statement regarding the level of internal borrowings utilised and the interest charged.
- A statement regarding the performance of council controlled organisations, including the council controlled organisations performance against its objectives and intended activities and performance.
- A whole of council funding impact statement.
- Rating base information including the number of rating units, total capital value, and total land value of properties at the end of the preceding financial year.
- Disclosures regarding the purpose, balance, and movement of reserve funds.
- Disclosures regarding the values of assets that are insured.
- A report on the activities undertaken to provide opportunities for Māori to contribute to decision making processes.
- Disclosures regarding the remuneration of elected members and the chief executive.
- Disclosures regarding the number of employees, including the number of full-time employees, and full time equivalent employees, and the remuneration bracket within which they are paid.
- Disclosure of any severance payments made during the year.
• A signed statement of compliance.
• Additional disclosures for councils with local boards.

138. The annual report must be completed and adopted by a council within four months of the end of the financial year to which it relates. Following publication of the annual report, a summary of the annual report must be published within one month.

139. Copies of the adopted annual report and the annual report summary must be provided to the Department of internal Affairs, the Auditor General and the Parliamentary Library.

**Pre-election reports**

140. In election years, a council must prepare a pre-election report that must be published no later than two weeks before the nomination day for the election.

141. The reports contents are prescribed, and include:
   • funding impact statements for the preceding three financial years
   • summary balance sheets
   • a comparison of actual rates, rates increased, and borrowing with their respective quantified limits
   • funding impact statements for the next three years
   • a summary forecast balance sheet for the next three years
   • details of major projects planned to commence in the next three years.

142. Some concessions exist for councils with less than 20,000 residents. Historical financial statements need only be prepared for the financial year ending in the same year as the election (as opposed to the three prior years).

143. Importantly, the Act makes it clear that the primary purpose of the pre-election report is to promote public discussion of the key issues facing a local authority rather than to inform potential electoral candidates.

**DIA benchmarks**

144. In addition to the financial prudence benchmarks set out in the planning section of this report, councils must also report on their non-financial performance against a set of performance measures that are set by the Department of Internal Affairs.

145. Performance measures are set for the core infrastructure activities of councils, being:
   • water supply
   • wastewater
   • stormwater
   • flood protection and control works
   • roads and footpaths.

146. The current set of non-financial performance measures are published on the Department of Internal Affairs’ website and were gazetted in November 2013.

147. There are 18 separate performance measures, spread across the core activities, however some of these performance measures require more than one measurement (e.g. fault response times are further broken down into attendance and resolution of both urgent and non-urgent calls).
**Funding impact statements**

148. As with the annual plan and LTP, councils are required to prepare funding impact statements for inclusion in both the annual report and pre-election reports.

149. Like the statements required in the planning stage, the precise disclosures and format of the funding impact statements are prescribed by legislation.

**Internal reporting**

150. In addition to the mandatory reporting set out above, councils also continue to provide reporting on financial and non-financial performance to their elected members and various committees on a regular basis.

151. The exact frequency and type of reporting that is provided varies from council to council and will depend on the specific needs of the elected members and various council committees.

152. This reporting is not typically audited, and while the information is ‘public’, it is not typically published on a council’s website (although it may be contained in council agendas and minutes that are published).

153. This information is primarily used by decision makers to ensure that the council is properly undertaking its responsibilities, to ensure that risks are being appropriately managed and identified, or to aid decision making.
The average annual report is 171 pages long

One council reported that its annual report cost 0.9% of its rates income (including staff time), excluding audit costs

In our survey, councils reported an average of 18% of total FTEs being involved in the preparation of the annual report

One council reported that 39% of its total FTEs were involved

The annual report is downloaded by one in every 432 residents on average*

The annual report summary is downloaded by around one in every 603 ratepayers on average*

*Total downloads divided by total population (2018). Downloads include out of region and may not be unique.
The monitoring framework as it currently stands

154. The monitoring framework is less prescriptive than other parts of the financial management framework. Although there are strict requirements for annual reports and LTPs to be audited, and for certain information to be provided to the Department of Internal Affairs and other government agencies, there are a number of other monitoring activities that occur but are not prescribed.

155. The key monitoring functions that we consider to be a part of the framework are outlined below.

**Audit**

156. Councils are required to have their LTPs, consultation documents, annual plans, and LTP amendments audited by the Auditor General. In practice, this audit is typically completed by Audit New Zealand (on behalf of the Auditor General) although other accountancy firms are also able to be contracted to provide audit services to councils on behalf of the Auditor General.

157. In particular, the audit of the LTP must comment on:
   - whether the plan gives effect to its legislative purpose
   - the quality of the information and assumptions that underlie the forecast financial information.

158. Importantly, legislation restricts the auditor from making statements about the merits of any policy content in the plan.

159. Similarly, among other things, the audit of the annual report must address:
   - the financial statements that are required to be prepared according to GAAP
   - the capital expenditure disclosures (including budgeted and actual)
   - the funding impact statements
   - the council’s compliance with the generally prescribed disclosures for the annual report
   - whether the annual report summary is representative of the major issues dealt with in the annual report.

**Audit and risk committees**

160. Audit and Risk committees are currently optional committees of councils that are specifically tasked with helping a council manage its financial and non-financial risk.

161. The audit and risk committee effectively acts in an independent advisory role to the elected members. Its role is not to override decisions made by elected members, but rather to provide an independent perspective of the key challenges and risks that the organisation is facing, and to ensure that those risks are being actively managed.

162. Because an audit and risk committee is voluntary for councils, not all councils have a committee. Further, the membership of these committees will differ between organisations. While most committees have independent members or chairs, some audit and risk committees are composed entirely of elected members.

163. The Office of the Auditor General, has for some time, recommended that councils should appoint an audit and risk committee.
**Ratepayers**

164. Ratepayers, as the key audience for most of the external facing documents of councils, play an important role as informal monitors of a local authority’s financial management. The legislation also formalises this relationship by requiring councils to consult and engage with their communities as part of the decision-making process.

165. While informal in many regions, ratepayers may form interest groups that lobby or challenge councils on their decision making, and consequently, their financial management. The extent to which this occurs differs for each council.

166. The level of ratepayer monitoring and engagement with council is likely to vary, based on topic, local demographics and the clarity and effectiveness of council communications.

**LGFA and other lenders**

167. Credit rating agencies have a role in monitoring the financial performance of the local government sector because good financial decision making is critical to ensuring the councils have the capability to repay borrowings.

168. All councils will be subject to some level of financial due diligence when they seek to borrow funds from outside credit agencies. The level and extent to which this monitoring takes place, and the extent to which the credit agencies provide useful feedback to the councils, may vary depending on the credit agency.

**Government agencies**

169. Councils are required to provide copies of their LTPs and annual report to various government agencies, including the Department of Internal Affairs, who administer the Act, the Ministry for the Environment, and the Ministry of Business, Innovation and Employment.

170. To differing extents, a broad range of government agencies have some involvement with local government, however the activities undertaken by these agencies are often limited to specific issues or operate in a more collaborative level, such as NZTA’s role in transport planning and funding.

171. Importantly, the Government does have some powers to enforce increased monitoring or oversight of councils, including the ability to appoint crown review teams, crown observers, crown managers, or commissions. These powers are rarely used and require the Minister of Local Government to have reasonable grounds that there is a significant problem that cannot otherwise be addressed. These powers have been used in the past to appoint commissions at Kaipara District Council and Environment Canterbury.
The Office of the Auditor General issued 78 audit reports on council’s annual reports in 2018.

The Office of the Auditor General issued a total 378 audit opinions to entities related to councils in the 2018 year.

Seven councils missed the deadline to complete and adopt their 2017/18 annual report.

Three councils missed the deadline for making summary annual reports available in 2017/18.

The costs for auditing a Long Term Plan ranged between $48,000 and $220,000 across all councils in New Zealand (excluding Auckland).

The costs for auditing an annual report ranged from $72,000 to $332,000 across New Zealand (excluding Auckland).

The Office of the Auditor General issued five qualified opinions for council’s 2017/18 annual reports.

Three audit reports also contained an “emphasis of matter” paragraph.

95% of councils have an Audit and Risk committee, and of those, 75% have an independent member*

*Based on our review of public information. The actual percentages may be higher than this.
Ability to respond to major future issues

172. This review of the framework seeks to answer the question of whether the current framework enables councils to adequately deal with the issues of today and tomorrow. While the framework has served a purpose for local government to date, there are several significant issues that are likely to affect the sector in the future: the framework’s ability to enable councils to respond to those issues is critical.

173. Significant issues are likely to arise in relation to:

- impacts of climate change and sea level rise
- demands of increasing compliance standards for three waters assets and any consequential reform of the delivery of three waters services that may arise in response
- the need to replace significant infrastructure, much of which was originally installed in the 1960s and may be due for replacement in the next 10 – 30 years.
- pressures arising from population and demographic changes, including high levels of growth as well as declining or aging populations, or a combination of these factors
- the reintroduction of the four wellbeings, and the impacts that may have on the way in which councils deliver services in the future
- continuous cost pressures arising from a range of external factors (e.g. increasing levels of service) and cost increases.

174. Workshop participants were asked to consider the appropriateness of the current framework for dealing with such future issues, however feedback in this regard was limited. Accordingly, the following discussion represents our views on the matters. We do note however, that workshops identified:

- the need for the framework to be agile and flexible – which will better allow councils to deal with externalities and competing/changing priorities
- the idea of presenting alternative views of the future, perhaps presenting different predications about cost inflation, service delivery solutions or projected growth.

175. Importantly, while the major issues facing the sector differ in significance and response, we consider that the way in which the framework addresses those issues should be broadly consistent.

176. In our view, there is nothing within the framework that would restrict a council’s ability to respond to any of the large issues listed. While there may be significant concerns in terms of the appropriate funding response for these issues, the terms of reference for this review excluded the specific consideration of funding mechanisms.

177. Importantly, we think the challenges with the framework lie with how effectively it encourages, or incentivizes councils to address those issues, and whether the framework could better encourage those issues to be addressed.

178. A number of the big issues are not new, and in fact have been on the horizon for some time, with foresight and strategic planning councils have had sufficient time to be able to prepare for slow-burning issues such as climate change, future infrastructure renewals and potentially increasing regulatory standards. Issues such as population growth, which have happened particularly rapidly in recent years, are not new either and the framework does not prevent response to these issues.

179. However, the framework could go further in encouraging councils to address these issues proactively. There has been continued suggestion of underinvestment in infrastructure assets for a number of years, despite the presence of the balanced budget provisions and amendments to the Act to shift focus to “core services” (and then back again).
180. The framework currently used by the sector has been in place for some time now, yet despite this, large issues continue to be raised, often with little indication that they have been effectively addressed.

181. It is recognised that certain big issues (for example climate change and population decline) are inherently too big to be able to be resolved simply through changes to the framework. While the framework may be able to go some way toward forcing the hands of local politicians, resolution to these big issues, which are often highly emotive or political, is more likely to be effective through other means. Our report does not consider the approaches that may be taken to deal with this political element.

182. To some extent the issues raised in workshops and discussed in further detail within this report highlight the challenges of the current system in dealing with the big issues. For example, the conflicting purpose of LTPs and the compliance burdens placed on small councils mean that the strategic focus, which is necessary to deal with big looming issues, is often lost.

183. We consider that addressing the key issues raised in this report should enable councils to take a more strategic approach to financial management and may help to prepare councils for the big issues in the future, however further investigation will be required to determine the appropriate policy responses.

184. Specific areas to consider further are addressed in our discussion on the key themes from the workshops. However, to summarise:

- There is a need to consider opportunities to refocus the LTP such that the mixed operational and strategic focus of the document is separated. This may facilitate greater engagement with communities and may enable councils to ensure that there is an appropriate level of focus applied to each element.
- Further consideration should be given to the type of assurance or review that is provided for LTPs, and whether an “audit” (in the technical sense) provides the best value given the opportunity presented. For clarity, it is broadly accepted that some level of assurance of the LTP is critical and valuable.
- The current balanced budget provisions should be reviewed to determine whether they are effective at delivering the intended outcomes, or whether there are opportunities to further strengthen them. Consideration should also be given to the interaction between the financial strategy, balanced budget provisions and the financial prudence obligations.
- Opportunities to address issues relating to size, scale, capability, and capacity of councils should be identified. In our view a number of issues within the sector relate to capability and capacity constraints, and access to the right level of capability and capacity is difficult for councils with limited resources. Improvements in this area may lead to significant gains for the sector.
- The current set of financial and non-financial benchmarks and performance indicators should be reviewed to make them effective, fit for purpose and relevant. The benchmarks and performance indicators have the power to drive and influence behaviour and should be considered with that lens.
- The ways in which the current documents produced within the framework are used to communicate and engage with users of those documents should be reviewed. While this may largely be an issue of practice, there may be opportunities to amend legislation or regulations to better enable effective communication methods to be used (such as reducing the level of prescription).
Key themes

186. We identified six key themes that were consistently raised throughout the workshops, which we consider require further discussion and comment.
   • The dual purpose of key planning documents between strategy and business planning
   • The role of audit of the LTP
   • The balanced budget provisions and asset management decisions
   • The impacts of size, scale, capability, and capacity, and the potential for standardisation
   • The role of benchmarking
   • The need to consider communications of data and engagement with communities

187. The following narrative presents our views on the discussions and key points of the six sector workshops.

Strategy versus business plan

188. The LTP has a natural conflict between the strategy, which is about the long-term direction and vision for a council, and business planning, which is about cost and delivery of services. This creates a natural risk that there is a lack of clarity about the document’s purpose and creates challenges with communication and engagement.

189. There is no question that both – a strategy and business plan – are required for sound decision-making and future accountability, but their combined role in engaging the community is marginalised by their:
   • technical nature
   • size.

190. For long term planning to be effective, particularly in local government, it is critical that the vision and aspirations of the community are well reflected in a council’s plans. However, LTPs currently require numerous disclosures and documents which make it challenging for the documents to be considered approachable, readable or strategic.

191. There remains a real risk that councils, particularly those with limited resources, focus on the compliance and business planning aspects of the development of a LTP, and not on the strategic objectives or outcomes. In these cases, particularly, it would appear that the current requirements are ineffective.

192. To effectively engage the community, it is important that the key issues are addressed and stated simply in this core strategic document, including:
   • confirmation of overall direction
   • large changes in direction or projects which require significant funding
   • the trade-offs or financial impacts of decisions
   • the impacts on rates affordability and predictability
   • the council’s plans to ensure that it is able to affordably look after the assets it currently has and maintain the services it currently provides.
The above key issues for communities are ‘commonly held’ by many involved in the sector. The legislation assumes the current LTP information is required by the public for effective consultation and accountability. Its preparation and need is not disputed but its ‘cut through’ with the community for effective development of views is questionable. It is important in developing external planning documentation to start from a community-centric perspective.

It would be valuable for the assumptions about the core information community needs to be engaged (as suggested above) to be tested through formal academic research.

The consultation document does address a lot of the issues that are important to ratepayers, but this document is only ‘alive’ for a short period of time (the consultation period), it exists, serves its purpose and then effectively disappears. The community’s views, collected from the consultation document are reflected in the LTP, however this document is large, technical and intimidating to readers. The maze of strategy, policy and financial information makes it challenging for ratepayers and the community at large to find and interpret information that is useful for them.

There may be opportunities to improve the usefulness of LTPs, which may include:
- a reduction in the level of disclosed prescription
- consideration about whether certain prescribed elements of an LTP can be removed from the LTP itself, but still required to be produced, including being developed from a digital communication channel perspective
- improved industry guidance regarding the strategic elements of LTPs
- possible optional standardisation of ‘compliance heavy’ parts of the LTPs to enable small councils to reduce compliance and focus on strategy
- changes to consultation documents to further remove prescription.

Audit role

The Act requires the LTP to cover both the strategic and business planning aspects of a council and they must be reviewed under auditing standards. It is important for parliamentary confidence and for external markets. It is the foundation of confidence any in interaction with a local authority – its financial plans are sound and prudent. The audit of the LTP is one of the many strengths of the existing financial management framework.

The sector generally accepts the role of external audit in expressing an opinion on the financial representations, yet the criticism is that, in order to meet auditable standards, the planning process is dominated by external audit (as demonstrated by comments during the workshops such as “the document is prepared for audit” and “it is a compliance document”), and in many cases strategy is lost.

However, workshops highlighted a perceived disconnect between the concept of the need and value of an external audit with the aim of an engaged debate with the community and decision-making by elected members.

There is substantial tension about the role of external audit and the LTP. This is entwined with the issue discussed previously regarding the purpose of the LTP.
- Strategy vs business plan – high level vs detail
- LTP vs annual plan – long term vs short term
201. In our view, strategy and prudence must intersect. The challenge is in determining the extent of the auditor’s role where strategy is about policy choices. The concern is that in auditing LTPs the Office of the Auditor General ‘strays’ into commenting on, and even setting, policy rather than expressing an opinion on prudence, although we note that the legislation contemplates that the auditor should not comment on policy, and this is reinforced in the actual audit opinion.

202. We have also heard examples where the audit process has prevented what otherwise may be good financial decision making, these include:

- councils being required to fully finance capital works programmes despite historical evidence that the programme will not be fully achieved
- capital works programmes in outer years of LTPs being understated due to a lack of evidence to support more realistic spending profiles
- prevention of innovation such as the embedding of infrastructure strategies within an LTP, because legislation requires a separate infrastructure strategy.

203. In these cases, it seems that the current role of the auditor may not be serving the best interests of the sector. It may be discouraging the right debate and a strategic discussion.

204. To some extent, this position is the function of the nature of the engagement. An audit is a specifically defined review process that must conform to international standards. Because of this, there are strict guidelines regarding the level of evidence that is required to support assertions.

205. It may also be the function of the environment in which audits are carried out. The obligations of auditors are strict, and the implications for auditors when things go wrong can be large. By providing an audit, auditors assume a level of risk that may drive a more direct compliance focus (for example, the issues revealed in the auditor’s role regarding Kaipara District Council LTP).

206. It would be appropriate to consider whether the role of the auditor in reviewing LTPs can be changed. The sector generally expressed doubt about the value of “auditing the future” and emphasised that more value could be gained through an audit of the key risks, assumptions and sensitivities of an LTP. We are inclined to agree with this general view. Yet it seems too narrow – a community-centric view is probably reliant on the audit addressing the larger assurance needs of ‘is it prudent?’ This is an important question of trust and confidence in our local authorities but raises issues of “auditing strategy” and “auditing the future”.

207. While there may be scope to review the role of the auditor in reviewing the LTP, noting that the role should be retained in some form, any such work should not be done without consultation with the Office of the Auditor General.

208. It is important to note that any reduction in the level of assurance provided will also create a risk that the level of assurance taken/assumed by the public is the same as the current audit. In this case the risk and liability adopted by the auditor may be too great.

209. Many of the concerns raised about audit, and the role of audit, were focussed on current practice. A natural tension has long existed between auditors and financial staff, and it is debatable whether these tensions are able to be resolved without significant effort from all parties. It is important to be aware of these tensions when considering the sectors views on the role of audit.
210. Notwithstanding the tensions between audit and financial staff, there may be practice matters which should be focused on such as clarity on what an auditor does when looking at strategy and the effectiveness of audit and risk committees in working with and understanding the role of external audit. Other opportunities identified during the workshops, such as the Office of the Auditor General making its annual brief to incoming auditors available to councils, may also improve tensions and clarify roles and focus areas.

**Balanced budget**

211. The balanced budget and financial prudence requirements are generally regarded as positive within the local government sector, and workshop participants suggested that these have resulted in improved financial management and sustainability practices. The requirements to manage finances prudently are generally seen as positive steps towards ensuring that councils are able to better respond to future investment requirements. Feedback from the sector is that the legislative principle needs to be retained.

212. However, there are a number of areas in which these requirements could be strengthened or clarified to better address future needs and to provide useful information to ratepayers about how councils are planning to address future investment requirements.

- Consideration of the removal of capital items from the calculation (particularly ringfenced capital receipts such as development contributions).
- Better or clearer guidance about the circumstances under which section 100(2) can apply, and the evidence that may be needed to support that decision.
- Better integration of asset management requirements.

We discuss each of these points in more detail below.

213. The short-term nature of the balanced budget is also of concern. The current provisions of section 100 of the Act require a council to only consider that year’s operating revenue and expenditure. This means future investment requirements may be overlooked in determining the level of funding and financing required. A longer-term view of a council’s future financial requirements is needed to ensure sustainability.

**Capital items in the calculation**

214. Section 100 of the Act requires a council to maintain a balanced budget. That is, it requires that a council’s operating revenues are set at a level that is sufficient to meet its operating expenses in any given year. The terms “operating revenue” and “operating expenses” in the Act have the same meaning as they do under GAAP, and therefore include amounts that may be more capital in nature including New Zealand Transport Agency (NZTA) grants, development and financial contributions and revaluation gains.

215. While the principles of the balanced budget are clear that a council should collect enough money from its operations to cover its day-to-day operating expenses, including the cost of depreciation, the current legislation allows for some capital items to be included. These capital receipts can only be used for certain capital projects (for example development contributions can only be used for the specific growth-related infrastructure for which they were levied).

216. When these capital receipts are included within the calculation, the effect is that the amount of operating revenue is inflated, and the total rates requirement that is needed to fully fund all operating costs is underestimated.
217. While section 100 of the Act relies solely on the GAAP meaning of operating revenue and operating expenditure, the Local Government (Financial Reporting and Prudence) Regulations 2014 (the Regulations) introduces a revised definition. In this definition many capital items are excluded, although it is worth noting that NZTA’s capital grants (which must be used on roads) are still included, as is the full associated depreciation cost for those roads.

218. It may be appropriate to align the definitions of revenue and expenditure across the Act and the Regulations and ensure that all capital receipts are appropriately either included or excluded.

**Financial prudence**

219. While the Act requires that a council should maintain a balanced budget, the Act does allow for a council to set revenues at a different level if they believe that it is financially prudent to do so.

220. In determining whether a council can opt out of the balanced budget provisions, it is required to consider the impacts of that decision on the council’s ability to maintain the service capacity of assets throughout their useful life. It is also required to consider the equitable allocation of that funding and financing requirement.

221. While there may be a number of reasons why a council may opt not to maintain a balanced budget, it would appear that under any circumstance the council should be able to demonstrate that it is otherwise able to manage its assets throughout their useful life in an affordable way. Councils may be able to do so by:

- Funding a renewals programme rather than depreciation. Although in our view, for this approach to be effective at reducing funding requirements it may either be too short-term or may rely (rightly or wrongly) on extending asset lives (in which case there may be justification for revising depreciation calculations).
- Managing the replacement of assets using debt – which may require debt repayments to be funded as opposed to depreciation.
- Making use of investment returns on depreciation reserves to reduce the amount required from ratepayers.
- Planning for obsolescence – although planned obsolescence should potentially be reflected in the asset valuation under an optimised replacement cost approach.

222. The amount of evidence, and level of confidence, that a council has to support its decision not to maintain a balanced budget seems variable, and there may be scope to provide more clarity about the information that must be held and disclosed in order to support a decision not to maintain a balanced budget. In our view, such a decision should not be made solely for ratepayer affordability concerns (unless it is part of a broader plan to slowly transition towards a balanced budget position).

223. It is also unclear how the ability to opt out of the balanced budget requirement interacts with the financial performance benchmark which states that a council only meets the balanced budget benchmark if its operating revenue exceeds operating expenditure.

224. Section 101 of the Act also requires councils to be prudent in their financial management. Given the ability to opt out of maintaining a balanced budget on the grounds of prudence, section 101 appears to be the dominant consideration for councils in setting their funding approach. The presence of this section, along with the requirements for infrastructure and financial strategies, may be enough to ensure that councils are adequately providing for future infrastructure costs.
In our view, further consideration should be given to the combined purpose of sections 100, 101, 101A, and 101B with a view to ensuring that those sections adequately encourage councils to consider the funding and financing requirements for both current and future costs (even where the exact quantum of those costs may be unknown). And at a simple level, their relative importance should be reflected in how they are ordered in the Act,

**Asset management reporting**

One of the primary reasons for the balanced budget requirements is to ensure that councils are prudently managing their finances in a manner that will enable them to respond to future investment requirements.

In order to understand how effectively this is being managed, and for ratepayers to understand the implications of the investment, funding and financing decisions made by their council, it is important to have good quality asset information disclosed in the annual report.

Currently:

- Councils are required to disclose the replacement value of their core infrastructure assets (roads and footpaths, water, wastewater, stormwater and flood protection and control works) though not all councils do so, and in some cases, it is not done correctly (they report the depreciated book value of the assets rather than the replacement cost).

- Councils are required to report on their performance against the essential services benchmark, which measures total investment in infrastructure assets against the depreciation on those same assets.

Disclosure of the actual replacement cost of infrastructure assets conveys important information to the users of financial information, as it allows them to understand what the actual cost of replacing core assets could be. Additionally, when combined with the depreciated replacement cost (or alternatively the actual amount of accumulated depreciation) of the assets, it allows readers to gain an understanding about the relative remaining life in the asset base.

Meanwhile, the essential services benchmark appears limited in its usefulness. In most cases, councils that are experiencing some level of growth or investment in improving the level of service of its assets will easily meet the benchmark. Investment in growth and level of service assets has no relationship to depreciation and should therefore not be measured against it.

Additionally, the benchmark does not appear to drive the behaviour that it is seeking to influence as the benchmark can theoretically be achieved without any investment in the renewal of core infrastructure (if growth and level of service investment is sufficient).

We believe that there needs to be some measure of investment in the renewal of assets specifically. While the most useful information in this regard would asset data such as the condition profile of different asset classes, we recognise that in many cases condition assessments are incomplete, or that condition is measured differently between councils. Further, the benefits of having complete asset condition data for entire infrastructure networks may be far outweighed by the costs involved in obtaining that data for many councils.
233. It may therefore be appropriate to measure renewals investment as a percentage of depreciation. However, for this to be useful, it must be accompanied with:

- some form of prescribed information about the asset lifecycle/maturity of the asset base (there are a number of ways to provide this context, but it should be consistent across the sector)
- additional prescribed contextual information regarding the current, and historical growth rates of the council for instance
- additional guidance or prescription around the allocation of capital expenditure to “renewals”, “levels of service” and “growth” assets. This should include guidance about apportionment of expenditure for projects that have mixed drivers.
- the measure should ideally be reported over a minimum of ten years.

**Standardisation, size, scale, capability and capacity**

234. Workshop participants regularly reflected on the significant compliance cost and resource burden that is placed on councils under the current financial management framework, particularly with councils with limited resources and small rates bases. This is also reflected in the examples presented in the body of the report, which show that the LTP draws upon the skills of around one third of the total workforce of a council, typically costs around $450,000 (excluding audit and staff costs), and takes around two year from start to finish.

235. It is therefore appropriate to consider whether the system is generating value for ratepayers, or other users of the various outputs of the system, or whether certain communities may benefit from appropriately scaled reporting requirements, or standardisation.

236. In our view there are potential opportunities to make some gains in this area, although they may be small.

**Standardisation**

237. There are two different ways in which standardisation may benefit the sector, with differing outcomes.

- Standardisation of the way in which certain performance benchmarks are measured, and the way in which certain types of expenditure is accounted for. To some extent this is already in place, with the application of GAAP, and prescription around the measurement of benchmarks.
- Standardisation of key documents, which limit flexibility, but may provide some councils with certainty about what needs to be reported, and how, and may improve the ability to compare councils.

238. As mentioned, standardisation of benchmark measurement and accounting is already undertaken to some degree. Accounting standards dictate how certain transactions must be classified, and prescribed benchmarks often contain guidance on the method of measurement. However, there are still instances where further standardisation could be achieved, which may allow for improved comparability.

239. For example, benchmarking completed by Water New Zealand looks at the cost of water production in different council areas. However, while overheads may be included within this calculation, there is significant variation between councils about what costs constitute overheads, and the basis for their allocation. Some councils, for example, apportion the costs of democracy services to different business units as an overhead, while others treat this as its own cost centre that is directly rates funded. Even where councils apply the same broad treatment to the type of costs that are allocated to business units, the method by which they do so can differ greatly.
240. For a reader of this information to be able to draw true and fair comparisons between councils it would be necessary for the councils to apportion overhead costs consistently, or for the differences in treatment to be clearly explained. While standardisation here may be appropriate, it is important to realise that this comes at the cost of preventing councils from being able to manage their business in the way that they see as being appropriate, and may have significant implications for the way in which budgets are set for those councils that do not currently conform with the agreed methodology.

241. Any attempt at standardisation should therefore be sector led to ensure that it is fit for purpose. We would suggest that voluntary guidelines are developed by the sector, and that councils may be required (or encouraged) to state whether those guidelines have been used, or a different method has been applied. This would at least allow for quick comparison between councils which have adopted the guidelines.

242. Other areas for potential standardisation of accounting include the classification of asset expenditure as maintenance, renewal, level of service, or growth related.

243. For the standardisation of key documents to be beneficial for the sector it would be important that the standard form documents are:
   - compliant with GAAP and any other legislative reporting requirements
   - easier or quicker to prepare than current documents (at least over the long term)
   - scalable, or representative of a minimum requirement (with for example, different tiers of mandatory and optional disclosures)
   - sector led and approved.

244. In our view, it is difficult to see how standardisation of documents is likely to lead to any real efficiency savings in the sector. However, if accompanied with changes to reflect the differing size and scale of councils, it may provide for some level of assurance that ratepayers are receiving the same core information from councils regardless of their size.

245. While standardisation may have minimal efficiency savings, there may be other benefits arising from standardisation, which could include increased comparability between councils and an improvement in the public’s ability to understand and interpret data.

**Size and scale**

246. There was a strong desire within the workshops for the framework to reflect the size and scale of councils in the level of compliance that is required. For example, in principle a small council such as Kaikoura typically must produce the same set of documents that a council as large as Auckland has to (excluding the local boards disclosures).

247. In our view, the question is, do the documents that are required to be produced by small councils represent good value for ratepayers, given the relatively high monetary and resource cost of production, or could more value be extracted?

248. While there may be some argument that the cost of compliance for a council such as Kaikoura is prohibitive (in 2017 it had 34 FTEs and rates revenue of only $5.4 million), it is important to realise that ratepayers still pay similar levels of rates as in Auckland. Further, when viewed on a per capita basis, the level of assets being managed by each council is still significant ($86,000 per ratepayer in Auckland versus $52,000 per ratepayer in Kaikoura).
We believe that there is a balance that needs to be reached. Ratepayers still need enough information from small councils to understand:

- What their rates are, and what they are likely to be in the future
- Whether there are any major issues coming up
- Whether assets are being managed sustainably, and whether levels of service are likely to be maintained
- What the council intends to do with the money it has collected
- The long-term strategy and vision for the community, and the steps the councils is intending to make to achieve that
- That the assumptions and planning decisions that are being made are sound.

While some possibilities exist for addressing size and scale issues, these inherently come with reduced transparency and accountability. Unless Parliament and the community are prepared to accept the risk of lesser standards for communities in smaller territorial areas, there seems limited opportunity for gains in dispensations on required information (including standardisation) or lesser approaches to planning.

**Capability and capacity**

Several issues with the effectiveness of the current framework are about the capacity and capability within councils to meet the requirements.

It is well recognised that most councils in New Zealand, as with many other industries, struggle to attract talent with the right set of skills to meet their needs. Where the right level of capability can be attracted, affordability constraints (relating to size and scale) mean that this capability is often spread thin.

In our view, many of the issues presented with the effectiveness of the framework relate to the sector’s current practice and not the framework itself. Addressing issues of capability and capacity in financial and asset management would be likely to go a long way towards improve sector practice.

These constraints mean capacity and capability issues must be addressed through working smarter, not harder. Increased use of technology, standardisation, and automation are all likely to go a long way towards improving this capacity constraint.

Capacity and capability issues may also be addressed through sub-regional, regional, or national initiatives with shared resourcing. There can be effective arrangements, such as the Manawatu/Rangitikei arrangement around asset management planning (and delivery), which can enable smaller councils to seek to maintain the balance.

We believe that further work is required to attempt to address capacity and capability issues within the sector. This should include exploring opportunities to encourage or facilitate greater levels for collaboration and resourcing between councils.

**Benchmarking**

Throughout the workshops we heard a general acceptance that benchmarking, in general, is good for the sector, and is useful for ratepayers and council officials alike. The sector through LGNZ has also been supportive through its CouncilMARK assessments. We broadly agree with this assessment but note that in order for the benchmarks to be useful to ratepayers they must first be accessible, and they must also be consistent.
258. Despite this general acceptance, there was some discussion that the current suite of non-financial performance measures and the financial prudence benchmarks, were not all useful, and in some cases were not comprehensive enough.

259. Some councils also noted that they had difficulty reporting on the measures, as they were unable to be measured easily (if at all), or where they can be measured, performance was unlikely to improve on a year to year basis.

260. For example, we are aware that many councils are unable to calculate water loss because they do not have residential water meters. For similar reasons, it is difficult for many councils to accurately determine average water consumption in their region. While this may encourage councils to install water meters, it is unlikely to be an effective encouragement as long as councils are able to make estimates.

261. Similarly, issues such as discharge compliance for sewage systems can take a long period to resolve and performance may be better viewed over an extended time period.

262. We recommend that the current set of non-financial and financial benchmarks are reviewed. In doing so, the following should be considered:
   - What does this tell the ratepayer about the service they are receiving?
   - How can ratepayers gain confidence that the council is improving its performance (and if it isn’t why not)?
   - How easy is it to compare the performance of councils?
   - Are councils able to measure their performance against the benchmark within their current means?
   - Are councils able to control their performance against the benchmark?
   - Does reporting on the benchmark incentivize the councils to make the appropriate investment decisions (does it drive behaviour)?

263. Benchmarks have the power to drive the behaviour of councils in positive and negative ways, and it is important that the full behavioural consequences of introducing benchmarks is well understood. For instance, we understand that the introduction of the renewals ratio and operating surplus ratio, as well as the other Fit for the Future benchmarks in New South Wales, has seen a significant increase in the planned and actual spend on network renewals.

264. Additionally, it may be helpful for any benchmarks to be made available publicly outside of official documents, rather than leaving this to the public to initiate. There are international examples of this, such as the “Know Your Council” website in Victoria, Australia. It would be important that any such website, or other resource, presented the full suite of financial and non-financial benchmarks, as well as specific contextual or explanatory information.

**Communication and engagement**

265. In considering whether the framework has been effective, it has been important to consider how well it facilitates good communication of key issues to, and engagement with, its intended audiences. In so doing, it is first important to identify the audience itself.

266. It is clear from the supporting legislation, and the parliamentary debates that surrounded the introduction of many of the current components of the financial management framework, that the primary audience for most of the documents is the ratepayer and affected community.
267. How well the current framework is serving the interests of ratepayers is a complex question and would be difficult to answer without engaging with ratepayers directly. However, there was a general consensus throughout our workshops that a large amount of the reporting, including the annual and LTPs, was not effectively presenting the right information to ratepayers and was not effectively eliciting engagement.

268. Equally, there was acknowledgement that the current framework does not restrict this engagement, and in fact, in many instances, council practice was the driving force for the poor communication. Due to the level of compliance involved with some of the stages of the framework, good communication may be overlooked or left until the last minute.

269. We believe that there are three main barriers to effective communication and engagement within the current system:
   - The amount of time, cost and human resources required to simply comply with the framework is challenging. We have made more comments regarding this under our earlier section titled “Standardisation, size, and scale”.
   - The technical nature of the documents.
   - The sheer size of documents produced may be intimidating to members of the community and makes it hard to find useful information.

270. Much of the criticism revolved around the effectiveness of current information – its form and length and including the usefulness of GAAP required information such as the primary financial statements or the regulatory required Funding Impact Statement.

271. There was no real criticism of councils needing to prepare GAAP-based information and there was recognition of the need of external stakeholders for formal GAAP-based disclosures. However, the practice of how councils communicate from the framework-based information and the usefulness of the disclosed information was criticised.

272. Those that did criticise the ability of GAAP based financial statements to convey the right information to ratepayers were often also the same group that questioned the usefulness of funding impact statements. Funding impact statements serve a similar role to other non-GAAP alternatives.

273. The nexus of disclosure prescription and understandability is still real to local authorities. Does greater understandability leading to more informed decision-making and accountability, require differently prescribed information or a clearer focus on practice by the sector in communication?

274. Prescriptive requirements for summary information exist for consultation, the LTP (the Consultation Document) and annual report, although there is a level of prescription and good practice in their preparation. A regular ‘narrative’ was the requirement for more than one option being disclosed in the consultation document when in fact none really existed but were ‘dreamt up’ to meet S77 and “audit” requirements. There is a sense that the key to better short form information is sector practice.

275. We consider that communication and engagement may be able to be improved through the de-coupling of a number of the LTP documents. That is to say, that those documents that are decoupled would still be mandatory, and the LTP could still rely on those documents, but there would be no requirement for joint publication, and indeed where appropriate their revision cycles could be altered to fall in earlier or later years of the financial management cycle.
276. For example, significance and engagement policies and even revenue and financing policies could easily ‘live’ outside of the LTP, with the LTP reflecting the content of these policies.

277. Such a decoupling could result in the production of a shorter, strategy or operationally focused LTP, that is more akin to the current consultation document (which is typically well regarded). Identification of the key issues, and important information to be included within that summary, would likely require a high level of consultation with ratepayer groups, elected members and council officials.

278. Similarly, a refocussing of the annual report summary as being the key outward facing document, may achieve similar gains in terms of ratepayer communication. To a large extent, this refocussing can already be achieved within the current framework, however sector practice has typically treated this as simply a compliance exercise.
Workshop feedback - Planning

280. The following section outlines the feedback received during the six workshops held with local government officers and professionals. The comments reflected in this section relate to the planning stage of the framework and reflect the views of the workshop participants. We make no comment on the validity or reasonableness of these comments in this section.

What is working?

281. Workshop participants were unanimous in their comments that the planning and in particular the long term planning, discipline was useful and effective and reflected best practice. Common positive feedback regarding the financial management framework included the following:

- There was broad agreement that the introduction of LTPs, financial strategies, infrastructure strategies and asset management plans has resulted in councils being able to make more informed decisions and has led to an improvement in council’s understanding of asset performance and condition.
- The concessions from consultation for annual plans, where they are not significantly different from LTPs, were regarded as being particularly useful, and had worked as an effective incentive to ensure high levels of accuracy in LTPs. However, in some cases elected members were making political decisions to consult with communities, even where there were no significant changes or new projects.
- The introduction of the consultation document was seen as a particularly good change as it enables councils to communicate the key strategic issues to, and engage with, communities, without having to introduce much technical information.

What could be improved?

282. The most resounding messages from workshops regarding the planning framework, and particularly the long term planning process, were about the cost and time commitments required of councils, and particularly of small councils. In particular:

- Small councils found that the amount of staff time and costs involved in the long term planning process is excessive and may not deliver good value for ratepayers. In some instances, the time commitment required to simply comply with legislation meant that long term planning documents were not as strategic in nature as they could be.
- Councils observed that the current legislation and regulations were too prescriptive, meaning that there is a danger that long term planning documents can be treated as compliance documents, while there is opportunity for the documents to be much more than that.

283. In addition to the above matters relating to the size and scale of the framework, several other more incidental matters were raised:

- While the consultation document was widely regarded as being a significant positive component of the current financial management framework, there was a view that this was still too prescriptive, and occasionally constrained councils’ ability to use the document as effectively as councils would desire.
There was some suggestion that the planning time period (i.e. the ten year period for LTPs and financial strategies) was not well suited for its purpose, however there was no consensus on whether this should be longer or shorter. Proponents of shorter time periods suggested that while councils should engage in long term planning over a ten year period or longer, the information communicated to ratepayers should be condensed to a shorter time frame due to the levels of uncertainty in later years. Alternatively, those suggesting longer term planning periods indicated that the level of detail and information required for later years may need to be amended.

The timing of LTPs was seen as challenging for some councils, particularly where there is a substantial change in the composition of council. In some cases, there may also be benefits in moving the long term planning process forward, if the composition of council remains stable. Flexibility in the timing of LTPs may help here, though would need to be carefully considered.

It is debatable whether the full LTP document is used or is useful for ratepayers, who are perceived to be one of its main audiences.

There was a lack of agreement about whether inflation should or should not be included in LTP estimates. Arguments for the inclusion were to assist in illustrating the real financial impact of future investment requirements, and to assist with the understanding of the time value of money, while arguments against the inclusion were focussed on the masking effect that inflation has on hiding other reasons for expenditure increases or decreases.

The three year cycle for LTPs can be restrictive in terms of its ability to respond to shocks or major changes. The current planning cycle is not agile enough to respond to change and may be facilitated better through having a range of scenarios that interpret the future of councils in different ways based on changing or differing assumptions.

The focus of LTPs on rates rises means that often the cheapest solution is adopted rather than the best solution. This can create additional costs for councils where the solution is not fit for purpose or for the long term.

Matters raised in workshops that may have direct policy implications

284. A number of councils saw the benefits of integrated planning, and could see merits in further enabling this, for instance by removing some of the barriers to developing a combined financial and infrastructure strategy. Some of the barriers cited included differing planning time frames, different requirements about the sets of assets that must be included, and duplication of disclosure requirements. We believe that improvements in this area may be readily achievable as they are unlikely to alter the purpose of the existing framework and are unlikely to be met by resistance from the sector due to their ‘enabling’ nature.

285. The sector would benefit from greater alignment between the timing of central and local government strategic documents and processes (including those of the Resource Management Act 1991 and the Land Transport Act 1998), which would enable councils to plan more effectively and accurately. Additionally, there is scope for further integrated planning between neighbouring councils and central government, to ensure investment priorities are better aligned.

286. The differing use of the nomenclature ‘Funding Impact Statement’ for two statements with different roles should be resolved. Specifically the funding impact statements that address the rating impact should potentially be renamed to avoid confusion.
Workshop feedback - Decision making

288. The following section outlines the feedback received during the six workshops held with local government officers and professionals. The comments reflected in this section relate to the decision making stage of the framework and reflect the views of the workshop participants. We make no comment on the validity or reasonableness of these comments in this section.

What is working?

289. Significance and engagement policies are effective and useful tools for ensuring that proper process was followed when making major decisions. In some cases, the policies would result in unusual outcomes regarding the level of consultation required, however this was typically due to the policy that had been developed and adopted, as opposed to the requirements of the legislation.

290. The financial prudence benchmarks help to focus elected members on the impacts of their decision making on ratepayers. This means that elected members are regularly focussed on understanding the impact of their decisions on predicted rates rises and affordability.

291. No councils expressed any concern with the concept of the balanced budget requirements, and the premise of being strongly encouraged to maintain a balanced budget (and by implication to fund depreciation) was generally seen as positive within the sector.

What could be improved?

292. In some cases, although the consultation concessions for annual plans applied, elected members had a strong desire to consult with communities. It was noted that, to some extent at least, legislative nomenclature regarding the terms ‘consult’ and ‘engage’ has created a desire to enter a formal consultative procedure, where the intention may not have been to do so.

293. Comments were made regarding the current suite of benchmarks:
   - There are too many
   - Some are difficult or challenging to measure
   - The benchmarks that are there may not be right, but other benchmarks could be useful
   - There is a need for greater levels of standardisation before benchmarks can be useful
   - While the measure may be standard across councils, there was a desire that ‘targets’ should differ at least between different natural groupings of councils
   - More asset management benchmarks would be useful

294. The financial prudence benchmarks are seen as being toothless, with no consequence for breach of the self-imposed limits. Additionally, because limits are set by the council with little specific guidance, they are not always limiting.

295. The balanced budget requirement and benchmarks are inconsistent in their interpretation of what constitutes a ‘balanced budget’. Additionally, the inclusion of capital items within the balanced budget measure should be revisited as it is inconsistent with the purpose of the provision.
296. The current frameworks regarding consultation are rigid and reflect a paper-based, traditional, approach to consultation. Most councils are now engaging more regularly with their communities through social media channels, and there may be opportunities to improve the framework to reflect modern consultation.

297. Some councils pointed to difficulties with managing cross-boundary issues. Currently the consultation process for these is challenging, and additionally there are limited mechanisms to address funding, financing or ownership of projects that cross boundaries.

298. It was recognised that newly appointed elected members can often take some time to understand local government rules, processes, and financial management, this can make it difficult for elected members to fully understand the financial implication of decision making.

299. Councils could make better use of the data that they currently have regarding assets to enable more informed decision making. Furthermore, councils should place greater value on the data that they have acquired and invest in the maintenance of that data.

300. The current electoral cycle is too short to facilitate good financial management and strategic decision making. Changing directions of newly appointed elected members makes it difficult to have a clear strategic direction for the council over a long term.

General observations

301. Workshop participants generally expressed a desire to better engage with communities and gain a true understanding of the priorities for ratepayers. There was a strong desire to ensure that the public documents produced as part of the framework effectively enabled better and more effective engagement.
Workshop feedback – Reporting

302. The following section outlines the feedback received during the six workshops held with local government officers and professionals. The comments reflected in this section relate to the reporting stage of the framework and reflect the views of the workshop participants. We make no comment on the validity or reasonableness of these comments in this section.

What is working?

303. Annual reports, prepared under GAAP, serve a valuable role in accountability and transparency of the use of public money. As local government is empowered with the ability to levy rates on a property, and to require payment of those rates, it is critical that local government organisations are able to demonstrate that public money has been used in a fiscally responsible manner.

304. The internal reporting prepared by councils was often seen as useful, and the flexibility in the format and regularity of internal financial reporting was welcomed. Many officials considered that the internal reports that are presented to councillors would be more useful for the community and ratepayers than the formal annual reports.

305. Some workshop participants found the funding impact statements as being useful communication tools. The statements were considered useful as they are better able to communicate where money has come from and what it has been used for, than a statement of financial performance that is prepared under GAAP.

306. A small group also noted that the current similarities between NZIPSAS and NZIFRS financial standards meant that consolidation of group accounts did not require too much re-statement and cautioned that further divergence in the standards may create substantially more work for council staff.

307. There was some perception amongst workshop participants that the summary annual reports had the potential to be useful documents for the communication of council’s annual performance to ratepayers.

What could be improved?

308. The general view of the reporting cycle and the annual report within the workshop groups is that it is heavily compliance focussed and is not an effective tool for communicating with ratepayers about how a council has performed against its objectives for the year. The following was noted:

- GAAP reporting is potentially confusing for ratepayers, due to the way in which certain receipts are capitalised. For example, GAAP requires vested assets to be treated as operating income within the statement of financial performance, though in nature they are more akin to capital receipts (as they are non-cash and are unable to be liquidated or applied for any other use). This results in some councils reporting large ‘surpluses’ which can be difficult for ratepayers to comprehend.
- Some of the disclosures required by GAAP did not appear to benefit the general public.
- Information that may be useful for the public to understand is often buried or difficult to find. While this can be highlighted in annual report summaries, these are still overly prescriptive and do not provide enough flexibility for reporting to meet the needs of the community.
309. In addition, the following points were raised regarding the current reporting requirements:

- Many workshop participants did not see any value in funding impact statements, and saw these as a compliance burden.
- The current suite of DIA benchmarks, both financial and non-financial, were not considered to be useful. In some cases, these benchmarks were either difficult to measure performance against or surplus to needs. Additionally, in some cases there were opportunities for new benchmarks to be introduced (for instance regarding asset condition or performance).
- Pre-election reports were generally regarded as not having a clear audience, and generally lacking usefulness. There was some view that pre-election reporting was helpful, and that some form of pre-election report could be useful, but the current format was not typically fit for purpose. Some councils are looking to adapt these reports to convey useful information.
- Summary annual reports are currently prepared as an after-thought and produced as quickly as possible. A refocus of the purpose and intent of the summary annual reports may improve their effectiveness.
Workshop feedback - Monitoring

310. The following section outlines the feedback received during the six workshops held with local government officers and professionals. The comments reflected in this section relate to the monitoring stage of the framework and reflect the views of the workshop participants. We make no comment on the validity or reasonableness of these comments in this section.

What is working?

311. Feedback on the monitoring stage of the financial management framework was typically limited in scope, given the lower levels of prescription in this area. However, specific areas of strength included:

- The Office of the Auditor General’s recent work in attempting to educate and advise the sector is valuable, as was the Office’s work more generally.
- The monitoring work undertaken by the Local Government Funding Agency is positive, although this is likely closely linked with the financial benefits provided by the Agency through its ability to borrow at very favourable rates.
- Audit and risk committees, particularly where these had an independent member or chair, are particularly valuable.

What could be improved?

312. The focus of the audit of LTPs should be on the financial and compliance data and not on the strategy. There was a general view that audit of strategy, and non-financial components of the LTP added little value.

313. There was some suggestion that audit of LTPs should be replaced with an audit of annual plans, which are more likely to be accurate in their projections.

314. Some participants expressed that the level of confidence imparted through the use of the term ‘audit’, particularly in the case of the LTP, gave ratepayers an expectation that the projected financial statements were going to be reflective of actual financial results. It was asked whether there was a different level of assurance that could be provided.
## Appendix A  Table of recommendations

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Potential impact</th>
<th>Parties possibly involved</th>
<th>Potential time to resolve</th>
</tr>
</thead>
<tbody>
<tr>
<td>Establish programme reference group</td>
<td>N/A</td>
<td>DIA, SOLGM, LGNZ, Local Government Professionals</td>
<td>N/A</td>
</tr>
<tr>
<td>Alignment of central and local government processes</td>
<td>High</td>
<td>DIA, NZTA, Treasury, MFE, Other government departments</td>
<td>Moderate</td>
</tr>
<tr>
<td>Changes to the Rating Act as suggested by the Courts</td>
<td>Low</td>
<td>DIA</td>
<td>Moderate – Long depending on extent of changes enacted</td>
</tr>
<tr>
<td>Funding impact statements</td>
<td>Low</td>
<td>DIA</td>
<td>Short</td>
</tr>
<tr>
<td>Balanced Budget alignment of definitions</td>
<td>Low</td>
<td>DIA</td>
<td>Short</td>
</tr>
<tr>
<td>Balanced budget removal of capital items</td>
<td>Medium</td>
<td>DIA</td>
<td>Moderate</td>
</tr>
<tr>
<td>Combined infrastructure and financial strategy</td>
<td>High</td>
<td>DIA, SOLGM, Wellington City Council, Rangitikei District Council</td>
<td>Moderate</td>
</tr>
<tr>
<td>Electronic rates invoices</td>
<td>Low</td>
<td>DIA</td>
<td>Short</td>
</tr>
<tr>
<td>Reduce unnecessary prescription in Act</td>
<td>Medium – High</td>
<td>DIA, SOLGM, LGNZ</td>
<td>Moderate</td>
</tr>
<tr>
<td>Investigate whether there are merits in separating components of LTP out</td>
<td>Medium</td>
<td>DIA, SOLGM, LGNZ, Overseas jurisdictions</td>
<td>Long</td>
</tr>
<tr>
<td>Recommendation</td>
<td>Potential impact</td>
<td>Parties possibly involved</td>
<td>Potential time to resolve</td>
</tr>
<tr>
<td>----------------------------------------------------</td>
<td>------------------</td>
<td>-----------------------------------</td>
<td>---------------------------</td>
</tr>
<tr>
<td>Promotion of best practice</td>
<td>Medium</td>
<td>DIA</td>
<td>Short</td>
</tr>
<tr>
<td></td>
<td></td>
<td>SOLGM</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>OAG</td>
<td></td>
</tr>
<tr>
<td>Role of auditor</td>
<td>High</td>
<td>DIA</td>
<td>Long</td>
</tr>
<tr>
<td></td>
<td></td>
<td>OAG</td>
<td></td>
</tr>
<tr>
<td>Financial prudence and interaction with balanced</td>
<td>High</td>
<td>DIA</td>
<td>Long</td>
</tr>
<tr>
<td>budget provisions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Asset management reporting improvements</td>
<td>Medium</td>
<td>DIA</td>
<td>Moderate</td>
</tr>
<tr>
<td></td>
<td></td>
<td>SOLGM</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>IPWEA</td>
<td></td>
</tr>
<tr>
<td>Financial and non-financial performance measures</td>
<td>Medium - High</td>
<td>DIA</td>
<td>Moderate</td>
</tr>
<tr>
<td></td>
<td></td>
<td>SOLGM</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>LGNZ</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Community groups</td>
<td></td>
</tr>
<tr>
<td>Standardisation of documents</td>
<td>Medium</td>
<td>DIA</td>
<td>Moderate</td>
</tr>
<tr>
<td></td>
<td></td>
<td>SOLGM</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>LGNZ</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>OAG</td>
<td></td>
</tr>
<tr>
<td>Encouragement of capability sharing arrangements</td>
<td>Medium</td>
<td>DIA</td>
<td>Short</td>
</tr>
<tr>
<td></td>
<td></td>
<td>OAG</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>SOLGM</td>
<td></td>
</tr>
<tr>
<td>Consideration of, and removal or barriers to larger</td>
<td>High</td>
<td>DIA</td>
<td>Long</td>
</tr>
<tr>
<td>scale capability sharing arrangements</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Scaled or tiered reporting and LTP requirements</td>
<td>Medium</td>
<td>DIA</td>
<td>Long</td>
</tr>
<tr>
<td></td>
<td></td>
<td>OAG</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>LGNZ</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>SOLGM</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Community groups</td>
<td></td>
</tr>
</tbody>
</table>
### Appendix B  List of councils attending workshops

The following councils attended workshops during the review. Some councils sent multiple representatives.

<table>
<thead>
<tr>
<th>Ashburton DC</th>
<th>Otorohanga DC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Auckland Council</td>
<td>Palmerston North CC</td>
</tr>
<tr>
<td>Bay of Plenty RC</td>
<td>Porirua CC</td>
</tr>
<tr>
<td>Carterton DC</td>
<td>Rangitikei DC</td>
</tr>
<tr>
<td>Central Hawkes Bay DC</td>
<td>Ruapehu DC</td>
</tr>
<tr>
<td>Central Otago DC</td>
<td>Selwyn DC</td>
</tr>
<tr>
<td>Christchurch CC</td>
<td>South Waikato DC</td>
</tr>
<tr>
<td>Clutha DC</td>
<td>Southland DC</td>
</tr>
<tr>
<td>Dunedin CC</td>
<td>Stratford DC</td>
</tr>
<tr>
<td>Environment Canterbury</td>
<td>Tasman DC</td>
</tr>
<tr>
<td>Environment Southland</td>
<td>Taupō DC</td>
</tr>
<tr>
<td>Far North DC</td>
<td>Tauranga CC</td>
</tr>
<tr>
<td>Greater Wellington RC</td>
<td>Thames-Coromandel DC</td>
</tr>
<tr>
<td>Gore DC</td>
<td>Timaru DC</td>
</tr>
<tr>
<td>Hamilton CC</td>
<td>Upper Hutt CC</td>
</tr>
<tr>
<td>Hastings DC</td>
<td>Waikato DC</td>
</tr>
<tr>
<td>Hauraki DC</td>
<td>Waikato RC</td>
</tr>
<tr>
<td>Horowhenua DC</td>
<td>Waimate DC</td>
</tr>
<tr>
<td>Hurunui DC</td>
<td>Waipa DC</td>
</tr>
<tr>
<td>Invercargill CC</td>
<td>Wairoa DC</td>
</tr>
<tr>
<td>Kāpiti Coast DC</td>
<td>Waitaki DC</td>
</tr>
<tr>
<td>Mackenzie DC</td>
<td>Wellington CC</td>
</tr>
<tr>
<td>Manawatu DC</td>
<td>West Coast RC</td>
</tr>
<tr>
<td>Marlborough DC</td>
<td>Western Bay of Plenty DC</td>
</tr>
<tr>
<td>Masterton DC</td>
<td>Whakatane DC</td>
</tr>
<tr>
<td>New Plymouth DC</td>
<td>Whanganui DC</td>
</tr>
<tr>
<td>Northland RC</td>
<td>Whangarei DC</td>
</tr>
<tr>
<td>Otago RC</td>
<td></td>
</tr>
</tbody>
</table>

Representatives from the Society of Local Government Managers, the Office of the Auditor General, and the Local Government Funding Agency also attended workshops.
Appendix C  Relevant legislation

- The requirements of Part Six of the Act, including but not limited to:
  - the requirement to maintain a balanced budget as set out in section 100 of the Act
  - the requirement under s101 to demonstrate prudent financial management of Council’s resources and the related funding and finance policies
  - the content of a LTP, annual plan, and their associated consultation documents
  - the content of financial strategies, infrastructure strategies, and the policies outlined in subpart 3
- To the extent that they relate to the financial strategies of a council, the provisions relating to the content of a development contributions policy, the use of development contributions and the nature of development agreements set out in sections 201 to 211 of the Act.
- Schedule 10 of the Act.
- Any obligations placed on councils through the operation of the Resource Management Act 1991, the Building Act 2004 or the Public Works Act 1981 that have an impact on the effectiveness of financial strategies employed by councils.
- The requirements of the Local Government Rating Act (‘the Rating Act’), but excluding provisions addressing the range of funding tools available to councils, or whether land is rateable or non-rateable.
- The requirements of Local Government (Financial Reporting and Prudence) Regulations 2014 (‘the Regulations’), including:
  - The mandatory information disclosures – including the requirement for funding impact statements
  - Reporting of benchmarks, including whether the current suite of benchmarks are fit for purpose.
Local Government
Review of the current financial management framework
May 2019
Background

In July 2018, the Government requested the Productivity Commission undertake an inquiry into local government costs and revenues. The Commission will report back to Government with its findings in November 2019.

The Department of Internal Affairs (DIA) is the Government’s lead advisor on local government policy and will be offering advice to Government on its response to the inquiry. The Department has started provisional work to prepare its thinking on local government finances, now and into the future. Their initial analysis has identified that local authorities are wrestling with a range of significant challenges which are driving cost increases, including:

- changing populations and demographics
- tourism
- climate change
- seismic strengthening
- roads in rural areas.

This initial analysis has also illustrated:

- growing affordability issues
- rates revenue growing faster than council long term plans predict
- depreciation and asset service requirements as significant factors in councils’ costs.

Over the next six months, DIA will fully prepare its thinking and advice on the issues facing the sector and the appropriate response from Government. DIA wishes to be well placed in its thinking by November 2019 so that it can fully support the Government’s response to the Productivity Commission’s findings and recommendations.

At a broader level, the Government is committed to ensuring that all New Zealanders have a safe and sustainable water supply and that local government’s focus on community wellbeing is strengthened and furthered. Both of these elements pose challenges for the current funding and financing framework operating across local government.

The DIA wishes to further its understanding of the utility and performance of the Local Government Financial Management Framework. More specifically, DIA wishes to better understand the effectiveness and efficiency of the current controls, obligations and powers conferred on local authorities, and the sector’s views on any required changes and improvements.

For the purpose of the review and the workshops, the financial management framework is broadly defined in Appendix One.
Scope of the workshops

DIA has considered the 130+ submissions on the Productivity Commission’s review from individual councils, SOLGM and LGNZ, as well as those from other interested parties. While a number of those submissions deal with issues relating to the financial management framework, there are also several matters raised in relation to the funding constraints faced by the sector.

The conversations regarding the funding constraints, alternative revenue sources and questions regarding the distribution and sharing of costs between local and central government are both useful and necessary, however this piece of work is not seeking to address or consider those issues.

The focus of this work and its workshops is on the current financial management framework, as imposed through legislation, regulations and expected by good practice. The study is interested in how these rules, regulations and practices enable, constrain and encourage good financial management within the sector, both now and into the future.

Workshops will focus on the aspects of a good financial management framework and the aspects of the current framework that may or may not contribute towards reaching ‘good’. DIA is particularly interested in having conversations about the specific challenges and issues that are being managed (or will need to be managed) by councils, and how the current financial management framework enables or prevents a council from being able to manage those issues and challenges effectively.

DIA are asking you to bring your specific examples and comments to share at this workshop.

While the review is seeking examples of where the current framework may have created issues or opportunities for the sector in the past, it is also focussed on how the framework can be better adapted to addressing the challenges of tomorrow. Again, examples and discussion about how the current framework has enabled or prevented councils from considering new or innovative ways of addressing upcoming challenges would be welcomed.

Example

DIA is interested in the ways in which councils manage their future funding requirements for the renewal of assets, and how the balanced budget requirements may influence the way in which councils manage this challenge and the related issues of ratepayer affordability.

Who should come

Due to the nature of the workshops, our preference is for attendees to be involved in setting the strategic direction and financial strategies and policies for councils.

The review is focused on the ‘big picture’ challenges that are faced by councils, and the strategic responses to those challenges, as opposed to the operational complexities of implementing those strategies.
While the perspectives of operational staff will also provide some useful insight, and those staff will be welcomed, the primary focus for the workshops will be strategic level issues. In this regard, appropriate attendees would include:

- Chief Executive Officers
- Chief Financial Officers
- General Managers of Infrastructure Services
- Lead staff in the development of revenue and financing policies, long term plans, financial strategies or infrastructure strategies.

**Key questions we want to answer**

Throughout the workshops we will be grounding the conversation on answering the following key questions in relation to the financial management frameworks ability to meet tomorrow’s challenges.

- What would ‘good’ look like?
- What is working well, should be retained, and why?
- Where does the Act (and other acts or regulations) and current good practice restrict, constrain or complicate financial management and financial management frameworks?
- Are there particular sections or provisions of the Local Government Act 2002 or the Local Government Rating Act that evidence these constraints? What should be amended, why and in what way?
- What could be done to take us even further?

**Format of the workshops**

The workshops will be structured into three sessions and will run for approximately 3 – 3.5 hours, including refreshment breaks (such as a working lunch). Depending on the number of attendees, workshops will be run through a combination of table top/workgroup discussions and formal question and answer sessions. Specifically:

**Session one: 15 – 30 minutes**

During this session we will discuss the context and objectives of this review. This will include discussion about how this review fits within the broader funding and financing work programme currently being undertaken by the government, and the key policy matters that the work is intended to inform.

This session will involve presentations from DIA and will also seek some feedback from the group about what the sector would like to see come out of the work programme.
Session two: 2.5 hours (including refreshment break/working lunch)

This session will be based around participants:

- sharing their views and experience – what is and isn’t working
- contributing examples from their experience working within the sector.

We will ask participants to share their experience in groups and in a plenary session to ensure we can hear and understand the nature of your experience and to distil the principles that your examples and experiences may raise.

In working with your examples, we will also seek to address the key questions raised earlier in this scoping paper, and also:

- explore the elements of the financial management framework, including what is
  - legislative
  - a practical response to legislation
  - established best practice
- consider differences between councils, and the factors that may drive those differences (e.g. size/capability)
- consider the relative merits of standardisation as opposed to councils adopting bespoke solutions
- consider the legislative (or other tools) that may be able to be used to encourage or facilitate good practice, and the relative merits of those tools
- discuss the way in which councils manage the funding of current and future renewals liabilities, and how this relates to both rates and depreciation charges
- discuss the way in which councils consider the impacts of decision making on ratepayer affordability, and the ways in which this can be improved or streamlined.

**Example**

DIA is interested in understanding the processes that councils go through to set their quantified limits on borrowing and rates, and

- how the requirement to report performance against these limits impacts on decision making
- how the imposition of these limits has altered decision making since introduction
- whether there may be better ways to either set the quantified limits, or to assess rates affordability and prudential use of debt.

The workshops will focus on issues relating to the Financial Management Framework (which is broadly defined in Appendix One), and we are interested in issues that affect the sector as a whole or subsets of the sector that may be facing similar issues.

This session will be facilitated through table group (if size permits) discussion and through formal questions and answers, and will rely on group participation. The session will be facilitated by Bruce Robertson. The session will consider the various stages in the financial management framework ‘lifecycle’ (see diagram in Appendix One) individually as well as the framework as a whole.
Session three: 15 – 30 minutes

In this session we will draw on the key themes and conclusions from the day’s discussions. We will also advise on how feedback will be sought in relation to the draft findings of this review, and how additional comments or examples may be provided to the review team.

DIA will explain how it intends to continue engagement with the local government sector as it prepares its policy advice for the Government (e.g. such as setting up reference groups from the sector).

Preparation

In preparation for the workshops, we would appreciate if attendees:

- have familiarity with the Productivity Commission’s Issues Paper for their inquiry into local government funding and financing (https://www.productivity.govt.nz/sites/default/files/Local%20government%20funding%20and%20financing%20issues%20paper_FINAL_3.pdf)
- have familiarity with their own council’s submission to the Productivity Commission inquiry
- come prepared with examples or evidence that are able to be shared of where the current financial management framework does or does not work.
Appendix One

The financial management framework

The financial management framework is illustrated diagrammatically in the figure below, which shows the various aspects of the framework that will be covered during the workshops.

While the workshops are not intended to be a technical discussion on specific legislative provisions or regulations, the following information attempts to provide some clear definition of what is being referred to as the “financial management framework”.

- Financial and infrastructure strategies
- LTPs
- Annual plans
- Revenue and financing policies
- AMPS

- Significance and engagement
- Prudence
- Balance budget
- Consultation
- Funding and financing decisions

- OAG
- Audit and Risk committees
- Government agencies
- LGFA and lenders

- DIA benchmarks
- Funding impact statements
- Pre-election reports
- Annual reporting
- Monthly/periodic management accounts
For the purposes of this review, the local government financial management framework includes (but is not specifically limited to) the following:

- The requirements of Part Six of the Local Government Act 2002 ("the Act"), including but not limited to:
  - the requirement to maintain a balanced budget as set out in section 100 of the Act
  - the requirement under s101 to demonstrate prudent financial management of Council’s resources and the related funding and finance policies
  - the content of a long term plan, annual plan, and their associated consultation documents
  - the content of financial strategies, infrastructure strategies, and the policies outlined in subpart 3
- To the extent that they relate to the financial strategies of a council, the provisions relating to the content of a development contributions policy, the use of development contributions and the nature of development agreements set out in sections 201 to 211 of the Act.
- Schedule 10 of the Act.
- Any obligations placed on councils through the operation of the Resource Management Act, the Building Act or the Public Works Act that have an impact on the effectiveness of financial strategies employed by councils.
- The requirements of the Local Government Rating Act (‘the Rating Act’), but excluding provisions addressing the range of funding tools available to councils, or whether land is rateable or non-rateable.
- The requirements of Local Government (Financial Reporting and Prudence) Regulations 2014 (‘the Regulations’), including:
  - The mandatory information disclosures – including the requirement for funding impact statements
  - Reporting of benchmarks, including whether the current suite of benchmarks are fit for purpose.
- The requirements to apply GAAP (although we are not specifically considering the content of the IPSAS standards themselves).
- The impact of prudential debt limits.
- The interface between financial management, asset management and governance
- Financial management controls that are established through industry practice rather than regulations, for example the requirement to prepare asset management plans.

We are also interested in discussing financial management controls that may be in place elsewhere in the world or may otherwise currently be non-existent. We’re interested in both the good and the bad in this regard, and this may include:

- increasing requirements for integrated long term planning across asset management, financial management, and potentially workforce management
- the ring-fencing of certain funding streams to limit the application of that funding for a specific purpose (for example ring-fencing the application of depreciation toward the renewal of assets or repayment of debt, or ring-fencing specific activity income to that activity)
- the relative merits of developing or expanding pro-forma financial reporting requirements.