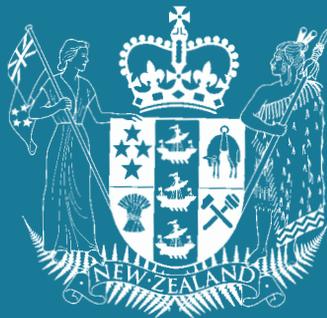


Local Government – Looking Back and Looking Forward

**Report of the
Controller and Auditor-General**

Tumuaki o te Mana Arotake

The Audit Office
Private Box 3928, Wellington
Telephone (04) 917 1500
e-mail: reports@oag.govt.nz
web site: www.oag.govt.nz



**Report of the
Controller and
Auditor-General**

Tumuaki o te Mana Arotake

on

**Local Government –
Looking Back
and Looking Forward**

Presented to the House of Representatives pursuant
to section 20 of the Public Audit Act 2001





Rt Hon Jonathan Hunt
Speaker
House of Representatives
WELLINGTON

Mr Speaker

I am pleased to forward this report to you for presentation to the House of Representatives pursuant to section 20 of the Public Audit Act 2001.

Yours sincerely

A handwritten signature in blue ink, reading 'D J D Macdonald'.

D J D Macdonald
Controller and Auditor-General

Wellington
3 May 2002



Contents

	<i>Page</i>
Introduction	7
The Local Government Environment in 1995	8
Legislative Changes and Other Influences	10
How Well Local Government Responded to the Issues	16
Auditor and Audited: A Mutuality of Interest	22
Challenges Facing Local Government	25
Challenges Facing the Audit Office	35



Introduction

I am making this report to place on record my perspective on the changes in local government administration during my term as Auditor-General, and to offer my views on the future challenges for both local government and the Audit Office.

Local government – by which term I refer collectively to all three types of local authority under the Local Government Act 1974¹ – has undergone significant change during my term of office from April 1995 to May 2002. The way the Audit Office fulfils its functions in relation to local government has had to reflect that change.

When I became Auditor-General, local government was near the end of implementation. These reforms had radically changed the face of local government with:

- extensive amalgamations of boroughs and counties;
- the creation of regional councils; and
- the absorption of minor authorities such as drainage boards and pest destruction boards.

At the same time, a new accountability regime was introduced which outlined more clearly the functions of local authorities and the manner in which they should operate, and prescribed new accountability mechanisms.

The new main accountability documents were the Annual Plan and the Annual Report. In addition, accounting was required to be in accordance with generally accepted accounting practice, and non-financial performance had to be reported and audited.

1 Regional councils, city councils, and district councils.

The Local Government Environment in 1995

By 1995, the major reforms of 1989 were starting to shed light on issues and concerns – many of which are still with us today. Some of what I see as the more pressing issues are noted later in this report.

Other new legislation to be administered by Councils

But the 1989 reforms were not the only legislative initiative that local government was coming to terms with. The Resource Management Act 1991 was (and is) a major piece of legislation. It represented a radical leap in the approach to planning and resource management compared with the raft of planning legislation that had preceded it. Local government was still in the early days of the Act's implementation, particularly in regard to District Plans.

The Building Act 1991 was passed a few months after the Resource Management Act. The Building Act may not have been as high in public perception as the Resource Management Act, but it posed just as many demands on local authorities. Indeed, it was quickly apparent that sound systems and careful administration were essential to avoid potential liabilities under the Building Act.

Reform of utilities and transport

Legislative reform in the utilities and transport sectors occurred in parallel with local government reform, and had an effect on the governance of local authorities. Electric Power Boards became Energy Companies and Harbour Boards became Port Companies – and, by 1995, local authorities became major shareholders in both of those types of company as well as in Airport Companies.

The shareholding local authorities were assessing whether holding the shares was consistent with their strategic goals. Those Councils deciding to

retain their shareholdings were in the formative stages of a new role as a major investor – having to agree a Statement of Intent with the companies and monitor their investment.

But more changes to local authority financial management were afoot. These changes were eventually enacted by the Local Government Amendment Act (No. 3) 1996 – the effects of which I refer to later.

Foreshadowing the 1996 financial reforms

For central government, the Fiscal Responsibility Act 1994 aimed to improve the conduct of the Government's fiscal policy by specifying principles of responsible fiscal management and by strengthening the reporting requirements of the Crown. The 1996 Amendment Act was (broadly) the local government equivalent of the Fiscal Responsibility Act.

Thus, the local government scene in 1995 was characterised by Councils still getting to grips with the myriad of legislation that had fundamentally changed local authorities in terms of their physical size, range of functions, ways of working, and accountabilities to stakeholders.

We had concerns about their ability to cope with the new environment – in particular, the declining investment in essential services, and the lack of longer-term planning.



Legislative Changes and Other Influences

Having ‘set the scene’ on my perception of the local government environment when I took office, I now traverse the legislative changes and other influences which I believe have had an impact on local government in the past seven years.

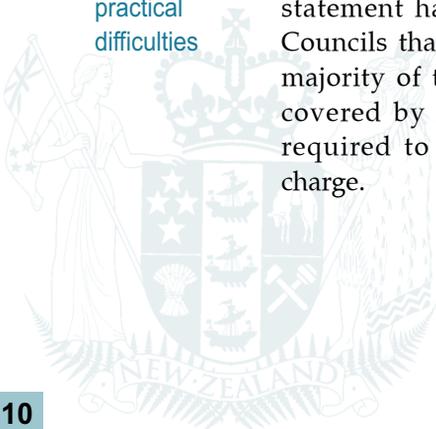
Influences On Accountability and Stewardship

The 1996 legislative changes have had a profound impact. They:

- specified the principles of financial management to be adhered to;
- established a new requirement for a 10-year financial strategy, with associated funding, borrowing, and investment policies; and
- freed up the borrowing regime.

The 1996 Amendments to the Local Government Act brought practical difficulties

The financial management principle that became the most talked about was the requirement that “operating revenues in any financial year shall be set at a level adequate to cover all projected operating expenses”. This seemingly innocuous statement has resulted in much public debate. Councils that had traditionally ensured that the majority of their cash operating expenses were covered by revenues were (for the first time) required to fund the (non-cash) depreciation charge.



The debate on funding depreciation brought into sharp focus some of the difficulties with implementing the legislation. Although the principles of financial management are sound, the prescriptive nature of other parts of the legislation (particularly the exemptions from funding depreciation) are unclear and difficult to understand or apply in practice. Another weakness was the lack of a requirement for a strategic plan – financial principles are well and good, but they need to operate within the context of an overall strategy.

Developments in financial reporting standards

Developments in financial reporting standards and (hence) generally accepted accounting practice have also had their effect. Notable more recently are:

- The new standard on physical assets.² One of the major issues facing local authorities is the identification, valuation, and assessment of depreciation of infrastructural assets.
- A standard that will result in better recognition (and, hence, disclosure) of environmental liabilities³ – particularly liabilities for landfill closure and post-closure costs.

Funding Council Services

Challenges to the levying of rates

The Local Government Act sets out a process for establishing a funding policy, but funding mechanisms are dealt with in the Local Government (Rating) Act 2002. Councils have struggled with the choice of funding mechanism and it comes as no surprise that there have been challenges to the levying of rates under the preceding legislation – particularly in the weighting of differential rating between residential property and commercial property. More recently, many Councils have had the lawfulness of their rating apportionment practices called into question through challenge in the Courts.

2 FRS-3: *Accounting for Property, Plant and Equipment.*

3 FRS-15: *Provisions, Contingent Liabilities and Contingent Assets.*

Influences On the Provision of Essential Services

Poor knowledge of service assets

Local authorities provide the bulk of essential services – such as water supply, sewage and stormwater disposal, and roading networks. When I took office I was more than surprised that local authorities did not have a good understanding of the assets that underpin those services or a full appreciation of all the elements of asset life cycle costs. Even more fundamental was the lack of agreement on service levels, and quality and quantity standards.

The influences that have emerged over the past seven years are:

- an emphasis on *better asset management*;
- a trend towards *outsourcing* or arm's length *delivery of services*; and
- the *pressures on* both fast-growing and declining localities to provide first-class *essential services*.

My office has been a major force in pushing for *better asset management*, and I make no apology for this. It is imperative that local authorities have comprehensive information on their assets, so that they are able to make reliable forecasts of the future investment needed to maintain the services that the community needs and wants. Asset management plans are a necessary underpinning for preparing long-term financial strategies.

Radical changes in service delivery

The *outsourcing of service delivery* has been driven by two influences:

- Mandatory competitive processes emanating from the Transit New Zealand Act 1989 – which reinforced the funder/provider split that had become the norm in central government.

- The statutory option to use in-house resources or contract out. If the contracting out is chosen (and the matter is significant), the local authority is obliged to decide whether to put the task out to tender. Should the decision be not to tender, the local authority must record its reasons for the decision.

Many local authorities passed functions to Local Authority Trading Enterprises (LATEs), so ‘keeping them within the family’. But some local authorities have fully contracted out functions – the two notable examples of which are the Papakura District Council’s franchising of its water and wastewater services, and Queenstown Lakes District Council’s contracting out of its regulatory functions.⁴

Increasing pressure on essential services

Demographic changes are creating increasing *pressure on essential services* in particular parts of the country. In areas of increasing population, the demand for more and better services is placing pressure on the local authority’s ability to provide roading and utility infrastructure. What is perhaps not as well appreciated is that areas with a declining population are facing the problem of how services will be maintained with fewer people to pay for them.

Influences On Governance

Chief Executive position pivotal

The 1989 reforms created a revised model of governance in which it is implicit that the Council sets policy and the Chief Executive is responsible for implementing it. In addition, the Chief Executive is the sole employee of the Council and the employer of all other Council officers. Thus, the Chief Executive’s position became pivotal.

4 Both of which we have examined and reported on. See *Papakura District Council: Water and Wastewater Franchise*, 1998, ISBN 0 477 02853 7; and *Contracting Out Local Authority Regulatory Functions*, 1999, ISBN 0 477 02865 9.

This revised model has tended to cut across what many Councillors (as elected representatives) see as their job to make sure things happen. Frustration builds up when councillors find that they cannot apply a ‘hands-on’ approach. By the same token, a Chief Executive can become frustrated by perceived Councillor interference in day-to-day operations.

A contributor to friction in the relationship between Councillors and the Chief Executive has been the requirement for the Chief Executive’s position to be advertised at least every five years. In some cases, this has resulted in the Council taking the opportunity to employ a new Chief Executive, or the incumbent Chief Executive not seeking re-employment.

Difficult relationships between Council and subsidiaries

Another major governance issue has been the relationship between a Council and its subsidiary entities, especially LATES. It has been difficult for some Councillors to appreciate that a council-owned subsidiary is an entity in its own right – charged with performing the service or function as a successful business. Again, the Council is responsible for providing policy direction, and the entity is responsible for carrying it out.

On the other hand, some Directors of subsidiary entities have not always appreciated the political sensitivities inherent in running a publicly owned entity.

Influences on the Management of Regulatory Activities

Impacts of the Resource Management Act

The major influence on local government regulatory activities has almost certainly been the Resource Management Act. The Act followed hard on the heels of the newly created local authorities. It also provided a defining difference between the functions of regional and territorial authorities.

One of the more obvious consequences of implementing the Resource Management Act has been the significant time and expense invested in preparing District Plans. Indeed, many local authorities had to rework or reissue their Plans. Recovery of the costs of administering the Act is also a contentious issue with many people.

Other significant pieces of legislation to affect regulatory activities have been the Building Act and the Hazardous Substances and New Organisms Act 1996.



How Well Local Government Responded to the Issues

I now offer my view of how well local government has responded to the legislative changes and other influences that it faced.

Accountability and Stewardship

How well have Councils coped with the consequences for planning and accountability of the 1996 changes?

Councils took a positive approach in planning ...

All Councils met the deadline for consulting with the public and finalising their first long-term financial strategy. Indeed, nine Councils opted to conduct this process a year early, as we reported in October 2000.⁵ Councils also took a positive approach to working through the funding decision process – many had extensive workshops to get conversant with the funding model.

However, the major problem with the first long-term financial strategy was that many Councils did not have available to them sufficient information on their infrastructural assets to provide a reliable base for their 10-year projections. Since these assets give rise to a very large proportion of local authority expenditure, the problem was deep-seated.

... but the soundness of forecasts was questionable

Of greater concern is the number of Councils that appear to put most of their planning effort into the Annual Plan, to the detriment of longer-term planning. Furthermore, many Councils still do not have a strategic plan which sets the scene for the long-term financial strategy.⁶ Thus, short-term planning

5 *Reviewing a Long-term Financial Strategy and Funding Policy – Experiences of the Early Nine.*

6 There is no legislative requirement for a strategic plan, which remains a weakness in the 1996 amendments to the Local Government Act.

still seems to be regarded as the most important planning tool because of its immediacy.

Difficulties have also been caused by the lack of synchronisation between the three-year electoral cycle and the planning cycle – making it hard for a Council to ‘own’ a plan that it has not had a full hand in preparing nor an opportunity to see how it is working in practice.

Prescriptive nature of the 1996 changes has caused uncertainty

The most difficult issue is the funding of depreciation, and the exemptions permitted. A number of breaches of legislation have been reported on this account. This has frustrated local government, many others, and me. One major problem is that funding involves *cash*, whereas revenue and expenditure are recognised on an *accrual* basis – yet the legislation appears to regard them as synonymous. It is little wonder that both Councils and my auditors have been struggling with the legislation.

I acknowledge the work of the Society of Local Government Managers, whose financial working party has done sterling work in providing guidance in interpreting some of the more difficult parts of the legislation.

Non-financial performance reporting is weak

An important element of local authority reporting is that of non-financial performance. Council plans should set out key tasks and associated performance measures and targets for each significant activity, and these measures and targets should be reported against in the Annual Report. I am disappointed with the overall standard of this reporting in local government. It is often being done in a perfunctory manner – with Councils doing sufficient to meet the legislative requirement, but not really communicating how the Council is attaining its goals or objectives. Even more worrying is that I have not noticed any significant overall improvement in non-financial reporting during my time as Auditor-General.

Accountability reports are lengthy and hard to read

Many Councils' strategies, Annual Plans, and Annual Reports are becoming large and unwieldy. Often, they are an unappealing document to all but the most determined reader. Councils could put this down to the extent of reporting that they are required to do, but I am not convinced. The tendency seems to be to keep adding to plans and reports. Only a minority of Councils stand back and reassess content critically – or think of Annual Reports as a communication vehicle of their stewardship and accountability, and Annual Plans as a basis for consultation.

Service Delivery

The work of NAMS laid an excellent foundation for better asset management

Better asset management has been an essential prerequisite for better service delivery. Generally, Councils have taken this seriously, and developed Asset Management Plans and enhanced management practices for assets delivering essential services. I pay tribute to the National Asset Management Steering Group (NAMS) in leading the way in asset management.

When NAMS was formed in 1995, little information was available (nationally or internationally) about integrated asset management. Considering this 'information vacuum', NAMS' energy and productivity has been remarkable. Its publications – particularly the *International Infrastructure Management Manual* – are recognised world wide as being at the cutting edge of asset management.

Councils therefore had a sound foundation on which to develop their own asset management practices, but not all made use of that foundation. However, it is pleasing to note that, by 2001, we had no cause to issue qualified audit reports on this issue. That being said, I perceive that some Councils, having attained an unqualified audit report, have relaxed their efforts in asset management.

Links between the Asset Management Plan and Council strategies not clear

There is an obvious link between the expenditure forecasts emanating from the Asset Management Plans and the expenditure forecasts in the Long-term Financial Strategy. Nevertheless, in some cases it appears that Asset Management Plan forecasts are being ignored or altered to fit the desired profile of forecast expenditure in the Long-term Financial Strategy. It would be foolhardy for any Council to ignore or inappropriately manipulate this link.

Conflicting interests in outsourcing service delivery

Contracts for outsourcing of service delivery tend to be complex and of long-term duration. This has posed some problems for Councils. For example, Councils owning LATEs were often caught in the conflict between their *ownership* interests and *purchase* interests. A 'sweetheart' contract from the Council to a LATE might satisfy the ownership interest (protection of the investment), but often left untested whether the purchase of services was in the best interests of ratepayers.

Quite a number of Councils have sold their LATEs – perhaps partly to avoid the ownership/purchase conflict, but more often knowing the difficulty of small-to-mid-sized businesses competing against large and well-financed competitors.

The trend toward longer and more complex contracts makes this increasingly a 'David and Goliath' struggle. While tendering and contract letting procedures have generally been satisfactory, my major concern is the weakness of Council monitoring of service contracts. In my view, proper monitoring is fundamental to the Council's responsibility for the service.

Demand issues are being partly addressed

The greater demands being placed on essential services are being addressed – especially in Auckland where (albeit slowly):

- there appears to be better co-operation among the Councils and other parties regarding transport issues;

- there is a large-scale project to upgrade wastewater treatment;
- combined sewerage and stormwater reticulation is being separated; and
- integrated catchment management studies are under way.

At the other end of the spectrum, I am not sure that Councils with declining populations and negative growth are facing up to the issue of affordability of existing services. With the advent of Asset Management Plans and a transparent process for decisions on funding, there should be no lack of information on which to take the hard decisions.

Governance

Concern at turnover of Chief Executives

I am concerned at the high replacement rate of Chief Executives. In a report to Parliament in June 2000⁷ I noted the following three contributing reasons why the relationships between a Council and its Chief Executive may be under strain:

- the changes in Council membership;
- the new financial management regime; and
- the uncertainty brought about by the legal clarification for Chief Executive contracts to be advertised no less frequently than five yearly.

Collectively, these reasons have had an unsettling effect. I also fear that some Chief Executives are becoming more isolated from their Council. When open and effective communication diminishes, suspicion and insular behaviour can replace it.

7 *Second Report for 2000*, parliamentary paper B.29[00b], pages 105-106.

Governance relationships between Councils and subsidiaries improving

The early problems in establishing effective governance relationships between Councils and subsidiary entities seem to have been overcome. For example, some Councillors who had been appointed to the Board of a LATE were having difficulty appreciating where their responsibility lay, and communication and reporting mechanisms between Councils and their LATEs tended to become somewhat opaque. I am encouraged that a better appreciation of the relationships is now evident.

Regulatory Activities

In 1996 we reviewed how well Regional Councils were coping with administering some aspects of the Resource Management Act – in particular, the resource consent process. Overall, we found that the process was being satisfactorily administered, although we noted some weaknesses in documentation.⁸

Later, we examined the Unitary Authority model as a means of integrating environmental management and delivering environmental outcomes. The key message was that the Unitary model can be as capable of delivering sound, integrated environmental management as any other model, subject to certain provisos.⁹

Because it was one of the first of its kind, we were keen to see how the Queenstown Lakes District Council had gone about contracting out its regulatory functions, and what lessons could be learned. We issued a report of our findings in which we made a number of recommendations that any other Council contemplating outsourcing its regulatory functions could use as a guide.¹⁰

8 *Second Report for 1996*, parliamentary paper B.29[96b], pages 115-163.

9 *Local Government Environmental Management: A Study of Models and Outcomes* (produced jointly with the Parliamentary Commissioner for the Environment), 1999, ISBN 0 908804 88 1.

10 See footnote 4 on page 13.

Auditor and Audited: A Mutuality of Interest

People sometimes regard auditors as aloof and remote – perhaps even feared. But to do the job properly, auditors must:

- be able to work co-operatively with all people, irrespective of their professional discipline or seniority; and
- at the same time, retain their independence and sense of judgement – characteristics that I believe have been amply demonstrated by my auditors during my term of office.

Likewise, local authorities and their associated entities recognise and respect the audit role. Taken together, this makes for a successful partnership and a sound platform for tackling problems.

Nature of our audits

Beyond the confines of the yearly financial report audit, however, my auditors keep a lookout for any issue that may impinge on the management of resources or legal uncertainties. In addition, each year the auditors specially examine three or four areas of activity that I think are worthy of across-the-board consideration.

Help from an advisory panel

I have set up an advisory panel of local government representatives, both to provide a sounding board for our thoughts and plans and to tell us of emerging issues in the sector. The representatives are chosen from both elected representatives and senior local authority staff – including particular disciplines such as engineering. I place on record my appreciation of the work of the various panel members and thank them for their contributions and insights.

With 86 local authorities and the host of subsidiary entities that they control, the local government sector is large and varied. Therefore, good lines of communication are important. In addition to me visiting all 86 local authorities my office has developed close working relationships with local government representative groups and central agencies having responsibilities relating to local government.

Successful relationships with representative groups and agencies

We have worked alongside representative groups such as Local Government New Zealand, the Society of Local Government Managers, and the Association of Local Government Engineers. The co-operative nature of these relationships has resulted in the issue of guidance that has been of considerable assistance to all local authorities (especially in relation to interpretation of the Local Government Act and the development of better asset management practices). Relationships with central government agencies involved with local government have also been cordial.

Over the last seven years, I have looked at and reported to Parliament on a wide range of issues relating to local government – some of which I have already mentioned here. This report is not the appropriate place to mention them all, but there are several strands that permeate all of the reports.

Ensuring what we do makes a difference

- First, the results of any performance audit or other study that I commission ought to be of practical use for the future. It would be unhelpful if we looked only at results from past actions. Our reports are of greater value when they provide lessons to be learnt or guidance for future actions. A good example is my 1998 report on *Public Consultation and Decision-making in Local Government*.¹¹

11 December 1998, ISBN 0 477 02857 8.

- Secondly, when selecting a topic for examination, I ensure that it has application across more than one local authority. Increasingly, topics have been chosen that identify emerging trends. For example, we have published a number of reports on governance which have identified, at an early stage, issues and concerns that have since become more apparent.¹²

The increased emphasis on identifying the emerging trends is not confined to Parliamentary reports on one-off topics. Over the last seven years, more effort has been put into reviewing the key planning documents of local authorities – especially the Annual Plan and Long-term Financial Strategy.

- Thirdly, before we publish a report, we give all affected local authorities or relevant agencies an opportunity to review the intended contents of the reports for factual accuracy and balance.

Communication with our auditors

To complete the communication cycle, each year we give all of our auditors a briefing on the local government environment and the particular topics to be explored in more detail. Over the years there has been criticism from some local authorities of what is perceived to be inconsistency of ‘audit’ policy from auditor to auditor. I have striven hard to minimise this criticism (particularly in relation to qualified audit opinions).

In summary, I believe our auditing has developed in an evolutionary way, building on the efforts of my predecessors. I am particularly proud of our ability to work alongside local government, the selection of topics for examination and reporting, and both the internal and external communication avenues we have established.

¹² See, for example, *Local Authority Governance of Subsidiary Entities*, March 2001, ISBN 0 477 02873 X.

Challenges Facing Local Government

What then, are the challenges I see confronting local government in 2002 and beyond? The seven challenges I have chosen are those that I see as most important for promoting effective management of public sector resources.

1 – Meeting the principles and requirements of a new legislative framework

Local Government Bill presents a new set of challenges

The Local Government Bill at present being considered by Parliament will continue the sequence of reforms begun in 1989 and built on in 1996. The Bill addresses the purpose of local government and provides the necessary powers to allow Councils to fulfil that purpose and meet the aspirations of their communities.

The challenge for local government will be to meet the requirements of the new legislation – whatever those requirements may finally be. I believe that local government will meet this challenge. Parliament has also recently passed the Local Government (Rating) Act 2002 which (mostly with effect from 2003) sets down a modernised framework for imposing and collecting rates to fund local government activities.

We have seen local government generally rising to the demands placed on it by the 1989 and 1996 reforms. From my observation, Councils want to have a legislative framework which is clear, and more broadly permits them to do what their communities desire. That, in itself, suggests that Councils want to respond to the spirit and the letter of a new framework.

2 – Improving governance

Governance is only as good as the will to make relationships work

The Local Government Bill proposes some provisions which will, I believe, be instrumental in promoting better governance. However, having the necessary framework is only the first step towards effective governance. The human element is the most important – actual behaviour rarely mirrors the fine-sounding rhetoric or best-laid governance policies.

The challenge, then, will be to put into practice and give real effect to established governance principles.

3 – Do councils have the capability to meet the demands placed on them?

The legislative requirements are the same for every local authority, notwithstanding differences in geographical size and characteristics, population, and location. In addition, community aspirations and expectations of their local authority may be quite different as between (for instance) a small rural local authority and a larger urban local authority.

Smaller Councils face capability gaps

By the term ‘capability’ I mean both the financial resources and the human resource capacity to meet the expectations of the community and the requirements of legislation. The Councils of several small rural authorities have approached us seeking dispensation for a more relaxed (or simplified) response to the legislative requirements. I have steadfastly resisted the temptation to go down this path.



However, the fact that such approaches have been made demonstrates that smaller local authorities (and even mid-sized ones) are struggling to provide the range of expertise needed (such as policy analysts, economists and experienced asset managers) to meet their legislative obligations. And, as I noted earlier, some Councils in areas of declining population and growth have not yet come to terms with the prospect of reassessing services which may be unaffordable in the long term.

The challenge for Councils is to face the realities of what they can achieve and what they cannot achieve. Already, we are seeing some adjoining Councils sharing administrative support, or jointly providing a service (e.g. libraries). Moving forward requires understanding the needs of the community – but, on the other hand, can often require overcoming parochial interests and political hurdles. I believe that sharing and joint effort will become a developing trend.

4 – Improving delivery of services to customers

I see this challenge in three parts:

- First, local authorities need to build on the work already achieved and engage in more advanced asset management.
- Secondly, the trend towards more complex and longer contracts for delivering services will demand management that entails more skilled packaging and monitoring of those contracts.
- Thirdly, many local authorities need to be thoroughly customer-focused in the way that they consult about the services that their customers want, and in the way that they then go about managing those services.

Advanced Asset Management

Almost all Councils have management plans and basic information for the assets that are delivering essential services. However, the plans and accompanying information are, in general, relatively unrefined. Quite rightly, effort has been concentrated on:

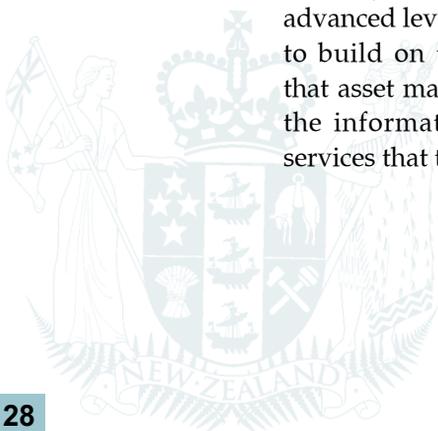
- identifying and quantifying the assets;
- gathering information on their age and condition;
- developing information systems; and
- providing forecasts of cost elements – such as new capital investment (as well as renewals and operational expenditure).

Few Councils have moved into advanced asset management

Few Councils have reached an advanced level of asset management. Advanced asset management is characterised by:

- a much higher level of knowledge of the assets held (thereby allowing predictions to be made about performance);
- a greater understanding of the desired level of service that the community wants the assets to provide; and
- a focus on addressing the risks associated with managing the infrastructure.

In my view, the benefits from asset management will only be fully realised by concerted effort on the advanced level. My challenge to local authorities is to build on the work already done, and ensure that asset management plans and systems provide the information to better manage the essential services that they provide.



Managing Contracts for Delivering Services

Higher skill level needed for contract management

Contracts for outsourcing the delivery of services are tending to be of longer duration (some up to 10 years and longer); they are more complex in structure; and their success is often related to the total performance or outcome of a service. These trends bring a raft of challenges for local authorities. Even more rigorous and transparent tender processes are needed because:

- the contracts are for a long time and (thus) of high value;
- better specifications and performance measurement data needs to be built into the contracts; and
- Council asset managers must retain the capability and skills to monitor the performance of the contract.

With large and diverse contracting firms now dominating the market in these types of contracts, Councils must be able to demonstrate that they are an effective contract principal and that they are able to ensure that the Council's (and, hence, its constituents') interests are protected.

Putting Customers First

Is the customer 'king'?

Users of local authority services are (notwithstanding, in many cases, the involuntary nature of the usage) customers of the Council. Many Councils seem not sufficiently customer-focused, or else pay lip service to the notion of users being customers.

In service industries generally over the past decade, there has been increased attention to the more sophisticated and varied demands of customers. This has taken the form of better quality of services, services targeted to market niches, and greater transparency of the roles and

responsibilities of the service provider and the service recipient.

I believe that local authorities are lagging somewhat in this respect – particularly when it comes to consultation about what services customers want (see my comments under Challenge 5 at the top of page 32). Take, for example, a major service provided by most local authorities – the supply of water. Typical questions that could be asked by a discerning customer could be:

- Have I had the opportunity to comment on the levels of service I want from my water supply?
- Am I treated as a customer with individual needs and wants?
- What sort of commitment or contract do I have with my water supplier?
- How do I know that all aspects of the service are being performed safely, efficiently and effectively?
- On what basis or rationale am I being charged for the service?
- What rights do I have, or what recompense do I receive, if something goes wrong or the service is interrupted?

The answers to the above questions could be problematic for many local authorities – even though many have put effort into help desks or providing web site opportunity for customer queries or complaints. But I wonder whether this is only a ‘show’ of customer sensitivity, and the old ways remain inculcated throughout the entire management of a service.

My challenge to Councils is that the rights and desires of customers of their services receive the attention due under the principle that ‘the customer is king’ – as in most service industries. It should be no different for customers of services provided by local authorities.

5 – Enhancing performance and accountability

Stewardship
has been
better
demonstrated
...

Local authorities have made giant strides over the past decade in demonstrating their stewardship of public resources. Most of this has been brought about by the requirements of the 1989 reforms, and (more particularly) the 1996 reforms on financial management. The challenge now is to change from thinking of reporting on performance (both financial and non-financial) as a ‘necessary evil’, to thinking of reporting performance in a way that:

- emphasises the whole organisation;
- is really useful as a management tool; and
- is readily understood by the layperson.

... but needs
a boost in
performance
reporting

One development that might contribute to making this happen is “sustainable development reporting”, a variant of which is “triple bottom line reporting”. I believe that this type of reporting is consistent with what I said in *Reporting Public Sector Performance*,¹³ which promotes a comprehensive or holistic model of reporting performance.

I hope that the Local Government Bill (once enacted) will provide the impetus for Councils to embark on performance reporting that is wide in its breadth, firmly based on actual management and performance, and clear in its accountability to the public.

In similar vein, the Local Government Bill (as presently drafted) provides for a long-term council community plan to be prepared. Such a plan should overcome the observation that I made earlier that a number of Councils have been drawing up their Long-term Financial Strategy in a ‘strategic vacuum’.

13 Hard copy version ISBN 0 477 02877 2, also available on our web site www.oag.govt.nz. An expanded version with full case studies is also available, but only on our web site.

Improvement
in consultation
process
needed

An associated challenge is for Councils to meet their consultation obligations in a sound and open fashion. During my tenure I have had a number of complaints by ratepayers and other parties about the way that their Council has undertaken consultation. These sorts of complaint were a catalyst for my report on *Public Consultation and Decision Making in Local Government*. The recommendations in the report – the importance of which will be increased under the additional consultation requirements proposed by the Local Government Bill – will present Councils with more rigorous yardsticks within which they will need to work.

6 – More emphasis on integrated risk management

Over recent years application of the discipline of risk management has grown in leaps and bounds. Both nationally and internationally, most sizeable organisations are now identifying, evaluating, and managing risk in a formal way.

After a joint Australia and New Zealand Standard on Risk Management was promulgated in 1999,¹⁴ the State Services Commission quickly took up the theme and actively encouraged the development of risk management in government departments. The Cave Creek tragedy provided further impetus to risk management. Indeed, the evaluation of performance of departments (and their CEOs) includes the extent to which risk management culture and practice permeate a department.

Unfortunately, integrated risk management in local government has not developed as quickly or as broadly as in central government.

14 AS/NZS 4360: 1999 Risk Management.

Systematic risk management lacking in local government ...

Since 1995 I have reported on several aspects of risk management in local government:

- funding the restoration of essential services following natural disasters (1996¹⁵); and
- managing the risks to assets providing essential services (1998¹⁶).

Very good work on risk management is being undertaken in some activities of Councils but, generally, this is not happening across the entire spectrum of Council activities – nor is it organised in a methodical way. However, two recent developments may spur the management of risk in local government.

In June 2000, Standards New Zealand published a handbook for risk management in local government.¹⁷ This handbook builds on the earlier generic standard, and outlines risk categories specific to local government.

... but there are encouraging trends

At about the same time, the Society of Local Government Managers launched a project on legal compliance – one of the key categories of risk in local government. Eighty local authorities are now participating in the project, which has designed a framework for legal compliance and five good practice ‘modules’ of critical activities of local government. Further modules are being developed.

I find this encouraging. The challenge for local government is to apply the risk management handbook and the approach now being taken to one element of risk management, and to extend the concept to the full spectrum of Council activities and the management of risks within each activity.

15 *First Report for 1996*, parliamentary paper B.29[96a], pages 113-144.

16 *First Report for 1998*, parliamentary paper B.29[98a], pages 31-37.

17 SNZ 4360: 2000, Risk Management for Local Government.

7 – Maintaining the integrity of regulatory administration

Capability and legal risk issues

Local government has been put under immense pressure in its administration of the Resource Management Act, as well as other regulatory responsibilities such as under the Building Act.

A challenge for local authorities is to ensure that they have the capability to effectively administer legislation under which they have responsibilities. Undoubtedly, there have been gaps in capability – particularly in relation to preparation of District Plans. When considering outsourcing regulatory activities, critical aspects are a Council's regulatory responsibilities and the potential risk of legal liability.

Another aspect of this challenge is to ensure that there are sound partnerships between the regional councils and territorial authorities, in order to avoid varying policy directions and the disjunction between regional policy statements and District Plans that is sometimes evident.



Challenges Facing the Audit Office

Impact of the Public Audit Act

I am conscious that I have expounded at length about how well or otherwise local government has dealt with the emerging issues over the last seven years – and what I see as the coming challenges for local government. This exposition would be incomplete without some thoughts on the challenges now facing the Audit Office in relation to local government.

For a number of years before I took up office it had been recognised that the legislation mandating the Audit Office and its activities was dated, inconsistent, and spread over a number of Acts. However, 2001 saw the passing of the Public Audit Act, which brings the whole of the public sector auditing portfolio into one statute and applies the audit mandate consistently across that portfolio.

The Public Audit Act does not significantly change the Office's role in relation to local authorities. However, it broadens the portfolio to include some Council-controlled public entities that were previously outside the mandate. The exact effect of this broadening is still being established, but a notable class of entity now included in the portfolio is trusts.

The Act also clearly sets out the Auditor-General's specific functions – including financial report audits, performance audits, and the power to inquire into any matter concerning a public entity's use of its resources.

With the breadth and clarity of mandate that Parliament has provided, the first challenge for the Audit Office is to put it to good use.

Understanding the new Local Government Act

The Office will need to understand and communicate (to both our auditors and local government) the provisions of the Local Government Bill when it is enacted. A lesson to be learnt from the 1996 amendments to the Local Government Act is that of the old adage “a stitch in time saves nine”. A more considered assessment of that legislation might have prevented the interpretative and procedural problems that we subsequently experienced – such as the meaning of “significant” and issues relating to “internal borrowing” and depreciation.

Supporting good governance

The Office must continue to play its part in encouraging better governance in local government. For example, it will be publishing in the near future a report on managing the relationships between local authority elected members and their Chief Executive. After publication, the Office may need to have a continuing dialogue with elected representatives and Chief Executives and Mayors about how it can help them.

The Office should continue to support good governance and appropriate behaviour. An example of this support is the guide to the Local Authorities (Members Interests) Act 1968.¹⁶

Helping to improve service delivery

Service delivery – particularly of essential services – is at the heart of local government and consumes most of a local authority’s resources. Better asset management practices (see page 28) that help to provide sounder forecasts of future expenditure will be an important contributor to better use of limited resources. The Office needs to continue its policy of making staff members available for assisting in key initiatives to build on the good work already achieved in asset management. And it needs to continue to promote best practice in the management and monitoring of outsourcing service delivery.

¹⁶ *Financial Conflicts of Interest of Members of Governing Bodies*, 2001, ISBN 0 477 02885 3 (also available on our web site www.oag.govt.nz).

Helping to demonstrate better stewardship

I believe that local authority Annual Reports contain too much financial information – too much of which is not readily understandable. Perhaps both the accounting profession and we can take some of the blame for this, with each new financial reporting standard adding complexity upon complexity. There needs to be better balance in local authority reporting of its stewardship. The move to sustainable development reporting may assist this balance – with the triple reporting of environmental, social and economic factors. Already, some in local government are showing the way (such as Watercare Services Limited). Others are gearing up to do the same.

Expanding our skills

I welcome this development – it reflects the view we have that holistic or comprehensive reporting is the path to pursue. However, this brings challenges to auditors, for we must widen our horizons and skills in order to provide credible assessments of the relevance and accuracy of environmental and social measures. This will indeed be a challenge for the Audit Office, and in the future we may need to employ a greater number of people in disciplines other than accounting.

I believe that both local authorities and their constituents would gain value from the Office placing more emphasis on auditing and reporting on key documents such as Council strategies and plans. Traditionally, auditors examine and form an opinion on representations of past events. But the audit opinion on the financial statements for the year ended 30 June 2002 could be issued as late as 30 November 2002, and the Annual Report containing the financial statements and audit opinion could be published even later. Consequently, events and transactions from July 2001 might not be reported to the interested reader until late-2002 or even 2003.

Shifting our focus from the past to the future

I also believe that there would be benefit in auditors giving their attention to the budgeting and planning processes and the practicalities of auditing ‘real time’ reports by the local authority. This poses a challenge for auditors, because:

- looking forward is uncertain, with the absence of objectivity and facts inherent in past data and events; and
- the auditor is forced to look at and pass judgement on risks, assumptions, trends, and probabilities.

I began this change of perspective by asking auditors to review Councils’ draft annual plans. This was followed up by a review of the preparation of a long-term financial strategy of one Council, with the observations from the resulting report being a helpful guide to other Councils.

Fostering systematic risk management

Sound business practice should be reason enough for local authorities to be more positive and systematic in managing their risks. I believe that auditors have a role to play in fostering risk management practices and reviewing risk management systems. They can do this by sharing knowledge of best practice and offering an independent view of what the local authority is doing. However, it should not be overlooked that the local authority’s staff are the people who are dealing day-to-day with risk issues, and who are best placed to identify and manage risks.

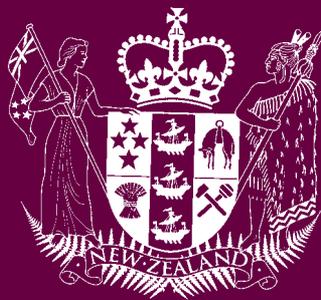
Seeking new ways to communicate

In order to be perceived as adding value, the Audit Office needs to maintain and foster positive relationships with all local authorities, their representative bodies, central agencies with responsibilities for local government, and Parliament and its committees.



I believe that the relationships that my auditors and I have with local government are excellent – but it is something that needs constant attention. The Office must look for new and innovative ways to communicate; communicate clearly and without fear or favour; ensure that its key messages hit home; and listen and be prepared to learn. I think that communication is one of the Office’s greatest challenges.





Controller and Auditor-General

Tumuaki o te Mana Arotake

***Local Government –
Looking Back and Looking Forward***